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 EXEMPTION REGULATION AND GUIDELINES ON SUPPLY AND DISTRIBUTION AGREEMENTS

September 2009

The views expressed herein are presented jointly on behalf of these Sections only. These Comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

INTRODUCTION

The Section of Antitrust Law and the Section of International Law of the American Bar Association (collectively, Sections) submit the following comments in response to the public consultation issued July 28, 2009 by the European Commission (Commission) in connection with its review of competition rules for the distribution sector. The Commission has proposed revisions to the current (1) Block Exemption Regulation on vertical restraints (Regulation), which is due to expire in May 2010, and (2) Guidelines on Vertical Restraints (Guidelines).[1]

In announcing the consultation, the Commission noted that it covers all issues dealt with by the Regulation and the Guidelines but stated that the Commission seeks in particular comments on, among other things, its suggested approach concerning buyers' market power and restrictions on on-line sales. In addition to these subjects, the following comments address resale price maintenance, category management, definition of "agreement" and definition of "agency." The Sections' members have considerable experience under U.S. antitrust laws with all of the foregoing subjects.

[1] Commission Regulation (EC) No. 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, 1999 O.J. (L 336) 21; Commission Notice -- Guidelines on Vertical Restraints, 2000 O.J. (C 291) 1. The Draft Regulation and Draft Guidelines are available at http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html.

The Sections welcome the opportunity to comment on the Commission's vertical restraints policies. Although they submitted comments in July 1997 on the Commission's Green Paper on Vertical Restraints in EC Competition Policy, they have not commented previously on either the Regulation or the Guidelines or any of the matters specifically addressed in the Regulation and Guidelines. The Sections hope that these Comments will provide a helpful perspective based on experience both with U.S. antitrust laws and competition laws in the EU, its Member States and other competition regimes. The Sections would be pleased to provide any additional comments, or to participate in further consultation, as appropriate.

EXECUTIVE SUMMARY

I. Buyer Market Power

The Draft Regulation changes Article 3 to require that market shares of the buyer and seller be taken into account in every case in determining whether the block exemption of Article 2 should apply, and the Sections generally support the Commission's decision to examine both upstream (buyer power) and downstream (supplier power) effects. The Sections believe that the Commission should focus analysis on the market affected by the restraint at issue to determine whether competition is substantially foreclosed, and they caution against allowing downstream effects to override or "trump" upstream concerns in analyzing buyer-side restrictions. (Pages 4-8 *infra*.)

II. Restrictions on Internet Sales

The Sections do not believe that there is need for special treatment of Internet sales in the Draft Guidelines. U.S. antitrust law generally applies the same basic rules to Internet selling no differently than to selling through traditional "brick-and-mortar" channels. Recognizing the Commission's policy objectives in encouraging Internet-based commerce across the EU and acknowledging that the general approach to restrictions in the Draft Guidelines appears to strike a workable balance among multiple competing considerations, the

Sections believe that clarification of certain elements of the Draft Guidelines would be appropriate. Clarification would be helpful in, among other areas, (1) delineating the circumstances in which Internet sales in an exclusive distribution system are to be treated as active or passive, (2) determining the amount or value of sales to which a supplier can lawfully limit a distributor's sales over the Internet, (3) determining whether a supplier's payment of a fee to a distributor to support its offline sales would be treated as the equivalent of charging offline distributors a lower price for goods than online distributors and (4) classification of restrictions by a supplier on Internet sellers which may not be the equivalent of restrictions imposed by the supplier on offline sellers. (Pages 8-19 *infra*.)

III. Resale Price Maintenance

The Sections welcome recognition in the Draft Guidelines that minimum resale price maintenance (RPM) agreements can be procompetitive, and they recommend that the Commission reconsider its continued treatment of minimum RPM as a hardcore restriction within Article 4 of the Draft Regulation. They also recommend that the Commission clarify its examples of respects in which RPM can lead to competitive harm, as well as enlarge the list of examples of respects in which RPM may produce procompetitive efficiencies. (Pages 19-25 *infra*.)

IV. Category Management

The Sections welcome consideration of category management agreements in the Draft Guidelines, and they recommend that the Draft Guidelines be modified to recognize that category management agreements can produce anticompetitive foreclosure only if the category captain has significant market power and can impede rivals from achieving efficient scale. The Sections also suggest that the list of respects in which category management agreements may lead to competitive benefits be augmented. (Pages 25-29 *infra*.)

V. Definition of "Agreement"

The Sections recommend that the Commission consider modifications in the definition of "agreement" in ¶ 25 of the Draft Guidelines. In particular, inferring an agreement from a distributor's reduction of orders following a supplier's unilateral announcement of a reduction of supplies, in order to prevent parallel trade, could lead to finding an agreement in the absence of any actual meeting of the minds. With respect to finding an agreement on the basis of distributor responses to supplier coercion, clarification would be helpful on the circumstances under which the existence of an agreement can be inferred from conduct considered to be coercive. (Pages 29-31 *infra*.)

VI. Definition of "Agency"

The Sections suggest that the definition of "agency" be clarified to omit consideration of activities that the agent may undertake on its own behalf, such as after-sales service or sales of other products. The definition now sweeps too broadly, the Sections believe, and has the potential to discourage the use of agents to bring products and services to the market. (Pages 31-32 *infra*.)

COMMENTS

I. Buyer Market Power

The Draft Regulation makes a significant change in how the 30% market share threshold for the block exemption is to be determined. In contrast to Article 3 of the Regulation, which requires the market share of the buyer to be taken into account only in the case of a vertical agreement containing an exclusive supply obligation (Regulation Art. 3(2)), the Draft Regulation requires in Article 3 that the market shares of the buyer and seller are to be taken into account in every case. The Sections believe that this is an important refinement in the scope of the application of the block exemption.

The Draft Guidelines reflect the Commission's concerns about buyer market power, and these concerns appear in the current Guidelines. The primary buyer-power concern is the potential foreclosure of rival buyers to important sources of supply. *See*, *e.g.*, Draft Guidelines at ¶ 190 ("The main competition risk of exclusive supply is anticompetitive foreclosure of other buyers"); *id.* at ¶ 152 ("Foreclosure of other distributors [through exclusive distribution] may however become a problem where there is «buying power» and market power downstream, in particular in the case of very large territories where the exclusive distributor becomes the exclusive buyer for a whole market"); *id.* at ¶ 177 ("Foreclosure of the market to more efficient retailers may especially result where a strong dealer organisation imposes selection criteria on the supplier aimed at limiting distribution to the advantage of its members").

