VERTICAL AGREEMENTS AND COMPETITION LAW

A Comparative Study of the EU and US Regimes

Sandra Marco Colino

VERTICAL AGREEMENTS AND COMPETITION LAW

This book focuses on the current legal framework for vertical agreements in the EC and the US. Over the last ten years, antitrust rules governing these agreements have undergone thorough reform. In the EC, the old sector-specific block exemptions were replaced by Regulation 2790/99, applicable to all sectors of the economy. In addition, changes introduced to the procedural rules have led to the decentralisation of Article 81(3) and the removal of the notification requirement. In like manner, in the US the Supreme Court has gradually taken vertical restraints out of the per se illegality rule. What Sylvania achieved in placing non-price vertical restraints under the rule of reason in the late 1970s, the Khan judgment did for maximum resale price maintenance in 1997, whilst most recently and most significantly in 2007 the Leegin case followed suit for minimum resale price maintenance.

The book is divided into four chapters. The first chapter considers the 'double nature' of vertical agreements and the regulatory dilemma. The second chapter explores the most influential economic theories underpinning current regulatory frameworks, and how these theories shape antitrust policy. The third chapter questions the adequacy of the current economic analysis in recent EU and US legislation and court decisions. The fourth chapter analyses how this maturing economic analysis can be reconciled with what commentators and regulators have identified as a key role for competition policy, redressing assumed imbalances between dealers and manufacturers. The author concludes by querying the prevailing logic of protecting sectoral interests above the competitive process.

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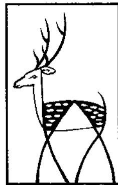

OXFORD AND PORTLAND, OREGON
2010

Published in North America (US and Canada) by
Hart Publishing
c/o International Specialized Book Services
920 NE 58th Avenue, Suite 300
Portland, OR 97213-3786
USA
Tel: +1 503 287 3093 or toll-free: (1) 800 944 6190
Fax: +1 503 280 8832
E-mail: orders@isbs.com
Website: http://www.isbs.com

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Hart Publishing Ltd, 16C Worcester Place, Oxford, OX1 2JW
Telephone: +44 (0)1865 517530 Fax: +44 (0)1865 510710
E-mail: mail@hartpub.co.uk
Website: http://www.hartpub.co.uk

British Library Cataloguing in Publication Data
Data Available

ISBN: 978-1-84113-871-8

Typeset by Hope Services, Abingdon
Printed and bound in Great Britain by
TJ International Ltd, Padstow, Cornwall

Dó Máirtín

Acknowledgements

The present book is based on my doctoral thesis, entitled *Towards a Sound Economic Analysis in Competition Law? The New Regulatory Framework for Motor Vehicle Distribution Agreements in the EU*. It was defended at the European University Institute in Florence in May 2007 before a panel consisting of Professors Christian Joerges, Luis Ortiz Blanco, Barry Rodger and Heike Schweitzer. Despite the narrower focus of the dissertation, my research led me to explore the minutiae of vertical agreements and directed me to innovative ideas on how to regulate these contracts. The seed of the monograph was therefore planted in 2001, when I began my research at the EUI, and was moulded into its final shape in various institutions around the world. The initial impetus of fascination, curiosity and instinctive ideas about a topic which proved more demanding than I could have ever expected soon made me realise the magnitude of the task I had undertaken. The fruit of my extensive investigation would never have ripened had I not been fortunate enough to have encountered true experts along the way willing to provide me with the guidance and knowledge I needed to achieve my objectives. The most crucial orientation came from my supervisor, Professor Christian Joerges, whose extensive knowledge and endless patience guided me along the years to overcome the hurdles I encountered. I was also extremely fortunate to be able to benefit from the guidance of Professors Hans Ullrich, Massimo Motta, Ernst-Ullrich Petersmann, Claus-Dieter Ehlermann and Giuliano Amato, to whom I am extremely grateful.

My frequent research travels and study visits have proved crucial in my writing. My second research home was the Institute of European Studies in Madrid, where over the years Professor Jerónimo Maíllo González-Orús provided me with the encouragement and guidance I needed to embrace this project. In addition, the solid support of the academics at the Universidad Carlos III of Madrid was most valuable. Special thanks are owed to Professor Carlos Moreiro González. Also, I want to thank the academic staff at the Fachhochschule Mainz in Germany, where during my Erasmus visit in 1999 I was persuaded to undertake my first ever project on vertical agreements—the seed of my interest in the area.

This study is based on a comparison between the EC and US antitrust regimes. Such a comparative approach was possible thanks to the possibility I had to spend two semesters as a visiting scholar in the US. In 2003, I spent one semester at the University of Wisconsin at Madison. I am particularly grateful to Professor Peter C Carstensen for his support in my visiting the University and his inspiring advice. His generosity and kind hospitality made my stay in Madison a true delight. During my visit, I also had the chance to discover Professor Neil K Komesar's theories—which have proven very influential in the structure of my work—as well as his sense of humour. Besides, the expertise of Professor Stewart Macaulay

and the hospitality of the EU Studies Alliance, in particular Professor David Trubek and Pam Hollenhorst, greatly contributed to my fruitful experience in Madison. More recently, I was a visiting scholar at the University of California at Berkeley while on research leave from the University of Glasgow. I want to express my gratitude to the Center for the Study of the Law and Society, and particularly to Rosann Greenspan and Meg Gentes.

In 2004, I had the chance to work as a trainee in the Directorate-General for Competition of the European Commission. I spent five months within the now defunct Unit F2, which dealt specifically with car distribution issues. This unique opportunity to work with the best team of experts on my research area was invaluable, particularly given the constant attention and generosity of those I worked in close contact with. I would particularly like to thank Konrad Schumm, Paolo Cesarini, Rainer Becker, Bertrand Saint-Aubin, Iona Hamilton, Hubert Gambs and Fernando Castillo de la Torre.

The final stage of this project was completed while holding a post as a Lecturer in European Law at the University of Glasgow. The demanding challenge of teaching competition law both at undergraduate and postgraduate level to enthusiastic, bright students forced me to grasp a fuller understanding of antitrust. My colleagues have been at all times supportive, particularly in the stressful final stages of my Ph D and the monograph. Their comments and advice have proven most useful in the development of my conclusions. I owe thanks to all of them.

Over the years, I have taken part in many conferences, seminars and events around the world. In my involvement I managed to collect essential materials and also hear the constructive criticisms of experts which have aided me enormously. Some of the institutions I would like to thank are the Competition Law Scholars Forum (CLaSF), the Europäische Rechtsakademie (ERA), the European Union Studies Association (EUSA), the European Community Studies Association (ECSA), the Industrial Organisation Society (IOS), the Athens Institute for Education and Research (ATINER), the Private Law in a Multicultural and Multilingual European Society (PrIME) Project within the University of Helsinki, the Transatlantic Technology Law Forum (TTLF) of Stanford University and the Instituto de Estudios Bursátiles of Madrid. I am particulary grateful to Professors Luis Ortiz Blanco, Barry Rodger, Alan Riley, Oliver Budzinski, Jens Hammer and Kathleen W Johnson.

Any academic merits hereby achieved would never have materialised without my family and friends. I owe everything to my family for always believing in me, in particular to my loving parents. Where I would be without their help is hard to imagine. My unconditional friends from Ciudad Rodrigo, London, Madrid, Mainz and Las Palmas, as well as those encountered in Florence, Madison, Brussels, Glasgow and Berkeley—to name but a few—have, throughout this project and beyond, aided me more than they will ever know. Last but by no means least, I want to thank my husband Martin Doris for his constant and unconditional support.

Glasgow, October 2009
Sandra Marco Colino

Note to the Reader: The Impact of the Treaty of Lisbon on this Book

On 1 December 2009, the Treaty of Lisbon entered into force after ratification by Ireland and the Czech Republic, the only countries to have not ratified previously. This book was finalised in September 2009, and therefore still uses the numbering of the provisions of the Treaty Establishing a European Union (EC Treaty) as modified by the Treaty of Amsterdam in 1996.

Apart from the renumbering of the Treaty articles, the new amendments do not significantly alter the content of competition law provisions, and the content of the book is not affected by the changes. Importantly, Article 3(1)(g) EC, which referred to 'a system ensuring that competition in the internal market is not distorted' as a means to achieve the general objectives of the Community has now been repealed. This does not, however, alter the substance of competition law and policy in the EU.

The EC Treaty is now the Treaty on the Functioning of the European Union. As a result, it is no longer appropriate to refer to the *European Community*, as it is now the part of *European Union*. Any references to *Community* should be read as *Union*, and likewise *EC competition law* is now *EU competition law*. Other important terminology issues are that the *Court of First Instance* has been renamed as the *General Court*, and the *common market* has been replaced by the *internal market*.

The reader should also note that, as of 2010, Neelie Kroes will be replaced by Joaquín Almunia as the EU Competition Commissioner.

A full table of equivalences has been published in the Official Journal;[1] below are the equivalences of the relevant provisions discussed in this book as they appear in the table.

Treaty on the Functioning of the European Union

Old numbering of the Treaty Establishing the European Community Union	New numbering of the Treaty on the Functioning of the European
Article 2 (repealed) [2]	
Article 3, paragraph 1 (repealed) [3]	
Article 5 (replaced)[4]	
Article 30	Article 36
Article 81	Article 101

[1] [2008] OJ C 115/361.
[2] Replaced, in substance, by Article 3 TEU.
[3] Replaced, in substance, by Articles 3 to 6 TFEU.
[4] Replaced, in substance, by Article 5 TEU

Old numbering of the Treaty Establishing the European Community Union (*cont.*):	**New numbering of the Treaty on the Functioning of the European**
Article 82	Article 102
Article 86	Article 106
Articles 81–89	Articles 101–109
Article 94 (*moved*)	Article 115
Article 234	Article 267
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Introduction

I THE SIGNIFICANCE OF VERTICAL AGREEMENTS IN THE STUDY OF ANTITRUST POLICY AND REGULATION

The intricacies of vertical agreements under competition law have inspired a wealth of literature in both Europe and the United States. The regulation of such accords constitutes one of the most animated disputes in competition law. These agreements exert mixed effects on the competitive process, which may serve to justify conflicting positions when it comes to their regulation. Their ambiguity implies that the study of vertical restraints in competition law is embedded in a fascinating complexity that unavoidably absorbs the attention of hordes of experts in the field.

Vertical agreements are commonly defined as those between undertakings operating at different levels of the production chain of one same set of goods or services. They take place when vertical integration does not occur—that is to say, the products or services are not distributed directly by the manufacturer—and the circulation of the contract goods is left to independent entities with experience in dealing with those products and who are familiar with the market where the goods are to be sold. Essential to the existence of a vertical relationship is that the firms are not acting as competitors in the context of the agreement in question, and hence that they do not operate in the same relevant market. The most common types of vertical accords are those for the supply, distribution, production, purchase and sale of goods, as well as research and development agreements. These contracts relentlessly contain vertical restraints, or potential restrictions of competition.[1] In general terms, the restrictions included in vertical agreements are of the following nature: First, the seller usually accepts not to supply goods to anybody else than the buyer within a territory. Secondly, the purchaser agrees not to buy goods from other providers. Thirdly, in some cases, the conditions under which the products can be resold can be determined in the agreement, particularly as regards price, location or consumers. Therefore, these restrictions effectively establish a division of labour between the different levels of production.[2]

[1] Vertical agreements and vertical restraints are defined, inter alia, in Art 2(1) of Commission Reg (EC) 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices [1999] OJ L336/29.

[2] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective', *Working Paper, 10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004). A very similar categorisation can be found in M Hughes, C Foss and K Ross, 'The Economic Assessment of Vertical Restraints Under UK and EC Competition Law' (2001) *European Competition Law Review* 424.

As a consequence of their ambiguous effects on competition, the legal framework for vertical agreements on both sides of the Atlantic has experienced noticeable swings over the years. The implications of these restrictions for competition law are complex, and to fully grasp the intricacies it is necessary to explore the solid theoretical foundations upon which antitrust policy has been shaped over the years—both in Europe and the United States. This book focuses on vertical agreements from a comparative perspective by analysing their regulation in these two legal systems. In America, such contracts have been considered to fall within the scope of section 1 of the Sherman Act since *Dr Miles*.[3] Originally, the Supreme Court considered these restrictions to be per se illegal. Over the decades, the initial ban was progressively lifted. Already in 1977, non-price territorial restraints were placed under the rule of reason with *Sylvania*,[4] but it took another two decades for the court to embrace changes for price restraints. In 1997, maximum resale price maintenance was declared to be subject to the rule of reason analysis in *Khan*, and more recently the perse illegality rule was removed from minimum price maintenance with *Leegin*.[5]

In Europe, as Wesseling has pointed out, 'the ambiguous effects of vertical restraints on the process of competition and on the market integration process have assured that the regulation of this type of business relation was central to the development of the notion of a restriction to competition in Community context.'[6] The Commission, very much in line with the early North American position, has been sceptical about the compliance of such agreements with Article 81(1) of the EC Treaty, which prohibits those agreements which affect competition when they bear an impact on interstate trade. In the institution's view, restrictions on the number of dealers could drastically reduce or even eliminate price competition, as exclusive dealers will be able to charge supracompetitive prices by virtue of the privileges granted to them. This logic can be better illustrated using the prisoner's dilemma:[7] if a dealer decides to charge high prices, other dealers will be tempted to profit from the situation and charge lower prices. Consumers will be attracted by this better deal, and therefore those charging lower prices will increase their profits. In such a scenario, the firm charging higher prices will be forced to lower its prices to remain in the game, leading to an enhancement of resource allocation efficiency. The theoretically beneficial effects will be even more noticeable since those other dealers selling the same product at a lower price will not have incurred in the costs the original dealer had to face, and since the newcomers do not need to recover these investments they can charge consumers even less. Furthermore, price differentials across regions should tend to disappear

[3] *Dr Miles Medical Co v John D Park & Sons* 220 US 373, 31 S Ct 376, 55 LEd 502 [1911]
[4] *Continental TV Inc v Sylvania Inc* 433 US 36 [1977]
[5] *Leegin Creative Leather Products PSKS Inc,* 127 US 2705 (2007).
[6] R Wesseling, *The Modernisation of EC Antritrust Law* (Oxford, Hart Publishing, 2000) 79.
[7] The Prisoner's Dilemma was formulated by Alfred Tucker to illustrate the Nash Equilibrium. For a detailed study, see SP Hargreaves Heap and Y Varoufakis, *Game Theory—A Critical Text*, 2nd edn (London, Routledge, 2004).

if the dealers who operate in the low-price areas are able to sell to consumers in the high-price areas. Territorial restrictions are thus regarded as a way of maintaining artificially high prices, which should be disallowed.

Such a view has been challenged over the last decades by the new 'US economics' since the boost of the Chicago School and subsequent microeconomic theories. Their approach to (vertical) territorial restrictions rests on Adam Smith's idea that an invisible hand turns each player's selfish pursuit of best interest into benefits for the whole society.[8] From this postulation, they assume that manufacturers do not have an interest in limiting consumers' access to their products, and therefore if they do so it is for a legitimate reason. In this sense, if dealers are not granted some protection from free-riders who will profit from their investments, they will hardly wish to assume the obligations and expenses of distribution. Contrary to the Commission's hostile position on vertical restraints, an exclusive dealer does not have control over price provided there are other dealers for competing goods operating within the same territory. As the prisoner's dilemma assumes, if one exclusive distributor is tempted to raise prices, then this could motivate the rest to lower theirs. Therefore, in competitive markets, where firms lack market power, vertical restraints are not detrimental, and they allow manufacturers to establish efficient distribution methods which in the long run benefit consumers.

Whereas these ideas linking the legality of vertical restraints to the existence of market power impregnated US antitrust policy already in the 1980s, resistance to accept such premises has been felt in Europe on the part of the EU institutions. Such a position, rather than sustained upon a predominance of alternative economic theories, can be seen as consequential to the peculiar '*EU-ropean*' context. Since the 1950s, some of the nations of in the Old Continent are engaged in a process of economic and (to a lesser extent) political integration which started with the creation of the European Coal and Steel Community in 1951 and received a crucial impulse in 1957, when the Treaty of Rome was signed, founding a European Economic Community—now the European Community. Over the 50 years that have passed since then, the resulting economic benefits have encouraged new countries to join the unprecedented phenomenon of integration, which has gradually expanded into multiple fields. Of particular importance has been the establishment of a single market, with the progressive elimination of barriers to the free movement of factors of production across their territories, and the adoption of a single currency—accompanied with the harmonisation of fiscal policies—among 12 of the now 27 members. In this sense, the interpretation of Articles 81 and 82 EC (originally Articles 85 and 86 EC) was systematically understood in the context of a Treaty with broader aims, and these legal provisions have clearly been used strategically to achieve these primary goals.

Currently, the EU is facing new challenges which have affected its economic performance, enhanced more than ever by the current global crisis. Its lack of

[8] A Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (London, Methuen & Co Ltd, 1776).

economic dynamism is questioning the sustainability of the European social system. Its problems are enhanced by low levels of employment and an ageing population, as well as increasing social and economic inequality as a result of the adhesion of new, less wealthy nations over the years which have increased the gap between rich and poor. In this context, the member states have regarded deeper integration as the best possible solution, following the rationale that there is a need to create economies of scale by eliminating the disparities between the 27 different national policies. This integration would affect economic, political and social aspects, but the economic dimension is prioritised in a belief that it is instrumental for any other form of integration.

In such a scenario, the Commission's hostility towards vertical restraints can be better understood. These restrictions can enhance the segmentation of the single market, since given the peculiar characteristics and market conditions of each Member State the allocation of territories to dealers usually coincides with national boundaries. Article 81(1) EC was interpreted in its broadest possible sense, and distribution agreements with restrictions such as the ones described above were overwhelmingly considered harmful. They were only permitted if they could qualify for an exemption under Article 81(3) EC. The European courts questioned such condemnation from the early days and attempted to reconcile the need to consider the actual effects of agreements using economic analysis with the enhancement of integration. Such a position led to some inconsistencies in the resulting strategy, but paved the way for policy reconsideration on the part of the Commission. Some vertical agreements were exempted on the basis of Article 81(3) EC by block exemption regulations. However, the system remained rigid and disconnected from economic considerations. The harsh criticisms to the Commission's overly hostile position towards vertical restraints paid off in the late 1990s, when a process of reform started that culminated with the adoption of Regulation 2790/1999,[9] a general block exemption for vertical agreements that would prevent them from being prohibited under Article 81 EC when certain conditions are met. Only a specific block exemption survived: that for the distribution of motor vehicles. The regime applicable to the car sector was reformed years after the adoption of Regulation 2790/99 with Regulation 1400/2002.[10] The changes in the legal regime for vertical agreements were followed by a notable transformation in the general antitrust procedural rules in 2004, when the 'Modernisation Package' entered into force. Regulation 1/2003 abolished Regulation 17/62 and the prior notification procedure it established, making it possible for national authorities and courts to apply the exemption and instauring an *ex-post* control system. New changes are on the horizon: in July 2009 the Commission published a new draft block exemption regulation for vertical agreements—together with

[9] Commission Regulation (EC) 2790/1999 on the application of Article 81(3) of the Treaty establishing the European Community to categories of vertical agreements and concerted practices OJ L336/21

[10] Commission Regulation (EC) 1400/2002 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector OJ L 203/30

accompanying guidelines—that will replace the current rules when they expire in May 2010.[11] It thus appears to be an optimal moment for a discussion on the regulation of these agreements.

In this progressive face-lift, EC competition law is beginning to take a new more US-style profile. Despite the 'self-conscious distancing between certain European and North American elites',[12] and a theoretical insistence upon divergence between Community and the main US schools of thought,[13] practice betrays ever closer uniformity of approach that is visible at all levels.[14] First of all, as regards private and decentralised implementation of antitrust, the US has a strong tradition of private and public antitrust enforcement, both in the federal and state spheres. The Antitrust Division of the Department of Justice (DOJ), the Federal Trade Commission (FTC) and the attorneys general of state all take active part in the application, even if private damage suits brought before the Supreme Court and the courts of each state have formed the core of US enforcement policy. Europe's private enforcement of competition law had been virtually inexistent until the *Courage* ruling,[15] but is now back on the table as a consequence of the procedural reforms introduced by Regulation 1/2003 and the recent White Paper on Damages. Secondly, the influence of antitrust impregnates most areas of competition law. For instance, the Leniency Notice is clearly inspired by the US Corporate Leniency Program (CLP).[16] As far as vertical restraints are concerned, the new block exemption regulations introduce an economic analysis that, despite notorious differences, has been compared to the rule of reason approach that has governed verticals in the US since the Chicago School revolution. Finally, the path towards Americanisation is visible even outside the scope of competition. In the very debate about the Convention on the Future of Europe, the US Constitution was a main point of reference. In this context, a comparative study of the two regimes is most insightful to examine the extent to which this process is affecting the regulation of vertical agreements.

[11] The new draft block exemption and guidelines can be found at http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html.

[12] N Walker, 'After the Constitutional Moment' (2003) at www.ecln.net/elements/conferences/booklisbon/walker.pdf, relying on Kagan, *Paradise and Power: America and Europe in the New World Order* (London, Atlantic Books, 2003).

[13] In particular, the Chicago and Harvard Schools. The position of the Commission has never quite accepted the tolerance of Chicago towards verticals. For a detailed exposition of this school of thought, see RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Free Press, 1993).

[14] The 'Americanisation' of the law goes beyond antitrust, as it is more a general trend impregnating the whole process of integration. In the very debate about the Convention on the Future of Europe, for instance, the US Constitution was a main point of reference. N Walker, 'After the Constitutional Moment' (2003) at www.ecln.net/elements/conferences/booklisbon/walker.pdf

[15] Case C-453/99 *Courage Ltd v Bernard Crehan* [2001] ECR I-6297.

[16] The most recent Leniency Notice is Commission Notice on immunity from fines and reduction of fines in cartel cases [2006] OJ C298/17.

II COMPETITION LAW IN A TIME OF FINANCIAL TURMOIL

Times of recession are widely considered to be inadequate periods for introducing regulatory reforms. However as this book goes to press, and coinciding with the expiration of the EC block exemption for vertical agreements, global and financial markets are going through difficult times, which commentators have already compared to the Great Depression of the 1930s. The problems are widely believed to have been originated by the deregulation trends of the 1990s in the US.[17] With the decline of the stock market in the early 2000s and a subsequent recession, the Federal Reserve decided to lower interest rates for loans to allow businesses and individuals to borrow money. The easy access to credit created a tendency to invest in homes, which following the rules of supply and demand quickly went up in price. The *New York Times* has observed that 'as the industry ramped up, the quality of the mortgages went down.'[18] Of course, when repayments were due and interest rates started to rise, buyers began to struggle and new and risky financial instruments for a quick-fix of the excess in debt emerged. Home owners began to look for fast, expensive credit and remortgages to pay their dues. The bubble finally burst when borrowers simply could not keep up with repayments, and mortgage facilities were drastically reduced. The lack of credit meant a decrease in property sales, which eventually led to the slump in prices. This subsequently resulted in a virtual collapse of the housing market, as prices fell dramatically and borrowers suddenly owed much more for their mortgages than their homes were worth. This triggered effects all over the economy, leading to the bankruptcy of some of the world's leading financial institutions,[19] a multitude of job cuts[20] and struggling businesses as a consequence of the lack of buying power of consumers. The crisis has spread to all sectors with astounding speed, and despite recent signs of recovery most economists estimate that it will not be overcome for some years.[21]

[17] The deregulation of the financial services industry under the Clinton administration and the 1999 Gramm-Leach-Bliley Act (which repealed the Glass-Steagall Act of 1933), some argue, was the seed of the problems. Clinton has defended his actions saying that 'one of the things that has helped stabilize the current situation as much as it has is the purchase of Merrill Lynch by Bank of America, which was much smoother than it would have been if I hadn't signed that bill': M Bartiroma, 'Bill Clinton on the Banking Crisis, McCain, and Hillary' (2008) *Business Week*, at www.businessweek.com/print/magazine/content/08_40/b4102000409948.htm.

[18] New York Times, 'Credit Crisis—The Essentials' (2009), at http://topics.nytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/.

[19] Most notably, in September 2008, Lehman Brothers filed for bankrupcy under US federal laws. See 'Lehman brothers collapse sends shockwave round world' *The Times* (London 16 September 2008) at http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4761892.ece.

[20] C Mortished, 'Global unemployment heads towards 50 million' *The Times* (London 29 January 2009) at http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article5607656. ece.

[21] On the financial crisis, see P Allen, 'Global recession: where did all the money go?' *The Guardian* (London 29 January 2009) at www.guardian.co.uk/business/dan-roberts-on-business-blog/interactive/2009/jan/29/financial-pyramid.

The unstable situation is undoubtedly having an impact on antitrust decisions at all levels. In order to provide an immediate way out of the crisis, legislators and enforcers have been forced to make questionable decisions that overlook the long-term effects of such decisions on the competitive process. First of all, industries in crisis are imploring governments for subsidies. The Bush II administration somewhat reluctantly approved a $700 billion bailout to prevent the collapse of financial institutions after the bankrupcy of Lehman Brothers and the tumbling of Fanny Mae and Freddie Mac.[22] In the United Kingdom, Brown's government has also tried to avoid panic by injecting £50 billion into the banking sector.[23] Among the sectors of the economy which have suffered the hardest hit in the EU and the US is the automobile industry;[24] partly, the blame of their problems resides in the unproductiveness and lack of innovation of manufacturers.[25] President Obama has promised subsidies, although subject to strict conditions forcing manufacturers to implement a regeneration plan—in a clear attempt to avoid subsidising inefficient companies and distorting the competitive process.[26] In Europe, the British government has promised subsidies of £70 million for the industry, and the French and German governments are expected to follow suit.[27] Commissioner Neelie Kroes has expressed her concern over these state aids, which may conflict with EC competition law in this regard. In her view, a subsidy race would bear disastrous consequences for the competitive process in the long run.[28] Secondly, mergers are being implemented in an attempt to rescue financial institutions which raise serious anticompetitive concerns, and which would not have been allowed in normal circumstances by antitrust rules. For instance, the American giant Merrill Lynch was taken over by the Bank of America to save it from

[22] US Senate originally vetoed the Wall Street bailout plan, and it was passed after a second voting round. C Hulse and DM Herszenhorn, 'House Rejects Bailout Package, 228–205; Stocks Plunge' *New York Times* (New York 29 September 2009) at www.nytimes.com/2008/09/30/business/30bailout.html.

[23] G Wearden and D Summers, 'Gordon Brown unveils £50bn rescue package for Britain's banks' *The Guardian* (London 8 October 2008) at www.guardian.co.uk/business/2008/oct/08/banking.economy1.

[24] In November 2008, Detroit's 'big three'—General Motors, Ford and Chrysler—which had experienced difficulties for quite some time, announced enormous economic problems. GM cofirmed that its losses rose to $2m per month. TL Friedman, 'While Detroit Slept' *International Herald Tribune* (New York, 10 December 2008) at http://www.nytimes.com/2008/12/10/opinion/10iht-edfriedman.1.18556393.html. In Europe, automobile production in 2008 fell by one third in respect of the previous year. Jaguar Land Rover described the situation of the sector in the UK as a 'national emergency': G Ruddick, 'Jaguar Land Rover Claims Car Industry Crisis is "National Emergency" for UK' *Daily Telegraph* (London 18 December 2008).

[25] 'Extinction of the Predator' *The Economist* (10 September 2005) 63.

[26] 'Obama vows aid for car industry' BBC News (7 December 2008) at http://news.bbc.co.uk/1/hi/world/americas/us_elections_2008/7770129.stm.

[27] In Germany, however, Finance Minister Peer Steinbrueck declared that the state should not have to account for the errors of the industry: 'German Finance Minister Rules Out Auto Industry Bail' *Economic Times* (Frankfurt 17 November 2008) http://economictimes.indiatimes.com/International_Business/German_finance_minister_rules_out_auto_industry_aid/articleshow/3722768.cms.

[28] N Kroes, 'Preserving the Competitiveness of European Industry—the Contribution of State Aid Policy', Speech (2008) at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/563&format=HTML&aged=0&language=EN&guiLanguage=en.

collapse.[29] Importantly, the merger of Britain's fourth and fifth biggest banks, HBOS and Lloyds TSB, was approved by the government in 2008 despite important competition concerns.[30]

The exemption of such practices from the ordinary application of competition laws is seriously undermining the policy. It is clear that exceptional circumstances call for exceptional decisions, but the long-term consequences of these choices may have a serious impact on the credibility of antitrust systems and their authority. In the field of vertical restraints, particular concerns may be raised in the European context, since the existing rules governing these restrictions are undergoing a process of reform given the imminent expiration of the applicable regulations. The current climate may leave an imprint on the new rules, perhaps leading to an excessive lack of intervention or to the protection of specific industries (as has been the case with the car sector for decades). In this sense, it is essential to develop means of reconciling the coherence of antitrust regimes and the protection of the essential goals of competition law with the current imminent difficulties. The sophistication and difficulty of such a task is manifest.[31]

III COMPETITION AND REGULATION: AN IMPOSSIBLE RELATIONSHIP? THE CHALLENGES OF REGULATING COMPETITION

' "Now, let me state the present rules,"
The lawyer went on,
"These very simple guidelines
You can rely upon:
You're gouging on your prices if
You charge more than the rest.
But it's unfair competition
If you think you can charge less.
A second point that we could make
To help avoid confusion:
Don't try to charge the same amount:
That would be collusion!
You must compete. But not too much,
For if you do, you see,
Then the market would be yours–
And that's monopoly!" '[32]

[29] 'Lehman Brothers collapse sends shockwave round world' *The Times* (London 16 September 2008) http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4761892.ece.

[30] 'Monster Mash' *The Economist* (London 25 September 2008).

[31] Some attempts have already appeared. See D Gerard, 'Managing the Financial Crisis in Europe: Why Competition Law is Part of the Solution, Not of the Problem' (2008) *Global Competition Policy Review* 1–14, http://www.globalcompetitionpolicy.org/index.php?id=1507&action=907.

[32] RW Grant, *The Incredible Bread Machine* (San Diego, World Research Inc, 1974) 174.

The regulation of competition is a relatively new phenomenon in Europe.[33] The earliest known attempt to regulate competition can be found in the Tang Code, promulgated in China in AD737.[34] The first recorded monopoly case takes us to England in 1602, in which a monopoly was considered to be illegal and void under the Magna Carta in *Darcy v Allin*.[35] However, it is not until the late nineteenth century that we can talk about the birth of competition law as we know it, in the shape of the Sherman Act in the United States.[36] This landmark regulation dates from 1890 and is the oldest competition statute still applicable today. The North American way of regulating competition has had a crucial influence on the latest European competition law reforms, hence the relevance of this comparative study.

Opening this reflection is a quote from Grant which echoes the intricacies of regulating competition. The legislator confronted with the task of establishing legal rules for antitrust cases faces great difficulties. Most business conducts, taken to the extreme, can be harmful to competition. The actual consequences of a conduct on the competitive process greatly depend on the circumstances of each case. Therefore, the complexity of competition law resides not only in the actual rules, but also in the need to adapt them to every case on the basis of objective criteria. From this reasoning, it is also evident that any adequate competition law regime should tend to be generic, as sometimes an excessive regulation leads to the situation described by Grant whereby all conducts seem to be forbidden and businesses may work under constant fear of incurring in anticompetitive behaviour. If the principle of legal certainty is taken too far in the field of competition, greater uncertainty and insecurity may come for firms when entering into agreements with other firms. Therefore, it could be that the key to an adequate competition law is the good establishment of general criteria leaving room for adaptations on a case-by-case basis.

Grant's words also draw our attention to the fact that the specific circumstances of a case will (or at least should) play a key role when it comes to determining whether or not a conduct should be labelled as anticompetitive. Therefore, the economic consequences of an agreement or conduct on the market should be carefully considered, as sometimes the result of a conduct will be pro- or anticompetitive, depending on a firm's potential to distort the relevant market where it is operating. As such, economic analysis is crucial, and no successful competition law system can overlook its importance. In this context, it has been necessary to explore the

[33] Of the 80 nations with competition laws, 56 have adopted the regulation in the late 20th century, as in 1960 there were only 24 nations that had competition law rules.

[34] Art 33 of the Tang Code prohibited price-fixing.

[35] *Darcy v Allin* [1602] 77 Eng Rep 1260, 11 Co Rep 84. See inter alia M Taylor, 'Looking to the Future—Towards the Exclusive Application of Competition Law?' (2003) Winner of the Young Lawyers' Writing Competition, International Bar Association; M Furse, *Competition Law of the UK & EC* (London, Blackstone Press, 2000) 4. Furse adds that the first known use of the word 'monopoly' dates from 1516 and St Thomas More's *Utopia*.

[36] Chronologically, it was Canada that enacted its competition statute before the US (1878). However, it is the Sherman Act that is considered to have inspired the evolution of modern competition law around the world.

economics of competition policy, franchises, territorial restrictions and price restraints, pivotal preparation to embrace an in-depth study of the rules for vertical agreements. The overall intention is to analyse not only how competition law needs to be kept closely linked to economics—a claim that academics have made for many years—but also the possible limitations of economic theory as the one and only guiding tool of antitrust policy, which is often overlooked.

The protection of integration may have, in this context, led to neglecting essential economic considerations in the assessment of agreements under EC competition law. The frictions between economic efficiency and integration may have caused inconsistencies in the development of the policy in the Old Continent. Moreover, the relevant Commission regulations and decisions which develop Articles 81 and 82 EC have challenged the traditional competition–regulation dichotomy. Motta explains that:

> [i]n general, competition policy applies to sectors where structural conditions are compatible with a normal functioning of competition . . . Instead, regulation applies to certain sectors, whose structure is such that one would not expect competitive forces to operate without problems . . . There are several differences between competition policy and regulation. While competition authorities generally limit themselves to checking the lawfulness of firms' activities, industry regulators have more extensive powers (they might impose or control firms' prices, investments, and product choices). While competition authorities usually intervene *ex post* (for instance, checking the legality of a certain business practice after it has already been taken), regulators act *ex ante* (for instance, authorising a certain business practice or not). Regulators' involvement with an industry is long-run and continuous, whereas competition authorities' interventions tend to be occasional.[37]

In Europe, block exemptions for vertical agreements have traditionally contained some of the characteristics of regulation highlighted by Motta: on occasion, they de facto allow the Commission to intervene in manufacturers' pricing policies (for instance, by condemning resale price maintenance and forbidding some types of territorial protection). At the same time, some of the clauses of the car sector block exemption imply a certain level of ex ante control of agreements, as there are specific requirements as to what clauses must or must not be included in distribution contracts in order to qualify for exemption. Also, since as long ago as the 1980s the Commission has interfered in both vertical accords in general and car distribution agreements in particular by means of specific exemption requirements, and therefore its involvement has been more continuous than occasional. Apart from these conditions, in the light of Motta's explanations it is questionable that vertical agreements would need specific regulation, unless they take place in markets lacking in optimal competition conditions. In this sense, the question is raised as to whether block exemption regulations, when excessively detailed and interventionist, could this imply an extra-limitation of the powers granted to the Commission in the founding Treaties.

[37] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) xviii–xix.

IV STYLE, STRUCTURE AND METHODOLOGY

The treatment of vertical agreements under competition law has been the subject of lengthy discussions and publications. The last decades have seen major changes in the area, and although there is abundant literature on the topic, rarely do monographs adopt a comparative approach like the one proposed in this book. The leading publications typically adopt a generalised textbook-style approach or are highly dense, practitioner-orientated works which tend to be prohibitively expensive for the average student. In addition, a number of monographs have indirectly discussed vertical restraints and the objectives of EC competition policy, overlooking the US dimension. By way of comparison, this book proposes a novel perspective in three different ways: First and most importantly, it adopts a comparative perspective of the subject, analysing vertical agreements under both EC and US regimes. Secondly, it focuses on how these two competition law regimes have progressively employed more sophisticated economic analysis when assessing vertical agreements. Lastly and critically, this book will aim to be the most up-to-date commentary on the recent reforms both in the EC and the US.

This comparative study has as its primary purpose to determine how competition law might and should evolve in the future in this area. As regards the European system, a question mark is placed not only on the relevance of the changes introduced in Regulation 2790/99, but also in the very adequacy of block exemption regulations for the well-functioning of the policy. Generally, regulation addresses possible market failures which cannot be overcome by the market process. In addition, the maintenance of the particular regime for the car sector is of dubious pertinence, particularly in the context of the new, more tolerant approach to vertical restrictions. In such context, it could perhaps have been more advisable to review the interpretation of Article 81(1) EC and consider the majority of distribution restraints to fall outside the scope of the prohibition. If that is the case, then no exemption may be needed in the first place. The possibilities of this approach are explored, particularly in the light of how this perspective may lead towards a more adequate economic analysis.

Placing the economic analysis under Article 81(1) EC as opposed to Article 81(3) EC would lead to a decreased ex ante control of agreements in favour of ex post vigilance of possible competition law breaches. Consequentially, the case-by-case analysis could be enhanced, and the development of competition policy would rest primarily in the hands of the courts rather than the Commission. The possible shortcomings of a casuistic approach have been highlighted by many and cannot be overlooked; the question resides in whether or not the possible problems could be overcome with the disappearance of specific rules in favour of general, easier to apply principles and a tolerant stance towards vertical restraints. To this end, North American economic and legal theory and practice is evaluated to estimate what lessons can be learned from the US experience, both its merits and its possible mistakes.

This book also pays attention to a sector that has rather bizarrely had a peculiar regime since the 1980s, the motor vehicle industry. The adequacy of abolishing or maintaining specific exemption rules for the car sector is analysed from the perspective of the dealer protection it grants. Article 81(3) EC, which provides an exception to the rule of Article 81(1) EC, appears to be used in practice to intervene in the manufacturer/dealer relationship and to regulate their agreements. Whether or not this is justifiable needs to be determined, and from this perspective the goals competition policy should pursue need clarification. Furthermore, the merits of any legislation depend greatly upon the way it is enforced in practice, and the practical implications of the new rules require detailed attention. In such a context, the impact of the procedural changes of Regulation 1/2003 is crucial.

In the US, the question lies in whether the recent extension of the rule of reason to price vertical restraints (both maximum and minimum resale price maintenance) should be welcome, or whether it has taken the tolerance towards these restrictions too far. The move has clearly increased the possibilities of economic analysis. However, this has happened at the expense of simplicity in the assessment, as courts and authorities are now obliged to carry out a detailed evaluation of agreements before coming to a conclusion as to their validity. If the new methodology based on the reasonableness of the restraints is to succeed, a structured economic analysis for the determination of the validity of vertical restraints must be developed in the near future. How to do this will be at the core of antitrust discussions over the next years. In addition, commentators have argued over the extent of the impact of political changes in antitrust, as it appears that there is a correlation between antitrust enforcement and the sign of the party in power at the time. In this sense, it remains to be seen how the Obama administration will embrace the extended rule of reason. While it is unlikely that it will be revoked, a narrow interpretation of the validity of price restraints is expected.

Underlying these issues is the need to determine the role of the different institutions in the shaping of competition policy. As Komesar has emphasised, 'good law and economics must be good comparative institutional analysis.'[38] This view raises the issue that, if market transactions are difficult and unlikely as a result of the existence of market failures, 'a different legal regime or result based on judicial balancing of costs and benefits occurs.'[39] In our specific analysis, a series of decision-making alternatives presents itself in order to address the problems pointed out: in Europe these are the market, national governments (contract law) and courts, the EU political branches (particularly the Commission) and the European courts. In the US, in addition to the market, the multiple levels of government involved in the enforcement of antitrust rules need to be considered, as well as state and federal courts. None of these alternatives is perfect or even sufficient alone to solve all troubles. However, an examination of the forces that work in

[38] N Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994) 10.

[39] ibid.

each of these decision-making institutions will provide us with an insight on which of them are better suited and therefore should play a greater role in the development of competition policy.

By its nature, this work sets out to explore a field that bears multiple inherent complexities. Therefore, the intention of the author is to state the main findings of her investigations with clarity and simplicity. In architectural terms, van der Rohe's 'less is more' approach to architecture takes priority in the style of the book, in an attempt create a 'glass-box' structure to prevent our principal suggestions from remaining hidden among complex grammatical constructions and intricate wording.[40] To achieve this straightforwardness, our comparative analysis has a dual perspective. On the one hand, the interplay between the different institutions is examined by resorting to deep institutional analysis. On the other, a comparative analysis of different legal systems—that of the EU and the US—allows to better assess the merits of the legal provisions under scrutiny and to establish solid predictions/suggestions for future policy developments. The theoretical framework remains an essential support for our deductions. With this purpose, the convergence of different strands of theories serves as essential sustentation of the building. Principally, economic theories in the context of the Harvard–Chicago School debate and post-Chicago microeconomic theories of the firm are employed to assess efficiency arguments and the impact on vertical restraints on competition. Also, theories evaluating efficiency implications of regulation on competition are considered. In addition, economic and legal arguments for the existence of alternative methods of distribution have been analysed, with particular attention to Macneil's relational theory that requires an analysis of contextual implications of the wording of agreements that go beyond the literal interpretation of contracts.

The 'less is more' premise hence applies to the entire structure of this monograph. Nurturing the skeleton provided by the relevant theories and moulding it into its final shape has proven to be an arduous and lengthy process, very much like the erection of a building. The final outcome can be compared to a skyscraper whose foundations are the underlying economic, legal and political theories that play an important role in competition law. The first chapter lays down the basics of the debate about the benefits and drawbacks of vertical agreements, and explores how their regulation is dependant upon the objectives pursued by the specific competition law regime under scrutiny. It assesses the the 'double nature' of vertical agreements and the regulatory dilemma from a legal perspective. This study leads in turn into a journey into the general theories of vertical restraints on both sides of the Atlantic, and the principles of their regulation in the EC and the US. The essence of these competition law regimes is explored in chapter 2, a journey through the most influential theories underpinning current regulatory frameworks and how these theories shape the goals pursued by antitrust law and policy. The

[40] Ludwig Mies van der Rohe is considered to be one of the fathers of modern architecture. For a study of his work and philosophy, see F Schulze, *Mies van der Rohe, a Critical Bibliography* (Chicago and London, Univeristy of Chicago Press, 1985).

third chapter questions the adequacy of current economic analysis in both the recent EU and US legislation and leading court decisions, and takes into consideration the implications of enforcement trends on the vertical restraints regime. The fourth chapter analyses how this maturing economic analysis can be reconciled with what other commentators and regulators have identified as a key role for competition policy, redressing assumed imbalances between dealers and manufacturers. The author therein queries the prevailing logic of protecting sectoral interests above the competitive process.

1

The Enduring Debate on the Nature of Vertical Agreements

I THE INTRICACIES OF THE REGULATION OF VERTICAL AGREEMENTS IN COMPETITION LAW

A Introductory Remarks

Co-operation between firms is frequent in the business world. While some forms of co-operation are traditionally believed to pose little or no threat to competition, others can have detrimental effects on the competitive process. Vertical agreements are at present widely considered to fall within the former category, but this has not always been the case. US antitrust broadly regarded the restrictions imposed in the context of vertical relationships as illegal per se until the late 1970s, while the European Commission still retains some of its famous mistrust towards these restraints as a consequence of the potentially harmful consequences for the competitive process, coupled with the market-partitioning effects of territorial restrictions. Despite the progressive tolerance for vertical restrictions, it is clear that they pose certain concerns for competition that the legislator should not overlook.

Firms often restrict competition in ways that are not necessarily injurious.[1] For instance, in their everyday activities, businesses enter into agreements for the distribution of products which impose constraints on the parties involved. A manufacturer organising its distribution chain is confronted with two basic options. The first would be to have people in its firm working on the distribution of its goods, also known as vertical integration.[2] Unless the firm is a monopolist or has a dominant position, it has been generally recognised that any restrictions imposed in the distributions of products distributed by vertically integrated firms escape the scope of competition law, since, for an agreement to exist, it needs to involve two or more firms.[3] Given that 'a parent corporation and its wholly-owned subsidiary

[1] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) xvii.

[2] See F Kessler, and RH Stern, 'Competition, Contract, and Vertical Integration' (1959) 69 *Yale Law Journal* 1, 1–130. They refer to 'cost reduction' as one of the principal advantages of vertical integration.

[3] See *Copperweld Corp v Independent Tube Corp* 467 US 752, 104 Sup Ct 2731, 81 L Ed 2d 628 (1984). In this sense, Sullivan believes that the extent of *integration* is the key when it comes to determining whether a distribution agreement is or not per se unlawful. If there is vertical integration, the restraints are not per se illegal. 'Restraints arising out of the integration are not naked restraints but concomitants of a new investment': LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976) 404.

constitute but a single economic actor,'[4] there will be no agreement and no capacity to conspire. The choice a manufacturer has to directly organise the distribution of its goods, however, can be costly and complex. Therefore, the second option—leaving it to entities with experience in retailing—is usually preferred. The manufacturer thus looks for either an agent who negotiates sales on its behalf[5]— without actually purchasing the goods—or an independent distributor with experience in the consumers and the conditions of the market it wants to penetrate. She then enters into a distribution agreement with this expert. For each market in which it wants its product to be distributed, it can enter into similar agreements to ensure the goods efficiently reach different points of sale in that region.

The swings in competition policy with regard to these accords are related to what is commonly referred to as the 'double nature' of vertical agreements. This term refers to the mixed effects of these restrictions on the competitive process—although they bear the harmless appearance of Dr Jeckyll, there could be a vicious Mr Hyde which needs to be closely monitored. The ambiguous consequences of vertical restraints have served to justify opposed views on how they should be regulated, and are precisely the root of the debate that is the focus of this book. How these agreements are regulated is clearly dependant upon the prevailing view of what competition law is and what it should achieve, making it necessary to take a close look at the objectives of competition policy in the following chapter.

This part of the book aims to provide a thorough understanding of the effects of vertical agreements by assessing the potential of the different kinds of restrictions they usually contain. The topic is a genuine classic in the antitrust literature, and lengthy discussions exist on the nature of these restrictions. Our aim is to explore the most important findings and discuss the validity of the arguments put forward by the many voices that have studied these restraints. Such an analysis is essential for our purposes as it should provide an optimal framework for the comprehension of the priorities of the legislator in the EC and the US.

B The Many Forms of Vertical Agreements

Agreements between non-competitors are varied and intricate. In the introduction of this study, vertical agreements were defined as those between firms operating at different levels of the production of the same goods or services.[6] The use of this terminology has been criticised on occasion, as it somehow 'lumps together a heterogeneous set of business relationships' with diverse effects on the competitive

[4] AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 214.

[5] Agency agreements are generally treated under different, usually more relaxed, rules. For instance, such accords are excluded from the scope of Regs 2790/99 and 1400/2002. In the US, even before the *Sylvania* ruling, when vertical agreements were still treated under the per se rule, the *Schwinn* case established that restrictions established by a bike manufacturer on those acting as his agents were reasonable. See *US v Arnold, Schwinn & Co* 220 US 373 (1967).

[6] See s I of the Introduction above.

process.[7] Our study focuses almost exclusively on supply and distribution,[8] as the nature of the problems under scrutiny is quintessential to these types of agreements.

Distribution schemes have been rightly described as 'one of the most challenging and difficult components of international marketing programs'.[9] Depending on the restrictions introduced in the agreements, they are classified in a series of categories, which nonetheless should not be regarded as 'black-box' concepts: each vertical accord is unique and will include various restrictions that will inevitably present characteristics of more than one class. For instance, it is possible that a system where territories are allotted exclusively to distributors also employs selective criteria to select the dealers. In the US, restrictions are broadly divided into two virtually self-explanatory categories: price restraints and non-price restraints.[10] Price restraints are restrictions imposed on the buyer as to the price at which she may resell the products or services. The buyer is sometimes forced to observe a minimum price threshold, below which she cannot sell. This constitutes minimum resale price maintenance, while maximum price maintenance occurs when the buyer cannot go above a set price when reselling the contract goods.

Non-price vertical restraints make up a blanket category for all other restraints that do not refer to price, mainly territorial and customer restrictions. More specifically, there are some types of agreements which are frequent in channelling strategies, and before plunging into the advantages and disadvantages of the restrictions contained in them it appears appropriate to define the most recurring kinds.

i Exclusive distribution and supply

Exclusive and selective distribution systems are two methods of circulating goods[11] which have raised specific concerns, particularly in Europe.[12] Exclusive distribution agreements include restrictions to ensure that the manufacturer only

[7] Such as franchise fees, royalties, resale price maintenance or territorial restrictions. PC Carstensen, 'The Competitive Dynamics of Distribution Restraints: the Efficiency Hypothesis versus the Rent-Seeking, Strategic Alternatives' (2001) 69 *Antitrust Law Journal* 571, quoting inter alia R Posner, 'The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality' (1980) 48 *University of Chicago Law Review* 6, 589.

[8] Supply and distribution agreements are generally equated to 'vertical agreements'. See, for instance, D Hildebrand, *Economic Analyses of Vertical Agreements: a Self Assessment* (The Hague, Kluwer, 2005) 1. Some authors however give the term a broader interpretation, and also include other agreements between non-competitors, such as research and development agreements.

[9] ibid 3.

[10] For a detailed economic analysis, see Y Spiegel and Y Yehezkel, 'Price and Non-Price Restraints when Retailers are Vertically Differentiated' (2000), downloadable from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236024.

[11] The goods distributed through selective and exclusive distribution channels tend to be technologically complex goods that require expertise on the part of the dealer (such as cars and electronics) or luxury products where brand image is crucial (like cosmetics).

[12] The European authorities have shown a dislike towards selective and exclusive distribution systems given their market-partitioning effects. For a clear explanation on the distinction between selective and exclusive distribution, see M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 304.

sells its product to a limited number of traders, who are usually granted exclusivity of the sale of the goods or products in question within a defined territory or to a specific group of customers.[13] This is granted as a reward for the investments exclusive distributors are required to make, as the terms of the contract typically require them to spend in advertising, brand image and penetrating a new market. Exclusive distribution should not be confused with exclusive supply; this kind of agreement is the most restrictive distribution system, generally used in scenarios where a supplier aims to create a new version of a good, following instructions from a specific buyer—who will invest in this new creation—but using her know-how and experience in the production of similar goods. The buyer will want to recover the investments she has made, and therefore she will be the only one allowed to purchase the new product for a specified time. At the same time, the buyer agrees to buy the product only from the supplier for the duration of the contract.

ii Selective distribution

Selective distribution systems require dealers to meet certain criteria before entering into the network. These criteria are (or at least should be) requirements on the basis of the nature of the product in question, which call for special training and expertise. This means that not only will these selected dealers be the sole distributors of the product; also, rather logically the dealers within the network may only sell to final consumers, and are precluded from selling to unauthorised resellers. This practice would clearly jeopardise the functioning of the entire distribution system, as there is no guarantee that these dealers outside the system would meet the requirements laid down by the manufacturer. Selective distribution is frequently used for the distribution of luxury goods.

iii Franchising

Another very important type of agreement is franchising. These accords are extremely common in our society for the sale of goods such as fast food, clothes or cars.[14] Sullivan defines these contracts as '[a] license granting the right to trade under the mark and name, provided that the licensor's standards for the business are maintained.'[15] The distinctive feature of these agreements is that customers

[13] The latter is also known as exclusive customer allocation.

[14] Regarding the car sector, the distribution of brand new motor vehicles in Europe and America is traditionally arranged through franchising agreements between manufacturers and their dealers. In fact, it is widely believed that it was precisely in the context of the distribution of motor vehicles that franchises emerged as a way of distributing commercial goods in the US: EC Díez de Catro, A Navarro García, and FJ Rondán Cataluña, *El Sistema de Franquicia: Fundamentos Teóricos y Prácticos* (Madrid, Pirámide, 2005). Some authors however trust the hypothesis that this distribution system originated in the fast-food business: D Hildebrand, *Economic Analyses of Vertical Agreements: a Self Assessment* (The Hague, Kluwer, 2005) 77.

[15] LA Sullivan, *Antitrust* (Minnesota, West Publishing Co, 1976) 400.

perceive an identification between franchisor and franchisee.[16] They create a network of selected retailers in each community who are in charge of ensuring that these products efficiently reach the end consumer.

iv Single branding

Single branding agreements are also recurrent. These contracts impose an obligation on the buyer to purchase all or a specific quantity of the good or service from one particular supplier, and are common between pub owners and their drinks suppliers. Often, tying agreements may lead to single branding. Tying occurs when a buyer, in order to purchase a product she desires, is forced to purchase a distinct good.[17] A good example of this would be a printer and the cartridges that it would require in order to work. In principle, there could be other ink cartridge suppliers who could provide the buyer of the printers with the cartridges; however, if the buyer is forced to buy all or part of her cartridge stock from the printer supplier, then this will limit her chances of looking for other deals on cartridges.

II THE REGULATORY DILEMMA: GENERAL ASSUMPTIONS ON THE 'DOUBLE NATURE' OF VERTICAL RESTRAINTS

A The Necessity of Vertical Restraints for the Establishment of Adequate Distribution Channels

The extent to which vertical agreements are potentially harmful, and hence about the correct approach for competition policy, has been the object of lengthy discussions. The reason for this controversy is that, depending on the circumstances, they can be favourable or harmful for the competitive process.[18] It is obvious that, in principle, such agreements are not only beneficial but even necessary to ensure proper channels to deliver goods from manufacturers to final consumers.[19] A distributor is bound to require guarantees that she will be compensated for any efforts and investments in order to promote a certain product, especially when a producer is trying to enter a new market and the distributor has to build up that

[16] ibid. The degree of identification may vary. Sullivan distinguishes three types of franchise agreements: The ones where the relationship is merely that of a buyer–seller, those where the retailer is a non-exclusive authorised retailer that operates under the manufacturer's guidance but they do not look to be one entity in the eyes of the consumer, and finally where most would assume that the manufacturer operates the outlet (the most frequent type).

[17] Two products are distinct if, 'in the absence of tying, from the buyers' perspective, the products are purchased by then on two different markets.' D Hildebrand, *Economic Analyses of Vertical Agreements: a Self Assessment* (The Hague, Kluwer, 2005) 80.

[18] See eg A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (London, Oxford University Press, 2006) 604 *ff*.

[19] J Faull and A Nipkay, *The EC Law of Competition* (London, Oxford University Press, 1999) 560, para 7.373. This is the case when there is an agreement between competitors producing identical or substitute goods or services. The situation could encourage competitors to behave anticompetitively.

market. In this context, vertical restraints act as an essential incentive for a dealer facing incurring sunk costs in penetrating a new market or continuing to serve an old one.[20] In the United States, the Chicago School has explicitly manifested in different occasions that the reason for the existence of these types of restraints is mainly, if not only, efficiency-seeking.[21] In this sense, such constraints on the parties' freedom would perhaps limit competition between sellers of the same product (intrabrand competition),[22] but would increase what is by many considered 'real' competition among competing goods by different manufacturers (interbrand competition).[23] Such contracts bear crucial importance, as they generally increase the choices available to consumers by enabling producers to penetrate new markets, and help setting up adequate distribution channels to improve pre- and after-sales support.[24]

Importantly, the main argument in defence of these restrictions can be found in the free-rider doctrine, which gains its maximum vigour in those cases when the contract goods are penetrating a new market. Given that the dealers are precisely chosen on the basis of their expertise in a particular market, the distribution contracts usually require them to invest in advertising, brand image and all necessary marketing operations to make the product known in that market. The price charged to the dealers' potential customers will have to allow them to recover those expenses. If, however, the manufacturer sells its goods to other dealers who are also able to sell within those territories, then these additional dealers will not incur any similar costs as advertising has already been taken care of by the original dealers. The newcomers would be free-riding on the investments of those distributors who had to do the necessary operations to penetrate those markets. In the EC and the US, the free-rider argument is often valid even in situations when the product is not new to the market, given the existence of price differentials. It is common to find that the price of similar goods varies from state to state, and in the EC this is even more frequent given the existence of national borders.

[20] V Korah, 'The Future of Vertical Agreements under EC Competition Law' (1998) 19 *European Competition Law Review* 8, 506–513. Guidelines on Vertical Restraints, para 116. Hence, the Commission accepts vertical restraints may be necessary to develop new markets and realise efficiencies.

[21] PC Carstensen, 'The Competitive Dynamics of Distribution Restraints: the Efficiency Hypothesis versus the Rent-Seeking, Strategic Alternatives' (2001) 69 *Antitrust Law Journal* 571. Bork, for instance, explains that the intention of manufacturer when imposing vertical restraints is to achieve distributive efficiency: RH Bork, *The Antitrust Paradox* (New York, Free Press, 1978) 289–90. A general overview of the Chicago School's principles is given in ch 2, s I below.

[22] Sullivan, however, believes that the advantages of intrabrand competition cannot be overlooked. In particular, he refers to how it helps to keep prices low and to stimulate efforts to reduce costs while increasing quality, service and shopping convenience: LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976) 214.

[23] EM Fox, 'Parallel Imports, the Intrabrand/Interbrand Competition Paradigm, and the Hidden Gap Between Intellectual Property Law and Antitrust' (2001–02) 25 *Fordham International Law Journal* 982–86.

[24] E Buttigieg, 'Vertical Agreements and Concerted Practices in the Motor Vehicle Sector under EC Competition Law—Implications for European Consumers' (2003) 14 *European Business Law Review* 6, 743–64.

Prices often differ even within countries across regions.[25] Motta has, on occasion highlighted the conditions for price differentiation to exist:[26] First, a firm must be able to differentiate between consumers so that it can charge different prices. Secondly, the absence of *arbitrage* is essential—that is, that consumers are unable to re-sell the goods among each other.[27] Territorial price discrimination, 'a company's ability to charge different prices for the same product in different countries',[28] clearly meets these conditions: The existence of national barriers makes it possible to distinguish between consumers in different countries (first condition), and, as will be discussed later, agreements between manufacturers and their distributors usually contain exclusivity clauses by which only those appointed dealers will be able to distribute the products in question within their allotted territory (second condition).[29] The author has thoroughly studied price differentials elsewhere,[30] and has concluded that these differentials are not necessarily harmful. In fact, sometimes they seem inevitable, as local costs like differences in wages and rent across the member states, as well as shipping expenses, unavoidably bear an imprint on the final price. However, the European authorities have fought long and hard to combat price differences across the EU, given their market-partitioning effects. This will be analysed in further detail in the next chapter.[31]

B Possible threats to the competitive process

Although vertical restraints can be used to promote competition and market integration, some argue that, in practice, they are also capable of restricting these

[25] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 491.

[26] ibid 492–493, relying on the classification made by AC Pigou, *The Economics of Welfare* (London, MacMillan, 1920).

[27] Varian believes that a third requirement would be the existence of market power: HR Varian, 'Price Discrimination' in R Schmalensee and RD Willig (eds), *Handbook of Industrial Organisation* (Amsterdam, Elsevier Science, 1989) 597–654. Motta agrees that firms with limited market power will have a limited impact on prices through discriminatory prices, but sees most firms in the real world as having some market power: M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 492, fn 107.

[28] E Bachis and C Piga, 'Do Prices Grow More in Euroland? Evidence from the Airline Industry' (2006), at www.unibs.it/on-line/dse/Home/Inevidenza/Convegnieseminari/documento5603.html. According to Motta, this would be third-degree discrimination, as opposed to first-degree discrimination—where a monopolist charges consumers the maximum price they are willing to pay—and second-degree discrimination—where consumers choose their deal from the different ones offered by a firm. See M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 492.

[29] Even if this is the case, the Commission is fighting to ensure that parallel imports are not precluded from making price differentiation more difficult.

[30] S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and its Implications for EC Competition Policy' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

[31] See ch 2 below.

processes.[32] Carstensen, for instance, insists that all firms have at least one main goal—that of maximising profits.[33] Therefore, if a firm is able to use such restraints to increase its gains, it will do so even if competition is harmed in the course. For instance, it may be able to exclude new entrants at the production level,[34] limiting interbrand competition and preventing an intensification of competition that would lead to downward pressure on prices. In a similar way, Comanor questions that vertical restrictions always achieve economic efficiency, since this concept is dependant upon the preferences of all consumers.[35] That is to say, some consumers may opt for a less specialised treatment when purchasing a product, and rather prefer to pay a lower price. They may already be familiar with the product (Comanor refers to them as 'knowledgeable' consumers), or simply willing to find out about the possible advantages by themselves without having to pay for the specialised knowledge of dealers. These consumers are therefore very sensitive to price increases, as opposed to 'ignorant' consumers who are prepared to pay more for the additional services. If the knowledgeable consumers outweigh the ignorant ones, then efficiency is clearly squandered.

Williamson, on his part, emphasises that despite the efficiency-enhancing effects of vertical restraints, problems may arise in some situations.[36] In particular, he refers to the case where an exclusive dealing agreement contains restrictions placed by dominant firms that impede access to the market by new rivals.[37] Kerber and Vezzoso highlight a problem related to the heterogeneity of knowledge, particularly relevant in the multicultural context of the EU. They depart from Hayek's remarks that the specific circumstances of time and space contribute to the dispersion of knowledge, thus making it difficult to centralise. Consumer preferences will greatly vary from one country to the next. This argument questions the adequacy of having uniform prices and selling conditions across countries, and therefore could be used to criticise the Commission's insistence upon price convergence in the EU. However, it could also raise doubts about the adequacy of limiting the retailers' freedom to sell the products flexibly and use their local

[32] See, inter alia, R Wesseling, *The Modernisation of EC Competition Law* (Oxford, Hart Publishing, 2000) 78 *ff*; LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976) 214 *ff*. This author is against restricting resale territories or customers because of the consequential elimination of intrabrand competition.

[33] PC Carstensen, 'The Competitive Dynamics of Distribution Restraints: the Efficiency Hypothesis versus the Rent-Seeking, Strategic Alternatives' (2001) 69 *Antitrust Law Journal* 571.

[34] If most retailers are already tied to other manufacturers, it can be very difficult for an entrant to find partners that are free to sell his product. See Kerber and Vezzoso (2004).

[35] WS Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy' (1985) 98 *Harvard Law Review* 983, 992. In a similar way, Motta notes that consumer welfare concerns are based on the fact that, since manufacturers may be in a better position to 'lobby' and fight for their interests before the government and may influence the adoption of legislation, if consumer welfare is prioritised in antitrust policy then the balance of interests may be better restored: M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 20.

[36] OE Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (Glencoe, Free Press, 1983). The author explains the advantages of vertical integration in this work.

