Vertical Agreements Under EU Competition Law: Proposals for Pushing Article 101 Analysis, and the Modernization Process, to a Logical Conclusion

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This paper can be downloaded without charge at https://ssrn.com/abstract=2930943
Abstract: This paper examines how vertical agreements are analysed under Article 101 of the Treaty on the Functioning of the European Union. It observes that, in spite of modernization and the Commission’s promise to adopt a more ‘effects-based’ approach towards vertical agreements, Article 101 analysis has not evolved as might have been anticipated. Rather, it argues that the legal system still fails adequately to reflect, and is out of kilter with, the economic logic of vertical restraints. Not only does it continue to rely heavily on broad presumptions of illegality which are not justified by economic theory or experience (creating a risk of Type I errors), but the dearth of decided cases has meant that a transparent structure for analysing and balancing the competitive harms and benefits of vertical arrangements (especially new online distribution practices) has not developed. This uncertainty has been compounded by the disparities in approach to enforcement emerging at the national level.

The paper considers how best to align EU law with mainstream economic thinking and proposes an approach which focuses more closely on the concepts underpinning the rules than the historic categories of analysis that have, to date, been relied upon. It also suggests how these changes might be effected and an administrable system governing vertical restraints put in place. It argues that, in order to achieve this change, the Commission should publish some carefully selected decisions in relation to vertical agreements, especially more complex effects cases. Such decisions will provide the opportunity for scrutiny of the Commission’s policy by the EU courts and ensure that the law in this important area is elucidated, particularly as distribution practices adapt to the challenges presented by the online environment and growth of e-commerce. These decisions, along with the information gathered in the course of the Commission’s e-commerce sector inquiry, may provide the crucial foundations for a necessary review and revision of the current regime and guidelines governing vertical agreements in the EU.

Keywords: Vertical Agreements, Hardcore Restraints, Antitrust Analysis

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1. INTRODUCTION

The analysis of vertical agreements under Article 101 of the Treaty on the Functioning of the European Union (TFEU) has been controversial since Article 101’s first enforcement. The problems created by the European Commission’s (the Commission’s) initial tendency to interpret the concept of a restriction of competition set out in Article 101(1) broadly, and to rely on Article 101(3), the legal exception to Article 101(1), as the main vehicle for authorising vertical agreements, are well-known. The resultant difficulties eventually led the Commission to recognise that modernization of the system was required.

Although the case-law of the Court of Justice (CJ) (the Court of Justice of the European Union is comprised of the CJ and the General Court (GC)) always displayed a more nuanced approach to that initially adopted by the Commission, and Commission policy towards vertical agreements has advanced considerably since modernization, this paper sets out the view that real difficulties still persist. Further, as the Commission (following the launch of its e-commerce sector inquiry) and a number of national competition authorities (NCAs) are now taking a renewed interest in vertical practices, especially in relation to online markets and online selling, it is important that these problems be resolved.

The paper commences in Section 2 by introducing the past difficulties that resulted from the initial appraisal of vertical agreements and by describing how the modernization proposals sought to resolve them. It observes that in spite of the Commission’s promise of a more ‘effects-based’ approach, antitrust analysis has not evolved in the way anticipated. Rather, in Section 3 it is argued that, in spite of the reform, the current legal framework still fails adequately to reflect the economic logic of vertical restraints. First, it continues to rely too heavily on broad presumptions of illegality which are not justified by economic theory, evidence or experience. This creates a risk of Type I errors (or false positives, arising from an overinclusive rule which sometimes condemns conduct that is competitive, benign or beneficial) and is likely to deter the conclusion of procompetitive distribution arrangements.

Secondly, the dearth of decided cases has meant that, despite significant advances in the economic and legal assessment of vertical mergers and abuse of dominance (which often involve the analysis of similar competitive effects), a transparent structure for analysing and balancing the competitive harms and benefits of vertical arrangements has not developed. This uncertainty has been compounded by the disparities in approach to enforcement emerging at the national level.