The Draft Guidelines place particular emphasis on whether a buyer possesses market power downstream, reasoning that without such downstream market power consumers are unlikely to be harmed by buyer-imposed vertical restraints. Thus, in addressing exclusive supply/distribution restrictions in the face of potential buyer power, the Draft Guidelines indicate that while "[t]he market share of the buyer on the upstream purchase market is obviously important for assessing the ability of the buyer to impose exclusive supply which forecloses other buyers," it is the effect of the restraint on the downstream market that is "the factor which determines whether a competition problem may arise." *Id.* ¶ 190. "If the buyer has no market power downstream, then no appreciable negative effects for consumers can be expected." *Id.* Even if a firm lacks upstream market power, "significant foreclosure effects may still result" if its share of the downstream market exceeds 30%. *Id.* Other factors also are considered to varying degrees in assessing different types of buyer-driven restrictions, including the length of the restriction (¶ 191), characteristics of the impacted good or service (¶ 195), the market position of the supplier (¶ 192), barriers to entry (¶ 193) and any justifications or efficiencies offered for the arrangement (¶ 196).

The Sections favorably note the Commission's recognition that power buyers can, in certain instances, employ vertical restrictions to foreclose rivals' access to important sources of supply. While it is well settled in the U.S. that buyer-side restraints and the unlawful exercise of "monopsony" power can impair allocative efficiency,[2] it is also clear that there are circumstances where restrictive supply arrangements can reduce uncertainty and enhance efficiency. In addition, it is well understood that strong or "power" buyers can counteract the influence of supply-side market power and extract price concessions that enhance the welfare of downstream consumers.[3] By extending the block exemption to these practices and requiring an investigation into both upstream and downstream market effects before the exemption can be lost, the Commission has adopted an appropriate framework for analyzing buyer-side restraints.

The roughly analogous treatment of seller-side and buyer-side restraints is appropriate given the symmetrical nature of the competition issues presented by monopoly and monopsony power.[4] Indeed, U.S. courts have long applied the same standards to evaluate restraints of trade regardless of whether they are imposed by a buyer or a seller.[5] The

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[2] *See, e.g.,* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 320-22 (2007).

[3] *See, e.g.,* Kartell v. Blue Shield, 749 F.2d 922, 927-29 (1st Cir. 1984).

[4] *See, e.g., Weyerhaeuser*, 549 U.S at 322 ("[t]he kinship between monopoly and monopsony suggests that similar legal standards should apply"); Roger G. Noll, *"Buyer Power" and Economic Policy*, 72 ANTITRUST L.J. 589, 591 (2005) ("asymmetric treatment of monopoly and monopsony has no basis in economic analysis"). For an economic analysis of *Weyerhaeuser*, see Roger D. Blair & John E. Lopatka, *Predatory Buying and the Antitrust Laws*, 2008 UTAH L. REV. 415 (2008).

[5] *See, e.g.,* FTC v. Motion Picture Adver. Serv. Co., 344 U.S. 392, 394-95 (1953) (using traditional analysis to find a violation of § 5 of the FTC Act for exclusive deals imposed by buyers that substantially foreclosed competition); Mandeville Island Farms v. Am. Crystal Sugar Co., 334 U.S. 219, 236-37 (1948); 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1803 at 100 (2d ed. 2005) ("[b]y and large, the considerations developed…for determining the threat of requirements contracts to competition apply equally to output contracts"). When the restraint is the result of cartel activity at the dealer level, it is subject, however, to evaluation as a per se illegal restraint under Section 1 of the Sherman Act (15 U.S.C. § 1). *See, e.g.,* United States v. Gen. Motors Corp., 384 U.S. 127, 145 (1966) ("[e]limination, by joint collaborative action, of discounters from the market is a per se violation of the Act"); *see also* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 897-98 (2007) ("The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer.").

Commission's use of a market share screen that applies to both the supplier and the buyer in creating a safe harbor exemption is consistent with applicable U.S. precedent.[6]

The Commission continues the 30% market share test as the cut-off in the Draft Regulation.[7] The Sections continue to believe, as we previously have recommended, that a 40% safe harbor for vertical agreements would be appropriate.[8]

The Sections support generally the Commission's decision to examine both upstream (i.e., buyer power) and downstream (i.e., supplier power) effects. Monopsonistic practices can result in a net efficiency loss through a reduction in the output purchased, and in unusual cases efficiency can be harmed even if consumers pay lower prices in the short term.[9]

Moreover, the anticompetitive effects of buyer-side market power can be compounded by downstream market power because rivals will be unable to effectively offset

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[6] The importance that the Commission places on the duration of the challenged restraints is also in line with settled U.S. authority. *See, e.g.,* Roland Mach. Co. v. Dresser Indus., 749 F.2d 380, 395 (7th Cir. 1984) (exclusive dealing arrangements terminable in less than a year are presumptively lawful).

[7] Under U.S. antitrust law, market share continues to be a conventional measure of market power. *See, e.g.,* Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1232 (8th Cir. 1987); Valley Liquors, Inc. v. Renfield Imps., Ltd., 822 F.2d 656, 666-68 (7th Cir. 1987). It is understood, however, that relying solely on market share can result in serious errors regarding market power. *See, e.g.,* William M. Landes, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981); Roger D. Blair & Jeffrey L. Harrison, *Cooperative Buying, Monopsony Power, and Antitrust Policy*, 86 NW. U. L. REV. 331 (1992).

[8] The Sections recommended a 40% threshold in their July 1997 Comments on the European Commission's "Green Paper on Vertical Restraints in EC Competition Policy," *available at* www.abanet.org/antitrust. The Sections recognize that a different threshold might apply in connection with Article 82.

[9] *See* Nat'l Macaroni Mfrs. Ass'n v. FTC, 345 F.2d 421, 425-27 (7th Cir. 1965); *see also, e.g., Mandeville Island Farms*, 334 U.S. at 235-36 (allowing Sherman Act § 2 monopsony claim even though the plaintiffs' complaint did not allege that the defendants' actions affected end-user prices); Telecor Commc'ns, Inc. v. Sw. Bell Tel. Co., 305 F.3d 1124, 1133-34 (10th Cir. 2002) ("Supreme Court's treatment of monopsony cases strongly suggests that suppliers…are protected by antitrust laws even when the anti-competitive activity does not harm end users"). Other decisions, however, have required proof of anticompetitive downstream effects. *See, e.g.,* Kamine/Besicorp Allegany L.P. v. Rochester Gas & Elec. Corp., 908 F. Supp. 1194, 1203 (W.D.N.Y. 1995) (where there is little risk that monopsony "can injure consumers by forcing up the price of the end product[,]…monopsony power *per se* does not create an antitrust concern"(italics in original)); Addamax Corp. v. Open Software Found., 888 F. Supp. 274, 280 (D. Mass. 1995) ("[o]nly with control of a downstream market can the monopsonist decrease output and raise prices"(footnote omitted)).

any output cuts imposed by the monopsonist/monopolist, and therefore both sellers and consumers may suffer injury.[10]

The Sections caution, however, against allowing downstream effects to trump upstream concerns in analyzing buyer-side restrictions. (Draft Guidelines ¶ 190.) Specifically, the Sections do not believe that evidence of significant upstream harm should be offset by the arguable existence of a competitive downstream market, nor that a firm that enjoys market power downstream (but not upstream) necessarily should be precluded from entering into an efficient (but restrictive) supply agreement. Rather, we urge the Commission to focus its analysis on the market directly affected by the restraint at issue to determine whether competition is substantially foreclosed. The fundamental antitrust problem with monopsony is that it reduces the output produced by the sellers, and thus the main focus of any analysis of buyer-side restraints should be primarily upon effects in the upstream market.[11]

In sum, the Sections commend the Commission for broadening its analysis of vertical restraints to include consideration of buyer market power. We believe that it is appropriate to analyze effects of vertical restraints both in downstream and upstream markets, and that a market-share screen applied to both suppliers and buyers is a reasonably sound basis upon which to create a safe harbor for the block exemption. However, we urge that the Commission rethink its Draft Guidelines position on the impact of downstream market power regardless of the restraint at issue.

