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LL.M PERSPECTIVE

The Reformation of the EC Competition Policy on Vertical Restraints

Georg Terhorst^{*}

I. INTRODUCTION

After nearly forty years, the European Commission ("Commission") has recognized the need for a revision of the Community's policy governing vertical agreements. The stage is set for change: single market legislation is largely in place, the Commission block exemption regulations governing vertical restraints expired at the end of 1999,¹ and methods of distributing have undergone major changes.

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¹ The previous block exemption regulations expired on December 31, 1999 and in order to prevent a legal vacuum, the new Regulation in Article 12(1) extended the previous block exemption regulations until June 1, 2000. Existing agreements will continue to benefit from the current block exemption regulations until December 31, 2001. This leaves the undertakings affected by the reformation a transitional period of nineteen months.

On December 22, 1999 the Commission finally adopted the Commission Regulation (EC) No 2790/1999 on the Application of Article 81(3)² of the Treaty to Categories of Vertical Agreements and Concerted Practices.³ This Regulation entered into force on January 1, 2000 and applied from June 1, 2000.⁴ As the final piece of a complex reformation process, the Commission adopted the accompanying Guidelines on May 24, 2000. The Guidelines will be revised in four years' time, in view of market developments and experience gathered by the European Commission in applying the new policy.

The Commission, equipped with the necessary powers by the European Union's Council meeting in Luxembourg on April 29, 1999, published on September 24, 1999 a draft of the new exemption regulation.⁵ This began the legislative procedure—including the final phase of public consultations with representatives from trade and industry institutions—for the adoption of the new rules applicable to vertical agreements.⁶

² Article 81 of the EC Treaty states that:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Treaty Establishing The European Community, art. 81, O.J. (C224) 28 (1992) [hereinafter EC Treaty].

³ See Commission Regulation 2790/1999, 1999 O.J. (L 336) 21.

⁴ See *id.* at 25, art. 13. Article 12(1) shall apply from January 1, 2000. See *id.*

⁵ The Guidelines are available online at <http://europa.eu.int/comm/competition/antitrust/other.html>.

⁶ See 1999 O.J. (C 270) 7. For an illustration of the potential significance of such a consultation process, see the history of the adoption process of the technology transfer block exemption. See 1996 O.J. (L 31) 2.

The Green Paper on Vertical Restraints in EC Competition Policy ("Green Paper" or "Paper"), adopted by the Commission on January 22, 1997 after two years of preparation time, started this reformation process.⁷ The Paper contained four policy options plus two sub-variants to amend the previous competition rules based on the analysis made in the Green Paper.⁸ However, the Commission did not consider itself limited to these proposals but explicitly stated the possibility of a combination of these options in different ways and the openness to new ideas.⁹ On the basis of the analysis contained in the Paper, the Commission held an official hearing and initiated a wide-ranging debate on the proposals' economic and legal ramifications.¹⁰ The Commission's Competition Directorate-General ("Competition DG")¹¹ reviewed the opinions of all parties—the Member States, the European Parliament, the Economic and Social Committee, industry, distributors and consumers—concerned with this proposal in a wide-ranging consultation exercise.

As a follow-up to the Green Paper, the Commission adopted the Communication from the Commission on the Application of the Community Competition Rules to Vertical Restraints ("Communication") on September 30, 1998.¹² Therein, the Commission set out the framework of the new policy in the field of vertical restraints. The Commission, pursuing the objectives of protection of competition and market integration, designed the new policy to deliver reduced costs to industry, provide a greater commercial flexibility and increase legal security for the enterprises.¹³ The new

⁷ Green Paper on Vertical Restraints in the EC Competition Policy, COM(96)721 final; see also European Commission's Press-Release IP 97/35. Initially the Green Paper was scheduled for March 1996. See Fiona M. Carlin "Vertical Restraints: Time for Change?" 5 ECLR 283, 283 (1996).

⁸ See *id.* at 75, ch. viii.

⁹ See *id.* at Exec. Summary, para. 38.

¹⁰ See Franz-Jörg Semler and Michael Bauer, *Die neue EU-Gruppenfreistellungsverordnung für vertikale Wettbewerbsbeschränkungen – Folgen für die Rechtspraxis*, Europäische Zeitschrift für Wirtschaftsrecht 193, 194 (2000).

¹¹ The mission of the Competition Directorate General is to establish and implement a coherent competition policy for the European Union. The Competition DG's main areas of activity are: antitrust (i.e. the Application of Articles 81 & 82 of the European Community Treaty and Article 65 of the European Coal and Steel Community Treaty), merger control (i.e. Application of Council Regulation 4064/89 on the Control of Concentrations Between Undertakings and of Article 66 of the European Coal and Steel Community Treaty), liberalization and state intervention (i.e. the Application of Articles 31 and 86 of the European Community Treaty; and State Aid, the Application of Articles 86 and 87-89 of the European Community Treaty, and Articles 4, 56 and 95 of the European Coal and Steel Community Treaty). The Competition DG also deals with the international dimension of competition policy, as partner of the industrially developed countries (i.e. USA, Japan, Canada, etc.) or as a counselor to countries with transforming economies (i.e. countries of Eastern and Central Europe).

¹² See COM(98)544 final; 1998 OJ (C 365) 3.

¹³ See 1998 O.J. (C 365) 3.

policy should originally have been adopted by the end of 1999 and was designed to enter into force on January 1, 2000,¹⁴ but was delayed for six months.¹⁵

The single market offers an opportunity for entities from the Member States as well as from Non-Member States to enter into new markets that previously may have been closed to them because of state barriers.¹⁶ This penetration of new markets is a risky endeavor that requires large investments of time and monetary resources. Such an entry can often be facilitated by agreements between the producer who wants to break into a new market and a local distributor. A specialized distributor can often gain economies of scale¹⁷ and scope¹⁸ by distributing many products simultaneously. Additionally, a local distributor with specialized knowledge of the markets in which the product is to be launched can also contribute to increase the chance of success of the endeavor and reduce risks. In this respect, vertical restraints, such as exclusive agreements, tend to increase the profits obtained by these relationships. They will also stimulate entry by other potential distributors and producers which promotes efficiency in the long run.

Karel van Miert, the European Competition Commissioner from 1993 until 1999, stressed upon the adoption of the Communication on September 30, 1998, that:

The aim of the present policy proposal is to shift toward a more economic approach while increasing the overall level of legal security for companies by providing them with a "safe haven" within which it is no longer necessary for them to assess the validity of their agreement under EU competition rules. It will restore freedom to contract for the vast majority of companies while improving the protection of competition to the benefit of consumers. This new policy is an important orientation which will be followed in other areas of competition law where the Commission needs to modernize its rules.¹⁹

With its 30 percent market share threshold, the new block exemption regulation provides a safe haven for small and medium sized companies that will enjoy more freedom and legal security in the drafting process of vertical agreements. Larger entities, however, with a market share around

¹⁴ See Press Release IP/99/699, European Commission, at http://europa.eu.int/en/comm/competition/index_en.html (Sept. 24, 1999).

¹⁵ See Commission Regulation 2790/1999, art. 12(1), 1999 O.J. (L 336) 21, 25; Press Release IP/99/1045, European Commission, at http://europa.eu.int/en/comm/competition/index_en.html (Dec. 22, 1999).

¹⁶ Cf. Green Paper, *supra* note 7, at ii., Exec. Summary.

¹⁷ Reduction in cost per unit resulting from increased production, realized through operational efficiencies.

¹⁸ Cost savings achieved by one company conducting business in two or more areas that would not be achieved by separate companies conducting business in each of those areas.

¹⁹ Press Release IP/98/853, European Commission 1-2, at http://europa.eu.int/en/comm/competition/index_en.html (Sept. 30, 1998).

or even higher than 30 percent, have to carry more responsibility under the new rules. They themselves have to make an honest assessment of their market share and their vertical agreements in light of the new rules. The Commission emphasized their willingness to discuss agreements with companies to ensure that they were on the right track, but undertakings will not need to give notice and in fact are discouraged from notifying the Commission of their agreements as they had done before.²⁰ The new rules are designed to free up competition officials, who previously had to plough through piles of paper work on many innocuous agreements, to investigate the really important anti-competitive deals.

In the present article, I present the main issues surrounding the reform process, its reasoning and the result it brought to the European Community's ("EC") competition policy on vertical restraints. Furthermore, I summarize some of the reactions by other bodies of the EC and industry sectors toward this reform process. Finally, I will discuss the responses by business toward these changes in the EC rules to vertical restraints and the way enterprises will operate in the Member States of the EC.

II. INTRODUCTION TO EC COMPETITION LAW

The EC's competition law applicable to undertakings²¹ is built on Articles 81 and 82 of the Treaty Establishing the European Community (the "Treaty")²² and Council Regulation No. 17/62/EEC ("Regulation No.

²⁰ See *Brussels to Ease Rules on Exclusive Sales Deals*, FIN. TIMES WEB-ARCHIVE, Dec. 22, 1999, at <http://www.ft.com> (on file with author).

²¹ The European Court of Justice and the Commission have defined "undertaking" as encompassing not only a company but an individual that "engages in economic activities." See *Reuter v. BASF AG*, 1976 O.J. (L 254) 40, [1976] 2 C.M.L.R. D44, at D55; *AIOP v. Beyrard* 1976 O.J. (L 6) 8, [1976] 1 C.M.L.R. D14. In this article I use the terms undertaking, entity and business company interchangeably. Agreements with non-commercial final consumers do not fall under the new block exemption since the regulation applies according to Article 2(1) only to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1). Article 81(1) only applies to agreements between undertakings, decisions by associations of undertakings and concerted practices. See *Guidelines*, *supra* note 5, at 5, ch. iii, pt. 24. In contrast, the block exemption regulation might be applicable, to the extent that the final consumer is an undertaking. See *id.*

²² Unless otherwise stated all Articles refer to the Treaty establishing the European Community as amended by the Amsterdam Treaty. The Amsterdam Treaty, which entered into force on May 1, 1999, provided for the amendment of the EC Treaty by altering its content, inserting new provisions, and also renumbering the majority of the existing provisions. Article 81(1) and (2) essentially forbids any agreements which prevent, restrict, or distort competition, such as vertical agreements which establish exclusive relationships between producers and distributors. Section 3 allows for exemptions to these rules if the agreements contribute to "improving the production or distribution of goods or to promoting technical or economic progress, while allowing a consumers a fair share of the resulting benefit." See generally EC Treaty, *supra* note 2.

17").²³ These rules are not only concerned with competition matters, but also seek to implement a broader range of industrial, social, and political policies, such as economic integration of the various Member States.²⁴ The tradition of economic integration as the overriding purpose of European competition policy goes back to the European Coal and Steel Community Treaty ("ECSC Treaty"). The preamble of the ECSC Treaty states that:

To substitute for historic rivalries a fusion of their essential interests; to establish, by creating an economic community, the foundation of a broad and independent community among peoples long divided by bloody conflicts; and to lay the bases of institutions capable of giving direction to their future common destiny.²⁵

The importance of creating a common European market and preventing the re-segmentation of the market, led the Commission and the European Court of Justice ("ECJ") to a strict application of Article 81(1) toward vertical restraints, specifically non-price vertical restraints.²⁶ Community law has always been very suspicious of attempts to segment and re-partition the markets. Thus, companies had to pay particular attention to the structure of their distribution networks inside the Member States of the EC.