[37] This argument, however, is linked to the existence of market power. Without it, it is dubious that vertical restraints can be harmful according to Williamson.

knowledge, which according to Kerber and Vezzoso could imply inefficiencies in the sale of these products.[38]

Besides these issues, for those who defend the protection of non-economic objectives through antitrust, important problems can arise for the integration of markets, as the restrictions described above naturally have market partitioning effects. In the context of the creation of the single market in Europe, the peculiar concerns regarding vertical agreements can be understood,[39] and as a result vertical restraints are consistently more strictly treated under EC competition law than in most other jurisdictions.[40] In the European motor vehicle industry, where selective and exclusive distribution (SED) systems are frequent, the concern is that such restrictions prevent the existence of parallel trade, thus allowing manufacturers to price discriminate by segmenting the market. The Commission's report on the evaluation of Regulation 1475/95 showed that the selectivity features of a motor vehicle distribution agreement based on quantitative as well as qualitative criteria effectively allow manufacturers in the industry to dictate to their retailers both the type and location of their customers. Besides, the exclusivity features of the agreement enable the manufacturer to split up the market and assign defined territories on an exclusive basis to its distributors.[41]

The different categories of vertical restraints examined in the previous section present diverse issues for competition; Hildebrand sums these up with notorious clarity.[42] For instance, price restraints will obviously reduce price competition.[43] Even maximum price maintenance, traditionally considered less harmful than minimum price maintenance, can have this effect: distributors are likely to set prices as high as possible within the threshold established by the manufacturer, and this would greatly diminish the benefits of the competitive process. Moreover, the establishment of a maximum price will inevitably increase price transparency, making it easier for competitors to collude, as they will be able to monitor each

[38] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective', *10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004). In our view, such a problem would be corrected provided that interbrand competition is strong, as no manufacturer would have an incentive to prevent the usage of local knowledge of retailers; this knowledge should precisely be the motivation behind their appointment as dealers.

[39] Other problems relating to vertical agreements have been highlighted. In particular, restrictions on intrabrand competition may have horizontal effects, and interbrand competition could be diminished by restricting intrabrand competition. For more details see AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002).

[40] See BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89.This is particularly the case when interstate trade may be affected.

[41] The European courts have, however, highlighted some of the beneficial effects of SED systems on competition. See, for instance Case C-230/96, *Cabour SA et Nord Distribution Automobile SA v ArnorSOCO SARL* [1998] ECR I-2055.

[42] D Hildebrand, *Economic Analyses of Vertical Agreements: a Self Assessment* (The Hague, Kluwer, 2005) 69–81.

[43] R Pitofsky, 'In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price-Fixing' (1983) 71 *Geo Law Journal* 1487; WS Grimes, 'The Seven Myths of Vertical Price-Fixing: The Politics and Economics of a Century-Long Debate' (1992) 21 *Southwestern University Law Review* 1285.

other's behaviour to ensure nobody is cheating by going under the agreed price. Barriers to entry by manufacturers may also be set up using price restraints.[44]

As regards non-price restraints, exclusive and selective distribution may also lead to the foreclosure of the market. Dealers who are not assigned an exclusive territory or group of customers, or do not meet the criteria laid down by the manufacturer, will not be able to obtain those goods. In addition, given that there will only be a limited number of distributors who sell the products, not only will intrabrand competition be limited, but also collusion could be facilitated, either between suppliers or buyers.[45] Franchises would also bear these problems, as they tend to contain restrictions that are typical of selective and exclusive distribution systems. As for single branding, market foreclosure is also likely to occur, as buyers are tied to specific suppliers, making it difficult for competing suppliers to contend. Furthermore, if single branding is a common practice for all suppliers in one industry, then once again this could make collusion plausible. These agreements could also bear an imprint on interbrand competition, as shops tied to one supplier will not deal with competing goods.

III THE ADEQUACY OF COMPETITION LAW IN ADDRESSING THE REGULATORY DILEMMA

The conflicting effects of vertical restraints require policy makers to define what is to be considered a harmful—and thus prohibited—restriction of competition. Any agreement, by its very nature, restricts: the parties voluntarily give up part of their freedom in exchange for being granted their desired goals. However, an adequate competition policy should aim to guarantee that competition in a certain market is not restricted in a way that is detrimental to society. Evidently, the specifications of a given competition policy will therefore be determined by what the legislator believes to be detrimental to the social order. More importantly, the harsh treatment of these restraints is a reflection of what policy makers believe competition policy should aim at protecting. Their views are the result of the influence of economic thinking and social, historical and political circumstances that need to be clarified in order to better understand specific antitrust provisions, on the one hand, and deciding how competition laws should evolve to better achieve its crucial goals, on the other. Some of these goals can be contradictory, and therefore they must be carefully analysed in order to determine those that should prevail in each specific context. In this sense, the analysis of vertical restraints provides

[44] TA Lambert, '*Dr Miles* is Dead. Now What? Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri 3.

[45] One of the crucial characteristics of markets prone to collusion is relative market concentration; the less distributors of that product, the easier it will be for them to collude. See A Jones and B Sufrin, *EC Competition Law: Text, Cases and Materials*, 3rd edn (Oxford, Oxford University Press, 2008) 858–939.

a unique opportunity to explore the very foundations of competition law and its purposes.

A The absence of a panacea

Competition has, throughout the history of western Europe, played a key role in providing wealth and economic progress by altering the global distribution of wealth. The desire to protect the benefits derived from the competitive process has served to propel the very existence of competition law. Over the course of European history, the law has generally been employed as a tool to exert a certain control over the enormous potential of this process. By regulating some conducts and prohibiting others, the authorities were able to pursue objectives and somehow impose their economic policies. This reasoning is implicit in any form of regulatory intervention: as the legislator aims to protect something, those laws also imply setting up limits and constraints, and therefore legislating necessarily implies exerting a certain control. However, in the late twentieth century, a shift of intention seems to have taken place, as the idea of establishing law to protect the process of competition from restraints and distortion started to emerge. This is very much the spirit of the present European rules on competition, and can be understood in a process of integration which is centred on the establishment of a single market where goods circulate free of any restrictions on imports or exports.

It seems logical to think that it is necessary to maintain a certain degree of regulatory activity in order to achieve the desired protection of competition and correct its possible problems. Practice has proven that often if market forces are completely released from legal rules the result could be economic concentration which ends up eliminating competition entirely, as a result of market failures. Petersmann calls this phenomenon the 'paradox of liberty'. In order to enjoy freedom of market, we must first self-limit this liberty and impose rules that grant the exercise of the freedom. He compares the situation to the myth of Ulysses, who voluntarily asked his men to blindfold him and tie him to the mast of his ship in order to escape from the enchanting but deadly singing of the sirens. According to the author, the self-limitation of our freedom is essential to protect ourselves against future risks.[46] In this sense, in continental Europe, law is traditionally the instrument used to protect competition,[47] and idea already highlighted by Adam Smith in his celebrated 'The Wealth of Nations'.

Competition law should be understood as a dynamic process which is subject to change and which evolves according to the objectives of the legislator. The reasoning behind what it is that competition law should aim to protect is crucial in the shaping of the policy, and is not exempt from controversy. It has led to

[46] See EU Petersmann, 'How to Constitutionalize International Law and Foreign Policy for the Benefit of Civil Society?' (1998) 20 *Michigan Journal of International Law* 1, 1.

[47] DG Gerber, 'Modernising European Competition Law: A Developmental Perspective' (2001) 22 *European Competition Law Review* 122.

substantial differences in the treatment of vertical restraints under EC competition law and US antitrust, which will be examined in the following chapter. The question posed in this section is how competition law can address the regulatory dilemma that arises from the double nature of vertical agreements. An optimal regulation would allow for the benefits of vertical agreements to blossom, while at the same time exerting a certain control over the negative effects. In practice, this has proven to be a very challenging task for the legislator.

It is clear that competition law, as any legislative solution, cannot alone solve all the problems regarding vertical agreements. Our analysis has shown the diversity and complexity of these contracts, which virtually require individual attention in order to determine whether or not they are anticompetitive. This is evidently an impossible task, and therefore the general rules affecting the restrictions contained in these agreements are of vital importance. They must take into consideration the mixed effects of the contractual provisions hereby analysed. To make matters even more intricate, there is no consensus on the impact of these restraints. Far from it, as our analysis suggests, there is a very heated debate surrounding the nature of the effects of these clauses.

Our concise review of the advantages and disadvantages of vertical agreements proves that there are plenty of reasons to justify contradictory stands on their regulation. How these restraints are treated by antitrust rules is dependant upon the goals the legislator considers worthy of protection. The changes in the regulation on vertical agreements over the years are inextricably related to the evolution of the concept of what competition law is and what it should aim to achieve. As a consequence, this study needs to be placed in the wider context of the goals pursued by EC competition law, which has determined the treatment given to vertical agreements. The existence of competition in any given market has proved to have highly beneficial consequences on economic welfare. Therefore, it seems reasonable that most nations have, by now, developed competition laws and policies that aim at protecting the competitive process from possible threats resulting from the existence of market imperfections. In Motta's words, competition policy is 'the set of policies and laws which ensure that competition in the marketplace is not restricted in such a way as to reduce economic welfare'.[48] Two assumptions are made in such a definition. First of all, that some restrictions upon competition will not be deemed detrimental to society. Secondly, that economic welfare is the main objective of competition policy, the sum of consumer and producer welfare. However, the extent to which these premises are accurate and therefore the specific role any competition policy should play has been a highly contested issue which has captivated the interest of imminent lawyers and economists over decades. As Craig and De Burca posit, 'a number of differing objectives may lay at the heart of competition policy, not all of which are mutually compatible.'[49]

[48] M Motta *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 30.
[49] P Craig and G De Burca, *EU Law: Text, Cases and Materials,* 3rd edn (New York, Oxford University Press, 2003) 936.

B Objectives of Competition Law

> One of the main criticisms in the vertical restraints area is that Community antitrust law is sometimes enforced in a way as to hamper competition, because the Commission and to a lesser extent the EC Courts have adopted a flawed concept of what constitutes a restriction to competition.[50]

Competition laws are a reflection of the prevailing ideological strands of the co-ordinates of time and place in which they develop. A particular state, in its task of protecting public interest, has to decide what its policies should protect. These interests can be contradictory: a choice must be made whether to give some up in order to achieve others or find the right balance to cause as little harm as possible when defending some interests. In this sense, it is clear that ideology is crucial when determining which goals should be protected and which ones should be sacrificed in antitrust. If this underlying rationale is mistaken or inappropriate, then it will have very negative consequences on the development of the policy and the notion of unacceptable restriction of competition, as Wesseling's words (above) suggest.

It has been argued that competition law should seek to protect competition, respecting as much as possible freedom of contract.[51] In today's antitrust, particularly in the US and within the context of introducing an economic analysis in EC competition law, resource allocation efficiency presents itself as an essential goal.[52] This general aim seems logical, since antitrust deals with industrial organisation, a specific brand of economics, and therefore the discipline's economic connotations take centre stage. However, other non economic goals have also exerted their influence, more or less intensely, throughout the history of competition law. This reflects that, at times, policy makers have thought it appropriate to protect values other than economic well-being.[53] The extent to which these other aims should be protected through antitrust has been the object of lengthy doctrinal discussions. Motta, for instance, questions the use of competition policy for finalities other than efficiency, as he claims that those aims could be probably best achieved through other public policies.[54] On the other side of the spectrum, Carstensen sees economics as a 'perhaps indispensable' tool for antitrust, but doubts that it alone

[50] R Wesseling, *The Modernisation of EC Competition Law* (Oxford, Hart Publishing, 2000) 80.

[51] CJ Joerges, 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 3.

[52] N Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994) 4.

[53] AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 32.

[54] In particular, he expresses these concerns when describing the possible environmental concerns of competition policy. Among the other public policies to address such issues, he refers to 'the imposition of taxes . . ., or even the imposition of a minimum environmental standard adopted at European-wide level.': M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 28.

can guide policy makers given its disconnection from 'real-world relationships'.[55] The interplay between these economic, political, social and even historical aims determines not only the design of a specific competition policy, but also its application.

i Economic Goals: From Economic Freedom to Economic Efficiency

In Europe, competition law has been greatly influenced by the reliance upon economic freedom as the main goal of antitrust policy.[56] There is no unanimous definition of what one should understand as economic freedom, but for our purposes Steiner's description is rather significant: he understands it as 'an individual's ability to participate in the economy with minimal outside interference'.[57] This includes, he goes on to say, two fundamental dimensions that often come into direct conflict in the field of antitrust: the freedom to contract and the freedom to compete.[58] As highlighted above,[59] the main aim of businesses is to maximise profits, and if limiting competition ensures greater benefits then it is likely that firms will go ahead with the restrictive practices. The role of the government in limiting anticompetitive behaviour is therefore crucial. Accordingly, this objective has served to justify interventionist approaches—the Commission's early position, for instance—and the concept has led to notorious conflicts in the area of territorial restraints.[60] Given that such restrictions may in some cases be imposed by the parties with the aim of increasing revenue, there are grounds for adopting an adverse position towards them. One must remember, however, that these restrictions tend to exert mixed effects on competition, and are often clearly beneficial for economic efficiency and necessary for the optimal organisation of a firm's distribution channels.[61] In addition, some authors have highlighted that there does not appear to be a solid principle in this theory that acts as a dividing line between what can be considered an acceptable restriction and a limitation of competition that should be forbidden, which has led to contradictions in the policies inspired by this goal.[62] In continental Europe, the Freiburg School interpreted that free-

[55] PC Carstensen, 'Vertical Restraints and the *Schwinn* Doctrine: Rules for the Creation and Dissipation of Market Power' (1976) vol 26 no 4 *Case Western Reserve Law Review* 771–809, 772.

[56] This goal is present in German competition laws, which were very influential at the time of drafting and interpreting EC antitrust provisions, and has therefore proven to be highly prominent in the evolution of the policy. It was one of the main objectives defended by the Freiburg School, discussed in ch 2 s I(B) below.

[57] M Steiner, *Economics in Antitrust Policy: Freedom to Compete v Freedom to Contract* (Zurich, Dissertation.com, 2007) 3.

[58] ibid.

[59] See ch 1 s II(B) above.

[60] Hawk harshly criticised the European Commission's clinging to the concept of economic freedom and its nefarious consequences for vertical restraints in his celebrated article: BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89. See also G Amato, *Antitrust and the Bounds of Power: The Dilemma of Liberal Democracy in the History of the Market* (Oxford, Hart Publishing, 1997).

[61] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 24.

[62] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89.

dom of contract of individuals should be limited by societal rules which ensure the achievement of equality and fairness.[63] This position further opens the door for a high degree of intervention.

Nowadays, and as a result of the problems of economic freedom as an antitrust policy objective, there is a wide consensus that the primary (if not the only) goal that should be pursued by competition policy is the attainment of economic efficiency.[64] In the field of economics, efficiency in the performance of any given industry is measured using the concept of economic welfare.[65] Economic welfare has been defined as the sum of the welfare of different groups in the economy,[66] mainly producers and consumers.[67] This means that, ideally, competition law should attempt to comply with the difficult task of finding the optimum equilibrium that ensures that consumers are not paying too much for their products, while at the same allowing firms to be rewarded for their investments. Otherwise, if a firm's expenditure is larger than the money it is making from the sale of its products, the firm will no longer be interested in producing and the choice of goods available to the consumer will be reduced, thus resulting in damage for consumers too in the long run. In order to estimate economic welfare, it is necessary to consider how much a consumer is willing to pay for a good and how much she effectively pays for it. Consumer surplus is the resulting difference between the two, while producer surplus is given by the sum of actual profits made by all producers of an industry for selling their products. Therefore, as a general rule, an increase of the price at which goods are sold reduces consumer surplus and increases producer surplus. It turns out, however, that in general as the price increases, the increase in profits made by the firms does not compensate for the reduction in the consumer surplus.[68]

In order to prevent producers from charging too much for their products, and thus reducing consumer surplus, competition laws attempt to control market power—'the ability of a firm to raise price above some competitive level . . . in a

[63] For further analysis, see ch 2 s I(B) below.

[64] Kerber and Vezzoso, however, advocate for the importance of the defence of the economic freedom of the parties, particularly of retailers, since their local expertise knowledge should encourage innovation: W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective' *Paper prepared for the 10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004).

[65] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 18.

[66] For a definition of the concept of economic welfare, see M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 18.

[67] In this sense, some competition law regimes also tend to favour consumer welfare rather than economic welfare (as the total surplus described above). In some circumstances, the two do not coincide, and an increase in total welfare might not result in an increase in consumer welfare. For a detailed explanation, and examples that illustrate this point, see M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 19–22.

[68] For a study of the concept of economic efficiency in the European context, see D Geradin 'Efficiency Claims in EC Competition Law and Sector-Specific Regulation' (2004) Working Paper, Workshop: *Comparative Competition Law, The Evolution of European Competition Law—Whose Regulation, Which Competition?*, European University Institute, Florence.

profitable way'—, in particular its exercise and its creation.[69] When a firm has an advantageous position in a given market (that is, it has market power), then it can raise prices either directly or by reducing output. This is particularly so when consumers are less sensitive to changes in price. However, it could be that a firm on its own does not have enough market power to do such a thing, but it enters into agreements or concerted practices with its competitors so that they all raise prices at the same time and therefore consumers do not have the option to go to other producers for cheaper prices. As a result, all the producers will increase their surplus to the detriment of consumer welfare. These agreements, as seen below, are also monitored by competition policy. In any case, the possession of market power is not considered punishable in itself, and it is only when the firm in question misutilises its power that antitrust intervenes.

To further clarify what is meant by economic efficiency it is important to distinguish between static and dynamic efficiency. There are typically two static types of efficiency which concern antitrust policy makers, namely allocative and productive efficiency. On the one hand, allocative efficiency is the optimal relation between the prices consumers pay and demand, and therefore affects consumer welfare. If firms are charging too much for their prices, then the increase in their welfare would be outweighed by the loss of consumer surplus. This argument could be used to justify, for instance, the Commission's concerns about car price differentials, and in particular the high car prices charged in some Member States, if and when those differences were freely decided by manufacturers. Free competition ensures that this relationship is optimal, and therefore antitrust policies will aim at protecting it. On the other hand, productive efficiency aims at enhancing the competitiveness of industries in their processes of production, in a belief that where competition in a market is scarce, a monopolist may operate less efficiently and thus incur higher marginal costs.[70] Monopolists have, in this sense, less motivation to change to more efficient ways of production, and will survive in any case as they have no competitors to steal the market from them. Motta emphasises, however, that empirical evidence is still ambiguous, as it is not clear why a monopolist would decide to act in an inefficient way.[71] Apart from these static forms of efficiency, dynamic efficiency would imply that the existence of competition encourages a firm to innovate and introduce new products or ways of production.[72] According to the

[69] There can be reasons other than market power for increases in price. For instance, inflation or raises in the cost of production could have the same effect. Controlling such increments exceeds the scope of action of the competition authorities. See AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 22.

[70] R Wesseling, *The Modernisation of EC Competition Law* (Oxford, Hart Publishing, 2000) 79, fn 5, relying on Hovenkamp's contribution in L Laudati, and CD Ehlermann (eds), *Robert Schuman Centre Annual on Competition Law* (Oxford, Hart Publishing, 1998).

[71] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 45–54.

[72] As opposed to productive efficiency, whereby firms are encouraged to use the most efficient processes of production available, dynamic efficiency involves firms actually inventing new processes of production. See M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 55–64.

strand of economic theories that can be labelled evolutionary and innovation economics, in particular the neo-Schumpeterian school,[73] competition policy should focus primarily on encouraging dynamic efficiency and innovation at all levels.[74]

This brief overlook of the many aspects of economic efficiency reflects its importance, and helps to explain why it is the protection of this goal that is believed to be of pivotal importance for the success of antitrust policies. However, it is currently widely recognised that, despite the merits of pursuing economic efficiency, this cannot be the sole objective of competition policy. Beyond pure economic efficiency, justification can be found for pursuing other goals. After all, as Komesar notes, Pareto's efficient transactions can be truly unjust.[75]

ii Non-economic Goals

In order to fully comprehend the reasons behind some of the policy decisions made on both sides of the Atlantic over the years, other social, political and even historical objectives pursued by antitrust policies must be considered.[76] Over the history of the discipline, many have been the goals considered worthy of protection through competition policy. Antitrust has thus evolved closely linked to the policy makers' goal choice. Furthermore, the ranking of these goals has also led to abrupt changes in the competition policies hereby considered—those of the EU and the US. In this section, reference is made to those which have left an imprint in today's antitrust regimes on both continents.

Undoubtedly the most relevant non-economic aim of antitrust is, in the context of a study of distribution restraints, the encouragement of integration. Promoting market integration seems to be one of the key objectives of the EU competition policy as stated by the Treaties, enforced by the EC and endorsed by the courts. Articles 81 and 82 EC are part of a Treaty which establishes in its Article 3(1)(c) that all EC rules have the task of constructing a Single Market by overcoming the existing fragmentation as a result of national barriers.[77] According to the Guidelines on Vertical Restraints, in order to achieve this goal of integration it is

[73] The neo-Schumpeterian school comprises a group of theories rooted in J Schumpeter, *Theorie der Wirtschaftlichen, Entwicklung* (Leipzig, Duncker & Humblot, 1912). Dynamic theories emerging from this work emphasise the central role of the entrepreneur and conceive competition as a process of rivalry involving innovation and imitation.

[74] Product, process and organisational innovations: W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective' *Paper prepared for the 10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004).

[75] V Pareto, *Manuale d'economia politica* (Milan, Società Editrice Libraria, 1906). N Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994) 32.

[76] In this sense, Carstensen highlights how '[e]conomics suffers from frequent confusion in the shift between a descriptive model of a hypothetical case, eg pure competition, and the prescriptive conclusion that all activity inconsistent with that model is undersirable.': PC Carstensen, 'Vertical Restraints and the Schwinn Doctrine: Rules for the Creation and Dissipation of Economic Power' (1976) 26 *Case Western Law Review* 4, 773.

[77] See JM Beneyto and J Maíllo, *El Nuevo Derecho Comunitario y Español de la Competencia* (Madrid, Bosch, 2002) ch 4, 71.

not sufficient to simply dismantle the existing barriers to the free movement of goods, people, capitals and services.[78] It is also essential that the different provisions of the Treaty are all interpreted in the context of integration, and they all play a crucial role. This is a political, rather than an economic, objective, not necessarily consistent with economic welfare. Integration and parallel trade, particularly in the early days of EC competition law, supplanted the protection of competition *stricto sensu*, much to the criticism of those who believe in efficiency as the main goal of competition policy. From the perspective of integration, distribution contracts which contain exclusivity clauses are cause for concern, as the privilege given to a distributor of being the only person authorised to sell a product leads to the fragmentation of markets. Those who highlight the perils of exclusivity clauses emphasise how this retailer will then be free to set prices for that product as high as she desires, as consumers in that territory will not be able to purchase the good from anyone else.

This vision is, at best, incomplete. Such restrictions on intrabrand competition—that which occurs between retailers of the same product—can be necessary in order to establish adequate distribution systems. A distributor is expected to make investments (advertising, brand image, customer services, stores, etc) in order to sell a manufacturer's product. Needless to say, she will not agree to incur such expenditure if she cannot expect to be rewarded for it—that is, if someone else is going to be authorised to sell the same product in that territory, free-riding on her advertising. Furthermore, the criticism of intrabrand restrictions of competition overlooks the fact that the freedom of the retailer to set prices will be determined by the extent to which similar products from other manufacturers are available in that same territory. If that is the case, then interbrand competition—between competing goods from different manufacturers—will force her to set competitive prices. In this sense, contractual restrictions on the freedom to trade (across borders) may enhance competition between products from different makes.

Another goal pursued at different moments both by EC and US antitrust is the defence of smaller firms. This line of action is a consequence of the imprecise notion originated in neoclassical economics that the more competitors in the market the fiercer competition will be. It is also related to the defence of quality of life, as it is believed that these small shops, even if they may not be as cheap as the big department stores, have a higher quality in their products and a better, more direct treatment for consumers. This objective does not contradict the protection of economic welfare. In this sense, it seems logical to offer small businesses advantages and protection from possible abuses by larger rivals. By contrast, it is not in the interest of economic welfare to artificially maintain smaller firms in operation when their problems are a result of inefficiency, as it would result in higher prices and the inefficient allocation of resources.[79] Very much in this line,

[78] See s 7 of the Guidelines.

[79] In this regard, the US Supreme Court has emphasised that antitrust should protect competition and not competitors. See *Brunswick Corp v Pueblo Bowl-O-Mat Inc* 429 US 477, 488, 97 S Ct 690, 697, 50 L Ed 2d 701 [1977]; *Brown Shoe Co v US* 370 US 294, 320, 82 S Ct 1502, 1521, 8 L Ed 2d 510 [1962].

the Commission's action is protective of small and medium-sized enterprises (SMEs). Its reasons for doing so are not only related to that quality of life which allegedly evaporates as small entities are absorbed by superstores, but are also connected to social goals: SMEs may create employment (or at least avoiding their disappearance is likely to reduce the levels of unemployment), and they are in a better position to innovate given their dynamism. In practice, such claims can be contested, and it is not clear that SMEs make a larger contribution to growth and innovation than large firms,[80] overprotection could have distorting effects on competition.

For our purposes, a further relevant aim of competition law has been the protection of equity and fairness. For instance, competition law attempts to prevent a dominant firm from charging excessive prices. With the exception of those markets prone to collusion where barriers to entry exist, whether such intervention is desirable is arguable. Motta highlights how a firm should be free to set prices if it is able to do so as a result of its merits. If no barriers to entry exist, then other firms should feel encouraged to enter the market, and prices will end up readjusting themselves. In this context, the protection of SMEs referred to above can also be linked to fairness: most small firms will not be able to match the prices or the services of big stores, and therefore want to be shielded from the competition posed by stronger rivals. However, the risk of protecting inefficient firms remains a concern. Just as with other non-economic goals, fairness does not necessarily have to be in contradiction with efficiency, and often conducts will be detrimental to both goals.[81]

In the context of the protection of fairness and equity, it is worth noting that price discrimination has been one of the Commission's most outstanding concerns in the EU. It is common to find price divergences across the Community, which according to the Commission reflect a lack of market integration. The prohibition of price discrimination however raises some fairness and equity concerns that appear to be overlooked. Price convergence, instead of implying lower prices for some consumers, could well lead manufacturers to raise prices in those countries where they were originally lower (generally those where consumers are worse off). These less wealthy consumers could therefore end up paying higher prices than they would if the manufacturer were allowed to discriminate. Fairness and equity concerns have played an important role in the shaping of EC competition policy, reflected in the protection of SME or the condemnation of predatory pricing. However, these worries are not taken into consideration when advocating for price convergence and defending parallel imports. Therefore, it seems that, in some cases, fairness concerns can be prioritised over efficiency, but when integration is endangered they are neglected. The condemnation of absolute territorial

[80] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 22.

[81] ibid. Motta uses the example of predatory pricing. Other such practices may be tying or charging supracompetitive prices (most of the Article 82 EC conducts). It is also worth noting that, among the goals of antitrust, Motta also refers to fighting inflation, particularly in German competition law. However, he questions that antitrust would be an efficient tool for such purposes.

protection—typical of the European regime—bears threats to efficiency and fairness that must be taken into consideration before placing such restraints under the per se rule. As Hawk emphasises:

> Competition law is economic law, and economics must play a predominant (if not exclusive) role in the examination of particular agreements. That is why the Commission's frequent inattention to market power and effects on price and output is so sorely criticized.[82]

This journey through the complexity of the goals of competition policy serves to give an idea of the meticulous task of the legislator, who needs to carefully balance the achievement of the objectives considered worthy of protection in the society. The multiple goals appear reflected more or less directly on today's regulation of competition in most legal systems around the world. The impact of these pursuits in the EC and US competition policies will be analysed in subsequent chapters; at this point, it is sufficient to say that it seems legitimate and appropriate to go beyond the protection of economic efficiency in competition policy. However, this objective should be prioritised when it comes into conflict with other goals. When this is not the case, the result can be a policy that does not prioritise the protection of competition *stricto sensu*, and experience shows that this can lead to significant inefficiencies.

[82] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89, 986.

2

Theorising Vertical Restraints: The Intellectual Foundations of EC Competition Law and US Antitrust Models

I THE INFLUENCE OF ECONOMIC AND POLITICAL THEORY IN THE EVOLUTION OF THE LEGAL FRAMEWORK FOR VERTICAL AGREEMENTS

The regulation of vertical agreements in the EC and the US presents a fascinating evlution over the years of existence of the regimes. On the one hand, US antitrust has generally moved from mistrust to tolerance towards these restrictions. Furthermore, regulation in America is well known for experimental 'swings' over the course of time (related by some to political changes in government),[1] which are particularly notorious in the treatment of vertical restraints. On the other hand, the European regime experienced a time of malfunctioning as a result of an overly paternalistic attempt on the part of the Commission to exert some control over the market-partitioning effects of these agreements. This nadir has now been significantly corrected with a series of thorough reforms which have shaped today's EC competition law rules, and currently—less than a decade after the introduction of the first changes—the debate is back on the table with the recent launch of reforms of the current block exemptions.

This chapter provides the starting point of the analysis of each of these legal systems. In this process, the underlying economic, social, political and historical co-ordinates that shape a specific competition policy are explored. Having examined some of the priorities in the mind of the legislator when regulating the competitive process, it is necessary to investigate the underlying economic and policy implications, and how the leading theories translate into the competition law systems under analysis. Underlying our analysis is the question, already hinted at in the previous chapter, of the extent to which non-economic competition goals should limit the economic efficiency of distribution systems. Undoubtedly, the reforms that have recently taken place in Europe and America introduce a more

[1] WE Kovacic, 'The Modern Evolution of US Competition Policy Enforcement Norms' (2003) 71 *Antitrust Law Journal* 377; T Calvani and G Breidenbach 'An Introduction to the Robison-Patman Act and Its Enforcement by the Government' (1991) 59 *Antitrust Law Journal* 765.

systematic economic analysis, but whether or not the approach is adequate is more debatable. As seen in the following chapter, the current European system relies on rigid market share thresholds and the need to determine the relevant market, a complex concept. This analysis has been, since 1 May 2004, in the hands of national courts and authorities, and their capacity to carry out a sound application of the relevant rules has been questioned. The changes over the years seem to follow neoclassical microeconomic theories, thus concentrating on efficiency-seeking arguments rather than dynamic efficiency and innovation. The consequences of the prevailing economic theories on competition policy are therefore considered by analysing the US and EU regimes, with a view to determining the best approach to follow and how to improve the application of competition law rules in Europe.

The objectives pursued by antitrust laws have been subject to change following the evolution of the economic theories the system rests upon. As Gavil, Kovacic and Baker put it, '[a]ntitrust laws have been, and will continue to be, a product of the prevailing economic and political thinking of their times.'[2] In general terms, antitrust aims at protecting the competitive process and intervening where market failures which could harm competition are detected. However, as seen in the previous chapter, what market failures are and how they should be addressed in any competition law regulation is dependant upon what goals the legislator believes are worth protecting. In order to carry out an adequate analysis of these aims, with the purpose of understanding how vertical restraints should be regulated, the framework in which the regulation of these restrictions is immersed in needs further analysis. To this end, an insight into the policy behind competition legislation is essential. The following pages provide a brief outline of the general economic theories that have existed over the years and that have been treated almost as an 'untouchable' and undisputed framework in which competition law should move. As Rodger and MacCulloch have put it, the different schools of thought have, over the years, fought a 'battle for the soul of antitrust'.[3] The object, far from an understanding of the full scope and complexity of the theories of such schools—such a task would be colossal and impossible to cover in a single monograph—is merely to emphasise those aspects that have been more influential in the shaping of the policy.

Summing up what has been said in hundreds, possibly thousands of studies is an exceedingly challenging mission. Therefore, for our purposes unfortunately drastic simplification is a must. In broad terms, it can be said that two fundamentally different streams of attitude towards competition policy exist: One upholds that free markets would themselves approach perfect competition conditions without any necessary policy intervention (laissez-faire of capitalism), while the

[2] AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 4. Political objectives are particularly intense in the US.

[3] B Rodger and A MacCulloch, *Competition Law and Policy in the EC and the UK*, 3rd edn (London, Routledge Cavendish, 2004) 12.

other one believes that since real world markets do not fit the conditions of the welfare-optimal 'perfect competition', a policy is needed to bring the markets closer to the ideal (interventionist). These views are represented by the Chicago and Harvard Schools, the two broad visions which dominated the debate on the right economic approach for competition policy. It has been said that 'the models of competitive analysis associated with each school are, in essence, related to the academics' fundamental beliefs as to what is meant by the competitive process and the role of the State via the law in that process.'[4] Modern economic analysis has somewhat overcome these extremes and softened the sharp dividing line between both tendencies. Nonetheless, their influence remains crucial, making it essential to briefly examine the main postulations of the axes of the debate. Alexander Schaub, former Director-General for Competition, has expressed on a number of occasions that it was precisely in the heated atmosphere of the Chicago-Harvard School debate and the intense discussion on the scope of Article 81(1) EC that the Directorate General for Competition (DG Competition) embarked on a reconsideration of the EC policy towards vertical restraints.

A Pre-Harvard Schools of Thought

Competition law in the History of economic theory can be traced back as far as the eighteenth century, and more particularly Adam Smith's well-known 'The Wealth of Nations'. Often referred to as the father of capitalism—even economics—Smith's view of the competitive process was virtually instinctive rather than based on solid empirical analysis. In his view, the market was driven by selfish concerns for individuals' own welfare. Each individual would be battling to become more efficient than the rest to be able to out-perform competitors and achieve greater benefits. Since all the players in the market are moved by these non-altruistic motivations, in the end this self-interested quest for efficiency would result in an increment of social wealth. It is in this context that his legendary 'invisible hand' that causes this transformation of self-centred interest into benefits for the society as a whole emerged. As Budzinski explains, two non-economic forces and one economic force then control the interaction between individual and common interests: morality and the institutional framework which serves to control and punish crime and unfairness in the egoistic race, on the one hand, and competition, on the other.[5] In this context, competition law serves to maintain the incentive to introduce more efficient means of market behaviour.[6] Despite the power of this invisible hand, and the lack of an explicit competition policy in his work, Smith already felt that, in order to maximise the benefits of market competition as described here, certain social constraints, both moral and political, needed to be

[4] ibid.

[5] See O Budzinski, 'Pluralism of Competition Policy Paradigms and the Call for Regulatory Diversity' (2003) 14 *Volkswirtschaftliche Beiträge Philipps-Universität*, Marburg, 3.

[6] ibid, relying on A Smith, *The Theory of Moral Sentiments* (Glasgow, 1761).

imposed.[7] Curiously, and very much in the line of the current prevailing view, he does not equate competition with a specific market structure:[8] it has been said that classic theories of economics see competition as a race in which rivalry acts as motivation to innovate and improve.[9]

In the nineteenth century, and borrowing Budzinski's illlustrative metaphor, the focus of economists seemed to drift from the race itself to the result of the race. The birth of the school of thought that we now know as neoclassical economics turned the classical theory into an exact science that attempted to turn competition into a mathematical process. Coinciding with Newton's theories of forces and equilibrium and the boost of mathematics, there is an attempt to soak up these ideas and translate them into economic theories on competition. This allowed insights into the working of the market, and the fact that market prices depend on the subjective relative value of the goods, the well known economic concept of marginal utility. This concept signifies the transition from classical to neoclassical economics. The result of the changes is the seed of price theory and the development of standard models of polypoly, monopoly and oligopoly. Market competition was equated to polypolistic market, called perfect competition. The most outstanding achievement of these theories is that they facilitate the quantitative description of markets. Among the shortcomings, as Kerber and Vezzoso have noted, is that these theories appear to hamper the analysis of dynamic aspects of competition like innovation, mutual learning or rivalry.[10]

B The Harvard School: From 'Perfect Competition' to 'Workable Competition'

In a similar way that the current economic turmoil is questioning some of the basic principles of our current regulation, the Great Depression of 1929 challenged price theory and the workability of free markets in an unprecedented manner. As a consequence, and flowing from specific analyses carried out by researchers of certain industries, in the 1930s the so-called Harvard School blossomed.[11] The fathers of this ideology came to the conclusion that 'perfect competition' is not met by real

[7] A Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (London, Methuen & Co Ltd, 1776) 59.

[8] Although he does believe that the more the suppliers, the stronger the competition, even a 'duopoly' is believed to be competitive: O Budzinski, 'Pluralism of Competition Policy Paradigms and the Call for Regulatory Diversity' (2003) 14 *Volkswirtschaftliche Beiträge Philipps-Universität*, Marburg, 4, relying on A Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (London, Methuen & Co Ltd, 1776) 160.

[9] O Budzinski, 'Pluralism of Competition Policy Paradigms and the Call for Regulatory Diversity' (2003) 14 *Volkswirtschaftliche Beiträge Philipps-Universität*, Marburg, 4, relying on GJ Stigler, 'Perfect Competition, Historically Contemplated' (1958) 65 *Journal of Political Economy* 1, 1–17.

[10] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective' *10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004).

[11] M Furse, *Competition Law of the EC and the UK*, 5th edn (New York, Oxford University Press, 2006) 11.

competition, nor should perfection be necessary to have a socially beneficial policy. Instead, what should be sought is the idea of 'workable competition', which thus emerged linked to the birth of a price theory of imperfect competition.[12] According to this new concept, imperfections are acceptable in the polypolistic structure. On the basis of the second best theorem and the remedy hypothesis, these failures can even act as a spur to the competitive process. It is believed that the market structure causally influences competitive and anticompetitive market conduct, with the latter leading causally to better or worse performances of the markets. This Structure–Conduct–Performance (SCP) approach became the paradigm of the Harvard School of Industrial Organisation.[13] Their competition policy relies predominantly on interventions into the market structure, in a belief that it has an impact on competition.[14]

The concept of workable competition leads to the view that competition policy is an integral part of the general economic policy strategy. This implies that it should serve the same goals as other disciplines of economic policy, which in turn favours a multi-goal approach that can include economic and non-economic goals: fair income distribution, freedom, promotion of small businesses, diversification, protection against unfair competition. This theory would serve to justify the multi-goal approach to the regulation of competition followed by early US antitrust and the EU competition policy even to date. This school had an important impact on competition policy in the US in the 1960s, and has been described as 'the American variant of workable competition antitrust policy'.[15]

C Ordo-liberalism and the Freiburg School

The Harvard School coincided in time—and in some of its postulations—with the Freiburg School, which takes its name from the German city where it originated.[16] Given its influence in continental Europe, and more importantly over the enactment and interpretation of EC antitrust rules with its emphasis on the notion of economic freedom—which was analysed in chapter 1 as being one of the principal goals of EC competition policy—this school of thought deserves particular attention. It was founded by an economist and two jurists, Eucken, Böhm and Großmann-Doerth, and their crucial contribution was the concept of '*Ordoliberalismus*', also

[12] Robinson refers to 'monopolistic competition'. See J Robinson, *The Economics of Imperfect Competition* (London, Macmillan, 1933). See also E Chamberlin, *The Theory of Monopolistic Competition* (Cambridge MA, Harvard University Press, 1933).

[13] C Kaysen and DF Turner, *Antitrust Policy: An Economic and Legal Analysis* (Boston, Harvard University Press, 1959).

[14] Using Budzinski's terminology, they place the focus on the result of the race.

[15] M Furse, *Competition Law of the EC and the UK*, 5th edn (New York, Oxford University Press, 2006) 11; O Budzinski, 'Pluralism of Competition Policy Paradigms and the Call for Regulatory Diversity' (2003) 14 *Volkswirtschaftliche Beiträge Philipps-Universität*, Marburg, 7.

[16] HG Grossekettler, 'On Designing an Institutional Infrastructure for Economies: The Freiburg Legacy after 50 Years' in G Meijer (ed), *The Institutional Basis of Market Economies: Walter Eucken's Contribution to Economics* (1994) 21 *Journal of Economic Studies* 9–24.

referred to as 'ordered liberalism'. This notion implied that competition and freedom of market would only be beneficial under certain constraints. Vanberg has thoroughly studied the assumptions of this school, and likes to compare the concept to a race. If competition is absent from the contest, then it loses all interest. However, if the competitors are cheating and utilising foul tactics to beat their rivals, then the result is even more disappointing. Therefore, although some kinds of competition are good, competition in itself is not always a synonym of welfare and efficiency.[17]

The founders of the Freiburg School seconded classical liberalism traditions, but not the laissez-faire attitude that Adam Smith had so vehemently defended.[18] They were in favour of the disappearance of the feudal system of privileges in favour of a context of fairness and equality of all players, as this should lead to an enhancement of competition.[19] However, they believed that a functional free market is not equivalent to the absence of government intervention, since it does not happen naturally, but rather must be induced and carefully cultivated by the authorities following a constitutional order.[20] In order to establish rules that create the desired scenario, and to ensure that these rules are observed, the role of the government is crucial. Their interpretation of what a competition law regime should entail is based on an essential distinction: the consitutional level and the subconstitutional level. On the one hand, the constitutional level comprises government intervention and legal rules, that is to say the establishment and enforcement of the rules that regulate the market and competition, for the benefit of the entire community. On the other hand, the subconstitutional level is made up of private choices of individuals (and in this case firms). This determines how the legal system actually works in practice. As a consequence of this distinction, their idea of freedom of contract—referred to in the previous chapter as an essential part of economic freedom—is limited at the subconstitutional level, and could not justify entering into contracts which have as a consequence a reduction or elimination of the freedom of contract (at the constitutional level). Therefore, the individual freedom to enter into contracts is limited by those general rules established for the achievement of the objectives of whole society.[21]

[17] VJ Vanberg, 'The Freiburg School: Walter Eucken and Ordoliberalism' (2004) 04/11 *Freiburg Discussion Papers on Constitutional Economics*, at opus.zbw-kiel.de/volltexte/2004/2324/pdf/04_11bw.pdf.

[18] ibid 9.

[19] F Böhm, W Eucken and H Großmann-Doerth, *Die Ordnung der Wirtschaft als Geschichtliche Aufgabe und Rechtsschöpferische Leistung* (Stuttgart, 1937).

[20] G Meijer, 'Value and Exchange in Economic Theorizing: The Contribution of the Freiburg School' (2007) 20 *The Review of Austrian Economics* 2–3, 171–85.

[21] VJ Vanberg, 'The Freiburg School: Walter Eucken and Ordoliberalism' (2004) 04/11 *Freiburg Discussion Papers on Constitutional Economics*, at opus.zbw-kiel.de/volltexte/2004/2324/pdf/04_11bw.pdf, 10–11.

D The Chicago School

It is no longer worth talking about different schools of academic antitrust analysis.[22]

With these words, Richard Posner described the new school of thought that developed in the 1950s as a reaction to the scepticism of the Harvard School towards unregulated markets. The Chicago School, which reached its splendour in the US in the 1980s with Reagan's republican government and continued by the Bush I administration, believes in the efficiency and well-functioning of the market. In contrast to the Harvard view, firms' behaviour usually responds to the model of perfect competition. This is the reason why Stigler, Posner, Demsetz, Bork, Easterbrook and Epstein—to name but a few of the fathers of the revolutionary ideas[23]—are rather sceptical about intervening in markets through regulation. As an exception, antitrust is an area where certain intervention is needed, given their reliance on price theory and evolutionary survivor principle, but this intervention is almost exclusively limited to those situations where firms possess market power.[24] They consider that when an enterprise has an advantageous position in the market, it is likely to use its influence to exclude other market entrants and charge supracompetitive prices.

This non-interventionist approach also leads to a general acceptance of vertical restraints, as any firm with market power would have easier means of restricting competition than through these restrictions. If interbrand competition exists, then restrictions on intrabrand competition among retailers should not be capable of restricting competition,[25] and the efficiency-enhancing effects of vertical restraints would outweigh any possible risks.[26] These restrictions can be used to eliminate pricing distortions at the retail level, and eliminate transaction costs that are unnecessary. As a consequence, problems emerge not from the restrictions themselves, but from possible market failures as a result of market power at the horizontal level in any of the relevant markets at stake, since vertical restraints cannot

[22] Richard Posner (on the Chicago School): RA Posner, 'The Chicago School of Antitrust Analysis' (1979). 127 *University of Pennsylvania Law Review* 4, 925–948, 925.

[23] Notorious works include RH Bork, 'The Rule of Reason and the Per Se Concept' (1966) 75 *Yale Law Journal* 3, 373–475; RH Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Free Press, 1993); RA Posner, *Antitrust Law: An Economic Perspective* (Chicago, University of Chicago Press, 1976); RA Posner, 'The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality' (1981) 48 *University of Chicago Law Review* 1, 6–26; GJ Stigler 'Perfect Competition, Historically Contemplated' (1958) 65 *Journal of Political Economy* 1, 1–17.

[24] See O Budzinski, 'Pluralism of Competition Policy Paradigms and the Call for Regulatory Diversity' (2003) 14 *Volkswirtschaftliche Beiträge Philipps-Universität*, Marburg, 3.

[25] But see Kerber and Vezzoso (2004). They claim that, from the perspective of evolutionary economics, 'the elimination of intra-brand competition among retailers might lead to the loss of the positive knowledge effects from experimentation on the retailing level, even if there is sufficient interbrand competition among the producers. The negative effect will be aggravated, if in addition thereto, we consider the existence of heterogeneity and local knowledge on the retailing level'.

[26] In this sense, see the Guidelines on Vertical Restraints, where the Commission explains why interbrand competition should be prioritised.

serve to enhance monopoly power or transmit this power from one level of the production chain to another.[27] In this manner, Chicago School scholars discarded old per se rules which could lead to inefficiency,[28] and not only with regard to non-price restrictions. In fact, they argued that even price restraints, when not intended to create a horizontal price-fixing cartel, could be procompetitive.[29] Although under the new industrial economics some of the extreme views of this school of thought have been proven to be inaccurate, especially about the effects of concentrations,[30] in the field of vertical restraints it is still the prevailing doctrine, particularly in the US.[31] North American courts hardly ever condemn vertical restrictions, and enforcement agencies seldom challenge these restraints, whether or not related to price.[32] The 2007 decision of the US Supreme Court to take minimum resale price maintenance out of the per se prohibition in *Leegin* is the most recent reflection of the influence of this recognised school.[33]

The Chicago School virtually advocates for the per se legality of vertical agreements. Followers always look for efficiency explanations to the restrictions imposed in these contracts. Experience and real-world evidence has nonetheless shown that this is a rather naïve position, and game theory contradicts the excessive optimism regarding these restraints. The Chicago assumptions have been described as 'unrealistic, divorced from observations in actual markets, and tending to obscure the importance of dynamic considerations, asymmetric information, and strategic behavior.'[34] In effect, position has been greatly overcome by more recent economic theory, but its influence in the shaping of antitrust laws and subsequent postulations remains indisputable.

[27] PW Dobson and M Waterson, Vertical Restraints and Competition Policy (1996) *Research Paper* 12, OFT, 1.

[28] See JB Baker, 'Vertical Restraints with Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses' (1996) 64 *Antitrust Law Journal* 517–34.

[29] A Tor, 'Developing a Behavioral Approach to Antitrust Law and Economics: An Executive Summary' (2004) Loyola University, at www.luc.edu/law/academics/special/center/antitrust/pdfs/torsumry.pdf, 2.

[30] Concentrations are now generally believed to be almost certainly damaging of consumer welfare. See M Furse, *Competition Law of the EC and the UK*, 5th edn (New York, Oxford University Press, 2006) 12.

[31] In this sense, Baker criticises the overly simplistic 'horizontal bad, vertical good' approach of the Chicago School: JB Baker, 'Vertical Restraints with Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses' (1996) 64 *Antitrust Law Journal* 517, 518. See also ACM Chen and KN Hylton 'Procompetitive Theories of Vertical Control' (1999) 50 *Hastings Law Journal* 3, 573–633.

[32] D Hildebrand, *Economic Analyses of Vertical Agreements: a Self Assessment* (The Hague, Kluwer, 2005) 11.

[33] *Leegin Creative Leather Prods v PSKS Inc* 127 US 2705 (2007).

[34] A Tor, 'Developing a Behavioral Approach to Antitrust Law and Economics: An Executive Summary' (2004) Loyola University, at www.luc.edu/law/academics/special/center/antitrust/pdfs/torsumry.pdf, 3.

E Current influences on competition policy

The mainstream theories sketched above have all had their impact on the antitrust regimes in America and Europe.[35] Nowadays, an ample amalgam of streams of thought moulds current visions on competition laws. As Cartensen explains:

> traditional theories based on premises of 'pure' competition (where many sellers of fungible products exist so that no producer has a large enough share of the market to have any control over price) have been supplemented by newer theories based on premises of 'monopolistic' competition (Where many individual sellers face their own non-horizontal demand curves and thereby have some measure of control over price). . . . Adam Smith and Alfred Marshall have been joined by Chamberlin and Robinson, and also important influence of Schumpeter and JM Clark, who criticise the assumption of a long-run equilibrium state in which demand and technology were fixed as a theory which does not provide a productive framework within which to deal with the observable economic world which is, in fact, a dynamic place with little equilibrium. Thus, the tools of economic theory are no longer limited to those constructed to analyse efficiency in a long run static equilibrium, but now also include those which provide different and more relevant perspectives on economic policy problems.[36]

The Harvard–Chicago debate has, by now, been greatly overcome by new, less severe standpoints.[37] Today, competition policy is regarded by some as a part of a broader action plan, one of the pieces of a regulatory system established for the protection of social welfare.[38] This position would clearly justify looking beyond efficiency and protecting wider aims, in contradiction with the views of the Chicago School. Over the last decades, for instance, heavily regulated industries have been deregulated in Europe and the US in order to promote free markets and competition, very much in line with Smith's 'invisible hand' concept.[39] The aim of these deregulatory trends in competition law is to replace government regulation for a minimalist approach, so as to enhance competition. Nevertheless, this does not imply that Smith's invisible hand has no constraints. Government regulation is still deemed to be crucial in those markets where market failures are present, and the role of competition policy is to make sure that any necessary

[35] The terms 'competition law' and 'competition policy' are indistinctly used in this paper. However, it is worth highlighting the differences between the two concept. As Taylor explains, competition law is an instrument of competition policy. The latter is 'a process through which a strategy is planned in order to maintain competition in the economy and maximise economic welfare. It implies a complex analysis of the surrounding market conditions in order to decide how the authorities should intervene or refrain from intervening in order to protect public interest and promote competition. In some cases, they might think that the tool to use is legislation and thus they will amend or create competition law.' M Taylor, *Looking to the Future—Towards the Exclusive Application of EC Competition Law?* (2003) Winner of the Young Lawyers' Writing Competition, International Bar Association, Budapest.

[36] PC Carstensen, '*Vertical Restraints and the Schwinn Doctrine: Rules for the Creation and Dissipation of Economic Power*' (1976) 26 *Case Western Law Review* 4, 771–860.

[37] S Bishop and M Walker, *Economics of EC Competition Law: Concepts, Application and Measurement* (London, Sweet & Maxwell, 1999).

[38] M Taylor 'Looking to the Future—Towards the Exclusive Application of EC Competition Law?' (2003) Winner of the Young Lawyers' Writing Competition, International Bar Association, Budapest.

[39] Examples include telecommunications, the airline industry, utilities and energy markets.

regulation is not in contradiction with the safeguarding of market incentives associated with competition.[40]

In this context, Taylor defines competition law as a policy embedded in neoclassical microeconomic thinking, 'in which the government deliberately intervenes in the economy to enhance market efficiency and address circumstances of imperfect competition.'[41] Modern competition law, in his view, should be specifically intended to regulate situations associated with the concentration of economic power within one or more market participants in particular markets—very much in line with today's regimes in the EC and the US.[42] Market power could shatter the balance in the relevant market, and may give the firms which posess it excessive weight in the market, making it possible for them to damage efficiency in the egoistic quest for their own welfare. Therefore, an optimal competition law regime will aim to strike the right balance between free competition and regulation. The role of regulation is to crush down anticompetitive practices, and to ensure that the market structure does not lend itself to anticompetitive behaviour, while the competitive process ensures the proper functioning of the market by promoting an efficienc allocation of resources—which in turn leads to social welfare. In short, this position would consider the elimination of market failures as the main purpose of competition law and policy. Since this tends to be linked to market power, it is in this ambit that intervention will be justified. The role of the policy would be limited to that of corrector of imperfections, thus acting as a safety net which removes possible threats to the competitive process.[43]

Another significant position on the role of competition law and policy is that which uses behavioural law and economics to correct some of the Chicago School's overly simplistic positions, without necessarily contradicting its core assumptions.[44] It is based on scientific findings rather on human behaviour than speculation, and 'incorporates within law and economics . . . behavioral insights drawn from various fields of psychology.'[45] The problem with the Chicago School, it is argued, is that they departed from the premise that the manufacturer would behave rationally, and furthermore, that this seemingly rational behaviour would be correct. In the case of vertical restraints, the wise manufacturer would only apply such restrictions to achieve the provision of expensive but optimal services that it is unable to provide, and needs to resort to experts in distribution who will only provide their services if they are adequately rewarded.[46] The reality is that

[40] ibid. The other instrument that can be used in order to establish a competition policy is deregulation.

[41] ibid.

[42] In such a scenario, it is clear that the definition of the relevant market becomes essential.

[43] ibid.

[44] C Jolls, 'Behavioral Law and Economics' (2004) Paper for the *Economic Institutions and Behavioral Economics Conference*, Helsinki, at www.law.yale.edu/documents/pdf/jolls_behavioral_law_and_economics.pdf.

[45] ibid 3.

[46] A Tor, 'Developing a Behavioral Approach to Antitrust Law and Economics: An Executive Summary' (2004) Loyola University, at www.luc.edu/law/academics/special/center/antitrust/pdfs/torsumry.pdf, 2.

mistakes are often made, since manufacturers, as humans, only have a limited knowledge of reality, and are conditioned by emotion. For instance, as Tor observes, it may be the case that, when designing a distribution system, excessive importance is given to the free-rider problem, or that there is a lack of awareness of the difficulties and costs of controlling prices when imposing resale price maintenance restrictions.[47] This could well lead to inefficiencies.

In Europe, the enthusiasm towards vertical agreements is more constrained, very much in accordance with the views of the Commission. In this context, and following the reforms of EC competition policy that have taken place over the last decade, some authors have already pointed towards the appearance of a European School, an 'emerging, pragmatic approach that transforms a scientific research results into a conceptual framework.'[48] This school utilises the ordoliberalist ideals of the Freiburg School, together with an acknowledgement of the many benefits of vertical restraints and yet an awareness of the problems experience has demonstrated they entail. Hildebrand, the principal defender of its existence and merits, believes that a European concept of competition has matured, which is centred around the concept of private economic power. Controlling it is the means of safeguarding the balance between the economic and political system, and this should be the main aim of antitrust. The concept of economic power is precisely 'one of the features of German and European competition law thinking that most clearly distinguishes it from US antitrust law analogies.'[49]

Importantly, according to Hildebrand, the European School is based on the SCP model used by the Harvard School, but it is improved and complemented by dynamic efficiency aspects. This is an idea that has been similarly defended by Kerber and Vezzoso in their application of evolutionary theories of competition,[50] and as opposed to being solely reliant on market structure-based evidence of anticompetitive practices, it requires additional evidence of conduct.[51] There is a recognition of the SCP model as the point of departure for the new economic analysis applied by the Commission, but dynamic aspects such as technology, progressiveness and profitability also play a key role in the evaluation. Despite Hildebrand's enthusiastic belief in the advantages of this approach, some authors remain dubious that it is possible to talk about a European School, since it is too early to consider the new approach a school of thought.[52] At this stage, the Commission has yet to produce a solid conceptual framework based on clear

[47] ibid 3–4.

[48] D Hildebrand, *The Role of Economic Analysis in the EC Competition Rules: The European School*, 2nd edn (The Hague, Kluwer Law International, 2002) 109; D Hildebrand, 'The European School in EC Competition Law' (2002) 25 *World Competition*, 3–23.

[49] D Hildebrand, *The Role of Economic Analysis in the EC Competition Rules: The European School*, 2nd edn (The Hague, Kluwer Law International, 2002) 159.

[50] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints and Innovation: An Analysis from an Evolutionary Perspective' (2005) 28 *World Competition* 4, 507–32.

[51] KJ Cseres, *Competition Law and Consumer Protection* (The Hague, Kluwer Law International, 2005) 109.

[52] ibid 110–11. For a criticism of Hildebrand's book, see Odudu's book review (2003) 40 CML Rev 1292–96.

economic theory, which is why Cseres reckons this labelling is somewhat premature. Rather, and quoting Bishop, she believes that there is a 'staging post on the road towards the stated goal of a coherent economic based policy.'[53]

Another interesting standpoint is that of Kerber and Vezosso which, also departing from neoclassical reasonings, attempts to apply three strands of evolutionary theories of competition to the assessment of vertical restraints: Neo-Schumpeterian approaches to competition and innovation economics, Hayekian market process theories, and knowledge-based theories of the firm.[54] In doing so, they find that 'local knowledge, the heterogeneity of knowledge bases of firms, communication and learning problems, the complementarity of knowledge, and the specific problems of systemic innovations can contribute considerably to our understanding of the impact of vertical restraints.'[55] Whereas they generally accept the advantages of vertical restraints, they believe that sometimes they can hamper innovation, and this needs to be controlled by any antitrust regime. At this stage, these theories remain to be fully developed, but they may lead to interesting new ways of assessing vertical restraints in the future.

Importantly, the Harvard/Chicago/Post-Chicago framework should not be used to merely label legislative tendencies, but rather to understand the evolution of the politics of antitrust. The author is partial to Kovacic's view that 'branding ideas with Chicago or Post-Chicago labels prevents Americans and Europeans from understanding why the US system developed as it did and from seeing more accurately why their systems differ.'[56] Each of these schools did not destroy the advances of the previously-held positions, but rather used the postulations to build more empirically-developed theories. In this sense, this evolution of antitrust laws should be understood as a continuum rather than an ideological war. As such, the EC and US regimes affecting vertical restraints will present an 'intertwined chain of ideas' with influences of all of the influential schools of thought.[57] As Kovacic posits, these theories have left an imprint in the DNA of current antitrust predicaments.[58]

II VERTICAL RESTRAINTS AND WIDER COMPETITION POLICY—AN OVERVIEW

The above theories and schools of thought have left a clear imprint on the regulation of competition in the US and the EU. At this point, it is time to plunge into

[53] KJ Cseres, *Competition Law and Consumer Protection* (The Hague, Kluwer Law International, 2005) 110–11.

[54] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints and Innovation: An Analysis from an Evolutionary Perspective' (2005) 28 *World Competition* 4, 507–32.

[55] ibid 531–532.

[56] WE Kovacic, 'The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix' (2007) *Columbia Business Law Review* 1, 9

[57] ibid 14

[58] ibid

the analysis of the regimes and their evolution over the years. The current systems and their ways of introducing economic analysis in the evaluation of vertical restraints are explored in the following chapter. The aim of this section is to provide an understanding of the rationale of antitrust policy in each of the regimes under scrutiny from the early days of their existence.

A US antitrust policy and its core economic underpinnings

'Antitrust' is the term used in North America to refer to competition law. The reason for this peculiar terminology has its roots in the late nineteenth century, when antitrust became a national policy. A form of business organisation known as 'the trust' attracted general opposition to its power to make pricing and output decisions for entire industries and was denounced for its ability to raise prices and exclude rivals that refused to co-operate in its price-raising schemes.[59] In the United States, freedom of contract was limited earlier than in the Old Continent. As the years went by and capitalism evolved, and as a consequence of this total freedom to enter into private agreements, the end of the nineteenth century is characterised by the existence of concentrated economies in the US. There were no rules that prohibited or at least controlled conducts such as the existence or the cration of monopolies and market power. The concentrated situation tirggered the appearance of the Sherman Act much earlier than Europe had begun to worry about these matters. Nowadays the US has a long, solid tradition of competition law based on economic analysis. The regulation of competition in the US evolved depending on the predominant economic theories of the specific time. The European approach to vertical restraints greatly differs from today's US antitrust regime, where the rule of reason analysis is normally the method used to determine whether agreements are void under US antitrust law. However, this has not always been the case, and until the late 1970s vertical restraints were treated under the per se rule.

Currently, under US antitrust law, the protection of interbrand competition is prioritised, and firms are allowed to impose restrictions to competition in their own product. Territorial restraints and limits to intrabrand competition are presumed to have efficiency-enhancing effects for firms, while at the same time they do not impose a serious threat for consumers.[60] Competition between competing brands is what encourages the efficient allocation of resources, as it is the cause of the maintenance of low prices and broad choice for consumers.[61] Therefore, the potential negative effects of restrictions to intrabrand competition are very low, as

[59] See AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002).

[60] EM Fox, 'Parallel Imports, the Intrabrand/Interbrand Competition Paradigm, and the Hidden Gap Between Intellectual Property Law and Antitrust' (2001–02) 25 *Fordham International Law Journal*, 982–86.

[61] See *Business Electronics Corp v Sharp Electronics Corp* 485 US 717 (1988)

they are only cause for concern when a producer has market power, and if it does it is bound to directly raise prices rather than entering into complex distribution agreements.[62] Vertical restrictions are considered an essential incentive to enter into distribution contracts, as otherwise the risk of free-riders could deter distributors from incurring in the necessary costs.[63] However, this was not always the view, and the current tendency in US antitrust is the result of its extensive experience, gathered over more than a century, and the influence of the prevailing economic theories of the moment, which have determined the goals pursued by the policy.

American academics have long highlighted the importance of economics in competition law, as competition and the industrial structures which stimulate it are simultaneously explicit subjects of a branch of economics, that of industrial organisation.[64] Already in the mid 1970s, Sullivan's words stressed the need to consider antitrust as a branch of law linked to economics: 'Habits of thought, techniques of analysis, and value preferences derived from economics have come increasingly to play a substantial part in the development and application of the law. Today, one interested in antitrust cannot ignore economics. The topic is addressed at the outset not only to stress its current importance, but also to put economics into perspective and to highlight both its utility and the severe limitations upon what it offers to the law, limitations which are too often ignored.'[65] Even today, the importance of economics is emphasised by the doctrine. Kovacic recently stressed that:

> [t]o a degree unmatched in other fields of economic regulation, the elaboration of antitrust doctrine draws upon the contributions of economic theory. In antitrust practice, economic analysis plays a central role in resolving such key antitrust issues as delineating the relevant market and assessing the efficiency consequences of various forms of behaviour.[66]

US courts and enforcement authorities tend to focus on the real impact of an agreement by examining the extent of market power. Despite a certain concern—in particular in the 1960s and 1970s—about the market-partitioning effects of certain agreements, integration has never been the main goal of antitrust. The main reason for this difference between the two continents is that the US is, to a much greater extent, already an integrated market. In the history of North America, political integration preceded economic integration, unlike in Europe, where for the first time political integration is following economic unity. Therefore, the

[62] But see D Gilo, 'Retail Competition Percolating through to Suppliers and the Use of Vertical Integration, Tying, and Vertical Restraints to Stop it' (2003) 20 *Yale Journal on Regulation* 25.