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[10] *See, e.g.,* Paul W. Dobson & Michael Waterson, *Countervailing Power and Consumer Prices*, 107 ECON. J. 414, 418-30 (1997); *see also* HOVENKAMP, *supra* note 5, ¶ 1802d at 73-74 ("[w]hen exclusive dealing is considered as a 'foreclosure offense,' it ordinarily becomes necessary to examine market power or share at *both* of the two market levels involved" (footnote omitted; italics in original)).

[11] *See generally* Roger D. Blair & Richard E. Romano, *Collusive Monopsony in Theory and Practice: The NCAA*, 42 ANTITRUST BULL. 681 (1997).

II. Restrictions on Internet Sales

Continuing the approach followed in the Guidelines, the Draft Guidelines take the position that every distributor "must be free to use the Internet to advertise or to sell products." (Draft Guidelines ¶ 52; Guidelines ¶ 51.) Using an "active" versus "passive" selling dichotomy, the Draft Guidelines permit certain limitations to be imposed by a supplier on Internet sales by a distributor but identify others as hardcore restrictions of passive selling (Draft Guidelines ¶ 52). The latter fall under Article 4(b) of the Draft Regulation as "market partitioning by territory or by customer group" (Draft Guidelines ¶ 50).

Contrary to the approach taken in the Draft Guidelines, the Sections do not believe that there is any need for special treatment of Internet sales. U.S. antitrust case law does not support special treatment for Internet selling different from that for selling from brick-and-mortar locations,[12] and there is no recognition of a distinction between "active" and "passive" selling. Restrictions on a distributor's sale of products over the Internet are evaluated for legality in the same way as contractual restraints imposed on a reseller generally. Recognizing, however, that the foregoing distinction is integral to the Commission's analysis of hardcore restrictions under Article 4(b) of both the Regulation and the Draft Regulation, the Sections will focus their attention in these Comments on areas of potential confusion or uncertainty that may arise from the approach adopted in the Draft Guidelines.

The Sections acknowledge that EU competition law is based on specific market integration considerations with regard to vertical restraints that do not arise under the U.S. antitrust law. The Commission has sought to ensure that, within the Community, firms are not able to "recreate private barriers between Member States where State barriers have been

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[12] *See generally* ABA SECTION OF ANTITRUST LAW, ANTITRUST HANDBOOK FOR FRANCHISE AND DISTRIBUTION PRACTITIONERS 111-12 (2008) ("Restrictions on Internet sales by franchisees or resellers are increasingly commonplace. … Generally speaking, the antitrust laws apply to e-commerce restraints to the same extent as to restraints affecting bricks-and-mortar businesses." (footnote omitted)).

successfully abolished."[13] The Sections also recognize that the Commission has wider e-commerce policy objectives and wishes to encourage Internet use across the EU and to be responsive to the complaints of consumers who feel they are prevented from engaging in cross-border transactions via the Internet.[14] In light of these broader Commission objectives, the general approach to restrictions on Internet sales set out in the Draft Guidelines appears to strike a workable compromise among multiple competing considerations -- i.e., economic theory, consumer demands, supplier concerns, market integration and e-commerce policy objectives. However, the Sections would welcome additional clarification on some aspects of the proposed approach, as explained more fully in this section of these Comments.

A. Proposed approach to restrictions on Internet sales in the context of exclusive distribution systems

Under Article 4(b) of the Draft Regulation, the block exemption cannot apply to "restriction of sales by a buyer party to the agreement or its customers, in as far as those restrictions relate to the territory into which or the customers to whom the buyer or its customers may sell the contract goods or services." (Draft Guidelines ¶ 50.) Certain exceptions apply, and a supplier can restrict "active" sales by a buyer party to the agreement to a territory or a customer group which has been allocated exclusively to another buyer or which the supplier has reserved to itself. (*Id.* ¶ 51.) The Sections understand that this means that, where an exclusive distribution system is in place, if a supplier wishes to benefit from the block exemption, it is permitted to restrict "active" sales by a distributor to another territory or customer group exclusively allocated to another distributor (or reserved to the supplier), but it

[13] Guidelines ¶ 7; Draft Guidelines ¶ 7. The Commission stressed the importance of this policy consideration in Decision 2006/895 in Case COMP/C-3/37.980 Souris-Topps [2006] O.J. L353/5, when it stated that "restrictions of passive sales impeded consumers from taking advantage of the Single Market and from benefiting from the price difference between Member States."

[14] The complaints include (1) being re-routed to websites of distributors located in their own Member State when they attempt to buy an item online in another Member State or (2) credit card checks which lead to termination of the transaction once the credit card data reveal an address that is not that of the "targeted Member State." ONLINE COMMERCE ROUNDTABLE, REPORT ON OPPORTUNITIES AND BARRIERS TO ONLINE RETAILING ¶ 12 n.11 (2009), *available at* http://ec.europa.eu/competition/consultations/2009_online_commerce/roundtable_report_en.pdf.

is not permitted to prevent "passive sales" to customers in that other territory or within that other customer group.

A key question that is raised in the context of exclusive-distribution-imposed restrictions on Internet sales is whether and in what circumstances Internet sales will be deemed to be "active" or "passive" sales for the purposes of the block exemption.

1. Classification of online sales as "active" or "passive"

The Draft Guidelines indicate that the Commission intends to continue to treat Internet sales as generally constituting "passive sales," on the basis that advertising and selling goods on the Internet are reasonable ways to reach every customer (Draft Guidelines ¶ 51) and so are not considered to be "actively" targeted at customers in a particular distributor's territory or a particular customer group.

The Sections understand the basis for classification of online sales as "passive sales" where all that occurs is that a customer visits the website of a distributor and contacts the distributor, and such contact leads to a sale, including delivery.[15]

The Sections understand also that there may be certain circumstances where online advertising/sales should be considered to constitute "active selling." They submit that the Draft Guidelines do not include sufficient guidance as to when such circumstances could arise in practice. For example, the Draft Guidelines confirm that a supplier should be permitted to restrict a distributor from sending unsolicited e-mails to individual customers located in a territory or within a discrete customer group which has been exclusively allocated to another distributor (on the basis that such e-mails would constitute active selling). (Draft Guidelines ¶ 53.) However, it is not entirely clear how this would apply in some instances. For example, if a customer purchased a product or service from Company A and, as part of that transaction, selected an option to receive further offers/promotions from Company A or companies

[15] Draft Guidelines ¶ 52.

associated with Company A (which included Company B), would an email containing an offer or promotion sent to that customer by Company A or Company B be considered an unsolicited email which amounted to active selling?