The analysis of whether an agreement infringes Article 81 takes place in two stages. The first inquiry is whether it falls within the scope of Article 81. A vertical agreement will only fall within the scope of Article 81(1) when all of the elements are fulfilled.²⁷ Restraints that fall within the scope of Article 81(1) are found null and void according to Art. 81(2).²⁸ Whether the underlying contract will become invalid in its entirety depends on the

²³ Council Regulation 17/62, 1959-1962 O.J. SPEC. ED. 87, *amended by* Council Regulation 59/62, 1962 J.O. (1655), Council Regulation 118/63, 1963 J.O. (2696), and Council Regulation 2822/71, 1971 O.J. (L 285) 49. For further discussion, see Arved Deringer *The Distribution of Power in the Enforcement of the Rules of Competition under the Rome Treaty* 1 COMMON MKT. L. REV. 30 (1963).

²⁴ See Ulrich Everling *Zur Wettbewerbskonzeption in der neueren Rechtsprechung des Gerichtshofs der Europäischen Gemeinschaften*, 40 WIRTSCHAFT UND WETTBEWERB 995, 1000 (1990).

²⁵ See TREATY INSTITUTING THE EUROPEAN COAL AND STEEL COMMUNITY, April 18, 1951, 261 U.N.T.S. 142, 143. [hereinafter COAL & STEEL TREATY].

²⁶ See Donncadh Woods and Mario Filippini, *Vertical Agreements*, in THE EC LAW OF COMPETITION 431, 432 (Jonathan Faull & Ali Nikpay eds., 1999). See generally Case 32/65, *Government of the Italian Republic v. Council of the EEC and Commission of the EEC*, 1966 E.C.R. 389 (discussing application of Article 85, which is now Article 81). Vertical agreements in the area of coal and steel are treated under Art. 65, § 1 of The Treaty Establishing the European Coal and Steel Community. See COAL & STEEL TREATY, *supra* note 25, at 195.

²⁷ For an analysis of the different elements of Article 81(1) in a vertical context, see Donncadh Woods and Mario Filippini, *Vertical Agreements*, in THE EC LAW OF COMPETITION *supra* note 26, at 432-438.

²⁸ This is the main difference between Art. 81 and the antitrust laws in the U.S., Canada and the Member States with older competition laws like, Germany. In these jurisdictions vertical agreement remains valid until a decision by the respective antitrust authority.

respective national law of the member state.²⁹ The Commission can, according to Art. 15(2) of Regulation No. 17, impose fines³⁰ on companies that participated in infringement. A recent well-known example is the *Volkswagen* case.³¹

Restraints found null and void under Article 81(1) and therefore unenforceable can be exempted from this remedy through a second examination following Article 81(3). This second analysis is according to Article 9(1) of Regulation No. 17 at the discretion of the Commission. This exemption provision is a device to consider the procompetitive aspects of an agreement condemned under a literal reading of Article 81(3). The agreement must not eliminate competition, and the efficiency gains or other objective advantages it promotes must outweigh the disadvantages from the loss of competition. Furthermore, the provision takes other Community goals, such as the health and safety of the consumer, as well as other social concerns, into consideration when determining whether a particular restraint should be authorized.³² An exemption can be made either within the scope of an individual case decision following a formal notification of the agreement with the Commission or by means of an abstract-general block exemption regulation, which expresses an exemption for the agreements that fulfill the elements of the regulation.

A. U.S. Law on Vertical Agreements

A detailed comparison of the EC and the U.S. law toward vertical agreements is beyond the scope of this article. Nevertheless, it is useful to delineate the following basic ideas and the subsequent different approaches underlying the two systems.

The Community and the United States have different approaches in their laws on vertical restraints. The EC competition rules governing vertical agreements are more regulatory than the U.S. law in this area. The latter permits greater freedom of action for the enterprises, e.g., in assigning territories to dealers and restricting transshipments.³³ This gap still exists after

²⁹ For the law in Germany, see GERMAN CIVIL CODE art. 139, *translated by* Simon L. Goren (1994) (F.R.G.).

³⁰ From 1,000 to 1,000,000 Euro, or a sum in excess thereof but not exceeding 10 % of the turnover in the preceding business year. *See* Council Regulation 17 of 21 February 1962 First Regulation Implementing Article 85 and 86 of the Treaty, art. 15(2), 1959-1962 O.J. SPEC. ED. 91.

³¹ *See generally* Commission Decision of 28 January 1998 Relating to a Proceeding Under Article 85 of the EC Treaty (Case IV/35.733 – VW), 1998 O.J. (L124) 60 (discussing the *Volkswagen* case). The Commission imposed a fine of ECU 102 million on Volkswagen. *See id.*

³² *See* Green Paper, *supra* note 7, at iv., Exec. Summary.

³³ *See* Spencer Weber Waller *Understanding and Appreciating EC Competition Law*, 61 ANTITRUST L.J. 55, 68 (1992); Shanker A. Singham, *Shaping Competition Policy in the Americas: Scope for Transatlantic Cooperation?*, 24 BROOK. J. INT'L L. 363, 401 (1998).

the completion of the present reform, but it has narrowed significantly.³⁴ American antitrust law has existed for more than a century and is assumed to have had a pervasive impact on the American economy.³⁵ In the past thirty years, the principles governing vertical arrangements in the United States have undergone extraordinary adjustment.³⁶ The 1960s was an era in which the Supreme Court expanded prohibitions against resale price maintenance ("RPM")³⁷ and tying arrangements³⁸ and imposed draconian limits on vertical territorial restrictions, exclusive dealing arrangements,³⁹ and other distribution strategies. The pre-reform European analysis of these agreements can therefore be described as an analysis similar to the 1960s era of antitrust analysis in the U.S.⁴⁰

³⁴ See Carlin, *supra* note 7, at 287.

³⁵ See Per Jebsen and Robert Stevens, *Assumptions, Goals and Dominant Undertakings: The Regulation of Competition Under Article 86 of the European Union*, 64 ANTITRUST L.J. 443, 454 (1996).

³⁶ See Murray S. Monroe, *Vertical Restraints*, 27 U. TOL. L. REV. 433, 460 (1996); Warren S. Grimes, *Brand Marketing, Intra-brand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 84-85; see also *White Motor Co. v. United States*, 372 U.S. 253 (1963) (declining to set a standard governing nonprice vertical restraints); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (adopting a per se rule); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (discarding the per se rule and returning to a rule of reason).

³⁷ See Richard M. Steuer, *Vertical Restraints in the Nineties*, 62 ANTITRUST L.J. 717, 718 (1994). In most circumstances, maximum RPM does not pose the risks of anticompetitive effects that may be present in minimum RPM. See *Comments of the Section of Antitrust Law and the Section of International Law and Practice of the American Bar Association on the European Commission's Green Paper on Vertical Restraints in EC Competition Policy*, available at <http://www.abanet.org/antitrust/ecvert.html> (on file with author). RPM is defined as "agreements between a supplier and a buyer under which the buyer agrees to resell the supplier's product at a given price or at a specified price level." See *Business Elecs. Corp. v. Sharp Elecs.*, 485 U.S. 717, 731 (1988); see also Michael L. Denger, *Resale Pricing Issues in Distribution and Franchisor Operations*, 60 ANTITRUST L.J. 419, 419 (1991).

³⁸ A tying agreement is one in which a supplier conditions the sale of one product or service (the "tying product") on the purchase of a separate product or service (the "tied product"), or upon the agreement that the tied product will not be bought from another supplier. See Monroe, *supra* note 36, at 439.

³⁹ In the case of "exclusive dealing," the distributor agrees not to buy any competing product from any other supplier. The restriction is based on the distributor. It forecloses competing suppliers from selling to the distributor and simply precludes the distributor from buying a competing product. See *Vertical Restrictions Upon Buyers Limiting Purchase of Goods From Others*, 8 A.B.A. ANTITRUST SEC. 84, 90 (1982). In the area of exclusive dealing, the European Commission and the Courts take this danger of foreclosure very seriously as an analytical tool. In particular, exclusive dealing arrangements are more likely to be prohibited where the industry is characterized by such agreements and the cumulative foreclosure is significant. See *Case 23/67, Brasserie de Haecht v. Wilkin and Wilkin*, 1967 E.C.R. 407, 415.

⁴⁰ See Steven P. Reynolds, *International Antitrust Compliance for a Company with Multinational Operations*, 8 INT'L Q. 76 (1996).

Until the U.S. Supreme Court's 1977 *Sylvania* decision, antitrust judgments often ignored potential pro-competitive effects of vertical agreements and presumed that vertical contractual restraints had sinister aims. The Court often evaluated vertical restraints by applying rules that governed similar conduct in a horizontal context. In *Sylvania*, the Supreme Court stated for the first time that vertical restrictions "are widely used in our free market economy, [that] there is substantial scholarly and judicial authority supporting their economic utility, [and that any departure from the rule of reason standard] must be based upon demonstrable economic effect rather than as in *Schwinn* upon formalistic line drawing."⁴¹ After *Sylvania*, the U.S. courts and the antitrust authorities recognized that vertical restraints may lead to real efficiencies, for example, by eliminating the free-rider problem.⁴² The Court began focusing on the real impact an agreement has on competition by examining the extent of market power to assess whether there is genuine anti-competitive effect.

Like sections 1 and 2 of the Sherman Act,⁴³ Articles 81 and 82 of the Treaty are phrased in broad language with the burden on the judiciary to fill in the details in creating a comprehensive legal regime. In the EC, the ECJ and later, the Court of First Instance, have played a critical role by extending the scope of the Treaty provisions to cover vertical restraints, mergers, and a variety of predatory and exclusionary practices.⁴⁴ While Article 81 has certain parallels with Section 1 of the Sherman Act, its very language prohibits concerted practices beyond the reach of even the most expansive interpretation of Section 1 of the Sherman Act.⁴⁵

Competition law in the EC developed for very different reasons than did antitrust law in the United States.⁴⁶ The evolution of U.S. antitrust law

⁴¹ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57-59 (1977). In *Sylvania* the rule of reason test was adopted for all vertical restraints other than vertical price-fixing. In *Business Electronics Corp. v. Sharp Electronics Corp.*, the Court extended this rationale to conduct that had the same economic impact as price-fixing. 485 U.S. 717 (1988).

⁴² Cf. Jebsen and Stevens, *supra* note 35, at 446. EC competition law on its face does not follow the economic model of competition as a generator of efficiency. Some scholars point out, however, that the approach of the European Competition Law as actually interpreted by the Commission, the European Courts and national courts, is noticeably more market-oriented than the legislation itself.

⁴³ Sherman Anti-Trust Act, 15 U.S.C. §§ 1-2 (2000).

⁴⁴ See Spencer Weber Waller, *EEC Competition Law: Business Issues & Legal Principles in Common Market Antitrust Cases*, 5 Nw. J. Int'l. L. & Bus. 951 (1983) (book review).

⁴⁵ See *id.* at 952, comparing *AFC Chemifarma v. Commission*, 1970 E.C.R. 661, with *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537 (1954).