Section 4 consequently proposes an approach which focuses on the underpinning objectives of the rules as opposed to historic categories of analysis (such as the application of

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1 Art 101 divides substantive analysis between Art 101(1) which prohibits agreements etc between undertakings which have as their object or effect the restriction of competition and Art 101(3) which provides a legal exception from the Art 101(1) prohibition for agreements which satisfy its four conditions, see n 52eg, A Jones and B Sufrin, EU Competition Law: Text, Cases, and Materials (OUP, 6th edn, 2016), Chaps 3, 4 and 11.

presumptions of illegality and distinctions between intra- and interbrand restraints\(^3\) and different types of vertical agreement). In particular:

1) The questions of when, and why, a vertical agreement is treated as restrictive by object and/or presumptively illegal need clarification, explanation and refinement. We argue that it is not justifiable to apply a presumption of illegality against vertical restraints as extensively and rigidly as is currently done;

2) A clearer framework is required for the assessment of vertical restraints to determine whether (a) they have as their effect the restriction of competition and, if so, (b) satisfy the conditions of 101(3). This should reduce uncertainty and diverging enforcement practices across EU Member States.

The paper suggests how these changes might be effected and an administrable system governing vertical restraints put in place. It argues that such a development requires the Commission to bring more vertical agreement cases, especially some complex effects cases\(^4\) and including both infringement and non-infringement decisions, that clearly delineate the boundaries of Article 101 and which may be reviewed by the EU courts.\(^5\) Commitments decisions\(^6\) could also be used, and monitored, to collect empirical data on the effects of contract changes on competition in markets. These cases, along with the information gathered in the course of the e-commerce inquiry, could then provide the crucial foundations for a necessary review and revision of the general regime and guidelines governing vertical agreements.

### 2. MODERNIZATION: EVOLUTION IN ARTICLE 101 ANALYSIS

#### A. The Initial Approach and Modernization

The Commission’s early approach to Article 101, interpreting the concept of a restriction of competition set out in Article 101(1) broadly to encompass many restraints on firms’ economic freedom and ability to engage in cross-border trade, led to conceptual and practical problems. It also created a central role both for Article 101(3) in the Article 101 framework\(^7\) and the Commission in its enforcement (national courts and NCAs could not apply Article 101(3)).\(^8\) As Carles Esteva Mosso, Deputy Director-General in DG Competition at the Commission, explains, under this

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\(^3\) Intrabrand restrictions, restrain competition (price or non-price) between distributors of a particular brand. Intebrand restraints, restrain competition between manufacturers and their competitors, see further Section 3. This paper does not deal with licensing of intellectual property rights (IPRs) or digital content.

\(^4\) See n 139 and text.

\(^5\) See W Wils, ‘The Relationship Between Public Antitrust Enforcement and Private Actions for Damages’ (2009) 32 World Competition 3 (stressing the importance of effective enforcement of the competition laws in ensuring not only deterrence, compensation and remediation but also clarification of the law).

\(^6\) Commitments decision under Reg1/2003, Art. 9, involve only a decision not to pursue a preliminary finding of an infringement on the basis that commitments are given by the parties to change their behaviour. They do not involve a finding of infringement or non-infringement.


\(^8\) The Commission had the exclusive right to grant individual exemptions, Reg. 17 [1959–1962] OJ Spec. Ed. 87, Art. 9(1).
previous, more form-based approach to the interpretation of “restriction of competition”, a large number of agreements were considered to be caught by the test of Article 101(1) and required exemption under Article 101(3) …”.

Although the Commission sought to resolve this bottle-neck problem through various techniques including, development of the de minimis principle,11 the use of comfort letters and the introduction of block exemption regulations (BERs, exempting certain categories of agreements from the Article 101(1) prohibition), these were imperfect solutions and trenchant criticism of its approach mounted. In particular, complainants asserted that the ‘anaemic’12 analysis conducted by the Commission under Article 101(1), combined with the rigidity of the early BERs and the Commission’s inability to deal with all agreements notified to it for exemption, generated legal uncertainty, led to legal formalisms and analysis of agreements by category, risked the condemnation and deterrence of innocuous agreements or legitimate business practices and, crucially, eliminated ‘what should be the heart of the matter and antitrust (i.e. economics/law) substantive analysis of a particular agreement or practice, i.e. its competitive harms and benefits’.

B. The Modernized Regime
i. Background and components of the modernized system

The pressure eventually led the Commission to recognise that change was required. The modernization programme commenced in January 1997, with the adoption by the Commission of a Green Paper on Vertical Restraints,14 which included an economic analysis of the impact of vertical restraints on competition. Its conclusions, and the debate which followed, led to a new regime centred around a more economic, flexible, overarching BER covering all vertical restraints concerning intermediate and final goods and services that met its requirements (1999),15 the publication of guidelines on the appraisal of vertical restraints (2000),16 and (in 2004) the abandonment of the authorisation and notification system and the removal, by Regulation 1/2003,17 of the Commission’s exclusive jurisdiction over Article 101(3). The latter developments paved the way for self-analysis by firms of their agreements and a fuller role for NCAs and the national courts in the enforcement process. The BER, now

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10 Until 2004 parties fearful that their agreement might infringe Art 101(1) had either to notify their agreement to the Commission (which had the exclusive right, see n 8, but limited resources, to grant such exemptions in practice) or draft it to fall within a block exemption.