The Draft Guidelines state that online advertisements specifically addressed to certain customers should be deemed a form of active selling to those customers. (*Id.*) However, it is not clear how it could be demonstrated in practice that an online advertisement was specifically targeted to certain customers. The Guidelines suggest that "banners or links in pages of providers specifically available to exclusively allocated customers"[16] could demonstrate that an online advertisement is specifically targeted at those customers, but this wording has been omitted in the Draft Guidelines. There is therefore no real guidance on this potentially very important question.

The Sections believe it would be helpful if the Commission were to provide illustrative examples in the Draft Guidelines explaining how it could be established that an online advertisement is "active" for having been specifically addressed to certain customers, and also provide guidance regarding which party bears the burden of proof to show that this is or is not the case.

2. Specific comments on examples of hardcore restrictions of passive sales in the context of Internet sales set out in ¶ 52 of the Draft Guidelines

a. Requiring a distributor to limit the proportion of overall sales made over the Internet

Paragraph 52 of the Draft Guidelines states that requiring a distributor to limit the proportion of overall sales made over the internet constitutes a hardcore restriction of passive selling. Footnote 29 explains that this does not bar a supplier from "requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products off-line to ensure an efficient operation of its

[16] Guidelines ¶ 51.

brick and mortar shop, nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model. . . . This absolute amount of required off-line sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location."

The Sections submit that it would be helpful if the Commission could provide further clarification as to the amount or value of sales that can be restricted within the safe harbor.[17] Is the reference to an absolute value intended to mean the absolute value of offline sales by the supplier to the buyer, or the absolute value of retail sales by the buyer to its customers? The Sections are concerned that potential resale price maintenance issues could be raised by the latter interpretation absent further clarification.

The Sections would also welcome clarification from the Commission of what rights the supplier would have in responding if the buyer does not meet the offline target.

b. Requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold offline

Paragraph 52 of the Draft Guidelines identifies as a hardcore restriction a requirement that a distributor pay a higher price for products intended to be resold by the distributor online than for products intended to be resold offline. The Sections note that draft footnote 30 provides that "this does not exclude the supplier offering the buyer a fixed fee to support its off-line or online sales." However, the Sections are concerned that payment of a fixed fee to the buyer specifically to support offline sales might be characterized as the functional equivalent of charging a lesser price for products intended to be resold offline, so we would welcome further clarification from the Commission on this issue to avoid confusion. It would

[17] This would not carry any implication that sales outside of the safe harbor would violate the Guidelines, only that they would need to be analyzed under a rule of reason approach.

be helpful to have confirmation that the Commission does not consider such a support fee the equivalent of charging offline distributors a lower price for goods than online distributors.

B. Restrictions on Internet Sales Where a Distributor Is the First to Sell a New Brand or First to Sell an Existing Brand in a New Market

Paragraph 56 of the Draft Guidelines approves restriction of passive sales into an exclusive territory if the distributor is selling a new brand or entering a new market with an existing brand and substantial start-up investment is required by the distributor. The Draft Guidelines state that this restriction would fall outside of Article 81(1) during the first two years. Assuming that this exception from treatment as a hardcore restriction is also intended to apply to restrictions of Internet sales, it would be helpful if ¶ 56 could be revised to state this explicitly. This could be achieved by amending the wording in ¶ 56 to refer to "restrictions of passive sales (*including Internet sales*) by other distributors into such a territory or to such a customer group." The proposed new text is in italics.

The Sections also submit that in circumstances where the investment required from the distributor has been particularly large, restrictions on passive sales lasting for longer than two years could potentially fall outside Article 81(1) or, alternatively, be justified under Article 81(3). The Sections believe it would be helpful if a sentence to this effect were added to this paragraph of the Draft Guidelines.

C. Restrictions on Internet Sales in the Context of Selective Distribution Systems

The Sections submit that, in the context of selective distribution systems, suppliers should be permitted to impose restrictions on distributors relating to Internet sales in order to protect brand image, combat counterfeiting or limit the effect of free-riding. Such restrictions may also help to ensure that offline retailers are not dissuaded from investing in the provision of customer services such as personalised technical advice, product demonstrations, and after-sales support. Some further clarification or illustrative examples of when restrictions on Internet sales can clearly be imposed in these circumstances would be welcomed. Without

further clarification, a supplier runs the risk that an otherwise reasonable restriction on a distributor's Internet sales may be deemed to fall within the hardcore restriction of Article 4(c) of the Draft Regulation as "restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade."

1. Dissuading appointed dealers from using the Internet by imposing criteria for online sales which are not "equivalent" to those for offline sales

The Sections support the Commission's proposed approach of classifying as a hardcore restriction any obligation which dissuades appointed dealers in a selective distribution system from using the Internet by imposing criteria for online sales which are not "equivalent to the criteria imposed for the sales from the brick and mortar shop."[18] The illustrative examples provided in footnote 31 of the Draft Guidelines are also welcomed. However, as currently drafted, it is not clear how the Commission would approach scenarios such as the following:

> - Could a supplier operating a selective distribution system which requires off-line dealers to provide an after-sales support team at each store require its "online-only" dealers to offer an after-sales helpline?
>
> - Could the same supplier also require online-only dealers to cover the costs of sending a faulty product to an after-sales support team for the product to be checked/repaired if the problem cannot be dealt with over the phone?
>
> - Could a supplier impose more onerous security requirements on online resellers in relation to processing of payments, given the greater security risks associated with online selling (perceived or actual)?

The above example restrictions should all fall within the scope of permissible restrictions in the context of selective distribution systems. However, this conclusion is not entirely clear from the Draft Guidelines, and the Sections believe it would be helpful if the Commission could provide additional clarification.

[18] Draft Guidelines ¶ 57.

The Sections also note that some criteria that are appropriate for an online dealer may not have an "equivalent" in the offline world. These could include, for example, response and downloading times for a website, use of an automatic recognition function, quality of text and images used on a website, and quality of search engines embedded within the site. It would be helpful if the Commission were to clarify the extent to which such restrictions can be imposed by suppliers on their online dealers in a selective distribution system, given the likely difficulties of pointing to a clearly "equivalent" set of criteria for offline retailers.

2. Requiring appointed dealers to have a brick-and-mortar shop or showroom before engaging in online distribution

The Draft Guidelines propose that a supplier should be permitted to require its distributors to have a brick-and-mortar shop or showroom before engaging in online distribution,[19] and the Sections generally support this approach. While some consumers may prefer to have an "online-only" distributor, the presence of online-only distributors may have the effect of distorting competition between retailers and indirectly make certain valuable customer services rare or eliminate them altogether, such as personalised technical advice, product demonstrations and after-sales support. This would ultimately be to the detriment of consumers.