[63] See *Business Electronics Corp v Sharp Electronics Corp* 485 US 717 (1988) 724–25. See also Commission of the European Communities, Green Paper on Vertical Restraints in EC Competition Policy (1997) COM (96) 721 Final.

[64] LA Sullivan, *Antitrust* (St Paul MN, West Publishing Co, 1976).

[65] ibid 1.

[66] WE Kovacic, 'The Modern Evolution of US Competition Policy Enforcement Norms' (2003) 71 *Antitrust Law Journal*, 377, 401.

evolution of US antitrust seems to be more influenced by political changes and the learning process given by the experience gained over the years rather than by the degree of integration between the different states. Despite the dominance of economic goals in the discussion of antitrust rules in the US, the possibility of protecting other goals through antitrust policy is not unknown in American legal tradition. The Harvard School, which was the predominant wave of thought until the 1970s, was very much in favour of this idea. In 1945, the Supreme Court referred to other objectives of antitrust policies: 'We have been speaking only of the economic reasons which forbid monopoly; but . . . there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results.'[67]

In particular, there are numerous court decisions which refer to social justice, fairness, the protection of small businesses or political stability as objectives worth protecting through antitrust. Although less likely to prove influential today, in the past these non-economic goals consistently found expression in the antitrust decisions of the federal and state courts and authorities. For instance, in the early days of US antitrust, the Supreme Court said on occasion that the disappearance of small businesses was 'unfortunate for the country by depriving it of the services of a large number of small but independent dealers who were familiar with the business and who spent their lives in it, and who supported themselves and their families from the small profits realized therein.'[68] Protecting a certain 'quality of life' and other benefits that arise from having numerous small actors, rather than favouring the establishment of major retailers—despite the offer of reduced prices and greater convenience for consumers—is an identifiable tradition that endures in several Member States of the EU.

Modern US antitrust case law has subordinated non-economic goals to the attainment of economic efficiency.[69] In the field of vertical restraints, this is particularly clear in the landmark *Sylvania* ruling, where the Supreme Court repealed the per se treatment that had governed verticals in the previous case law and established that departure from the rule of reason could only be justified by 'demonstrable economic effects'.[70] In doing so, it implicitly rejected reliance on non-economic goals as a guide for antitrust analysis. Hereafter, the development of antitrust policy would be premised upon economic efficiency considerations. The ruling marks a significant turning point and an ideological reorientation towards the doctrinal foundations of the Chicago School. Accordingly, since then vertical restraints have encountered general acceptance, as it is accepted that any

[67] *US v Aluminium Co Of America* 148 F 2d 416, 428–29 (2nd Cir 1945)

[68] *US v Trans-Missouri Freight Assocn* 166 US 290, 324 [1897].

[69] Nevertheless, non-economic goals occasionally find expression in modern judicial decisions. For instance, in *US v Brown University* 5 F 3d 658 (3rd Cir 1993), the Court of Appeal assesses whether it should consider the diversity and social welfare goals in analysing antitrust claims. See AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 32.

[70] *Continental TV Inc, v Sylvania Inc* 433 US 36 [1977].

firm with market power would have easier means of restricting competition than through vertical restraints.

EC competition policy emerged under the influence of the early American antitrust experience, which favoured the protection of non-economic goals through antitrust. In the early days, US antitrust received similar criticisms to those currently made of EC competition law.[71] In the European context, since the development of antitrust has coincided with the construction of a unique legal order through the pooling of national sovereignties, it has been necessary to maintain the non-economic objective of integration. Europe has clung to this idea, while the US has almost abandoned it completely. American antitrust soon evolved towards economic analysis and under the influence of the Chicago School became increasingly permissive towards verticals and much more business-orientated. Europe remained ideologically wedded to the Harvard and Freiburg approaches, and this has arguably affected the competitiveness of European firms.

Since the enactment of the Sherman Act,[72] the US economy has undergone a massive growth, which, allied to radical changes in transportation, production and sales technologies, greatly transformed the systems by which goods are distributed and the regime affecting such systems. The reforms are not only linked to economic theory, but some argue also coincide with political modifications and governmental changes.[73] The threat posed by foreign firms on the competitiveness of American brands abroad acted as a critical spur in the process of reform and criticism of the interventionist approach of the early years. Overall, the judgments of the American courts respond to two views of the competitive process. One believes in intervention as a corrector of the possible distortions firms can cause on the fragile markets. From this perspective, the importance of efficiency is constrained by the possibility of achieving social and political goals through antitrust. The other vision supports the idea that rivalry is healthy (following Adam Smith's invisible hand) and tends to act as a self-corrector of market imperfections, in which case the role of antitrust is more limited.[74]

i The Per Se Illegality Justification in the Early Supreme Court Decisions

Section 1 of the Sherman Act established already back in 1890 a prohibition which remains enforceable even today, and that served as inspiration for Article 81(1) EC: 'Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign

[71] For instance, Professor Posner has said 'for several generations, the Supreme Court has been deciding restricted distribution cases without any theory *at all* as to why manufacturers restrict distribution'. See R Posner, 'Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions' (1975) 75 *Columbia Law Review* 282, 285.

[72] An Act to Protect Trade and Commerce Against Unlawful Restraints and Monopolies, 15 USC § 1 (1970), enacted July 2, 1890.

[73] See ch 3 below.

[74] These views are summarised online at http://law.jrank.org/pages/4364/Antitrust-Law-U-S-Supreme-Court-Evolving-Doctrine.html.

nations, is declared to be illegal.' Those who enter into such agreements can be fined and even imprisoned.[75] Such a provision is evidently very broad, as agreements by nature impose restraints. The term 'every', interpreted in the literal sense, could lead to an overly restrictive position on concerted action.[76] It was for the courts to establish what restrictions could be considered acceptable and which ones would not be tolerated. In this context, a distinction was founded between per se illegal restraints and those which could be treated under the rule of reason. The former comprised all those restrictions which, by their mere existence, would cause a harmful distortion of competition, and they have no objective other than the restriction of competition. In such a scenario, the courts would not have to enter into a detailed economic analysis of the impact of the restraint. The US Supreme Court has on occasion justified the existence of the per se rule by explaining that there are

> certain agreements or practices which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable, and therefore illegal without elaborate enquiry as to the precise harm they have caused or the business excuse for their use.[77]

These clauses would therefore be automatically considered illegal. The latter, those restrictions governed by the rule of reason, are such that could be necessary for the legitimate purposes of an agreement. If this is the case, the courts have to evaluate the specific consequences of the restraints in the economy in order to determine whether or not a restraint is lawful.

A look at the case law gives us a better notion of the extent of these rules. Of particular interest is the *Addyston Pipe* case,[78] in which Judge Taft's opinion distinguished between two types of restraint of trade: those which had no other purpose other than restraining trade in an anticompetitive way and were not related to the legitimate main purpose of the agreement they were embedded in—'naked' restraints—and those which served a broader goal within a legitimate agreement—'ancillary' restraints.[79] The first category would be per se illegal, while a test of reasonableness would be used to determine whether or not those restraints falling under the second category were lawful. The subsequent case law used this distinction to determine the legality of the agreements presented before them.[80] In

[75] In particular, fines can be up to $10,000,000 for corporations and $350,000 for individuals, and imprisonment can be up to 3 years.

[76] See eg *Chicago Board of Trade v US* 246 US 231 (1918), where the Supreme Court introduced a rather black-letter interpretation of the word 'every'.

[77] *Northern Pac R Co v US* 556 US 1 (1958).

[78] *Addyston Pipe & Steel Co v US* 175 US 211 (1899).

[79] AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 81.

[80] However, in *Trans-Missouri Freight*, the Supreme Court opted for a literal interpretation of the Sherman Act and its prohibition of 'every' restraint of trade. It stated that the prohibition extended not only to unreasonable restraints, but also to 'all contracts . . ., and no exception or limitation can be added without placing in the act that which has been omitted by Congress.' This interpretation, despite its straightforwardness, meant that agreements with no anticompetitive effects could be declared illegal. See *US v Trans-Missouri Freight Assocn* 166 US 290, 17 Sup Ct 540, 41 L Ed 1007 (1897).

particular, *Standard Oil* and *Chicago Board of Trade* emphasised the need to consider the purpose, nature and effects of restraints.[81]

As regards vertical restraints in particular, originally they were treated under the per se rule. The concerns of the Supreme Court affected not only price-related restrictions (that is, when the manufacturer sets a minimum or maximum price at which its buyers may resell),[82] but also those restraints imposed by a seller on the territories within which or the customers to which the buyer may resell.[83] The Court was very quick to declare price restrictions were contrary to section 1 of the Sherman Act. The per se rule regarding minimum resale price maintenance was first declared in one of the earliest antitrust decisions, *Dr Miles*.[84] In justifying its decision, the Court concentrated on two problems: the existence of a restraint on alienation and how this restriction would reduce the freedom of distributors.[85] Some authors have indicated that these concerns, on the one hand, are not strictly speaking competition related, and, on the other, can hardly serve to justify the per se treatment of these restrictions.[86] Nevertheless, subsequent case law confirmed this position. For instance, in *Bausch & Lomb* the Supreme Court stated that vertical restraints were unlawful when they were part of an aggregation of trade restraints which included resale price-fixing. In the 1940s, *Socony-Vacuum Oil* explicitly pronounced business practices 'formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce' illegal per se.[87] Also, in *Brown Shoe* the FTC declared the possible breach of competition of an exclusive dealing agreement that resulted in vertical foreclosure of less than one per cent.[88] Market power was evidently not taken into consideration when declaring these restrictions anticompetitive. It took 86 years for the Supreme Court to tamper with the per se illegality of price restraints—when *Kahn* did away with the per se rule for maximum resale price maintenance—and a further 10 years before minimum resale price maintenance would become subject to the rule of reason.[89]

[81] *Standard Oil Co v US* 221 US 1 (1911); *Chicago Board of Trade v US* 246 US 231 (1918).

[82] Price vertical restraints were treated under the per se rule since *Dr Miles Medical Co v John D Park & Sons* 220 US 373, 31 Sup Ct 376, 55 L Ed 502 (1911). See also *US v Bausch & Lomb Optical Co* 321 US 707, 64 S Ct 805, 88 L Ed 1024 (1944), where the Supreme Court stated that vertical restraints were unlawful when they were part of an aggregation of trade restraints which included resale price-fixing.

[83] But see *US v Colgate & Co* 250 US 300, 316 (1919), where the Court held that 'in the absence of any purpose to create or maintain a monopoly, the [Sherman] Act does not restrict the long recognized right of trader or manufacturer to freely exercise his own independent discretion as to the parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.' The restraints were found lawful given the absence of an agreement.

[84] *Dr Miles Medical Co v John D Park & Sons* 220 US 373, 55 L Ed 502 (1911).

[85] ibid 404.

[86] See, for instance, TA Lambert, '*Dr Miles* is Dead. Now What? Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) 2008–25 *Legal Studies Research Paper Series*, University of Missouri 3, fn 12.

[87] *US v Socony-Vacuum Oil Co* (1940) 310 US 150, 223.

[88] *Brown Shoe Co* 62 FTC 679 (1973).

[89] For an analysis of *Kahn* and *Leegin*, see ch 3 below.

The per se rule also applied to non-price restraints, although for a shorter period of time. Until the 1970s, there was a general concern that, although competition *stricto sensu* is between competitors and not buyers and sellers, agreements between them could affect competition at the horizontal level occupied by either.[90] The first case in which these presumptions were question was *White Motor Company*,[91] but it did not do enough to provide the grounds for doctrinal change. Only four years later, *Schwinn* established a distinct treatment for that merchandise sold to distributors and merchandise handled by distributors as sales agents taking orders from a producer. The former would be per se illegal, while the latter would escape the scope of the section 1 prohibition.[92] According to this landmark case, it seems that the concept of 'restraint on alienation' is used to differentiate between per se illegal and the rule of reason, that is, whether the restriction is associated with vertical integration or it is a naked restraint. As Judge Browning said in the dissenting opinion in *Sylvania*, 'the question is whether the position and function of the dealer are, in fact, those of an agent or salesman, on the one hand, or those of an entrepreneur, on the other.'[93] The *Schwinn* rule was applied in cases such as *Topco*,[94] where the Court said that territorial restraints, even when they adversely affect competition in only one brand, are per se unlawful, and they cannot be justified on the ground that they aid competition in other aspects. Also, in *Adolph Coors Co v FTC*,[95] the Court declined the invitation of the Court of Appeals to reexamine the *Schwinn* issues.

ii Reasons Behind the Subsequent Proliferation of the Rule of Reason

The per se illegality rule of *Dr Miles* and *Schwinn* approach was virtually untouched until the late 1970s. This treatment of vertical restraints in the absence of vertical integration showed some problems in practice, given that it does not provide the means to take into consideration the reasons why a manufacturer may be encouraged to introduce a particular restraint. Therefore, those benefits and advantages inherent in these restrictions analysed in chapter 1 were being almost entirely overlooked, as there was no room for individual analysis. Given the complicated nature of these restrictions and the agreements they are contained in, it

[90] LA Sullivan, *Antitrust* (St Paul MN, West Publishing Co, 1976) 376.

[91] *White Motor Co v US* 372 US 253, 83 S Ct 696, 9 L Ed 2d 738 (1963).

[92] Sullivan points to certain tensions between this ruling and the *Simpson* case (*Simpson v Union Oil Co* 377 US 13, 84 S Ct 1051, 12 L Ed 2d 98 (1964)). *Schwinn* seems to indicate that bona fide consignments are enough to remove resale restraints from the per se area, while *Simpson* suggests that where a system of consignments is used to cover a network of retailers having other attributes of independent business, it is not. Both rulings could be integrated by saying that a consignment would take the transaction out of the per se area if it involved significant integration, but it would not do so if the transaction was trivial. LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976).

[93] Judge Browning in the dissenting opinion of *GTE Sylvania Inc v Continental TV Inc* 537 F 2d 980 (9th Cir, 1976), LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976). 405.

[94] *US v Topco Associates* 405 US 596, 92 S Ct 1126, 31 L Ed 2d 515 (1972).

[95] *Adolph Coors Co v FTC* 497 F 2d 1178 (10th Cir 1974), cert denied 419 US 1105, 95 S Ct 775, 42 L Ed 2d 801 (1975).

appears the blanket application of such a strict rule would never suffice to adequately deal with the multi-faceted intricacies that present themselves. Moreover, these restrictions appear to be not only beneficial, but even essential in some cases. However, the strict US antitrust enforcement in the 1960s and 1970s left very little room for manoeuvre.[96]

Eventually, these problems became apparent, and the need to allow an assessment of the impact of vertical restraints on competition began to be considered. At the end of the 1970s and the beginning of the 1980s, several factors contributed to the progressive changes introduced, the first being the flourishing of the Chicago School ideas that had, by then, been around for almost a couple of decades and had began to mature and impregnate society.[97] US antitrust enforcement agencies had also been faced with these challenges, and were eager for policy changes. These issues pushed US courts to rethinking their position at a time when the Chicago School ideals had flourished in economics. Importantly, the political context of the time also favoured the expansion of laissez-faire ideals, as in 1981 Ronald Reagan was elected President of the US, starting a new republican era after Jimmy Carter's four years in office. The successive changes and their merits will be assessed in the next chapter.

B EC competition policy and vertical restraints

The US antitrust tradition has affected legal attitudes everywhere, and the EC is no exception. However, there are peculiarities in the European context that have led to a conscious divergence in the treatment of vertical restraints. The three main axes of power in the world—the United States, Japan and the European Union—have strived towards protecting their own production against competition from other countries in different ways.[98] Traditionally, the United States had a hegemonic position that drove the country to an interest in the opening of the world markets. Its greater capacity to compete enabled the US to enter into the national markets of the rest of the world, yet at the same time in its own market national products were able to resist the competition posed by imported goods. The situation has eventually evolved and since the 1970s, the US shares its privileged position with Japan and the EU. Nowadays, American firms call for larger protection, even more so in the light of the current economic downturn. Japan has solid protectionist mechanisms in its economy, and the EU, composed of countries that find it hard to reach an agreement on any field, also has a protectionist attitude towards third nations. The specific problem in the EU resides in that it still lacks

[96] Sullivan believes that the justification of the legality of such restraints resides in the fact that 'no less restrictive alternative which would have provided equivalent protection to the public and the manufacturer was apparent': LA Sullivan, *Antitrust* (St Paul, MN, West Publishing Co, 1976) 411.

[97] See s I D above.

[98] For an analysis of the evolution of the World Economy in the last century, see J Requeijo, *Economía Mundial: Un Análisis Entre Dos Siglos* (Madrid, McGraw Hill, 1995).

the political and social union of the others and there are still barriers to trade within the Member States.

The solid tradition of competition policy in the United States has been based upon economic analysis since the end of the 1970s, but this has not been the case in the Old Continent. Antitrust became a national policy in the late nineteenth century, yet it was not until the end of the Second World War that most European countries began to regulate competition.[99] Given the experience of US antitrust, it seems natural that the emerging European Economic Community would look towards the US for inspiration, and that the unique experience of American antitrust law—gained over decades—would impact upon the formulation of a budding Community policy. In this sense, the prohibition of Article 81(1) EC is clearly inspired by Article 1 of the Sherman Act, which dates back to 1890. However, the interpretation given to these two provisions differs greatly, as in Europe the prohibition has been understood in a much broader sense. It is herein argued that this is a consequence of the specific goals pursued by both legal orders and in particular by the fact that EC competition policy is fundamentally impregnated with overarching considerations of the wider process of integration.

Integration has for many years been perceived as a solution to the many problems affecting the European continent. Even before the current economic crisis, the EU had for quite some time been affected by a lack of competitiveness of its firms and an ageing society, factors which have had an important impact on welfare and economic performance.[100] The Community suffers a lack of economic dynamism, especially in comparison to its competitors: its growth in the last 35 years has been slow when compared to other parts of the world, and the gap increased over time until the year 2000, when a slight narrowing has been perceived.[101] Therefore, in terms of economic growth the EU currently cannot match the US or the 'Asian Dragons'.[102] Moreover, the difficult sustainability of the European social system is leading to political tensions within the Union.[103] Such a system implies high costs, and it is being threatened by an ageing population and low levels of employment and employment creation in most of the EU—particularly in Continental Europe. To make matters worse, in the context of the process of integration of different independent nations with divergent historical, political and economic backgrounds, social and economic inequality is very marked

[99] Germany and the UK were the first European nations to adopt antitrust policies. In Germany, the first regulation came as early as 1923, after the economic crisis of the First World War.

[100] The data included in this section were principally gathered in the Seminar 'The Future of the European Union', organised by the LSE and Fundación Cajamadrid in Madrid in April 2005, particularly in the lecture given by Prof Andrés Rodríguez Pose.

[101] Those countries experiencing a greater growth are Ireland, the UK, the Baltic and Nordic Countries, Slovenia, Malta and Luxemburg. As for Germany, Italy and France, Germany is 30 per cent of GDP of the EU, while its population amounts to less than 20 per cent. Germany and Italy together represent about 48 per cent of GDP of the EU. Adding France, the figure rises to over 60 per cent: ibid.

[102] Particularly Thailand, China, India and Taiwan: ibid.

[103] According to Rodríguez Pose, one of the reasons why there might have been a negative vote in France for the European Constitution is its questioning of the social system: ibid.

and has been emphasised by the successive enlargements.[104] Therefore, the gap between rich and poor is outstanding, in the detriment of economic dynamism. The Community's technological capacity also remains much more reduced than that of the US and Asia. Solutions have been sought over the years to increase the economic performance of the EU. One way out of the problems, mainly propelled by Germany and much to the UK's discontent, has been integration. The promotion of a single market responds to an attempt to create economies of scale, and has been done on three levels: economic, political and social. In this context, the importance of economic integration is vast, as it is seen as the *chemin* to achieve the desired political and social unity. Economic integration implies the removal of the powers that sovereign nations have relating to macro- and micro-economic policies and currency.[105] This scenario provides a better understanding of the predominant concerns in Europe with integration, which are reflected in the legislation and activity of the courts at all levels.

In Europe, the protection of non-economic goals through antitrust has been explicitly present since the early days, an idea robustly defended by the Harvard and Freiburg Schools.[106] In particular, European competition policy has often been criticised for being more concerned with achieving market integration than actually protecting competition.[107] This preoccupation for enhancing the integration process can be better understood in relation to the very idea of establishing a common market, which was the priority behind the very birth of the European Economic Community back in 1957.[108] It was believed that the principal advantage of the common market would be the reconciliation of mass production with the absence of monopolies.[109] Under this ideal theory, symmetric, equal bargaining conditions for all European market participants and increased opportunities for business would emerge from enhanced specialisation, mass production and

[104] With the exception of the 1995 Enlargement, when Austria, Finland and Sweden became members of the EU, new Member States have been poorer States.This is particularly enhanced in the 2004 and 2007 Enlargements: ibid.

[105] Those policies include, eg, the regulation of domestic production, labour and financial markets and trade; the imposition of taxes on labour and goods; the control of the international movement of goods (imports and exports), people (migration) and money (currency exchange): ibid.

[106] In this sense, Verouden comments that the expression 'restriction of competition' has been interpreted in the light of the overall objectives of the EC Treaty rather than considering competition principles. See V Verouden, 'Vertical Agreements and Article 81(1): The Evolving Role of the Economic Analysis' (2003) 71 *Antitrust Law Journal* 525.

[107] See, inter alia, R Wesseling, *The Modernisation of EC Antritrust Law* (Oxford, Hart Publishing, 2000) 10; BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89.

[108] The Treaty of Rome was the foundational Treaty of the European Economic Community. The competition provisions are in line with the general objectives of the Community described in Art 2 EC, in particular promoting 'harmonious development of economic activities in the Community through the establishment of the common market and the approximation of the economic policies of the Member States.' Art 3 included, among the instruments for establishing the common market, 'guaranteeing the free movement of goods, persons, services and capital between Member States'—Art 3(1)(c)—and a 'system ensuring that competition in the internal market is not distorted'—Art 3(1)(g).

[109] R Griffiths, 'The European Integration Experience' in K Middlemas (ed), *Orchestrating Europe* (London, Fontana Press, 1995) 1–70, 58–59.

economies of scale, and above all via the progressive removal of obstacles to intraCommunity trade. Furthermore, enhanced international competition would boost European business' competitiveness. In order to ensure the correct functioning of the market mechanism, it was essential that competition would not be hampered by private or public impediments to free trade. It was in this context that, in the preparatory phase of the Treaty of Rome, the Spaak Committee emphasised the need for Treaty provisions directed at preventing private undertakings from obstructing the common market.[110] Economic integration would require the emergence of a new economic order from the disparate national models. For the Spaak experts, the reallocation of factors of production could be better achieved by guaranteeing the proper functioning of the market. This was the underlying reasoning behind the antitrust provisions of the foundational Treaties.

EC competition policy emerged very much embedded in the continental notion of competition law. In the continental tradition, freedom of contract and private property have been the inspiring principles of most of the legal and economic traditions ever since the ideals of the French Revolution impregnated society. Freedom of contract implies that firms should be allowed complete freedom to organise their businesses. When the law begins to be codified and the first civil and commercial codes are introduced for most countries of continental Europe, this freedom seems to be the inspiring concern. As a consequence of this virtually unlimited liberty proclaimed by the Codes, the need for competition law rules was not felt at the time. Agreements were the law between the contracting parties, hence no rules limited the choice of the parties as to what clauses may or may not be included. It is mainly after the Second World War that governments began to intervene in the economy in Europe. National authorities started to set out the objectives of economic policy, and to take responsibility for pursuing justice through law. In this scenario, the derogation of the principle of freedom can be justified where there are situations of previous inequality (consumer protection, labour law). Antitrust emerged after contract law to control the external effects of the contracts.[111] Therefore, its reservations about vertical restraints should be seen not as a basis for intervention in the contractual relation, but an external limit to freedom of contract for the parties concerned.[112] This, as we will see, has not always been the case.

The emergence of these ideas coincides in time with the birth of the European Economic Community and the enactment of the Treaty of Rome. It is then that what we know now as EC competition law started to take shape, some sixty years after the enactment of the Sherman Act in the US. In the early 1950s, at the dawn

[110] '*Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères*', prepared by the Intergovernmental Committee created by the Messine Conference and presented on 21 April 1956 in Brussels.

[111] CJ Joerges, 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 3.

[112] ibid.

of the process of European integration, the importance of protecting competition started to be perceived, particularly given the results of US antitrust rules and the need to encourage the functioning of the new integrated market.[113] Therefore, the Treaty of Paris, which created the European Coal and Steel Community (ECSC) in 1951, already prohibited trade barriers, discriminatory and restrictive practices capable of distorting competition among the six founding countries of the Communities.[114] Only six years later, Articles 81 to 89 (then 85 to 93) of the Treaty of Rome, which founded the European Economic Community, established the pillars for the development of a supranational competition policy in Europe.[115] Even though the founding Treaty has been amended on several occasions,[116] the competition law provisions have remained intact over the years. However, the developing secondary legislation has been thoroughly reformed over the years.[117] For our purposes, block exemption regulations (BER) and Commission decisions are of particular relevance,[118] since they have given a precise definition to the general framework established in the Treaties. These primary and secondary legislation provisions, along with the interpretation given to them by the European courts and the soft-law instruments,[119] have highlighted the main features of EC antitrust and its evolution over the years, and have determined the direction of the policy.

When compared to US antitrust, EC competition policy has not yet accomplished an adequate economic analysis. US policy developments have been mainly introduced by the courts on a case-by-case basis, and the result is a usually a coherent policy centred around economic welfare and focused on the protection of interbrand competition. In Europe, although the courts introduced some economic analysis in the cases presented before them (albeit incomplete and sometimes incoherent given the preoccupation for integration), it was not until the introduction of Regulation 2790/99—analysed in the next chapter—that a

[113] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 13.

[114] In particular, see Arts 65 and 66 of the ECSC Treaty.

[115] Germany, the most cartelised country, was the main propeller for the inclusion of Arts 81 and 82 in the Treaty of Rome. These Articles are the role model followed by national legislating authorities when enacting their competition laws. These rules aim mainly at guaranteeing the freedom of the actors.

[116] The Treaty has been reformed by the Single European Act (1986), Treaty on the European Union or Treaty of Maastricht (1992), the Treaty of Amsterdam (1996) and Treaty of Nice (2003). The most recent reform proposal is the Constitutional Treaty, which has not yet been ratified by the Member States after the veto in the French and Dutch referenda. In this respect, see, inter alia, A Tomkins, 'Constitutionalism and the "Failure" of the Constitutional Treaty' in D Chalmers, C Hadjiemmanuil, G Monti and A Tomkins, *European Union Law* (Cambridge, Cambridge University Press, 2006) 45–85.

[117] M Furse, *Competition Law of the EC and the UK*, 5th edn (New York, Oxford University Press, 2006).

[118] Regulations and decisions are among the instruments of Art 249 EC. According to this provision, '[a] regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States', while '[a] decision shall be binding in its entirety upon those to whom it is addressed.'

[119] Soft-law instruments (such as notices and guidelines), although not legally binding, may 'create legitimate expectations in those subject to the application of the relevant law': M Furse, *Competition Law of the EC and the UK*, 5th edn (Oxford, Oxford University Press, 2006) 25.

major reform of the system took place. This reliance on the Commission for the design of competition policy dwells on the problem highlighted by Hayek that governments and institutions have fundamental knowledge problems with regard to intervening successfully in market processes.[120] Evidently, the protection of competition on the part of the Commission is essential. Hayek however suggests that the role of governments and competition agencies should be to establish framework rules as opposed to the detailed norms contained in the old block exemption regulations.

Some authors have interpreted that these general rules should stand in place of a case-by case analysis.[121] In such a scenario, according to these voices, the per se rules would be more desirable than the rule of reason, which implies weighing the pros and cons of the specific agreements. In our view, the framework established in the general rules requires casuistic development. Precisely the advantage of having flexible principles is that they can be adapted to the specificities of each case. In the context of distribution restraints, advances and new technologies are currently revolutionising the way products reach end consumers, particularly with the boost of the Internet. Therefore, it is important that competition policy allows these changes in the channelling of products, as it will lead to greater efficiency. If, as Hayek suggests, competition is to be seen as a 'discovery procedure', then the role of the case-by-case analysis cannot be underestimated. Kerber and Vezzoso, following Williamson's transaction costs approach, have nonetheless emphasised the high costs of monitoring and enforcing contracts between partners, which acts as a limit on the potential role of the courts.[122] Following this approach, it seems logical to believe that the contracting parties would prefer low transaction costs. Such expenses can be controlled, for instance, by giving a literal interpretation to the wording of contracts. However, as Kerber and Vezzoso observe, the limitations on innovation, freedom and flexibility which could be derived from such a view are clear. Moreover, literal readings of rigid contracts miss relational theory considerations, which advocate the need to examine contractual provisions in the context of long-term relationships and human interactions and involve good faith considerations.[123]

[120] FA Hayek, *Law, Legislation, and Liberty* (Chicago, University of Chicago Press 1978).

[121] W Kerber and S Vezzoso, 'EU Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective' *Paper prepared for the 10th International Joseph A Schumpeter Society Conference (ISS)* (Milan, 2004).

[122] Macaulay insists on the high costs of litigation in S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 179–237.

[123] Relational theory is mainly developed by Macneil in the field of contract law. See, for instance, I Macneil, 'Relational Contract: What We Do and Do Not Know' (1985) *Wisconsin Law Review* 483.

i The Early Days: The Malfunctioning of a Regime Built Around the Protection of Economic Freedom and Integration

> It is perfectly natural that a fast-growing forest contain and underbrush of detritus. The history of vertical restraints . . . contains some of that underbrush. . . . That underbrush does significantly impede the traversal of the EC competition forest by firms and lawyers who themselves spend more time fighting their way through the doctrinal formalisms than relying on the valuable compass of economics.
>
> Nature's solution is a forest fire to clear out the underbrush so that the forest can renew itself.[124]

With this metaphor comparing EC competition law to a forest that needs to be cleared in order to achieve its full glory, Hawk described the situation of vertical restraints under EC competition law back in 1995. His views reveal an almost unanimous position at the time about the need for changes. For many years, academics, practitioners and basically all stakeholders had been most vocal in their criticism of a system disconnected from economic reality.[125] Such general disapproval forced the Commission to look for arguments to justify its course of action, and consequentially unwittingly hardened the position of the institution.[126] By the mid 1990s, the wait for the application of an economics-based analysis to the assessment of vertical restraints had begun to feel as frustrating as the wait for Godot described by Beckett.[127]

The Commission's approach to vertical restraints has been one of the most severely criticised aspects of EC competition policy. Ever since the appearance of the Guidelines on Vertical Restraints,[128] an effort towards a change of perspective can be perceived, the main step being the adoption of Regulation 2790/99,[129] a single block exemption for these agreements that takes into consideration market power and that broadens considerably the scope of the exemption. The reform was the result of a long process that commenced in 1997. In September 1998 a Communication from the Commission on the application of the EC competition rules to vertical restraints summarised the results of the comments on the Green Paper and established a framework for the policy reform, which was the pillar upon which the new block exemption regulation rests.[130] Finally the Commission

[124] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89, 989.

[125] See also V Korah, 'The Future of Vertical Agreements under EC Competition Law' (1998) 8 *European Competition Law Review*; R Wesseling, *The Modernisation of EC Competition Law* (Oxford, Hart Publishing, 1999) 78; S Bishop, and D Ridyard, 'EC Vertical Restraints Guidelines: Effects-Based or Per Se Policy?' (2002) 1 *European Competition Law Review*.

[126] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CMLR 973–89, 973.

[127] S Beckett, *Waiting for Godot* (London, Grove Press Inc, 1954).

[128] Commission Notice, Guidelines on vertical restraints [2000] OJ C291/1.

[129] Commission Regulation (EC) 2790/1999 of 22 December 1999 on the Application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21.

[130] Communication on the application of the EC competition rules to vertical restraints—follow-up to the green paper on vertical restraints [1998] OJ C365/3; [1999] 4 CMLR 281, http://ec.europa.eu/competition/antitrust/others/archives.html.

took account of the countless complaints that it received and endeavoured to adopt a more economic approach, based on the market power of undertakings. The new regime established by the block exemption was the result of a necessary in-depth policy review that had been delayed when the application of the old block exemption regulations was extended.

Indeed, a mere glance at the development of the regime affecting vertical agreements until the end of the last decade can suffice in order to detect the motivation of the complaints. The concept of 'economic freedom' to which the Commission steadfastly clung resulted in the chaotic situation where virtually all agreements were deemed to contravene the prohibition laid down in Article 81(1) of the EC Treaty, so that in one way or another the parties' liberty to act is bound to be restricted when they enter into a contract.[131] The Commission basically identified the concept of restriction upon competition as negative effects that can be derived from these restrictions by defining the concept as a restriction on the 'economic freedom' of operators in the marketplace.[132] Unfortunately, and as highlighted above, this conception can justify a breach of Article 81(1) EC by almost every contract, since the reason of entering into a contract is precisely assuming mutual obligations and this generally means a restriction of the freedom of the parties.[133] The European courts attempted to adopt a more economic approach in their decisions. By the 1990s, when the Commission realised changes were needed, they had generally opted for a more economic analysis in the cases presented before them. Nevertheless, this contrasting approach of the courts made the situation even more confusing for firms, which regularly need to enter into distribution agreements to enhance efficiency and productivity but that could be considered to infringe the general EC competition provisions.

Freedom of competition had one limit: it did not include those business practices which were capable of dividing the market along national lines, even if such behaviour had the effect of enhancing competition. Integration concerns have thus been central to the development of EC antitrust policy. Vertical agreements were, as a consequence of the broad definition of restriction on competition and the integrationist approach, considered to fall within the scope of Article 81(1) EC, and thus there was a large demand for exemptions on the basis of Article 81(3) EC.[134] Originally, the way an agreement could be exempted was to follow the procedure established in Regulation 17/62, and apply for an individual exemption after notifying the Commission of the agreement. Given the impossibility of the

[131] AJ Riley, 'Vertical Restraints: A Revolution?' (1998) 8 *European Competition Law Review* Editorial.

[132] For a criticism of the Freiburg School's approach to vertical restrictions, see BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89, 978.

[133] The US Supreme Court has stated in this respect that from the point of view of the limitation of the freedom of the parties 'every contract is a restraint to trade, and . . . the Sherman Act was intended to prohibit only unreasonable restraints to trade': *National Collegiate Athletic Association v Board of Regents of University of Oklahoma* 468 US 85, 98 (1984).

[134] Art 81(3) EC provides an exemption for potentially beneficial restrictions ('ancillary restraints' in US terminology). In particular, an agreement must contribute to improving the production or distribution of goods or promoting technical or economic progress, and it should not enable firms to eliminate competition in respect of a substantial part of the products concerned.

Commission complying with the task of examining every individual agreement, solutions had to be found. Although some of these agreements had very little potential to harm the competitive process, the restrictive interpretation of Article 81(1) meant that they were interpreted to fall within the scope of the prohibition. Their only salvation was either to apply for an individual exemption for each agreement that contained a restriction of one of the parties' freedom, or to try to adapt their agreements to one of the block exemptions. If the agreement was considered to be inexemptible, they could still bring the case before one of the European courts and hope that the court would apply an economic analysis. The resulting complexity was far from desirable, and some agreements with no anti-competitive effects were considered void, whilst some seriously anticompetitive agreements where large market sales were involved and which could have the effect of foreclosing the market were escaping the nullity sanction.

If Article 81(1) EC had not been interpreted in such a restrictive way, many vertical agreements would have escaped the Commission's competence. This would have allowed national courts and authorities to give the green light to agreements without the need for an exemption, if and when they complied with national contract law provisions. On the contrary, the Article 81(1) EC prohibition forced national authorities to give up jurisdiction from all these cases in favour of the Commission, as they did not have the power to grant exemptions of Article 81(3) EC. Article 9 of Regulation 17/62 gave the Commission the exclusive right to exempt agreements. In this way, the Commission enjoyed had almost exclusive powers to foster the development and interpretation of EC antitrust rules, under the exclusive control of the European courts. The motivations behind the strict approach are twofold: first of all, by not allowing national authorities and courts to grant exemptions, the Commission was able to achieve uniformity in the interpretation of antitrust provision, which would otherwise have been difficult considering the divergent legal traditions of the Member States. Secondly, integration was the priority at the time and by interpreting the Article 81(1) EC prohibition in such a restrictive way with such a complex system of exemption territorial restraints could be controlled. However, from an economic perspective, the consequences of such a restrictive approach were that contracts with no anticompetitive effects in the economic welfare sense were being declared void and sometimes important fines were imposed by the Commission for territorial restrictions.

It was in the 1960s' *Consten and Grundig* decision where the Commission clarified that restrictions on intrabrand competition contained in vertical agreements were caught by Article 81(1) EC,[135] and it did so on the basis of the promotion of integration. The decision, later confirmed by the ECJ, established that an agreement which granted absolute territorial protection and thus had the potential to divide the single market along national lines could not be considered lawful, regardless of

[135] *Consten and Grundig* [1964] OJ 161/2545. In this case, an undertaking faced limitations when trying to import Grundig products from Germany into France, as it was prevented from selling some of the relevant products because of the exclusive right to the Grundig trade mark held by Consten. See M Furse, *Competition Law of the EC and the UK*, 5th edn (Oxford, Oxford University Press, 2006) 170.

its possible efficiency-enhancing effects. In order to escape the prohibition, in those early days before the introduction of the block exemption regulations, agreements affecting distribution had to follow the procedure provided in Regulation 17/62 in order to be exempt.[136] Under this Regulation, undertakings interested in obtaining an exemption for their agreements on the basis of Article 81(3) EC were forced to notify those contracts which could fall within the Article 81(1) EC prohibition (that is, virtually all of them). This inconvenient method of waiving the prohibition resulted in an enormous amount of notifications, thus the Commission was incapable of producing all the formal decisions required to answer every petition.[137] The figures highlighted by Wesseling speak for themselves: in 1963, 34,000 bilateral agreements had been notified,[138] and by 1971 the figure of exclusive dealing agreements alone was of 30,000.[139] The DG Competition could hardly cope with the enormous amount of decisions it was being asked to issue.

Normally, the notifying parties would receive an informal 'comfort letter' from the institution expressing that it did not intend to take action against them. Such a document was nonetheless not binding upon the Commission or the courts,[140] and remained unpublished and thus unavailable for other firms to consult.[141] Comfort letters did not prevent the Commission from eventually initating proceedings in respect of those agreements. Therefore, firms could see their contracts being declared void (which would free the parties from their obligations), and even face considerable fines. The climate of legal uncertainty for firms was evident, and by the 1970s it was clear that changes urged. However, narrowing the scope of the prohibition of Article 81(1) EC was not regarded as an option. Instead, mass exemptions were introduced relying on Article 81(3) EC. The informal notices issued by the Commission eventually showed that certain types of agreements were nearly always granted an exemption, and therefore solutions were sought so that they would be able to escape the notification requirement. This is how the idea of using block exemption regulations came up, and gradually their use became crucial in the development of Community antitrust policy.

Block exemptions intended to provide enterprises with a reliable way of self-assessing their agreements.[142] A series of block exemptions emerged for different

[136] Council Reg 17 of 13 March 1962 [1962] JO 13/204 [1959–62] OJ Spec Ed 87.

[137] See R Wesseling, *The Modernisation of EC Antitrust Law*, Studies on European law and integration (Oxford/Portland, OR, Hart Publishing, 2000) 23.

[138] D Goyder, *EC Competition Law* (Oxford, Clarendon Press, 1998) xli. To make matters worse, the small number of officials administering DG VI were not able to fully concentrate on competition matters, since they were also in charge of taxation and approximation of laws. See R Wesseling, *The Modernisation of EC Antitrust Law*, Studies on European law and integration (Oxford/Portland, OR, Hart Publishing, 2000) 24.

[139] Commission of the EC, *First Annual Report on Competition Policy*, Brussels 1972, 15, 57.

[140] In particular, in case 99/79 SA *Lancome & Cosparface Nederland BV v Etos BV & Albert Heyn Supermarket BV* [1980] ECR 2511, the ECJ held that comfort letters do not bind national courts.

[141] See T Rodríguez de las Heras Ballel, 'Decentralised Application of EU Competition Law: A Strategic Approach' (2004). Working Paper 05, CLaSF Working Paper Series.

[142] Since block exemptions are introduced as regulations, they will be directly applicable in all Member States. For a detailed description of what direct applicability implies, see R Greaves, *EC Block Exemption Regulations* (London, Chancery Law Publishing Ltd, 1994).

types of agreements, in particular exclusive distribution, exclusive purchasing, franchising agreements, motor vehicle distribution and technology transfer.[143] BERs are exclusive to EC law,[144] and have been adequately described as a self-regulatory mechanism: if the parties to an agreement are careful. to comply with all their requirements, they can be certain of the agreement being in accordance with EU law. In this sense, BERs are a method of harmonising agreements: they impose procedures on all those who want to produce an agreement exempt from the prohibition of Article 81(1) EC. One of the major advantages of having block exemption regulations is that the parties who wish to be protected from entering into an agreement that might fall within the scope of Article 81(1) of the Treaty are able to know how to organise their distribution systems. The original block exemptions for vertical agreements were criticised for being too formalistic, as lawyers had to spend valuable time manoeuvring the wording of agreements so that they would comply with the requirements to be exempted rather than worrying about the underlying economic effects. The system was also far from exhaustive, as selective distribution and agency agreements were not covered by any block exemption. The result has been an overly formalistic written 'pattern of business contracts' represented in the various block exemptions, to which lawyers had to tailor-make their agreements in order to ensure that the contracts would not be declared void. Needless to say, the problem of lack of legal certainty and inconsistency at best remains unsolved, and while certain agreements with little or no potential to harm competition were being minutely scrutinised, other anti-competitive agreements were evading sanction.

The decisions adopted by the Commission regarding the different types of vertical agreements did little to improve the situation. In its enforcement of EC competition law, the institution consistently followed the principle that it would not permit the adoption of measures that could partition the market. Exclusive

[143] Commission Regulation (EEC) 1983/83 of 22 June 1983 on the Application of Article 85(3) of the EEC Treaty to Categories of Exclusive Distribution Agreements OJ [1983] L173/1, as amended by OJ [1983] L281/24; Commission Regulation (EEC) 1984/83 of 22 June 1983 on the Application of Article 85(3) of the EEC Treaty to Categories of Exclusive Purchasing Agreements OJ [1983] L173/5, as amended by OJ [1983] L 281/24; Commission Regulation (EEC) 123/85 of 12 December 1984 on the Application of Article 85(3) of the EEC Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements OJ [1985] L15/16 (subsequently replaced by Commission Regulation (EC) 1475/95 of 28 June 1995 on the Application of Article 85(3) to Certain Categories of Motor Vehicle Distribution and Servicing Agreements OJ [1995] L145/25, replaced by Commission Regulation (EC) 1400/2002 of 31 July 2002 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector OJ [2002] L 203/30); and Commission Regulation (EEC) 4087/88 of 30 November 1988 on the Application of Article 85 (3) of the EEC Treaty to Categories of Franchise Agreements OJ [1988] L 359/46. These regulations were adopted on the basis of Council Regulation (EEC) No 19/65 of 2 March 1965 On the Application of Article 81(3) of the Treaty to Certain Categories of Agreements and Concerted Practices OJ L36 which enabled the Commission to declare certain categories of vertical agreements exempted from the prohibition of Article 81(1). Motta has criticised the exemption of some types of vertical agreements (and not all of them) as he believes that treating different kinds of restraints in different ways can find no economic justification. In his view, it is not the type of restraint but market power that matters. M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 377.

[144] See R Greaves, *EC Block Exemption Regulations* (London, Chancery Law Publishing Ltd, 1994) 3.

distribution or supply obligations were considered against Article 81(1) EC without examining actual anticompetitive effects. *Langanese Iglo* and *Schöller* reflect that the institution only ever analysed market power under Article 81(3) EC.[145] Even selective distribution was deemed problematic.[146] This is only the coherent consequence, it argues, of aiming at achieving a single market.[147] It insisted in enforcing a policy under which 'agreements between companies with a combined market share of 80 per cent were treated in much the same way as an agreement between two companies with a combined market share of 15 per cent'.[148] In particular, the possibility of preventing parallel imports, inherent in the absolute territorial protection, was consistently found incompatible with EC law since *Consten and Grundig*. EC antitrust law was deemed to be a tool for promoting integration by guaranteeing the proper functioning of the free market mechanism, and freedom of competition did not include those business practices which were capable of dividing the market along national lines, even if such behaviour enhanced competition. The ECJ, like the Commission, considered it intolerable under Community antitrust law that an agreement between a producer and a distributor could restore the division of the common market along national boundaries.[149] However, the courts' views have generally differed from those of the Commission on these restrictions.

ii Torn Between Integration and Competition—The Challenge for the European Courts

The importance of the economic context when examining the purpose of agreements was emphasised by the courts from a very early moment, even if the protection of effective competition the economic freedom of the parties plays an important role in some of the landmark rulings.[150] In general terms, the case law of both the ECJ and the CFI reflects the view that, when the object of an agreement is not a priori anticompetitive, its market consequences should be examined before deciding. Nonetheless, the rule of reason for vertical restraints in the hands of the European courts has on occasion been described as the Loch Ness Monster of EC competition law, that everybody talks about but nobody has

[145] *Langanese Iglo* [1994] CMLR 51. The lack of economic analysis under Art 85(1) (now Art 81(1)) is criticised by the CFI in Case T-7/93 *Langanese v Commission* [1995] ECR II-1533, paras 94–114. See V Korah, 'The Future of Vertical Agreements Under EC Competition Law' (1998) 8 *European Competition Law Review* 506–13, 507.

[146] There are some exceptions to the general hostility towards selective distribution dating back to 1985, before *Pronuptia*. See Commission decision *Villeroy & Boch* [1985] OJ L376/15.

[147] See S Bishop and D Ridyard, 'EC Vertical Restraints Guidelines: Effects-Based or Per Se Policy?' (2002) 23 *European Competition Law Review* 1, 35.

[148] BM Audia, PT and D Hull, 'Recent Developments in European Competition Law: Vertical and Horizontal Agreements' (2001) vol 19 no 7 *ACCA Docket* 52, 58.

[149] Joined Cases 56/64 and 58/64 *Consten/Grundig* (1966) ECR 418, 473.

[150] Case C-234/89 *Stergios Delimitis v Henninger Brau* [1991] ECR I-935. Case 56/65 *Societé La Technique Minère (STM) v Maschinenbaum Ulm GmbH* [1966] 1 CMLR 357. For an analysis of the case law from *STM* to *Delimitis*, see Amato *Antitrust and the Bounds of Power* (Oxford, Hart Publishing, 1998) 47–54.

actually seen.[151] The reason for this is that, despite the courts' insistence on the importance of taking into consideration the actual effects of vertical agreements, their fixation with the protection of integration has often led to inconsistencies. Some decisions considered the economic analysis essential, whilst others disregarded it when the case could distort the general objectives of the Community or lead to a division of the common market along national boundaries.[152] The Court has confirmed that that Article 81(1) EC can be applied to distribution agreements, although the parties concerned operate at different levels of the economic activity and are therefore unlikely to compete with each other in the first place. As Wesseling highlights, the early decisions suffer from inherent inconsistencies, consequence the intention of building a common market and destroying all obstacles to integration.[153] These contradictions are the result of the per se prohibition of those restrictions which could potentially harm integration.

The courts have pursued the abstract goal of achieving the single market in their rulings,[154] but at the same time they have applied a certain rule of reason analysis to the cases presented before them. While the Commission was labouring under the complex exemption system, the Court of Justice also acknowledged the possibility of pursuing alternative goals beyond integration through competition policy, beginning with the *Metro I* case, which seems inspired by the principle of effective competition.[155] The ECJ argued that the objectives of the Community could be better pursued if reconciled with other objectives. This case remains crucial since the Court referred to the need to maintain a degree of competition that guarantees the objectives of the Treaty, which strongly resembles the Harvard School's notion of 'workable competition'.[156] It was clear, nonetheless, that economic efficiency was not the primary goal of the EC antitrust.

Just as US courts examine the real impact of agreements on competition by going one step further and applying an economic analysis, which includes taking

[151] J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and the Realities of a Changing Retail Sector and of National Contract Laws' (Draft, 2002) *Secola Conference*, London School of Economics.

[152] Joined Cases 56/64 and 58/64 *Etablissements Consten Sàrl and Grundig-Verkaufs GmbH v Commission* [1966] ECR 299.

[153] For instance, in *Consten Grundig* the Court estimated that the agreement in question had market-partitioning effects, and would therefore frustrate the objectives of the Commission. Joined Cases 56/64 and 58/64 *Consten GmbH and Grundig Verkufs GmbH v Commission* [1966] 299; Case 5/69 *Völk v Etablissements Vervaecke* [1969] ECR 295, 302; Also case 26/76 *Metro-SB-Grössmärkte GmbH v Commission* [1977] ECR 1875.

[154] *Consten and Grundig* defends the free movement of goods, while *Pronuptia* reflects market integration concerns. The importance of integration is highlighted by the courts even in the 1990s. For instance, in the case *Herlitz v Commission*, the Court emphasised that 'by its very nature, a clause prohibiting exports constitutes a restriction of competition' because it is intended to partition the market (*Herlitz v Commission*, case T-66/92 [1994] ECR II-531). The Court also held that clauses which have the effect of partitioning the single market into national markets 'are inherently contrary to Article 85(1) [now 81(1)] of the Treaty' (Case T-43/92 *Dunlop Slazenger International v Commission* [1994] ECR II-441).

[155] Case 26/76 *Metro-SB-Grössmärkte GmbH v Commission* [1977] ECR 1875.

[156] Robinson refers to 'monopolistic competition'. See Robinson, J. (1933). *The Economics of Imperfect Competition*, London. See also E Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, MA, Harvard University Press, 1933).

into consideration the market power of the firms involved, the European courts have generally required an economic analysis before considering that a specific vertical restraint was against Article 81(1) EC. This is the approach of the ECJ from *Societé La Technique Minère*[157] in 1966 to *Delimitis*[158] in 1991. The former confirms that exclusive distribution could fall within the scope of Article 81(1) EC, but where an agreement is necessary to penetrate a new market it is questionable that it harms competition. In the latter, when an agreement which included a beer tie was challenged before the Court, it established that exclusive purchasing agreements do not appreciably restrict competition, and are lawful unless they have the effect of foreclosing market access to competitors. In order to determine if that is the case, it would be necessary to

> analyse the effect of a beer supply agreement taken together with other contracts of the same type, on the opportunities of national competitors or those from other Member States, to gain access to the market for beer consumption or to increase their market share and accordingly the effects on the range of products offered to consumers.[159]

If there are barriers to entry, then the 'cumulative effects' of the agreements must be considered (that is, if other retail outlets did not bear the same obligations and thus a new firm could enter the market). It is also crucial to determine the duration of the obligations, in order to determine whether a new entrant would be able to find outlets in the short term.[160] Nonetheless, the economic analysis carried out by the ECJ and the CFI is different from that of the US Courts. In *Wouters*,[161] for instance, the Court emphasised the importance of the context of the agreement, and in particular its objectives, to determine whether the consequential restrictive effects are inherent in the pursuit of those aims. This reflects a distancing from the US, where even certain contracts with anticompetitive aims have been declared valid in the absence of market power.

Korah however rightly argues that there is a lack of economic reasoning in the Commission decisions and ECJ case law with respect to agreements which contain restrictions on free cross-border trade.[162] In the early days, it seems that every time and agreement or concerted practice could potentially harm intraCommunity trade it was considered against Article 81(1) EC, and it was not granted an exemption on the basis of Article 81(3) EC. Integration in this sense supplanted the protection of competition. This is particularly clear in the treatment of exclusive

[157] Case 56/65 *Societé la Technique Minère v Machinenbau Ulm GmbH* [1966] ECR 235, [1966] CMLR 357.

[158] Case C-234/89 *Stergios Delimitis v Henninger Brau* [1991] ECR I-935, [1992] 5 CMLR 210, [1992] 2 CEC 530.

[159] Case C-234/89 *Stergios Delimitis v Henninger Brau AG* [1991] ECR I-935, 984.

[160] Korah estimates that only one of the three circumstances would have been enough to prevent the agreement from falling within Art 81(1). See V Korah, 'The Future of Vertical Agreements under EC Competition Law' (1998) 8 *European Competition Law Review*.

[161] Case C-309/99 *Wouters el al v Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-15 77.

[162] See eg V Korah, 'EEC Competition Policy—Legal Form or Economic Efficiency' (1986) 39 *Current Legal Problems* 85.

and selective distribution clauses. As regards exclusive distribution, in 1982 in *Nungesser* the ECJ distinguished between clauses introduced to achieve a legitimate aim to launch a new product and those with achieve absolute territorial protection.[163] While the first type of clauses would not be per se unlawful, the second type of restrictions prevents the flow of parallel imports, and is therefore considered contrary to Article 81(1) EC, without the chance of being exempt on the basis of Article 81(3) EC. Such clauses are not considered essential to the finality of the agreement, and therefore their regime would be comparable to naked restraints in the US. It is evident that some economic analysis is introduced—particularly in comparison to the Commission, which limited itself to declaring the agreements void. However, the possible economic advantages of restricting parallel trade are overlooked following noticeable integration concerns. This view may be changing as some of the more recent cases have approved agreements where absolute territorial protection was granted.[164]

Metro I is the seminal case regarding selective distribution.[165] Already in 1978, the ECJ defended the treatment of these agreements under the rule of reason by establishing conditions that, when fulfilled, would imply the validity of selective distribution systems. The first condition is that nature of the product requires such restrictions in order to provide a better service to consumers. This is the case of those which require specialised staff—cars would meet this requirement. The second condition is that only qualitative criteria will be valid for determining the dealers in the network. Thirdly, absolute territorial protection cannot be granted on the basis of the limitations. This is the line followed by later judgments.[166] For instance, the *AEG* case related to a selective distribution system which did not have market-partitioning effects.[167] Both qualitative and quantitative criteria were taken into consideration when selecting the distributors. The ECJ found that the limitation on the freedom of the parties imposed by AEG was against Article 81(1) EC, but defended the legality of selective distribution when the nature of the product would require it, and only if qualitative, non-discriminatory criteria were used to select the dealers. Besides, parallel trade must not be prevented. Again, the predominance of integration is obvious. Whether competition policy should aim at protecting integration and parallel trade rather than enhancing competition is questionable. Some academics have highlighted the risk of destroying interbrand competition by pursuing integration.[168]

In the car sector, both the Commission and the Court showed a certain tolerance towards SED systems. Before the existence of block exemptions, the Commission

[163] Case 258/78 *LC Nungesser KG and Kurt Eisele v Commission,* [1982] ECR 2015, [1983] 1 CMLR 278.

[164] Case 5/69 *Volk v Vervaecke* [1969] ECR 295.

[165] Case 26/76 *Metro-SB-Grossmärkte GmbH & Co KG v Commission and SABA* [1977] ECR 1875, [1978] 2 CMLR 1.

[166] See, eg, Case 70/93 *Bayerische Motorenwerke AG v ALD Autoleasing D GmbH* [1995] ECR I-3439, [1996] 4 CMLR 478.

[167] Case 107/82 *AEG v Commission of the European Communities* [1983] ECR 3151.

[168] See R Wesseling, *The Modernisation of EC Antitrust Law* (Oxford, Hart Publishing, 2000) 81.

had already granted individual exemptions to certain car distribution agreements on the debatable grounds of consumer protection:[169] it was argued that given the specific characteristics of motor vehicles, it was justified to require dealers to meet certain quality requirements. The ECJ, in *Cabour*,[170] explained how the reason for allowing such restrictions is to give manufacturers the chance to continue to influence the quality of their product by ensuring that a small concentrated number of dealers have the degree of expertise and quality necessary to offer a high standard of service for the consumer.

The *Pronuptia* case is also of particular importance, as it deals with franchises under EC competition law. According to the Court, franchising is lawful as its object is not to restrict competition. Franchise contracts are, in principle, procompetitive since they allow small firms to enter a market. Therefore, such contracts benefit from a more favourable treatment than other distribution agreements. Dealer location clauses, minimum purchasing obligations and stocking requirements do not fall within Article 81(1) EC. The difficulty resides in the fact that many distribution agreements have elements that are characteristic of franchising.[171] In this sense, the economic effects must be considered according to this landmark case. Yet the ECJ estimated that the clauses by which the franchisor was forced to prevent other franchisees from opening a retail outlet outside the alloted territory implied market partitioning. This is a restriction on competition in the sense of the prohibition of Article 81(1) EC, especially if it is a known brand. The Court considered that some clauses that amounted to granting absolute territorial protection were unlawful. In particular, the agreement prevented the franshisor from selling directly in the allotted territory and obliged it to preclude the sales of all other franchisees within that same area. This would have market-partitioning consequences. In effect, the ECJ is distinguishing between those restrictions that pursue a broader legitimate goal, and those which appear only to restrict competition—a distinction somewhat similar to that between naked and ancillary restraints in the US.

Integration as a goal of antitrust policy has therefore led to inconsistencies in the European courts' decisions. Practice has shown that, when the protection of integration is *the* priority of a competition policy, and it is prioritised even before the protection of competition *stricto sensu*, the results can be detrimental for the single market. These negative effects were particularly highlighted in the *Distillers* decision, later confirmed by the ECJ.[172] The institutions considered that a double pricing scheme for UK wholesalers applied depending on whether the whisky was

[169] In particular, *BMW* [1975] OJ L29/1, *SABA* [1976] OJ L28/19 and *Campari* [1978] OJ L70/69.

[170] Case C-230/96 *Cabour SA et Nord Distribution Automobile SA v ArnorSOCO SARL* [1998] ECR I-2055.

[171] D Waelbroeck, 'The *Pronuptia* Judgement: a Critical Appraisal' in Hawk (ed), *1986 Fordham Corporate Law Institute* 213, 225. V Korah, *Franchising and EEC Competition Rules: Regulation 4097/88* (Oxford, ESC Publishing, 1989).

[172] Commission Decision of 20 December 1977 *Distillers Company Limited* [1978] OJ L50/16, upheld by the ECJ in Case 30/78 *Distillers Co Ltd v Commission of the European Communities* [1980] ECR 2229. See also V Korah, 'Goodbye, Red Label: Condemnation of Dual Pricing by Distillers' (1978) 2 *EL Rev* 62–71.

to be sold in the UK or elsewhere in the EC hindered free trade between Member States and was therefore declared as fall within the prohibition of Article 81(1) EC. The main reason behind the pricing policy was to avoid distributors in the UK reselling the product on the continent, where local distributors would need to invest in additional promotional efforts to market the brand on the continent and sell it at a higher price. Supporting the rationale of the Commission and the ECJ was the protection of parallel imports, as the double-pricing policy would discourage them. The result was that Distillers ceased from selling Johnny Walker Red Label in the UK, an outcome which clearly squanders benefits for competition, the free movement of goods or consumers. Another example of the problems of prohibiting vertical restraints was the Court's condemnation of the requirement imposed by an ice cream manufacturer to only stock its own brand products in freezers provided for retailers in Ireland.[173] The argument of the Court was that such a restriction would impose limits on access by potential competitors to the market for the supply of impulse ice cream—which clearly implies a very narrow definition of the relevant market.

iii The rationale of the current legal framework

It was not until the 1990s that the Commission realised the urge for changes in its competition policy, as the result of its previous line of action was often *restrictive* of competition. More importantly, it deviated from the key goal of promoting economic efficiency.[174] The flaws of the system, combined with the dissenting views of the European courts, called for a new coherent line of action, and the advances in the process of integration over the years allowed a shift in the attention of the institutions from establishing the common market to regulating and protecting it. This facilitated alternative economic and political considerations, even if integration is still present as a major goal.[175]

Several justifications can be given for the Commission's inadequate views. In particular, the use of the concept of economic freedom, the pursuit of objectives other than the maintenance of competition through competition policy, and the seizure of power over contractual issues (which otherwise would still be ruled by national contract law). The Commission eventually became aware of its erroneous position and began to introduce changes. In the last decade, EC competition

[173] Commission Decision 98/531/EC *Van Den Bergh Foods* OJ 1998 L246/1, approved on appeal by the Court of First Instance in Case T-65/98 *Van Den Bergh Foods Ltd v Commission* [2004] 4 CMLR 1.

[174] For a study of the concept of economic efficiency in the European context, see D Geradin, *Efficiency Claims in EC Competition Law and Sector-Specific Regulation* (2004) Working Paper, First Workshop on 'Comparative Competition Law, The Evolution of European Competition Law—Whose Regulation, Which Regulation?', European University Institute, Florence.

[175] The importance of integration is highlighted by the courts even in the 1990s. For instance, in Case T-66/92 *Herlitz v Commission* [1994] ECR II-531, the Court emphasised that 'by its very nature, a clause prohibiting exports constitutes a restriction of competition' because it is intended to partition the market. The Court also held that clauses which have the effect of partitioning the single market into national markets 'are inherently contrary to Article 85(1) [now 81(1)] of the Treaty.' (Case T-43/92 *Dunlop Slazenger International v Commission* [1994] ECR II-441).

policy has undergone a substantial, progressive face-lift which has transformed the application of Article 81 EC, affecting both substantive and procedural issues. The concerns of scholars were first heeded in 1997, when the Commission published the Green Paper on Vertical Restraints.[176] The Guidelines highlighted the factors that should be considered when determining whether an agreement falls within Article 81(1) EC,[177] thus opening the door for a more relaxed interpretation of the prohibition. For the first time, the Commission proposed a more economics-based approach. However, the Guidelines criticise the exclusive use of economic analysis to determine the validity of agreements: paragraph 86 explains that:

> economic theory is just one of the sources of policy. In practice, the application of economic theory must take place in the context of the existing legal texts and jurisprudence. . . . [E]conomic theories are necessarily based on simplifying assumptions often obtained in the context of stylised theoretical models that cannot take into account all the complexities or real life cases.

