International Distribution Institute

Hardcore restrictions and restrictions by object: a policy perspective

Ginevra Bruzzone

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The revision of the EU framework has started

The revision of the vertical block exemption regulation (Commission Reg. 330/2010 - VBER) and of the Commission Vertical Guidelines (VGL) on the application of Art. 101 TFEU to vertical agreements will take place in 2022, but the process has already started (public consultations etc.)

Hardcore restrictions and restrictions by object in the spotlight

- Whether the list of hardcore restrictions in Art. 4 VBER should be modified/clarified is one of the main open issues in the ongoing revision of the EU framework
- How does this issue interact with the scope of restrictions by object (RBO) for vertical agreements?
- What are the main policy options?

Outline

1. Two different notions: RBO and hardcore restrictions

2. A goldilocks approach to the list of hardcore restrictions: not too narrow, not too broad…just right

3. Critical areas and suggestions for the revision of the VBER/VGL framework

1. Two different notions: restriction by object and hardcore restriction

Structure of Art. 101

- Art. 101(1): prohibition of anticompetitive agreements (either restrictive by object or restrictive by effect)
- Art. 101(3): agreements are exempted from the prohibition if they satisfy four cumulative requirements: efficiency, consumer benefit, necessity of the restriction, no elimination of competition in respect of a substantial part of the products in question

Restriction by object

- The notion of RBO concerns the application of Art. 101(1) (prohibition of anticompetitive agreements): if an agreement is restrictive by object, the prohibition can be applied with no need to prove that, in the case at issue, the agreement has either an actual or potential negative impact on the market => it attains to how the infringement can be proved
- Notion developed by the case-law (*STM*, 56/65; *Cartes Bancaires*, C-67/13 P)

Who decides whether the agreement is RBO?

- Whether an agreement is RBO can be established by:
- the European Commission (subject to judicial review by the General Court and ECJ, Art. 263 TFEU)
- national competition authorities (subject to judicial review at the national level)
- national courts
- the ECJ also intervenes with preliminary rulings when national courts raise issues concerning the interpretation of Art. 101 (Art. 267 TFEU)

=> developments in the application of Art. 101(1) strongly depend upon the attitude of public enforcers, but the ECJ may have the opportunity to steer the process

RBO in historical perspective

- The way in which Art. 101(1) is applied has evolved over time:

- more impact-based approach at the end of the 1990s (but an impact-based assessment is contemplated also in some landmark judgments in the old case-law e.g. *STM; Franz Völk,* 5/69)
- after the adoption of Council Reg. 1/2003, which spurred more decentralized enforcement, widespread use by Commission and national competition authorities of the RBO notion
- in *Cartes Bancaires* (2014) the ECJ stresses that, since RBO entails the reversal of the burden of proof, applying Art. 101(1) by means of the RBO approach cannot be the general rule and should be interpreted restrictively

Cartes Bancaires: rationale and assessment of RBO

- **Rationale**: some types of coordination between undertakings (e.g. cartels) can be regarded by their very nature as being harmful to the proper functioning of normal competition: on the basis of experience, the likelihood of negative effects on competitive variables (p, quantity or quality) is so high that it may be redundant to prove in each case that they have a negative impact =>although RBO are an open category, use of the notion should be linked to experience of deleterious impact on the market
- **Assessment** of whether the agreement reveals a sufficient degree of harm: regard must be had to the content of its provisions, its objectives and the economic and legal context (nature of the goods or services affected, real conditions of the functioning and structure of the market)

Takeaways on RBO

- The evolution in the application of Art. 101(1) shows that there may still be developments in the future
- The most important contribution of the *Cartes Bancaires* judgment is not the notion (already implicit in *STM*) but the methodological requirement: the normal application of Art. 101(1) requires proving the negative actual or potential impact on competitive variables (price, quantity, quality, innovation)
- The application of RBO always requires that the intrinsically harmful nature of the allegedly restrictive clauses be assessed in the light of the relevant economic and legal context: the use of the RBO notion cannot follow a mere form-based approach

About RBO and de minimis

- *Franz Völk*, case 5/69 - the prohibition of Art. 101(1) must be understood with reference to the actual circumstances of the agreement. In particular, an agreement may escape the prohibition because, in view of the weak position of the parties on the market, it is not capable of hindering the attainment of the objectives of the single market, even if it creates absolute territorial protection
- *Expedia*, C-226/11- main issue: the de minimis Notice is not binding on national authorities, which can prohibit agreements even below the market share thresholds (different from BER); obiter dictum: a RBO is, by its nature and independently of any concrete effect it may have, an appreciable restriction of competition
- Are the two statements incompatible?