As currently drafted, ¶ 54 of the Draft Guidelines would appear to permit a distributor in a selective distribution system to operate a brick-and-mortar shop or showroom in one Member State and then engage in both active and passive online sales to customers located in other Member States where the distributor maintains no physical presence. Yet under the Draft Guidelines, the supplier could not include the territorial restrictions permitted in the context of exclusive distribution systems if it chose to pursue a selective distribution system, and therefore it could not restrict the ability of the distributor to sell to end users either actively or passively. This would mean that a distributor could, for example, open a small

[19] Draft Guidelines ¶ 54.

shop in Paris and then actively target customers in Edinburgh, Rome or Madrid via the Internet, even if those customers would be very unlikely to actually visit its Paris shop or benefit from the "additional" customer services offered at the brick-and-mortar shop.

The Sections submit that it would be preferable to allow suppliers that have chosen to adopt a selective distribution system to also restrict the territorial extent of online sales by its distributors, provided that any such restrictions can be objectively justified.

3. A website as a "place of establishment" for the purpose of Article 4(c) of the Draft Regulation

The Sections note that the wording of Article 4(c) of the Draft Regulation remains the same as in the Regulation, excluding the restriction of active or passive sales to end users by members of a selective distribution network, without prejudice to the possibility of prohibiting a member of the network from operating out of an "unauthorised place of establishment." The statement in the Draft Guidelines, that "within a selective distribution system, the dealers should be free to sell, both actively and passively, to all end users, also with the help of the Internet,"[20] appears to indicate that the Commission does not consider a website to be a "place of establishment" in this context. Assuming that this interpretation of the Commission's position is correct, the Sections submit that it would be helpful if this were to be made expressly clear in the Draft Guidelines.[21]

In this respect, the Sections welcome the fact that the Draft Guidelines acknowledge in ¶ 54 that, for reasons of health or safety, an outright ban on Internet selling may be justified and may either fall entirely outside Article 81(1) (because it is objectively necessary and does not restrict competition) or because it benefits from Article 81(3) on the basis of an efficiency justification.

[20] Draft Guidelines ¶ 57.

[21] The Sections note that in ¶ 58 of the Draft Guidelines the Commission states that use of the Internet "cannot be assimilated to the opening of a new outlet in a different location." However, the Sections submit that this is not the same as making expressly clear that the Internet cannot be deemed an unauthorized place of establishment in the context of Article 4(c).

D. Restrictions on Sale of Competing Goods or Services over the Internet in the Context of Noncompete Obligations

In the context of noncompete obligations, the Draft Guidelines specifically address the interpretation of the Draft Regulation with respect to Internet sales in ¶ 62: "A prohibition to sell competing goods or services over the internet will be considered as a non compete obligation if it practically causes the buyer to limit its purchases of competing goods or services to less than 20% of its total purchases." It is not clear what this text adds in practice, given that a provision which prevents the buyer from purchasing competing goods or services or limits such purchases to less than 20% of its total purchases is already defined in Article 1(1)(b) of the Draft Regulation as a noncompete obligation (regardless of whether the competing goods or services are intended to be sold online or offline).

The text seems to imply that the block exemption will still apply to a noncompete clause even if a buyer were expressly restricted from selling competing goods over the Internet, provided that the restriction were limited to a 5-year duration and the buyer's purchases of competing goods were less than 20% of its total requirements. If this is the Commission's intention, it could lead to the awkward result that a supplier may prevent a buyer from selling any competing products over the Internet, notwithstanding that the supplier could not limit the buyer from selling the supplier's own products over the Internet (the supplier only being allowed to require the buyer to sell at least a certain amount offline).

If a supplier allows a buyer to deal in competing products, the Sections submit that it is difficult to see in what circumstances the supplier could be justified in expressly imposing an outright ban on the buyer selling those competing products over the Internet, particularly in light of ¶ 52 of the Draft Guidelines, which states that requiring a distributor to limit the proportion of overall sales made over the Internet is a hardcore restriction of passive selling.

E. Restrictions on Online Sales into the EU by a Distributor Outside the EU

The Draft Guidelines do not currently expressly address the question of how the block exemption would be applied in the case of a supplier that wanted to impose a restriction on a distributor located outside the EU, for example in the U.S., preventing online sales of the relevant goods to the EU via a U.S. website.

The Sections recognize that if a supplier of Product X imposes a restriction on its U.S. distributor preventing it from selling Product X over the Internet to customers in the EU, this could arguably have effects within the EU. The Sections submit that formulation of guidelines or rules for treatment of any such restrictions would necessarily need to take into account a range of potentially competing interests, and we recommend that the Commission reserve formulation of any such guidelines or rules for a separate consultation. The Sections would welcome the opportunity to comment at that time.

III. Resale Price Maintenance

The Draft Regulation continues the treatment of minimum resale price maintenance (RPM) as a hardcore restriction. Article 4(a) makes no change in the Commission's view that a limitation on a buyer's ability to determine the minimum selling price for goods is a hardcore restriction. The Draft Guidelines contain new text, at ¶¶ 219-21, that recognizes that minimum RPM may under some circumstances, however, lead to efficiencies that would satisfy the efficiencies defense of Article 81(3). The Sections believe that this salutary acknowledgment that minimum RPM can be procompetitive in some circumstances strongly suggests that the Commission should reconsider whether RPM should continue to be treated as presumptively anticompetitive.

The U.S. Supreme Court abandoned in its 2007 *Leegin*[22] decision the view that minimum RPM agreements are per se illegal under Section 1 of the Sherman Act (15 U.S.C. § 1),[23] and the Sections welcome the consultation process for the Draft Regulation and Draft Guidelines as a timely opportunity to discuss and review the position of RPM under EC competition law. The new section in the Draft Guidelines on RPM (¶¶ 219-21), which sets out theories of harm and examples of efficiencies, is an important and useful starting point for these discussions.

A. Minimum and Fixed RPM

The Draft Guidelines provide a more detailed discussion of the potential effects of RPM than the Guidelines, both in relation to the potential for RPM to harm competition and in relation to the efficiencies to which RPM can give rise.[24] The Sections welcome this more detailed effects-based discussion. In particular, the Commission's examples of scenarios in which RPM may be procompetitive provide helpful guidance for firms considering RPM clauses. Given the efficiency benefits that the economics literature has identified as potentially flowing from RPM,[25] the Draft Guidelines could benefit from a more extensive list of circumstances under which the Commission would regard RPM as benign or even pro-competitive.

B. Maximum RPM or Recommended Prices

The Draft Guidelines do not propose any change to the treatment of maximum RPM or recommended prices. (Draft Guidelines ¶¶ 222-25.) Given that the Guidelines already call

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[22] Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877 (2007). Similarly, Canada has repealed its previously per se criminal RPM provision, replacing it with a civil provision that contains a market power element. (Competition Act, R.S.C. 1985, C-34, as amended, s.76).
[23] The Sections acknowledge that there is continuing debate on whether the Court's decision should be followed by state courts in interpreting antitrust laws of the various states and that bills are pending in the U.S. Congress to repeal the holding in *Leegin.*
[24] Draft Guidelines ¶ 220.
[25] For an overview of the recent literature on procompetitive effects of RPM, see generally ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION 58-76 (2006) [hereinafter ANTITRUST LAW AND ECONOMICS].

for an effects-based analysis of these measures (Guidelines ¶¶ 225-28), the Sections agree with the Commission's proposal to continue this approach.