Therefore, the Commission still insists upon defending other non-economic goals through competition, and remains sceptical about economic efficiency as the primary concern.

The Guidelines were the first step towards a thorough reform of EC competition policy at all levels. By now, some of the undergrowth Hawk referred to has indeed been cleared away. As far as vertical restraints are concerned, and besides some isolated attempts to limit the scope of the Article 81(1) EC prohibition,[178] the main modifications were introduced when the Commission adopted a new block exemption in the shape of Regulation 2790/99,[179] which substitute the previous block exemptions—except for the one for motor vehicle distribution[180]—and attempts to bring the treatment of these restrictions in line with a more economics-based approach. In this sense, the influence of the neo-liberalism position of the Chicago School has left its imprint in the European continent, even if there is a conscientious distancing between the Commission's policy and its ideals. The new 'umbrella' block exemption, which is applicable to all sectors of the economy, somehow portrays the comeback of Neo-liberalist theories, and the belief that market can, itself, provide answers to some of the problems that arise. The

[176] Commission (EC), 'Vertical Restraints in EC Competition Policy' (Green Paper) COM (96) 721, 22 January 1997. In particular, ch II refers to the *Economic Analysis of Vertical Restraints and the Internal Market.*

[177] In particular, para 121 of the Guidelines refers to the market position of the supplier, the market position of competitors, the market position of the buyer, entry barriers, the maturity of the market, the level of trade and the nature of the product, as well as other factors.

[178] For instance, the notions of 'agreements' and 'restrictions of competition' have been narrowed by the courts. As regards the former, Volkswagen ruling which annulled the fine imposed by the Commission on the basis of the inexistence of an agreement. The latter has been implicitly reduced by introducing the economic analysis, therefore not all restrictions are 'bad'.

[179] Commission Reg (EC) 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L/336/21–29. The Council empowered the Commission to adopt this Regulation via Regs 1215/99 and 1216/99.

[180] The distribution of cars was explicitly excluded from the scope of Reg 2790/99. Therefore, it remained under Reg 1475/95, recently substituted by Reg 1400/2002.

legal consequence of this new trend is deregulation and privatisation in the legal field.

In September 1998, the Communication on the application of the EC competition rules to vertical restraints summarised the results of the comments on the Green Paper and established a framework for the policy reform, which was the pillar on which the new BER was based. Former Commissioner Monti summed up the Commission's intentions behind the introduction of Regulation 2790/99, describing the

> commitment of the Commission to review and modernise the Community's 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.[181]

The new block exemption is ruled by the economic results of the agreements. When vertical agreements do not intend to restrict competition, then their effects must be take into account. This new approach, which had previously been hinted at in some of the case law, somehow reflects a new vision of the concept of restriction on competition: by examining the effects of agreements there is an implicit recognition that not all restrictions on the parties' freedom are necessarily anticompetitive. However, the fact that vertical agreements are still block-exempted also proves that they are still considered to contravene Article 81(1) EC.

In his speech, Monti referred to 'market power', indicating that the Commission had finally listened to the countless complaints and adopted a more economic approach in the assessment of these agreements. On 24 May 2000, a set of Guidelines on Vertical Restraints was approved by the institution, a document consisting of 229 paragraphs intended to complement Regulation 2790/1999 and to serve as guidance for its interpretation.[182] The Regulation came into effect on 1 June 2000, and consists of 17 Recitals and 13 Articles. The regime established by the block exemption was the result of a necessary in-depth policy review that had been delayed when the application of the old block exemption regulations was extended. For the first time, a more economic approach towards the nullity or validity of vertical agreements and the restrictions contained in them is laid down in the Regulation. This reformed system is in accordance with the process of deregulation and the attempt to look at vertical restraints from a less formalistic point of view which does not leave room for a case by case analysis. In this context, as opposed to the previous detailed sector-specific Regulations, the rules tend to be generic, in an attempt to preserve freedom of contract and to leave room for interpretation on a case by case analysis.[183] Generally speaking, as Whish points out, the basic tenden-

[181] Speech in May 2002, when the Commission announced that it had finally completed its long awaited reform of the EC competition rules concerning supply and distribution agreements.

[182] Commission Regulation (EC) 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L/336/21–29.

[183] In this sense, Whish highlights how mechanical application of the rules is not desired. See R Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' (2000) 37 CML Rev 887–924.

cies of change of the 1999 system point in three main directions: A wider scope of application of the block exemption, the introduction of an economic analysis by taking into consideration the market power of undertakings, and the per se prohibition of certain restrictions by means of a black clause list. An assessment of these changes and the impact of subsequent modifications of EC competition law rules on vertical agreements will be carried out in the next chapter.

At this point, and following our assessment of the early days of antitrust policy in the EC and the US, it is possible to state that economic analysis was originally somewhat deficient in both approaches to vertical agreements. In the US, the per se rule meant that up until the late 1970s courts and authorities only had to focus on demonstrating the existence of the restraints, squandering a detailed evaluation of the benefits and inconveniences of these business practices. In the EU, and shielded from the need to pursue bigger and better integration aims following the Treaties' general aims, an excessively harsh policy developed over the years of all kinds of restrictions that could pose a threat to the integration of national markets and the elimination of barriers to trade. The system was also overly centralised as a consequence of the notification system required by the now defunct Regulation 17/62—seen in the following chapter—which left any possibility of exemption of these agreements in the hands of an overburdened Commission. The resulting economic analysis was therefore limited and faulty, a clear handicap for an area of the law so clearly related to economics.

Despite the obvious shortcomings of such regimes, it is mistaken to simply take for granted that they were based on incorrect assumptions and deny any merit. Economics-based antitrust is riddled with complexity; it is naïve to assume that the many courts and authorities empowered to apply competition law provisions would have the knowledge to carry out adequate assessments of these agreements from the outset. In this sense, it is likely that the Supreme Court of the US and the Commission and European courts in the EU encouraged simplicity in the application of the rules. This quest for uniformity and straightforwardness in the warm-up phase of the policy serves to at least partially justify the overly simplistic approach. In Europe, the added complexity was synchronising the legal regimes of an ever-increasing number of nations with disparate legal traditions. Unfortunately, leaving economic analysis in the hands of the Commission only was not the optimal solution, as it soon became apparent. In the US, and despite some resulting deficiencies, state authorities and courts were involved in the application of antitrust rules from the very beginning, and this has been considered to be one of the crucial aspects for the success of the policy.

In addition to the inherent difficulty of developing a sound and uniform economic analysis, antitrust policy makers are also faced with the difficult task of regulating a constantly evolving reality. Innovation in supply and distribution methods is essential, and over the last century new technologies have made possible novel, efficient ways of ensuring products reach end consumers. An overly strict policy may well hinder advances in this regard. Rules that perhaps worked competently in a specific context can soon become obsolete, and the legislator

sometimes struggles to keep up with the requirements of a dynamic reality. In any case, the many criticisms of US and EU antitrust regimes cannot be disregarded as mere cavils without foundation. Many were the voices that advocated in favour of changes, and they played a fundamental role in triggering the successive reforms that have by now greatly improved the situation. It took decades before the institutions finally faced the problems of the old regimes, but finally the concerns could not be ignored. Whether or not the result of those changes is satisfactory is the subject of the next chapter.

3

Questioning the Achievement of an Adequate Economic Analysis

In recent years, the EC and US regimes have, using different tactics, increased the need to individually assess vertical agreements before coming to a conclusion about their validity. In North America, per se illegality has gradually vanished from the regime applicable to vertical restraints. In practice, enforcement agencies had virtually abandoned the pursuit of these restrictions for quite some time, and at the federal level the Supreme Court first placed non-price territorial restraints under the rule of reason, and eventually expanded this treatment to maximum and minimum resale price maintenance.

In Europe, the EC Treaty itself contains rules that allow an assessment of the potential positive and negative consequences of agreements in the shape of Article 81(3). Nonetheless, the Commission originally showed a certain reluctance to apply this provision and to acknowledge the benefits of vertical agreements as a consequence of their ambiguous impact on integration. Since the 1990s however, a series of reforms led to the adoption of Regulation 2790/99 for all vertical agreements and Regulation 1400/2002 for distribution agreements in the car sector. These regulations place the assessment of the firms' position in the relevant market at the centre of the analysis needed before coming to a conclusion on the validity of the agreements under scrutiny. Both the general and the sector-specific block exemption expire in May 2010, and the Commission has recently revealed the changes it intends to introduce to replace these regulations, providing an optimal opportunity for analysis and discussion. The rules for vertical agreements must be studied in the context of other important reforms of EC competition law which unavoidably bear an impact on the area. Most importantly, antitrust enforcement rules were thoroughly reformed in 2004, as the 'modernisation package' enabled decentralised enforcement of Article 81(3) EC—the exemption from the prohibition of Article 81(1) EC, which is so frequently used in the field of vertical agreements. In this context, recent developments show that there is an attempt to encourage private enforcement of antitrust law. The latest step in this process is the White Paper on Damages, which should soon lead to legislation regulating the award of damages for breach of competition law rules.

This chapter assesses the merits of these changes and the future perspectives. In the US, the expansion of the rule of reason to all forms of vertical restraints has been achieved, but now the challenge resides in structuring that rule of reason

analysis. In the EC, after a decade of enforcement of the new-style block exemptions, the Commission's proposed modifications to the current rules are gentle, but finally consider moving towards a unified regime for all kinds of vertical agreements—albeit at a slow pace. Of questionable merit are the changes introduced to the economic assessment of these restraints. More specifically, the extension of the 30 per cent market share threshold to the buyer in an attempt to control the power of new almighty retailers, may lead to a more restrictive approach. Both the general regime for vertical agreements and the sector-specific rules that apply to the car industry call for a thorough analysis in the context of the present work; as regards the latter, a detailed study contributes to understanding the existence of the differentiated treatment and enables a study of how competition rules apply to a concrete scenario. The Commission should take the unique opportunity given by the imminent reform to reflect upon the impact of these rules and reshape the policy according to the problems that have come to light in the last decade. It is feared, however, that the current economic crisis may make it difficult for the legislator to look beyond short-term solutions, and may lead to a weakening of the coherence and sturdiness of the antitrust regime. A careful assessment of these issues is therefore of paramount importance.

I THE PROGRESSIVE DISAPPEARANCE OF THE PER SE RULE IN THE US

Unlike Article 81 EC, which recognises the possibility of applying a rule of reason in the shape of 81(3) to restrictive practices that could ultimately bear benefits for the competitive process, section 1 of the Sherman Act does not contain any exceptions to the illegality of the practices that fall within its scope. As a consequence, the interpretation of the extension of the prohibition is of vital importance; it must allow the prevention of anticompetitive behaviour while at the same time tolerating those agreements that may have beneficial effects. As seen in the previous chapter, the Supreme Court soon clarified that, to be illegal, a restriction of trade had to be unreasonable.[1] However, by placing virtually all vertical restraints under the per se illegality rule, estimating reasonableness was hampered, and economic analysis was very restricted if not inexistent. This principle simplified the application of antitrust provisions in the early days, but as the policy matured more and more voices began to advocate for a more tolerant position on these agreements. Once these restraints are declared to be subject to the rule of reason analysis, the courts and authorities have the difficult task of structuring this rule of reason in order to achieve a solid, consistent framework of analysis to determine the conditions for the validity of the restraints. The progressive acceptance of individual assessment and the methodology of the rule of reason by the Supreme Court is analysed in this section.

[1] *Addyston Pipe & Steel Co v US* (1899) 175 US 211; *Arizona v Maricopa County Medical Soc* (1982) 457 US 332, 342–343. See ch 2 s II A above.

A Non-price restraints since *Sylvania*

US courts refrained from tampering with the general per se illegality rule for vertical agreements until the late 1970s. Up until *Sylvania*,[2] the majority of the case law of the Supreme Court and the federal courts in one way or another held that absolute territorial protection contradicted the very essence of antitrust laws.[3] The rationale behind the prohibition of non-price restraints is a belief that it is not in the interest of manufacturers to maintain such territorial restrictions, as the more dealers they are able to appoint the more goods they are bound to sell. The result is that, while contract law provisions regarding franchises attempted to confer the dealer greater power vis a vis the manufacturer, it seems that, through antitrust, the dealers' interests were disregarded as a consequence of the conviction that there are advantages for consumers in the protection of intrabrand competition. A series of legislation was adopted by the states and at the federal level, insisting on the need to balance the dealer–manufacturer relationship; however, antitrust decisions prove that this goal was subordinated to what was believed to be in the manufacturers' and consumers' interests.[4]

The *US v General Motors Corp* case of 1966 sums up the old view of the US courts on territorial restrictions on competition.[5] It emerged as a consequence of a complaint on the part of General Motors (GM) about the practice of some of the Los Angeles Chevrolet dealers to sell their cars through discount houses, which sold many makes and models side by side, thus equating car sales to supermarket sales. This practice violated a location clause contained in the Dealer Selling Agreement (DSA) which prohibited the dealer from establishing 'a new or different location, branch sales office, branch service station or place of business including any used car lot or location without the prior written approval of Chevrolet.' The Supreme Court, agreeing with the government, estimated that such a clause was per se illegal:[6]

[2] *GTE Sylvania Inc v Continental TV Inc* 537 F 2d 980 (9th Cir, 1976).

[3] *Dr Miles Medical Co v John Park & Sons Co* 220 US 373 (1911), *US v Bausch & Lomb Optical Co* 321 US 707 (1944), *Fashion Originators Guild v FTC* 312 US 457 (1941), *US v Addyston Pipe & Steel Co* 85 Fed 271 (6th Cir, 1898), *US v White Motor Co* 194 F Supp 562 (ND Ohio, 1961).

[4] Examples of the legislation adopted can be found for instance in the car sector. By the late 1950s, 20 states had adopted statutes regulating the distribution of motor vehicles with the aim of eliminating unfair practices inflicted by manufacturers. These statutes encouraged the US Congress to adopt the Day in Court Bill or the Automobile Dealers Franchise Act (ADFA) of 1956, which, from a contractual perspective, attempts to solve the cancellation of franchises and introduces a requirement of 'good faith'. For a closer analysis, see ch 4 below.

[5] *US v General Motors Corp* 384 US 127, 86 S Ct 16 L Ed 2d 415 [1966]. For the analysis of this case, I was fortunate enough to come across a thorough case study carried out by Barry Forbes in 1981 while he was a student at the University of Wisconsin at Madison. With the permission of Professor Peter C Carstensen, the author refers to some of his arguments in this section.

[6] It is worth noting, however, that the District Court's decision upheld the validity of the location clause, as competition among dealers was not considered to be restricted given that dealers could sell at any price and could attempt to sell cars in other dealers' areas. According to the court, if the clause is considered an unreasonable restraint of trade, there would be a loss of competition and the distribution system would be destroyed. The restraint was therefore estimated to be reasonable, as dealer contracts promote rather than suppress competition and benefit the purchasing public. *US v GM Corp* 234 F Supp 85 (S D Cal, 1964).

> Because the action taken constitutes a combination or conspiracy, it is not necessary to consider what might be the legitimate interest of a dealer in securing compliance by others with the 'location clause', or the lawfulness of action a dealer might individually take to vindicate this interest.[7]

It was believed that discount houses could enhance the freedom of choice of consumers, and the fact that they dealt with more than one brand would grant the provision of independent advice. Such a decision, however, neglects GM's right to legally enforce its contracts and to freely set up its distribution chain. It also fails to consider the effects on interbrand competition of the location clause. Discount houses told their customers that any Chevrolet official dealer would be contractually obliged to provide warranty services. Therefore, the sale of Chevrolet cars through these outlets not only violated the territorial exclusivity of dealers, but also imposed burdens on the disadvantaged dealers without any additional reward. Thus, the practices of discount houses, which may a priori seem to enhance competition, may actually drive some marginally profitable dealers out of the market.

As regards exclusive dealing and the prohibition imposed on dealers selling more than one brand, the court's decision in *Standard Oil Co v US*,[8] more commonly known as the *Standard Stations* case,[9] is of particular relevance. This decision is overwhelmingly considered the leading precedent on exclusive dealing,[10] and it coincides in time with a warning issued by the Department of Justice in 1948 to industry manufacturers, directing them to cease using exclusive representation provisions. The court established that tying and exclusive representation clauses 'serve hardly any purpose beyond the suppression of competition'.[11] Even so, an economic analysis is carried out to verify the actual impact of exclusive representation. In the specific case, Standard Stations controlled 16 per cent of retail outlets in the area.[12] The court highlighted that all major suppliers used these agreements, and that the relative share of the market obtained by each had remained fairly constant, while new entrants were unable to gain a significant position. Therefore, no showing that the defendant company actually dominated the industry was required. Moreover, the maintenance or improvement of the control of the market over time was also considered in order to determine dominance. At that time, the automobile industry was experiencing an overwhelming transformation which led to the disappearance of many of the smaller car

[7] 384 US 127 139–40.

[8] *Standard Oil Co v US* 227 US 293 (1949).

[9] The reason for referring to the case as *Standard Stations* is purely practical, as it needs to be distinguished from the case *Standard Oil Co of New Jersey v US* 221 US 1 (1911), commonly referred to as *Standard Oil*.

[10] RA Posner, *Antitrust Law: An Economic Perspective* (Chicago, University of Chicago Press, 1976) 201–02.

[11] 227 US 305–06.

[12] PC Carstensen, 'Vertical Restraints and the Schwinn Doctrine: Rules for the Creation and Dissipation of Economic Power' (1976) 26 *Case Western Reserve Law Review* 4, 771–860.

producers and left the market in the hands of GM, Ford and Chrysler, therefore these companies had reasons for concern. Influenced by these developments, GM opted for the elimination of such clauses from its 1949 contracts, and most of the other companies followed GM's lead.[13]

The *White Motor Co v US* judgment reflects the first uncertainties a propos per se illegality of vertical restraints, particularly in the distribution of trucks.[14] The case questioned the compatibility of provisions including in a franchise contract granting the dealer an exclusive selling territory in which she was to confine her activities and prohibiting the dealer from selling to persons outside the manufacturer's network with sections 1 and 3 of the Sherman Act. The court estimated that such restrictions would not be per se illegal.[15] Although the judgment does not go as far as placing territorial exclusivity under the rule of reason, it states that such restrictions 'may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business.'[16] The reasoning behind such a decision, which appears to be in contradiction with *Dr Miles* and *Bausch & Lomb*, is a cost–benefit analysis that had long been lacking in the rulings of American courts. Without rewarding the dealers for their investments by allowing others to sell the same product in their territories, there would be no incentive for dealers to commit to distribution. Hence, the higher prices consumers theoretically pay as a result of the exclusion of free-riders are actually less damaging for them than the consequences of dealers losing their interest in engaging in selling the products altogether.

Therefore, already in 1963 a shy attempt on the part of the Supreme Court to consider resource allocation efficiency can be observed. This case established a trend subsequently followed in other areas of the law. A fuller development of the rationale can be found in the *Boomer* case,[17] where the court refused to grant an injunction against a polluting cement plant on the basis that the cost of closing down the plant was much higher than the cost of the damages suffered by those who lived in the area. Instead, it opted for awarding compensation to those who had been affected by the factory. These efficiency considerations, clearly inspired by the Coase Theorem,[18] have become frequent in the courts' cost–benefit analysis. If this logic is applied to the scenario in *White Motor*, the increase in price consumers would pay for trucks if intrabrand competition were restricted is smaller than the

[13] Information gathered in interviews with car manufacturers' and dealers' representatives in November 2003.

[14] *White Motor Co v US* 372 US 253, 83 S Ct 696, 9 L Ed 2d 738 (1963).

[15] But see Justice Clark's dissenting opinion, which explains that since the dealers were prohibited from establishing exclusive territories among themselves under the authority of, inter alia, *Addyston Pipe* and *Apex Hosery*, the manufacturer could 'fare no better' under the principles established in *Dr Miles*.

[16] 372 US 263.

[17] *Boomer v Atlantic Cement Co* 26 NY2d 219, 309 NYS2d 312, 257 NE2d 870 (1970).

[18] According to the Coase Theorem, in the absence of transaction costs and independently of legal provisions, the interests of two conflicting parties should reach an agreement that maximises their wealth. It is formulated in R Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386–405.

losses the dealer could suffer as a consequence of free-riders.[19] The benefit–cost evaluation, as Posner argues, should generally be done by the market itself, however when the market does not work then the courts may step in and make the ultimate efficiency decision.[20]

The US Supreme Court's decision in *Sylvania* changed the treatment of non-price vertical restraints in the US for good.[21] The case raised the question of whether the per se rule applied where a television manufacturer (GTE Sylvania) forced its dealers to resell only from store locations first approved by the manufacturer through a franchise system, particularly given that the restraint appeared to enhance interbrand competition. One of Sylvania's most prosperous franchised outlets, Continental TV, became upset when the manufacturer appointed another retailer for the San Francisco area, assigned exclusively to Continental. It asked Sylvania for permission to open a new store in Sacramento, but this was denied on the grounds that this market was already sufficiently covered by other retailers. The refusal led to a deterioration of the dealer–manufacturer relationship, and the case was brought before the courts, claiming that Sylvania had breached section 1 of the Sherman Act by prohibiting appointed dealers from selling outside their allotted territories. Sylvania however claimed that the restraint would only breach section 1 if it imposed unreasonable restrictions. After several appeals that disputed whether or not this was the case, and even questioned if the case could be distinguishable from *Schwinn*, the case reached the Supreme Court.

Curiously, Continental's market share for the sale of national televisions was very small: it had fluctuated between one and two per cent and subsequently increased to five per cent after a reform of the distribution system. The Supreme Court admitted that, before coming to a conclusion as to the validity of the agreement in question, 'the specifics of the challenged practices and their impact upon the marketplace' have to be analysed.[22] It took the view that the situation was similar to that of *Schwinn*, and therefore the rule laid down in that case should be reconsidered—justified in part by the unjustified departure from *White Motor* that *Schwinn* had implied. The principal argument of the court in defending the validity of territorial restrictions was that, in some situations, vertical constraints on intrabrand competition may bear positive effects for interbrand competition, in which case the per se rule should be disapplied. Therefore, there was an explicit recognition of the priority to be given to interbrand competition, and a balance of the pros and cons of territorial restraints. The rule of reason would require that the specific effects of the agreements would have to be examined on a case-by-case

[19] However, and unlike in *Boomer*, the possible increase in price affects a dispersed and undetermined collective (consumers), and therefore they will not be compensated for this loss of welfare. Therefore, larger number of parties results in higher costs of transaction, because more transactions must be accomplished.

[20] R Posner, *Economic Analysis of Law*, 4th edn (Boston, Little Brown, 1992) 62–63.

[21] Even before *Sylvania* and the Chicago School influence, some cases had stressed the importance of economic analysis. For instance, the *Cellophane* case reflects a direct application of economic analysis. See *US v EI Du Pont de Nemours & Co* 315 US 377 [1956].

[22] 433 US 45.

basis. Later cases have confirmed this view, and by now it is generally accepted that most vertical restraints are reasonable, and hence lawful.[23] In order to determine whether or not a specific restriction is lawful, the existence of market power is essential. In the absence of market power, if competition is effective, consumers have adequate choices available to them and that the market will correct temporary deficiencies far more efficiently than the law. This implies that, under the current US tendency, firms can introduce restrictions on intrabrand competition, provided that they are not dominant.

More than 30 years have passed since *Sylvania*. Over this time, the rule of reason that applies to these agreements has been progressively structured. The resulting policy is one that almost advocates for the per se legality for non-price verticals imposed by firms with lack of significant market power.[24] Anticompetitive intent (the 'object' referred to in Article 81(1) EC) will, in general terms, greater tolerance, the evidentiary requirements that plaintiffs must satisfy to establish liability are also increased in this landmark case. Since Sylvania, plenty of evidence is required before coming to a decision on the legality of agreements. As a consequence of this change, in 1985 the Department of Justice adopted the Vertical Restraints Guidelines,[25] recommending the consideration of all kinds of vertical agreements (including price restraints) subject to the reasonableness analysis. These guidelines, now defunct, will be commented on below.[26]

B The Extension of the Rule of Reason to Maximum Resale Price Maintenance in *Khan*

Resale price maintenance is typically considered to have the potential to cause more serious harm to competition than territorial restraints. As highlighted in chapter 1, problems may arise with the establishment of a maximum price dealers may charge, particularly since distributors may be encouraged to set this highest value for the goods. This would ultimately discourage those who would be in a position to offer a more competitive price from doing so. Such a view would be enhanced if the price restraint were accompanied by territorial restrictions, since dealers would be even less tempted to enter into a price war if consumers in their buyers of operations were not able to purchase those same goods from other distributors. The result of such behaviour would be greatly inefficient. Even more

[23] The case law confirms that this is the case for exclusive distribution, exclusive supply, exclusive purchasing and selective distribution among others, even though they are not defined as such.

[24] Since *Sylvania*, very few vertical restraints have been estimated to be unreasonable. When this has been the case, market power has almost always been a determining factor. See *Graphic Products v ITEK Corp* 717 F 2d 1560 (11th Cir, 1983). For a criticism of *Sylvania*, see RL Steiner, 'Sylvania Economics—A Critique' (1991) 60 *Antitrust Law Journal* 41. See also *Toys 'R' Us Inc v FTC* 221 F 3d 928 (7th Cir, 2000), where the court highlighted the need to adopt a cautious approach towards the free-rider defence of vertical restraints when the product in question is not entering a new market.

[25] DOJ, Vertical Restraints Guidelines (1985), reprinted in 4 Trade Reg Rep (CCH) 3, 105.

[26] See s D below.

worrying was the facilitation of collusion as a consequence of the increased price transparency.[27] Accordingly, the Supreme Court had explicitly declared such restrictions to be per se illegal in *Albrecht v Herald Co*, on the basis that such restrictions could end up 'substituting the perhaps erroneous judgment of a seller for the forces of the competitive market.'[28]

The predominance of the ideas of the Chicago School eventually led to a more relaxed approach towards these restrictions. The advantages of fixing a maximum price that dealers may not exceed were eventually highlighted by academics and practitioners. Such a ceiling would prevent dealers from charging supracompetitive prices. At the same time, if interbrand competition is fierce, then any possible incentive to refrain from entering into price competition and cutting prices in order to be able to increase sales would vanish. In addition, in 1983 Overstreet produced a report on behalf of the Bureau of Economics Staff Report for the FTC, where he analysed all cases of retail price maintenance presented before the FTC between 1965 and 1982.[29] He concluded that in most of the cases analysed collusion was not possible at any level of the distribution chain, and therefore he estimated that resale price maintenance is overwhelmingly not anticompetitive.[30] Moreover, a 1991 study by Ippolito comes to similar conclusions after analysing reported cases of resale price maintenance between 1975 and 1982.[31] In these cases, collusion was hardly ever an issue; yet Ippolito estimates that because of the per se illegality of resale price maintenance, plaintiffs tried to use these claims to justify its existence. As a consequence of these theoretical and practical estimations, 20 years after *Sylvania State Oil Co v Khan* opened the door for a reconsideration of maximum resale price maintenance.[32] In this case, a lease to operate a gas station and a convenience store between Mr Khan and State Oil Company contained a suggested retail price for gasoline. Mr Khan was allowed to charge a price that was lower than the one suggested in the contract, but that would have an impact on his profit margins. Following a dispute between the District Court and the Court of Appeals as to the per se illegality of the restriction, the case reached the Supreme Court.

The idea of unreasonableness was reinforced for the application of the per se rule. Moreover, and in harmony with preceding cases in other areas of antitrust, the interpretation and purpose of this principle was drastically constrained, as the court was not in favour of applying it to 'restraints imposed in the context of

[27] See ch 1 s II B above.

[28] *Albrecht v Herald Co* (1968) 390 US 145. Posner described this case as being based upon 'increasingly wobbly, moth-eaten foundations' 93 F 3d, 1363.

[29] TR Overstreet Jr, 'Resale Price Maintenance: Economic Theories and Empirical Evidence' (1983) *Bureau of Economics Staff Report*. This report is used by Lambert to justify the benefits of resale price maintenance. TA Lambert, '*Dr Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri, 43–44.

[30] ibid 44.

[31] PM Ippolito, 'Resale Price Maintenance: Empirical Evidence from Litigation' (1991) 34 *Journal of Law and Economics* 263. This report is also used by Overstreet, ibid 46.

[32] *State Oil Co v Khan* (1997) 522 US 3.

business relationships where the economic impact of certain practices is not immediately obvious.'[33] Accordingly, the per se rule is now seen as exceptional, and only applicable to those restrictions that have been demonstrated to bring about negative effects upon the competitive process. If in doubt, and as opposed to *Albrecht*, then the agreement must be individually assessed before coming to a conclusion as to its compliance with section 1 of the Sherman Act. In its reasoning, the court explicitly refers to Bork and Posner, thus clearly accepting the predominance of the views of two of the Chicago School's main representatives.[34] Albrecht was finally overruled, putting an end to the per se illegality of maximum resale price maintenance.

C Per Se Illegality Gone For Good? *Leegin* and Minimum Resale Price Maintenance

Until 2007, the establishment of a minimum price by manufacturers for the resale of the products distributed by non-integrated retailers remained per se illegal in the US.[35] Nonetheless, the economic and legal context had, over the years, paved the way for what was an unsurprising change of position. *Sylvania* and *Khan* had limited the application of the per se rule, isolating minimum resale price maintenance from all other vertical restrictions. Acceptance towards vertical restraints had drastically increased by the late 2000s, and economists and jurists had devoted many pages to proving how resale price maintenance may be beneficial for competition.[36] Although still mainly considered anticompetitive, given that these restrictions may actually also purport benefits it seems logical to allow for an analysis before condemning such practices. That was the rationale of the court when deciding upon the *Leegin Creative Leather Products Inc v PSKS Inc* case and overruling the *Dr Miles* per se prohibition that had been in force for almost a century.[37]

The case concerned an agreement between Leegin, a leather manufacturer, and PSKS, owner of Kay's Closet, a women's apparel store in Texas, which contained a peculiar pricing policy: the manufacturer refused to sell to retailers when they discounted certain products below the prices it recommended. Leegin subsequently discovered that Kay's Closet had been selling the specified products at

[33] ibid, relying on *FTC v Indiana Federation of Dentists* (1986) 476 US 447, 458–59.

[34] In fact, Posner wrote his opinion of the case when it was brought before the Court of Appeals, and stated that 'State Oil might want to place a ceiling on the dealers' resale prices in order to prevent them from exploiting that monopoly power fully. It would do this not out of disinterested malice, but in its commercial self-interest. The higher the price at which gasoline is resold, the smaller the volume sold, and so the lower the profit to the supplier if the higher profit per gallon at the higher price is being snared by the dealer.' 93 F 3d, 1362.

[35] TA Lambert, '*Dr Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri.

[36] See, inter alia, R Deneckere, HP Marvel and J Peck, 'Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition' (1997) 87 *American Economic Review* 4, 619–41.

[37] *Dr Miles Medical Co v John D Park & Sons Co* (1911) 220 US 373.

prices as low as 20 per cent below the minimum established, and when ordered by the manufacturer to cease the discounts, PSKS refused to do so. Leegin subsequently stopped selling its products to Kay's Closet and the retailer filed a suit against the manufacturer. The Supreme Court recognised that some types of agreements were unlawful per se, but it only expressly referred to horizontal price-fixing agreements. It expressly recognised that resale price maintenance can have negative effects, but since according to the court some beneficial results have also been proven the per se illegality rule does not seem to be able to fully respond to the complexity of these restrictions. The court once again refers to Bork and the Chicago School when declaring minimum resale price maintenance subject to the rule of reason. In determining the validity of such restrictions, the court estimated that three factors would set off alarm bells: first, if resale price maintenance is used collectively by manufacturers who hold a significant position of the relevant market, it could lead to horizontal price-fixing; secondly, if retailers were the ones instigating the restraint, rather than the manufacturers, there could be a protection of inefficient distributors; and thirdly, when the manufacturer is dominant and has market power, the restraints can be used anticompetitively.[38]

While this change in the treatment of minimum resale price maintenance has received mixed reception among academics, there is no question that all vertical restrictions are now subject to the rule of reason in the United States. Therefore, as Lambert has rightly pointed out, the attention of academics should focus on how that rule of reason is to be applied in order to achieve a sound, coherent interpretation. Whilst suggestions of per se legality seem far-fetched—the courts do highlight the negative effects price restraints may bear—[39] it is crucial to determine who bears the burden of proof and what a plaintiff needs to establish in order to file a successful claim of resale price maintenance. Lambert has carefully studied the different positions that could be adopted; given their importance, it is necessary to explore some of them here. The first option, clearly justified by the concerns about the problems derived from resale price maintenance, is to assume the burden of proof of procompetitive effect lies in the defendant who has introduced it. It was the position of the majority the states in *Nine West* in 2008.[40] It would also need to be proven that the procompetitive effect could not have been achieved by using less restrictive means (reminding us of the principle of proportionality in EU law). This seems like a reasonable position in order to keep the negative effects of these restrictions under control. However, as Lambert highlights, this could well lead to a situation where most claims of resale price

[38] *Leegin Creative Leather Prods Inc v PSKS Inc* (2007) 127 US 2705, 2719 .

[39] Posner advocates for the per se legality of vertical restraints. See R Posner, 'The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality' (1981) 48 *University of Chicago Law Review* 6.

[40] TA Lambert, '*Dr Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri, 26.

maintenance will be likely to succeed, as proving these benefits would be extremely difficult.[41]

The FTC has advocated a more tolerant approach. In order to prove pro-competitive effects, the defendant would only need to prove that the three negative factors established in *Leegin* and mentioned above were not present in the specifc agreement. If that is the case, then there is a rebuttable presumption of validity of the restrictions.[42] Another proposal comes from the hands of Comanor and Scherer. Also in the context of *Nine West*, they suggested the restoration of a two-tier analysis of resale price maintenance. The first part of the evaluation would be determining who called for the imposition of the restraint. If it was the dealers, then there could be a problem of inefficiency that would make the restriction unlawful unless proven otherwise. In the case that it was the manufacturer who had promoted the resale price, the legality of the restriction would depend on either of the two following tests. On the one hand, a quantitative substantiality test is considered. Anyone challenging the agreement would need to prove that, first of all:

> at least 50 per cent of sales in the relevant product market were subject to RPM (presumably including sales by manufacturers that have vertically integrated forward into retailing); and [second of all] that the challenged RPM extended the practice's coverage by at least 10 per cent of relevant sales.

On the other hand, in order to condemn the agreement it could be enough to prove that, first, the structure of the relevant market is that of an oligopoly with a Herfindahl-Hirschman index exceeding 1,800; and, secondly, that the market share of the manufacturer implementing the restraint is equal to or above 10 per cent. Once one of these tests is demonstrated, the chances of escaping illegality would be slim.

In a belief that this test would also be too narrow, Lambert refers to yet another way of interpreting the rule of reason. Under the 'antitrust law approach', as he calls it, is adopted from Areeda and Hovenkamp's work,[43] and it implies that one of the following factors would need to be proven for the illegality of an agreement containing a price restraint:

1. the manufacturer's market is concentrated (HHI > 1200), and RPM arrangements or their equivalent cover a substantial portion of total sales (at least 15 per cent);
2. the dealer market is concentrated (HHI > 1200);

[41] As Lambert explains, proving procompetitive effects 'would require the defendant to show that sales figures following the imposition of RPM were more favorable than they would have been absent the RPM. To make that showing, the defendant would have to employ sophisticated statistical methods to separate out conflating influences and thereby isolate the effects of RPM.' As regards demonstrating that there is no other less restrictive means, it 'would require the defendant to prove the high costs of ex ante contracting for the provision of desired services.': TA Lambert, '*Dr Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri, 29.

[42] ibid 31.

[43] PE Areeda and H Hovenkamp, *Antitrust Law*, 2nd edn (New York, Aspen Publishers, 2004) 328–39.

3. RPM arrangements or their equivalent are widespread throughout the product market, covering at least 50 per cent of sales;
4. the RPM arrangement was dealer-initiated, meaning that it was adopted after demand by dealers acting collectively (defined as two or more dealers acting in concert or an association of dealers) or a request by a dominant dealer (defined as one that accounts for 30 per cent of the manufacturer's local or total sales of a brand—local when restraint is employed only in that dealer's locality);
5. the RPM arrangement covers a powerful brand, meaning that the manufacturer's brand comprises at least 30 per cent of total sales in the product market;
6. there is a dominant dealer responsible for at least 30 per cent of the manufacturer's sales within the area covered by the restraint;
7. the manufacturer imposes the RPM arrangement selectively (in only one or a few geographic markets); or
8. the covered product is homogeneous so that there is an obvious absence of any need for special promotional efforts by retailers because the product is not that different than competing brands.[44]

With the exception of the last factor, which is irrebuttable, all others create a rebuttable presumption of illegality. Lambert appraises this perspective and recognises the effort to structure the rule of reason; however his position towards these restraints is even more benevolent. He suggests giving priority to the benefits of resale price maintenance and allowing for an easier way to avoid illegality. As opposed to the previous suggestions, in this scenario it would be the challenger who would bear the initial burden of proof, and for a claim to be estimated it would have to be demonstrated that there is direct evidence of competitive harm or circumstantial evidence of competitive harm 'by showing that the prerequisites to such harm are satisfied.'[45] The manufacturer would still have the chance of escaping unlawful behaviour, but the only way to do this would be to show that the there was an error in the initial proof provided by the challenger of that the practice has procompetitive benefits that outweigh its negative effects.[46]

An overview of these possibilities for the new rule of reason approach shows an important drawback of eliminating per se illegality: the analysis has become far more complex, and antitrust enforcers are now faced with the task of assessing agreements before coming to a conclusion as to their validity. In addition, there is a need to establish how the rule of reason is to be interpreted and, as reflected in the above summary of the different positions in this regard, the crucial issue is determining whether to assume that price restraints are mainly beneficial or whether they should be considered overwhelmingly harmful—legality being the exception. Lambert's approach, although clearly addressed at facilitating the legitimacy of resale price maintenance, is perhaps a little overenthusiastic about the benefits of these restrictions. One must not forget that they could pose a threat to

[44] TA Lambert, '*Dr Miles* is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance' (2008) *Legal Studies Research Paper Series* 2008–25, University of Missouri 36–37.

[45] ibid 51.

[46] ibid.

the competitive process and result in consumer harm when inefficient dealers are being protected, or when interbrand competition is limited.

In the author's view, Areeda and Hovenkamp's eight-factor approach would be much better suited to respond to the problems of price restraints, while at the same time giving the manufacturer enough scope to overturn the presumption of illegality when the restraints are clearly procompetitive. Nonetheless, and to allow a more equitative ground for the manufacturer to fight for the validity of the agreement and for the challenger to contest it, it may be worth reconsidering the impossibility of rebutting the presumption when the contract in question concerns homogeneous products—the eighth factor. Not only does this irrebuttability seem disruptive with the interpretation of the rest of the provisions; like Lambert argues, it also seems to be based on flawed assumptions.[47] It departs from the premise that the main reason for introducing these restrictions is to prevent free-riding problems. But other justifications are also present. Sometimes if dealers enter into a price war, they will try to cut costs in aspects which would seriously jeopardise the quality of the service manufacturers expect them to offer to consumers. It is true however, as Comanor has argued, that some consumers may not wish to pay for this enhanced service and would rather simply spend less on the product, and efficiency will only be achieved if the preferences of all consumers are taken into consideration and not just those of ill-informed clients.[48]

Finding adequate criteria for the application of the rule of reason is the next challenge for US antitrust. It is bound to take some time and practice until this is achieved. It will be curious to see how far the rule of reason is taken in this increasing enthusiasm towards vertical agreements. There are some signs that tolerance will still be increased further; there have been cases where vertical restraints imposed by firms with market power have been upheld where there is a legitimate business justification.[49] The Supreme Court has, to date, not specified if vertical restraints by imposed by dominant firms can help exploit buyers or dealers even while increasing output and increasing aggregate consumer surplus. As Fox indicates, the reason for this could be that the court thinks that antitrust is not the best means to control the pricing power of firms.

D Implications of the General Evolution of Public and Private Enforcement of US Antitrust Rules

> [Antitrust] rules in practice, as distinct from the theory, are critically affected by sanctions, by procedures, and by the policies and incentives of enforcers. Thus the situation

[47] ibid 38.

[48] WS Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy' (1985) 98 *Harvard Law Review* 983, 992. See ch 1, s II B above.

[49] *Trans Sport Inc v Starter Sportwear Inc* 964 F 2d 186 (2d Cir 1992). More recently, the *Eastman Kodak* case showed a less enthusiastic attitude towards verticals, as the greater tolerance calls for caution if they are only a pretext to limit competition. Therefore, they must be closely analysed. *Eastman Kodak Co v Image Technical Services Inc* 112 S Ct 2072, 2079 (1992).

> in antitrust law is fluid and uncertain and is frequently in conflict with the legal theory, such as it is.[50]

The genuine implications of competition law provisions are dependant upon their actual application. As Posner's words suggest, no theoretical study of the law can be detached from the practical impact of its procedure and enforcement. Thus far, our study has focused on regulatory changes in EC competition and US antitrust, and the mutual influence of market forces and the law in the changes of reality. Such an analysis has relied upon economic and legal theories and their practical implications on legislation. The way antitrust rules are enforced plays a fundamental part in the development of a policy. In the US, federal enforcement has coexisted with state enforcement for decades, and the role and interpretation of the rules given by all the actors involved in the application has greatly shaped the profile of US antitrust. The regime affecting vertical agreements has also experienced changes that are dependant upon who enforces these rules; sometimes, contradictions have presented themselves between the positions of the states on the one hand and the federal authorities on the other.

i Enforcement of antitrust rules in the US

The different levels of government in the US all have powers in the process of implementation of antitrust provisions. As a consequence, the matter dwells upon the delicate issue of the division of sovereignty between the states and the federal system, and has not been exempt from controversy.[51] To better understand enforcement procedures both in the US and the EU, it is convenient to rely on Gavil, Kovacic and Baker's 'step-by step guide' guide on how antitrust legislation is actually enforced.[52] The first step is identifying the possible violations, and providing the means to examine the conduct of those under suspicion of breaching antitrust rules. Once it has been established that a violation is possible, the means to enforce the law need to be determined. In the US, they are referred to as 'rights of action', and they can be exercised by both public entities and private parties. Private enforcement, which has been 'a central feature of US antitrust law since the Sherman Act was adopted in 1890,'[53] is not always present in other jurisdictions, as was the case in Europe until *Courage*.[54] Private enforcement is considered to have played a key role in the success of the evolution of US antitrust,[55] as roughly 90 per cent of cases with antitrust connotations are litigated privately.[56]

[50] R Posner, *Antitrust Law: an Economic Perspective* (Chicago, University of Chicago Press, 1976) 3.
[51] AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 924.
[52] ibid.
[53] ibid 925.
[54] Case C-453/99 *Courage Ltd v Bernard Crehan* [2001] ECR I-6297.
[55] A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (Oxford, Oxford University Press, 2006) 1189.
[56] ibid, relying on the White Paper on Competition Policy 'World Class Competition Regime' (Cm 5233, 2001) para 8.1.

The next step is to establish who decides if the claims of the plaintiff or prosecutor are founded. In the US, it is the federal district courts who, according to section 16 of the Clayton Act, have jurisdiction in this regard.[57] Finally, the sanctions and remedies (which range from fines to imprisonment) are also imposed by the adjudication authorities after determining that there has indeed been a breach of antitrust laws. It needs to be noted that the relevant courts—whether federal or local—have quite a broad margin of discretion in the interpretation of antitrust laws. Their role therefore remains crucial in the development of a sound antitrust policy.

ii The competences of state prosecutors

The Antitrust Division of the DOJ, the FTC and the attorneys general of each state all take active part in the application of antitrust rules. Private damage suits brought before the Supreme Court and the courts of each state have formed the core of US enforcement policy. Overall, as regards the different states, and despite their limited role in the implementation of antitrust in the early days, their possibilities have been increased since the 1970s—shortly before the *Sylvania* ruling—and currently state prosecutors have increased their responsibilities in this regard.[58] Their enhanced position was consequential upon the enactment of state antitrust statutes and the creation of new antitrust offices to enforce them. In distribution, the action of state prosecutors is particularly relevant. By way of example, in the car sector there has been state legislation since the 1980s affecting the restrictions imposed on manufacturers appointing a new dealer in an existing dealer's area without good cause. Therefore, nowadays they can either apply such state legislation to their ultimate consequences, or file a federal antitrust suit like any private person injured or threatened with injury by reason of antitrust violations under sections 4 and 16 of the Clayton Act.[59]

The multi-level enforcement system has, on occasion, had curious repercussions for vertical agreements. For instance, in 1985 the DOJ 1985 adopted its Vertical Restraints Guidelines,[60] directed at providing some direction as to how to enforce section 1 in relation to vertical restraints. In line with *Sylvania*, they advocated a careful consideration of the restrictions before coming to a conclusion as to their validity. However, the Guidelines went one step further than the Supreme Court had done at this stage, as they also included agreements which set resale prices. This was followed shortly afterwards that same year by vertical restraints guidelines adopted at the state level by the the National Association of Attorneys

[57] This jurisdiction was deemed as exclusive in *General Inv Co v Lake Shore and Mich Rwy Co*, 260 US 261 (1922).

[58] State prosecutors are mainly attorneys general and the multistate antitrust task force (part of the National Association of Attorneys General).

[59] The courts have explicitly recognised that states and subdivisions are 'persons' for the purposes of private right of action. See *Chattanooga Foundry & Pipe Works v City of Atlanta* 203 US 390 (1906).

[60] DOJ, Vertical Restraints Guidelines (1985) reprinted in 4 Trade Reg Rep (CCH) 3, 105.

General (NAAG);[61] however, and contrary to what had been established only a few months earlier by the DOJ, resale price maintenance is treated as per se illegal. The contradictory position was lawful given that, as the Supreme Court has clarified in 1978, it is possible for a state to forbid a conduct that does not violate an Act of Congress.[62] As a consequence, the NAAG was able to maintain its guidelines even after *Khan* declared maximum resale price maintenance to be subject to the rule of reason.[63]

iii Is federal antitrust enforcement influenced by political changes? Possible impact on the regulation of vertical agreements

The DOJ and the FTC are both responsible for the enforcement of federal antitrust laws. The DOJ's antitrust division enforces the Sherman and the Clayton Acts before the federal courts, and has exclusive competence in criminal offences. The FTC is also in charge of civil cases under the Clayton Act, as well as enforcing its own acts through its Bureau of Competition. Importantly, their implementation of antitrust laws has very often been criticised for being overly linked to political changes in the government of the US.[64] In the words of Kovacic, 'No metaphor-based story is more potent or commonplace in the discussion of modern federal enforcement than the narrative of the swinging pendulum. Enforcement officials and scholars often use pendulum imagery, or close substitutes, to describe adjustments in federal policy, and business journalists frequently use versions of the pendulum narrative to discuss the DOJ or FTC antitrust enforcement.'[65]

Such claims find strong justifications in the evolution of US antitrust. The field of vertical restraints is particularly representative of the swinging pendulum which has gone from too much intervention in the 1960s and 1970s under democratic governments, a virtual halt during Reagan's presidency in the 1980s (and Bush's four years in power), a subsequent middle point under Clinton in the 1990s and a possible new swing towards minimum intervention under the Bush II administration, *Leegin* being the result. Indeed, until *Sylvania* most vertical restraints were treated as per se illegal regardless of the fact that they could actually have procompetitive

[61] National Association of Attorneys General (NAAG), Vertical Restraints Guidelines (1985) s 2.1, Antitrust and Trade Reg Rep 49 (BNA) No 1243, 996.

[62] *Exxon Corp v Governor of Md* 437 US 117 (1978). What is forbidden is for states to declare lawful conducts that have are considered illegal at the federal level. *N Sec Co v US* 193 US 197 (1904).

[63] DH Ginsburg, 'Comparing Antitrust Enforcement in the United States and Europe' (2005) 1 *Journal of Competition Law and Economics* 3, 427–39.

[64] See, inter alia, JJ Flynn, and JF Ponsoldt, 'Legal reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes' (1987). 62 *NYU Law Review* 1125; R Pitofsky, 'Antitrust at the turn of the Twenty-First Century: A View From the Middle' (2002) 76 *St John's Law Review* 583; R Pitofsky, 'Proposals for Revised United States Merger Enforcement in a Global Economy' (1992) 81 *Georgetown Law Journal* 195; DA Balto, 'Antitrust Enforcement in the Clinton Administration' (1999) 9 *Cornell Law Journal and Public Policy* 61; E Correia, 'Antitrust Policy After the Reagan Administration' (1987) 76 *Georgetown Law Journal* 329.

[65] WE Kovacic, 'The Modern Evolution of US Competition Policy Enforcement Norms' (2003) 71 *Antitrust Law Journal* 377, 382.

effects, and overall there was an excessive activism on the part of the federal authorities on antitrust cases. This position coincides with the hegemony of neoclassical economics and Harvard School ideals, which saw in intervention a panacea of all ills. In *Sylvania*, which extended the rule of reason to non-price vertical restraints, there was a general recognition that there was a need to restrict the scope of intervention of antitrust authorities. During the following decade, enforcement turned very lenient, not only in this field but also in most areas of antitrust, and is described as having moved 'radically to the right',[66] and even as a time of intellectual and moral decay.[67] During Reagan's years, increasing the competitiveness of US firms was the principal priority, and therefore enforcement of antitrust laws relaxed. This led to the virtual inexistence of vertical cases, and even to the non-application of the Sherman Act to cartels. Only blatantly anticompetitive practices were condemned, particularly price-fixing agreements.[68] During these years, the number of antitrust cases filed in district courts steadily declined.[69]

This trend was very much followed by the first Bush administration, and it was not until the Clinton years that antitrust enforcement is believed to have reached an optimal middle stance between the two extreme tendencies of previous decades. In the field of vertical restraints, there were 16 prosecutions,[70] while at the same time maximum resale price maintenance was removed from the per se category under *Khan*.[71] In addition, in 1993 the very benevolent Vertical Restraints Guidelines adopted during the Reagan years were withdrawn under Clinton's Democratic Administration. By then, however, the Harvard and Chicago School extremes had been substituted by more sophisticated theories of industrial economics.[72] Therefore, Kovacic challenges the pendulum narrative, arguing that it is too simplistic and that it overlooks the impact of many converging factors in the evolution of antitrust. On the one hand, more refined economic theories have undoubtedly influenced government officials in their prosecutions and the courts in their decisions. On the other, the accumulation of experience which acts as a historic learning process should, in his view, be the main factor accounting for the

[66] ibid 384, quoting P Behr, 'Wave of Mergers, Takeovers Is a Part of Reagan Legacy: Next Presidency Will Be Test of Regulatory Policy Success' *Washington Post* (Washington DC, 30 October 1988).

[67] ibid.

[68] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004).

[69] The figures from 1161 cases in 1977 to 638 in 1989 support this idea. See Motta, ibid 8–9. As regards vertical restraints in particular, Kovacic notes that Reagan's antitrust agencies 'issued consent orders in five vertical restraints matters that appear to have originated as investigations during the Carter Administration. During the tenure of Reagan's appointees, it does not appear that the DOJ or the FTC initiated an investigation that led to the issuance of a vertical restraints complaint. . . . The Bush administration brought four vertical cases, including two matters challenging resale price maintenance.' WE Kovacic, 'The Modern Evolution of US Competition Policy Enforcement Norms' (2003) 71 *Antitrust Law Journal* 377, 462.

[70] ibid. Of particular relevance for our purposes was the case *Toys 'R' Us Inc v FTC* 221 F 3d 928 (7th Cir, 2000), in which the validity of the free-rider problem for the justification of territorial protection is questioned. For an analysis, see AI Gavil, WE Kovacic and JB Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (Minnesota, Thompson West, 2002) 798–801.

[71] *State Oil Co v Khan* 522 US 3, 118 S Ct 275, 139 L Ed 2d 199 (1997).

[72] See ch 2 s I E above.

changes.[73] In particular, he emphasises the importance of 'norms' or principles developed by agencies 'that lack the force of law to decide how to execute their prosecutorial discretion,'[74] which despite certain constraints he sees as playing a key role in the shaping of antitrust policy.[75]

Kovacic evidently makes a very strong point, backed up by the evolution of economic thinking and reflected in the progression in US antitrust over the years. Also, in the field of vertical agreements the increase in tolerance towards territorial restrictions coincided with the convergence of certain problems affecting the competitiveness of US firms; therefore it seems that the market has also played a key role in the shaping of the policy. While his notion of antitrust evolution as a continuum is meritorious, and the emphasis he places on the accumulation of experience and knowledge is very accurate, the importance of political changes in antitrust cannot be totally excluded. This influence is particularly notorious in the light of the most recent developments. The Bush II administration reflected a change of approach to antitrust enforcement. Of particular relevance is the approval in 2002 of the settlement of the Microsoft investigation that started under Clinton for its alleged monopolisation. The settlement was promoted by the new DOJ appointees.[76] Of course, *Leegin*, which still draws upon Chicago School principles, is the clearest and most recent example of a possible swing in this respect during the Bush II administration. Therefore, it does appear to be the case that US antitrust policy is greatly dependant upon the ideology of government and federal authorities. If this is the case, it will be interesting to witnesss the impact of the Obama administration over the next years, as it should somewhat clarify how strong the influence of political changes is in the development of antitrust policy. It remains to be seen whether the current enthusiasm for vertical agreements will continue to rise, or whether the interpretation of the rule of reason will only imply a faint recognition of the validity of price restraints under section 1.

II THE EUROPEAN REGIME FOR VERTICAL AGREEMENTS SINCE 1999

A The Application of Article 81(1) EC: Is There Room for Economic Assessment of Agreements?

Regulation 2790/99 heeded many of the concerns of academics and practitioners about the problems of a regime radically disconnected from economic analysis. As opposed to the previous 'multiple regulation' system, the new Regulation broadens the possibility of exemption of vertical agreements from the application of Article 81(1) EC. However, its existence is based on the presumption that they

[73] WE Kovacic, 'The Modern Evolution of US Competition Policy Enforcement Norms' (2003) 71 *Antitrust Law Journal* 403.

[74] ibid 395.

[75] The possible constraints would be imposed by Congress, the President and the judiciary. ibid 396.

[76] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 9.

harm Article 81(1) EC in the first place; otherwise they would not need an exemption. Some have proposed placing the economic analysis under Article 81(1) EC entirely.[77] If, at the same time, the interpretation of prohibition is altered so as only to catch harmful agreements (in the economic welfare sense), then most vertical accords might escape the prohibition in the first place. The overwhelmingly positive effects of such restrictions have been proved above, and accordingly defenders of the theory of effective competition emphasise that distribution ties are lawful under Article 81(1) EC. In this sense, Joerges defends the legality of distribution restraints provided that there are enough suppliers of substitutable goods and competition among distribution practices exists.

The European courts have clarified that a 'rule of reason' type of analysis is only possible under Article 81(3) EC, thus excluding the possibility of such considerations under Article 81(1) EC. In *Métropole*, the CFI effectively equates Article 81(3) EC to the American rule of reason, and therefore carrying out a similar analysis under Article 81(1) EC would seem unnecessary.[78] Nonetheless, it is questionable that the courts are correct in excluding any kind of economic analysis under Article 81(1) EC. In fact, *some* analysis is, in the author's view, inevitable. First of all, the Article refers to practices which have as their 'object or *effect*' (emphasis added) the 'prevention, restriction or distortion' of competition. Therefore, there is a distinction made between those agreements which will be anticompetitive by object (and therefore forbidden without further analysis) and those whose effects will need to be evaluated before determining whether or not Article 81(1) EC is breached. In the past, the courts have estimated that vertical restrictions that do not establish maximum price maintenance or absolute territorial protection can escape the Article 81(1) EC prohibition, provided their effects are mainly beneficial. The assessment of the effects unavoidably involves an evaluation of the economic consequences of agreements. To deny the possibility of scrutinising these effects would appear to be in contradiction with the wording of this legal provision.

Secondly, the *de minimis* doctrine necessarily requires economic analysis.[79] The rule that agreements that do not surpass certain market share thresholds (10 per cent for horizontal agreements and 15 per cent for vertical accords) will not breach Article 81(1) EC makes indispensable the determination of the relevant market even at this stage of the application of Article 81 EC. It does prevent having to assess the legal and economic context,[80] but the definition of the relevant market

[77] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 973–89.

[78] Joined Cases T-528/93, T-542/93, T-543/93 and T-546/93 *Métropole Télévision and others v Commission* [1996] ECR II-649, para 76.

[79] Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty Establishing the European Community (*De Minimis*) [2001] OJ C368/13. This notice substituted a previous one, Commission Notice on agreements of minor importance which do not fall under Article 85(1) of the Treaty Establishing the European Community [1997] OJ C372/13. In the 1997 Notice, the tolerated thresholds were narrower: 10 per cent for vertical agreements, and only 5 per cent for horizontals.

[80] Commission Notice, Guidelines on vertical restraints [2000] OJ C291/1, para 9.

still requires careful consideration and attention. It is true that the *de minimis* norm, which comes in the form of a non-binding notice, is weakened by the black clauses that accompany the general rule. Since the market shares permitted are relatively small, the author tends to agree with the voices that have advocated for the removal of the hardcore list for a real impact on the scope of Article 81(1) EC. Their rationale is that, even when there is anticompetitive intent, in the absence of market power firms will simply not be able to cause considerable harm to competition. This was partly the logic behind the introduction of market share thresholds, and it appears that the black list of per se illegal agreements weakens the economic analysis. For the time being, few changes are likely to be introduced in this respect—the new draft regulation and guidelines for vertical agreements published in July 2009 do not seem to prioritise these issues in the forthcoming reform.

In practice, the resulting regime has similar consequences, as most vertical agreements will be considered lawful in the last stance. As Ferenc Vissi, Head of the Hungarian competition authority asks, '[d]oes it make more sense to condemn all vertical restraints and then (block) exempt 90% à la Brussels, or to accept 90% and condemn only 10% (à la Budapest)?'[81] However, the position of the Commission enhances the complexity of an already intricate policy. This is particularly worrying given that now Article 81 EC as a whole is applied by national courts and authorities with the decentralised application of EC competition law provided by Regulation 1/2003. In such a context, there appears to be an urge to simplify the economic analysis that must be carried out.

Whether or not these suggestions are considered in the near future, the Commission needs to clarify the orderly procedure of analysis under Article 81 EC. The provision is very clear as to the order of the application of paragraphs 1 and 3: first, it is necessary to determine whether or not the Article 81(1) EC prohibition is applicable to the agreement in question; second, and only if and when the contract does fall within the scope of Article 81(1) EC, the relevance of the exemption contained in Article 81(3) EC—either by applying one of the block exepmtions or examining the possibility of exempting the agreement individually—can be considered. This order of events is clearly the only valid interpretation of the wording of Article 81 EC; moreover, it is recognised by the Commission in the 2004 Guidelines on the Application of Article 81(3) EC.[82] In the Guidelines on Vertical Restraints however, paragraph 120 leaves doubts as the the correctness of the Commission's approach in this respect. According to this provision, there are four basic steps to the analysis of vertical restraints. The first of these steps is to define the relevant market and establish the market share of the parties—which seems logical and reasonable. Once that is determined, according to this paragraph, the second move is to apply the block exemption regulation if and when the market share of 30 per cent is not exceeded. Only if the relevant market share is

[81] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 CML Rev 980.

[82] Commission Notice—Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C101/0097.

above the threshold does Article 81(1) EC come into play, as the third step of the analysis is to check whether or not those agreements that surpass the 30 per cent limit fall within the scope of the prohibition. If it does, then the fourth step would be to see if it can be individually exempted on the basis of Article 81(3) EC. This approach looks set to remain unchanged, as the new draft Guidelines on Vertical Restraints follow the same pattern of analysis.[83] In the author's view, it reflects a basic flaw in the understanding of the concept of the role of block exemption regulations. These regulations are adopted using Article 81(3) EC as a legal basis, and this provision can only apply to agreements that fall within the scope of Article 81(1) EC in the first place. Bluntly put, there can be no exemption granted to an agreement that is not forbidden in the first place. Therefore, if an agreement does not meet all the conditions of Article 81(1) EC, then Regulation 2790/99—or 1400/2002 in the case of the car sector—is not applicable as the agreement is not unlawful according to EC competition law rules.

There are some signs that point towards a narrower interpretation of the Article 81(1) EC prohibition, in particular in the European courts' decisions—which again appear to be one step ahead of the Commission. For instance, the 2001 Commission decision to fine Volkswagen for resale price maintenance[84] was annulled by the CFI given that the court did not believe that an agreement existed.[85] This ruling, later confirmed by the ECJ,[86] stated that no 'concurrence of wills' could be inferred from circulars sent by the manufacturer to the dealers explaining the pricing policy they were supposed to adhere to.[87] Rather, this should be considered unilateral conduct of the manufacturer. The fact that dealers adhered to that policy did not represent acceptance of an offer, as they were not considered to be in a solid bargaining position vis a vis the manufacturer. However, in this case the prices set by the dealers even differed from those announced in the call by the manufacturer. Therefore, the European courts have limited the interpretation of the scope of Article 81(1) EC not by increasing the economic analysis, but by merely confining the notion of agreement—essential element for the application of the legal provision. These limits can be loosely compared the arguments employed decades earlier by the US Supreme Court in cases such as *Colgate*.[88] The court held that when the objective of a practice is other than the maintenance or creation of monopoly power, manufacturers are allowed to

[83] See para 106 of the Draft Guidelines on Vertical Restraints, which contains virtually the identical four-step analysis. The only difference is that the market share of the buyer also needs to be assessed in the first step.

[84] *Volkswagen* [2001] OJ L262/14.

[85] Case T-208/01 *Volkswagen v European Commission* [2003] ECR II-5141, para 45.

[86] Case C-74/04 *Volkswagen v European Commission* [2006] ECR I-06585. The ECJ confirmed the view of the CFI, although, unlike the latter, it estimated that 'a call which is contrary to the competition rules may be regarded as being authorised by seemingly neutral clauses of a dealership agreement' (para 44).

[87] A 'concurrence of wills' is the basic requirement for the existence of an agreement, as the CFI clarified in the case T-41/96 *Bayer AG v Commission* [2000] ECR II-3383. On this definition, see O Black, 'Agreement: Concurrence of Wills, or Offer and Acceptance?' (2008) 4 *European Competition Journal* 1.

[88] *US v Colgate & Co* 250 US 300, 316 (1919).

exercise their discretion in the running of their businesses. This includes choosing their dealers and imposing conditions for the sale of their goods. Such conduct would not constitute an agreement, and therefore cannot be punished under section 1 of the Sherman Act.