⁴⁶ See Robert T. Jones, *American Antitrust and EEC Competition Law in Comparative Perspective*, 90 LAW Q. REV., 191, 198-199 (1974); Gabriele Dara, *Antitrust Law in the European Community and the United States: A Comparative Analysis*, 47 LA. L. REV. 761, 764 (1987). "Apart from the Monopolies and Restrictive Practices (Inquiry and Control) Act of 1948, passed in the United Kingdom, and the West German Gesetz gegen Wettbewerbsbeschränkungen of 7.27.1957, none of the other European countries developed any sub-

has arisen out of a deep-rooted distrust of political and economic power.⁴⁷ Subsequently, in order to combat this distrust, efficiency became a vital thing to consider in the administration of U.S. antitrust laws.⁴⁸ The creation of the European competition law can be traced back to two chains of reasoning. The first fundamental reason for its creation was that a common competition law would lead to a greater unity among the Member States, a moral imperative after the bloody conflicts of the past.⁴⁹ An economic imperative provided the second reason. The enterprises of the Member States of the European Economic Community ("EEC"), in a very weak state after the Second World War, needed to improve their position in order to be better able to compete with their competitors outside the Community, especially in the United States.⁵⁰

Following these different motivations for their existence, the most fundamental difference between the two systems lies in the overriding purpose of the various competition laws.⁵¹ The antitrust laws of the United States are based on a notion that competition is valuable for its own sake.⁵² While the origins of U.S. antitrust law are in many ways connected to an economic philosophy favoring competition, this is not the primary goal of the EC Treaty. The Treaty recognizes this aim, but only as a subsidiary goal to the

stantial legislation prior to the establishment of the EEC." *Id.* at 762; *see also* Waller, *supra* note 33, at 55 (emphasizing the importance of that fundamental difference for the interpretation of the two systems).

⁴⁷ *See* Eleanor Fox, *Antitrust, Trade and the Twenty-First Century - Rounding the Circle*, 48 REC., N.Y. CITY B. ASS'N 535, 539 (1993).

⁴⁸ *See* Singham, *supra* note 33, at 349; Eleanor Fox, *Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness*, 61 NOTRE DAME L. REV. 981, 983 (1986) (suggesting that courts in the U.S. generally apply antitrust laws only in ways that do not harm economic efficiency); Emmanuel P. Mastromanolis, *Insights from U.S. Antitrust Law on Exclusive and Restricted Territorial Distribution: The Creation of a New Legal Standard for European Union Competition Law*, 15 U. PA. J. INT'L BUS. L. 559 (1995). "Efficiency is hence a purely economic principle necessitating the allocation of all available market resources in the best possible way, ultimately leading to an increase in market output." *Id.* at 561.

⁴⁹ After the rejection of attempts to move towards political solutions and the plans for a European Defense Community had been defeated largely by the French government, the only way left to build a new Europe was therefore on economic cooperation and integration. *See* RICHARD MAYNE, *THE RECOVERY OF EUROPE: 1945-1973*, 235-304 (1973).

⁵⁰ *See* David J. Gerber, *The Transformation of European Community Competition Law*, 35 HARV. INT'L L. J. 97, 102 (1994).

⁵¹ *See* Dara, *supra* note 46, at 764; Mastromanolis, *supra* note 48, at 561. Another major difference between EC and U.S. antitrust systems lies in the role of private enforcement and the activities in enforcing the law and implementing competition policy. *See* Jonathan Faull, *The Enforcement of Competition Policy in the European Community: A Mature System*, 15 FORDHAM INT'L L. J. 219, 222 (1992); Singham, *supra* note 33, at 389.

⁵² *See* N. Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958); *see also* Waller, *supra* note 44, at 952 n.8. (referring to the debate in the U.S. whether to define competition in economic, social or political terms).

achievement of an integrated European common market.⁵³ The twin goals set out by the Treaty for its antitrust regulations are economic integration within the EC and the creation of a common market, while avoiding "a weakening of competition [which] would be contrary to the goals of the common market."⁵⁴ Articles 81 and 82 are functional instruments of this *raison d'être* of economic integration making companies and consumers comfortable with the idea that they are living and working in a common market. Practices considered illegal under these provisions are prohibited as incompatible with the common market.⁵⁵ This is a role that the provisions of the Sherman Act do not need to play. The different dominating function of the European competition law of creating a common market is illustrated by two crucial distinctions of the two systems: first, the hostility to any form of territorial protection or export prohibition and second, the existence of Article 81(3).

B. Introduction to Vertical Agreements

The concept of vertical restraints encompasses arrangements between companies at different levels of the manufacturing or distribution chain that restrict the conditions under which enterprises may acquire, sell or resell certain goods or services. Article 2(1) of the new Commission Regulation (EC) No 2790/1999 defines vertical agreements as:

Agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, see or resell certain goods or services.⁵⁶

On one hand, these arrangements can be introduced in a positive way for competition to facilitate the entry of enterprises into new markets. By permitting manufacturers to have more influence over the way their brands are marketed, vertical agreements help them to be more successful and thus

⁵³ Article 2 of the Treaty states:

The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

EC TREATY, *supra* note 2, art. 81(2).

⁵⁴ Case 6/72, *Europemballage Corp. v. Commission*, 1973 E.C.R. 215, 244, [1973] 12 C.M.L.R. 199, 224 (1973); *see also* Gerber, *supra* note 50, at 101-102 (explaining the goals of European Competition Law).

⁵⁵ *See* EC TREATY, *supra* note 2, art. 81(1).

⁵⁶ *See* Commission Regulation, *supra* note 3, at 23; *see also* Guidelines, *supra* note 5, at 5 for more detailed comments on the three main elements in this definition. A vertical restraint should be contrasted with a horizontal restraint, which is a restraint imposed by an agreement between two or more competitors. *See* *Business Elecs. Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 730 (1988).

promote competition. On the other hand, arrangements between producers and distributors can also be used to re-partition the common market or exclude new entrants who would intensify competition, thus foreclosing markets and bring about downward pressure on prices.⁵⁷ The desire to prevent the territorial division of different national markets in the Community and to achieve a common market means that the European Union is unsympathetic to the U.S. position articulated by the Supreme Court in *Sylvania*,⁵⁸ that in the absence of market power on the supply side, nonprice vertical restraints are unobjectionable.⁵⁹

1. The Economics of Vertical Agreements

Economists have intensively discussed the economic analysis of vertical agreements in the past decades.⁶⁰ The economic thinking behind the previous tough approach to vertical restraints in the EC was to tackle exclusively the anticompetitive character of these agreements. In the present reform this strict approach has now been relaxed by the Commission due to the belief that the economic consensus in the EC is now more balanced toward such agreements.⁶¹ A further economic consensus exists that vertical restraints are, on average, less harmful than horizontal competition restraints.⁶²

In the area of vertical agreements competition concerns can only arise if there exists a certain degree of market power because of insufficient interbrand competition.⁶³ The stronger this interbrand competition is the more likely it is that vertical agreements do not have a negative effect. Depending on the specific market structure, the identical vertical restraint can therefore have a different effect. The introduction of the market share test is the implementation of this more economic based approach. If a party to an agreement has a market share above the threshold, a case-by-case approach is warranted for the vertical agreement in order to analyze the potential positive and negative effects.

⁵⁷ See Eleanor Fox, *Toward World Antitrust and Market Access*, 91 A. J. INT'L L. 1, 7 (1997) (questioning whether a firm, acting alone, can isolate and re-partition national markets).

⁵⁸ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

⁵⁹ For examples of how the European Court of Justice values the danger of foreclosure, see Case T-7/93, *Langnese-Iglo GmbH v. Commission*, 1995 E.C.R. II – 1533 and Case T-9/93, *Schöller Lebensmittel GmbH v. Commission*, 1995 E.C.R. II-1611.

⁶⁰ See F. M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L. J. 687 (1983) (discussing an overview of the developments).

⁶¹ See Luc Peepkorn *The Economics of Verticals*, COMPETITION POL'Y NEWSL. (Competition Dir. Gen., Brussels, Belg.), June 1998, at http://europa.eu.int/comm/competition/speeches/text/sp_1998_020_en.html (last visited Oct. 29, 2000).

⁶² See *id.*

⁶³ See *id.*

These agreements are very important for the functioning of the economy. They may contain certain restrictions that, absent significant market power, can have neutral or even positive effects. The first and major possible effect is the avoidance of the free-rider problem; a second possible effect is the improvement of production and distribution.⁶⁴ However, such agreements can also have negative effects on the market. Potential negative effects include foreclosure, the deterioration of price and non-price conditions, collusion among the distribution chain and, in the Community context, the creation of obstacles to market integration.⁶⁵ Due to this ambiguous nature, vertical agreements can be used pro-competitively to promote market integration and efficient distribution or anti-competitively to block integration and competition.

C. Former EC Rules on Vertical Agreements

Because of concerns over the threats vertical restraints pose to market integration, the previous Commission policy has applied Article 81(1) relatively strictly.⁶⁶ The Commission decided that both intra-brand⁶⁷ and inter-brand⁶⁸ competition were of equal concern for the strategy of European competition policy toward the single market.⁶⁹ Vertical restraints of intra-brand competition, such as grants of exclusive territories by means of absolute territorial protection ("ATP")⁷⁰ and exclusion of parallel imports/exports, generally triggered the application of Article 81(1), regardless of their overall effect on interbrand competition or efficiency.⁷¹

⁶⁴ See *id.*; Warren S. Grimes, *Brand Marketing, Intra-brand Competition, and the Multi-brand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L. J. 83, 89-97 (1995).

⁶⁵ See Peeperkorn, *supra* note 61.

⁶⁶ See Carlin, *supra* note 7, at 283.

⁶⁷ The competition between sellers of one brand.

⁶⁸ The competition between different brands.

⁶⁹ See Carlin, *supra* note 7, at 284 (discussing the significance of intra-brand competition). In the U.S. since *Sylvania* interbrand competition is deemed more significant than intra-brand competition. See Grimes, *supra* note 64.

⁷⁰ Absolute territorial protection ("ATP") of a distributor exists, for example, where, there is no other source of supply for a customer within the territory other than the exclusive distributor. While a distributor may be allocated an exclusive territory in order to better penetrate the market and make distribution more efficient and may be forbidden to sell or promote directly in the territory of other exclusive distributors, this protection must not be absolute. Cf. Green Paper, *supra* note 7, at 8. To guard against this, the Commission insists on allowing distributors outside the territory to respond to orders from customers in the territory, so-called "passive sales" or, where a distributor is appointed for the whole of the EU, normally the supplier must be free to respond to orders from customers in the territory.

⁷¹ See Joined Cases 56 & 58/64, *Etablissements Consten, S.A.R.L. v. Commission*, 1966 E.C.R. 299, 342, [1966] 5 C.M.L.R. 418, 475 (1966); Robert L. Steiner, *Intra-brand Competition - Stepchild of Antitrust*, 36 ANTITRUST BULL. 155 (1991); see also Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints*

Agreements of minor importance did and still do not fall under Art. 81(1) according to the "*de minimis*" notice.⁷² According to this notice, vertical agreements are not covered by Art. 81(1) if the aggregate market shares held by all of the participating undertakings do not exceed 10 percent⁷³ or if the participating companies are small and medium sized undertakings.⁷⁴ However, this notice does not apply where competition is restricted by agreements involving territorial protection and by the cumulative effects of parallel networks of similar agreements established by several manufacturers or dealers.⁷⁵

If these explicit exceptions from the application of Article 81(1) did not apply, a notification and a subsequent case-by-case analysis of the respective vertical agreement were necessary to determine the application of Article 81.⁷⁶ Even if the individual agreement did not fall within the scope of Article 81(1), the cumulative impact of several similar agreements may have appreciably restricted competition.⁷⁷ The analysis allowed exemptions to the rule if, broadly speaking, agreements contributed to the improvement of production and distribution and also benefited the consumer. To reduce the burden of having to deal with large volumes of standard notifications due to the wide application of Article 81(1) to vertical agreements, the Commission had adopted block exemption regulations covering the categories of agreements mentioned above.⁷⁸ Agreements falling under these Regulations, although restrictive of competition, are deemed to fulfill the requirements for exemption under Article 81(3).