C. Anticompetitive Effects of Minimum RPM

The Draft Guidelines discuss in ¶ 220 the potential anticompetitive effects of RPM, leading off with the observation that "RPM may restrict competition in a number of ways." The Sections agree with the observation, but the corollary should also be emphasized -- i.e., minimum RPM can also be procompetitive in a number of ways.

Paragraph 220 identifies a number of mechanisms through which RPM can lead to competitive harm. These include facilitation of collusion among manufacturers or retailers, the "softening" of competition between manufacturers or retailers, reduction of pressure on the profit margins of manufacturers and reduction of innovation at the distribution level. These examples are helpful, but the Sections believe that the value of the guidance would increase if the Commission were to specify in more detail the circumstances in which the various forms of competitive harm could (or would be likely to) arise.

For example, the Sections consider that the concern that RPM may facilitate cartel behaviour (whether among manufacturers or retailers) would be implausible in industries that do not feature at the very least a tight oligopoly with high barriers to entry. Moreover, where a cartel could be monitored and enforced through other more effective or less conspicuous means, it would seem unlikely that RPM would be chosen by the participants as the means by which to facilitate the cartel.[26] It would be helpful if the Draft Guidelines could address these issues and provide some guidance as to the circumstances in which the Commission is likely to be concerned about cartel facilitation issues.

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[26] *See, e.g., id.* at 51 ("RPM is at most a facilitating practice, and therefore strengthens, but does not in and of itself establish, a cartel").

The statement that RPM may "soften competition" (¶ 220) would benefit from further clarification. It is not clear from the Draft Guidelines how RPM clauses may have this effect or what form of softening of competition could be expected to take place in the absence of cartel behavior at the manufacturer or retailer level. If the Commission is aware of examples of how this may occur, it would be helpful to provide illustrations in order to clarify the issue for firms considering RPM clauses.

It is also unclear in which circumstances RPM would be expected to "reduce dynamism and innovation at the distribution level." (¶ 220.) The Draft Guidelines refer to the possibility that RPM may deter entry or expansion of price discounter retailers, but it is not clear whether by this the Draft Guidelines are referring to anything more than the direct effect that RPM measures have of preventing retailers from offering prices below the specified minimum level. Moreover, the Draft Guidelines overlook the fact that large multi-brand retailers (e.g., "Big Box" stores) have buying power that can effectively block RPM and that their presence in the retail markets makes improbable any widely-implemented minimum RPM programs for the kinds of consumer goods carried in these stores. As one commentator has noted, this buying power gives the large retailer control over "whether [items] will be priced or marketed aggressively," and this, in turn, gives it "substantial leverage in dealing with even the largest producers of strong brands of consumer products."[27]

The Sections believe that greater emphasis should be placed on the importance of interbrand competition and the fact that RPM can serve as a tool to enhance interbrand competition.[28] As with other vertical restraints, by protecting retailers' profit margins, RPM can ameliorate the free-rider problem associated with retailers' investments in, for example,

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[27] Warren S. Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller*, 72 ANTITRUST L. J. 563, 579 (2005).

[28] *See, e.g., Leegin*, 551 U.S. at 890 (RPM "can stimulate interbrand competition . . . by reducing intrabrand competition among retailers").

high-quality service.[29] RPM can therefore operate to the benefit of the manufacturer, the retailer and the consumer by increasing the competitiveness of the nonprice elements of the product offering.[30] The Sections believe it would be helpful for the Draft Guidelines to discuss the circumstances in which the Commission expects that these positive effects on competition may be outweighed by negative effects.

D. Efficiencies

The Draft Guidelines provide in ¶ 221 three examples of efficiencies that can result from RPM: (1) product or brand development at the time of entry; (2) coordinated short-term price campaigns in franchise systems or similar distribution systems; and (3) preventing loss-leader strategies by large distributors. The Sections appreciate that the list of efficiencies is only illustrative, but they believe that it would be helpful to make clear that efficiencies may result from RPM in many other situations. As the Supreme Court noted in *Leegin*, minimum RPM can lead to increased interbrand competition by increasing retailers' incentives for investing in customer service.[31] Minimum RPM can also help avoid inefficiently low purchase volumes as a result of concerns about demand uncertainty,[32] although it admittedly limits a buyer from responding to weak demand by discounting.

Including some of these additional examples in ¶ 221 would also provide a more balanced description of both the competitive harms and the procompetitive efficiencies that can arise in RPM cases.

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[29] *See, e.g., id.* (without RPM, "discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate").

[30] *See generally* DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 423 (4th ed. 2005) ("Minimum price restrictions channel competition among distributors toward sales effort and away from price cutting. They lead to more sales effort than occurs without them."); ANTITRUST LAW AND ECONOMICS, *supra* note 25, at 67 ("RPM provides higher margins as an incentive for dealers to compete with one another on a nonprice basis").

[31] 551 U.S. at 890.

[32] *See, e.g.,* ANTITRUST LAW AND ECONOMICS, *supra* note 25 at 71 ("RPM, by ensuring that retailers get something of value for their inventories when demand is low, induces higher inventory holdings, lower prices in the event of high demand, and greater expected sales, thereby leading to increased economic welfare" (footnote omitted)).

E. Overall Approach: RPM Continues to be a Hardcore Restriction

Since minimum RPM continues to be a hardcore restriction, an RPM clause would not fall within the protection of the block exemption, even where the parties have a low market share. According to the Draft Regulation, this is because the Commission considers that minimum RPM is "more likely than not to restrict competition and harm consumers." (Draft Regulation, Recitals ¶10.) Neither the Draft Regulation nor the Draft Guidelines, however, provides any evidence to support this conclusion in relation to RPM.

The Draft Guidelines state at ¶ 220 that the presumptions as to the net negative effects of RPM and the exclusion of agreements including RPM clauses from the Draft Regulation do not preclude parties from raising an efficiency defense under Article 81(3), but the Sections are not aware of an instance in the last 50 years in which a firm has successfully made efficiency arguments to defend an RPM clause under EC competition law. Since the economic evidence establishes that RPM -- like other vertical restraints -- can plausibly give rise to both positive and negative effects[33] and strongly challenges the assumption that those effects are more likely to be harmful than beneficial, the Sections consider that the better approach to minimum RPM would be to apply a standard effects-based analysis to the assessment of RPM clauses and to remove them from Article 4 of the Draft Regulation as a hardcore restriction.