The Commission has also introduced some noteworthy limitations. By way of example, there has been a shy attempt to limit the very broad notion of affection of trade between Member States, a requirement for the application of both Articles 81 and 82 EC. This limit to the scope of EC competition law rules is jurisdictional, and is clearly rooted in the division of competences between national governments and European institutions. Following the principle of attributed competence, the Commission and other supranational bodies may only act when they are empowered to do so by the Treaties, and according to the subsidiarity rule their action should be restricted to those areas where intervention at the Community is strictly necessary for the attainment of the goals of the EC.[89] This boundary was interpreted in a very broad sense by both the Commission and courts. The requirement would be met even if both parties were nationals of the same Member State,[90] and even an actual enhancement of trade between the countries of the Community could not prevent the application of Article 81(1) EC, given the potential negative effects on trade in the future.[91] More recently, the need for the affection to be 'appreciable' has been emphasised. The Commission recognises in its Guidelines on the Effect on Trade Concept that, if the parties' market power is small, interstate trade will hardly be harmed.[92] In particular, two conditions need to be met for a vertical agreement to fall outside the scope of Article 81(1) EC: the market share of the pertinent parties must be below five per cent of the relevant market in question, and the aggregate turnover of the supplier must not exceed €40 million.[93] Importantly, there are no black clauses that limit the application of these criteria, which means that they apply even to resale price maintenance and absolute territorial protection. Despite the very small scope of this notice given the narrow thresholds, it can be considered an important step towards the reduction of the scope of Article 81(1) EC.

B Individual and Block Exemptions Under Article 81(3) EC

The extensive scope of the prohibition contained in Article 81(1) EC has given particular vigour to the exemption system in Europe. The frequency with which Article 81(3) is invoked and utilised has de facto turned these 'exceptions' into the

[89] For a definition of these basic EU law principles, see Art 5 EC.

[90] Case C-234/89 *Stergios Delimitis v Henninger Bräu AG* [1991] ECR I-935.

[91] Joined cases 56 and 58/64 *Etablissements Consten Sàrl and Grundig-Verkaufs GmbH v Commission* [1966] ECR 299.

[92] Commission Notice—Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty [2004] OJ C10/81.

[93] ibid para 52.

general rule. The provision is the legal basis for all block exemptions in the area. With regard to the treatment of vertical restraints, once the Commission published its Green Paper on Vertical Restraints in 1997, it was clear that important reforms would soon follow to achieve the objectives highlighted in the document and to correct the mistakes outlined.[94] Soon afterwards, Regulation 2790/99 and the Guidelines on Vertical Restraints clarified the extent of the reform, and in 2002 a new block exemption for motor vehicle distribution made clear that the Commission did not intend to allow this sector to fall within the general regime of Regulation 2790/99. However, economic analysis is not limited to these block exemptions. When the conditions laid down are not met, individual exemptions may also be sought, ensuring that, in practice, the overwhelming majority of vertical agreements manage to escape the nullity sanction of Article 81(2) EC.

The introduction of Article 81(3) in the EC Treaty confers a solid advantage upon the European regime over that of the US. Section 1 of the Sherman Act does not contemplate the possibility of exempting agreements as a result of their potential benefits. There are no exceptions to the prohibition within the Act, hence the importance of the role of the courts in creating and subsequently extending the rule of reason analysis to those types of agreements which may, in some circumstances, claim to hve advantages. In this context, the revolutionary approaches of *Khan* or *Leegin* seem less pioneering. In theory, since the adoption of the EC Treaty nothing has precluded any kind of agreement from being assessed under the terms of Article 81(3). In practice, most types of restrictions considered per se illegal in the US have hardly ever been granted an exemption in Europe.[95] However, one must bear in mind that the adoption of the rule of reason in the US merely implies opening the door to an analysis similar to that of 81(3) and not a propensity towards upholding the kinds of restrictions that are subject to such scrutiny.

Since Article 81(1) has been interpreted in a broad sense to catch virtually every agreement, recurrence to Article 81(3) is perhaps more frequent than originally intended. The application of this general exemption can be riddled with uncertainties for the parties to the agreements under scrutiny. The conditions laid down in the article—improving the production or distribution of goods or promoting technical or economic progress, transferring these benefits to consumers, respecting the proportionality principle[96] and refraining from allowing the elimination of competition—can be subject to ambiguous interpretations, much to the dismay of

[94] Vertical Restraints in EC Competition Policy (Green Paper) COM (96) 721, 22 January 1997.

[95] However, in some limited instances some exceptions can be found. For instance, the Commission approved an agreement between banks in Europe to charge a uniform commission for cashing travellers' cheques (Uniform Eurocheques [1985] OJ L35/43). It is unlikely that such a measure would have been allowed in the US, which treats any form of price-fixing as per se illegal.

[96] The proportionality principle is a recurrent and fundamental analysis in EU law, which implies that any limitations imposed must be the least restrictive means of achieving the desired (in this case procompetitive) objectives. For a detailed, comparative analysis of the principle, see N Emiliou, *The Principle of Proportionality in European Law, A Comparative Study* (Leiden, Kluwer Law International, 1996)

the parties. In this context, the importance of block exemptions in establishing more specific parameters can be appreciated. As such, and despite our reservations regarding these legal instruments, their practical role in the context of the extensive application of Article 81(1) ought not to be overlooked. However, by addressing legal certainty with further specific regulation the system runs the risk of becoming overly complex, and oftentimes excessively detailed regulation implies unsuitability of the rules for particular scenarios—thus requiring more regulation to address these emerging lacunae. The author is therefore of the opinion that it would be more appropriate to limit the scope of the 81(1) prohibition with a view to simplifying the exemption process.

i Economic Analysis and Regulation 2790/99

The current regulation has addressed some of the recurring issues for vertical restraints. Its broad scope of application means that most vertical agreements are able to escape the prohibition. The old cluster-bomb approach of pursuing all potentially anticompetitive agreements appears to have given way to a new more streamlined and rationalised strategy based upon the distinction between object and effect. The Commission now mainly focuses on the actual impact of agreements and refrains from intervening where the parties hold such a limited market power that they could not harm competition even if they tried. Basically, where there is no market power and no hardcore restrictions, there is little role for the Commission. The strict formalism of the previous multiple block exemption system has, to a great extent, been overcome and the economic effects of agreements are now considered in order to determine whether or not they are lawful. The Regulation constitutes an important and decisive step towards a sound economic analysis of vertical restraints under EC competition law.

a The scope of the regulation

Compared to the previous block exemptions, Regulation 2790/99 considerably widens the scope of validity of vertical agreements. This has been achieved through a number of reforms. To begin with, the BER does not *stricto sensu* contain a white list of 'good' vertical agreements, following the rationale that 'all that is not explicitly prohibited is allowed'.[97] This was one of the most important criticisms of the previous block exemptions, as obliging the parties to include specific contractual clauses appeared to be excessively interventionist and possibly beyond the scope of antitrust policy. In addition, the very definition of vertical agreements contained in the Regulation is broader than that of the previous regulations: it comprises:

[97] The disappearance of the white list approach has been particularly welcomed by the doctrine. See, inter alia, R Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' (2000) 37 CML Rev 898, and V Korah, 'The Future of Vertical Agreements Under EC Competition Law' (1998) 8 *European Competition Law Review* 508.

> 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, sell or resell certain goods or services.[98]

Agreements do not need to be written, and specific reference is made to the inclusion of multilateral agreements ('two *or more* undertakings').[99] The accords can relate to goods or services, and the exemption may apply whether the supplied goods are for resale or use.[100]

As regards agency contracts, they are generally considered to fall outside the scope of Article 81(1) EC, and therefore do not need to be exempted.[101] The exclusion of agency from the scope of the prohibition is expressly clarified in the Guidelines on Vertical Restraints,[102] with the exception of those agency agreements which 'are not genuine' or could foreclose access to the market for new firms.[103] In relation to these prohibited agency contracts, most authors believe that they could still be exempted on the basis of Regulation 2790/99, as they could fall within the scope of the definition of vertical agreements given in Article 2(1) of the block exemption, and the Guidelines refer to this possibility.[104] There is still, however, a relative obscurity not clarified by the broad definition of the Guidelines as to how to determine on a specific case if the agent is genuine or not, and in the past companies have attempted to profit from the tolerance towards agency contracts by defining their agreements as genuine 'agencies' even if this was not the case. It is a matter that is difficult to judge, and practitioners have called for further guidance from the Commission on this point.[105]

Most importantly, it seems as though vertical agreements are not automatically considered to infringe Article 81(1) EC. Article 2 tacitly opens the door for a reinterpretation of Article 81(1) EC, as the Regulation is said to apply 'to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1)'. This specification could be a decisive step towards a restriction of the application of the prohibition of the Treaty if it is interpreted in the sense that it is now the Commission which has to prove that a real violation of 81(1) exists in order to declare the agreement void, as Whish has noted. The narrowing of the scope of the prohibition contained in the EC Treaty is crucial, and the extension of the possibility of exemption should not be regarded as a solution to the

[98] Art 2(1) of Reg 2790/99. The definition of agreements covered by the former block exemptions—'[agreements] whereby one party agrees with the other to supply certain goods for resale within the whole or a defined area of the common market only to that other'(Reg 1983/83)—was more limited.

[99] Art 2 of Reg 2790/99. Emphasis added.

[100] Even so, agreements with consumers are excluded, as they are not considered an 'undertaking'.

[101] The treatment is thus similar to that of the US for agency agreements, which have been considered to fall outside the scope of s 1 of the Sherman Act since the *Schwinn* case.

[102] Paras 12–20.

[103] The Guidelines specify that for an agency agreement to be genuine, the agent must not bear any or only insignificant financial or commercial risk.

[104] Para 13.

[105] See 'Wish List Item No 3' in S Mobley, 'Assessment of the Vertical Restraints Reform 2 Years On' (2002) presented at the *IBC Ninth Annual Conference on Advanced Competition Law*, Brussels, 5–7.

over-broad application of Article 81(1) EC, but as a necessary complement to achieve an effective reform of the legal regime affecting verticals.

To sum up, the enlarged application of the block exemption regulation means that, in theory, the only way the Commission has of controlling these otherwise exemptible agreements is either if the agreement contains a black clause, or if the exemption is withdrawn on the basis of Article 6 of Regulation 2790/99. In addition, Member states are also able to withdraw the block exemption from agreements having effect exclusively in their territories, since the application of EC competition law is dependant upon the existence of an affection of trade between Member States. These changes paved the way for a more relaxed approach towards vertical agreements, particularly considering that any exemption decisions take effect from the date on which the agreement was concluded and not from the date of notification as previously established.[106]

b Market Share Thresholds: An Adequate Assessment of Market Power?

Article 3 of Regulation 2790/99 and section V of the Guidelines show an attempt on the part of the Commission to lay down the foundations for economic analysis of vertical agreements. The way in which the institution opted to evaluate market power was through the establishment of market share thresholds. The implications of these caps are described in Recitals 8 and 9 of the Regulation: when the market share of the supplier—or, in some limited cases, the buyer—[107] is below 30 per cent, and provided there are no black clauses, agreements will be exempted, as the restrictions imposed are expected to allow improvements in production or distribution. The decision to set the limit at 30 per cent was somewhat arbitrary,[108] and the first drafts originally provided a differentiated treatment with two different market share thresholds: one of 40 per cent for certain types of vertical agreements,[109] and another 20 per cent for those more serious restrictions.[110] The 30 per cent limit coexists with that of the *de minimis* Notice.[111] Taking into

[106] Richard Wish believes the application of Reg 2790/99 on this point could be retroactive, despite it not being mentioned on the text. See R Wish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' (2000) 37 CML Rev 887–924, 983.

[107] The general rule is that the market share of the supplier will be taken into consideration, with the exception of exclusive supply obligations defined in Art 1(c) of the Regulation: see R Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' (2000) 37 CML Rev.

[108] J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and the Realities of a Changing Retail Sector and of National Contract Laws' (Draft) Secola Conference, 13 May 2002, LSE, 17.

[109] This threshold applied to what were considered 'less serious restraints', and included exclusive distribution with a restriction on active sales if there is no restriction on handling competing goods, exclusive purchasing (with the same exception about handling competing goods), non-exclusive vertical restraints with the exception of quantitative criteria for selective distribution, and agreements between small and medium-sized enterprises. See p 26 of the introduction of the draft.

[110] These more serious vertical restraints were exclusive supply or customer allocation, non-competition clauses, selective distribution (when it was contrary to Article 81(1) EC) and tying.

[111] Commission Notice relating to the revision of the 1997 notice on agreements of minor importance which do not fall under Article 81(1) of the EC Treaty [2001] OJ C149/18. See s A above.

consideration Regulation 2790/99 and the *de minimis* Notice, the regime for vertical agreements is as follows: agreements where the relevant market share is below 15 per cent will be considered to fall outside the scope of the prohibition contained in Article 81(1) EC,[112] while those between 15 and 30 per cent will be exemptible on the basis of the block exemption.

In his studies of franchises, Norton emphasised that market power is, at the very least, difficult to define, and severe problems arise in formulating empirical tests of theories using notions of market power.[113] Indeed, it would appear that the introduction of market share thresholds is not only an incomplete parameter to measure market power and to carry out an economic analysis, it is also far from adequate.[114] In the first place, it is excessively formalistic. The application of the thresholds without any further analysis might render void some agreements with positive efficiency effects of firms with a large degree of market power. There is a presumption that all of these firms' agreements are suspicious, while some anticompetitive agreements might escape the control because the firms have small market share thresholds (alleviated to a certain extent by the black clause list). In the second place, it relies on the complex concept of the relevant market and its definition, a matter which the Commission tends to leave open in all of its decisions. Since 2004, with the materialisation of decentralised application of EC competition rules, and with the increasing encouragement of private enforcement, the national courts and authorities will have to determine the relevant market, which requires a complex analysis. The capacity of national competition authorities and courts to do this correctly has been questioned, as studies show that some of the NCAs hardly possess the experience and the means to do so effectively.[115]

It is down to certain subjectivity to outline the specific relevant market on each occasion, thus there is a danger that it can lead to a battle between firms—who will try to consider relevant a market where they do not exceed the thresholds—and the Commission, who, in an attempt to stretch its control over a certain agreement, might opt for a narrower definition of the relevant market. To make things even more complicated, those agreements above the caps could still be exempted on an individual basis, and the Commission can withdraw the exemption to those below the cap. The complexity and uncertainty of such a system is evident.[116] By

[112] The *de minimis* Notice, however, is not a binding instrument. The original Notice established a 10 per cent market share threshold for vertical restraints, which did not apply to vertical agreements intended to fix prices or confer absolute territorial protection. The revised Notice increases the market share threshold to 15 per cent and establishes a list of exceptions to this general rule in Art 12(2) 'provided that the condition of effect between Member States is fulfilled'. The threshold can be surpassed by up to one per cent for two calendar years (see Art 10).

[113] WS Norton, 'An Empirical Look at Franchising as an Organizational Form' (1988) 61 *Journal of Business* 2, 197–218.

[114] Despite this difficulty, the truth is that up until now no better indicator of market power has been suggested.

[115] A Riley, 'EC Antitrust Modernisation: The Commission DoesVery Nicely—Thank You! Part Two: Between the Idea and the Reality: Decentralisation under Regulation 1' (2003) 12 *European Competition Law Review* 657.

[116] In an attempt to increase legal certainty, the Guidelines clarify that no fines will be imposed if the agreement is not notified in good faith.

contrast, in the US, the definition of the relevant market is not subject to such rigid criteria. In *Standard Stations*, for instance it was established that the market power could be inferred from a 'substantial share' percentage, without actually giving a specific figure. In no case has a 30 per cent market share on its own been considered enough to determine market power. Moreover, the maintenance or improvement of the control of the market over time was also considered in order to determine dominance. In cases such as *US v General Electrics,*[117] even a market share of over 80 per cent was not enough to warrant a finding under monopoly power.

Market share thresholds are also rather arbitrary. Definition of the market is far from an exact science,[118] yet very much in line with neoclassical economics, the 30 per cent limit appears to turn the application of Article 81(3) EC into a rigid mathematical operation.[119] Other indicators need to be considered, as the courts have demonstrated, when examining dominance under Article 82 EC. Factors that have been taken into account include the number of competing suppliers for the same products, countervailing power of suppliers and purchasers, availability of substitutes and product differentiation, barriers to entry and potential competition, the nature of the oligopolistic interaction between firms. In sectors where innovation is essential, the market share is likely to change rapidly.[120] In this context, Waelbroeck suggests a system without market share thresholds, under which prohibition would only be possible if there were abuses or hardcore restrictions, or a withdrawal of the exemption.[121] In his view, it is enough to consider market shares under Article 82 EC, and the double contemplation resulting from the BER is excessive.

While the logic of a system without strict market share thresholds is clearly comprehensible, this may not an optimal solution in practice, at least not at the stage of development of EC competition law and policy by the late 1990s. One must not forget that before Regulation 2790/99, economic analysis was scarce. Taking the plunge from a system which barely looks at the economic effects of agreements to one where these agreements have to be so thoroughly scrutinised on an individual basis could have been an overwhelming leap for competition

[117] *US v General Electrics Co* 272 US 476, S Ct 192 (1926).

[118] D Waelbroeck, 'Vertical Agreements: 4 Years of Liberalisation by Regulation 2790/99 After 40 Years of Legal (Block) Regulation' in HP Ullrich (ed), *The Evolution of European Competition Law: Whose Regulation, Which Competition?* (Cheltenham, Edward Elgar Publishing, 2006) 87.

[119] See ch 2 s I A above.

[120] For instance, several merger decisions adopted by the Commission itself reflect that market share alone does not equate market power: *Alcatel/Telettra* (Case IV/M042) Commission Decision 91/251/EEC [1991] OJ L122/48 a merger was allowed despite a combined market share of 81 and 83 per cent.

[121] D Waelbroeck, 'Vertical Agreements: 4 Years of Liberalisation by Regulation 2790/99 After 40 Years of Legal (Block) Regulation' in HP Ullrich (ed), The Evolution of European Competition Law: Whose Regulation, Which Competition? (Cheltenham, Edward Elgar Publishing, 2006) 88–90. Waelbroek refers to examples of similar regimes, including the German Act against Restraints of Competition (as enacted before its most recent reform) and the UK's Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000 SI 2000/310, which exempts vertical agreements in general to avoid notifications.

authorities, particularly since 2004, when national competition bodies were empowered to apply exemptions. However, it does seem that the 30 per cent ceiling is somewhat low and inflexible. What may have been more desirable is perhaps to have opted for a higher threshold (perhaps 40 per cent) and subsequently introduce situations where that market share could in fact be exceeded—for instance, in cases where the most problematic restrictions are absent. Such a system would still ensure an economic analysis, but with an increased flexibility that would dispense with the need to look for individual exemptions in scenarios where the 30 per cent mark is exceeded and yet there is little or no harm to competition. One must remember nonetheless that even under US antitrust, vertical agreements are in practice subject to similar market share caps of between 20 and 40 per cent. Going above that would therefore seem to be excessive, as it could be a case of dominance according to EC standards—in which case it may be punishable under Article 82 EC. In any case, for those agreements exceeding the cap there is still the possibility of individual exemption on the basis of Article 81(3) EC, so vertical contracts by firms with larger market shares can still manage to escape nullity. Rather disappointingly, the new draft block exemption regulation for vertical agreements (scheduled to come into force when the current rules expire in 2010) not only does not change the 30 per cent cap, but also extends its application to the market share of the buyer.[122] Such a measure will further complicate the required economic analysis and ought to limit the possibilities for exemption.

Apart from the rigidness of the market share threshold system of Regulations 2790/99 and 1400/2002, the process of defining the relevant market is not exempt from confusion, which the Commission has attempted to clarify in its Notice on the Definition of the Relevant Market (hereinafter the RM Notice).[123] In general, it relies on an assessment of product substitutability from the consumer's perspective, relying on both the characteristics of the products and their location.[124] In this context, Motta explains that it should include those products 'that exercise some sort of competitive constraint on each other.'[125] Obviously, this is rather subjective, as some consumers may still opt to buy the product which is now more expensive, while others may wish to look for many different kinds of alternatives. The Commission, in its RM Notice, referred to the SSNIP test (Small but Significant Non-transitory Increase in Price) as a means to determine what

[122] Article 3 of the Draft Regulation states that the 30 per cent market share threshold cannot be surpassed by any of the 'undertakings party to the agreement'.

[123] Commission Notice on the definition of the relevant market for the purposes of Community competition law [1997] OJ C372/5, [1998] 4 CMLR 177. Of particular importance is also the infamous Case 27/76 *United Brands Co v Commission*, [1978] 1 CMLR 429.

[124] Although no reference is made in the notice or in the *United Brands* case, some have highlighted that it would perhaps be advisable to also examine the temporal market. The Commission, however, has examined this aspect in Commission Decision *Re ABG Oil* [1977] 2 CMLR D1, where it limited the 'market for oil to the period of crisis following the OPEC action in the early 1970s'. See J Steiner and L Woods, *EC Law*, 8th edn (London, Oxford University Press, 2003) 443.

[125] M Motta, *Competition Law: Theory and Practice* (Cambridge, Cambridge University Press, 2004) 102.

products constitute the relevant market.[126] The rule established is that the following question should be answered: if the price of a product rises between five and 10 per cent, would consumers turn to other goods, or would they go elsewhere to purchase that product? If that is the case, those other goods would be included in the same relevant market, and the price raise would not be profitable for firms. The importance of determining the relevant market had been emphasised—although not in so many words—by many authors over the years,[127] and numerous Commission Decisions have defined the relevant markets of the specific cases presented before them. In general, certain ambiguities can be perceived, as the Commission has used the flexibility of its definition to prevent those practices of manufacturers that, in its view, posed a threat. In such cases, it has opted for very narrow definitions of the relevant market.[128]

c The Persistence of Per Se Illegality: Black and Grey Clauses

As opposed to the system suggested in the previous section, where the absence of the most threatening restraints could lead to exceeding the market share threshold, Regulation 2790/99 opted for the introduction of 'black clauses' which would make agreements void even below the cap.[129] This more cautious approach is contained in Articles 4 and 5, which list a series of restrictions that are considered to breach Article 81(1) EC, and will not qualify for an exemption under the BER. These provisions are irrespective of market power or market share, since they are considered per se illegal and thus no economic analysis is needed to determined their validity under EU antitrust. In this sense, the differentiation between hardcore and severable clauses could be inspired by the US distinction between naked and ancillary restraints. 'Naked restraints', just like hardcore restrictions, are considered to be void regardless of other circumstances, given their negative effects on

[126] The SSNIP test is also known as the Hypothetical Monopoly Test (HMT), and is used, inter alia, in the US, Canada, New Zealand, Australia and the UK. See A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials,* 2nd edn (Oxford, Oxford University Press, 2006) 53.

[127] In this respect, Joerges explains how an analysis of the competitive conditions for the sale of new cars needs to distinguish between 'regional markets within the Community . . . and between different sizes of cars.' See C Joerges, E Hiller, K Holzscheck and HW Micklitz, *Vertriebspraktiken im Automobilersatzteilsektor*, Frankfurter wirtschaftliche Studien (Frankfurt, Verlag Peter Lang GmbH, 1985) 365. He uses data from studies by Berg and Locksley which reflected the possible dominance of some manufacturers in certain areas of the common market and for certain kinds of vehicles. See H Jürgensen and H Berg, '*Konzentration und Wettbewerb im gemeinsamen Markt*' (Göttingen, Vandenhoeck & Ruprecht, 1968); G Locksley, 'Pricing Strategies of Car Manufacturers in the UK Compared with Some Other EEC Member States'(1983) *Evolution of Concentration and Competition Series,* Collection Working Paper IV/427/83-EN, 77.

[128] For instance, its definition of the relevant market for ice cream in the *Schöller* and *Langanese* decisions was criticised by the CFI, who 'agreed . . . that craft-trade ice-cream belongs to a separate market, but argues that industrial ice-cream for bulk buying customers intended for sale in individual portions should be included in the industrial impulse ice-cream.' M Motta, *Competition Law: Theory and Practice* (Cambridge, CUP, 2004) 393. See Commission Decisions *Schöller Lebensmittel* [1993] OJ L183/1 and *Langanese Iglo* [1993] OJ L183/9.

[129] The 30 per cent safe harbour is further limited by the possibility given to the Commission to withdraw the exemption even to agreements even in the absence of hardcore restrictions when the conditions of Art 7 of Reg 2790/99 are met.

competition. Nevertheless, grey clauses and ancillary restraints cannot be equated. As a common feature, neither type of restrictions endanger the validity of the agreement they are embedded in, as they relate to secondary aims of the parties rather than the actual object of the contract. Nevertheless, the provisions .in Article 5 of Regulation 1400/2002 are considered illegal, and as a result they are prohibited. Ancillary restraints, according to the opinion of the US courts, are lawful despite being restrictive as they introduce constraints with pro-competitive effects to achieve a bigger, efficiency-enhancing role—the true purpose of the contract that contains such restrictions.

There is a differentiated treatment of the clauses depending on whether they are listed in Article 4 or Article 5, as the former lists the basic hardcore exclusions, which would render an entire contract void, while the latter refers to 'severable' clauses, which are themselves considered null but do not impede the validity of the rest of the agreement they are embedded in.[130] As a result, the restrictions in Article 4 are known as 'black clauses', whereas the ones in Article 5 are rather logically referred to as 'grey clauses'.

There are five black clauses listed in Article 4. First, a seller shall not, in any case, be allowed to determine minimum sale price.[131] With regard to maximum or recommended prices, these are permitted, as they would not pose any greater threat if and when there is total freedom to set the prices below the recommendation. However, maximum price maintenance is not per se legal: it is subject to a rule of reason analysis under Article 81(3) EC. The rationale of the prohibition of minimum prices is that resale price is estimated to contribute to market-partitioning by dividing national markets and is therefore regarded as a serious restraint to competition. The parallels with the US are evident, as only a couple of years before the adoption of the BER maximum resale prices had been declared legal by the Supreme Court in *Khan*.[132] The forthcoming reform raised expectations as to whether there would be a shift towards minimum resale price maintenance following *Leegin*; the new draft block exemption regulation does not introduce such changes, and therefore these practices are only salvageable by virtue of individual exemptions using 81(3)—a highly unlikely occurrence.

Secondly, restrictions on the territory in which or customers to whom the buyer may sell the contract goods or services are forbidden, albeit with some exceptions.[133] The aim of such a prohibition is to impede absolute territorial protection; integration concerns could not be completely abandoned after the strong preoccupation shown by the Commission and the courts over the years. The exceptions to the black clause deserve closer scrutiny. The first is for restrictions of active sales in territories allocated exclusively to a distributor or to customers reserved for a specific buyer, and implies that exclusive distribution and exclusive customer

[130] A similar double 'black' and 'grey' list system is also applied to the distribution of motor vehicles, by virtue of Reg 1400/2002 (Arts 4 and 5).

[131] Art 4(a) of Reg 2790/99.

[132] *State Oil Co v Khan* 522 US 3, S Ct 257, 139 L Ed 2d 199 (1997).

[133] Art 4(b) of Reg 2790/99.

allocation may be deemed to be lawful if and when the protection offered to the distributors is not absolute.[134] The second exception applies to restrictions of sales to end users by wholesalers. Wholesalers act as the middle person between dealers and manufacturers, and if allowed to sell directly to end customers they may jeopardise the setup of the distribution system, as they would be able to offer lower prices than retailers.[135] Restrictions of sales to unauthorised distributors by dealers appointed on the basis selective distribution system are the third exception.[136] This entails an acceptance of the validity of selective distribution systems; the rationale of this means of distribution is that dealers possess the required level of expertise to sell products that require special skills. If distributors are allowed to sell the goods to dealers outside the loop, the manufacturer would lose control over the ability of the dealers to competently sell the goods or services. Finally, the fourth exception relates to spare parts and components, and restricts the buyer's opportunity to sell these to those who may intend to 'copy' them and produce competing products.[137] While these exceptions do appear to be justifyable, the structural effects of the construction of this black clause seems overly complicated: Article 4 contains exceptions to the general rule of validity of vertical agreements below the 30 per cent market share cap, and at the same time there are some 'exceptions to the exception' that would resucitate the presumption of legality. It seems more logical to remove the black clause altogether, and leave territorial restrictions to be analysed under the rule of reason. The complexity of such clause, in our view, reflects the inherent contradictions that can arise when integration is prioritised over efficiency.

Thirdly, another black clause is the restriction of sales (whether active or passive) to end users by members of selective distribution systems.[138] The aim of this prohibition is clearly rooted in the protection of parallel trade, a priority of the Commission that has been proven to have rather problematic consequences. The protection of dealers based in cheaper member states who wish to engage in *arbitrage* and sell their products in other national markets where the goods are more expensive may well help eliminate price differentials and bring down obstacles to intraCommunity trade, but is a practice that has proven to backfire. A good example is the *Distillers* case commented above.[139] The Commission appears to ignore the fact that price discrimination is usually introduced by the manufacturer for a legitimate reason, and that price differentials may be (and usually are) explained by objective factors. If the prohibition of arbitrage is so vehemently forbidden, sellers based in the more expensive markets will suffer the consequences, and in the long run consumers could also be worse off, as price harmonisation is likely

[134] Art 4(b)(i) of Reg 2790/99.
[135] Art 4(b)(ii) of Reg 2790/99.
[136] Art 4(b)(iii) of Reg 2790/99.
[137] Art 4(b)(iv) of Reg 2790/99.
[138] Art 4(c) of Reg 2790/99.
[139] Commission Decision of 20 December 1977, *Distillers Co Ltd* [1978] OJ L50/16, upheld by the ECJ in Case 30/78 *Distillers Co Ltd v Commission of the European Communities* [1980] ECR 1980 02229. See ch 2, s II(B)(ii) above.

to take place by raising prices in the cheaper markets—clearly in the detriment of the consumers in these areas. Given the mixed effects of parallel trade, it appears that any measures adopted by the manufacturer in order to prevent this deserve a careful analysis before determining whether or not they should be deemed to be unlawful.[140]

The fourth hardcore restriction is that of cross-supplies between distributors within a selective distribution system; the prohibition applies even if the distributor selling the goods and the one purchasing them operate at different levels of the chain.[141] It seems logical to allow those dealers who have met the criteria needed in order to be in the distribution system to sell to other dealers within the system. Unlike the scenario of Article 4 (b) (iii), where the buyers who will resell the product are not authorised distributors, these sales guarantee the proper functioning of the system designed by the manufacturer, as the buyers meet the necessary criteria and have been previously approved. Finally, a supplier of components and a buyer who incorporates those components cannot agree to limit the supplier to selling these as spare parts to end users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.[142] In this case, and rather similarly to the previous case, there seems to be an attempt to protect the freedom of buyers against unfair, unjustified restrictions imposed by the buyer. This reflects a long-running concern for the disadvantaged situation of distributors in their relationship with manufacturers.[143]

As regards grey clauses, the Article 5 list consists of three main types of restrictions, the first being any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years.[144] Second, any direct or indirect obligation that forces the buyer not to manufacture, purchase, sell or resell goods or services after termination of the agreement shall also be prevented from enjoying the benefit of the application of the block exemption. There is an exception to this general prohibition, and the block exemption will indeed be applicable in the event such obligation relates to goods or services which compete with the contract goods or services, is limited to the premises and land from which the buyer has operated during the contract period, is indispensable to protect know-how transferred by the supplier to the buyer, and if the duration of such non-competion

[140] For a detailed analysis of the reasons behind price discrimination and the problems of prohibiting restritions to parallel trade, see S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and Its Implications for EC Competition Law' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

[141] Art 4(d) of Reg 2790/99.

[142] Art 4(e) of Reg 2790/99.

[143] The implications of these concerns are analysed in ch 4 below.

[144] A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration. However, as Art 5 clarifies, the time limitation of five years shall not apply where the contract goods or services are sold by the buyer form the premises and land owned by buyer, provided that the duration of the non-competititon obligation does not exceed the period of occupancy of the premises and land by the buyer. See J Stuyck, and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and the Realities of a Changing Retail Sector and of National Contract Laws' (2002) (Draft) Secola Conference, 13 May 2002, LSE.

obligation is limited to a period of one year after the termination of the agreement. Finally, any direct or indirect obligation causing the members of a selective distribution system no to sell the brands of particular competing suppliers shall also be excluded from the application of the exemption.

Overall, the black and grey lists reflect similarities with the US policy regarding price restraints at the end of the 1990s, but important differences when it comes to non-price restraints. As an assessment to the prohibition of territorial restrictions of Regulation 2790/99, it is worth noting that paragraph 103 of the Guidelines on Vertical Restraints explicitly mentions that the elimination of obstacles to market integration will not be justified on consumer welfare grounds, but rather purely political objectives. Therefore, there may be a conflict between consumer welfare and efficiency as a result, which reinforces our argument against the per se illegality of territorial restraints. As regards the protection against free-riders, and despite the Commission's ambiguous approach towards such safeguards, paragraph 119 of the Guidelines recognises that it may be necessary to provide distributors with immunity from intrabrand competition, particularly in the case of the introduction of new products on a different geographic market. This is coherent with the the view reflected in the US in the case *Toys 'R' Us*, where the free-rider argument was considered to be weakened when the products are already known to the public and consumers do not need to pay for the additional advertising and promotional costs incurred by appointed dealers.[145] According to the Guidelines, there would not be a restriction of competition in the sense of 81(1) EC, irrespective of market share, when it is a restriction on sales—whether active or passive—by direct buyers of the supplier located in other markets to intermediaries in the new market. Furthermore, passive sales to end consumers should always be permitted.[146] Given the boost of the Internet as a forum for the sale and purchase of goods and services, there has been a need to clarify what is to be understood by online active and passive sales. In this respect, the Guidelines clarify that having a website in different languages where products are sold should be considered passive, as it is customers who, after carrying out online searches, are able to come upon the offers of the seller.[147] However, sending unsolicited emails and using pop-up windows is to be interpreted as active sales.[148] Some authors have highlighted how this interpretation of Internet-based passive sales could be excessively broad, as the impact of the translation of websites into different languages is underestimated.[149] In this regard, and as seen below,[150] the new draft Guidelines

[145] *Toys 'R' Us Inc v FTC* 221 F 3d 928 (7th Cir, 2000).

[146] Guidelines on Vertical Restraints, para 50.

[147] The only exception is when the website is clearly addressed at captivating customers or territories allocated to other distributors. ibid.

[148] Guidelines on Vertical Restraints, para 51.

[149] D Waelbroeck, 'Vertical Agreements: 4 Years of Liberalisation by Regulation 2790/99 After 40 Years of Legal (Block) Regulation' in HP Ullrich (ed), The Evolution of European Competition Law: Whose Regulation, Which Competition? (Cheltenham, Edward Elgar Publishing, 2006) 101.

[150] Section II(B)(ii)(d) below.

on Vertical Restraints attempt to provide further clarification as to the concepts of online active and passive sales.[151]

d Recent Proposals for Change: the New Draft Block Exemption Regulation and Guidelines

Regulation 2790 is set to expire on 31 May 2010. This date has acted as a deadline for the Commission to propose changes and assess the merits of the current BER system. As a consequence of the forced reflection on the ten years of application of the current rules, in July 2009 the Commission published a new draft regulation and accompanying guidelines, and launched a public consultation on the review of the system.[152]

The conclusion of the assessment of Regulation 2790/99 is that it has worked well in practice, and only two emerging issues need to be addressed: the appearance of increasingly powerful retailers and the boost of online sales of products with the continuous expansion of the Internet as a forum for the sale and purchase of goods and services. To deal with these matters, the new draft regulation and guidelines suggest some modifications. In order to control market power, Article 3 of the proposed regulation intends to examine the market share of *both* parties to the agreement and not just the supplier (or the buyer in the case of exclusive supply oblications). The consequence is that the concerns previously expressed as to the adequacy of the 30 per cent market share threshold not only remain unheeded, but even look set to be aggravated with the extension of the application of the cap. Such an analysis is also likely to reduce the scope of the block exemption, as Regulation 2790/99 could apply irrespective of the market share of the buyer.

The list of hardcore and severable clauses is not only not removed from the scope of the BER, but remains virtually unchanged. As a consequence, the distinction between active and passive sales remains crucial. In this context, the new proposed Guidelines on Vertical Retraints provide further detailed guidance as to what constitute active and passive sales. Paragraph 51 of the draft guidelines includes a new reference to the circumstances under which general advertising and promotion may be considered passive sales. This is the case where 'it would be attractive for the buyer to undertake these investments also if [the advertising] would not reach customers in other distributors' (exclusive) territories or customer groups.' As a consequence, such campaigns cannot be specifically targeted at consumers in other distributors' exclusive areas of operation. In addition, paragraphs 52 to 54 address how this distinction applies in the case of online sales with specific details. Paragraph 53 clarifies that, although the establishment of a website and online advertising are not considered active selling, distributors may be prevented from targetting specific customers.

[151] Draft Guidelines on Vertical Restraints, paras 51–54.

[152] Press Release, 'Antitrust: Commission Launches Public Consultation on Review of Competition Rules for Distribution Sector' (28th July 2009) Brussels IP/09/1197.

Overall, there is an attempt to endorse the advantages of the Internet, which should tend to bring down national barriers and invigorate price competition across the EU. As such, paragraph 52 contains some examples of conduct that would be considered hardcore restrictions uponpassive sales and would therefore be prohibited. These include requiring exclusive distributors to prevent customers outside their territories from accessing their websites or forcing them to re-route customers to other distributors' sites, or compelling these distributors to reject sales to customers with billing addresses in other areas. In addition, the proportion of Internet sales should not be limited, and manufacturers are prevented from charging higher prices for goods sold online. These problems are likely to have manifested themselves in the 10 years of application of the current rules and guidelines, hence the additional clarification. However, despite this attempt to break down the barriers imposed by manufacturers on Internet sales, the Commission acknowledges that excessive tolerance may enhance the free-rider problem, and some protection ought to be granted to prevent this. To address the issue, paragraph 54 allows manufacturers to impose quality standards for Internet and catalogue sales similar to those that may be required for selling the goods in shops. In selective distribution systems, dealers may even be required to have an actual showroom before being allowed to engage in online distribution. Moreover, in some cases, manufacturers will have the opportunity to ban Internet or catalogue sales altogether without breaching Article 81(1) EC.

ii Individual Exemptions on the Basis of Article 81(3) EC

The Guidelines on Vertical Restraints are clear in establishing that individual exemptions on the basis of Article 81(3) EC will only apply to vertical agreements when the requirements for the application of one of the block exemptions (whether the general Regulation 2790/99 or the specific BER for car distribution) are not met. This is the case when the market share of the parties is beyond the relevant thresholds, or when the agreements contain black clauses. The latter problem is virtually unfixable; black clauses de facto carry the lumber of per se illegality, which precludes any economic analysis.[153] With regard to the former, when the established market shares are exceeded, an assessment of the agreement is carried out to determine whether or not it can benefit from an individual exemption. Overall, the authorities and courts must assess if the procompetitive effects outweigh the possible negative consequences of the restrictions. Companies with market shares exceeding the thresholds therefore face considerable obstacles for the implementation of vertical restraints in their agreements, and should pay particular attention to this when enacting contractual clauses. They may indeed be able to obtain an exemption exempted by virtue of Article 81(3) EC, when the four criteria laid down in the article are met.[154] These criteria however are very broadly

[153] Guidelines on Vertical Retraints, para 46.
[154] See section II(B) above.

construed, and leave considerable scope for interpretation. However, provided they do not involve minimum resale price maintenance or absolute territorial protection, the restrictions should be considered 'ancillary'—intended to achieve a greater, procompetitive goal. The Commission's Guidelines on the application of Article 81(3) EC clearly specify that the analysis should be constrained to determining whether 'a particular restriction is necessary for the implementation of that transaction or activity and proportionate to it.'[155] However, the evaluation of the pros and cons of the agreements gives the relevant authorities an opportunity to smooth the rough edges of some contracts. Often, in order to be granted an exemption, the parties must make concessions and remove certain clauses from their distribution and supply contracts. It is likely that parties with considerable market shares may be forced to modify their agreements in one way or another before being obtaining the green light.

iii The Peculiar Situation of the Car Sector: An Analysis of Regulation 1400/2002

Our analysis of vertical agreements would not be complete without referring to the regulation of motor vehicle distribution agreements. Curiously, the car industry has been the only sector of the economy to have its very own block exemption since the 1980s, and this differentiated treatment is still maintained today. On 1 October 2002, a thorough reform of the rules governing the distribution of new cars in Europe entered into force in the shape of Regulation 1400/2002—the third specific block exemption granted to the sector. The rules reflect the outcome of a long, intensely political legislative process influenced the pressures of manufacturers, dealers, consumers and the representatives of all of the above. The privileges granted to the industry by the previous Regulations were in contradiction with the system governing the rest of vertical agreements since 1999 and with the new, economics-based approach to competition policy. In such a scenario, it seems logical that the Commission would attempt to bring the car distribution regime in line with the policy's new look, and even more so in the light of the subsequent changes introduced in the enforcement rules of Articles 81 and 82 EC. The 2002 reform put an end to the long battle car manufacturers had fought to impede the disappearance of Regulation 1475/95, given the enormous influence of their powerful lobby in its enactment. Previous attempts to introduce changes had been blocked by the industry. Already in 1985, Joerges had insisted that the Commission should reject the demands of manufacturers using the US 'new economics' since *Sylvania*, and opting for a reconsideration of the (in-) validity of vertical restraints.[156] Nevertheless, they still managed to obtain specific rules for the sector, in contrast

[155] Commission's Guidelines on the Application of Article 81(3) EC [2004] OJ C101/97, para 31.

[156] See C Joerges, E Hiller, K Holzscheck and HW Micklitz, *Vertriebspraktiken im Automobilersatzteilsektor*. Frankfurter wirtschaftliche Studien (Frankfurt, Verlag Peter Lang GmbH, 1985) 139.

to the general assumption that car distribution would end up governed by the general rules of Regulation 2790/99 upon expiration of the specific BE.[157]

a The Problems of the Previous Car Sector Block Exemptions

The first time car distribution contracts were scrutinised under EC competition law was in 1974, just a few years before *Sylvania*'s removal of the per se ban on vertical restraints in the US. The ECJ's judgment on the *BMW*[158] case estimated that franchise contracts could be caught by Article 81(1) EC. The principal reason for this were the 'cumulative effects' on competition of all competing car manufacturers operating to the same selective and exclusive model.[159] Not only was the discovery of new distribution methods hampered, but also effects on interbrand competition were feared as a consequence the possible consequential foreclosure of the dealership market.[160] The industry was nonetheless discontent with the prohibition of its distribution methods, and by the late 1970s tolerance of vertical restraints had already been accepted in America. In such a context, European car manufacturers began to exert pressure on the Commission to legitimise the imposition of restrictions on dealers, under claims that SED systems were the ideal way for marketing an expensive commodity requiring expertise maintenance and with such direct impact upon safety and environmental considerations. To make up for such limitations on the dealers' freedom, and to allow them to recuperate their investments, they offered dealers security by allocating territories and granting protection from free-riders.

In this scenario, in the years subsequent to the *BMW* judgment the Commission granted a series of individual exemptions on the basis of Article 81(3) EC to motor vehicle distribution agreements,[161] on consumer protection claims. According to the institution, only by having specially controlled outlets could a high standard of supply and service be guaranteed. Following this view, the ECJ's 1976 *Cabour* ruling laid out the possible justifications for SED systems.[162] Subsequent cases, and particularly the *Metro I* judgment,[163] virtually developed a rule of reason analysis

[157] This possibility is contemplated, inter alia, in D Voillemont and A Choffel, 'Recent reforms in vertical restraints' (2002) *The European Antitrust Review*, *Global Competition Review* 61 *ff*, and K Middleton, 'The Legal Framework for Motor Vehicle Distribution—a New Model?' (2001) 1 *European Competition Law Review* 3.

[158] *BMW Belgium NC and Belgian BMW Dealers* [1978] OJ L46/33. This case is in line with the *Pronuptia* ruling on franchising, Case 161/84 [1986] ECR 353, [1986]. See also a later *BMW* case, Case C70/93 *BMW AG v ALD Autoleasing D GmbH* [1955] ECR I-3439.

[159] A Tongue, 'Understanding 1400:02—What It Is and What It Means' (2003) Research Report 01/03, International Car Distribution Programme Ltd 8.

[160] ibid.

[161] *BMW* [1975] OJ L29/1. In fact, the first ever BER was drawn along the lines set out in the Commission BMW exemption decision. Also, *SABA* [1976] OJ L28/19 (for electronic devices) and *Campari* [1978] OJ L70/69.

[162] Case C-230/96 *Cabour SA et Nord Distribution Automobile SA v ArnorSOCO SARL* [1998] ECR I-2055.

[163] Case 26/76 *Metro-SB-Grossmärkte GmbH & Co KG v Commission and SABA* [1977] ECR 1875. Van Houtte criticises the claims that the decision is in the benefit of consumers: 'The Court's insistence on intra-brand competition within the distribution channel is presumably intended to benefit

for selective distribution by establishing the conditions under which such agreements would be compatible with EC law. The Commission's response in the mid-1980s attempted to reconcile its concern for the market-partitioning and anticompetitive effects of such restrictions with the industry's insistence upon the need for SED systems. As such, it opted for considering such agreements to be contrary to Article 81(1) EC so as to retain control of the possible anticompetitive effects of the restrictive clauses and the manufacturers' possible abuses. However, it then exempted car distribution accords—in coherence with the general trend of adopting sector-specific block exemptions of the time—using Article 81(3) EC to grant the sector its very own block exemption by means of Regulation 123/85.

In broad terms, this regulation reflects attempts to reconcile contradictory interests. It justified exclusivity claiming that it would give dealers an incentive 'to develop sales and servicing of contract goods and thus promot[ing] competition in the supply of those products as well as between those products and competing products.'[164] Such words seem to reflect the influence of the Chicago School's acceptance of vertical restraints, but utilised in a rather peculiar and half-hearted way, as they are still caught by Article 81(1) EC. In an attempt to increase consumers' choice and allowing them to decide between a higher price and (allegedly) higher quality or more economic alternatives, the Regulation also endeavoured to open the spare parts market by prohibiting any discrimination between manufacturer-approved and non-approved parts.[165] Even so, this theoretical freedom is then restricted by allowing manufacturers to impose minimum stocking obligations of original spare parts on dealers.[166] Great flexibility is also granted to manufacturers to impose restrictions on the basis of Articles 3 and 4 of the Regulation, with the exception of resale price maintenance, deemed as per se illegal in Article 6. To compensate, some dealer protection clauses were included in the Regulation, and manufacturers were restricted in their freedom to terminate contracts without cause and specified notification periods,[167] or to appoint new dealers on territories assigned exclusively to dealers or to unilaterally alter those territories.[168] Integration concerns are present in the attempt to limit car price differentials by condemning differences of more than 12 per cent (or up to 18 per cent for one year

consumers, but it is doubtful that consumers' interests are served when products can be purchased only from approved dealers, who will usually employ a more expensive selling apparatus than would be the case in an openly competitive market. A plausible argument can be made that at least some consumers would prefer a completely competitive distribution system permitting them to buy products "off the shelf" at the lowest possible prices. Regardless of whether insistence on intra-brand competition adequately protects consumers it is clear from the Court's approval of selective distribution systems that it gave more weight to the interests of manufacturers that to either consumers or excluded dealers.' B Van Houtte, 'A Standard of Reason in EEC Antitrust Law: Some Comments on the Application of Parts 1 and 3 of Article 85' (1982) 4 *Northwestern Journal of International Law and Business* 497, 503.

[164] Recital 7 of Reg 123/85.

[165] Such a liberalisation did not affect the repair and maintenance market.

[166] CJ Joerges, 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 3, 371.

[167] Art 5(2)(3) of Reg 123/85.

[168] Art 5(2)(1)(b) of Reg 123/85.

in some cases), together with a limitation of the capability of manufacturers to prevent parallel imports.[169]

The rules laid down in Regulation 123/85 were reformed in 1995 after further pressure from car manufacturers and their representatives to increase their freedom to establish selective and exclusive distribution schemes.[170] The reforms came in the shape of Regulation 1475/95, which allowed manufacturers to continue to influence the quality of their product by ensuring that a small concentrated number of dealers have the degree of expertise and quality necessary to offer a high standard of service for the consumer. Thus, on consumer welfare claims, the manufacturer usually agrees to supply only to dealers satisfying certain professional or technical requirements while the approved dealers accept certain territorial restrictions and undertake not to purchase or sell contract goods from or to wholesalers or retailers outside the official network. The Commission itself used consumer protection as a justification for the restrictions that it allowed in the block exemption, noting in the preamble for Regulation 1475/95 that nature of cars required SED systems, and restrictions were indispensable in order to achieve better motor vehicle distribution and servicing.[171]

Selectivity and exclusivity are deemed the most adequate ways of distributing cars, and therefore manufacturers are allowed to request dealers to meet a series of requirements before they can be appointed. Central to SED as sanctioned by the block exemption was the supplier's refusal to supply new cars to retailers other than its franchised dealers, the associated prohibition on dealers from reselling except to final customers and other dealers in the manufacturer's network, the granting of exclusive territories to dealers and the requirement that dealers sell exclusively one brand of new cars. Articles 3 and 4 of the Regulation contain a list of possible obligations that suppliers can impose on buyers, including the possibility of preventing them from manufacturing or selling competing brands (unless they use 'separate sales premises')[172] and from selling outside their allotted territories. In this regard, active sales in which the dealers use personalised advertising campaigns are of particular concern.[173] Moreover, the manufacturer is very much free to request the dealer to meet high standards in distribution—both in sales and aftersales—by imposing strict requirements regarding advertising, the training of staff or the equipment of the business premises. Minimum stock obligations are also exempted, as are requests to order goods at certain times or within certain periods.

Even more surprisingly, Regulation 1475/95 contained a white list of clauses which must be included in car distribution contracts in order to benefit from the block exemption. In particular, dealers *must* be requested to provide repair and

[169] Art 3 of Reg 123/85.

[170] See *The Block Exemption and the European Market,* Europe Automotive Insight, North American Automotive Products Industry European Office, Brussels, Vol 9, No 8 g.

[171] Recital 4 of Reg 1475/95.

[172] According to the Preamble, the ban may be lawful if 'it does not inhibit the dealer from distributing vehicles of other makes in a manner which avoids all confusion between makes'. (Recital 7).

[173] Art 3(8) of Reg 1475/95.

maintenance work on any vehicle of the manufacturer's brand that requires it. To compensate this imposition on dealers, some obligations are also placed on suppliers regarding, for instance, termination with cause, but the possibility of resolving any possible disputes through arbitration is strictly precluded. Also, Article 6 lists black clauses which will not be exempted. The list reflects an attempt on the part of the Commission to reduce price differentials, as manufacturers were forced to supply vehicles through their distribution networks to residents of any country of the European Union. In addition, the electronic codes necessary to make repairs were to be facilitated to independent repairers.[174]

Of particular relevance is also the regulation of spare parts. These could be obtained from independent suppliers and distributors provided only their quality was similar and the customer is properly advised of their use.[175] If the dealer wished to sell spare parts manufactured by an independent spare parts producer meeting such requirements, it could not be prevented from doing so.[176] The Commission however upheld the right of manufacturers to prevent wholesalers outside the approved distribution system from accessing original spare parts. Elsewhere the right of manufacturers to impose such restrictions under competition law has been defended, provided that no market power is involved. However, the Commission used consumer protection arguments for its position, since, in its view, the benefits of ensuring the availability of the whole range of spare parts within the official dealerships could be put at risk.[177] Such an argument is, at best, questionable.

b Motivation Behind the Changes Introduced in Regulation 1400/2002

In 2001, an independent report by the MFBI, the UK motor industry consultants, estimated that the rules of BER 1474/95 not only restricted consumer choice and inflated prices, but also created a practical monopoly in spare parts.[178] In particular, it is claimed that the regime did not address properly issues such as competition between dealers of the same brand, the problems occurring for cross-border sales, competition in the after-sales servicing and the need to strengthen dealers' position with respect to manufacturers. Regulation 1475/95 was considered to be overwhelmingly protective of manufacturers' interests as a consequence of the strong lobbying of the industry during its adoption. In this regard, the author is inclined to agree with Joerges in that it is doubtful that competition policy should be dtermined by the claims of the actors involved. He advocates the rejection of the demands of the industry on the basis of economic theories which consider vertical restraints as per se lawful.[179] The influence of manufacturers was particularly

[174] Art 6(7) of Reg 1475/95.

[175] Art 3(5) of Reg 1475/95.

[176] Such a restriction was considered a black clause in Art 6(9).

[177] Recital 6 of Reg 1475/95.

[178] Global Antitrust Weekly, NERA Consulting Economists, National Economic Research Associates Inc, 30 November–6 December 2001.

[179] See C Joerges, E Hiller, K Holzscheck and HW Micklitz, *Vertriebspraktiken im Automobilersatzteilsektor*. Frankfurter wirtschaftliche Studien (Frankfurt, Verlag Peter Lang GmbH, 1985) 139.

noticeable not only in the exemption of selective and exclusive systems, but also in the possibility of impeding multibranding and the obligation upon dealers to carry out after-sales services. Such requirements impeded car supermarket sales, and the powerful dealers of the time were largely dissuaded from entering into car distribution agreements as a consequence of this requirement. Needless to say, Internet sales were prevented, as these operators are normally able to offer lower prices by saving costs on premises and outlets, as well as personnel. These resources would be necessary for the performance of repair and maintenance services. Furthermore, the prohibition made it difficult for independent repairers to access the market. The prevention of multibranding made it difficult for consumers to compare brands, in particular in rural areas where the different dealers may be disperse.

Manufacturers claimed that the difficulties were compensated by the high standards of after-sales service of franchised dealers. However, consumer organisations showed, with market studies in Britain, France and Germany, that franchised dealers charged much higher prices for servicing cars bought through them and provided no better service than independent garages outside the dealer networks. The dealer's position was further weakened by the fact that distribution agreements contained other restrictions and obligations beyond the ones mentioned in the block exemption concerning matters such as sales targets, advertising and promotion, and which are difficult to scrutinise. The importance of these de facto impositions on the dealer, deemed essential by Macneil's relational contract theory,[180] can hardly be controlled by law without considering the context of the agreements rather than their wording. It would seem more appropriate to control these issues by national contract law rather than in the context of the protection of competition. In this sense, the provisions aimed at protecting dealers appear to be at odds with the general purposes of Article 81 EC.

Despite the Commission's consideration of manufacturers' interests, its integrationist approach could not be totally suppressed. Partly, car distribution agreements were purposely left out from the general block exemption for vertical restraints as a consequence of the significant price differentials between the Member States, which tend to act as an incentive to parallel imports. *Ad hoc* regulation formulated to protect and encourage parallel imports (carried out by authorised dealers or wholesalers) was the option that the Commission wanted to retain in this sector. In practice, the way distribution networks were set up proved to block the effectiveness of cross-border sales, and consumer complaints led to the first *Volkswagen* decision, in which the Commission imposed a fine of €68 million for the brand's forcing Italian dealers to obstruct sales to German and Italian consumers, who tried to benefit from the lower prices of cars in Italy.[181] Although the fine was later on reduced to €61 million by the Court of First Instance,[182] the case

[180] See eg I Macneil, 'Relational Contract: What We Do and Do Not Know' (1985) *Wisconsin Law Review* 483.

[181] Commission Decision of 28 January 1998 relating to a proceeding under Article 85 of the EC Treaty, Case IV/35.733 *Volkswagen* [1998] OJ L124/60.

[182] Case T-62/98 *Volkswagen AG v Commission* [2000] ECR I-02707.

set a key precedent, since it is the first time that such a large sum was fined for vertical restraints to competition, and subsequent similar fines imposed on other manufacturers followed.[83] Nonetheless, the courts attempted to restrict the fining policy of the Commission in later cases, and particularly when a second decision to fine Volkswagen[184] reached the CFI in 2001.[185] The court opted to refrain from entering into the adequacy of prohibiting restrictions on parallel trade—which would probably have been considered defensible given the integrationist view of the courts in previous decisions—but overturned the fine on the basis that there was no agreement in the meaning of Article 81(1) EC. Therefore, despite these attempts from the courts to lessen the detrimental effects of the Commission's position, the system reflected tensions between the interests of consumers, dealers and (principally) manufacturers, along with conflicts between a belief in the need for such restrictions and the potential harm for integration. The maintenance of the system laid down in Regulation 1475/95 was politically unacceptable in a climate of modernisation and growing competition, and even more so after the reforms of EC competition law in general and vertical restraints in particular in the late 1990s.

The industry's pressure to maintain the restrictive rules was stark; nevertheless, the regime was unsustainable, particularly in the light of the general overhaul of competition policy. In this context, the regulation of motor vehicle distribution had to either disappear to let agreements in this sector benefit from the same rules as the rest or be brought in line with the general regime for the exemption of vertical agreements contained in Regulation 2790/99. In the end, the powerful lobby of the industry managed to retain specific rules. On 5 February 2002, the EU announced plans for 'a major overhaul of the system'.[186] It was not the first time the Commission attempted to introduce changes in the car sector since 1995, but all the previous endeavours were blocked by industry pressure. The Commission opted for maintaining a specific regime, albeit potentially different from the old one.[187] Thirty eight recitals and 12 articles enacted in 'dense, technical language' make up the text of the renewed car sector block exemption.[188] Nonetheless the new rules introduced noticeable improvements when compared to the erstwhile rules.

[183] Fines have been imposed, for instance, on Opel (*Opel* (Case COMP/36.653) Commission Decision of 20 September 2000 relating to a proceeding under Article 81 of the EC Treaty [2001] OJ L59/1), Daimler Chrysler (*Mercedes-Benz* (Case COMP/36.264) Commission decision of 10 October 2001 relating to a proceeding under Article 81 of the EC Treaty [2002] OJ L257/1) and more recently Peugeot (*SEP et autres/Peugeot SA* (Cases F-2/36.623/36.820/37.275) Commission Decision of 5 October 2005 relating to a proceeding pursuant to Article 81 of the EC Treaty [2006] OJ L173/20).

[184] *Volkswagen* (Case COMP/F-2/36.693) Commission Decision of 29 June 2001 relating to a proceeding under Article 81 of the EC Treaty [2001] OJ L262/14.

[185] Case T-208/01 *Volkswagen AG II v Commission* [2003] ECR II-5141.

[186] 'EU plans radical shake-up of car retailing' *The Economist* (London 6 February 2002).

[187] The possibility of extending the application of Reg 2790/99 to the car sector was contemplated, inter alia, by D Voillemont and A Choffel, 'Recent Reforms in Vertical Restraints' (2002) *European Antitrust Review, Global Competition Review* 61 and K Middleton, 'The Legal Framework for Motor Vehicle Distribution—a New Model?' (2001) 1 *European Competition Law Review* 3.

[188] 'European Commission Shakes up Car-Retailing' *The Economist* (London 25 January 2002).

c Scope of the exemption

As stated in Article 2(1) of Regulation 1400/2002, the block exemption applies to those restrictions of competition contained in vertical agreements, and covers the sale, resale and purchase of new motor vehicles,[189] after-sales servicing and/or[190] spare parts[191] within the European Economic Area (EEA).[192] Therefore, it applies to all levels of motor vehicle trade, with the exception of agreements related to components for incorporation in a new vehicle and related to accessories. Service-only agreements are also covered, and as regards goods which are not specific of the motor vehicle industry, they only fall within the scope of the BER where 'it is reasonably certain that they are destined for installation in or upon a motor vehicle'.[193] More importantly, the BER will only enter into play if and when the vertical agreement contains restrictions of competition falling within the scope of Article 81(1) EC.[194] Those agreements where the market share of the supplier does not exceed the thresholds of the *de minimis* Notice will not need to be exempted as they are not considered to breach Article 81(1) EC in the first place.[195] Therefore, most kinds of vertical agreements in the car sector can qualify for an exemption under the current regime, provided that they do not exceed the stipulated market shares and they do not contain any hardcore restrictions.

One of the most important differences between Regulation 1475/95 and the new rules is the introduction of an analysis of market power before condemning an agreement. Market share thresholds are established in a very similar way of that or Regulation 2790/99 had done three years earlier for all other vertical agreements. As a result, those agreements which contain the clauses required in Articles 3(3) to 3(6) and do not contain any hardcore restrictions of Article 4 will be able to benefit from the exemption provided that the market share of the supplier (or the buyer in case of exclusive supply agreements)[196] does not exceed the limits established in Articles 3(1) and 3(2).

[189] The definition of new motor vehicles remains unchanged from that of Reg 1475/95, and includes passenger cars, LCVs, trucks, buses and coaches. Sales of second-hand cars are still excluded.

[190] Emphasis needs to be placed in the 'or', as the previous Regulation only applied to agreements which covered the supply of both new motor vehicles and their spare parts.

[191] The definition of spare parts of Art 1(s) of Reg 1400/2002 is broader than before, as it now includes lubricants and other goods 'which are necessary for the use of a motor vehicle, with the exception of fuel'.

[192] The EEA includes the EU members plus Norway, Iceland and Liechtenstein.

[193] A Kmiecik, 'Analysis of Regulation 1400/2002: The New Block Exemption for the Motor Vehicle Sector', IBC Conference Proceedings, *Advanced Course on Competition Law* (Informa, Brussels, 2002).

[194] Art 1(d) defines vertical restraints as those restrictions which fall within the scope of Art 81(1) EC, therefore there is a tacit recognition that some restrictions may not breach the provision.

[195] Commission Notice on agreements of minor importance which do not fall under Article 85(1) of the Treaty Establishing the European Community [1997] OJ C372/13, reformed by Commission Notice relating to the revision of the 1997 notice on agreements of minor importance which do not fall under Article 81(1) of the EC Treaty [2001] OJ C149/18.

[196] Exclusive supply agreements affect competitors of the buyer, who are foreclosed access to supplies. In practice, the definition of exclusive supply obligation is rather narrow, which means that the application of the new BER will almost always depend on the market share of the supplier. The general principles that apply to these clauses were established in Case C-234/89 *Stergios Delimitis v Henninger Brau* [1991] ECR I-935.