Reconciling *Völk* and *Expedia*

- when assessing whether a restriction is sufficiently deleterious to be regarded as a RBO, we have to take into consideration not only the terms and objectives of the agreement, but also the economic context, including the position of the parties on the market (*Cartes Bancaires*)
- the treatment of restrictions can be differentiated depending on their intrinsic degree of harm: for cartels, in order to preserve a strong deterrent effect, the market position of the parties may be ignored; for less intrinsically harmful restrictions (such as RPM) in the presence of very small market shares it may be reasonable to exclude the classification as RBO=>the assessment of the economic context before classifying the agreement as RBO may neutralize the conclusion reached through a mere examination of its terms (for Art. 102, see *Meo, 2018)*

The second notion: hardcore restrictions

- The HR notion refers to lists of restrictions which, if included in an agreement, entail the loss of a presumption of compatibility with Art. 101
- In the context of block exemption regulations, HR concern the application of Art. 101(3): they remove the benefit of the block exemption, i.e. the safe harbor
- Block exemption regulations, like the VBER, are regulatory acts (Art. 288 TFEU), legally binding in all Member States
- The scope of the list of HR is a regulatory choice, which should follow the better regulation principles and resist judicial review by the ECJ (Art. 263: lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers) => bounded regulatory discretion

The role of the VBER

- Formally the VBER defines a category of vertical agreements(VA) which the Commission regards as normally satisfying the conditions laid down in Art. 101(3)
- For the application of Art. 101(3) by regulation, not necessary to define those vertical agreements which are capable of falling within Art. 101(1) (recital 4): => the safe harbour applies also to non restrictive agreements eg. selective distribution agreements satisfying the *Metro* requirements

=>the VBER enhances legal certainty also for such agreements and ensures uniform application of Art. 101 in the EU

Challenges: the VBER should ensure effective application of Art 101 + proportionate constraints on freedom of enterprise

Outside the safe harbour

- the VBER applies to VA when market shares are below the thresholds and the agreement does not contain HR (Art. 4);
- it does not cover excluded restrictions (Art. 5, e.g. non compete obligations with duration > 5 years), which are conditions for the application of the safe harbor aimed at ensuring access/preventing collusion
- **above the market share thresholds with no HR**: individual application of Art. 101(1) and 101(3), no negative presumptions (recital 9)
- **excluded restriction:** individual application of Art. 101(1) and 101(3)
- **hardcore restriction:** currently, the consequences in terms of application of Art. 101 go much beyond Art. 4, i.e. the loss of the benefit of the VBER

Including a hardcore restriction

Application of Art. 101(1):

- § 23 VGL (on the safe harbour): "..hardcore restrictions ..are restrictions of competition by object"
- § 47 VGL: where a hardcore restriction is included, the agreement is presumed to fall within Art. 101(1)

Individual application of Art. 101(3)

- § 47 VGL: presumed that the agreement is unlikely to fulfil the conditions of Art. 101(3) "for which reason the block exemption does not apply"
- § 47: where undertakings substantiate that likely efficiencies result from the restriction and in general all the conditions of Art. 101(3) are fulfilled, the Commission is required to effectively assess the likely negative impact on competition before making an ultimate assessment on Art. 101(3)

2. A goldilocks approach to the list of hardcore restrictions

Not too narrow, not too broad…just right

- market share thresholds, hardcore restrictions and excluded restrictions define the boundaries of the safe harbor. Recital 5 indicates that “the benefit of the VBER should be limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Art. 101(3)”. The likelihood of efficiency enhancing effects should outweigh any anticompetitive effects
- what if the safe harbor is not properly circumscribed, in particular if the list of HR is either too narrow or too broad?

When the HR list is too narrow

- power of the Commission and NCAs, pursuant to Art. 29 Reg. 1/2003, to withdraw the benefit of the VBER if in a particular case an agreement has effects incompatible with Art. 101(3)
- for parallel networks of VA which have similar anticompetitive effects and which cover > 50% of a given market, the Commission may by regulation declare the VBER inapplicable to specific restraints relating to the market concerned, restoring the full application of Art. 101 (e.g. parallel non compete agreements with duration <5 years) *Never applied so far, but useful: these mechanisms combine legal certainty (effect only ex nunc) and flexibility since they allow to take into account different market situations in different Member States (e.g. Germany). They enable ex post correction if the list turns out to be too narrow*

When the HR list is too broad

- since in the Vertical Guidelines HR are considered RBO, pursuant to Art. 101(1), being regarded as hardcore entails a quasi per se prohibition
- indeed, it is highly unlikely that the agreement will be considered compatible by means of individual application of Art. 101(3): no individual positive decision in application of Art. 101(3) adopted by the Commission so far
- an assessment pursuant to Art. 101(3) is more rigid than an assessment pursuant to Art. 101(1): not sufficient to show that the agreement is harmless, necessary to meet the requirements of Art. 101(3), especially indispensability (see the 4 cases on consumer electronics and *Guess*) => strong deterrent and straight jacket effect + absence of correction mechanisms

HR in the revision of the VBER: a tricky issue

- in the public consultation on the revision of the VBER, DG Comp asks whether there are agreements currently included in the hardcore restriction list which are likely to normally satisfy the 4 requirements in Art. 101(3) and should be removed from the list
- meeting the 4 requirements is difficult, but the approach would be fine if the consequences of being an hardcore restriction were just losing the benefit of the block exemption
- however, the situation is different (i.e. the list entails a quasi per se prohibition) => the starting point of the revision should be acknowledging the main problems in the current formulation of Art. 4 and discussing possible solutions within the VBER + VGL framework