Efficient? 65 ANTITRUST L. J. 407 (1997) (regarding the economic importance of intra-brand competition); Donncadh Woods and Mario Filippini, *Vertical Agreements*, in THE EC LAW OF COMPETITION, *supra* note 26, at 445-448.

⁷² See Notice on Agreements of Minor Importance Which Do Not Fall Within the Meaning of Article 85(1) of the Treaty Establishing the European Community, 1997 O.J. (C 372) 13. In the field of vertical agreements, subject to the conditions set out in the *de minimis* notice concerning hardcore restrictions and cumulative effect issues, agreements entered into by undertakings whose market share on the relevant market does not exceed 10 per cent are generally considered to fall outside the scope of application of Article 81(1). See Donncadh Woods and Mario Filippini, *Vertical Agreements*, in THE EC LAW OF COMPETITION, *supra* note 26, at 445 (regarding the vertical aspects of the *de minimis* concept).

⁷³ See Notice on Agreements of Minor Importance, *supra* note 72, at 14.

⁷⁴ See Commission Recommendation of 3 April 1996 Concerning the Definition of Small and Medium-Sized Enterprises, 1996 O.J. (L107) 4, 8.

⁷⁵ See Notice on Agreements of Minor Importance, *supra* note 72, at 15. Since these types of restraints are typical for vertical agreements, this Notice was often not applicable in cases of vertical agreements. See Semler and Bauer, *supra* note 10, at 193.

⁷⁶ See Waller, *supra* note 33, at 66. The U.S. antitrust law does not have a notification system with respect to restrictive agreements; see also Green Paper, *supra* note 7, para. 212.

⁷⁷ See Donncadh Woods and Mario Filippini, *Vertical Agreements*, in THE EC LAW OF COMPETITION, *supra* note 71, at 467, for the assessment required to find a cumulative effect which falls within the scope of Article 81(1).

⁷⁸ See Waller, *supra* note 33, for an overview of the block exemption regulations.

1. Criticism of the Previous Competition Rules on Vertical Restraints

During the reform process of its policy, the Commission, aided by consultation with industry and legal experts, identified several key criticisms of the previous system.⁷⁹ A major complaint concerned the inflexible, over-regulated and therefore costly nature of the previous vertical restraint regime introduced by the EEC nearly 40 years ago.⁸⁰ Businesses were burdened with the pressure to write agreements that fit the rigid categories of the exemptions and this exercise encompassed both a good deal of time and a considerable amount of money in attorneys' fees. In summary, criticism of the previous block exemption regulations described them as being too legalistic, prescriptive and limited in scope.⁸¹

The practice of five different block exemption regulations in the area of vertical agreement contributed to the problem because they were narrowly defined and because their static character was not suited to corporations' needs for flexible contract formulation.⁸² The objective of creating vital legal certainty for the enterprises concerned with this policy caused the so-called "strait-jacket-effect"⁸³ of the block exemption regulations, which was a structural flaw inherent in any system that attempts to identify that clauses are exempt.⁸⁴ This system of individual block exemption regulations also included the consequence that a number of vertical agreements, such as those in the service sector,⁸⁵ were not covered by any block exemption regulation. Therefore, under the old regime these companies had to notify the Commission of their agreements in economically important cases in order to be on the safe side.

Other critics based their call for reforms on the overload of notifications that are received by the Commission.⁸⁶ In order to ensure the uniform

⁷⁹ See Green Paper, *supra* note 7, at 2; see also Hermann H. Kalfass, *Vertikale Verträge in der Wettbewerbspolitik der EU*, 49 WIRTSCHAFT UND WETTBEWERB 225, 236 (1999).

⁸⁰ The European Economic Community, now officially entitled the "European Community", is a constituent part of the European Union, which was established by the TREATY ON EUROPEAN UNION, Feb. 7, 1992, O.J. (C 191) 1 (1992), 31 I.L.M. 247 (1992).

⁸¹ See Green Paper, *supra* note 7, at 2.

⁸² The block exemption instrument has been invaluable in dealing with areas which were once controversial and gave rise to hundreds, sometimes thousands, of notifications. See Faull, *supra* note 51, at 226.

⁸³ See Commission Communication, *supra* note 12, at 3. The "straight-jacket-effect" describes the constraints imposed on entities during the drafting process of vertical agreements under the old regime.

⁸⁴ See Commission Report (XXVIII) on Competition Policy, SEC(99)743 final at 21, available at http://europa.eu.int/comm/competition/annual_reports/1998/en/001_130.pdf.

⁸⁵ See Commission Regulation 1983/83, 1983 O.J. (L 173) 1; Commission Regulation 1984/83, 1983 O.J. (L 173) 5 (block exemption regulations did not apply to these agreements).

⁸⁶ For details, see Laraine L. Laudati, *The First European Competition Forum: Vertical Restraints*, COMPETITION POL'Y NEWSL. (Competition Dir. Gen., Brussels, Belg.), Summer 1995, at 2, at http://europa.eu.int/comm/competition/speeches/text/sp1995_035_en.html.

application of the competition rules within the common market from the outset, extensive powers necessary for their implementation have been combined and assigned to the Commission.⁸⁷ The Commission receives many notifications of agreements that do not give rise to any serious competition problem.⁸⁸ This results in many unclosed files, time consuming procedures and a general legal uncertainty during this period of time, even in cases of insignificant agreements. The Commission takes up to two or three years to respond to a notification with a formal decision.⁸⁹ The Competition DG only had the limited capacity to formally decide about 20 notifications by formal decision and to issue about 150 comfort letters per year.⁹⁰ In a comfort letter, the Competition DG writes to say that it is satisfied on the basis of the information available to it that a vertical agreement does not fall within Article 81(1) or that it does but merits exemption under Article 81(3).⁹¹ The Competition DG then states that it does not intend to recommend to the Commission that it should make a formal decision, but instead should close its file in the case. The file, however, may be reopened in the event of a complaint or a material change of law or fact.⁹² Commentators question whether comfort letters provide a satisfactory solution.⁹³ In order to maintain at least minimal legal security, the undertakings

⁸⁷ See Commission Regulation 17/62, art. 9, 1959-1962 O.J. SPEC. ED. 87.

⁸⁸ See Helmut Schröter, *Zur Beurteilung vertikaler Wettbewerbsbeschränkungen nach Artikel 85 des EG-Vertrages*, at <http://europa.eu.int/comm/dg04/speech/six/de/sp96047.htm> (last visited Oct. 31, 2000).

⁸⁹ See Frank Montag, *The Case for a Reform of Regulation 17/62: Problems and Possible Solutions from a Practitioner's Point of View*, 22 FORDHAM INT'L L.J. 819, 827 (1999) (referring to "cases where parties notified agreements as long as fifteen years ago without ever receiving a clearance decision to date.")

⁹⁰ See Hermann H. Kalfass, *Vertikale Verträge in der Wettbewerbspolitik der EU*, WISCHAFT UND WETTBEWERB 225, 235 (1999).

⁹¹ In a discomfort letter, the Competition DG writes to say that an agreement falls within Article 81(1) and does not, in its view, merit exemption. It may therefore, in whole or in part, be null and void pursuant to Article 81(2). However, the Competition DG does not propose to recommend that the Commission take a decision in the case, and it closes the file on the same terms as for a comfort letter. A discomfort letter will frequently be used when a national court is better placed than the Commission to resolve a dispute. See Faull, *supra* note 51, at 233. Discomfort letters and block exemption regulations were a response to the Commission's inability to supply negative clearance or exemption decisions to meet the demand by notifiers of agreements. See *id.* at 226. Currently no more than around twenty formal decisions a year are adopted. See *Commission Report (XXVII) on Competition Policy, SEC(98)636 final at 38-40*, available at http://europa.eu.int/comm/competition/annual_reports/rap97/en.html [hereinafter Commission, XXVIIth Report]. In 1997, 27 formal decisions were made. See *id.* Similarly, 21 formal decisions were made in 1996, while 209 notifications were received pursuant to Article 81. See *Commission Report (XXVI) on Competition Policy, SEC(97)628 final at 50*, available at http://europa.eu.int/comm/competition/annual_reports/rap96_en.html.

⁹² See Faull, *supra* note 51, at 223.

⁹³ See Tara Burns Newell, Comment, *The Removal of Vertical Restraints in EC Competition Policy*, 4 COLUM. J. EUR. L. 191, 193 (1998); Singham, *supra* note 33, at 389; Montag,

were forced against their own belief to follow the white list approach,⁹⁴ which led to the strait-jacket-effect of the previous systems of block exemption regulations.

Critics have been consistent in urging that a market analysis should be the initial step in analyzing vertical restraints in order to determine whether a restriction of competition exists under Article 81(1).⁹⁵ Previously, too much emphasis had been put on analysis of individual clauses within an agreement at the expense of considering the economic impact of the agreement as a whole.⁹⁶ Enterprises view the possibility of "one-stop-shopping" with one agency as valuable. Legal security, feared to be lost under the new market share threshold approach, is also viewed as valuable.⁹⁷

III. THE NEW COMPETITION REGULATION ON VERTICAL AGREEMENTS

A. Reform Process

The Commission began the extensive reform process under two premises: first, that Article 81 remains applicable to vertical agreements and second, that no policy reform which goes beyond the bounds of Article 81 as interpreted by the Community Courts should be contemplated.⁹⁸ The implementation of the policy proposal required three new legislative texts, namely, the amendment of two Council Regulations and a Commission block exemption regulation covering all vertical restraints in almost all sectors of distribution. Additionally, accompanying guidelines were introduced. The first amended Council Regulation was Regulation No. 17.⁹⁹ The second was Council Regulation No. 19/65/EEC of March 2, 1965 on the Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices,¹⁰⁰ as last amended by Council Regulation (EC) No. 1215/1999 of June 10, 1999.¹⁰¹

supra note 89, at 826-827; Mario Siragusa, *The Millenium Approaches: Rethinking. Article 85 and the Problems Challenges in the Design and Enforcement of the EC Competition Rules*, 21 FORDHAM INT'L L.J., 650, 662-663 (1998).

⁹⁴ A "white list" is an exhaustive catalogue of the restrictive clauses that are exempted under the regulation.

⁹⁵ See Laudati, *supra* note 86, at 2.

⁹⁶ See Lucas Peepkorn, *Commission Adopts Green Paper on Vertical Restraints in EU Competition Policy*, at http://europa.eu.int/comm/competition/speeches/text/sp1997_002_en.html (last visited Oct. 31, 2000).

⁹⁷ See *id.*

⁹⁸ A "[t]reaty amendment is *not* an option." Green Paper, *supra* note 7, at 2.

⁹⁹ See Council Regulation 17/62, 1962 O.J. (204), 1959-62 O.J. SPEC. ED. 87.

¹⁰⁰ Council Regulation 19/65, 1965-1966 O.J. SPEC. ED. 36, 533.

¹⁰¹ See Council Regulation 1215/1999 O.J. (L 148) 1.

1. Amendment of Council Regulation 17/62/EEC

In the form of Regulation No. 17, the Council adopted the first Regulation concerning the implementation of Articles 81 and 82, according to Article 83(1), subparagraph 1.¹⁰² The intention behind this Regulation was to give effect to the principles set out in Articles 81 and 82 by giving the Commission the exclusive competence to grant exemptions under Article 81(3) but also by setting up a system of notification to the Commission for agreements for which an exemption or negative clearance is sought. The regulation states that undertakings are obliged to submit a notification prior to the date of exemption in order to be exempted from the application of the provisions of these Articles. Such a notification ensures a protection from fines and, in the event that an individual exemption is granted, guarantees the enforceability of the agreement and constitutes a bar to private actions for damages.