The thresholds established for the car sector differ from those of Regulation 2790/99. As with the umbrella block exemption, below 30 per cent of any form of distribution established by the manufacturer will benefit from the exemption. The threshold for car distribution is raised to 40 per cent for selective distribution systems which employ quantitative criteria, while those selective distribution schemes imposing only qualitative requirements may benefit from the exemption regardless of market power. Exceptionally, the benefit of the BER will be retained if the threshold is originally met and then exceeded for one year, or for two if it is only exceeded by five per cent. The same criticisms made of the market share threshold system of Regulation 2790/99 apply here, as the resulting regime is somewhat rigid, and it is questionable that these thresholds alone are enough to draw the line between harmful and beneficial agreements.[197] Reliance on the complex determination of the relevant market, particularly now that it has to be carried out by 27 different national competition authorities and courts, endangers not only the homogeneity of interpretation, but also the effectiveness of the economic analysis given the practical difficulties in confidently determining the real market shares.

d Hardcore and Severable Restrictions and Withdrawal of the Exemption

Like Regulation 2790/99, the current car sector block exemption follows the back list and grey list approach of clauses which will respectively render an agreement void or be inexemptible without affecting the validity of the entire agreement. These clauses are considered to breach Article 81(1) EC regardless of market power, and will not qualify for exemption under the new car distribution regulation, nor are they likely to be able to obtain an individual exemption.

Article 4 of Regulation 1400/2002, contains a long list of prohibited practices in three parts: those restrictions which concern the sale of new cars, repair and maintenance services or spare parts, those which affect only the sale of new motor vehicles and those concerning only repair and maintenance and spare parts. In general terms, the restrictions prohibited relate mainly to price-fixing and territorial protection. The underlying logic for this coincides with Posner's view that exclusive territories and resale price maintenance should be similarly treated, since they are both ways of dealing with the free-rider problem.[198]

The general restrictions that affect both the primary and secondary car markets are virtually identical to those contained in the general block exemption for vertical agreements. Article 4(1)(a) prohibits minimum resale price maintenance, and the remainder of the provision enumerates different types of prohibited territorial restrictions and some exceptions. As a general principle, manufacturers are prevented from imposing resale restrictions on the buyer regarding the territory in which or the customers to whom it sells. However, the prohibition is not absolute,

[197] See s II(B)(i)(b).

[198] RA Posner, *Antitrust Law: an Economic Perspective* (Chicago, University of Chicago Press, 1976) 160.

and some exceptions are regarded. For instance, and despite an attempt to increase the flow of parallel trade, active sales in selective distribution systems may be prohibited[199] when they are not to end users and they are not imposed on sub-dealers appointed by the authorised dealer.[200] The prohibition also affects the previous linkage of sales and after-sales services. On the basis of Article 4(1)(g), dealers can no longer be requested to perform repair and maintenance work, as they must be allowed to subcontract such services to authorised repairers.

The specific block exemption regulation includes clauses aimed at opening competition in the repair and maintenance market, as well as spare parts. Under Regulation 2790/99 it would be possible to prevent a spare parts producer from selling to a manufacturer's authorised service and network. Article 4(1)(j) requires parts or equipment manufacturers to be able to supply to any resellers of their choice, including dealers within the distribution system. They can also display their trademark or logo on parts supplied for the assembly of, or the repair or maintenance of motor vehicles. Such provisions attempt to eliminate obstacles to spare parts manufacturers independently trying to access the market. Alongside these provisions, the Regulation also opens the market to independent repairers, by facilitating the access to technical information, diagnostic and other equipment and tools including software and training.

The severable clauses of Article 5 mainly refer to non-competion obligations[201] imposed on authorised dealers and repairers (Article 5(1)) and location clauses (Article 5(2)). Under Regulation 2790/099, non-competion obligations are exempt. provided their duration does not exceed five years. In the context of motor vehicles, their repair and maintenance and spare parts, the general rule is that non-competion obligations are prohibited, whether direct or indirect. This includes the obligation of the dealer to sell or repair the manufacturer's brand only,[202] even after the expiry of the agreement.[203] As regards location clauses which affect the sale of new motor vehicles in particular, Article 5(2)(b) prohibits imposing obligations on dealers of a selective distribution system not to open sales or delivery outlets anywhere in the common market (therefore the entire territory

[199] Art 4(1)(b)(i) of Reg 1400/2002.

[200] Art 4(1)(d) of Reg 1400/2002.

[201] The definition of non-compete obligations in the context of car distribution can be found in Art 1(b) of Reg 1400/2002: it is an 'obligation on a buyer to purchase from the supplier more than 30 per cent of the buyer's total purchases.' However, under Reg 2790/99, 'an obligation to purchase up to 80 per cent of requirements would not even fall within the scope of the definition of a non-compete obligation and could therefore be imposed without any time period limitation.' A Kmiecik, 'Analysis of Regulation 1400/2002: The New Block Exemption for the Motor Vehicle Sector', IBC Conference Proceedings, *Advanced Course on Competition Law* (Informa, Brussels, 2002) 59, fn 108.

[202] Art 5(1)(c) of Reg 1400/2002. Curious terminology issue: the regulation specifies that they cannot be prevented from selling products from 'competing suppliers'. Kmiecik rightly argues that, in practice, since 'passenger motor vehicles segment comprises several distinct relevant product markets, a supplier could prevent its dealers from selling any passenger cars which are not considered to compete with the contract goods, for not being in the same relevant market.': A Kmiecik, 'Analysis of Regulation 1400/2002: The New Block Exemption for the Motor Vehicle Sector', IBC Conference Proceedings, *Advanced Course on Competition Law* (Informa, Brussels, 2002) 61.

[203] Art 5(1)(d) of Reg 1400/2002. Under Reg 2790/99, such restriction would be lawful.

of the EU) where selective distribution is employed. Such a restriction is prohibited with the clear aim of eradicating price discrimination, by encouraging parallel imports across the EU.

In addition, the Commission or the relevant national competition authority can,[204] by virtue of Article 6 of Regulation 1400/2002, withdraw the exemption even for agreements which comply with the required market share thresholds and do not include punishable clauses. This is the case when the negative effects of the restraints outweigh the benefits of the agreements.[205] This provision aims to address the problems related to interbrand restrictions of competition consequential upon the cumulative effects of intrabrand restrictions when all leading manufacturers use similar systems and thus preclude new entrants' possibilities of finding dealers for their products. Although each manufacturer's market share in the relevant market may be below 30 per cent, the combined market share of all those manufacturers introducing similar restrictions could be very high, and could therefore have similar effects to restrictions by dominant firms.[206] Moreover, car price differentials are regarded as a cause for the removal of the exemption to specific agreements.[207] This means that the Commission can intervene in order to force manufacturers to reduce their prices, thus leading to a *de facto* prohibition of price discrimination despite the ambiguous economic effects of such differences on competition.[208]

It is questionable that such a provision is necessary. On the one hand, Article 81(1) EC prohibits agreements which have negative effects on competition. As such, these agreements might be considered to breach the prohibition given its effects on the market. On the other hand, Article 81(3) EC could be interpreted to exclude the possible exemption of these agreements with interbrand implications. Moreover, the harmful results of the agreements could be overcome if multibranding becomes popular. If selective dealers are able to sell more than one brand, then nothing should prevent them from dealing with new competing products. Nevertheless, this argument is weakened by the practical limitations of multibranding.

e Dealer protection

The new Regulation shows concern for the disadvantaged situation of dealers against manufacturers and the possible abuses they may suffer. To this end, transparency as

[204] In particular, national competition authorities will be able to withdraw the benefit of the exemption from those agreements which 'have effects incompatible with the conditions laid down in Article 81(3) of the Treaty in the territory of [that] Member State . . . which has all the characteristics of a distinct geographic market': Art 6(2) of Reg 1400/2002.

[205] The effects of such a withdrawal will be *ex nunc*.

[206] In a similar way, Art 7 of Reg 1400/2002 refers to the Commission's right to declare the BER inapplicable to a particular market in its entirety where 'parallel networks of similar vertical restraints cover more than 50% of the relevant market.'

[207] Arts 6(1)(c) and 6(1)(d) of Reg 1400/2002.

[208] S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and its Implications for EC Competition Policy' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

to the duration and termination of agreements is essential, as the right of sellers to terminate agreements is limited by formal and substantive conditions.[209] Article 3(5) requires that the duration of the agreement in question is a minimum of five years, or indefinite. In the first case, the parties have to notify their intention not to renew the agreement within at least six months. In the second scenario, the general period notice for regular termination will be two years, or one year in some special situations.[210] In addition, Article 3(6) expands the minimum rights of contractual protection by forcing the contracting parties to include clauses in their agreements providing their right to resort to arbitration to solve possible disputes, without affecting their possibilities of litigating before national courts. The provision includes a non-exhaustive list of the kinds of disputes that may be resolved by arbitration. The position of the dealer is further enhanced the right of assignment given to distributors, which allows them to assign their agreements to other authorised distributors or repairers within the network.[211] This attempt to protect dealers through competition law is rather unique, and deserves further scrutiny. It will be dealt with in the following chapter.[212]

f Practical Consequences of the Rules

Whereas Regulation 1475/95 contained strict rules which only allowed specific distribution methods, such provisions have disappeared from the new block exemption, hence allowing any form of distribution. Both selective and exclusive distribution systems are still permitted. As regards the former, the dealers must be chosen following qualitative criteria, and the manufacturer cannot place a ceiling on the number of dealers. Despite criticisms of SED systems,[213] the Commission still adheres to the view that they are adequate for 'expensive and exclusive goods such as motor vehicles'.[214] Nevertheless, a reference to a possible extension of SED systems 'to other products' as well as cars reflects an awareness on the part of the Commission cars are no longer unique in technical complexity. Car manufacturers and dealers—in particular through ACEA[215] and CECRA[216]—had been

[209] Art 3(4) of Reg 1400/2002.

[210] In particular, a one year notice is allowed when either the supplier 'is obliged by law or by special agreement to pay appropriate compensation on termination of the agreement' (Art 3(5)(a)(i)) or 'the supplier terminates the agreement where it is necessary to re-organise the whole or a substantial part of the network.'

[211] Art 3(3) of Reg 1400/2002.

[212] See ch 4, s II B below.

[213] See J Gillen, 'UK—Competition Commission Report on Supply of New Cars' (2000) Competition Comment, Freshfields Deringer, London. The author expresses that 'the adoption of the SED system coupled with [the suppliers'] reluctance to compete with each other when setting the level of their recommended retail prices and their lack of price transparency operated against the public interest.'

[214] Explanatory brochure for Commission Regulation (EC) 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector, para 12, which can be downloaded at http://ec.europa.eu/competition/sectors/motor_vehicles/legislation/legislation.html.

[215] The ACEA is the European car makers' association, based in Brussels.

[216] The CECRA is the European Council for Motor Trades and Repairs, the European car dealers' association. For details, see www.cecra.eu.

strongly pressuring the Institution not to scrap the possibility of using SED systems.

A clear attempt can be perceived on the part of the Commission to promote innovation in the motor vehicle retail market in these rules, which facilitate the unbundling of sales and servicing activities by the removal of the obligation previously imposed on dealers to carry out repair and after-sales services.[217] In such a way, the position of the dealers is strengthened as, in principle, the retailer will be able to freely decide if outsourcing or sub-contracting the repair services to an independent operator would be an efficient choice. Potentially, this measure could also increase the much needed competition in repair services, since authorised dealers who choose to undertake repair tasks must compete with other authorised and independent repairers. Also, as a consequence of the unbundling of activities, is that entry barriers are lowered, because new firms need not offer simultaneously distribution and repair services. Thus, by unbundling single activities that form a complex performance, the new rules could encourage experimentation within the vertical chain. Now, vehicle manufacturers are allowed to enter into multi-party agreements.[218]

One of the consequences of such a system is that Internet or 'supermarket' car sales are encouraged.[219] The requirement to undertake repair and maintenance services previously prevented sales through the Web, as Internet operators are usually able to offer lower prices by saving costs on outlets and personnel. These costs are unavoidable if they are forced to offer customers post-sales services. Besides, the necessary commitment of dealers to commit themselves to selling but one brand of cars made it impossible to imagine multibrand houses similar to those in the US. The Andersen study[220] reflects a rather sceptical view on supermarket sales of cars, as according to its estimates it could lead to a 'concentration of players, cause product ranges to shrink, decrease product innovation and could, after a short period of lower car prices, lead to less effective intra-brand competition and ultimately to higher prices'.[221] However, the US experience, where such sales have been common for decades, does not reflect such problems.

To date, supermarket and Internet sales have not grown as much as expected when the Regulation came into being. Kmiecik argues that the practical effects of the regulation in this regard could be hampered if, in the context of a selective distribution network, one of the requests for dealers to enter the network is that they

[217] Art 5(1) of Reg 1475/95 provided that the exemption only applied if the dealer undertook post-sale repair and maintenance work on vehicles.

[218] For instance, greements between vehicle manufacturer, dealer and local repairer

[219] With regard to Internet sales, it is important to determine whether ought to be considered active or passive sales. The Commission addresses the issue in its Guidelines on Vertical Restraints by judging them to be passive except for when dealers send unsolicited email or the website is specifically targeted at customers in other exclusive territories—for instance, by the placing of banners or links on the pages of service providers in those territories. See Guidelines on Vertical Restraints, para 51.

[220] European Commission, DG COMP (2001). *Study on the Impact of Possible Future Legislative Scenarios for Motor Vehicle Distribution on All Parties Concerned*, produced by Andersen.

[221] See http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/02/18&format=HTML&aged=0&language=EN&guiLanguage=en.

were previously capable of providing sales and aftersales services. Even if these dealers can subcontract, since they have already made an investment on offering such services, it is rare for them to do so. This is particularly likely since the profit margins for dealers in the aftersales market are much larger than for the sale of new cars, where they are usually of about two per cent. Importantly, nothing in the text of Regulation 1400/2002 prevents suppliers from prohibiting such sales if they so wish. The rationale of this modification is based on the idea that, in a free market economy like the EU, manufacturers may choose to whom they sell, and only in extreme circumstances should a competition authority intervene to force them to sell to a certain individual or class of operator. Therefore, free-riding possibilities of Internet operators can be contractually limited. In this sense, Internet sales remain controversial, but given the generalised use of the Web as a forum for transactions in today's world Internet car sales are likely to be of increasing importance. Such restrictions are nonetheless not encouraged, as the facilitation of parallel trade is still one of the Commission's priorities. In addition to the fines imposed on manufacturers for attempting to impede cross-border trade, the current system seeks to further limit their ability to carry out such practices, as reflected in some of the hardcore territorial restrictions of Article 4. For instance, Article 4(d) and (e) prohibit both active and passive sales to end users by selective distribution members.[222] Also, while the previous regulation allowed suppliers to limit the activities of intermediaries in selective distribution systems,[223] Regulation 1400/2002 prevents such a possibility, which leads to a 'finer distinction between intermediaries and unauthorised resellers.'[224]

An additional advantage of the separation of sales and aftersales activities is the possible increase in competition in the repair and maintenance market. It should enhance the position of independent repairers and 'quick-fit' workshops. Still, in practice, manufacturers reflect attempts to protect their franchisees, as these repairers from outside the network have been complaining that access codes and technical information to facilitate the reparation of motor vehicles is often withheld or facilitated with delays, despite the Regulation's prohibition of such practices.

Dealers' dependence on manufacturers is limited by the encouragement of multi-branding possibilities. Whereas Articles 3(2) and (3) of the previous block exemption limited intermediaries' possibilities to sell more than one brand of cars,[225] the

[222] Some exceptions are provided, and the exemption applies to 'agreements containing a prohibition on a member of a selective distribution system from operating out of an unauthorised place of establishment,' (Art 4(d)), provided that it does not fall within the prohibition of Art 5(2)(b), and suppliers are also able to forbid distributors from operating outside an unauthorised place of establishment (Art 4(e)).

[223] Art 3 of Reg 1475/95.

[224] A Kmiecik, 'Analysis of Regulation 1400/2002: The New Block Exemption for the Motor Vehicle Sector' (2002) IBC Conference Proceedings, *Advanced Course on Competition Law*, Informa, Brussels.

[225] 'Intermediary' is a jargon term used to describe the local representative that can be appointed to sell cars in a market that, due to its specific characteristics—language, specificities of the commercial environment—is better prepared to undertake the sale of cars within that market. In this respect, see http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/02/18&format=HTML&aged=0&language=EN&guiLanguage=en.

preamble of Regulation 1400/2002 specifies that restrictions of such nature 'should not be exempted'.[226] Such a provision not only attempts to strengthen the position of the middle man, it also aims at heeding consumers' claims that such a system facilitates their access to motor vehicles (particularly in remote rural areas) and enables them to better compare prices. Also, in the context of facilitating parallel trade (and this is perhaps the most important reason fro the Commission), under Regulation 1475/95 the intermediary was not allowed to buy more than 10 per cent of his vehicles from the same dealer. Currently, the only requirement that manufacturers are able to impose on them is the production of a mandate from the consumer. Dealers may however still be required to have different showrooms, as such a request is not considered to fall within the definition of non-compete obligation of Article 1(b), and therefore the possibility of seeing different brands within one room is still hampered. In practice, this may limit the possibilities of dealers to sell more than one brand. Those who do choose to engage in multibranding must be able to have access to special premises to meet the conditions required to this end. In addition, manufacturers in practice tend to force their dealers to incur in important investments which may also deter them from wishing to double their expenditure by contracting with a competitor.

Decoupling sales and aftersales services and promoting multibranding could, as explained above, contribute towards enhancing the dealer's position. Also, opening up the market for the sale of spare parts should bear an impact on the dealer–manufacturer relationship, as it should increase the freedom of the dealer to obtain supplies. Nonetheless, Regulation 1400/2002 also remains involved in the contractual aspects of the relationship between dealers and manufacturers. It appears that the Commission attempts to grant protection to dealers from, inter alia, unfair termination of their contracts. In that sense, the block exemption's objectives are similar to those of the US statutes regarding franchises. The implications of such measures are analysed in the following chapter, but it certainly seems awkward to use competition law to grant this kind of protection. It is even questionable that the Treaties empower the institutions to do so.

e The End of the Specific Regime? Recent Developments

In preparation for the looming expiry date of Regulation 1400/2002, the Commission has been carefully examining the ability of the current block exemption to set out new policy orientations for the future legal framework of distribution agreements in the car sector. Thus far, the institution has adopted a Communication[227] and an Impact Assessment Report analysing the merits of the range of possibilities for substituting the exemption.[228] Importantly, the

[226] Recital 27 of Reg 1400/2002.

[227] Communication from the Commission, 'The Future Competition Law Framework Applicable to the Motor Vehicle Sector' (22 July 2009) Brussels COM(2009) 388 final.

[228] Commission Staff Working Document Accompanying the Communication from the Commission, The Future Competition Law Framework Applicable to the Motor Vehicle Sector: Impact Assessment (22 July 2009) SEC(2009) 1052.

Commission finds that while competition is stark in the market for the sale of new motor vehicles, problems can still be detected in the market for repairs and after-sales services. Therefore, for the first time the Commission has acknowledged that there is no reason to maintain a specific regime for car distribution agreements, although it seems some peculiarities will survive.

An analysis of the Commission's recent Communication and Impact Assessment Report shows very little change in the objectives to be pursued in the regulation of motor vehicle distribution agreements. However, the Commission does reflect a certain awareness of the problems of the previous block exemptions, as it insists that the new regime 'should [. . .] not impose regulatory constraints which might increase distribution costs and are not justified by the objective of protecting competition on the market.'[229]

The Commission considers four different legislative options after the expiration of Regulation 1400/2002. Option 1 would iinvolve maintaining a *statu quo*, with a new wide sector-specific block exemption. Option 2 involves extending the application of the block exemption for vertical agreements in general to car distribution, while options 3 and 4 are two variants of this second choice: respectively, they would entail accompanying the application of the general rules with specific guidelines (mainly but not only related to the after-sales market), or including a specific block exemption in addition to the general one with a list of hardcore restrictions aimed at protecting the servicing and repair market. After an analysis of the pros and cons of each option, the Commission concludes that option 3 (the extension of Regulation 2790/99 alongside some specific guidelines) would be the most suitable, although it does not rule out adopting a specific block exemption regulation to work alongside the general rules (option 4).

As a consequence, the likely outcome of the forthcoming reform will be the application of the the general rules combined with specific guidelines or a specific block exemption. The reasons for this choice are explained in detail in the Report. It seems clear that unifying the rules applicable to this sector with those that apply elsewhere is necessary to ensure coherence. However, some differences will persist. In the primary market, the Report emphasises the need to maintain a strict attitude towards clauses that may lead to market foreclosure or the imposition of prices on the part of the manufacturer. The concerns about market integration are still present, and the Commission remains hostile towards the impediment of cross-border sales and market segmentation through territorial protection. As regards the aftersales market, the specific guidelines or block exemption need to regulate independent operators' access to technical information, access to spare parts and access to the network of authorised repairers—issues which are addressed in Regulation 1400/2002.

It is obvious that, while changes to the structure of the current regime that will ultimately lead to the abolition of specific rules for the car sector are likely,

[229] Press Relase, 'Antitrust: Commission Proposes Future Competition Law Regime for Motor vehicle Sector' (22 July 2009) IP/09/1168.

very little has changed in the Commission's mindset. At the time of the 2002 reform, the Commission claimed that the general BER 'would not remove all the problems identified in the evaluation report [of Regulation 1475/95].'[230] The future regime is likely to contain similar hardcore restrictions and some specific exceptions for the industry. Furthermore, the application of the general regime for vertical agreements to the primary car market looks set to be delayed, as the Commission has proposed extending the application of Regulation 1400/2002 for another three years to ensure a smooth transition.

It seems a shame to delay the convergence of the two regimes. It is argued that the peculiarities of the motor vehicle block exemption are related to the weak position of car dealers as opposed to dealers of other products. Nonetheless, the problems are less significant than they are made out to be, and they tend to manifest themselves in other markets of technologically complex goods which, however, do not have a unique regime. Moreover, the difficulties were possibly aggravated (if not created) by the very regime established by Regulation 1475/95, which encouraged (and in some cases forced) the inclusion of clauses which on the one hand greatly prevented distributors from becoming more powerful, and on the other hand prevented stronger dealers from entering the car market. Such were the effects of the restrictions on multibranding or the obligation to carry out repair and maintenance work.

Once the general block exemption regulation for vertical agreements is applied to motor vehicle distribution, important changes should take place. First and foremost, the 'white list' of Articles 3(3), 3(5) and (6) of Regulation 1400/2002 will finally disappear. The general regime does not contain requirements with respect to territorial restrictions and non-competion obligations, access to technical information, the duration of agreements, the use of arbitration, the freedom to transfer contractual rights and termination of contracts. The 'white list' approach disappeared when Regulation 2790/99 was adopted. It appears that the Commission has finally realised that although dealer protection may be encouraged through competition law provisions by promoting multibranding or breaking the link between sales and aftersales, including contractual protection clauses is not appropriate in competition law. To delay the elimination of the 'white list' of Regulation 1400/2002 would thus appear to squander an optimal momentum for change.

Curiously, the application of Regulation 2790/99 will reduce the market share threshold for selective distribution. The specific block exemption raised the limit to 40 percent for this distribution method when quantitative criteria were used, and exempted all systems based solely on qualitative criteria regardless of the market share of the supplier. The threshold will be 30 percent for all agreements unless otherwise specified in the forthcoming specific guidelines or block exemption. To date, it seems unlikely that this threshold will be increased, as the Commission has expressed its satisfaction that 'competition authorities could investigate a wider

[230] Explanatory note on the Draft Regulation on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle industry, para 9.

number of potentially anti-competitive practices'.[231] However, it would be a pity to reduce the threshold for these agreements when they have been shown to have overwhelmingly positive effects, and having to examine these agreements individually under Article 81(3) would seem to impose an unnecessary burden on the Commission and the national authorities who should be focusing on the more serious violations of competition law provisions. Furthermore, it must be remembered that the Commission has proposed that a market share threshold should also be established with respect to the market share of the buyer. The application of the new draft regulation to the car sector would, in this context, impose additional restrictions on the possibility of exemption of these distribution agreements.

f The Need for Specific Rules: Sectoral 'Regulation' Inefficiency Arguments

Block exemption regulations often challenge the boundaries between competition (law) and regulation.[232] The general trend in the recent competition policy reforms is that the system is moving from ex ante control of agreements to a more rationalised ex post system based on effect rather than object. However, the terms set out in the block exemptions question whether in fact that control is to take place *a posteriori*. The rules set out in Regulation 1400/2002 actually require the inclusion of certain provisions in the agreements to benefit from the exemption it provides, as well as the disappearance of certain territorial restriction clauses. At the same time, the freedom of manufacturers to set prices is limited by forbidding price differentiation. These are usually characteristics of regulation rather than competition. In this context, the arguments that are traditionally employed to determine whether sectoral regulation is desirable can be used to evaluate the existence of this kind of regulation.

The Harvard–Chicago dialectic is crucial in this respect. For the Harvard School, market failures need to be corrected by regulatory intervention. In contrast, the fathers of the Chicago School considered that in most cases the market would tend to automatically correct those deficiencies. The modern regulatory approach moves within the co-ordinates of these positions by recognising the existence of market failures but limiting intervention to very specific cases. As a consequence, intervention in competition should be restricted to those situations where it is reasonably necessary.[233] As this author has demonstrated in previous works, the Kaldor-Hicks efficiency test would question the appropriateness of

[231] Commission Staff Working Document Accompanying the Communication from the Commission, The Future Competition Law Framework Applicable to the Motor Vehicle Sector: Impact Assessment (22 July 2009) SEC(2009) 1052, para 17.

[232] See M Motta, *Competition Law: Theory and Practice* (Cambridge, CUP, 2004) xviii.

[233] See, inter alia, F Rombo, 'Liberalisation and Competition Policy' (1998) 17 *International Business Lawyer* 504; MD Taylor, MD and M Webb, 'Light-handed Regulation of Telecommunications in New Zealand: Is Generic Competition Sufficient?' (1999). 2 *International Journal of Communications Law and Policy* 42.

specific block exemptions.[234] Inefficient regulation bears significant costs, and statistics seem to back this idea. For instance, according to Hopkins' calculations, that the net efficiency costs of excessive regulation in the US were around 9.5 per cent of real GDP per capita,[235] whilst Milhar estimated that the net efficiency costs of excessive regulation were roughly 12 per cent of real GDP per capita.[236] Other studies reflect that the removal of inefficient regulation may realise significant welfare benefits, depending on the extent and efficiency of pre-existing regulation. In this sense, the deregulation of seven major US service industries during the 1980s was estimated as generating an increase of US$32–42 billion per capita improvement in that part of GDP affected by the reforms.

In this context, the specific block exemptions may indeed be excessive regulation, and maintaining them could involce considerable costs. From the perspective of regulation, however, beyond efficiency considerations there are other underlying social objectives that require protection. For instance, a particular efficient allocation of resources may involve a situation in which welfare is concentrated in the hands of a minority at the expense of the majority, which is generally considered to be 'unfair' by most societies.[237] In the context of car distribution, these arguments could perhaps explain the inclusion of dealer protection clauses, as well as the concerns for consumers in some Member States paying too much for their prices. Despite a recognition that such goals could indeed be taken into account under some circumstances (particularly when they can be reconciled with efficiency), the dubious impacts of regulation on competition and coherence can hardly be overcome by these aims. It would appear that the mere removal of the problematic Regulation 1475/95 would have sufficed to correct a large number of the problems related to the industry. These arguments support the need for a coherent, unified treatment for vertical agreements in all sectors.

C The Impact of the Reforms of EC Competition Law Enforcement Rules on Vertical Agreements

In 1998, Korah had asked if there was 'any chance of the Commission abandoning its monopoly over individual exemptions to permit national authorities and the

[234] 'A KH improvement is defined as a change that is either a Pareto improvement—that is, where at least one participant would be better off as a result of a change and no participant would be worse off'—or 'such that the "winners" from the change would be able to compensate the "losers" and still be better off, and the "losers" could not afford to bribe the "winners" to prevent the change'. S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and its Implications for EC Competition Policy' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

[235] M Taylor, 'Looking to the Future—Towards the Exclusive Application of Competition Law?' (2003) Winner of the Young Lawyers' Writing Competition, International Bar Association, relying on TD Hopkins, 'Costs of Regulation: Filling the Gap' (1992) Report for the Regulatory Information Service Centre, Washington DC.

[236] ibid, relying on F Millar, *Regulatory Overkill: The Costs of Regulation in Canada* (Ottawa, Fraser Institute, 1996).

[237] M Taylor, 'Looking to the Future—Towards the Exclusive Application of Competition Law?' (2003) Winner of the Young Lawyers' Writing Competition, International Bar Association.

courts of the Member States to apply Article 85(3) [now 81(3)].'[238] Her hopes have by now been addressed, and following the transformation of substantive competition law rules affecting at all levels, the Commission's attention shifted towards enforcement. Decentralised enforcement of European competition policy rules is a reality as of 1 May 2004 with the introduction of the so-called 'modernisation package',[239] and in particular Regulation 1/2003,[240] which has finally put an end to the four decades of existence of Regulation 17/62.[241]

It has been claimed that the new rules imply a fundamental u-turn *vis-a-vis* a 'decentralised, effective and uniform application of EC competition law in an enlarged and integrated market'.[242] Indeed, Regulation 17, which governed the implementation of EC competition law for over four decades, has finally been abolished, along with the obsolete system it prescribed. From Komesar's institutional choice perspective, there has been a change in the decision-making alternatives, and now national courts and authorities seem (at least in principle) to have increased their powers in the detriment of the Commission.[243] The changes are of particular relevance for these vertical restrictions, since the arguably the most outstanding consequence of the reform is the fact that Article 81(3) EC—the legal basis for individual and block exemption regulations—can now be directly enforced by the Member States. Until 2004, national authorities and courts had the power to apply Articles 81(1), 81(2) and 82 EC, but they lacked the capacity to

[238] V Korah, 'The Future of Vertical Agreements under EC Competition Law' (1998) 8 ECL Rev 512. See also the encouragement of decentralised enforcement suggested in CA Jones, *Private Enforcement of Antitrust Law in the EU, UK and USA* (Oxford, OUP, 1999).

[239] The 'modernisation package' comprises a series of binding and non-binding legislation:

- —Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2004] OJ L1/1.
- —Commission Regulation 773/2004 on the Conduct of Proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty (the Implementation Regulation) [2004] OJ L123/18.
- —Commission Notice on co-operation within the network of competition authorities [2004] OJ C101/43.
- —Commission Notice on co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC [2004] OJ C101/54 (the Co-operation Notice).
- —Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty [2004] OJ C101/65.
- —Commission Notice on informal guidance relating to novel questions concerning Articles 81 and 82 that arise in individual cases (guidance letters) [2004] OJ C101/78.
- —Guidelines on the Effect on Trade Concept Contained in Articles 81 and 82 of the Treaty [2004] OJ C101/81.
- —Guidelines on the Application of Article 81(3) [2004] OJ C101/96.

All of these documents are available online at http://ec.europa.eu/competition/antitrust/legislation/legislation.html.

[240] Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2004] OJ L1/1.

[241] Council Regulation 17 of 13 March 1962 [1962] JO 13/204 [1959–62] OJ Spec Ed 87.

[242] M Vromans and K Vromans, 'Modernisation of European Competition Law: From Notification to Self-Assessment' (2004), at http://www.consulegis.com/?p=1499.

[243] NK Komesar, *Imperfect Alternatives. Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994).

exempt agreements from the Article 81(1) EC prohibition on the basis of Article 81(3) EC, since the latter was not directly applicable.

In such a context, the Commission retains the responsibility of providing unity and guidance in the application of competition law, and especially in the clarification the ambiguous legal terms upon which the application is dependant. The new regime has emerged in a context of a greater need for flexibility in integration which at the same time has to be reconciled with coherence, even more so as a consequence of the subsequent enlargements of the Union which now comprises 27 countries of diverse backgrounds. As with the previous reforms, it was the European courts that first reflected an awareness of how the new European reality required adaptations in the way competition law is enforced. Of particular relevance is the groundbreaking *Courage* judgment,[244] where the court, in recognising a true 'Community' rights to damages, emphasised the role of national courts in granting protection for complainants in the sphere of EC competition law. This acknowledgment paved the way for the revision of Regulation 17, and more recently for the Commission's White Paper on Damages,[245] which announces legislation harmonising the award of damages for breaches of antitrust provisions across the EU will soon see the light.

i Previous Centralised Enforcement: The Shortcomings of Regulation 17/62

In April 1999, the White Paper on the Modernisation of the Competition Law Implementation Rules (hereinafter the White Paper on Modernisation)[246] established a point of departure for a 'wide-ranging debate between the Commission, the Member States and all interested parties,[247] and with two main intentions: making the enforcement of competition law more effective and simplifying the bureaucracy. Consequently, it appears that the former regime was both inefficient and highly bureaucratic. To solve such problems, it was believed that national courts needed to become more involved in the enforcement of EC competition law rules.[248] Up until May 2004, national competition authorities and national courts

[244] *Courage Ltd v Bernard Crehan*, C-453/99 [2001] ECR I-6297.

[245] 'Damage Actions for Breach of the EC Antitrust Rules' (White Paper) COM (08) 165, 2 April 2008.

[246] Commission (EC), 'White Paper on the modernisation of the rules implementing Articles 85 and 86 of the EC Treaty' [1999] OJ C132/1. It refers to the present Arts 81 and 82—the White Paper was enacted before the entry into force of the Amsterdam Treaty which changed the numeration of the Articles of the Treaty, hence the reference to the former system.

[247] Commission (EC), 'White Paper on the modernisation of the rules implementing Articles 85 and 86 of the EC Treaty' [1999] OJ C132/1, para 140. For a detailed analysis of the general reform affecting EC competition law, see R Wesseling, 'The draft-regulation modernising the competition rules: the Commission is married to one idea' (2001) 26 EL Rev 5, 357–378.

[248] On this point, the *Notice on Co-operation between National Courts and the Commission in Applying Articles 85 and 86 of the EC Treaty* is important, [1993] OJ C 39/6, as it states in paras 17/18 that 'The national court may have to reach a decision on the application of Articles 85 and 86 in several procedural situations. In the case of . . . actions relating to contracts . . . the defendant usually relies on Article 85(2) to dispute the contractual obligations invoked by the plaintiff. . . . In such situations, the direct effect of Article 85(1) and Article 86 gives national courts sufficient powers to comply with their obligations to hand down judgment'.

had the power to apply the Article 81(1) EC prohibition and the nullity sanction of Article 81(2) EC.[249] However, they lacked the authority to apply Article 81(3) EC, under which these arrangements may be declared exempted from the prohibition. Regulation 17 established a system whereby those agreements that wished to benefit from an exemption on the basis of Article 81(3) of the EC Treaty had to be individually notified to the Commission.[250] Such a requirement, combined with the broad interpretation of Article 81(1) EC—understood to catch any agreement limiting the parties' economic freedom—resulted in procedural chaos. Virtually all agreements firms entered into could be understood to restrict competition in this sense, and the Commission received immense amounts of notifications. The institution could not cope with issuing individual decisions for all those notified contracts, most of which did not pose effective threats for competition. This is particularly relevant for vertical agreements, which have been described above as being mainly procompetitive.[251] However, without a decision the firms could not know for sure if their agreements complied with EC competition law rules. Block exemptions regulations were enacted to reduce the notification requirement, and those agreements which complied with the conditions laid out in these regulations could directly escape the Article 81(1) EC prohibition. Since the 1999 reform, most vertical agreements are considered exempted by virtue of Article 81(3) EC (not however lawful under Article 81(1) EC).

The Commission enjoyed wide latitude under Regulation 17/62 to foster Community antitrust law, under the exclusive control of the Court of Justice. Competition policy provisions therefore provided the institution with broad powers, which it used to achieve not only the protection of competition *stricto sensu*, but also other goals of the Community related to the achievement of a single market. Curiously, the wording of Article 81(3) EC does not specify the body which should be in charge of granting exemptions. On the basis of Article 84 EC, it would seem that, in the absence of specific provisions, it would be the authorities of the Member States who would decide which agreements could escape the Article 81(1) EC prohibition. However, the Council opted for giving the Commission the exclusive power to exempt agreements in 1962 when it adopted the first enforcement Regulation. Such a decision was motivated by the desire to provide the institution with the necessary tools to ensure that integration would not be hampered and that those agreements which could endanger the achievement of the single market could be controlled. It can be better understood in the context of the 1960s, when only six countries were members of the Community and there was no competition culture within their national legal systems.[252]

[249] Case 127/73 *BRT and SABAM* [1974] ECR 51, para 16.

[250] Remarkably, it was the adoption of this Regulation by the Council that created the Commission's monopoly over Art 81(3). The Treaty provision itself does not specify who shall decide which agreements can benefit from an exemption.

[251] This is particularly the case in the absence of market power.

[252] CD Ehlermann, 'The Modernization of EC Antitrust Policy: A Legal and Cultural Revolution' (2000) 37 CML Rev 537, 539. This author also emphasises the important political weight of France in the adoption of the legislation, a country highly concerned with uniformity of the legal order.

As the years went on, the common market was consolidated and the system started to reveal its flaws. This led to the adoption of the White Paper at a time when the single market ideal had already significantly advanced, and the outline of EC competition law had been clearly defined by the Commission and the courts. In addition, the incorporation of nine new countries into the EC with the three enlargements that took place since the enactment of Regulation 17 had created a Union of no less than 15 members with about 380 million inhabitants. This meant that the number of notifications was further increased by the growth of the integration process, and Commission officials who were familiar with the official languages of the new members were needed to be able to examine the notified agreements. Simultaneously, national authorities had eventually become more familiarised with competition law, since most members had adopted competition laws since their adherence to the Community. The original setbacks which had originally discouraged these bodies from applying Article 81(3) EC had thus eventually faded.

The former rules therefore gave the Commission exclusive power to exempt agreements on the basis of Article 81(3) EC. The institution itself soon realised that such a system not only hampered the application of EC competition provisions by national courts and authorities, but also slowed the Commission down by forcing it to examine potentially beneficial agreements and preventing it from focusing on the real anticompetitive practices.[253] NCAs and national courts, which have typically had the power to apply Article 81 EC under their national laws, in practice were reluctant to do so in cases when the parties had notified their agreement to be granted an exemption. By the late 1990s, when the Commission started to rethink enforcement rules, the legal orders of the Member States had already developed an important body of law dealing with conflict between national and EC laws in this regard, and centralised enforcement of Article 81(3) EC was causing inconsistencies. Stuyck and van Dyck pointed out how, in distribution restraints where a manufacturer in one Member State appoints a distributor in another, it is likely that disputes may arise between them, or their agreement's compliance with EC competition law may be questioned. Yet, the parties' knowledge of each other's legal systems is likely to be very narrow. In such a case, 'the exact limits between the voidance sanction of 81(2) and the particular remedies provided for under the respective national laws of the member states is in most cases difficult to predict.'[254] EC competition law is generally applied by NCAs and national courts through national procedural rules, which could be alien to the parties who are not acquainted with the legal order of the country where the agreement is challenged, and legal certainty for them could be threatened. This matter leads to analysing the national level of effectiveness of enforcement of EC competition law and the national availability of appropriate remedies.

[253] Recital 3, Reg 1/2003.

[254] J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and The Realities of a Changing Retail Sector and of National Contract Laws' in H Collins (ed), *The Forthcoming EC Directive on Unfair Commercial Practices* (The Hague/London/New York, Kluwer Law International, 2004).

Indeed, Articles 81 and 82 EC do not make any specifications regarding possible damages for those affected by anticompetitive practices,[255] and only the nullity sanction of Article 81(2) EC could be used in this regard. However, new Regulations 2790/99 and 1400/2002 both contain severable clauses, which are non exemptible on the basis of Article 81(3) EC but do not preclude the validity of the remainder of the contract they are part of. Therefore, in such cases, nullity will be applicable to the specific provision, but not to the rest of the agreement. As seen in chapter 4, national contract laws may be used to grant dealer protection from abuses of the power of manufacturers by virtue of the franchise agreement between the parties. It is possible that, in the parties' views, a specific clause declared unlawful by the block exemptions is essential to the agreement, and it may be more appropriate to obtain a reduction of the obligation or declare the entire agreement void under national contract law. However, under the new exemption regime, if an agreement meets the requirements established in the pertinent block exemption regarding market shares and black clauses, then it may be valid under competition law. In such a case, the possible conflict between national contract law and competition law was difficult to address as a consequence of the decentralised enforcement of Article 81(3) EC, as national competition authorities were prevented from entering into the evaluation of the conditions for exemption. Even if Articles 81 and 82 EC are a matter of community law, legal remedies are still very much embedded in national law. The election of appropriate procedural rules that preserve the right of defence of the stakeholder is still governed by national procedural rules. Such guarantees may clearly differ from those which apply in community law proceedings.[256]

The notification system and the Commission's monopoly over Article 81(3) EC complicated the outcome of such situations. Very few of the notified agreements were actually formally exempted,[257] and therefore the validity of the contracts under EC competition law remained uncertain. In addition, given the possible 'dual enforcement',[258] national courts having to decide on the validity of an agreement under investigation by the Commission or the European courts have to suspend proceedings or adopt interim measures until a decision is reached.[259] The

[255] Such provisions can be found in US antitrust (see s 4 of the Clayton Act), as well as some national competition laws in Europe (inter alia Art 13(2) of the Spanish *Ley de Defensa de la Competencia* (LDC) or s 33(2) of the German *Gesetz gegen Wettbewerbsbeshränkungen* (GWB)). See AP Komminos, 'New Prospects for Private Enforcement of EC Competition Law: *Courage v Crehan* and the Community Right to Damages' (2002) 39 CML Rev 3, 447–87, 450.

[256] As stated in Case C-60/92 *Otto BV v Postbank NV* [1993] ECR I-5683.

[257] Ehlermann estimates that no more than five formal decisions a year were taken by the Commission in the years before 2000. CD Ehlermann, 'The Modernization of EC Antitrust Policy: A Legal and Cultural Revolution' (2000) 37 CML Rev 537, 541.

[258] See A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (Oxford, Oxford University Press, 2006) 1191.

[259] Cases C-234/89 *Stergios Delimitis v Henninger Brau* [1991] ECR I-935 and C-344/98 *Masterfoods Ltd v HB Ice Cream Ltd* [2001] ECR I-11369 emphasise that national courts are under a duty to avoid rendering judgements which would either conflict with a decision which the Commission might take or has already taken but still under review before the courts under Arts 81 or 82 EC. J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and The Realities of a Changing Retail Sector

centralised enforcement of Article 81(3) EC further prevented national courts from 'what the legal system of the United States understands by antitrust analysis,'[260] and acted as a deterrent of private litigation. In some jurisdictions, the uncertainty surrounding the remedies available to compensate those affected by an infringement of competition provisions was particularly dispiriting.[261] Jones has, on occasion, emphasised the importance of private implementation of the provisions, by emphasising that:

> no antitrust regulation system has any realistic chance of success without it. Government antitrust authorities will never have the resources to prosecute all infringements which should be pursued and should not be in the business of awarding compensation. . . . To those who believe that private enforcement is wasteful, I reply that this is sometimes true, but it is better than the alternative of inadequate private enforcement. If we are to have private antitrust laws, we should have effective ones which are enforced.[262]

ii The Role of the European Courts in the Path Towards Decentralised and Private Enforcement

In Europe, private enforcement has not been as successful as in the US, given the existence of important factual limitations. In America, the general 'litigiousness' of citizens is enhanced by the availability of treble damages, class actions or contingency fees.[263] Already in the 1960s—when Regulation 17/62 was adopted—the importance of private actions for the effective enforcement of EC competition law was highlighted in the Deringer Report for the European Parliament.[264] However, no action was taken on the part of the Commission for many years, and it was the European courts who embraced the promotion of private litigation by taking the first steps towards granting rights to damages under EC competition law, as well as decentralised enforcement of antitrust provisions. Of particular relevance is the *Banks* case,[265] where the court recognised that the direct effect of Treaty provisions should be understood as a minimum legal protection which does not exclude setting higher standards for national courts to comply with.[266]

and of National Contract Laws' in H Collins (ed), *The Forthcoming EC Directive on Unfair Commercial Practices* (The Hague/London/New York, Kluwer Law International, 2004).

[260] CA Jones, *Private Enforcement of Antitrust Law in the EU, UK and USA* (Oxford, Oxford University Press, 1999) xii.

[261] This was, for instance, the case in the UK.

[262] CA Jones, *Private Enforcement of Antitrust Law in the EU, UK and USA* (Oxford, Oxford University Press, 1999) 85.

[263] See A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials* (Oxford, Oxford University Press, 2006) 1191–92.

[264] Rapport Deringer, *Assemblée Parlamentaire Européenne, Documents de Séance* 1961–62, Doc 57 para 123. Cited by AP Komminos, 'New Prospects for Private Enforcement of EC Competition Law: *Courage v Crehan* and the Community Right to Damages' (2002) 39 *CML Rev* 3, 447, 450.

[265] Case C-128/92 *HJ Banks & Co Ltd v British Coal Corp* [1994] ECR I-1209.

[266] J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and The Realities of a Changing Retail Sector and of National Contract Laws' in H Collins (ed), *The Forthcoming EC Directive on Unfair Commercial Practices* (The Hague/London/New York, Kluwer Law International, 2004).

Importantly, Advocate General van Gerven's opinion called for the recognition of a true Community right to damages resulting from an infringement of competition provisions which have direct effect, in line with the horizontal direct effect of directives and the general individual liability for damage caused by infringements of EC law as identified in *Francovich*.[267] Drawing expressly on US antitrust experience and the importance of private enforcement across the Atlantic, Van Gerven argued that competition policy was a field in which private enforcement was particularly desirable, given the need to make antitrust 'more operational'.[268] Nevertheless, the specific case was not related to competition law, and the Treaty provisions under scrutiny were held to lack direct effect.[269] Therefore, the ECJ squandered an opportunity to address the important issues highlighted by the Advocate General. His observations, however, did not go by the wayside. The subsequent case law in the sphere of competition emphasised the role of the Treaty's antitrust provisions on 'private autonomy and on national procedural autonomy.'[270] In the court's eyes, efficacy of EC law could not be undermined by national procedural rules. In direct link with the new decentralised application of EC competition rules, the case *Masterfoods* specified that the Commission is not bound by a decision by a national court in application of Articles 81 and 82 EC,[271] otherwise the role of the Commission as established in the Treaty would be jeopardised.

It is not until *Courage* that the court fully embraced the possibility of a Community right to damages, as well as the need to decentralise the application of the Treaty's antitrust provisions.[272] The case, taken to the ECJ using the preliminary ruling procedure by the English Court of Appeal,[273] related to a dispute over a contractual clause in a lease contract that required the purchase of minimum fixed quantities of beer. The ECJ was therefore required to clarify the fundamental issue of the whether a Community right to damages for EC competition law violations existed. The English Court of Appeal defended, following the principles stated in previous national case law, that a party or co-contractor to an illegal agreement could not claim damages from the other party,[274] and Article 81(1) EC had to be understood to protect only third parties.[275] Nonetheless, if one of the parties could

[267] Cases C-6/90 and C-9/90 *Francovich v Italy* [1991] ECR I-5357.

[268] AP Komminos, 'New Prospects for Private Enforcement of EC Competition Law: *Courage v Crehan* and the Community Right to Damages' (2002) 39 CML Rev 3, 447–87, 454.

[269] Arts 66 and 65 EC.

[270] AP Komminos, 'New Prospects for Private Enforcement of EC Competition Law: *Courage v Crehan* and the Community Right to Damages' (2002) 39 CML Rev 3, 447–87, 448. This is particularly emphasised in Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055.

[271] Case C-344/98 *Masterfoods Ltd v HB Ice Cream Ltd* [2001] ECR I-11369.

[272] C-453/99 [2001] ECR I-6297.

[273] Art 234 EC.

[274] *Gibbs Mew plc v Gemmell (CA)* [1998] EuLR 588.

[275] In this case, competitors or consumers. This dwells upon Joerges' idea that competition law is only concerned with 'external effects' of agreements. C Joerges, 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 594.

be in a weaker position in the negotiation of the contract, then it may be appropriate to allow the fragile party to challenge the validity of the agreement before the courts and claim damages.[276] The ECJ confirmed the existence of a Community right to damages for breach of antitrust provisions relying principally on the direct effect of Article 81(1) EC and the rights that Treaty provisions confer on individuals,[277] which national courts must guarantee in order to protect the *effet utile* of Treaty provisions. It is however left to the courts to assess, on the basis of the principles of equivalence and effectiveness,[278] if such rights should be denied in a specific case given the 'significant responsibility' of the party claiming damages.[279]

The ECJ reflected in its decision an intention to make private litigation more open to EC antitrust. In its view, damages before a national court can make a significant contribution to the maintenance of effective competition in the Community. The ruling is a particularly important step in the process of modernisation of EC competition, as national courts are explicitly regarded as appropriate fora for establishing their rights flowing from EC competition law. In this context, a shift in the decision-making alternatives seems to be encouraged by the European courts: national courts should play a greater role, and therefore implicitly the position of the Commission is constrained. It appears that the ECJ, aware that the Commission cannot possibly take the burden of enforcing Articles 81 and 82 EC alone, promotes a more efficient, case-by case enforcement of antitrust provisions. In many respects, *Courage* marked the starting point for the practical application of the modernisation package, in that the English courts have pledged to adopt what they call a 'deferential' approach to EC competition law.[280] The Court of Appeal articulated that English courts will henceforth seek to apply national competition law in accordance with the decisions and statements of the Commission. Although no reference was made to the modernisation regulation, the judgment has paved the way for private enforcement of EC antitrust rules in accordance with the principles envisaged therein.

iii Main features of the 'Modernisation Package'

To further advance in the process of decentralised enforcement, Regulation 1/2003 was adopted on 16 December 2002, and took effect on 1 May 2004 along

[276] Such an argument had been used by the US Supreme Court in *Perma Life Mufflers Inc v International Parts Corp* 392 US 134 [1968], and *Bateman, Eichler, Hill Richards Inc v Berner* 472 US 229 [1985].

[277] Paras 19 and 23.

[278] The principle of equivalence requires that the rules are not less favourable than those governing similar domestic actions, while the principle of effectiveness implies that they do not impede the exercise of the rights conferred by EC law. J Stuyck and T Van Dyck, 'EC Competition Rules on Vertical Restrictions and The Realities of a Changing Retail Sector and of National Contract Laws' in H Collins (ed), *The Forthcoming EC Directive on Unfair Commercial Practices* (The Hague/London/New York, Kluwer Law International, 2004).

[279] Paras 31 *ff.*

[280] See A Andreangeli, '*Courage Ltd v Crehan* and the Enforcement of Article 81 EC before the National Courts' (2004) 25 ECL Rev 12, 758–64.

with the remainder of the modernisation package. Scholars had long been calling for economic analysis to be done by courts other than the ECJ. In 1995, Hawk had proposed a change of attitude by placing the complete economic analysis under Article 81(1) EC so that it could be applied by any court, as it has direct effect.[281] The Commission instead opted to declare the entire Article 81 EC directly applicable as a whole, and to abolish the notification system, which means that notifying agreements will no longer be required.[282] It was clear that the reform of substantive competition law rules of the late 1990s and early 2000s on its own was not enough to alleviate the burden imposed upon the Commission. Complementary procedural amendments were required to grant the effectiveness of the renovated policy framework.

The new system shifts the focus from the written clauses of contracts to the actual effects of such agreements by moving from an ex ante control to an ex post vigilance.[283] This is the principal characteristic of the new rules, which therefore implies that in most cases only those agreements or practices which can be demonstrated to have detrimental effects on competition when challenged before national courts or investigated by the Commission will be the object of concern. The principal reason for this change of attitude is the Commission's awareness that the previous centralised enforcement was unsustainable in practice. Ideally, perhaps it would seem wise to aim for uniformity of application of EC antitrust provisions by having a single authority deal with all the cases, and strike down anticompetitive practices even before they cause any harm on competition. Evidently however, the limited resources for the Commission to analyse every possible infringement of Articles 81 and 82 EC called for alternative means of dealing with these potential violations, even more so in the context of a expanding Union of 27 members. The principal aim of decentralised enforcement and ex post control seems therefore to grant practical effectiveness to the system. These changes bear important consequences on the interpretation of Article 81 EC. Crucially, the emphasis is placed on the effect and not the object of agreements. This new approach contributes towards the economic analysis of agreements, and complements the rules of the current block exemption regulations for vertical agreements and their market share threshold system.

Despite the encouragement of decentralised application of EC antitrust provisions, the Commission is still empowered to start proceedings against undertakings for breaches of competition law.[284] The disappearance of the Commission's monopoly over Article 81(3) EC and the ex post control method is accompanied

[281] BE Hawk, 'System Failure: Vertical Restraints and EC Competition Law' (1995) 32 *CML Rev* 973–89.

[282] Art 1 of Reg 1/2003.

[283] T Rodríguez de las Heras Ballel, 'Decentralised Application of EU Competition Law: A Strategic Approach' (2004) *Working Paper 05*, CLaSF Working Paper Series, www.clasf.org/assets/CLaSF%20Working%20Paper%2005.pdf, 2.

[284] It can do so not only acting on a complaint, but also on its own initiative, according to Art 7 of Reg 1/2003.

by an increase of the Commission's powers of investigation and a carefully implemented method of co-ordination to grant coherence to the new system. The latter is established through the European Competition Network (ECN). As regards the former, Articles 17 to 21 of Regulation 1/2003 furnish the Commission with broad investigatory competences, both in fact-finding and during the formal procedure. The principal reason for this is that since 2004, the burden of the proof has been changed,[285] and it is now on those claiming an infringement of antitrust provisions to demonstrate the infringement.

Under Regulation 17/62, the Commission was already entitled to request information and inspect the premises of undertakings under suspicion of antitrust violation. The new rules enable the Commission not only to take statements and conduct interviews,[286] but also to inspect private premises—such as the homes of directors or employees.[287] Such a possibility is only subject to the requirement of 'reasonable suspicion', and therefore gives the Commission enormous—and controversial—means of obtaining evidence for its investigations.[288] The rationale behind this new power is that firms engaged in anticompetitive practices will hardly keep any evidence in the firm's premises, and may well use the homes of employees to hide incriminating documentation. Unless the Commission is entitled to actually search private premises, gathering the necessary proof may be unfeasible in practice. The broad powers of the Commission are nonetheless limited by the general principles and rights prescribed by EC law,[289] in particular the right of the accused to be heard[290] not to incriminate oneself.[291]

After its investigations, if an antitrust violation is proven, the Commission is able to issue a decision ordering the cessation of an infringement[292] and even imposing

[285] Art 2 of Reg 1/2003.

[286] Art 19 of Reg 1/2003.

[287] Art 21 of Reg 1/2003.

[288] This right is limited by Art 8 of the ECHR, as established by Advocate General Mischo in Case C-94/00 *Roquette Frères SA v Directeur Général de la Concurrence, de la Consommation et de la Répression des Fraudes* [2002] ECR I-9011, [2003] CMLR 53.

[289] L Garzaniti, J Gudofsky and J Moffat, 'Dawn of a New Era? Powers of Investigation and Enforcement under Regulation 1/2003' (2004) 72 *Antitrust Law Journal* 159, 173. The authors emphasise that proportionality and privilege are the most important limitations on the Commission's investigatory powers.

[290] This includes the right to know what accusations are being made against the firm, and to respond in writing or orally in some cases. See Art 27(1) of Reg 1/2003 and Art 12 of Reg 773/2004.

[291] This is based on the rights conferred by the ECHR, in particular Art 6, and was recognised as applicable in Community law proceedings by the ECJ in Case 347/87 *Okrem SA v Commission* [1989] ECR 3283, [1991] 4 CMLR 502.

[292] Art 7 of Reg 1/2003. Additionally, the Commission may decide to force the parties to make commitments to avoid further infringement of competition law on the basis of Art 9 of the Regulation, or even issue a 'positive decision' declaring Arts 81 or 82 inapplicable according to Art 10. Furthermore, informal settlements are possible, when the parties make concessions or agree to amend their agreements to bring to a close proceedings against them. One of the disadvantages is that it will be more difficult to establish binding precedents (similar to the situation described by Macaulay with US legislation and informal settlements), although it will encourage the removal of anticompetitive practices to avoid the possibility of facing fines, and may lead to faster and less costly solutions. On informal settlements, On informal settlements, see A Jones and B Sufrin, *EC Competition Law*, 2nd edn (London, OUP, 2006) 1143.

fines.[293] In this regard, the new rules maintain the harshly criticised system whereby the Commission can be 'law-maker, policeman, investigator, prosecutor, judge, and jury' in the process of determination of antitrust infringements.[294] This reflects that its position remains overwhelmingly strong in spite of decentralisation of application of competition law, only under the scrutiny of the European courts. Judicial review offers some reassurance given the generally economics-oriented approach the courts have followed in their rulings. Nevertheless, integration as a guiding line of competition policy is likely to remain present, since the courts have consistently emphasised the need to promote integration through antitrust. This aspect, which remains unchanged in the new procedural rules, may endanger the efficacy of the economic analysis.

The modernisation rules imply that Article 81(3) EC is directly applicable both by national competition authorities and national courts. Besides, these bodies are not burdened with the task of having to grant exemptions to agreements on the basis of this provision, since the notification system has been totally scrapped. As a consequence, national entities now have the power to perform the analysis of agreements to its ultimate conclusion. According to Article 5 of Regulation 1/2003, the competition authorities of the Member States may adopt decisions 'requiring that an infringement be brought to an end, ordering interim measures, accepting commitments, imposing fines, periodic penalty payments or any other penalty provided for in their national law.' Therefore, in the light of this provision its powers are very similar to those granted to the Commission, and there is an express recognition that national penalties may differ from those established in Community law.

Case allocation is also described in Regulation 1/2003, and further developed by the Co-operation Notice of the modernisation package.[295] One or more NCAs may deal with a specific case, and the general rule is that the case should be handled by the authority that is best placed to do so.[296] The Co-operation Notice clarifies that this is determined by three principles: the agreement must have a substantial effect on competition within the national territory of the NCA, the authority has to be capable of effectively putting an end to the unlawful conduct and able to gather the necessary evidence to prove the infringement on its own or with the aid of other authorities. Prompt case allocation is encouraged so that breaches of competition law may be addressed as soon as possible. The Notice establishes a two-month limit as the desirable maximum time to decide on the best placed NCA.

[293] The quantity of the fines that may be imposed is detailed in Arts 23–25 of Reg 1/2003. Further guidance is provided by the Commission's Guidelines on the Method of Setting Fines Imposed Pursuant to Article [23(2) of Reg 1/2003] [1998] OJ C9/3.

[294] A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (Oxford, Oxford University Press, 2006) 1055.

[295] Commission Notice on co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 [2004] OJ C101/54.

[296] In practice, in most instances the authority that receives a complaint or *ex officio* starts proceedings will remain in charge of the case. Reallocation of a case is only possible at the outset of the proceeding where either the NCA considers that it is not well placed to act or where another NCA or several consider themselves better placed to act.

All Member States have, by now, introduced a more or less sophisticated competition policy within their legal systems. NCAs therefore have experience applying national competition rules, as well as Articles 81(1), 81(2) and 82 EC. Both of these national and Community rules can apply simultaneously to specific cases. This possibility raises the issue of what happens when these provisions differ. This is particularly important now that 81(3) EC too has direct applicability and Article 3(1) of Regulation 1/2003 forces NCAs to apply the Treaty's antitrust provisions as well as national competition law. Following the general principle of supremacy of EC law, it would seem that EC competition provisions should be prioritised over national competition law. Some limits to this general rule are established in Articles 3(2) and 3(3) of Regulation 1/2003, and Member States are permitted to apply rules that pursue different objectives, as well as stricter national laws guaranteeing the same goals. In this sense, Articles 81 and 82 EC are considered as setting 'minimum standards' which must consistently be protected by national entities—very much in line with the Community's general policy-making.[297] Nonetheless, the question arises as to whether or not decentralised application will have harmonising effects on national competition laws.

In the *Courage* case, the ECJ established that national courts have a duty to apply EC competition law provisions, and must ensure the protection of the rights that such rules confer on individuals to grant effectiveness. Therefore, the recognition of damages before a national court was seen as a significant contribution to the maintenance of effective competition in the EC. Since 2004, given that Articles 81 and 82 EC are considered directly applicable, national courts can apply them to their full extent and grant damages for the parties affected by the unlawful practice. Through the modernisation package, a further attempt to overcome the obstacles to private litigation in Europe and thus promote private enforcement is evident, as it is seen as a faster and more efficient way of fighting infringements.[298] In this regard, the most recent step towards private enforcement is the White Paper on Damages,[299] which aims at establishng the direction of future Community legislation aimed at granting a true right to compensation for breach of EC competition rules. The Commission's intention is twofold: on the one hand, it seeks to establish effective minimum judicial protection and, on the other hand, it prioritises uniformity and coherence in the award of damages across the territory of the EU.[300]

[297] The approach would put one in mind of the general view of harmonisation of product standards across the Community for the encouragement of the free movement of goods around the EC. Harmonising directives adopted on the basis of Art 94 EC establish minimum standards which must be guaranteed across the EU territory. Nonetheless, in some specific circumstances, national legislation can elevate those standards. However, in that field, and given that such legislation can act as an obstacle to the free movement of goods, there must be a justification for the stricter national regime (for instance, Art 30 EC or a 'mandatory requirement' as described in *Cassis de Dijon*). In contrast, in competition policy no justification appears to be required.

[298] A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (Oxford, Oxford University Press, 2006) 1192.

[299] Damages actions for breach of the EC antitrust rules (White Paper) COM (08) 165, 3 April 2008.

[300] S Marco Colino, online updates for M Furse, Competition Law of the EC and the UK, 6th edn (Oxford, OUP, 2006), OUP Online Resource Centre, at www.oup.com/uk/orc/bin/9780199237920/resources/updates/. For an in-depth analysis of the implications of the White Paper on Damages, see

To instigate private enforcement, Regulation 1/2003 grants national courts the power to apply Articles 81 and 82 EC,[301] even when they are simultaneously applying national competition law.[302] Also, Article 15 enhances the need for co-operation between the Commission and the courts to grant the uniform application of EC antitrust rules. Of particular relevance is also the Commission Notice on the handling of complaints by the commission under Articles 81 and 82 of the EC Treaty,[303] which emphasises the complementarity of private and public enforcement, as well as the advantages of actions before the national courts.[304] Moreover, the new rules do not only empower the courts to apply EC competition law, but also oblige them to do so 'even when the party with an interest in the application of those provisions has not relied on them,'[305] and the Commission is encouraged to decline to act on a complaint if the complainant's rights can be protected by a national court.[306]

The involvement of 27 NCAs plus the Commission in the enforcement of antitrust provisions, alongside private enforcement before national courts, require a solid co-ordination mechanism to ensure that no cases remain unaddressed and at the same time avoiding that one case is not dealt with by two different authorities without them being aware of each other's decisions. At the same time, uniformity of interpretation of EC competition rules needs to be protected; the systems has already shown some conflicts in this regard.[307] Consequently, the new rules aim to encourage co-operation and exchange of information between the Commission, the NCAs and the national courts.[308] Of particular importance is the establishment of the European Competition Network (ECN),[309] integrated by the Commission and the NCAs. In practice, the ECN exchanges information using several means of communication. For instance, they employ a computerised database where all ongoing cases are recorded. Commission officials regularly check the database to ensure that the cases are being dealt with by the appropriate authorities. The ECN should provide an optimal means of maintaining coherence and unity in the application of EC competition provisions. The development of telecommunications simplifies keeping in touch. EC members can, for instance, have videoconference contacts with each other, and use the Internet and its resources to be aware of the

A Komninos, 'The EU White Paper for Damages Actions: A First Appraisal' (2008) *Concurrences Review* 2-2008, 84–92.