It is also questionable whether the inclusion of an RPM clause in an agreement should lead to loss of the block exemption, given that there is no evidential basis for the view that RPM clauses are more likely to cause competitive harm than to improve outcomes for consumers. If the Commission were concerned, however, that moving from *de facto* per se illegality to per se legality (albeit only for parties with low market shares) would be too radical

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[33] Even the dissenting Justices in *Leegin* noted that minimum RPM can have beneficial effects. *See* 551 U.S. at 914 ("as many economists suggest, sometimes resale price maintenance can prove harmful; sometimes it can bring benefits").

a departure, an interim approach could be to treat RPM in a fashion similar to treatment of noncompetition clauses with a duration longer than five years. RPM clauses, under this approach, would remain outside the block exemption and subject to analysis under Article 81(3) while allowing the rest of the agreement to continue to benefit from the block exemption.

IV. Category Management

The Draft Guidelines address category management agreements in ¶¶ 205-09. These are agreements in which a distributor designates a supplier as "category captain" with authority for the marketing of a category of products including not only the supplier's own products, but also the products of its competitors.[34] In the U. S., such agreements have been analyzed by scholars, the antitrust agencies and the courts.

The Draft Guidelines set forth a safe harbor for category management agreements "when both the supplier's and buyer's market share on their respective downstream markets does not exceed 30%."[35] For agreements that do not fit within the exemption, the Guidelines identify several potential sources of harm to competition as well as several potential pro-competitive benefits.[36]

The Sections agree that category management agreements that fall within the Draft Guidelines' safe harbor are unlikely to cause competitive harm and deserve an exemption from Article 81(1). Moreover, they believe that many category management agreements that fall outside the safe harbor are also unlikely to cause competitive harm and may offer pro-consumer efficiencies. In this regard, the Commission might consider emphasizing that the safe harbor should not be interpreted to suggest that category management agreements falling outside of it pose any threat of harm to competition.

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[34] Draft Guidelines ¶ 205.
[35] *Id.*
[36] *Id*. ¶¶ 206-09.

The Draft Guidelines identify three general threats to competition that category management agreements might pose. First, such agreements may foreclose other suppliers, in particular when the category captain is able, due to its influence over the marketing decisions of the distributor, to limit or disadvantage the distribution of products of competing suppliers.[37] Second, such agreements might facilitate collusion between distributors when a supplier, which serves as a category captain for all or most of the competing distributors in a market, provides distributors with a common point of reference for their marketing decisions.[38] Third, such agreements might facilitate collusion between suppliers through increased opportunities to exchange sensitive market information, such as information related to future pricing, promotional plans or advertising campaigns, via retailers.[39]

The Sections concur that these are potential sources of anticompetitive harm. They suggest, however, that the Draft Guidelines be modified to state that category management agreements will only produce anticompetitive foreclosure if a category captain has significant market power and can control a sufficient amount of distribution for a sufficient period of time that competing suppliers are effectively prevented from reaching efficient scale.[40] Horizontal collusion at either the supplier or distributor level is anticompetitive and is to be condemned. The Guidelines might point out, however, that category management agreements, by themselves, provide no evidence of such collusion.

With respect to the procompetitive effects of category management agreements, the Draft Guidelines note that such agreements: can allow distributors to achieve economies of scale as they ensure that the optimal quantity of products is presented timely and directly on

[37] *Id.* ¶ 206.
[38] *Id.* ¶ 207.
[39] *Id.* ¶ 208.
[40] In Conwood Co. v. United States Tobacco Co., 290 F.3d 768 (6th Cir. 2002), the Sixth Circuit upheld antitrust liability under § 2 of the Sherman Act in part based on the defendant's conduct as a category captain.

the shelves;[41] allow suppliers to achieve economies of scale by helping them to better anticipate demand and to tailor their promotions accordingly;[42] and may lead to higher customer satisfaction as they meet better demand expectations.[43] The Sections agree that these are some of the benefits of category management agreements and believe that the Draft Guidelines might be expanded to mention additional procompetitive benefits, including:

> *Distributor access to supplier expertise and information.* Category captains often possess extensive market knowledge and expertise that retailers lack, including information about consumer trends and motivation, demand and other factors that affect retail sales.[44] In addition to greater access to information, category captains often have greater resources to analyze it.[45] They may also be best situated to know the kinds of promotions that are most effective in moving a product or the kinds of complementary goods that might be advantageously displayed in adjacent shelf space.[46] As a collaborative process, category management attempts to leverage the unique resources of supplier and retailer trading partners. By combining tools and resources in collaboration, category management helps suppliers and retailers align their strategies, systems, processes, and people to provide better value to consumers.[47]

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[41] Draft Guidelines ¶ 209.
[42] *Id.*
[43] *Id.*
[44] *See, e.g.,* Debra M. Desrochers, Gregory T. Gundlach & Albert A. Foer, *Analysis of Antitrust Challenges to Category Captain Arrangements*, 22 J. PUB. POL'Y & MKTG. 201, 201-215 (2003); Subir Bandyopadhyay, Anna Rominger & Savitri Basaviah, *Developing a Framework to Improve Retail Category Management Through Category Captain Arrangements*, 16 J. RETAILING & CONSUMER SERVS. 315 (2009).
[45] *See,e.g.,* Desrochers *et al., supra* note 44, at 202.
[46] *See, e.g.,* Federal Trade Commission, Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry 48 (2001), *available at* http://www.ftc.gov/os/2001/02/slottingallowancesreportfinal.pdf.
[47] *See, e.g.,* Desrochers *et al., supra* note 44, at 202.

Reduced costs, optimized shelf space and increased consumer welfare. By improving retailers' product assortments, eliminating slow-moving items and offering a selection of products that more closely reflect consumer preferences, category management can help the retailer generate more sales and profits per square foot of space and decrease inventory and warehouse costs.[48] In addition, suppliers often pay the retailer for the privilege of becoming a category captain.[49] In the usual case where the retailer faces competition, these payments and cost savings can be expected to be passed on to consumers in the form of lower prices or increased non-price amenities.[50]

Increased interbrand competition. Category management can add another dimension on which supplier competition takes place -- namely, the competition to be the category manager.[51]

In addition to an expanded discussion of potential procompetitive effects, the Draft Guidelines would benefit from clarification as to how the Commission will weigh category management agreement efficiencies against anticompetitive effects, including which efficiencies will be recognized by the Commission, what criteria will be applied for determining the plausibility of the estimated efficiencies or their claimed magnitudes, as well

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[48] *See, e.g.,* Robert L. Steiner, *Category Management – A Pervasive, New Vertical/Horizontal Format*, ANTITRUST, Summer 2001, at 77, 78.

[49] *See, e.g., id.*; Leo S. Carameli, Jr., Note, *The Anti-Competitive Effects and Antitrust Implications of Category Management and Category Captains of Consumer Products*, 79 CHI.-KENT L. REV. 1313, 1326-27 (2004).