The amendment to this Regulation broadens the scope of the application of Article 4(2) of Regulation No. 17, which exempts all vertical agreements from the requirement that they be notified prior to individual exemption.¹⁰³ The practical goal the Commission pursued with this amendment is that, even in the event of late notification, it will consider whether the agreement in question satisfies the conditions of Article 81(3) and, if so, it will adopt an exemption decision taking effect on the date on which the agreement was entered into.¹⁰⁴ According to the Commission, this scope for retroactive exemption gives enterprises greater legal certainty by ensuring that agreements satisfying the exemption conditions laid down in Article 81(3) can be implemented.¹⁰⁵ In this way, the legal security afforded to firms would be strengthened without jeopardizing the enforcement of Article 81(1) with regard to anticompetitive agreements.¹⁰⁶ The Commission further hopes to reduce the number of notifications by enterprises, which are only filed as a precaution to block subsequent antitrust objections.¹⁰⁷

¹⁰² Regulation No. 17 has remained unchanged in substance since the 1960s. See Faull, *supra* note 51, at 222. For different proposals for reforming the present enforcement procedure of EC competition law under Regulation No. 17, see Montag, *supra* note 89, at 829-847.

¹⁰³ See Press Release IP/99/286, European Commission, *Council Gives Green Light for Reform of the EU Competition Rules Applicable to Vertical Restraints* (May 7, 1999), at http://europa.eu.int/en/comm/competition/index_en.html.

¹⁰⁴ See Montag, *supra* note 89, at 837.

¹⁰⁵ See Bureau of National Affairs, 76 ANTITRUST AND TRADE REGULATION REPORT OF MAY 6, 1999 484 (1999).

¹⁰⁶ See Commission Report, *supra* note 84, at 23.

¹⁰⁷ See Council Regulation 1216/1999, 1999 O.J. (L 148) 5.

2. Amendment of Council Regulation 19/65/EEC

On June 10, 1999, the Council adopted Council Regulation (EC) No. 1215/1999, amending Regulation No 19/65/EEC on the application of Article 81(3) of the Treaty to Certain Categories of Agreements and Concerted Practices.¹⁰⁸ With Regulation No. 19/65/EEC, the Council empowered the Commission in accordance with Article 81(3) of the Treaty to adopt regulations declaring that Article 81(1) does not apply to certain categories of agreements. The compliance of the Block Exemption Regulation with the agreement in question confers automatic exemption under Article 81(3) from the prohibition of Article 81(1).¹⁰⁹ It thus defines the non-application of Article 81(1) to certain types of agreements that generally fulfill the conditions of Article 81(3) and are, therefore, exempted. This Regulation requires that the Commission block exemption regulations contain lists of conditions that must be fulfilled, the types of agreements covered, restrictive clauses that are exempted and clauses that must not be included.

Council Regulation No. 19/65/EEC was restricted to a limited number of vertical restraints, namely, the exclusive distribution of goods for resale, the exclusive purchase for resale, and the restrictions imposed in relation to the assignment or use of industrial property rights. It was also limited to agreements entered into between two parties. The Commission block exemption regulations in the field of distribution, which were adopted pursuant to Council Regulation No. 19/65/EEC, covered only the areas of exclusive distribution (where a producer agrees to appoint only one distributor in a specific territory),¹¹⁰ exclusive purchasing (whereby a distributor agrees only to take supplies from a single producer, including special provisions for beer and petrol),¹¹¹ franchising (whereby a franchisee is allocated an exclusive territory in which to exploit the know-how and intellectual property rights of the franchiser and agrees to sell the products in a standardized format),¹¹² and motor vehicle distribution and servicing

¹⁰⁸ See Council Regulation 1215/1999, 1999 O.J. (L 148) 1.

¹⁰⁹ For the requirements of Council Regulation 19/65, see Donncadh Woods and Mario Filipponi, *Vertical Agreements*, in *THE EC LAW OF COMPETITION*, *supra* note 26, at 436.

¹¹⁰ See Commission Regulation 1983/83, 1983 O.J. (L 173) 1, *amended by* Commission Regulation 1582/97, 1997 O.J. (L 214) 27. This form of distribution enables the supplier to concentrate his sale activities without having to contract with numerous small dealers, in return for limited or absolute exclusivity, the distributor can be required to focus his sale efforts within the territory and refrain from manufacturing or distributing competing products.

¹¹¹ See Commission Regulation 1984/83, 1983 O.J. (L 173) 5, *amended by* Commission Regulation 1582/97, 1997 O.J. (L 214) 27. Exclusive purchasing agreements enable the supplier better to plan his sales over a longer period and increase security of supply for the reseller.

¹¹² See Commission Regulation 4087/88, 1988 O.J. (L 359) 46, *amended by* Commission Regulation 1582/97, 1997 O.J. (L 214) 27; *see also* Christoph Liebscher and Alexander Petsche, *Franchising nach der neuen Gruppenfreistellungsverordnung (EG) Nr. 2790/99 für*

agreements.¹¹³ No block exemption regulation has been adopted for selective distribution.¹¹⁴

The amendment of this Council Regulation by the Council on April 29, 1999 extended the Commission's legislative powers, allowing it to adopt the new Commission Regulation regarding vertical agreements. The Commission was able to adopt a broad Block Exemption Regulation to cover all vertical restraints affecting finished or intermediate products and services, including vertical agreements concluded by certain associations of retailers.¹¹⁵ The Council Regulation extended the scope of Articles 1(1)(a) and 1(2)(b) of Council Regulation No. 19/65/EEC in order to enable the Commission to cover, by block exemption regulation, all types of agreements concluded between two or more firms, each operating at a different stage of the economic process, with respect to the supply and/or purchase of goods for resale or processing or with respect to the marketing of services.¹¹⁶

Moreover, Article 1(4) of the Council Regulation (EC) No. 1215/1999 contains a procedural novelty which affects the competition procedural laws in the Member States. According to Article 7(2) of Regulation No. 19/65/EEC, the competent authorities in the Member States now have the authority, with respect to particular agreements or concerted practices to which the block exemption regulation applies, to withdraw the benefit of that block exemption regulation if the agreement has an effect which is incompatible with the conditions laid down in Article 81(3) of the Treaty.¹¹⁷

Nevertheless, the new Commission Regulation is subject to certain conditions. In particular, the Block Exemption Regulation will apply only to firms whose market shares do not exceed a specific threshold of 30 percent market share.¹¹⁸ In order to increase the flexibility of the legal rules, the Commission thereby limits the Exemption's availability to agreements above this threshold. In addition, the Block Exemption excludes certain fundamental restrictions, such as practices involving the imposition of fixed

Vertikalvereinbarungen, in *EUROPAISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT* 400, 400-404 (2000).

¹¹³ See Commission Regulation 1475/95, 1995 O.J. (L 145) 25, amended by Commission Regulation 1582/97, 1997 O.J. (L 214) 27.

¹¹⁴ See Green Paper, *supra* note 7, at Introduction, para. 5. Selective distribution is a distribution system, whereby distributors are chosen on the basis of objective criteria necessary for the efficient distribution of the goods in question. Selected distributors normally provide some pre- or after-sales services and may only sell to final consumers or other selected dealers. See *id.*

¹¹⁵ See Press Release, *supra* note 103.

¹¹⁶ See Council Regulation 1215/1999, art. 1(1), 1999 O.J. (L 148) 1.

¹¹⁷ It is surprising that this important part of the new legislation is not mentioned in the official press release of the European Commission. See Press Release, *supra* note 103.

¹¹⁸ See Commission Regulation 2790/1999, art. 3(1), 1999 O.J. (L 336) 21, 23.

or minimum resale prices, and certain forms of territorial protection that may thwart the objective of market integration.¹¹⁹

3. Guidelines

On May 24, 2000, the Commission adopted the Guidelines on Vertical Restraints which complement the new Block Exemption Regulation. These Guidelines are designed to allow a company to make its own individual assessment of its respective market share and more generally of the vertical agreements under the EC competition rules.¹²⁰ Each case has to be evaluated in light of its own facts and the Guidelines have to be “applied reasonably and flexibly.”¹²¹

The Guidelines indicate specific criteria that the Commission will apply in examinations of individual cases not covered by the Block Exemption. Furthermore, the Guidelines also cover the general criteria for withdrawal of the Block Exemption in individual cases where an agreement has effects incompatible with the conditions enunciated in Article 81(3). Finally, the Guidelines detail the conditions for regulations displaying the Block Exemption on a particular market.

The Commission hopes to reduce enforcement costs and as far as possible to eliminate notifications of agreements that do not give rise to any serious competition problem.¹²² The Guidelines are intended to cover two issues, namely the application of Article 81(1) and 81(3) above the 30 per cent market share cap and the Commission’s policy on withdrawal of the benefit of the Block Exemption, particularly in cumulative effect cases. Agreements that do not fall under the amended Block Exemption Regulation can be designed according to the guidelines in such a way that they can be exempted individually. If the vertical agreement is objected to at a later date, the affected enterprise is able to notify the Commission of the agreement. The Commission then can adopt an exemption decision that takes effect on the date the agreement was concluded. Such a system will therefore not punish those companies that may make mistakes in the assessment of their market shares based upon the market share threshold.

In Chapter II(2) of the new Guidelines, the Commission also comments on agency agreements. This Chapter replaces the Commission’s Notice on

¹¹⁹ Community competition law derives from the Treaty of Rome. Article 81 EC Treaty prohibits agreements or concerted practices which restrict, prevent or distort competition between Member States, except as exempted. See EC TREATY, *supra* note 2, at Article 81.

¹²⁰ See Commission Notice - Guidelines on Vertical Restraints, ch. i, para. 5, 2000 O.J. (C 291) 3. A question remains as to the “authoritative nature” of the Guidelines, not only for the European Commission but also for national authorities and courts dealing with them. See *id.*

¹²¹ See *id.*

¹²² See Commission Report, *supra* note 84, at 21.

exclusive dealing contracts with commercial agents.¹²³ Competition restraints in agency agreements continue to be outside the scope of Article 85(1), as the agency relationship is genuine, i.e., the principal bears the full financial or commercial risk.¹²⁴

B. The New EC Rules for Vertical Agreements

The Commission intended the reforms to shift EC competition policy from form-based requirements with sector-specific rules, to a more economic approach in the assessment of vertical restraints covering virtually all sectors of distribution equally. The new approach is based on the recognition that vertical agreements generally lead only to competition problems in cases where weak interbrand competition and a certain degree of market power exist. The focus therefore is on the "net" negative effect of agreements. The new regulation is based on the fundamental goals of the protection of competition and market integration.¹²⁵

1. Substantive Provisions

With a very wide scope of application,¹²⁶ the new Regulation will exempt from Article 81 all vertical restraints concerning intermediate and final goods and services except for a limited number of "hardcore restraints"¹²⁷ contained in Article 3(a) of the new Block Exemption Regulation.¹²⁸ These restrictions include the imposition of resale prices and certain types of territorial and consumer protections, leading to a partitioning of markets. An agreement that contains one of these "hardcore restraints" will

¹²³ See 1959-1962 O.J. SPEC. ED. 139, 2921.