[301] Art 6 of Reg 1/2003.

[302] Art 3 of Reg 1/2003.

[303] [2004] OJ C101/65.

[304] S B para 16 of the Notice.

[305] Commission Notice on the Co-operation between the Commission and the Courts of the EU Member States in the Application of Articles 81 and 82 EC [2004] OJ C101/54.

[306] Commission Notice on the Handling of Complaints, para 17. A Jones and B Sufrin, *EC Competition Law: Texts, Cases and Materials*, 2nd edn (Oxford, Oxford University Press, 2006) 1192.

[307] By way of example, the Greek competition authority estimated that maximum and minimum price discounts amounted to resale price maintenance. Decision of 29 November 2007, *Hyundai Hellas SA*. See P Lugard and J Haans, 'Ten Points to Consider When Reviewing Regulation 2790/99' (March 2009) *Online Magazine for Global Competition Policy* 1.

[308] Art 11 of Reg 1/2003.

[309] Recitals 15 and 16 of Reg 1/2003, and para 1 of the Co-operation Notice.

actions taken in other Member States. However, when it comes to deciding the substance of a case, it should be up to each authority to decide whether they want to respect the decision made by other national courts on the issue or whether the circumstances of the case require a different view. In any case, the European courts can always be relied upon to solve possible disputes.

Disagreements may arise between the different enforcement actors as to who should be handling a specific case. Article 13 of Regulation 1/2003 is a useful tool in such cases. However, the obligation placed on the enforcement authorities to inform the rest and wait for their views might in practice result in delays. It is therefore important that case allocation remains transparent and fast, as otherwise the efficiency-increasing effects of decentralised enforcement and the relief of the burden of the Commission may be shadowed by the possible hindrance of determining who should handle each specific case. One useful suggestion could be to have people both in the NCAs and in the different sections of the DG Competition in charge of checking the ECN on a regular basis and immediately become aware of any possible updates on ongoing cases.[310]

Regulation 1/2003 further establishes formal channels of exchanging information among the Commission and national entities. As regards the flow of information between the Commission and the NCAs (as well as the NCAs between themselves), Articles 11 and 12 impose a two-way obligation of providing any documents essential to the assessment of cases, even when confidential data are included.[311] Simultaneously, information exchanges with national courts are essential given the need to ensure that they are correctly applying EC competition provisions and that they are developing a sound economic analysis. Article 15(1) of Regulation 1/2003 enables national courts to consult the Commission on the application of EC competition rules, and the relevant advice should be provided within 4 months.[312]

iv Repercussions of the new European enforcement rules on vertical agreements

The new enforcement rules of EC competition law provide an overall laudable framework for efficient, economics-based enforcement of antitrust in Europe. In this context, they adequately complement the current block exemptions for vertical agreements in general and motor vehicle distribution in particular. As a consequence of the new BERs, a greater number of vertical agreements will escape antitrust provisions. As Regulations, the block exemptions are directly applicable in the Member States,[313] and therefore when an agreement's compliance with the conditions for exemption is questioned the issue can be analysed by both national

[310] P Massey, 'Criminal Sanctions for Competition Law: A review of Irish Experience' (2004) *Competition Law Scholars Forum: Decentralised Enforcement: from the Idea to the Reality*, Glasgow, www.compecon.ie/Clasf%2004.pdf.

[311] In such cases, confidentiality requirements are applicable, and the Commission and the NCAs are required to respect professional secrecy (Art 28(2) of Reg 1/2003).

[312] Para 28 of the Co-operation Notice.

[313] Art 249 EC.

courts and authorities. Moreover, those agreements which may not automatically qualify for a block exemption (for instance, when the parties surpass the established market share thresholds in the pertinent relevant market) may now be individually exempted on the basis of Article 81(3) EC also by the national bodies, since its direct applicability has been recognised in the new rules.

Importantly, the current enforcement rules open the door for further changes in the future regulation of supply and distribution agreements. Dealers tend to have a disadvantageous position in their relationship with manufacturers, yet at the same time it seems dangerous and impertinent to grant contractual protection for dealers using competition provisions. Nevertheless, facilitating private enforcement of competition provisions before national courts and striving towards a Community right to damages may help in the effective protection of dealers without having to put at risk the general objectives of competition policy. Litigation in antitrust gives the parties the possibility of obtaining damages, legal costs and protection by interim measures.[314] Moreover, they are in a better position to assess the consequences of the nullity sanction of Article 81(2) EC in the context of the contractual relationship of the individuals. The possible problems derived from the BER's list of severable (grey) clauses may be overcome, since the effects of the nullity of those specific clauses on the remainder of the contract can be casuistically analysed. Furthermore, the courts are in a privileged position to rule on contractual obligations derived from an agreement that they are scrutinising under Article 81 EC,[315] as they are familiar with national contract law and may provide the necessary intertwining (and not bundling) of the two interacting disciplines. Ex post control of the agreement's compliance with EC competition rules serves also to open the door to analysing agreements beyond their literal wording, and considering the context and manner in which they are applied—highlighted by Macneil's relational contract theory as absolutely determinant of the actual effects of agreements.

Nonetheless, some significant issues ought to be considered which endanger the practical implications of the merits of the current enforcement rules. Our concerns are principally related to the fact that national courts are faced with the thorny task of carrying out the necessary economic analysis. More specifically, they must define the relevant market to determine whether agreements may benefit from the exemption granted by the BER, or if despite their non-compliance with the thresholds they can still qualify for an exemption because they have limited market power. In John Irving's novel 'A Widow for One Year',[316] Ted Cole teaches his sons that the way to become a good driver is to assume that everybody else is a bad driver. If one expects other drivers to comply with the established rules, one is totally unprepared for any sudden unpredictable actions. The new decentralised application of EC competition law implies that the Commission

[314] Commission Notice on the Handling of Complaints by the Commission Under Articles 81 and 82 of the EC Treaty [2004] OJ C101/65, para 16.

[315] ibid.

[316] J Irving, *A Widow for One Year* (New York, Ballantine Books, 1998).

has opted for trusting that NCAs and national courts are all good 'drivers' of EC competition law. In this sense, a fervent discussion has arisen on whether or not national judges are adequately trained and prepared to apply the complex economic analysis of block exemption regulations. It seems that there is still a diminishing but outstanding lack of knowledge with regard to these issues in some Member States. When examining market power and significant effect on competition, the authorities need not only be familiar with the rules, but also have a strong economic background in order to be able to apply the criteria set out in the Regulations.[317]

This need not necessarily be an impediment for the sound development of economic analysis of competition provisions. In the US, for instance, the courts have proven to be as good at economic analysis as other institutions. In fact, by now European national courts have a certain degree of experience in antitrust, as they have been applying the relevant national competition laws. In some of the Member States, attempts to familiarise national judges with EC competition law by providing strong training in the area have been performed.[318] Also, they can use Commission decisions, ECJ rulings and other guiding documents issued by the European institutions to enlighten them in their analysis. In this sense, the Commission has increased responsibilities in developing a sound and coherent methodology for defining the relevant market. An agreement on the basic legal and economic terms in this context may somehow have to be developed. However, the substantial effect of such a tendency could be a harsh globalisation of legal concepts, which can also be undesirable as it would destroy part of the local culture of the Member States.[319] Therefore, the decentralised application of EC competition law might necessarily have 'spill-over effects' and lead to harmonisation of national procedural rules and legal terms, areas which are impregnated with national traditions and cultures.

III AN ASSESSMENT: INHERENT BENEFITS AND DANGERS IN THE EXTENSION OF THE RULE OF REASON

Thorough economic analysis is of pivotal importance for the development of an adequate antitrust regime. In the field of vertical restraints, individual assessment carries an exceptional vigour as a result of the mixed consequences of the restrictions. In the US, the progressive extension of the rule of reason has opened up possibilities for a more substantial assessment of agreements under section 1 of the Sherman Act. In the EU, the so-called 'new style' block exemptions have finally provided a more structured rule of reason by relating the validity of agreements to

[317] A Riley, 'EC Antitrust Modernisation: The Commission DoesVery Nicely—Thank You! Part Two: Between the Idea and the Reality: Decentralisation under Regulation 1' (2003) 12 *European Competition Law Review* 657.

[318] In the UK, for instance, judges were trained by Sir Christopher Bellamy, former President of the Competition Appeal Tribunal (CAT) and Judge of the CFI.

[319] See ch 4 below.

the market power of the parties. It seems that both regimes have, by now, regognised that the benefits of economic welfare are the essence of competition. Despite converging trends towards a rule of reason analysis, important differences remain in the two regimes.

In the US, courts and authorities have focused on protecting economic efficiency since the late 1970s. As a consequence, economic analysis has been used for decades to determine the validity of certain vertical restrictions. Since *Sylvania*, those restraints that do not directly affect price have been virtually treated as per se legal, while price restraints have progressively moved from being prohibited without further analysis to a careful assessment to determine their soundness. Tolerance towards the latter is more limited than when it comes to the former, however the parties are currently given the chance to defend their contractual clauses by allowing careful scrutiny under the rule of reason. Consequentially, economic analysis of these restrictions has been developed almost exclusively by the courts on a case-by-case basis. The result is a policy where currently no vertical restrictions are unlawful per se. This would, at first sight, appear to be a very welcome development, particularly since the individuality and mixed effects of these restrictions make it almost impossible to establish general rules as to their legality. It could be questioned, however, whether US antitrust policy has taken the tolerance towards these restrictions a little too far, particularly since *Leegin*. At this moment in time, it is rather early to estimate if this is the case, as the shift to the rule of reason does not and will not imply per se legality, but rather an opportunity to take into consideration potentially beneficial consequences of such agreements. Reservations about the merits of the extension of the rule or reason arise when balancing whether the reluctance to crush the potential advantages of price restraints can justify the increased complexity in the analysis of these restrictions implied by the rule of reason. The theories that defend the benefits of price restraints—particularly minimum resale price maintenance—are still somewhat weak and underdeveloped, and practice suggests that in most cases these restrictions will have very narrow possibility of exerting a positive influence in the competitive process. In such context, the sacrifice of the straightforwardness of the per se rule may not have been the most adequate solution.

Whether or not the new approach succeeds greatly depends upon how that rule of reason analysis is interpreted and applied. If coherent, clear rules are developed in order to judge the legality of price restraints then the move towards the rule of reason could be the sensible alternative to the rigidity of per se illegality. Of the possibilities analysed above, it would appear that the eight-factor method suggested by Areeda and Hovenkamp could be an optimal way to balance the advantages and disadvantages of price restraints, if and when they all create a rebuttable presumption of illegality. This would imply that resale price maintenace would still be mainly unlawful, and legality would only be granted in exceptional circumstances. Tilting the balance towards the validity of these restrictions, as some authors have suggested, could lead to an excessively tolerant policy where consumers could end up paying higher prices and efficiency could be seriously undermined.

As our analysis indicates, US antitrust has proven to work rather efficiently in practice, and Europe often looks to this experienced regime to solve emerging problems. Nevertheless, this legal system is threatened by two factors that have often affected its shape and evolution. On the one hand, to date there seems to be a strong reliance on the ideas of the Chicago School, which despite their historic value and revolutionary consequences are clearly oversimplistic. The influence of more elaborated and sophisticated theories is present in some court decisions and notably in the position of some of the national antitrust agencies, yet in the extension of the rule of reason to price and non-price restraints courts have expressly relied on Bork and Posner to justify the change in the case law. On the other hand, political changes do appear to affect antitrust trends, leading to considerable swings in the policy when there is a change of government. In this sense, decentralised enforcement has somewhat softened the disparities, as states are empowered to consider unlawful actions that are tolerated at the federal level. When the laissez-faire approach has peaked, they have managed to retain stricter rules, thus helping to diminish the swings of the pendulum. It remains to be seen whether state authorities will assimilate the rule of reason established by Leegin or if they will retain their reluctance to accept the merits of price restraints.

In Europe, a greater mistrust towards vertical restrictions still exists. The changes introduced by Regulations 2790/99 and 1400/2002 represented noticeable progress when compared to the old formalistic BERs. The formal introduction of economic analysis in the evaluation of the impact of vertical restraints is crucial, as they will only be considered harmful when they are linked to market power. This approach has resulted in a more relaxed policy towards these potentially beneficial limitations. Nevertheless, it is the author's view that the way in which economic analysis has been brought into the evaluation of these restraints is still somewhat rigid and complex. The problems derived from the reliance on inflexible market share thresholds, and which can hardly be conclusive alone of the presumption of dominance, have been highlighted above. Even more disappointing is the maintenance of hardcore restrictions, which means that even when the market share of the parties is below the thresholds the agreements will be null. This is a major obstacle in the way towards a sound ecnomic analysis, and is an aspect which differs from the US regime. Whereas the declaration of the per se illegality of minimum price-fixing appears to be inspired by the US—where, at the time of the adoption of the block exemptions, minimum resale price maintenance was still unlawful per se—the black clauses related to absolute territorial protection are a conscious distancing from the American regime. The motivation can be found in the strong integration concerns, which are present even over half a century after the birth of the Community. The logic of pursuing the elimination of barriers to trade is obvious; nevertheless, the result of developing a competition policy guided mainly towards achieving integration was an overly restrictive situation with negative consequences for efficiency without necessarily achieving the desired benefits on the integration of markets.

An additional consequence of the excessive concerns over the market-partitioning effects of agreements is the fact that the interpretation of the prohibition of

Article 81(1) EC remains excessively broad. The European courts have negated the possibility of a rule of reason under this paragraph, but as previously demonstrated this exclusion is more than questionable.[320] In addition, and placing yet another question mark on the logic of the regime, the existence of specific rules for the car sector seems rather random and arbitrary. It appears that car manufacturers have exerted a notorious influence on the Commission when regulating their agreements. The dangers of a policy exceptionally influenced by particular interests rather than efficiency concerns are evident. The protection of specific actors through antitrust, when disconnected from economic analysis and basic efficiency considerations, can lead to an inadequate, excessively interventionist competition policy. In this case, the early block exemptions to a large extent prevented innovation in distribution methods. The car sector in particular remained isolated from the general transformation of distribution of the second half of the twentieth century as a direct result of the appearance of the superstore and the Internet. While it has been consistently argued that when the market conditions are optimal restrictions of this nature imposed by manufacturers are doubtfully unlawful, it is certainly unjustified to actually hamper the use of new distribution channels through antitrust. In the words of Kessler, 'it would seem wiser to let the marketplace determine which elements are most efficient rather than by legislation lend support to the existing distribution pattern.'[321] The procompetitive effects of such regulation are difficult to find. Therefore, the attempted blockage of new developments in distribution of the car sector constitutes another pivotal criticism of the current regime.

The Commission is currently faced with an imminent reform of the regime for vertical agreements with the nearnesss of the expiration date of the current block exemptions. This should have been seen as an optimal opportunity to correct the mistakes of the system in favour of a rationalised solid and coherent regime. The reforms that urge are fourfold: first, the interpretation scope of Article 81(1) EC should be narrowed to avoid that those agreements with little potential to harm the competitive process. Secondly, if the block exemption system is maintained—the most likely option—modifications would be highly recommended. For instance, an increase of the safe harbours provided by the market share thresholds ought to be considered. Importantly, the keeping of a list of hardcore restrictions needs to be reassessed. While the per se rule usually makes analysis for courts and authorities much easier, the black and grey clause lists of the block exemption regulations are subject to exceptions, and the result is a complex system that is shy of full economic analysis. Of particular concern is the per se prohibition of some kinds of territorial protection, clearly guided by integration concerns. Hayek has highlighted on occasion that competition should not be a way of achieving specific objectives, but rather a co-ordination mechanism which pursues an abstract goal. The Commission has not followed this approach in the BERs, and it seems clear that factors other than these clauses are to blame for the lack of integration in the

[320] See s II A above.

[321] F Kessler, 'Automobile Dealer Franchises: Vertical Integration by Contract' (1957) 66 *Yale Law Journal* 8, 1135–90, 1189.

EU.[322] As long as these issues remain—and some of them are unlikely to ever disappear—complete integration will never fully materialise, regardless of absolute territorial protection. However, by protecting integration through competition the European institutions risk endangering economic welfare and thus missing out on the potential benefits of a system directed mainly at protecting essential interbrand competition. Thirdly, the car sector regulation should be abolished, as it simply lacks sense to maintain specific rules for this industry. Fourthly, an orderly application of Articles 81(1) and 81(3) EC needs to be clarified, as the current Guidelines on Vertical Restraints seem to confuse the rationale of the analysis. Article 81(3) EC, whether applied individually or *en bloc*, can only enter into play when an agreement falls within the scope of Article 81(1) EC in the first place, and any policy developments should reflect this orderly analysis. Rather disappointingly, the vast majority of this 'wish list' remains unaddressed in the proposed reforms publicised in July 2009.

Strengthening the analysis under Article 81(1) EC seems particularly vital, yet it is an unlikely development given the insistence on placing the rule of reason entirely under Article 81(3) EC. Despite some attempts to limit the scope of this prohibition, it is still far too broad, and the mere existence of a block exemption regulation for vertical agreements is proof of this problem. To this end, the emphasis should be placed on the actual effects of agreements rather than their object. In practice, the effects of the system enforced by Regulation 2790/99 need not be essentially different than those achieved by a restricted interpretation of Article 81(1) EC, as it is possible that most of the agreements that would be considered to escape the scope of the prohibition will be exempted any way on the basis of the block exemption. However, such an approach would greatly simplify the application of Article 81 EC as a whole, particularly in the context of decentralised enforcement. This position may leave two issues unanswered. The first of these would be the problem related to the possible abuses suffered by dealers as a result of the unbalanced relationship between dealers and manufacturers. Economic efficiency on its own as defined above will not always lead to policy decisions which benefit dealers. In order to address such a difficulty, one option is to defend other goals through antitrust—which experience proves undesirable—or perhaps resorting to other legal tools outside the sphere of competition law to grant this protection. Instinctively, contract law would seem like an adequate field in which to protect the dealer, but this is an issue that deserves greater analysis and that will be analysed in chapter 4. The second issue relates to the possible limitations on interbrand competition as a result of restrictions on intrabrand competition. In this sense, if all expert dealers have exclusive agreements with manufacturers, then newcomers might find it difficult to find someone interested in distributing their products. This can be resolved by placing vertical restraints under the rule of reason and analysing their consequences.

[322] For an analysis of these factors, see S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and its Implications for EC Competition Policy' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

On the brighter side, the reform of the procedural rules with the abolition of Regulation 17/62 has been a crucial step toward the sound development of the policy. Substance and procedure are inextricably related, and in this sense the modernisation package introduced in 2004 is an optimal complement to the new economics-based, ex post approach to antitrust regulation in Europe. In broad terms, the model on which the European institutions are sculpting the new rules is the US. The influence of American antitrust experience is more visible in the enforcement reforms than in any other area of competition law. There is a patent intention to increase the role of national authorities and courts in the enforcement of EC antitrust, which is further enhanced by the fomentation of private litigation—encouraged more than ever with the recent appearance of the White Paper for Damages Actions and the harmonising legislation that will soon follow suit. The motivation for change stems from both a recognition of the merits of such a system and an inevitable acceptance that centralised enforcement is in practice not only detrimental but virtually unsustainable. However, the real extent of the 'Americanisation' process can be questioned on the basis of two core ideas. Firstly, the evolution of antitrust is dependent upon the teleological *raison d'être* of the political system of which it forms part. In this sense, the EU is further constrained and influenced by its own peculiar historical, political and economic context and in particular by the unprecedented process of integration. Secondly, the practical implementation of 'US-style' decentralised enforcement is jeopardised by the shortcomings of the EU system and substantial cultural differences. There is a litigiousness in the American society that is not matched anywhere in the EU, and this is bound to have an impact on the number of cases reaching the courts. In addition, there is a conscious distancing from some of the characteristics of the US system in the European rules. A good example is the limitations imposed on collective and representative claims, which are subject to stricter requirements than class actions in the US.[323]

The European enforcement rules also attempt to grant coherence in the application of competition provisions, while at the same time allowing a certain degree of flexibility to adapt to the circumstances of the specific national cases. By increasing the powers of NCAs and national courts to apply EC competition provisions, the bringing of infringements to an end should be faster, while at the same implying a step towards the feeling of closeness of decision-making in the EU for the citizens of the different Member States.[324] Also, scrapping the notification system allows the Commission to concentrate on veritably harmful practices. For such

[323] One must opt into collective claims rather than opt out, as is the case in the US. See M Komninos, 'The EU White Paper for Damages Actions: A First Appraisal' (2008) 2 *Concurrences* 84–92.

[324] The democratic deficit of the EU's policy-making is one of the most severely criticised aspects of the Community. In this regard, see, inter alia, D Chalmers, 'Community Law Making', ch 4 in Chalmers, Hadjiemmanuil, Monti and Tomkins, *European Union Law* (Cambridge, University Press, 2006) 131; P Craig, 'The Nature of the Community: Integration, Democracy and Legitimacy' ch 1, in P Craig and G De Burca, *The Evolution of EU Law* (Oxford, University Press, 1999); F Bignami, 'The Democratic Deficit in European Community Rulemaking: a Call for Notice and Comment in Comitology' (1999) 40 *Harvard International Law Journal* 451.

conducts, the institution is now in possession of increased investigatory powers which should enable it to put together the evidence required to bring them to an end. Nevertheless, in future the excessive weight of the Commission from the beginning to the very end of the procedure and its multiple law-maker–prosecutor–judge roles should be reconsidered. Its responsibility to grant coherence of the decentralised system is crucial for the adequate functioning of the scheme. However, NCAs should regard the task of safeguarding harmony in the application of competition law as their own.

American antitrust enforcement and its success may be an optimal role model for Europe. Nevertheless, it is generally asserted that US antitrust implementation at the federal level is greatly subject to political changes in the government. This raises the issue of whether a similar situation could be achieved in Europe through decentralisation, and particularly with the involvement of national competition authorities in the enforcement of EC competition law. Such a possibility appears rather far-fetched given the mechanisms established for co-operation between the enforcing authorities to grant coherence to the system. The Commission may still intervene if necessary, and the control of the courts should also act as a prevention of possible political influences. Moreover, the keys to the accomplishment of US antitrust are principally the accumulation of experience over the years and the development of the policy mainly in the context of private (rather than federal) litigation. These are the two principles EC antitrust should utilise to evolve in an improved way. In practice, however, the desired increase in private litigation may not occur easily in Europe, given that the European citizen, as stated above, is less prone to litigation than the American. In order to encourage private enforcement in the Community, the possible benefits of litigation ought to be boosted; the forthcoming harmonisation of damage actions across Europe could provide that encouragement.

As a general conclusion for both US and EC regimes, the evolution of antitrust is currently being tested under the current economic climate. The crisis of the housing industry has spread to all sectors of the economy and has eventually led to the bankrupcy of long-established financial institutions, job losses in virtually all industries. The lack of credit prevents consumers from spending, and businesses are suffering as a consequence. Emergency measures have seemed to be the only way to prevent catastrophes, and the field of antitrust is no exception. Subsidies are being granted to struggling companies and industries, and mergers which appear to raise anticompetitive concerns are being given the green light to avoid the collapse of even more enterprises.[325] It remains to be seen if the economic crisis will leave an imprint on the shape of any emerging antitrust rules affecting vertical agreements. On the one hand, it is feared that the situation may encourage the legislator to increase the benevolence towards these contracts, squandering the possibility of controlling the potential negative effects. After *Leegin*, this could be the case in the US if the rule of reason is de facto interpreted

[325] See Introduction s II above.

to mean per se legality. Similar reforms may be introduced here in Europe now that changes are imminent. It does however seem less likely in the Old Continent given the traditional reluctance to accept the benefits of these restrictions. On the other hand, the panic about the collapse of industries may lead to an attempt to protect businesses that bear negative consequences for the solidness and coherence of the policy. For instance, it is possible that the crisis of the automobile sector is partly responsible for the temporary maintenance of a specific regime for the industry in Europe. Overall, these problems may seriously jeopardise the soundness of imminent developments in antitrust policy, undermining the credibility of the discipline. The legislator needs to look beyond the panic and take coherent decisions that will ensure the sturdiness of the legal system.

4

The Impact of Competition Rules on Vertical Contractual Relationships

> Do you see a bridge as an obstacle—as just another set of steps to climb to get from one side of a canal to the other? We Venetians do not see bridges as obstacles. To us bridges are transitions. We go over them very slowly. They are part of the rhythm. They are links between two parts of a theatre, like changes in scenery, or like the progression from Act One of a play to Act Two. Our role changes as we go over bridges. We cross from one reality . . . to another reality. From one street . . . to another street. From one setting . . . to another setting.[1]

When it comes to regulating specific phenomena, it is common to find frictions between different legal disciplines. Reality often presents situations which defy the general classifications commonly used, and legal disciplines, rather than black boxes represent a way of giving order to what would otherwise be an incomprehensible amalgam of rules. In the field of vertical restrictions, there is an interesting occurrence that is frequent in distribution contracts. In theory, when dealership contracts work well, the interests of buyer and seller coincide, as they both profit. In practice, often the interests of the parties enter into conflict. It is obvious that not all distributors achieve the same performance levels. Some simply fail, in which case the manufacturer could easily cancel the dealership. But there are many ambiguous situations.[2] When this happens, the distributor usually claims that the agreement needs to be considered in good faith and in its context rather than literally, since solidarity and trust should govern the dealer–manufacturer relationship and create tacit relational norms between them.[3] In addition, as Stanworth has noted in his study of franchise agreements, 'franchisees see contracts as being weighted in the franchisor's favour. Less than one in 10 franchises saw it as weighted in their favour.'[4] In order to defend its interests, the manufacturer on its

[1] J Berendt, *City of Falling Angels* (London, Hodder and Stoughton Ltd, 2005).

[2] This is the case, for instance, when a successful dealer is located in an area which the dealer may lose interest in serving. This could be one of the consequences of forbidding manufacturers to price-discriminate.

[3] Macneil is the father of relational theory. See, inter alia, IR Macneil, *The New Social Contract* (New Haven, Yale University Press, 1980); IR Macneil, 'Relational Contract: What We Do and Do Not Know' (1985) *Wisconsin Law Review* 483.

[4] J Stanworth, 'The School of Management Studies of the Polytechnic of Central London' in M Mendelsohn (ed), *The Guide to Franchising* (Oxford, Pergamon Press, 1985) 93. See also J Stanworth, 'The Franchise Relationship: Entrepreneurship or Dependence? (1995) 4 *Journal of Marketing Channels* 161–176.

part may call upon freedom of contract and choice, under which the dealer voluntarily signed a document which by retaining the flexibility necessary to adapt to changing consumer preferences.[5]

The conflict of interests gives rise to two basic controversial issues which have captivated the attention of academics over decades and which will be closely looked upon in the following pages. The first of these issues is related to this unbalanced relationship between manufacturers and dealers in distribution contracts. Dealerships have long been criticised for their one-sidedness. Manufacturers have used franchising agreements, selective and exclusive distribution and other restrictions as a means to gain maximum control over the management of the dealers' business. The manufacturers' desire to exert power over dealers can be understood bearing in mind that dealers are normally regarded by the general public as the producers' representatives.[6] The success of a certain brand in an allotted territory depends very much on how the dealer performs his functions, as we normally associate the manufacturer with the person we have direct contact with when purchasing the contract goods. Therefore, the efficiency arguments used to justify the restraints imposed by manufacturers may, however, be weakened by the serious fairness concerns.[7] Traditionally, contract law has been used to address such problems, but in Europe it seems that some BERs have attempted to grant a certain degree of dealer protection. It raises concerns regarding whether competition law is an adequate means to balance the dealer–manufacturer relationship and if it is possible to use the rules with this purpose.

The second problem has connotations which enter into the sphere of competition law and therefore raise antitrust concerns: The contracts between manufacturers and their dealers normally established exclusive rights for both sides.[8] Producers generally requested retailers to sell only their products, and at the same time retailers also wished to have the privilege of being the only persons authorised to sell the manufacturers' brands in their allotted territories. In this protection, some have seen a conflict of interests: On one hand, the dealers' weak position could be compensated by rewarding them with territorial exclusivity and protection from free-riders who might be able to offer the same product at a lower price by taking advantage of their investments and efforts. On the other hand, this exclusivity might jeopardise access to the market for newcomers not only at the retail level, but also at the production level. If all the expert dealers in a specific area have exclusivity contracts, then new manufacturers may struggle to find someone willing and able to sell their products. This may have an impact on prices and

[5] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 179–237, 230.

[6] Hearings before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce.

[7] N Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994) 33.

[8] Anderson '*American Motors Sales Corp v Peeters*: Green Light to Territorial Security for Automobile Dealers' (1980) 63 *North Carolina Law Review* 1081.

therefore threaten resource allocation efficiency, and eventually lead to a negative blow on consumer welfare.[9]

Therefore, the legislator stumbles across a situation in which a contract clause which is in principle mutually beneficial to both parties in the agreement (exclusivity) can have harmful external effects on others—in this case, consumers. This conflict of goals is very present in US courts' decisions and therefore remains crucial to the development of antitrust cases. In this context, Komesar emphasises the limitations of resource allocation efficiency as the only goal of any given policy, as it is far too vague.[10] The specific circumstances need to be considered, as depending on them one or another institutional choice might be valid. It seems that, for the protection of the dealers' interests, the most adequate tool could be contract law. However, for the protection of efficiency and consumers' interests, antitrust and the market process would appear to be more suited.[11] In the words of Kessler, perhaps 'it would seem wiser to let the marketplace determine which elements are most efficient rather than by legislation lend support to the existing distribution pattern.'[12] To analyse the frictions between institutions and their impact upon the transformation of distribution techniques, our analysis needs to surpass the limits of antitrust.

In Europe, the two areas of law under consideration—contract and competition—are undergoing two parallel processes of transformation at the supranational level which, when jointly analysed, reflect broader implications for the integration process. As regards the former, whilst contract law has for long remained in splendid isolation from the wider process of Community integration, the debate concerning the codification of European contract law returned to the agenda in the early 2000s as a consequence of the Commission's Action Plan on European Contract Law.[13] The Commission is spearheading the compilation of a Common Frame of Reference (CFR)[14]—founded on common principles and a uniform legal terminology—that it believes will further harmonise national contract laws. The institutions have also called for the future development of an

[9] F Kessler, 'Automobile Dealer Franchises: Vertical Integration by Contract' (1957) 66 *Yale Law Journal* 8, 1135–90, 1189.

[10] N Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (Chicago, University of Chicago Press, 1994).

[11] The possible inconsistencies of controlling the one-sideness of car franchises and at the same time permitting exclusive dealing and purchasing agreements under competition law are highlighted in C Joerges 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations Between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 3, 581.

[12] F Kessler, 'Automobile Dealer Franchises: Vertical Integration by Contract' (1957) 66 *Yale Law Journal* 8, 1135–90, 1189.

[13] Communication from the Commission to the European Parliament and the Council: A More Coherent European Contract Law: An Action Plan COM (03) 68 final, [2003] OJ C63/01, 12 February 2003.

[14] Communication from the Commission to the European Parliament and the Council, 'A More Coherent European Contract Law: an Action Plan', COM (03) 68 final. Online at http://europa.eu/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/com_2003_68_en.pdf.

EC Optional Instrument on contract law.[15] With respect to the latter, the process of reforming EC competition law analysed in the previous chapter began more than a decade ago and has considerably altered substantive national and European law and procedure. New rules now govern not just vertical agreements and the implementation of competition law—the focal areas of this study—but also merger control, horizontal restraints, and Article 82 EC.

In the context of this chapter, the reform of the enforcement rules is the most important change, as the system was drastically transformed in 2004 when Regulation 1/2003 finally substituted the rules of Regulation 17/62.[16] Whereas Article 81(3) previously lacked direct applicability, the changes introduced empower national competition courts and authorities to apply Articles 81 and 82 EC in their entirety. The new regime contained in the 'modernisation package' aims for the decentralised application of competition law provisions by national authorities and courts. The systems set up by manufacturers in order to deliver their products across the EU territory are affected by Regulation 1/2003 in a particular way: on the one hand, as contracts they are governed by national contract law, and on the other, as agreements that might have an impact on free trade between Member States they have to comply with EC competition law rules—now also applied by national entities. The interweaving of the two disciplines is further enhanced by the fact that, while national competition authorities will have the power to apply EU competition law, they will do so using existing national enforcement procedures.[17] The harmonisation or 'Europeanisation' of national contract laws coincides with this decentralised enforcement or 'nationalisation' of competition law provisions, and the implications of such tendencies for vertical restraints require further attention.

Inspired by Berendt's description of Venice in his novel 'City of Angels', the present chapter attempts to build a bridge between these two settings based on the most recent trends. Our interest remains on the competition regimes of the US and the EU, but the focus of this chapter rests on the external effects of the changes. Importantly, the centre of attention is how the emerging conflicts have been addressed by the legislator on both sides of the Atlantic. Whereas US authorities could use contract law for regulating the emerging issues, the Commission and the European courts lack competence in this area and have therefore tried to stretch the Treaty's competition law provisions to grant minimum protection. The adequacy of such practices is questioned in the following pages.

[15] MW Hesselink and JW Rutgers, 'The Legal Basis for an Optional Instrument on European Contract Law' (2007) *Centre for the Study of European Contract Law, Working Paper* 2007/04.

[16] See ch 3 s II C above.

[17] See also P Massey, 'Criminal Sanctions for Competition Law: A review of Irish Experience' (2004) *Competition Law Scholars Forum: Decentralised Enforcement: from the Idea to the Reality*. Glasgow.

I THE INTERACTION BETWEEN CONTRACT AND COMPETITION LAW

When compared to contract law, competition law is a relatively recent discipline with a much shorter tradition. Antitrust as a distinct legal discipline as we know it today emerged at the end of the nineteenth century, when the landmark Sherman Act was enacted in the United States—the oldest competition statute still in force today. The regulation of competition is something of a new phenomenon in the Old Continent.[18] The North American way of regulating competition has greatly influenced the later European competition law. Since the *Sylvania* ruling,[19] the development of US antitrust policy has been almost exclusively premised upon economic efficiency considerations. *Sylvania* marks a significant turning point and an ideological reorientation towards the doctrinal foundations of the Chicago School. In the European Union, competition law has been present since the origin of the Communities in the 1950s.[20] The Founding Treaties already contained Articles 85 to 91 EC (81 to 87 EC since the Amsterdam reform), and therefore the antitrust provisions which prohibited anticompetitive agreements and the abuse of dominance were available for the European institutions to create a European competition policy since the very birth of the integration process. However, the application of EC competition law in the early days was harshly criticised for pursuing almost every agreement (even if the anticompetitive effects were minimal) and for being disconnected from economic reality. The last decades have therefore brought about big changes for EC competition law, and by now new rules have been established which give the policy a fresh normative framework in which to develop.

That competition law interacts with economics is a natural consequence of its nature and its close links with industrial organisation. For similar reasons, frictions between contract law and competition in the context of supply and distribution agreements are frequent, since both 'have used the competitive process as a focal point.'[21] While the former typically regulates the relation between the contracting parties and the reasonableness of agreements, the latter regulates the possible external effects of those same contracts.[22] This would seem to suggest that the conflicts arising in the dealer–manufacturer relationship should be addressed via contract law and not antitrust, which ought to focus on the repercussions of the agreements on competition.

[18] Of the 80 nations with competition laws, 56 have adopted the regulation in the late 20th century, as in 1960 there were only 24 nations in the world that had competition law rules.

[19] *Continental TV Inc v GTE Sylvania Inc* 433 US 36 [1977].

[20] By 'the Communities' the author refers to the three communities established in the 1950s in Europe: The European Coal and Steel Community (Treaty of Paris 1951), The Euratom (Treaty of Rome 1957) and the European Economic Community, which later became the European Community (Treaty of Rome 1957).

[21] C Joerges, 'Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations Between Automobile Manufacturers and their Dealers in Germany' (1985) *Wisconsin Law Review* 593.

[22] ibid 594.

Following this logic, the US has typically addressed dealer protection issues arising from these agreements through legislation both at the federal and the state level, while at the same time controlling the possible negative effects of territorial protection on competition through antitrust. This originally led to inconsistencies between the two disciplines, since the dealers' weak position in their relationship with the manufacturers they serve needed to be safeguarded, while at the same time the territorial privileges granted to them by producers to prevent the risks posed by free-riders was considered unlawful as a consequence of the consequential restriction of intrabrand competition. The possible tension was overcome with the 'new economics' approach to competition, which focuses on interbrand competition thus generally approves territorial protection as long as there is no market power involved. In Europe, however, a different approach is followed; of particular importance is the fact that Regulation 1400/2002, the specific block exemption for motor vehicle distribution, actually includes some provisions that are clearly addressed at protecting dealers. The requirements that need to be included in dealership contracts regarding, inter alia, termination and duration of the agreements. While there may be some fairness considerations in this logic, it is questionable that it is adequate and legitimate to force the inclusion of such protection in order to grant an exemption from the Article 81(1) prohibition. At first sight, it would appear that issues may be better left to the national contract law provisions.

A The limits of contract law in regulating dealer–manufacturer relationships

A question that remains to be answered is whether contract law may be a better tool than antitrust for controlling possible dealer abuses. A study of the US car sector provides an illustrative example. In the United States, the problems arising in the dealer–manufacturer relationship on the basis of their franchising agreements have often been challenged before the courts, and this led to the enactment of statutes in the different Member States which attempted to grant protection for what is normally considered the weaker part of these agreements. As Rogers, Kenworthy and Macaulay observe, expenditures on legal services have increased among all three major categories of law 'consumers'—business, individuals and government—businesses being the 'primary consumer in the rapidly expanding legal services market.'[23] Therefore, a general rise in contract law litigation can be perceived in America since the 1970s, which as Macaulay observes has become a greater part of large elite corporate law firm practice.[24] The litigating trend has also

[23] L Kenworthy, S Macaulay and J Rogers, '"The More Things Change . . .": Business Litigation in the America Automobile Industry' (1996) 21 *Law & Social Inquiry* 3, 632.

[24] This is partly due to the fact that most corporations now have legal services, as well as the emergence of big law firms which act worldwide. In turn, the rise in litigation has led to alternative ways of dispute resolution. See S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 179–237.

affected car dealerships. The contractual aspects of car franchises have proven to be a source of conflicts and tensions ever since the early days of motor vehicle distribution. Through their dominant economic position, the manufacturers have employed the franchise to gain maximum control over the management of the dealers' business without corresponding 'legal' responsibility. The modern franchise enables the manufacturer to wield great 'vertical power' in the form of supervisory control over retail operations.[25] In these circumstances, it seems logical to think of looking for some sort of protection in the sphere of contract law for dealers. However, it took the courts a long time to act for the dealers on the basis of contract law. In the *Ford Motor* case,[26] the federal court held that, even if the dealer was disappointed in his expectations, there was no evident breach of contract which would justify awarding damages. As is typical of the US and European common law regimes, contracts were given a literal interpretation and all their clauses were treated as law between the parties, disregarding good faith considerations.

The problems relating to the relationship between manufacturers and dealers have been of varied nature. In the early days, for instance, it was common to include a clause in the contracts which required dealers to invest their best efforts in the development of the territory.[27] This meant that the manufacturer had to be satisfied with the dealer's performance. This requirement relies upon the subjective concept of satisfaction, which presents difficulties when it comes to measuring it. The judgement of the manufacturer had replaced that of the dealer on retail merchandising operations typically reserved to the retailer's judgement, which allied to other investment requirements and obligations left the dealer in a vulnerable situation. Tying clauses were also frequent. Since 1942, there are no express provisions in the franchises tying the dealer to the manufacturer's products, but the practice this practice continued to a substantial degree.[28] As for the duration and cancellation of the contracts, it was normally provided that the franchise would terminate at the end of a model year, but manufacturers retained the right to cancel on the basis of a cause.[29] Even when a contract had the semblance of a permanent agreement, it could be terminated by either party without cause, with short notice.

The abundant case law reveals constant attempts on the part of the dealers to break the vertical power of the manufacturer conferred on it by virtue of the franchise contract. Abuses, such as non-delivery or the invasion of the dealer's territory, were common.[30] In the 1950s, these situations gave way to damage suits by dealers

[25] JC Palamountain, *The Politics of Distribution* (Cambridge, MA, Harvard University Press, 1955).

[26] *Ford Motor Co v Kirkmeyer Motor Co* 65 F 2d 1001 (4th Cir, 1933)

[27] It was also common to require a minimum number of cars, but this type of obligation was soon abandoned.

[28] Staff Report of the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 84th Congress, 2nd Session (1956), cited in F Kessler, 'Automobile Dealer Franchises: Vertical Integration by Contract' (1957) 66 *Yale Law Journal* 8, 1135–90.

[29] *Erskine v Chevrolet Motors Co* 185 N C 479, 117 S E 706 (1923).

[30] eg *Schiffman v Peerless Motor Car Co* 13 Cal App 600, 110 Pac 460 (1910); *Randall v Peerless Motor Car Co* 212 Mass 352, 99 N E 221 (1912); *Dildine v Ford Motor Co* 159 Mo App 410, 140 S W 627 (1911).

against manufacturers for 'wrongful' termination of a franchise contract, failure to deliver cars ordered before the franchise was effectively cancelled or failure to deliver in accordance with a separate agreement. The response of the manufacturer to the intervention of the courts and the legislator was an attempt to draft franchise clauses insulating them from liability and measure of damages. The main argument for the manufacturer was that a franchise marked by the absence of indefiniteness of obligations is not a valid and enforceable contract. Many courts upheld this until the late 1930s, when courts found the 'provisions and the acts of the parties are consistent only with the existence of a contract imposing some reciprocal conditions and at least binding upon the parties to some extent.'[31] The manufacturers claim that, even if it is true that the dealers have a disadvantageous position, it is because of their own will, as they freely assume franchising obligations.

Even if on a case-by-case basis the courts on occasion managed to contribute to balancing the situation in favour of the dealers in the actual clauses of the contracts, Macaulay rightly argues that one important problem has remained unsolved.[32] The terms of the contract do not always faithfully reflect reality, because they do not show the manner in which the contract is effectively administered. Once the dealer has committed his capital and entered the business with the manufacturer, the power of the manufacturer comes into operation. American ideology, culture and law focuses on individuals,[33] but as Macneil's relational theory emphasises often it is only when long-term relationships, social fields and private governments are examined that it is possible to have a complete perspective.[34] Human interactions, which are at the end of the day underlying any contract, are usually founded on trust, good faith, solidarity, role integrity and mutuality. This, according to Macneil, impacts upon theories about the law and functioning legal systems, to the extent that social fields can blunt enforcement of laws and transform their practical meaning.

In common law systems, however, the legislators and the courts tend to fail to consider good faith and adhere to a literal interpretation of the contracts. This justification for this approach is that traditional contract law tends to focus on the formation of agreements, where good faith plays a limited role.[35] The parties decide on how best to regulate their activities and allocate risks for the entire duration of the contract. If disputes arise during the life of the contract, the plan set out in the original agreement is analysed, and any posterior circumstances are largely ignored. Therefore, the terms 'contract' and 'agreement' are understood to refer

[31] *Kane v Chrysler Corp* 80 F Supp 360, 362 (D Del, 1948).

[32] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 179.

[33] ibid 180.

[34] IR Macneil, *The New Social Contract* (New Haven, Yale University Press, 1980). IR Macneil, 'Relational Contract: What We Do and Do Not Know' 1985 *Wisconsin Law Review* 483.

[35] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 184.

only to the formal text of the document signed by the parties and its literal meaning, excluding the validity of any reasonable expectations the document may have created.[36] This view, somewhat mitigated by neoclassical contract law,[37] overlooks the fact that normally, at the time of entering into an agreement, the parties are vague and general about obligations and contract provisions. It is likely that, even if the parties wished to leave all knots well tied, they are unable to as the circumstances may well change and flexibility is needed so that adjustments can be made over time. In this sense, Mathewson and Winter emphasise how the contract is bound to be incomplete.[38] If all decisions could be completely specified in an explicit agreement, franchisor and franchisee could guarantee their joint profit maximisation at the start of the relationship.[39] Failure to sense the need to take into consideration the context of agreements and possible implicit norms on the part of the courts can have bad consequences for dealers, as 'parties treat their contracts more like marriages than like one-night stands.'[40]

In Feinman's view, adhering to a literal interpretation has seen the courts squander an opportunity to develop modern contract law,[41] and therefore the American legal tradition does not adequately react to interferences in long-term contractual relationships. Whether or not courts and agencies should enter into a valuation of such circumstances is however a much more complex issue. It is not always easy to determine what could be considered rational dealers' expectations, and the costs of a legal system which entered into the valuation of such circumstances could be enormous. Whitford has on occasion referred to the difficulties involved in making decisions on the basis of good faith, due cause and reasonableness.[42] In this sense, the difficulty to evaluate implicit norms, which would lead to a better enforcement of contracts, is hampered by the limits of the law. 'Usually, a dealer only reads the agreement when he's in trouble.'[43] Holding dealers responsible to read and understand their franchise document, as Macaulay argues, eases the burdens on franchisors and courts.

Given the insufficient protection granted by the courts in the view of the dealers, their lobbies fought a long battle to pass legislation to limit the control of

[36] ibid.

[37] Macaulay observes how neoclassical contract law imposes some exceptions designed to bring contract law closer to the reality of modern business practices.[38]Unfortunately, it is not clear when the general body of law applies and when the exceptions come into play: ibid. For a criticism of Macneil's lack of rejection of neoclassical contract law, see D Campbell 'The Social Theory of Relational Contract: Macneil as the Modern Proudhon' (1990) 18 *International Journal of the Sociology of Law* 75.

[39] GF Mathewson and RA Winter, 'The Economics of Franchise Contracts' (1985) 28 *Journal of Law and Economics* 3, 504.

[40] ibid. In this sense, Mathewson and Winter argue that incomplete contracts digress from joint-profit maximisation, and thus deviate from what would be a first best world. Klein suggests however that completely explicit contracts are not feasible, as some aspects of the relationship are difficult to measure. See AW Dnes, *Franchising: a Case-study Approach* (Aldershot, Ashgate, 1992).

[41] RW Gordon, 'Macaulay, Macneil and the Discovery of Solidarity and Power in Contract Law' (1985) *Wisconsin Law Review* 565, 569.

[42] JM Feinman, 'The Significance of Contract Theory' (1990) 58 *University of Cincinnati Law Review* 545, 551.

[43] It is particularly difficult for legal agencies, who do not have the resources to gather enough facts, see all interests, make necessary judgements.

franchisors over franchisees, particularly after the Second World War when manufacturers began to pressure dealers to sell under the threat of cancelling their franchises.[44] Eventually, the Uniform Commercial Code (UCC) started to apply to problems in distribution.[45] By the late 1950s, 20 states had already adopted statutes regulating the distribution of motor vehicles with the aim of eliminating unfair practices inflicted by manufacturers.[46] Wisconsin was the pioneer state in this regard, and most other statutes are largely inspired by the 1935 Wisconsin Act,[47] which labels as wrongful some abusive conduct on the part of the manufacturer and its representatives.[48] The sanctions imposed for such practices vary from denial, suspension or revocation of the licence of the infractor to even criminal penalties. Those dealers affected can also bring civil actions for damages. The statute is administered by an independent agency with an advisory board of dealers available for consultation. Almost 20 years later, the 1953 Oklahoma Act established the creation of a Motor Vehicle Commission for the administration of the statute, which would be composed of seven dealers or people who had previously been involved in car retailing.[49]

These statutes encouraged the US Congress to adopt the Day in Court Bill or the Automobile Dealers Franchise Act (ADFA) of 1956,[50] which, from a contractual perspective, attempts to solve the cancellation of franchises and introduces a requirement of 'good faith'. The latter was to be understood as the

> duty of each party to any franchise . . . to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threat of coercion or intimidation from the other party. . . . [R]ecommendation, endorsement, exposition, persuasion, urging or argument shall not be deemed to constitute a lack of good faith.[51]

[44] D Smith, Chairman of the NADA's GM line group, cited in M Krebs, 'GM Maps Franchise for 90s' (1989) *Automotive News* 1.

[45] One example of these lobbies is the National Automobile Dealers Association (NADA). The NADA was founded in 1917 to exercise group action for the dealers. It was the pioneer dealers' association to lead such a campaign, and its success served to encourage other dealers associations to follow its footsteps.

[46] Art II of the Uniform Commercial Code was passed by all but one of the American state legislatures before the end of the 1970s. S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 193 *ff.*

[47] Unfair termination of franchise by the manufacturer is the priority of the statutes, which impose sanctions that vary from fines to the loss of licence or the dissolution of the firm.

[48] It was amended in 1937. S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 197.

[49] These include forcing dealers to accept the delivery of products which had not been ordered, compelling them to do anything under the threat cancellation of the franchises the dealer's franchise, or cancelling franchises without cause.

[50] According to Brown, such an initiative blurs the line between the public and private governments. See GM Brown, 'State Motor Vehicle Franchise Legislation: A Survey and Due Process Challenge to Board Composition' (1980) 33 *Vanderbilt Law Review* 385, 432–33.

[51] 70 Statute 1125 (1956) 15 USC § 1222 (1958). This statute however does not exclude the application of the relevant state legislation regulating car franchises. Therefore, the statutes of the different states remain in force.

The ADFA also has antitrust implications, as it upholds and defends the territorial exclusivity granted to the dealers in car franchise agreements. As a consequence, by the mid 1980s most states had some type of restriction on terminating or failing to renew dealers' franchises. The legislation does not forbid franchisors from terminating franchise agreements altogether, and they are still able to do so when a clear justification exists. In such cases, dealers will not succeed in challenging the manufacturer's decision before the courts. In other more ambiguous situations, it may still be possible for the manufacturer to cancel the contract, but it will have to offer the dealer the possibility of selling his business to another party or having the manufacturer buy out his franchise.

Nowadays, car franchising agreements tend to impose fewer obligations on dealers than they did in the early days. The actual impact of such legislation on this evolution and the effective protection of dealers is, according to Macaulay, not easy to determine, given the limited information available.[52] The scarce case law—only an average of five cases a year under the ADFA is reported and few appeals under state statutes can be found—points to a limited interpretation of the above-mentioned statutes by the courts, and few dealers have actually won cases related to this legislation. These data may, however, be misleading, as according to Macaulay there could well be a gap between law in the books and the law in action and some dealer protection statutes may be enforced in such a way that the dealer always wins. Besides, those cases where dealers are most likely to be successful are probably settled before they reach the courts, and records of proceedings before state administrative agencies are not easily accessible.[53]

Some of the information available seems to indicate that the impact of the statutes on the transformation of car dealerships was rather limited. When interviewed by Macaulay, dealer trade association representatives questioned the effectiveness of the statutes.[54] However, motor vehicle dealer trade associations worked to get these statutes passed in the 1970s and 1980s. In a similar way, Smith found a 15.3 per cent reduction in the number of new car dealerships between 1954 and 1972, which led him to conclude that the effect of legislation 'is fewer dealerships and increased market power resulting in higher prices. The impact appears

[52] The original bill proposed by NADA defined good faith as the 'duty of the automobile manufacturer . . . to act in a fair, equitable, and nonarbitrary manner so as to guarantee the dealer from coercion or intimidation, and in order to preserve and protect all the equities of the automobile dealer which are inherent in the nature of the relationship between the automobile dealer and the automobile manufacturer'. Eisenhower's administration stated that, in the protection of dealers against pressures from the manufacturer, the advantages of competition for consumers could not be affected. S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 198.

[53] ibid 200.

[54] For instance, Wisconsin had an informal enforcement system by virtue of which any dealer cancellations had to be presented to the Executive Director of the Wisconsin new car dealers' trade association, which could provide dealers with expert legal help. Besides, in order to avoid formal hearings, the officials of the Motor Vehicle Department held mediating pre-hearings. Nowadays manufacturers have internal units (such as Ford's Dealer Policy Board) which offer dealers second chances and compromise settlements.

mitigated somewhat by increased scale economies arising from restricted entry.'[55] This claim could be ambiguous, as the decrease in the number of franchises could be a consequence of other factors. In fact, Macaulay claims that in the 1960s manufacturers embarked upon a policy of closing small dealerships and focusing on big ones as a result of efficiency considerations. In addition to the data gathered by Macaulay and Smith, some authors have emphasised how dealer-protective legislation may have negative effects for manufacturers, who have to face additional burdens.[56]

Despite these concerns, which do not always rest on reliable undisputed data and are based on assumptions, the merits of the legislation cannot be ignored. In this sense, Macaulay argues how even

> symbolic legislation can have an indirect impact on behavior. Franchisee organizations are not without resources . . .. If a franchisor behavior is too outrageous, franchisees can use this conduct as an atrocity story in legal battles. This possibility alone may affect franchisor behavior and deter some abuses, at least when the gains from outrageous behavior are not too great.[57]

Therefore, whereas before the enactment of the statutes the courts' literal interpretation of the agreements rarely granted protection to the dealers, franchisees' interests can now be safeguarded against clearly unfair violations and abuses. They also prepare the ground for relational contract law to play a role—albeit limited—in the evaluation of the clauses of agreements. Up until now, the courts have opted for a very restrictive interpretation of the statutes in an attempt to grant legal certainty. It is in the hands of the courts to develop a sounder application of these provisions.

In addition, the case law would not reflect improvements on the bargaining position of the dealer in the negotiations of the franchise. The statutes are likely to have evened the unbalanced manufacturer–dealer relationship, provided that the dealer is aware of their existence. Another important consequence of this regulation is that it encouraged manufacturers to introduce changes to the terms of their franchises while they were attempting to block the entry into force of the statutes. Macaulay rightly argues that such modifications may have been more beneficial for dealers than the actual legislation. Finally, the alternative dispute resolution methods contemplated in the statutes are also worthy of appraisal. Litigation is expensive and can be distressing, and the possibility of avoiding such an arduous process and still offer protection for dealers is certainly beneficial.

[55] S Macaulay, *Law and the Balance of Power: The Automobile Manufacturers and their Dealers* (New York, Russel Sage Foundation, 1966). Nevertheless, Macaulay clarifies later that motor vehicle dealer trade associations fought to get these statutes passed in the 1970s and 1980s, after his interviews took place. S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 200.

[56] RL Smith, 'Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution' (1982) 25 *Journal of Law and Economics* 125 *ff.*

[57] See MJ Lockerby, 'Franchise Termination Restrictions: A Guide for Practitioners and Policy Makers' (1985) 30 *Antitrust Bulletin* 791.

At this point, one might ask oneself about the adequacy of the law as a possible solution to the problems faced by dealers. As mentioned above, the legal system involves high costs and limited guarantees of success. In this sense, legal action can serve to enhance the dealer's weak position, as '[a]lmost always, franchisors are better able than franchisees to hire lawyers, lobbyists and expert witnesses as well as make campaign contribution to friendly legislators. Most franchisors are large corporations, some of them are the largest in the Americas if not the world.'[58] Macneil is therefore sceptical about legal action as a solution to relational problems. He observes that ordering manufacturers what to do and forcing them to act against their wish may encourage a feeling of resentment which could lead them to seek evasion and coping strategies which threaten the norms of co-operation. Macaulay, on his part, emphasises how contract law in action is a defective product, promising far more than it can deliver:

> The American legal system offers almost unlimited opportunities for opposing interests to wage a long-term war, but it is not a neutral battlefield. . . . It is easier to block legislation than to get favourable statutes enacted. It is easier to persuade legislators to pass statutes that are largely symbolic than to enact laws with real teeth. Judges, too, avoid generating new theories and expanding old ones to cover new situations.[59]

B Competition Law and the External Effects of Vertical Agreements

The security granted to dealers by the legislation introduced to regulate franchise contracts was often criticised for providing a means of lessening competition in the chain of distribution: protecting the middle person from the risks of competition, some believed, could happen at the consumer's expense.[60] This notion is based on neoclassical conceptions of competition, which did not take into consideration the advantages of limiting intrabrand competition to enhance interbrand competition. In such a context, territorial exclusivity clauses introduced in franchise agreements to grant the dealer protection from free-riders and the exclusive representation requirement which forbid dealers to sell more than one brand have an impact on competition.[61] These types of provisions were recurrent in franchises since the 1920s.[62] Even then, exclusivity requirements were moderated as manufacturers began reserving for themselves the right to sell directly within the dealer's territory, as well as the right to appoint other dealers within that territory.

[58] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 236.

[59] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 336–37.

[60] ibid 189.

[61] RL Smith, 'Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution' (1982). 25 *Journal of Law and Economics* 125 *ff.*

[62] FTC, *Report on Motor Vehicle Industry* (1939).

Between 1949 and 1952, the Antitrust Division of the DOJ forced the industry to drop both territorial security and exclusive representation clauses as express terms of contract. Dealer thus lost the benefits of territorial security, but did not cease to be the exclusive representatives of the manufacturers.

The importance of antitrust in the reshaping of distribution systems in the US is reflected mainly on two different levels: private action and government intervention. As regards the former, any actions taken give a limited perspective of the situation as they only occur in cases where a dealer's franchise has been cancelled. Those dealers which have existing contracts do not seem to resort to legal action against the manufacturer, which dwells on the idea of profit-sharing between franchisors and franchisees and the mutual benefits for both parties in the agreement. This limitation makes it difficult to establish antitrust violation by the manufacturer. The importance of the role of the courts was analysed in chapter 3, where the landmark cases were closely examined.[63] On the other hand, government attempts to regulate franchises in order to protect competition need closer examination. In the early days, the view of the American legislator and the courts was that antitrust could also be used to balance the relationship between the dealer and the manufacturer—very much like the current European regime—and also to protect consumers from the abusive prices that might exist in a situation of exclusively assigned territories.

i Government intervention

In the US, the adoption of legislation on the antitrust connotations of distribution agreements dates back to the late 1930s, when the FTC conducted an investigation of automobile distribution to find out the extent to which franchising could be detrimental for antitrust. As a result, the FTC published a report in 1939 in which it claimed that, although the wording of such contracts would not necessarily harm competition, some of their clauses could 'lend themselves to illegal practices'. Specifically, exclusivity clauses were estimated to pose potential threats. The interest in introducing such restrictions in the first place on the part of manufacturers and dealers are obvious: a car maker prefers that its dealers concentrate on selling only its vehicles and spare parts. At the same time, if the dealer is going to undertake such an obligation, he will want to evade the possible competition he could face if others are allowed to sell the same cars in his territory.

The FTC report led to some specific actions. For instance, proceedings were brought against GM regarding some of its tying obligations and exclusivity requirement, and in 1942 a cease and desist order forced the manufacturer to remove the obligation it imposed on dealers to buy only GM or GM-approved parts.[64] However, although such requirements were forbidden in the contracts, in

[63] RA Heuerman, 'Dealer Territorial Security and "Bootlegging" into the Auto Industry' (1962) *Wisconsin Law Review* 486.

[64] See ch 3, s I above.

practice manufacturers managed to hold on to exclusive representation by exercising their power over dealers in different ways. For instance, they would threaten to cancel the franchise of dealers who resorted to multibranding, even though no specific exclusivity clauses appeared in the agreements. As a result of the literal interpretation of agreements upheld by the courts and their lack of consideration of such relational contract issues, manufacturers still managed to get away with these practices, which were also very difficult to prove.[65] Therefore, the elimination of restrictive clauses favouring the manufacturer was largely supplanted by restrictive practices which escaped the control of the FTC and the courts.

The consequences of the prohibition of exclusivity on the dealers were ambiguous. As a consequence of the disappearance of those clauses forcing dealers to commit to one brand, provisions which protected the territorial exclusivity of dealers were also threatened, and the increase in intrabrand competition was not welcomed by the dealers. In 1954, only two years before the ADFA was passed, NADA started a movement to have antibootlegging or comparable provisions reinserted in their franchise agreements in a way that they could be reconciled with antitrust law provisions.[66] Dealers were not the only ones with an interest in such clauses, as manufacturers were still keen to avoid multibranding. The DOJ however refused to cease prosecuting those manufacturers who imposed such restraints, and some attempts to adopt antibootlegging state legislation were declared unconstitutional.[67] The government, on its part, clearly opposed to the introduction of legislation permitting territorial security and antibootlegging provisions, and in the process of adoption of the ADFA the hearings in the House of Antitrust Subcommittee only supported the hostility towards clauses granting absolute territorial protection. It was believed that appointing various dealers in one area was a competitive way of improving car distribution,[68] and thus no laws could uphold such anticompetitive restrictions.

The prohibition of territorial protection was backed by some leading academics. Heuerman, for instance, argued that

> [t]he inherent objectives of territorial security and anti-bootlegging, and the means of attaining them, are not only inconsistent with long established, well-founded precepts in the field of antitrust, but also are in conflict with those propositions on which our free enterprise system is founded.[69]

Marvel, to criticise exclusive dealing clauses, distinguishes these restrictions from other vertical restraints, and argues that the former is but an excuse to 'create a

[65] *General Motors Corp* 34 FTC 58 (1941), modified 34 FTC 84 (1942).

[66] See *US v General Motors Corp* 121 F 2d 376 (7th Cir).

[67] The term 'bootlegging' in this context refers to 'the practice of a franchise dealer's selling new cars at distress prices to a nonfranchised new car discounter'. RA Heuerman, 'Dealer Territorial Security and "Bootlegging" into the Auto Industry' (1962) *Wisconsin Law Review* 486, 487.

[68] See *Rebsamen Motor Co v Phillips* 226 Ark 146, 289 S W 2d 170 (1956), cited by RA Heuerman, 'Dealer Territorial Security and "Bootlegging" into the Auto Industry' (1962) *Wisconsin Law Review* 486, 489.