3. Critical issues and suggestions for the revision of the VBER/VGL framework

New challenges and non price competition

- e-commerce raises new challenges in terms of brand positioning and multichannel strategy: huge increase in price transparency at the retail level; potential huge impact of free riding on the sustainability of the network and of a consistent marketing strategy for the brand=>control on distribution network should not be prevented unless there is a risk of actual or likely harm to competition
- according to the ECJ (*Coty*), protecting the image of the product is legitimate competition => price competition is very important but just one of the relevant dimensions of competition

A fresh look at the theories of harm

- the revision of the VBER and the VGL provides the opportunity to take a fresh look at the relevant theories of harm in the application of Art. 101 to vertical agreements in the current legal and economic context

Intrabrand competition is not a goal per se

The application of Art. 101(1) should prevent agreements with a negative impact on the competitive process (p, quality, innovation):

- anticompetitive foreclosure
- reduction of interbrand competition
- reduction of intrabrand competition when interbrand competition is not strong enough to ensure that customers still have broad choice and that undertakings maintain strong incentives to compete on price, quality and innovation
- moreover, the market integration objective requires that end customers are free to purchase, offline or online, with no territorial restrictions on passive sales and that territorial or customer allocation do not go beyond what is justified by efficiency reasons

Getting rid of the loop HR/RBO

- the role of HR in the VBER is identifying categories of restrictions which, if included into an agreement, entail the loss of the benefit of the safe harbor
- the list is necessarily form-based, i.e. focuses on the nature and goal of the restrictions, whereas for the open category of RBOs the ECJ requires an assessment based not only on the form, but also on the economic and legal context

⇒ the role of the 2 notions is different; any automatic link (e.g. HR in Art. 4 are RBO) is misleading and it is controversial that entails a proper application of Art. 101

⇒ § 23 and § 47 of the VGL should be revised so as to allow developments in the application of Art. 101(1) consistent with *Cartes Bancaires*

Narrow interpretation of indirect HR

- Art. 4 refers to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object one of the five different HR
- The issue of indirect 'de facto' HR entails a problem of legal certainty, since it is impact-based and requires taking into account all circumstances, i.e. a factual analysis
- On the other hand, a revision of Art. 4 aimed at including only direct restrictions is unlikely, since it would make extremely easy to circumvent the rule
- Since the legal consequences of being hardcore are so serious, it is essential that the standard of proof for indirect "de facto" hardcore restrictions is sufficiently high

RPM: legal and economic assessment

- the *Binon* case-law, whereby RPM is a RBO is quite old (1985); it should be considered in the light of *Cartes Bancaires* (2014), taking into account economic and legal context
- most economists argue that in the absence of market power (very small market shares, lively price and non price interbrand competition) RPM does not entail appreciable harm for consumers (Motta et al. 2009, Reindl 2011, OECD 2017)

Options for RPM

1. Getting rid of the loop: HR does not entail RBO (revision of the VGL)

and

2. Adding in Art. 4(a) one or more exceptions:

e.g.

(i) minimum or fixed resale prices when the market share of the supplier does not exceed (5%/10%) of the relevant market on which it sells the contract goods or services

and/or

(ii) restrictions of minimum prices which may be advertised online in a selective distribution system/to protect the image of the brand

Online sales restrictions

1. Getting rid of the loop: HR does not entail RBO
2. A new exception might be added to Art. 4(b) and (c) in order to incorporate the *Coty* case-law:

e.g. except "the restriction on the use of third party platforms discernible to the public which is consistent with the characteristics of a selective distribution system"

Taking inspiration from *Coty*, restrictions on the use of price comparison tools and use of the brand in online advertising should not be considered hardcore restrictions in themselves, but only if, taking into account the economic situation (including all available channels for online sales), they de facto amount to a ban on the use of the internet by the distributor (it is a way to reconcile *Asics Germany* and *Coty*) => should be clarified in the VGL

Other issues concerning Art. 4

Art. 4(b) Territorial or customer resale restrictions

(iii) the restriction of sales by the members of a selective distribution system to unauthorised distributors "within the territory reserved by the supplier to operate that system"

is this specification justified? Should it be clarified?

Art. 4 (c) Restrictions of active and passive sales for selective distribution

Should we reintroduce an exception for restrictions of active sales for franchising (like in the 1988 BER)? Is a hardcore treatment justified?

Art. 4(d) Restrictions of cross supplies within a selective distribution system: is the hardcore treatment of restrictions of the active sales by wholesalers into exclusive territories justified?

In the discussion on RBO…

- in the light of *Cartes Bancaires,* selective distribution (even quantitative restrictions) cannot be considered RBO: the *Metro* approach cannot be the only way in which selective distribution agreements are compatible with Art. 101(1)
- maintenance of the safe harbour is needed for practical reasons (certainty, uniformity), but the ultimate goal should be the proper application of Art. 101(1) to distribution agreements
- the application of Art. 101 should take into account the approach required by the Court of Justice in *Intel* (§ 140): the possibility of objective/efficiency justifications must be considered only after an analysis of the intrinsic capacity of the agreement/conduct to restrict competition