¹²⁴ Whether the requirements are fulfilled in a specific case is to be determined on the basis of the guidelines. See *id.*

¹²⁵ In particular, it should focus on the following elements:

- a general block exemption which may cover all types of vertical agreements;
- a more economic approach to assessing the positive and negative effects of vertical restraints;

- a reduction of the bureaucratic burden on the competition authorities and the undertakings concerned;

- adequate legal certainty for undertakings; and

- an extended decentralization of control.

See *id.*

¹²⁶ For more detailed comments on the application of the new Block Exemption Regulation, see Guidelines, chap. III, paras. 21-70, 2000 O.J. (C 291) 6-15.

¹²⁷ See Communication from the Commission on the Application of the Community Competition Rules to Vertical Restraints: Follow-up to the Green Paper on Vertical Restraints, §5 at para. 3, at <http://europa.eu.int/comm/competition/antitrust/other.htm> (last visited Feb. 15, 2001).

¹²⁸ See Guidelines, chap. III, paras. 46-56, 2000 O.J. (C 291) 6-15. The previous block exemption regulations, except the franchise regulation, covered only vertical agreements concerning the resale of final goods and not intermediate goods or services.

remove the entire agreement from the Block Exemption Regulation coverage.¹²⁹ These restrictions are based on a "black list" approach, which defines what is not exempt under the Block Exemption rather than defining what is exempt. Blacklisted restrictions are excluded from the scope of application of the Block Exemption, but all restrictions not explicitly forbidden are now allowed under the new rules. Companies are advised not to use these restrictions in their agreements, as they would be unlikely to qualify for individual exemption and could attract fines.¹³⁰

The Commission's goal in introducing such a list¹³¹ is the removal of the strait-jacket-effect, which was at the center of the criticism of the old regime's "white list" approach. In addition to this "black list," there are certain restrictions that are not automatically exempted but that may, under certain circumstances, nonetheless be incompatible with the EC competition rules. The most important concerns non-compete obligations—requiring distributors to resell only the brands of one supplier—when their duration exceeds five years.¹³² Such agreements are not covered by the Block Exemption Regulation, as they are considered by the Commission to have a strong foreclosing effect on the market.

The principal objective of a wide block exemption is to grant companies who lack market power a safe haven in which it is no longer necessary for them to assess the validity of their agreements under the EC competition rules. In order to preserve competition and to limit the extent of this exemption to companies that do not have significant market power, the Exemption Regulation establishes a single market share threshold to determine the relevant market power beyond which companies may avail themselves of the safe haven. The advantage of a single-threshold-system, in contrast to a two-threshold-system that has also been proposed in the Green Paper, is that there is no need to define specific vertical restraints other than hardcore restraints. Additionally, the Commission has expanded the ruling of Article 4(2) of Regulation No. 17 on all vertical agreements. These agreements therefore do not have to be registered with the Commission in advance but, if necessary, can be exempted retroactively.

It must be stressed that for companies above the caps of the Block Exemption there will be no presumption of illegality.¹³³ The market share cap

¹²⁹ See Guidelines, chap. III, para. 46, 2000 O.J. (C 291) 11.

¹³⁰ For the calculation of fines, see Council Regulation, *supra* note 30 and Commission Guidelines on the Method of Setting Fines Imposed Pursuant to Article 15(2) of Regulation No. 17 and Article 65(5) of the ECSC, 1998 O.J. (C 9) 3.

¹³¹ This list includes fixed resale prices or minimum resale prices, maximum or recommended resale prices, territorial restrictions, customer's restrictions, the prevention of cross-supplies, and the combination of different distribution agreements. See Commission Regulation 2790/99, art. 4, 199 O.J. (L 336) 23.

¹³² See Commission Regulation 2790/1999, art. 5(a), 1999 O.J. (L 336) 24.

¹³³ See Guidelines, chap. III, para. 62, 2000 O.J. (C 291) 14.

only serves to distinguish those agreements that are presumed to be legal from those that may require individual examination and have to be notified. The safe harbor of below 30 per cent market share offers companies the freedom to create supply and distribution agreements best suited to their individual commercial interests and to adapt to the changing economic conditions. The Commission offers the use of its Guidelines to assist companies in carrying out their own assessment without notification.

According to Article 3(1) of the new Block Exemption Regulation, the relevant market share is calculated on the basis of the supplier's market in which it sells the contract goods or services.¹³⁴ The basis on which the market share is calculated is the data of the preceding calendar year;¹³⁵ all connected undertakings of the respective undertaking are to be included in this calculation.¹³⁶

The new Exemption Regulation includes one wide block exemption regulation covering all vertical restraints affecting finished or intermediate products and services.¹³⁷ This differs from the previous system of different regulations for specific forms of vertical restraints or sectors.¹³⁸ It thus treats different forms of vertical restraints having similar effects in a similar way, preventing unjustified differentiation between forms or sectors. In this manner, the Commission intends to avoid a policy bias in the choices companies make concerning their formats of distribution. The decision should be based on commercial merit and not, as under the previous system, on the particular clauses present in distribution contracts.

Moreover, the new "umbrella" Block Exemption Regulation No. 2790/1999 also covers franchising agreements. While franchising agreements were defined in the old Block Exemption Regulation No. 4087/88, they are not defined in the new Regulation. Only in the accompanying Guidelines are franchising agreements described as agreements that contain licenses of intellectual property rights relating to trade marks or signs and

¹³⁴ The Block Exemption Regulation provides an exception for exclusive supply agreements. See Commission Regulation 2790/99, art. 3(2), 1999 O.J. (L 336) 23. An exclusive supply agreement is where the supplier is obligated to sell the goods or services to only one purchaser. See *id.* at art. 1(c). In this case the buyer's market share is the relevant market share.

¹³⁵ See Commission Regulation 2790/99, art. 9(2)(a), 1999 O.J. (L 336) 24.

¹³⁶ See Commission Regulation 2790/99, art. 11(1), 1999 O.J. (L 336) 25.

¹³⁷ Including vertical agreements concluded by certain associations of retailers.

¹³⁸ See Commission Regulation 1983/83 of 22 June 1983 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Distribution Agreements, 1983 O.J. (L 173) 1; Commission Regulation 1984/83 of 22 June 1983 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Purchasing Agreements, 1983 O.J. (L 173) 5; see also Commission Regulation 1475/95 of 28 June 1995 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements, 1995 O.J. (L 145) 25 (expires 2002)

know-how for the use and distribution of goods or services.¹³⁹ According to Article 2(3) of the Block Exemption Regulation, franchising agreements are covered, provided the provisions that relate to the assignment to the buyer of intellectual property rights do not constitute the primary object of such agreements and are directly related to the use, sale, or resale of goods or services by the buyer or its customers.

Therefore, franchising agreements will not be given preferential treatment, as they involve a combination of vertical restraints, usually of selective distribution and non-compete obligations for the goods that form the subject of the franchise.¹⁴⁰ Sometimes exclusive distribution obligations like a location clause or exclusive territory are also added.¹⁴¹ These combinations would be treated according to the general criteria set out in the Block Exemption Regulation, whereby ATP will, in any event, be under the hardcore list. Related licensing provisions will be cleared, provided that they are, first, necessary for or complementary to vertical restraints and, second, not more restrictive than otherwise exempted provisions.

Furthermore, the new Block Exemption Regulation covers associations of independent retailers that are established for the purpose of collectively purchasing goods for final resale and supplying services to final customers under a common format.¹⁴² To benefit from the Block Exemption, no individual members of the association can exceed a turnover of Euro 50 million. It is recognized that there are horizontal aspects to these associations, and therefore the benefit of the Block Exemption is also subject to the provision that the horizontal aspects do not infringe Article 81. These horizontal aspects will be examined in a manner that accords with the general approach to vertical restraints as part of the review of the Commission's policy on horizontal agreements.

The new Block Exemption Regulation contains, like the previous Block Exemption Regulation No. 1983/83, No. 1984/83 and No. 4087/88, a withdrawal mechanism from the presumption of legality for the rare cases where a serious competition problem may arise involving parties that fall below the market share threshold.¹⁴³ This withdrawal mechanism would, in

¹³⁹ See Commission Notice – Guidelines on Vertical Restraints, adopted on May 24, 2000, para. 199, at : <http://europa.eu.int/comm/dg04/entente/other.htm>.

¹⁴⁰ A franchise is defined as a package of industrial or intellectual property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how, or patents, to be exploited for the resale of goods or the provision of services to end-users. See Commission Regulation 4087/88, 1988 O.J. (L 359) 46.

¹⁴¹ For the first time a Block Exemption Regulation contains provisions dealing with selective distribution. However, these provisions do not deal with the legal validity of the selection criteria, which is still determined by Art. 81(1) or the respective national law, if applicable. See EC TREATY, *supra* note 2, at art. 81(1).

¹⁴² See Commission Regulation 2790/99, art. 2, 1999 O.J. (L 336) 23.

¹⁴³ See Commission Regulation 2790/99, art. 6, 1999 O.J. (L 336) 24; see also Guidelines on Vertical Restraints, *supra* note 120, at ch. IV.

particular, be applied in cumulative effect cases. The Commission hopes to ensure effective supervision of markets and greater decentralization in the application of the Community Competition Rules.¹⁴⁴ Furthermore, in order to ensure greater decentralization in the application of the Community competition rules, Article 7(2) of Regulation 19/65/EEC has been amended.¹⁴⁵ The new provision is designed to provide that where the effects of vertical agreements are felt in a Member State that possesses all the characteristics of a distinct market, the competent national authority may withdraw the benefit of the block exemption in its territory and adopt a decision for the purpose of eliminating those effects.¹⁴⁶

Finally, in order to ensure effective control of the effects of parallel networks of similar agreements on a given market, Article 7(1) of Regulation No. 19/65/EEC was amended to allow the Block Exemption Regulation to establish the conditions under which such networks of agreements are excluded from its application.¹⁴⁷

2. *Procedural Provisions*

Under the previous system, in the absence of an applicable block exemption, the Commission could grant an individual exemption only as of the date when it was formally notified of an agreement.¹⁴⁸ Under the new system, when a company fails to notify the Commission because it has incorrectly assessed its market share, it may be permitted at any time to apply to the Commission for an individual exemption, which would apply retroactively.¹⁴⁹ This proposal is designed to dissuade companies from seeking individual exemptions unless they believe that they clearly exceed the market share cap, and that their distribution arrangements have a significant effect on competition and are vulnerable to challenge. A notifying party does not have to explain why the Commission was not notified of the agreement earlier. The Commission emphasizes in its guidelines that such a party "will not be denied retro-active exemption only because it did not notify earlier."¹⁵⁰

¹⁴⁴ See Gerber, *supra* note 50, at 141-143.

¹⁴⁵ See Council Regulation 19/65, *supra* note 100.

¹⁴⁶ See Council Regulation 1215/1999 of 10 June 1999 amending Regulation 19/65 on the Application of Article 81(3) of the Treaty to Certain Categories of Agreements and Concerted Practices, para. 11, 1999 O.J. (L 148) 3.

¹⁴⁷ See Commission Regulation 2790/99, art. 6, 1999 O.J. (L 336) 24.

¹⁴⁸ See Commission Regulation 17, art. 6(1), 1959-1962 O.J. SPEC. ED (204) 89. The nullity of the agreement was therefore at least final until this date of notification. Accordingly claims for damages, which had been based on an infringement of Art. 81(1), could not be enforced.

¹⁴⁹ See Guidelines, chap. III, para. 63, 2000 O.J. (C 291) 14.