[69] This is reflected in the letter from the Deputy Attorney General Warren Olney to the House of Judiciary Committee, ibid.

property right to information concerning potential customers for a manufacturer's product.'[70] Accordingly, the 'dealer-services explanation is valid only where exclusive dealing is combined with customer and/or territorial restrictions.'[71] Even so, some dissenting views were expressed, such as that of the Deputy Attorney General Rogers, who focused on the large investments dealers must incur and the need for rewarding such costs. In that sense, it seems logical that the manufacturer would aim at protecting the dealer's profits rather than just concentrate on selling as many cars as possible.

Eventually, the views changed. Despite continuous frustrated attempts to see exclusivity been declared lawful under antitrust, the NADA never ceased in its battle against the per se treatment. Already in 1961, 16 years before *Sylvania*, a bill was introduced before the New York House of Representatives intending to exempt the granting of territorial security for automobile dealers and the prohibition imposed on them to sell cars to non-authorised third parties for resale purposes from the application of antitrust provisions.[72] This legislation, known as HR 1212, amended the FTC act so that territorial exclusivity and antibootlegging clauses could be considered legal. At the time, the 'big three' US car manufacturers dominated the market, but had begun to face robust competition from foreign brands, which made it necessary for them to rethink their distribution practices, and forced policy makers to reassess their position. Also, innovation eventually transformed the way cars were distributed, and in the 1980s, states also began to adopt legislation regarding restrictions imposed on manufacturers appointing a new dealer in an existing dealer's area without good cause. Such changes opened the door for multibranding and the legality of granting territorial protection.

ii Is there a conflict between the interests of dealers and consumers?

In the context of our analysis of contract law and antitrust regulation of franchises,[73] the question arises as to whether or not dealer protection has come at the consumer's expense. When examining the protection granted to dealers by the legislation enacted to avoid possible abuses on the part of the manufacturer, one comes across claims that such a shield could bear negative impacts on competition. In fact, some data reflected a decrease in the number of franchises since the enactment of the protective statutes, which some believed to be a consequence of this legislation—despite the lack of direct proof. In the author's view, these worries are founded on an erroneous conception of competition and its aims. In previous chapters, the goals of competition and the importance of economic

[70] ibid 499.

[71] HP Marvel, 'Exclusive Dealing' (1982) 25 *Journal of Law and Economics* 1, cited by CJ Joerges, E Hiller, K Holzscheck and H-W Micklitz, *Vetriedbspraktiken im Automobilersatzteilsektor* (Frankfurt, Peter Lang, 1985) 367.

[72] ibid.

[73] H R 1212, 87th Congress, 1st Session (1961). See, inter alia, RA Heuerman, 'Dealer Territorial Security and "Bootlegging" into the Auto Industry' (1962) *Wisconsin Law Review* 486; F Kessler, 'Automobile Dealer Franchises: Vertical Integration by Contract' (1957) 66 *Yale Law Journal* 8, 1135–90.

analysis to adopt adequate efficient competition policies were explored. Considering the findings hereby obtained, it is dubious that competition can be equated to a high number of dealers. In fact, nothing prevents an increase in competition in a situation where there are fewer dealers with more power. The key question that needs to be considered is if dealers of other substituting brands are also active in that territory. Again, as long as interbrand competition is strong, the reduction on the number of dealers need not bear negative consequences on prices for consumers.

It is therefore unlikely that the restrictive position of the early antitrust case law on franchises and their restrictions implied beneficial consequences for consumers. In scenario described above, multibranding was achieved; whether or not it was as a direct consequence of antitrust intervention remains far from clear. Furthermore, in the *General Motors* case, GM attempted to justify the restrictions introduced in its contracts on the basis that distributors provide parts and services at convenient locations, and the maintenance of a strong service system allowed GM to provide through warranty and free repair services on recently purchased automobiles through its dealers. There was evidence that the automobile purchasers buying through discount houses did not receive the same level of service as purchasers buying through franchise dealers. Hence, the benefits for consumers of prohibiting dealer protection are at best questionable.

In order to reconcile dealer protection and consumers' interests, the best alternative appears to be that no regulation or court decision should artificially protect dealers from market forces. Otherwise, the consequence will be inefficiency, and higher prices could result. Despite these observations, the effects of exclusive representation remain ambiguous. On the one hand, they give the dealers the opportunity to make profits from their investments and increase the producers' capital without any additional investment, therefore allowing him to expand. On the other hand, if all dealers in one area are bound by such contractual clauses, new entrants to the market may find it difficult to find somebody willing and able to agree to sell their products. Therefore, if there is such a market failure, then the law may play an important role in allowing market access for newcomers. In the case of the car sector, competition remains strong not only between the big three, but also between them and foreign car makers from Japan and Europe.

II REBALANCING THE DEALER–MANUFACTURER RELATIONSHIP

A The myth of the almighty manufacturer: towards a restoration of the equilibrium

The conflicting pressures of franchise legislation and antitrust somehow exerted an important role on the transformation of distribution systems in the US. Nonetheless, beyond the law other circumstances may well have encouraged the changes that took place in car distribution in the US. Kenworthy, Macaulay and

Rogers provide us with a detailed overview of the situation.[74] The market for automobiles continued to grow at a steady pace until 1972, when profit rates for the industry averaged above the US manufacturing sector as a whole.[75] In a period of 12 years, the production of cars in the US experienced an increase of three million units—from 8 million in 1960 to more than 11 million in 1972. Already back then, the 'big three' held the American automobile market largely to themselves, since most of the smaller independent manufacturers had been forced to merge or close in the 1950s.[76] American Motors Corporation, formed by the merger of Nash and Hudson in 1954, only accounted for three per cent of US car sales in the 'sixties. The big three's share of the American market remained large and stable during these years, with overall market share of 45–50 per cent for GM, 22–26 per cent for Ford and 12–16 per cent for Chrysler.[77]

Worldwide, however, the situation was less rosy for US car makers. During the same period of time, US automakers went from a 48 per cent share of the world's motor vehicle production to 33 per cent. This decrease happened despite the emergence of new markets for cars in Western Europe and the former USSR, since American cars faced strong competition in those markets posed by domestic producers, which also forced US firms to comply with the restrictions and product regulations of their governments. In figures, the US balance of trade in automobiles and their spare parts fell from a surplus of $2.2 billion in 1964 to a deficit of $4.3 billion in 1972. It was since 1972 that competition from foreign brands began to impact upon the US domestic car market. Up until then, the share of imports had gradually increased, and by 1971 it had reached 15 per cent. Between 1967 and 1975 the share of import cars doubled from nine to 18 per cent, and by 1987 it had reached 31 per cent. This leads to an increase in interbrand competition in the seventies, when Japanese carmakers such as Toyota, Honda or Nissan had become an important factor in the American car market.[78] Therefore, those exclusive dealers assigned to the different territories may have squandered competition from free-riders, but now they faced strong competition from other brands. This pressure on US manufacturers, which suffered a decline in their performance in terms of market share and profits,[79] may have forced them to adopt new less restrictive

[74] See also F Kessler and RH Stern, 'Competition, Contract, and Vertical Integration' (1959) vol 69 no 1 *Yale Law Journal* 1–130.

[75] L Kenworthy, S Macaulay and J Rogers, '"The More Things Change . . .": Business Litigation in the America Automobile Industry' (1996) 21 *Law & Social Inquiry* 3, 634.

[76] Profit rates during these years averaged 13 %, while the profit rate for US manufacturing as a whole averaged 10 %. See R Candall, 'Import Quotas and the Automobile Industry: The Costs of Protectionism' (1984) *Brookings Review* 8, 10.

[77] Kaiser, Willys and Studebaker had merged, while Studebaker-Packard continued to produce until 1966.

[78] L White, *The Automobile Industry since 1945*, (Cambridge, Harvard University Press 1971) app, cited by L Kenworthy, S Macaulay and J Rogers, '"The More Things Change . . .": Business Litigation in the America Automobile Industry' (1996) 21 *Law & Social Inquiry* 3, 636.

[79] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 203.

distribution strategies, in which the priority is to efficiently deliver products to end consumers avoiding unnecessary costs to be able to remain competitive.

Further pressure was placed on the industry by changes in consumer preferences during the seventies.[80] The product market experienced a sudden dramatic shift towards smaller cars and a general increase in variability and volatility, mainly as a consequence of the general macroeconomic instability and the oil price shocks of the decade. The preference for small cars benefited European and Japanese car makers, but US manufacturers had to adapt to the new demand. In addition, as Carstensen observes, the radical changes of transportation and communications have had an impact on the manufacturer–dealer relationship.[81] Advertising has gone from newspapers and pamphlets to television and radio ads, and more recently the Internet has completely revolutionised not only advertising trends, but also the way transactions are carried out creating a real worldwide forum to buy and sell products. These innovations have decreased the costs of advertising and have challenged the traditional territorial exclusivity of franchises.

Additionally, such technological advances are complemented by the appearance in the 1950s of almighty distributors in the shape of department stores and shopping centres.[82] This trend not only affects distribution in the car sector but everywhere, as the potent new dealers not only offer new efficient ways of selling products; their strong position also means that they possess power to bargain and negotiate on a more even basis with the manufacturer when signing distribution agreements. In the car sector, the appearance of powerful dealers took a little longer to be noticeable than in other sectors, but currently in the US it is common to see large car dealers which sell various brands of automobiles.[83] In this sense, since the 1960s, manufacturers have followed a trend to close small dealerships in rural areas, as they found it more efficient to deal with fewer but larger dealers who order both cars and parts in large quantities. Therefore, there are now fewer dealers with more power in relation to the manufacturer. This coincides with a tendency to refrain from granting dealers territorial exclusivity, as manufacturers gradually began reserving for themselves the right to sell directly within the dealer's territory, and also the right to appoint other dealers within that territory.

Territorial price discrimination in the US has never been as big an issue as in the EU. Although price differences do exist,[84] they are not as significant as those existing within the European territory. This is mainly because greater integration

[80] L Kenworthy, S Macaulay and J Rogers, '"The More Things Change . . .": Business Litigation in the America Automobile Industry' (1996) 21 *Law & Social Inquiry* 3, 632.

[81] ibid.

[82] PC Carstensen, 'Vertical Restraints and the Schwinn Doctrine: Rules for the Creation and Dissipation of Economic Power' (1976) vol 26 no 4 *Case Western Law Review* 771–860, 774.

[83] J Stuyck, and T Van Dyck, 'EC Competition Rules on Vertical Restricitions and the Realities of a Changing Retail Sector and of National Contract Laws' (2002) (draft) Proceedings of the Secola Conference, London School of Economics, London, 16–17 May 2002. PC Carstensen, 'Vertical Restraints and the Schwinn Doctrine: Rules for the Creation and Dissipation of Economic Power' (1976) vol 26 no 4 *Case Western Law Review* 771–860, 775.

[84] For instance, this is the case of Zimbrick in Madison, Wisconsin. There are even chains of dealers, which reflect the increase in power.

exists, and the barriers which exist in Europe (such as language, cultural, economic, etc) are unknown in the US. In addition, new transportation methods have improved the mobility of consumers, and any chance of price discriminating through territorial exclusivity is even more limited, given consumers' ability to travel to other points of sale.[85] However, manufacturers and their dealers employ ways of implementing price discrimination other than territorially. In particular, differentials are introduced by having different purchase incentives for consumers.[86] Nonetheless, price discrimination remains a rather unproblematic issue in America.[87] Seemingly low prices can be combined with high financing charges, and many consumers will not see that they have been actually induced to pay higher prices in the long run.

In the resulting scenario, new concerns call for government intervention. In 1966, safety regulations for motor vehicles were introduced, which imposed important economic burdens on manufacturers. Besides, emerging environmental concerns (regarding the pollution caused by motor vehicles and manufacturing techniques) also resulted in additional legislation with further obligations and costs for manufacturers. Allied to that, the dramatic increase of competition, instability and uncertainty gave way to a general increase in litigation.[88] In such a context, the decisions of the courts and the legislation enacted to protect the dealer on one hand and protect consumers and competition on the other acquire particular relevance, as seen previously.

New technologies have also contributed to rebalancing the relationship between manufacturers and distributors. In addition to the figure of the almighty superstore chain, the Internet has led to the establishment of new atypical dealers which are defying the traditional distribution channels.[89] The Internet has served to cut many of the regular costs dealers had to incur before. It is no longer essential to have a physical outlet where the goods are sold, a mere warehouse to store the goods until they are shipped is enough. Also, fewer staff are required, and advertising is much easier and more economic through the Internet. It can also be used to provide technical support and conduct consumer surveys to verify satisfaction.

[85] For instance, in the *General Motors* case, analysed above, it was shown that retail prices of Chevrolet dealers in Orange County were higher than those of Chevrolet dealers located in other parts of the Los Angeles metropolitan area (DOJ brief, 21-3). *US v General Motors Corp* 384 US 127, 86 S Ct 16 L Ed 2d 415 [1966].

[86] Posner emphasises that market divisions do not necessarily have to have an impact on price. R Posner, *Antitrust Law: an Economic Perspective* (Chicago, University of Chicago Press, 1976) 159.

[87] ibid.

[88] Macaulay does refer to the possible pricing abuses on ill-informed consumers, as a priori low prices can prove to be fictitious if combined with high financing charges. S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991). However, Forbes, in his study of the case *US v General Motors Corp* 384 US 127, 86 S Ct 16 L Ed 2d 415 [1966] at the University of Wisconsin at Madison, notes that 'automobile purchases are too significant to the consumer to allow us to assume that the consumer would make a purchase without comparing prices.' See ch 3, s I A above.

[89] L Kenworthy, S Macaulay and J Rogers, '"The More Things Change . . .": Business Litigation in the America Automobile Industry' (1996) 21 *Law & Social Inquiry* 3, 632.

From the point of view of consumers, it is a time-saving option which allows for quick price comparisons and which is progressively becoming safer and more common, hence the success of the Web as a forum for selling and purchasing all kinds of goods. This has evidently had an impact on the distributor–manufacturer relationship, as these dealers can sell virtually everywhere, challenging territorial exclusivity and being able to offer prices that can hardly be matched by traditional distributors. It would seem some of the old-school selective and exclusive distribution requirements could, in the long term, become obsolete.

Internet sales have overall enhanced competition; not only is it possible to have more operators in the market selling the same goods, but there should also be an increase in price competition given the costs saved by the web. The challenge for the legislator is clear: on the one hand, antitrust regulation should not hamper the development of new efficient, cost saving technologies. Therefore, these techniques should be permitted (unlike under the old car sector BER in Europe). On the other hand, traditional dealers are left in a vulnerable position, as they face larger investments (including advertising and promotion of the product) and will struggle to recoup their expenses if clients visit their stores to see the product and obtain all the information they need to make up their minds, but then proceed to purchase online—the ever-present free-rider argument. For the time being, it seems unlikely that traditional distribution methods will disappear, as many customers still prefer a more direct service by going to purchase the goods from a physical location where they can immediately collect their purchases and obtain direct advice from the experts on site. The coexistence of new and old distribution methods is challenging the limits of exclusivity rights and obligations.

B The problems of competition law as a tool for protecting dealers

A look at the clauses of some of the European BER will suffice to refect the difficulties associated with protecting dealers through antitrust. Unlike in the US, where contract law has been used to regulate these problems, in Europe the EC institutions have very limited powers in this area, and have had to look for alternative ways to regulate the issues. The Treaties do not directly empower the Community to march into this overwhelmingly national area of the law, and apart from the harmonisation attempts covered above,[90] little has been done at the supranational level. In addition, national contract laws have become deeply disjointed as a result of piecemeal legislation at Community level. EC secondary legislation has created problems in both its implementation and interpretation for national authorities. This state of incoherence has provided the institutions with an opportunity to advocate for a 'more coherent' European contract law. Some evidence of problems for the internal market that arise through divergence in

[90] There is abundant literature on the implications of the Internet for distribution. By means of example, see B Rao, 'The Internet and the Revolution in Distribution: a Cross-Industry Examination' (1999) 21 *Technology in Society* 3, 287–306.

national contract laws have indeed been identified. One appropriate example is provided by Beale, who notes the difficulties experienced in the sale of Smart cars across Europe in the 1990s as a consequence of the barriers created by differences in national contract laws.[91] Yet, above all, the mutual compatibility of otherwise largely efficient national rules continues to prove troublesome and legal disunity appears to be complicating internal trade and business. As a consequence, the European Commission launched its CFR research strategy aimed at developing uniform private law principles, model rules and legal terminology. Above all, the Commission aims to improve the coherence of the *acquis* in the area of consumer law.[92] The European Parliament has also long promoted the case for a European civil code. Very much in line with the goals pursued by competition policy, the European Commission, particularly Directorate General for the Internal Market, had aimed at promoting 'freedom of contract' and party autonomy in relation to harmonisation. However, the CFR strategy appears to be almost entirely consumer law focused, and so less concerned with the liberal dimension of contract law.

Of course, with the appearance of ever more specific Directives impacting on a range of specific fields it is not possible for any lawyer or court to ignore emerging EC contract rules. Yet this secondary legislation, much like a fish in water, is itself ever dependent on existing national contract law systems.[93] In the absence of a full contract law system, agreed at European level, the European courts cannot provide autonomous decisions. As such, all preliminary rulings are typically referred back to national courts for final decisions, since the European courts do not have a solid EC contract law system they can rely on. It could be argued that the European courts are quite content, at least for the present, to limit the caseload appearing before them. For this reason, national contract rules remain most relevant, as do the underlying ideologies supporting the law in each Member State.

At the supranational level, EC competition law has sometimes been stretched to fill this lacuna and afford dealers a minimum level of protection across the Community. Importantly, as seen in the previous chapter, Regulation 1400/2002 still reflects some of these concerns.[94] Article 3(3) grants distributors the right to subcontract with authorised distributors or repairers of the network, a privilege commonly known as the right of assignment. There are also some limitations on

[91] See the introduction to this chapter above.

[92] H Beale, 'Comments at the Conference on European Contract Law' (Trier, Academy of European Law (ERA), 2003). S Vogenauer and S Weatherill (eds), *The Harmonisation of European Contract Law* (Portland, Hart Publishing, 2006) 117 *ff*.

The CFR grew out of the earlier Communication from the Commission to the Council and the European Parliament on European Contract Law COM (01) 398 final, 11 July 2001. The Communication led to a subsequent 'Action Plan' in February 2003 (Communication from the Commission to the Council and the European Parliament, 'A More Coherent European Contract Law, An Action Plan' COM (03) 68 final, 12 February 2003) and a Follow-Up Communication in 2004 (Communication from the Commission to the European Parliament and the Council on 'European contract law and the revision of the *acquis*: the way forward' COM (04) 651 final, 20 January 2005).

[93] P Rott, 'What is the role of the ECJ in EC Private Law?' (2005) 1 *Hanse Law Review* 6–17.

[94] See ch 3 s II A iii above.

the right of sellers to terminate agreements in Article 3(4), while Article 3(5) requires that the duration of the agreement in question is of a minimum of five years. Article 3(6) obliges the parties include clauses contemplating the right to resort to arbitration for dispute resolution.

Several criticisms can be made in respect of these clauses, principally related to the lack of relation between the aim of competition law rules—which should be the promotion of competition—and the possible effects of the requirements contained in paragraphs 3 to 6 of Article 3. Joerges has criticised dealer protection as a means to achieve competition since, apart from antidiscrimination clauses, shielding the middle person rests upon social (rather than strictly efficiency) objectives.[95] As a consequence, the Commission is regulating contractual aspects of the dealer–manufacturer relationship through competition provisions, and it is questionable that it is empowered to do so on the basis of the Treaties. Articles 83 to 85 EC allow the institution to adopt legislation to ensure the application of Articles 81 and 82 EC. These legal provisions hardly serve as a legal basis for this kind of intervention, which could lead to an erosion of the principle of freedom of contract without purporting benefits to competition.[96] In the introduction of this study, the difficulties of regulating competition were highlighted.[97] Traditionally, competition policy implies protecting the competitive process in those sectors where competition works adequately. Regulation is reserved only for some sectors where market forces are confronted with structural problems, and involves greater control on the part of the authorities (which usually takes place ex ante).[98] Studies of the car sector show that this industry can hardly be categorised as problematic from the point of view of the competitive process, and no outstanding structural problems present themselves.[99] Yet the clauses of Regulation 1400/2002 that are under scrutiny here seem to be more regulatory in nature than competition policy rules ought to be. At the same time, the principle of attributed competence and subsidiarity implies that the Community can only act when a Treaty provision has granted it competence to act in the area, and that its action should be confined to areas where the action of the Member States is not sufficient to achieve certain objectives. These principles are questioned by the Articles 3(3) to 3(6) of the block exemption. The Regulation recognises that national courts can grant protection to dealers on the basis of national contract law provisions. Therefore, other legal disciplines could perhaps be used as tools to achieve the necessary protection of dealers, in which case there would be no need for dealer protection in competition policy.

[95] C Joerges, E Hiller, K Holzscheck and HW Micklitz, *Vertriebspraktiken im Automobilersatzteilsektor.* Frankfurter wirtschaftliche Studien (Frankfurt, Verlag Peter Lang GmbH 1985) 379.

[96] A Kmiecik, 'Analysis of Regulation 1400/2002: The New Block Exemption for the Motor Vehicle Sector' (2002) IBC Conference Proceedings, *Advanced Course on Competition Law*, Informa, Brussels, 66.

[97] See s III of the Introduction above.

[98] M Motta, *Competition Law: Theory and Practice* (Cambridge, CUP, 2004) xviii–xix.

[99] S Marco Colino, 'On the Road to Perdition? The Future of the European Car Industry and its Implications for EC Competition Policy' (2007) 28 *Northwestern Journal of International Law and Business* 1, 35–88.

Additional specific problems become apparent when analysing each of the legal provisions of the Regulation. For instance, the obligation to contemplate the use of alternative dispute resolution methods may be desirable for both parties, whilst possibly desirable, can hardly be justified from the perspective of the protection of competition. In practice, it is likely that both parties will be interested in including such clauses to avoid the costs of litigation should disputes arise, and the previous prohibition of the usage of arbitration in Regulation 1475/95 was certainly inappropriate an unjustified. However, it should be left to them to decide whether or not they wish to do so; imposing the inclusion of such clauses so that agreements can be exempted from the application of the prohibition contained in Article 81(1) EC seems radically absurd. Furthermore, the notification requirements for the non-renovation of five-year contracts or the termination of indefinite agreements are not only as incongruent with the protection of competition, but also seem rather excessive. In defending the inclusion of such requisites in the BER, the Commission may claim that competition among dealers should be preserved. Indeed, the institution still appears to be fixated on the misconception that an increased number of dealers necessarily implies an enhancement of competition. As previously argued, such an idea overlooks the impact of the competition posed by dealers of competing products.

Furthermore, the protection of dealers as contemplated in Articles 3(3), 3(5) and 3(6) of Regulation 1400/2002 could have detrimental effects on competition, as it does not distinguish between efficient and inefficient dealers. It seems that the protection is granted even when the dealer does not meet the expectations of the manufacturer, and the excessively long notification periods established may in fact serve to protect inefficient dealers. In the context of competition law, such a result is far from desirable. Therefore, the author contends that that such clauses should not be included in the block exemption, and dealer protection should be a matter restricted to contract law and national legislation. In the context safeguarding competition, dealers may be shielded if, as a consequence of that protection, some efficiency-enhancing effects could materialise. Such benefits for the competitive process could serve to reconcile dealer protection with the main objectives of antitrust policy. According to this logic, facilitating multibranding and breaking the link between sales and after-sales would seem licit, as opposed to these contractual provisions included in the BER.

Part of the reason for this seemingly untimely protection could be an attempt to correct the mistakes of the previous regime. Until 2002, antitrust legislation affecting cars was excessively protective of manufacturers in more ways than one. Not only was multibranding not encouraged by the 1985 and 1995 block exemptions, it was effectively prohibited. The consequences of forcing manufacturers to allow their dealers to handle other brands have been questioned; however, the prohibition of such a possibility seems absurd, as it hampers innovative ways of distribution and enhances the dealer's weak position. Importantly, the protection of the dealer was for a long time relegated below the protection of the manufacturer. In this sense, Regulation 1400/2002 changed this tendency by attempting to enhance

the position of the dealer. Dealer protection in the EU has therefore been mainly granted through competition law rather than contract law. The European institutions have had to stretch their competition provisions to grant such a protection given that contract laws remain national. This, allied to predominant integration concerns, has sometimes forgotten efficiency and economic welfare as the main goal of antitrust.

Whether or not national contract laws across the EC are equipped to provide the necessary protection is another matter. Presently there are no agreed European rules applicable to franchise agreements. However, common contract principles and model rules on franchise, agency and distribution contracts are just some of the focal areas under the Commission's ongoing CFR research process.[100] To varying degrees, national contract rules have provided appropriate albeit patchy solutions, both legislative and judicial, in emphasising 'co-operative dealing'. By means of example, in Spain failure to renew an existing contract may result in a successful claim for damages when there is a long-term contract in existence.[101] Moreover, damages may be imposed if one party abruptly, unexpectedly or 'abusively' ends a long-term franchising agreement.[102] Similar protection can be found in most legal systems across the Union, even though important differences remain. For instance, a key difficulty both for the CFR review and the development of franchising law at Community level concerns the common law's continued refusal to impose positive duties to inform in contract law and to regulate the pre-contractual phase of negotiations.[103]

As a consequence of the existing divergences in national contract laws and the dealer-unfriendly climate created by previous block exemptions, it would appear that the Commission is attempting to restore the balance in the manufacturer–dealer relationship using antitrust law—arguably one of the areas of law where it has more extensive powers. However, this seems inadequate for a number of reasons. First of all, as previously argued, it is questionable that such blatant regulation of dealership contracts through antitrust can be justified. This is particularly obvious following our analysis of the objectives of competition law in chapter 1.[104] Secondly, the protection seems untimely, as by the time these clauses were introduced in Regulation 1400/2002 the unevenness in the relationship had already considerably diminished by changes in the circumstances beyond the law—namely the proliferance of superstores and online distributors. These factors, allied to the crisis the car industry is going through—currently exacerbated by the global credit crunch—have served to ameliorate the state of affairs for distributors, despite some

[100] See the Commission's 'First annual progress report on the CFR and *acquis* review' COM (05) 456 final, 23 September 2005.

[101] '*Indemnización por daños y perjuicios*' Royal Decree 419/2006, 7 April 2006 (*Boletín Oficial del Estado 100*, 27 April 2006) modifying Royal Decree 2485/1998, 13 November 1998. Also applicable is *Ley 7/1996, Ley de Ordenación del Comercio Minorista*, 15 January 1996.

[102] See Spanish Supreme Court decisions, 22 March 1988, 24 May 1993, 16 October 1995, 18 January 2002.

[103] See, eg, J Poole, *Textbook on Contract Law*, 8th edn (Oxford/New York, OUP, 2006) 202.

[104] See ch 1 s III B above.

resilient differences. In any case, it seems evident that the Commission has taken its powers one step too far, arguably breaching the essential principles of attributed competence and subsidiarity.

III THE PATH TOWARDS THE RECONCILIATION OF THE EVOLUTION OF CONTRACT AND COMPETITION LAW

Franchise contracts are common distribution agreements, chosen by the parties as their preferred distribution alternative following important economic justifications. Apart from the achievement of cost- (and profit-) sharing, the reasons for opting for franchises are related to the adequacy of appointing distribution experts who are familiar with the technicalities of those goods and who can represent the manufacturer with diligence, as consumers tend to identify franchisor and franchisee. Investment requirements on the dealer can be understood, on the one hand, as a means for manufacturers to expand capital with no additional costs, thus facilitating expansion for firms. On the other hand, it is a way of monitoring the performance of the franchisee, which would otherwise be difficult given the usual remoteness between the two contracting parties.

Conflicts regarding the contractual relationship between franchisors and franchisees emerge frequently, mainly in the context of abuses of the manufacturer given the disadvantageous position of dealers. The responses of the law and the adjudicative process have been ambiguous. In the US, courts have had difficulties in granting dealers the necessary protection given their limited possibilities to take into consideration relational, good faith considerations when interpreting the clauses of agreements. Local and federal governments enacted protective dealer regulation to encourage a reflection on the basis of good faith on the part of the courts and find alternative dispute resolution methods to avoid costly litigation, where franchisors normally have advantages given their strong legal services. The impact of such legislation is hard to evaluate given the absence of data on cases which may have been settled before reaching the courts, but existing judgements reflect very few dealer victories, thus questioning the effectiveness of the legal protection.

To enhance the dealer's difficult position, the territorial exclusivity granted to dealers in franchise agreements was deemed per se illegal by the FTC 1939 report and by the US courts until the late 1970s. Therefore, the investments of appointed dealers were put at risk by the impossibility of preventing free-riding. Nevertheless, the requirement of exclusivity in representation imposed on dealers by manufacturers preventing them from selling other brands was also prohibited, and could have had the consequence of strengthening the dealers' position. However, manufacturers could have, in practice, employed other ways to prevent their franchisees from contracting with competitors, given that, as Macneil's relational theory has repeatedly emphasised, the manner in which contracts are enforced is as important as their actual words. The possible abuses on such a basis are more difficult to detect by courts, highlighting one of the legal system's main limitations.

As opposed to the situation in Europe, US antitrust legislation and court decisions do not reflect dealer protection concerns. Instead, dealer–manufacturer problems were treated as contractual issues. In the early days, US authorities believed that the priorities of antitrust should be the protection of consumers and competition, and took the view that in order to do this, any clauses limiting the number of dealers or the possibility of free-riders selling at lower prices should be forbidden. This erroneous position has now been discarded, as theory and practice have shown that the possible anticompetitive consequences of such restrictions can be eliminated by the existence of competition between competing brands. Nevertheless, the original perception of competition as enforced by the courts led to conflicts between contract law and antitrust provisions which could have been evaded if antitrust had been developed on better assumptions of what competition implies.

Over the last century, the distribution of cars suffered major transformations which altered the dealer–manufacturer relationship. Nowadays, dealers are stronger, and 'supermarket' sales of cars in multibranding houses are very common in the US and are becoming increasingly popular in Europe since Regulation 1400/2002 removed the prohibition of these practices. This progressive revolution is the result of the convergence of many interacting factors. Great pressure was exerted on manufacturers as a result of foreign competition and changes in consumer preferences for cars, as well as having to comply with new safety and environmental regulations. In such a context, the legislation enacted to protect dealers, as well as requiring them to devote their efforts to their brand came as additional burdens which dwelt on their difficulties. At the same time, dealers became stronger over time, not only as a consequence of the enactment of franchise protection legislation, but also—and mainly—since the appearance of superstores and retail outlets in the 1950s. The revolution in telecommunications and transportation methods of the twentieth century, as well as the development of new technologies, also had an impact on the transformation process.

The analysis of contract law and antitrust law in the US has revealed opposed trends in the evolution of both disciplines. Contract law has increased its protection of dealers, while the new trend in antitrust since the 1970s (which allows virtually all non-price restraints), centred on the protection of the competitive process, offers the dealer very few possibilities of declaring restrictive clauses void. The impact of the law in such a transformation was limited, but by no means inexistent. Despite the possible (though uncertain) shortcomings of the franchise protection legislation, it appears that the most serious dealer abuses on the part of manufacturers can now be struck down by the courts. As Macaulay has emphasised, legal procedures exist to safeguard trust and expectations, and 'defeating these expectations may endanger the patterns of co-operation needed for a working large-scale society.'[105] More questionable is the effect of antitrust regulation on

[105] S Macaulay, 'Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises' in C Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Berlin, Nomos Verlagsgesellschaft, 1991) 223.

the reform. It is possible that the facilitation of multibranding by prohibiting exclusivity clauses may have encouraged the increase of power of dealers and the emergence of new ways of distribution. However, whether that effect was desirable in the context of the mistaken assumptions on competition such a policy is based on is debatable. Furthermore, the overall changes in the position of the dealer question that such a result would not have been achieved any way as a consequence of the new circumstances. In such a context, it seems that dealer protection, where necessary, can be better achieved by contract law than antitrust, despite the limitations of the legal system.

There are lessons to be learned for the European Union from the American experience, particularly given the similar market transformation that is currently taking place in the European car industry. Under EC competition law, for a long time, sector-specific automobile distribution regulations hampered the transformation of distribution by preventing the use of new methods of selling cars, such as multibranding or Internet sales. This was a result of an attempt to protect European car manufacturers through competition policy. Whereas the prohibition of exclusive requirements in the US may be inadequate, impeding multibranding by regulation seems even more illogical. Furthermore, the European regulation of the sector is impregnated by integrationist concerns. These concerns are peculiar to the European context and are almost unknown in the US. Nevertheless, the history of US antitrust reflects inconsistencies and controversial situations where the aims of antitrust have diverged from the attainment of efficiency. Such problems have also appeared in Europe, as seen in the previous chapters. Therefore, the attempts of the new regulations both for vertical restraints in general and car distribution agreements in particular to protect dealers seem, in the light of the US experience, rather risky.

That is not to say that dealer protection should be overlooked. If the market does not automatically correct the problems in the dealer–manufacturer relationship, the action of the law may be necessary. However, it seems that, for such purposes, contract law seems like a better alternative of intervening in franchises. Even if contract law in Europe is fragmented, it still seems like the best solution for dealer problems without harming consumer welfare and efficiency. In that case, national legislators should be the ones granting dealer protection. Most, if not all, Member States already have contractual provisions that could be used to that end. As such, the attainment of efficiency through competition law should not be overshadowed by dealer protection concerns, when these goals enter into conflict. Therefore, the possibility of removing the block exemption system and analysing distribution agreements under Article 81(1) can be reconciled with the protection of dealers. The question then is to ensure that national contract law provisions and EC competition law rules are applied with consistency and coherence, and solving the possible conflicts between the two. To this end, it is important to reconcile the goals pursued by both disciplines.

The recent evolution of contract and competition law at the European level reflects how tradition-based national contract laws and legal approaches are being

consistently challenged by an emerging body of Community rules in search of an overarching tradition. Continual references to European contract law cannot disguise the fact that, despite two decades of Community directives, there is still no such thing as a system of EC contract law. In contrast to contract law, which has always had a strong basis in each national legal order, and despite the absence of explicit harmonisation, the decentralised enforcement of EC competition law has led to the emergence of an increasingly uniform approach to competition law at the national level. Importantly, however this de facto harmonisation has had much less impact on national legal cultures generally, and by extension faced little or no opposition. There simply was no established legal culture to threaten as the majority of national competition rules were first enacted in accordance with EC competition law. It has been and continues to be viewed as a contested, though largely sound, *European* legal discipline. At the same time, integration is still a guiding principle in EC antitrust, even if it has been greatly limited with the new reforms and the introduction of ex post control. However, Community rules that affect contract law have been heavily criticised, particularly by civil lawyers, for endangering the coherence of national contract law systems. Evidently, harmonisation of law is less problematic in 'legal culture free' zones. That said, the spill-over effects of harmonising trends in both disciplines will doubtless have increasingly unpredictable effects on national procedural rules and, may further alter the definition and meaning of core legal terms and concepts. Finally, and most crucially, developments in both disciplines are critical, given the importance of franchise agreements in both fields. Despite the concerns raised previously, both wider harmonisation moves in contract law and the narrower research work on the CFR may provide an appropriate level of EU-wide dealer protection via contract law. Clearly, from the point of view of competition law, a contract law solution to this issue would be much more appropriate than the current approach of linking dealer protection to exemptions to the agreement from the Article 81(1) prohibition.

Conclusions

> To air differences and still remain friends, the essence of civilised existence, don't you think?[1]

Over four chapters, the multiple dimensions of the regulation of vertical agreements in Europe and US antitrust systems have been explored. The analysis carried out over the course of this study had led the author to normative solutions for future policy development on both sides of the Atlantic. The aim of these concluding remarks is to 'air the differences' and emphasise those areas where shortcomings have become apparent in an effort to suggest means of overcoming these potential hurdles. In formulating these proposals, a solid contribution to the development of a sound economic analysis in antitrust regulation is sought. To this aim, Walker has pointed out that the European context is 'forward-looking' and requires prediction rather than explanation.[2] In the context of economic crisis and instability, prediction has also become essential in the US. The author hereby attempts to firstly find suitable *explanations* for the current legislative scenario for vertical agreements to assess the rules in the light of the objectives they pursue, and secondly to come up with *predictions* regarding future evolution of the regime and the necessary adaptations of the current rules. On that basis, suggestions for potential change are put forward.

I EXPLANATIONS: VERTICAL AGREEMENTS AND ANTITRUST LAW

The importance of a sound economic analysis in the scrutiny of vertical agreements has become progressively apparent over the years. If market power is not taken into consideration, then the result is a system that can be compared to a faulty fishnet: if the holes are too small, some agreements which were not originally the target of the mission with very limited effects on competition could be caught, while other harmful ones could end up slipping through the rips in the net. Years of experience in the US and the EU have served to improve the design of the 'fishnet' regulation and mend some of the existing rips. Objective criteria for the evaluation of the market power of the parties have been developed, and this assessment is pivotal for the determination of the validity of potential contractual restrictions of competition—except for those restraints which are considered so dangerous that their mere existence breaches the law. As a consequence, there has

[1] I McEwan, *Amsterdam* (London, Vintage 1998).
[2] N Walker, 'After the Constitutional Moment' (2003), online at www.ecln.net/elements/conferences/booklisbon/walker.pdf.

been an overall increase in concern over hardcore antitrust violations, and at the same time a more tolerant system towards those restrictions that could bear positive effects on the competitive process has been introduced. As a result, EU and US antitrust regimes have experienced a progressive increase in the benevolence towards vertical restrictions. Legislators on both sides of the Atlantic have acknowledged that individual assessment is crucial when assessing vertical restrictions, albeit in different manners.

A Overruling per se illegality in the US

In the US, the effects of vertical agreements on competition are controlled by virtue of section 1 of the Sherman Act, which has been interpreted to be applicable to these contracts since the early days of the policy. Originally, the prohibition contained in this provision was strictly applied and most price and non-price restraints were deemed to be per se illegal. This interventionist approach was very much in line with the predominant theories on the role of regulation and antitrust policy, in particular the ideas of the Harvard School, and helped to simplify the determination of the validity of the contracts under scrutiny. As the years went on, the accumulation of experience by courts and authorities involved in antitrust enforcement allowed for more detailed individual assessment of contracts, taking into consideration their economic impact. Currently, no vertical agreements are treated as per se illegal in the US under section 1 of the Sherman Act. In *Leegin,* the Supreme Court removed the last remaining vestige of per se illegality by extending the rule of reason to minimum resale price maintenance, following a trend rooted in the 1970s to focus on economic effects of agreements rather than merely potential harm. This evolution was a consequence of the maturity achieved over decades of active multilevel antitrust enforcement, along with the proliferation of theories that focus on the effects of agreements and defend a less interventionist approach—the Chicago School being the seed of these schools of thought. Overall, the benevolent approach to vertical restraints is worthy of appraisal. The rule of reason seems to be the only realistic option for achieving a genuine solid economic assessment of the agreements. Nonetheless, some problems inevitably arise as the analysis to determine the validity of these agreements becomes increasingly complex.

The coherent evolution of US antitrust has been threatened by two principal factors. The first of these is the possible influence of political changes in the development of the policy at the federal level. Despite the doubts raised by the likes of Kovacic in this respect, the progression of the treatment of vertical agreements reflects swings that faithfully correspond to political changes in government. This dependency constitutes a menace to the merits achieved as antitrust policy becomes more mature, and their frailty is reason for concern as any possible successes remain exposed to future swings. The second factor that impends over the consistency of the policy is the breadth of the rule of reason; despite its merits, if it is not coupled with coherent rules for determining the validity of agreements it

could be far too vague, leading to uncertainty; at the same time, if the rule of reason is virtually equated to per se validity of vertical restraints there is a risk of overlooking the potential negative effects of these restrictions—which, as practice has demonstrated, are frequent despite the enthusiasm of the Chicago School. In this sense, the excessive reliance on the ideals of this wave of thought—even to date—has led to some simplistic and unrealistic policy decisions.

B A criticism of the block exemption system in Europe

The regulation of vertical agreements at the European level has been carried out using the Treaty's antitrust provisions. The more obvious justifications for this are related to the interference of such contracts with what have been considered essential objectives of competition policy, namely the protection of competition and integration. As regards the former, it was originally believed that a limitation on the number of dealers restricted consumer's access to products while eliminating price competition. As for the latter, territorial protection granted to dealers through the establishment of selective and exclusive distribution systems served to retrace national boundaries (and price discriminate among member states), an effect which seems indefensible in the context of an endeavour to establish a common market among the Member States. In such a context, vertical agreements were originally considered to fall within the Article 81(1) EC prohibition, and needed to be exempted using Article 81(3) EC to be valid. The agreements were believed to be exemptible, given the beneficial effect they may bear on the competitive process. It seemed crucial to allow manufacturers to establish efficient distribution channels, and where competition is fierce, competition between competitors should tend to overcome the possible negative effects of the limitations on the number of distributors. Regulation 2790/99 provides the conditions for exemption for all vertical agreements with the exception of the car sector. The enormous pressure exerted by the industry—and to a lesser extent consumer organisations—led to the adoption of a specific block exemption for motor vehicle distribution, currently Regulation 1400/2002. Changes have already been proposed in the light of the expiration of both regimes, but they address rather immediate issues and do not imply a major change in the mindset of the Commission. Importantly, the future should see the car sector fall within the general block exemption for vertical agreements. This desired coherence is however jeopardised by the desire to maintain some specifications in the regulation of after-sales servicing and spare parts markets.

The old BERs suffered from inherent contradictions as a result of simultaneously attempting to address integration, the protection of competition *stricto sensu* and at the same time the protection of the different stakeholders. The principal flaws of the system follow four principal lines. First of all, the general antitrust system is developed on the basis of an inappropriate notion of competition and the goals competition policy should pursue. Competition was equated to intrabrand

competition, and any limitation on the parties' freedom or limitation on the number of dealers was looked upon with suspicion. The lack of economic analysis was overwhelming. Simultaneously however, the car sector benefited from particularly benevolent rules regarding territorial restrictions and the obligations imposed on dealers. Moreover, the distinct treatment cannot find objective economic justifications, and the reasoning behind the privileges are related principally to the pressure exerted by the industry at the time of the adoption of the specific block exemption. The dangers of giving excessive consideration to the interests of specific stakeholders have been consistently highlighted, and particularly in the light of the consequential incoherencies that may result.

A second criticism is linked to the consideration of integration as a main goal of antitrust policy, even before efficiency. On this basis, most means of territorial protection, regardless of their actual impacts on competition, have been considered per se illegal. Also, an excessive protection of parallel trade can be perceived, which economic theory has questioned as adequate. This has led to a condemnation of price differentials across Europe which although allegedly based on consumer protection claims, is better explained by this obsession with integration. While those differentials are outstanding within the Community, our conclusion is that they are a result of a lack of integration resulting from factors which escape the scope of Community action. Moreover, recent changes in the market and technologies are leading towards a decrease in the differentials, which is not only more advisable than using legislation to reduce price discrimination, but also more efficient. The result of the Commission's policy has often been contradictory from a purely economic perspective.

A third strand of criticism is related to the problems that arise for attempting to grant dealer protection by only exempting those agreements whereby suppliers include clauses relating to certain contractual aspects of the manufacturer–dealer relationship. This is particularly obvious in Regulation 1400/2002. Such a position is contrary to the principles of subsidiarity and attributed competence, as Article 81(3) EC should not be used as a legal basis for the adoption of legislation regarding contractual conditions. It seems as though what has not been yet achieved by the harmonisation of European contract law initiative is being pushed through competition policy. The adequacy of such a position is doubtful, as it endangers the efficiency of competition policy while at the same time fails to purport any additional protection for dealers that would not be granted through national contract law. Moreover, it appears that the requirements established by the regulation (such as prohibiting resorting to arbitration or requiring dealers to perform after-sales services) would bear little or no benefits to competition, while working in the detriment of the dealers and effective conflict resolution for possible disputes relating to the franchise agreement.

Finally, our fourth criticism relates to the implementation of competition law through Regulation 17/62, which provided a centralised system of enforcement with ex ante control of agreements which was not only unworkable, but also excessively slow and formalistic. This problem also increased the lack of economic

analysis, as the Commission could not possibly enter into the evaluation of the economic effects of all agreements to determine whether or not they merited an exemption. The block exemption system that emerged to alleviate the problems did not provide sound economics-based criteria for determining which agreements could be exempted, but rather just responded to the concurrence of manufacturer and consumer interests and integration concerns.

The above problems can be summed up by stressing the mistaken approach to decision-making alternatives. The Commission, which remained at the centre of the application of competition law, bears a role in the process of integration that almost prevents it from setting aside integration claims. It was only through the cases that reached the European courts that economic analysis began to be introduced in the assessment of agreements. However the courts, as European institutions, were precluded from developing a sound, coherent pattern of economic analysis by their position within the Community. They too could not avoid being drawn towards integrationist concerns, as the landmark *Consten and Grundig* reflects. It would have made more sense to involve national authorities and courts in the implementation of the rules since, despite their limitations, they would have at least served to relieve the European institutions from their vast workload. At the same time, it would have allowed the Commission to focus on developing sound principles for the application of competition law in general while pursuing truly anticompetitive behaviour.

The practical problems of the system forced the Commission to rethink its policy. Regulations 2790/99 and 1400/2002 introduced a number of laudable changes. However, the Commission's decision to fine Peugeot in 2005 reflects that in practice there has been little or no change in its position. Moreover, some of the criticisms made above of the former regime are still present in the current regime. There are still strong integrationist concerns reflected in the long black and grey lists of per se illegal clauses, and contractual dealer protection requirements are actually increased in Regulation1400/2002. Nonetheless, there are some important modifications. There is, for the first time, an attempt to introduce an economic analysis by linking the application the exemption to market power and market share thresholds. Such an economic analysis is, at best, incomplete, as market shares on their own cannot be determinant in asserting whether or not a firm is dominant. Also, some of the most indefensible requirements of the previous regime have been eliminated, such as the practical imposition of SED systems for car distribution, the duty imposed on dealers to carry out repair and maintenance services and the possibility of selling more than one brand. Such requirements were essential to allow innovation in distribution to penetrate into the car industry. Nonetheless, the most praiseworthy feature of the new rules, rather than in their inherent provisions, relies on the fact that they removed the previous system.

The advantages of the new enforcement rules are even more outstanding. By promoting decentralised enforcement of competition provisions and encouraging litigation, the Commission is finally giving in to the fact that the previous system was unworkable and detrimental. Moving to an ex post system of enforcement

enhances the role of national courts, who will be able to carry out the economic analysis on a case-by-case basis taking into consideration circumstances other than market shares.

C Towards the Americanisation of European Private Law?

Both EC competition law and European contract law have been heavily 'Americanised' as a consequence of the influence of US scholarly contributions and experience. Competition law is specifically representative of this trend: the 1999 vertical restraints reform introduced an economic analysis that has been compared to the American rule of reason. In the United States there is also a strong tradition of decentralised private and public antitrust enforcement. Nonetheless, as regards contract law, there is an abundance of literature examining the limits of this phenomenon.[3] Codification is simply not as important a debate in the US, which appears reasonably comfortable with different contract laws and sees no reason to work towards a single, comprehensive system. Moreover, besides the legal efficiency argument, it would appear that cultural implications in European private law continue to act as a significant barrier that prevents Americanisation. Where these cultural barriers are present, both harmonisation and indeed Americanisation of private law will be hampered. Awareness of this fact should encourage greater openness as to the real aims and intentions of harmonisation at the European level. It is argued here that, as with antitrust policy generally, integration is one of the guiding objectives of harmonisation in contract law. What is therefore critical to bear in mind is that, at first sight, the new Commission reforms in competition hint at an increasingly less integrationist approach; however, when these reforms are reconsidered in the light of ongoing developments in contract law the complexion changes significantly. The integrationist goal is every bit alive within the competition reforms, particularly when considering the condemnation of absolute territorial protection and price differentiation.

II PREDICTIONS AND SUGGESTIONS

The application of the rule of reason to all types of price- and non-price vertical agreements in the US could indeed lead to a more economics-based approach. However, to achieve a sound development of the policy the courts must clarify how the rule of reason is to be interpreted, as it could lead to very different results depending on the conditions for legality of agreements. The rule of reason potentially allows for any outcome; if vertical agreements are seen as overwhelmingly

[3] See, inter alia, G Howells and T Wilhelmsson, 'EC and US Approaches to Consumer Protection—Should the Gap be Bridged?' (1997) *Yearbook of European Law* 207–67, and G Howells, 'EC and USA—The Scope for Harmonised Legislative Activity Compared' (2002) 6 *European Review of Private Law* 601–22.

harmless, then it could be equated to per se legality. However, if the negative effects of vertical restrictions are taken into consideration, only rarely will some kinds of restrictions escape the prohibition. Above, it was suggested that the Areeda and Hovenkamp eight factor method could provide a solid structure to the analysis. Nonetheless, the extension of the rule of reason to minimum resale price maintenance could lead to some objectionable consequences. Given the ample scope for interpretation, policy swings—related to political changes or any other factors—could be facilitated. This could seriously undermine the progress made over years of application of antitrust rules; given that, as demonstrated above, minimum resale price maintenance tends to have overwhelmingly negative effects, sacrificing the legal certainty provided by the per se rule would seem less wise.

This should not, however, detract the merits of analysing vertical restrictions under the rule of reason. Even if the cases in which minimum resale price maintenance can have beneficial effects for the competitive process are scarce, these constructive restrictions will now be able to escape automatic illegality. The possible practical problems should encourage courts to lay down clear, straightforward rules for economic analysis in the evaluation of agreements. In addition, despite the current delicate situation, the legislator should try to look beyond the economic crisis and develop a coherent, solid policy without being blinded by imminent threats to the economy. If this is the case, there is a risk that an excessively tolerant policy that disregards the negative effects of vertical restraints could be on its way. The rule of reason ought to be applied with caution when it comes to price restraints to ensure that their potential to restrict price competition and increase prices for consumers is minimised.

Simultaneously, an analysis of the current system for vertical agreements in Europe (both substantive and procedural rules) leaves some scope for doubt as to whether an adequate economic analysis is in force. It is clear that a more economics-based approach has, at least timidly, been introduced with the market share thresholds established in order to analyse market power. Nonetheless, the rigidity of the analysis may question its practical effectiveness. Decentralised ex post enforcement and the consequential enhancement of the role of national courts may well contribute to a better application of the economic analysis, albeit limited by the actual preparation of these courts to apply complex economic tests to the agreements they are scrutinising. However, the long history of private litigation in the US seems to be the key to the policy's efficiency and success, and therefore in practice more efficient changes should take place with the enhancement of private enforcement, particularly with the expected harmonisation of actions for damages.

The block exemptions will soon expire, and yet at this crucial moment in time the most urgent changes look likely to be forgotten. One crucial question, particularly in thecontext of decentralised enforcement, is whether a specific block exemption regulation for car distribution is required. As things stand, the lifespan of the specific regime is likely to be extended, and some specific rules will survive in the shape of guidelines or a new specific block exemption. It is the author's conviction

that removing the special system would contribute towards the construction of an optimal, coherent European competition policy. This claim is justified by the findings along the present investigation. First of all, the specific regulation punishes the maintenance of car price differentials and the prohibition of parallel trade. However, an exploration of the underlying economics of price differentiation questions the adequacy of considering such practices as per se illegal, as this may also bear negative consequences if those consumers in the cheaper locations end up paying a higher price, or if the manufacturer loses an interest in serving those cheaper locations (highlighted in practice by the *Distillers* case). In the context of the European Union, it does not seem licit for manufacturers to prevent those well informed consumers from the more expansive locations to go across the border to buy their vehicles. The Commission's work in this regard needs to be praised, as it has de facto dismantled the barriers faced by those consumers.

A second argument for the removal of the specific block exemption would be the criticism put forward in chapter 4 to granting dealer protection through antitrust, instead of leaving it in the hands of national authorities and courts through national contract law. Evidently, one risk of such an option is that the level of protection offered to dealers varies from country to country and that, since litigiousness is not as pronounced in Europe as it is in the US, few cases reach the courts and therefore dealer protection is hardly enforced. Nevertheless, these are inherent limits to the legal system which can hardly be overcome. Certainly, by intervening in the manufacturer–dealer relationship through competition provisions it does not seem likely that the benefits from the possible increase in protection may be enough to justify the possible harm to efficiency and to the distribution of powers between the Member States and the Community. Furthermore, in the context of an emerging harmonisation of contract law, it seems that minimum dealer protection may in future be granted at the European level through the proposed CFR. Leaving aside the wider debate on the desirability of such harmonisation, from the perspective of competition law it seems more desirable to opt for this kind of protection.

More generally, a third argument for the removal of the specific block exemption would be the fact that vertical agreements have been generally recognised to have efficiency-enhancing effects. In practice, it seems that they may only be used to restrict competition where the market structure and conditions are susceptible to cartel behaviour. A study of the car market proves that it does not generally respond to these characteristics. Therefore, it is more than likely that, if Article 81(1) EC were interpreted correctly, it would not catch these distribution agreements, and therefore no exemption would be needed in the first place. Therefore, and despite the possible positive effects of the regulation in practice, we believe that it is premised upon inadequate interpretations of the Treaty provisions which need to be redefined to simplify the application of competition rules and render economic analysis easier and more flexible. Critics of Chicago School its tolerance towards vertical agreements may of course contest the efficiency enhancing effects of agreements. Less informed consumers, for instance, could end up paying more as a consequence of price discrimination. In the car sector, however, such prob-

lems are hard to imagine, as cars are too expensive for it to be presupposed that buyers would not check for lower prices before putting down the money for a new car. The question that needs to be answered, in this context, is whether regulation should try to replace the buyer's imprudent behaviour of buying without comparing prices first.

Fourthly, most of the changes introduced by the new regulation were in fact taking place naturally even before the introduction of the new rules. A transformation in distribution had been instigated by new technologies, and the boost of Internet sales has begun to question the effectiveness of the territorial boundaries established in SED systems. Given the high degree of competition in the market, it is only a matter of time until these kinds of sales become more frequent. This, allied to the boost of superstore-type dealers who bear a greater degree of power in relation to the manufacturer, is bound to imply changes in the medium to short term. It could well be, though, that previous restrictive regulation was in fact not only not contributing to the expansion of these innovative distribution methods, but virtually hampering the changes. The undesirability of such rules is clear. The protection of integration, manufacturer or dealer interests should not go as far as hampering innovation; rather, they should be encouraged to adapt to new realities. Stronger competition may mean that inefficient dealers will find it even more difficult to survive, and if this is the result of increased competition, then dealers must try to become more efficient to avoid being crushed by the competitive process rather than relying on protective legislation.

Finally, as suggested above, the system relies on a suboptimal institutional choice: the structured rule of reason has been introduced by the Commission through block exemption regulations, rather than by the courts, like in the US. This makes the system overly disconnected from reality while at the same time too specific in some areas to be able to survive in time and to respond to all real-life problems. Despite the problems of further emphasising the role of the courts, it appears to be the 'better' option among those available. In this sense, the 2004 enforcement reform was a crucial step towards an adequate economic analysis.

The arguments presented above lead to a critical question: going beyond sector-specific BERs, are block exemptions truly necessary for the regulation of vertical agreements under Article 81 EC? It would appear that a reinterpretation of Article 81(1) EC, together with the application of Article 81(3) EC, would alone provide an adequate balance for controlling the possible anticompetitive effects of vertical agreements. This dilemma is analysed below.

III FINAL EVALUATION—ASSUMING THE LAW'S LIMITS?

It is difficult to make predictions and establish general legal rules regarding the distribution of products, given the influence of technological changes in these channels. New, currently unimaginable ways of distributing products may soon emerge, and which could require a whole new regulatory perspective. In addition,

as authorities in the EU and the US have realised over the years, the limits of the law in theory and most importantly in practice hamper the success of any legislation, as well as any normative suggestions that hereby depicted. It has been highlighted that legal doctrines are filtered through bargaining systems and social norms. In this sense, rights do not vindicate themselves, and judicial or administrative procedures are costly. Any legal reform must be pictured in the context of these costs, and the fact that it may be giving the undeserving too much and the worthy too little.[4] The law cannot solve all problems, and it needs to be clear that our choice, as Komesar has highlighted, moves between imperfect alternatives which prevent the possibility of finding a panacea.

In such a scenario, our proposal of removing the block exemption regulation is not perfect, but seems to be the second best option in the light of all circumstances. Particularly, reinterpreting Article 81(1) EC would mean that, whereas those non-restrictive agreements will not be caught by the provision, when an agreement poses a real threat it will not risk being automatically exempted on the basis of a block exemption. In order to adequately interpret Article 81(1) EC, the emphasis must be placed on the actual effects of agreements and not so much the object, as otherwise there is a risk that small firms with very little power to restrict competition will be unduly burdened with having to meet legislative requirements that bear no justification. The removal of the block exemption system on this basis would mean that most vertical agreements would be generally considered lawful, unless they did in fact impose a restriction on competition with demonstrable effects. Such harmful (and therefore illegal) practices could still be controlled by the national courts and authorities now that decentralised enforcement and private litigation are facilitated by the new enforcement rules, using both national and EC competition law. The courts would be in a better position to develop a sound economic analysis not subject to rigid market shares, as well as to consider those possible issues arising in the relationship between manufacturers and dealers under national contract law. In addition, the possible market foreclosure resulting from the cumulative effects of such agreements could also be controlled through the 'effect' requirement of Article 81(1) EC. This option would also better address the necessary interweaving of competition and contract law. Moreover, the changes in the market, along with the increase in competition currently experienced with the arrival of new highly competitive manufacturers from Asia, should tend to correct both abusive pricing and dealer abuses.

Additionally, removing the block exemptions could mean that some forms of territorial and customer restrictions are actually considered under the rule of reason. This does not mean that they would be per se legal, but rather that they could be analysed by the courts to assess if their benefits could justify their lawfulness. It is for these situations that the Article 81(3) EC exemption would remain crucial. What would need to be determined is whether or not as the agreements are purely

[4] RE Scott 'Conflict and Cooperation in Long-Term Contracts' (1987) 75 *California Law Review* 2005 *ff.*

vertical and involve horizontal conspiracy among the dealers, and whether the specific manufacturer has market power that enables it to produce anticompetitive effects on the market. Also, it could be analysed if, in the specific circumstances, the possible anticompetitive effect of the restraint on intrabrand competition could be outweighed by the procompetitive effect on interbrand competition generated by strengthening the seller's ability to compete.

Such problems can only be determined on a case by case basis, and the attempt in Europe to establish rigid market share thresholds does not do it justice. Despite the problems of case-by-case approach, it still appears to be more desirable than the alternatives. As Areeda notes when referring to common law systems based on a greater role of the courts, 'the weakness of the common law approach to antitrust is its uncertainty; its strength is its adaptability and thus survivability.'[5] To ensure the effectiveness of such a system, we also recommend attempting to address the practical limitations of litigation in Europe, particularly the costs and risks of litigation, the difficulty of gathering evidence, the lengthy proceedings and the limited 'rewards' available for the parties for undergoing such troubles. The *Courage* case already opened the door for the establishment of a true Community right to damages. In the US, for instance, the system is much more efficient as a consequence of the availability of wide discovery powers, treble damages, class actions, or contingency fees. Besides, now that arbitration for dispute resolution is no longer prohibited by the block exemption, a new door may have been opened for faster, cheaper conflict resolution between dealers and manufacturers.

Therefore, upon expiration of the current block exemption regime in 2010, our ultimate suggestion is not to renew the block exemption. The role of the Commission in this area, in the view of decentralised enforcement, should be refocused to pursuing blatantly anticompetitive abuses, granting coherence and supervising the interaction between the different NCAs, and even issuing further guidance on how to carry out a sound economic analysis for national authorities and courts. Whether or not this will take place remains to be seen. Realistically, the block exemption system is unlikely to disappear with the forthcoming reforms. On this basis, it would appear that a satisfactory outcome would be a reassessment of the scope of Article 81(1) EC, together with a reconsideration of the market share thresholds and the hardcore list contained in the current BER.

Competition law has, and will probably remain to be used, in strategic ways. This is not only peculiar to Europe; the evolution of American antitrust has been proven to respond to political influences rather than merely the accumulation of experience and the prevalence of specific economic theories. In the EU, strategic use of competition policy is related to integration and other general EC goals. The latest reforms reflect that the Commission still remains highly influenced by integration concerns in the development of competition policy, and even more so if the new reforms are considered in the wider context of the changes taking place in

[5] P Areeda, 'Monopolization, Mergers and Markets: A Century Past and the Future' (1987) 75 *California Law Review* 959 *ff*, 981.

other areas of private law (such as contract law). Integration in Europe has been an objective in itself and also a means to achieve the desired economic growth.

The protection of such goals through competition policy is more than questionable. As US antitrust experience has proved, an optimal competition law focuses on the economics of antitrust and seeks mainly welfare and economic efficiency. The pursuit of other goals needs to be reconciled with this powerful and central objective, particularly when regulating vertical restraints—which have been generally proven procompetitive. In order to harmonise and to integrate, perhaps the Commission should resort to other tools in its power, such as internal market provisions. In any case, the problematic integrationist approach to antitrust reflects the general criticisms made to EU law of interfering with almost irrelevant aspects of everyday life and over-regulating. This should not be interpreted as an acceptance of the positions of the Chicago School on these matters. The stance of this school has largely been corrected by more recent economic theory. A virtually unlimited *laissez faire* approach to antitrust could be just as detrimental for competition as excessive interventionism.[6] If nothing else, the pressure of the mere existence of the controls of the firms' behaviour may already act as a deterrent from entering into harmful practices, not to mention the essential need to control those hardcore restrictions which could (particularly when linked to market power) bear nefarious consequences on competition. In such a context, the limits to the integrationist approach should be better defined. The European institutions need to accept that, in the 'EU-ropean' context, historical and cultural barriers to trade exist within the Member States which are virtually impossible to overcome. It is precisely this diversity that makes up the EU's unique character and richness, and refusing to accept it leads to objectionable attempts to tamper with the essential fibre of the Old Continent. The quest for integration should not turn into a process of excessive harmonisation and globalisation that deprives the EU of its essence.

[6] Such a problem has also been felt in the US. For instance, in *Eastman Kodak Co v Image Technical Services* 504 US 451, 122 S Ct 2072, 119 L Ed 2d 265 [1992], Justice Blackburn warned about the dangers of relying completely on economic theory to substitute for 'actual market realities'.

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