[50] *See* Joshua D. Wright, *Antitrust Analysis of Category Management:* Conwood Co. v. United States Tobacco Co., 17 SUP. CT. ECON. REV. (forthcoming 2009), *available at* http://ssrn.com/abstract=945178. Category management agreements can mitigate double marginalization between the retailer and category captain the benefits of which are shared between the retailer, category captain and consumer. *See* Mumin Kurtulus & L. Beril Toktay, *Category Captainship: Who Wins, Who Loses?*, 4 ECR J. 1, 5 (2004).

[51] Kenneth Glazer, Brian R. Henry & Jonathan Jacobson, *Antitrust Implications of Category Management: Resolving the Horizontal/Vertical Characterization Debate*, THE ANTITRUST SOURCE (July 2004), *available at* www.abanet.org/antitrust/at-source/04/07/Jul04-CatMgmt7=23.pdf.

as how the Commission will assess the magnitude of projected anticompetitive effects from foreclosure.

V. Definition of "Agreement"

The Sections welcome the efforts of the Commission to provide clarity on the definition of vertical "agreements" falling within the scope of Article 81(1). In light of the complexity of the issue and the developments in the EU case law that have occurred since publication of the Guidelines, the Sections believe that additional clarification is appropriate and would be of significant assistance to practitioners seeking to apply and firms seeking to comply with the rules.

Several modifications concerning the discussion of the definition of "agreement" contained in the first bullet point in ¶ 25 of the Draft Guidelines might be considered. First, we note the statement in the Draft Guidelines that, in order to establish tacit acquiescence, "it is necessary to show first that one party requires explicitly or implicitly the cooperation of the other party for the implementation of its unilateral policy." This statement would seem equally true for the discussion of what constitutes acquiescence in the context of an agreement as it does for the discussion of tacit acquiescence. Thus, we would suggest that the statement be moved up in the text to precede the discussion of acquiescence.

Second, the example of when an agreement may arise in the context of a unilateral reduction of supply would seem inconsistent with the general principle that the cooperation of the other party is necessary for the implementation of the unilateral policy in order for an agreement to arise. This example could lead to the conclusion that there is an "agreement" even when there is no evidence of "concurrence of wills" as required for a finding of an agreement under EU law. The Draft Guidelines state that "if after a supplier's announcement of a unilateral reduction of supplies in order to prevent parallel trade, distributors reduce immediately their orders and stop engaging in parallel trade, then those distributors tacitly acquiesce to the supplier's unilateral policy." (¶ 25.) With regard to the first action of the

distributor suggesting acquiescence -- the immediate reduction of orders -- the example would seem to suggest that, unless the distributor continues to place orders at its previous level even when it has been told by the supplier that the quantities supplied will be reduced, it will be deemed to have acquiesced in the reduction of supplies. Such an approach would seem to be overly broad, because the distributor may well disagree with the reduction but consider that it is useless to continue to place orders in excess of the amounts that the supplier has said it will make available to the distributor. With regard to the second action suggesting acquiescence on the part of the distributor -- to stop engaging in parallel trade -- the example suggests that the distributor can choose to continue to engage in parallel trade despite the reduction of supplies. In some sectors, notably the pharmaceutical sector, distributors may be required by national law to ensure the supply of products for the domestic market. Thus, if a supplier reduces supplies to the amount required for the domestic market, the distributor will have no choice but to stop engaging in parallel trade because it will no longer have product available for export. In these circumstances, a reduction in parallel trade would not indicate acquiescence on the part of the distributor.

Third, the discussion of the level of coercion by the supplier and the number of distributors that are implementing the supplier's unilateral policy is unclear. The Draft Guidelines state that "tacit acquiescence may be deduced from the level of coercion exerted by a party to impose its unilateral policy on the other party or parties to the agreement in combination with the number of distributors who are actually implementing in practice the unilateral policy of the supplier." (¶ 25.) As an example of coercive measures, the Draft Guidelines mention a system of monitoring and penalties. For the sake of clarity, it would be helpful to explain in greater detail the circumstances under which the existence of an agreement can be inferred from conduct deemed to be coercive. For example, the text could explain that such a system may well suggest that an agreement exists because it suggests that the supplier is selling product to the distributor on the condition that the products not be

exported and the system of monitoring and penalties is a means of policing this agreement. The text also refers to the number of distributors implementing a policy as relevant to whether an agreement exists. Without further explanation of why this should necessarily be the case, this language risks creating confusion.

VI. Definition of "Agency"

The Sections note that, in an attempt to exclude RPM agreements that are "disguised" as agency agreements from the shelter of the block exemption, the Commission has, over time, sought to draw a line between "non-genuine" and "genuine" agency agreements. Under the Draft Guidelines, an agency agreement may fall within the scope of Article 81(1) if it affects intrabrand competition in the market where the agent is active, if noncompete obligations included in the agency agreement would affect interbrand competition in the markets where the contract products or services are sold or purchased by foreclosing competition buyers or sellers (Draft Guidelines ¶¶ 18-19), or if the agreement would facilitate collusion (¶ 20). The Commission's approach focuses on the financial or commercial risk borne by the agent in relation to the activities for which it has been appointed by the principal. While the Sections concur with the Commission that the determining distinguishing factor is indeed the types and magnitude of risk borne by the intermediary, they also note that over time, the factors to be considered under competition policy as laid down by the Commission have become increasingly complex and difficult to apply. Moreover, the Community Courts have held that the Commission's evaluation of risks under the Guidelines -- and, as a consequence, the category of non-genuine agents -- has been inaccurate and over-inclusive.[52]

It appears that the Draft Guidelines seek to address those concerns. However, the Sections are concerned that the approach taken will require an even more complex interpretation, lead to uncertainty and continue to be subject to the Courts' criticism. The

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[52] *See* Case T-325/01, DaimlerChrysler AG v. Comm'n (2005).

Draft Guidelines now add that, for an agent to be considered as a genuine agent, the agent may not bear any significant contract-specific risks or risks related to market specific investments (¶¶ 14-15), but in addition should not bear any significant risks in relation to other activities that the agent engages in on its own behalf -- such as after-sales services, repair services or sales of other products -- that the principal requires it to undertake and that are indispensable to act as agent in relation to the contract products (*id.*). The Sections are concerned that the addition of this third category of risks, identified in ¶ 14, would expand the already broadly defined category of non-genuine agents considerably, thereby diminishing the practical use of this part of the Guidelines and discouraging the legitimate use of agents as a way to bring products and service to the market. By way of example, the Sections note that the notions of "indispensability," "other activities" and "insignificant risks" in ¶¶ 14 and 15 can, by their nature, be subject to different interpretations.

The Sections suggest that the Commission should redirect its focus more clearly on the effects that agency may have on interbrand competition, in particular by giving rise to foreclosure and collusion. Such an approach would be in line with the current economic insights that competition policy should particularly target those vertical restraints that are likely to give rise to interbrand restrictions.

CONCLUSION

The Sections commend the Commission for addressing new distribution developments in the Draft Regulation and Draft Guidelines. We are grateful for the opportunity to provide the Sections' views on the Draft Regulation and Draft Guidelines and hope that these Comments are useful.