¹⁵⁰ See *id.*

In order to effectively dissuade companies from filing precautionary notifications, however, there must be commercially acceptable time limits within which the Commission can undertake to grant retroactive clearance should notification for individual exemption appear necessary. In the case that an agreement is challenged in proceedings before a national competition authority or court, the possibility of obtaining retroactive exemption within a reasonable time is essential for the enterprises involved. The Commission therefore gives priority to notifications for the enterprises involved in litigation in national courts or complaints in its enforcement policy.¹⁵¹

The Commission will have the power to withdraw the block exemption regulation, even in the case that a supplier falls below the market share threshold when a sector is characterized by a small number of distribution networks that have the combined effect of seriously restricting competition in the market.¹⁵² Such a proposal, however, would not have retroactive effect, and the parties involved will be given six months to make the necessary adjustments deemed necessary to maintain competition in the relevant market.¹⁵³

3. National Competition Authorities and National Courts

Due to the fact that the date of notification no longer limits the possibility of exemption by the Commission, national authorities and courts have to apply Article 81(1) above the market share cap by assessing the likelihood of application of Article 81(3) in respect of all vertical agreements falling within Article 81(1).¹⁵⁴ In response to concerns about these proposals, the Commission has sought to reassure industries that national authorities and courts are accustomed to dealing with complex economic issues in competition cases and that the Commission itself will endeavor to provide guidance generally by increasing transparency concerning its own analysis of cases under Article 81(1). This new rule is strongly opposed by the industries concerned, who favor the one-stop-shop approach in this area of competition policy because of the danger of conflicts between EC and national legal systems and among the national legal systems. Such conflict would enhance legal uncertainty for the companies.¹⁵⁵

¹⁵¹ See Guidelines, chap. III, para. 65, 2000 O.J. (C 291) 15.

¹⁵² See Commission Regulation 2790/99, art. 6, 1999 O.J. (L 336) 24.

¹⁵³ See Commission Regulation 2790/99, art. 12(2), 1999 O.J. (L 336) 25.

¹⁵⁴ See Guidelines, chap. III, para. 64, 2000 O.J. (C 291) 15 (If such likelihood exists, the national authorities and courts should suspend proceedings pending a position by the Commission as is already practiced in cases where a notification is submitted at the time of entry into force of the agreement.)

¹⁵⁵ See discussion *infra* Section IV (describing the concerns of the beer, oil and chemistry industries).

C. Scope of the New Commission Regulation (EC) No 2790/1999

The new "umbrella regulation" covers virtually all sectors except for the sector of motor vehicles¹⁵⁶ and certain categories of technology transfers.¹⁵⁷ In particular, breweries and petrol companies, which often conclude exclusive sales agreements, are affected by the reform of the policy in this area. The previous block exemption regulations covered only the resale of finished goods. The new regulations are the first block exemption regulations dealing with the distribution of intermediate goods and services.

The Commission stated that, with regard to its proposals for the future treatment of the motor vehicle distribution sector, it will reexamine this area before deciding whether to maintain or abandon the present arrangements, which will expire on September 30, 2002.¹⁵⁸ During the discussions, before the Council on the Commission's proposals, the Commission expressed concern that the Member States might prejudge the choice of the future exemption regime in this sector. Any exemption regime for motor vehicle distribution after 2002 will be made after consultation with Member States and interested parties. The Council has asked the Commission to convene a meeting of the Advisory Committee immediately after having established its report on the block exemption for the distribution of motor vehicles scheduled for the year 2000. Article 11 of Regulation No 1475/95 requires the Commission to draw up an assessment report by December 31, 2000 before a decision is made on the future exemption regime for the car sector.¹⁵⁹ The European Union's competition commissioner Mario Monti, however, signaled in May of 2000 that he might seek radical changes to the current regime in the car sector.¹⁶⁰ The commissioner pointed out that most of the objectives of the existing rules had not been achieved due to a lack of respect by the car manufacturers to the block exemption rules.

¹⁵⁶ See Commission Regulation 1475/95 of 28 June 1995 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements, 1995 O.J. (L 145) 25 (expires 2002).

¹⁵⁷ This is true, in particular, when these agreements involve the use of "know-how" or patents. See Commission Regulation 240/96 of 31 January 1996 on the Application of Article 85(3) of the Treaty to Certain Categories of Technology Transfer Agreements, 1996 O.J. (L 32) 2. The subject matter of the Notice on subcontracting is outside of the scope of the new Block Exemption Regulation. See 1979 O.J. (C1) 2.

¹⁵⁸ Reexamination will be in accordance with Commission Regulation 1475/95, 1995 O.J. (L 145) 25. See also Antitrust and Trade Regulation 1908 (1999) 484.

¹⁵⁹ Therefore the Commission has sent out questionnaires to parties involved in the motor vehicle distribution trade intended to collect information about recent developments in the specific distribution trade and achievement of the Regulation's objectives.

¹⁶⁰ See Deborah Hargreaves, *Monti Attacks Carmakers on Restrictive Sales*, FIN. TIMES, May 12, 2000, at A2.

D. Reform as Part of an Overall Reform of the Commission's Competition Policy

The new Block Exemption Regulation (EC) No. 2790/1999 governing vertical restraints is part of an overall reform of the Community's Competition Policy. The reform is designed to reach both the substantive and procedural rules applicable in all fields to modernize European competition law: antitrust, mergers and state aids.¹⁶¹ The basic objectives of the comprehensive reform are the more efficient enforcement of the EC competition rules, the increased involvement of national competition authorities and national courts, the reduction of bureaucracy in the enforcement and the development of a common competition culture in the EC. Other visual parts of this reform next to the present reform in the vertical area are the White Paper for a reform of Regulation No. 17¹⁶² and the Commission's recent proposal for a regulation implementing Articles 81 and 82.¹⁶³ It includes the proposal to hand back decisions to national authorities in cases of price fixing and abuse of dominant market power for all but the most important cases, which will remain within the authority of the Commission's Competition DG.

Increasingly close partnerships are being formed between manufacturers and distributors to ensure that the products are available when and where consumers request, to maximize sales and to reduce waste.¹⁶⁴ When the new draft legislation was published, current European Competition Commissioner Mario Monti stressed that:

This important reform project is well advanced and confirms the commitment of the Commission to review and modernize Community rules on competition. The aim is to simplify our rules and reduce the regulatory burden for companies, while ensuring a more effective control of vertical restraints implemented by companies holding significant market power. This will allow the Commission to concentrate in the future on important cases, in co-operation with the

¹⁶¹ See Mario Monti, *Address at the Formal Introduction Ceremony of the New President of the Bundeskartellamt Festveranstaltung Präsidentenwechsel Bundeskartellamt Bonn*, at <http://europa.eu.int/rapid/start/egi/gies...ngetxt=gt&doc=SPEECH/00/6/0/RAPID&lg=EN> (Jan. 13 2000).

¹⁶² See European Commission, *White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty*, Commission Program No 99/027, at http://europa.eu.int/comm/dg04/entente/en/wb_modernisation.pdf (Apr. 4, 1999); see also *Comments of the Section of Antitrust Law of the American Bar Association on the European Commission's White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty*, at <http://www.abant.org/antitrust/eumodern.html> (Nov. 3, 1999). In this White Paper, the Commission proposes to render Article 81(3) directly applicable and eliminate the notification system for most transactions.

¹⁶³ See *Press Release IP/00/1064, European Commission*, at http://europa.eu.int/en/comm/competition/index_en/html (Sept. 27, 2000).

¹⁶⁴ See *Vertical Reality*, FIN. TIMES WEB-ARCHIVE, Dec. 22, 1999, at <http://www.ft.com>.

Member States, who will play an increased role in the application of Community competition rules.¹⁶⁵

The Commission's overriding concern is to promote and preserve integrated and competitive markets in the EC and to implement an efficient and effective competition policy in order to serve the consumer interest and foster the competitiveness of industry, with special regard for small and medium sized enterprises.¹⁶⁶

E. Significance of Vertical Agreements to the European Community and the Single Market

The regulation of vertical agreements has been of particular importance to the Commission's competition policy since the first regulation in this area.¹⁶⁷ While national systems tend to focus generally on horizontal agreements because they represent the most obvious distortions of the market, the supranational system of the EC has focused on vertical restraints, largely because they represent the most obvious obstacles to trans-border trade.¹⁶⁸ Due to their strong links to market integration, vertical agreements can be either positive or negative. Vertical agreements may promote efficiency and market integration. The restraints contained in these agreements, however, can also give rise to competition concerns. For example, manufacturers that collectively have significant market power may be able to tie up a large part of the distribution outlets in a country using exclusive contracts. This could result in market foreclosure negatively affecting competition and access to the market.¹⁶⁹

¹⁶⁵ See Press Release IP/99/699, European Commission, at http://europa.eu.int/en/comm/competition/index_en.html (Sept. 24, 1999).

¹⁶⁶ See Green Paper, *supra* note 7, at 75, ch. VIII, pt. 271. "The Commission considers that subject to cumulative effect and hardcore restrictions, agreements between small and medium-sized undertakings as defined in the Annex to Commission Recommendation 96/280/EC, 1996 O.J. (L 107) 4, are rarely capable of appreciably affecting trade between Member States or of appreciably restricting competition within the common market as long as these undertakings do not hold a dominant position in a substantial part of the common market." Guidelines on Vertical Restraints, *supra* note 120, at 3, ch. I, pt. 10.

¹⁶⁷ See Green Paper, *supra* note 7, at i., Exec. Summary; see also Waller, *supra* note 33, at 56.

¹⁶⁸ See Waller, *supra* note 33, at 66-67; Tim Frazer, *Competition Policy After 1992: The Next Step*, 53 MOD. L. REV. 609, 618-620 (1990).

¹⁶⁹ The Court of Justice refers to foreclosure in the *Delimitis* case as to the "necessity to examine whether there are real concrete possibilities for a new competitor to penetrate the bundle of contracts." Case C-234/89, *Delimitis v Henninger Bräu*, 1991 E.C.R. I-935. Therefore, foreclosure can only said to occur when the cumulative effects of a parallel series of agreements makes it difficult to enter the market and there are no concrete ways of bypassing those agreements. See *id.*

IV. RESPONSES TO THE REFORM OF VERTICAL RESTRAINTS

The reformation of the competition policy on vertical restraints has caused a wide and diverse response not only from the businesses affected by this amendment but also from the European Parliament, the Economic and Social Committee and commentators.¹⁷⁰ In general, it is fair to say that the overall reaction to the reformation process has been positive.¹⁷¹ The general consensus is that it became apparent that it was time to change the EC rules in this area of competition law. The previous blacklist approach and the formalistic view of customer restrictions and selective distribution reflected the EC's traditional preoccupation with intra-brand competition. This preoccupation, which existed regardless of the level of interbrand competition and whether or not the supplier had market power, was found to be too long and complicated.¹⁷² The general openness to the reform by the business community was thus overshadowed by the fear of legal uncertainty presented by the market share threshold in the new block exemption regulation.¹⁷³ The business community's need for adequate legal security is based on the aim to protect the investment made by the enterprises, to stay competitive, and to plan and to avoid the burdens of speculative litigation. Some companies demanded that the market share test be flanked with sufficient measures to protect legal security.¹⁷⁴ Future experiences with the Commission's guidelines will prove whether they will provide this protection.¹⁷⁵

During the reformation process, the Commission has reported on the response to the call for wide reaching consultation among interest groups.¹⁷⁶

¹⁷⁰ Both the European Parliament and the Economic and Social Committee generally welcomed the revision. See 1997 O.J. (C 296) 19; 1999 O.J. (C 101) 1; see also Carlin, *supra* note 7, at 283.

¹⁷¹ See "CEFIC Comments on the Green Paper of the Commission on Vertical Restraints in the EC Competition Policy", at http://www.cefic.be/position/sec/pp_sec14.htm (Mar. 14, 2000).

¹⁷² See *id.*

¹⁷³ See EU Committee of the American Chamber of Commerce in Belgium, Business Guide to EU Initiatives 1 (1998/1999) (on file with author).

¹⁷⁴ See *id.*

¹⁷⁵ The Confederation of Brewers in the Common Market ("CBMC") is very skeptical in its evaluation of the impact of the draft guidelines. See Comments on the Draft Guidelines on Vertical Restraints of November 22, 1999 (on file with author).

¹⁷⁶ The Consultation phase of the policy reform had produced the following results:

97 per cent of those who answered believe the previous system was too legalistic and lacked an economic approach;

42 per cent view vertical restraints as having a positive effect on competition and 50 per cent believe that they have both a positive and a negative effect;

over half of the submissions favor the first two policy options mentioned in the Green Paper, though many are open to compromise their positions;

nearly half believe market share to be a good indicator of market power, though difficulties remain in the definition of the market share threshold; and

Of the 227 written submissions, the large majority—64 per cent—have come from companies or associations, while six consumer organizations have responded to the call.¹⁷⁷ The majority of these companies and associations hail from the beer and petrol industries. The primary concern has been the maintenance of legal certainty, with only 41 submissions placing the primary emphasis on the protection of competition.

Companies with market shares around 30 per cent will have to review their previously block exempted trading activities to see whether they are still block exempt, and thereafter may need to change or request specific clearance of their vertical agreements.¹⁷⁸ The fundamental change in approach has shifted the balance away from minor agreements toward those involving market power, and away from the form of the contracts and clauses concerned toward their overall market effects. On the one hand, there is a clear reduction of the regulatory burden for smaller companies, who are clearly below the market share cap of 30 per cent. But on the other hand, the new approach makes matters more complex for those companies with market power.

Despite the reassurances that national authorities have dealt with complex economic issues in the past, and even though the Commission has offered guidance such as the recent Commission notice on the definition of the relevant market,¹⁷⁹ some industries fear that overlapping jurisdiction between multiple authorities may result in divergent views on market definition.¹⁸⁰ This fear is bolstered by the fact that enterprises see a tendency by national authorities and courts to define markets more narrowly than the Commission itself.¹⁸¹

The Union of Industrial and Employers' Confederations of Europe ("UNICE"), the European employers' body, predicts a positive effect for

numerous companies showed a willingness to consider a market share test, if it were flanked with sufficient measures to protect legal certainty.

See Commission Communication, Summary of Reactions to the Green Paper, sect. ii., 1 (on file with author).

¹⁷⁷ See *id.*

¹⁷⁸ See CEFIC Comments on the Green Paper of the Commission on Vertical Restraints in the EC Competition Policy, at http://www.cefic.be/position/sec/pp_sec14.htm (Mar. 14, 2000).

¹⁷⁹ See Commission Notice 1997 O.J. (C 372) 5 (defining relevant market for purposes of Community competition law).

¹⁸⁰ For the difficulties of a relevant market definition and the calculation of the market shares, see Montag, *supra* note 89, at 837. With regard to national courts, however, it is important to keep in mind that the Commission's policy merely allows them to play the same role as in all other areas of Community law, including the rules on abuse of a dominant position, and on public undertakings, which are at least as difficult to apply as the rules on agreements and concerted practices. See Monti, *supra* note 160.

¹⁸¹ See Paul Lugaard, Notes for a Presentation at the IBC Global Conference at the Conrad Hotel 5 (Oct. 13 1998) (on file with author).

companies that invest in distribution networks and forecasts that ultimately the reformation will have an effect on the way they sell their goods. However, the Union would have preferred to see a higher market share cap at 40 per cent.¹⁸²

Particularly for larger enterprises with pan-European distribution networks, such as the beer, oil and chemistry sectors, the point of legal uncertainty was an essential issue. In many cases, the argument was made that defining the relevant market requires a complex economic analysis and is a difficult exercise despite the Commission's "Notice on the Definition of Relevant Market for the Purposes of Competition Law."¹⁸³ The introduction of a market share threshold will oblige suppliers to monitor their market shares constantly during the lifetime of each agreement, with a view to notification, modification or termination if and when the critical level is reached. This will be particularly burdensome when multiple products and multiple geographic markets are involved, and the companies are concerned with protecting their investments and avoiding the burdens of speculative litigation.¹⁸⁴

The Confederation of Brewers in the Common Market ("CBMC")¹⁸⁵ lobbied to retain the previous supply contract system and its system of distribution, or tied-tenancy, in order to continue boasting the largest brewing industry in the world.¹⁸⁶ In this context the CBMC pointed out that following research conducted from 1989 to 1990, the European Commission concluded that the block exemption in the brewery industry was "satisfactory" for all parties and should not be changed.¹⁸⁷ The main concerns expressed by the CBMC in its comments on the reformation include the introduction of the market share cap, the duration of contracts in Article 4 of the block exemption regulation, the issue of leased and owned premises and the transitional period of nineteen months in Article 12. All of these concerns lead back to the consequence of the potential lack of legal security.

The two main types of the beer delivery contract, the loan system and the tenancy or leasehold system, seek to stimulate hundreds of thousands of full- and part-time jobs by providing financing and expertise to individual

¹⁸² See *Brussels to Ease Rules*, *supra* note 20.

¹⁸³ See 1997 O.J. (C 372) 5; see also, Lugard, *supra* note 180, at 3.

¹⁸⁴ See *Statement by EUROPIA*, at <http://www.europia.com/Retailing/html/rules.htm> (last visited Mar. 14, 2000).

¹⁸⁵ The Confederation of Brewers in the common market represents the national brewing industry associations of the 15 European Union Member States, plus Switzerland and Norway.

¹⁸⁶ See European Information Service, European Report 2316 (on file with author); see also CBMC Comments on the Draft Commission Regulation (Oct. 21, 1999) (on file with author). But see Carlin, *supra* note 7, at 285.

¹⁸⁷ See European Information Service, European Report, *supra* note 185.

establishments. They are also designed to ensure high quality products and service by supplying modern equipment and professional support. These issues, plus the benefits from a more efficient distribution system, e.g., cost reduction for customers, are viewed to be in danger due to the reform. Furthermore, the Confederation predicted a shift in the dynamic of the brewing market because brewers with market shares around the threshold will focus their future investments more on brand promotion rather than on individual relationships with cafés, bars and restaurants. The consequence would be a disadvantage for medium-sized breweries who cannot afford the same level of investment. Additionally, the new umbrella block exemption, in contrast to the previous Regulation No. 1984/83/EEC, does not take into account the particularities and specifics of the European beer market. The CBMC also denied the consequence of a reduction of notifications pursuant to the reform, due to the fact that large companies that wish to continue to use the beer delivery contract would have to notify the Commission of their agreements in order to receive the Commission's decision in this matter.¹⁸⁸

The European Government Affairs Organization of the Oil Refining and Marketing Industry ("EUROPIA"), opposed the introduction of the market share cap test.¹⁸⁹ It emphasized the risk of introducing greater legal uncertainty, which would only be alleviated by costly and time-consuming applications for individual exemption of agreements.¹⁹⁰ The organization emphasized three main negative consequences of the policy reform. The first was further vertical integration—petroleum suppliers buy previously dealer-operated service stations and instead use their own employees to manage those service stations. The second was a reduction of investment in dealer-operated service stations, in effect forcing dealers to find alternative sources of finance. Lastly, in cases where companies do not wish to make investments on the basis of agreements which are subject to legal uncertainty, application to the EC Commission for individual exemption would be onerous for petroleum suppliers and for the Commission's services.¹⁹¹

The European Chemical Industry Council ("CEFIC") also emphasized its major interest in the enhancement of legal security. Although such an uncertainty would remain embodied in the prospect of a market share test given the difficulty in assessing market share, the organization regards a

¹⁸⁸ See *id.*; CBMC Comments, *supra* note 185.

¹⁸⁹ See Statement by EUROPIA, *supra* note 184; see also Written Question 3619/97 of Ricardo Garosci to the Commission About the Situation of Fuel Retailers, 1998 O.J. (C 174) 88.

¹⁹⁰ The organization sees an "excessive legal uncertainty", which is an "inherent imprecision in market definition and market share quantification." See Statement by EUROPIA, *supra* note 183.

¹⁹¹ See *id.*

“market share test as attractive.”¹⁹² The Council welcomed the fact that the new block exemption covers all kinds of vertical restraints and that the requirement to notify industrial supply agreements of this kind is distinctly limited.

V. CONCLUSION

The Commission's approach represents a significant departure from the existing rules on vertical agreements. The broadening of the scope to cover services, industrial supply arrangements and the like is welcomed by most interested parties. By treating different forms of vertical restraints having similar effects in a similar way, the new rules will avoid any policy bias in the choice of the specific distribution format. The inclusion of a market share threshold was not welcomed by industry, but looked inevitable.¹⁹³ And, as the Commission pointed out in its Communication, market shares are not an unknown phenomenon in the EC competition rules.¹⁹⁴ For companies that fall below the market share cap, the new rules were welcomed. For those that exceed or come close to the threshold, their approach to the new rules is not as clear. The new regime will involve a long-overdue simplification of the rules for many businesses and allow Commission officials to investigate more effectively other, more “dangerous” areas of competition policy. But leaving it to companies to determine their individual market share also creates a degree of uncertainty, especially for enterprises with a market share close to or above the market share cap of 30 per cent.¹⁹⁵ However, a more economic approach is unfortunately incompatible with absolute legal security.

The introduction of market share caps implicitly introduces an element of legal uncertainty hinging on the issue of how to define the relevant product and geographic market in any given case. The possibility of retroactive exemptions falling under Articles 4(2) and 6(2) of Regulation No. 17 for all vertical agreements not falling within the block will mitigate part of this legal uncertainty. Without the obligation to notify in advance in order to obtain the benefit of an individual exemption *ex tunc*, the undertakings will not carry the risk of having operated under a void agreement. Finally, it

¹⁹² See CEFIC Comments on the Green Paper of the Commission on Vertical Restraints in the EC Competition Policy, at http://www.cefic.be/position/sec/pp_sec14.htm (last visited Mar. 14, 2000).

¹⁹³ The inclusion of a market share threshold system was inevitable due to a lack of viable alternatives to this system.

¹⁹⁴ See Commission's Communication, *supra* note 127, at § IV, para. 2. Note the 15 per cent market share in Article 4(2) of Regulation No. 17, *supra* note 23, the 10 percent market share creating a presumption of negative clearance in the Notice on Agreements of Minor Importance, *supra* note 72, and the 25 per cent market share threshold creating a presumption of negative clearance in the Merger Regulation, Council Regulation 4064/89, 1989 O.J. (L 395) 1-12, amended by Council Regulation 1310/97, 1997 O.J. (L 180) 1-6.

¹⁹⁵ See Commission Regulation 2790/1999, 1999 O.J. (L 336) 21, 23.

does remain doubtful whether the whole reform will significantly reduce the Commission's workload by the cases falling within the block exemption, and not simply shift them from the Commission to the national authorities and back again to the Commission.

Although it is too early to reach a sophisticated conclusion about the present EC reform on vertical restraint, and only practice with the new rules will show whether the Commission has met the goals it set for itself, the efforts undertaken by the Commission in its analysis of this area of competition law and the wide consultation exercises give rise to an optimistic view of the future.