11 The CJ has confirmed that Art 101(1) applies only to agreements which both restrict competition and affect trade appreciably, see Case 5/69, Völk v Vervaecke [1969] ECR 295.


13 ibid, 2.5 (the author complained that the notification and authorisation system set up by Reg 17, nn 8 10, had failed).

14 Green Paper on Vertical Restraints in EC Competition Policy, COM(96) 721.


17 [2003] OJ L1/1. The Commission’s determination to follow a ‘more economic’ approach was also epitomized by the creation of the post of Chief Competition Economist in July 2003.
Regulation 330/2010\(^{18}\) (the Verticals Regulation), and the Vertical Guidelines (the Guidelines),\(^{19}\) were revised and replaced in 2010.

Collectively, these changes marked a major shift in Commission policy and a recognition that appraisal of vertical agreements should not be based primarily on their content and form but should also take account of their competitive effects. The Commission thus promised more realistic analysis of agreements under Article 101 based on a consumer welfare objective,\(^{20}\) utilising Article 101(1) to identify anticompetitive effects in terms of parameters of competition and Article 101(3) to weigh countervailing efficiencies. In the Guidelines, the Commission recognises that tested against this benchmark many vertical agreements will not restrict competition at all: rather, competition concerns can arise only if there is insufficient competition/ some degree of market power at the supplier or buyer level (or both levels).\(^{21}\)

‘When a company has no market power, it can only try to increase its profits by optimising its manufacturing or distribution processes’.\(^{22}\)

Although the guidelines, for the most part, have taken on board lessons from the economic literature and recognise that reductions in intrabrand competition are generally likely to be problematic only where interbrand competition is weak, this paper argues that, in the detail, they fail sufficiently to reflect these broader statements on policy and that:

(i) By better aligning complementary activities (manufacturing and distribution) vertical restraints tend to generate efficiencies\(^{23}\) that benefit parties to the agreement and end customers;
(ii) Interbrand competition and not intrabrand competition is the main driver of economic efficiency and consumer welfare;
(iii) Firms compete for downstream customers not only on price but on quality, service, availability, after-sales support and new product development; and
(iv) Vertical restraints which facilitate discrimination across different customer segments may increase overall welfare.

In our view the net result of these omissions is that, even post-modernization, the legal system still has problems, especially as it continues to rely on presumptions of legality and illegality and concern itself acutely with certain (mainly intrabrand) restraints and, in many scenarios, effectively disregards efficiencies associated with them. Consequently, there is still analysis of agreements by category (see section (ii)), and a scarcity of modern guidance on how antitrust analysis of vertical agreements ought to be conducted (see section (iii)).

In Section 3 we argue that as this current system fails to reflect fully the economic logic of vertical restraints it risks the condemnation and deterrence of innocuous or legitimate

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19 Commission Guidelines on Vertical Restraints (Guidelines) [2010] OJ C130/10
20 Guidelines on the application of Article 81(3) [now 101(3)] (Art 101(3) Guidelines) OJ [2004] C 101/97, paras 13 and 42. Although the case-law of the EU Court has not fully endorsed the approach, and places greater focus on market integration (see 2.B.iv) and the need to protect not only the interests of consumer but the structure of the market and the process of competition, the welfare of consumers certainly forms at least part of the EU competition law fabric, see e.g., Case C-501/06 P, GlaxoSmithKline Services Unlimited v Commission [2009] ECR I-9291, paras 61-63.
21 Guidelines, para 6.
22 ibid, para 106.
23 Contrast ibid, para 6.
business practices, generates legal uncertainty and fails to elucidate how substantive antitrust analysis is to be conducted.

ii. A Category of Vertical Restraints is Presumed to be Incompatible with Article 101

There remains a category of vertical restraints which are strongly discouraged and which the Commission describes as presumed to be incompatible with Article 101. These restraints are ordinarily found (a) to restrict competition by object, and so are ‘assumed’ to restrict competition within the meaning of Article 101(1), and (b) to be unlikely to satisfy the Article 101(3) conditions24 - consequently they cannot benefit from the Verticals Regulation (they are designated by the Commission as hardcore restraints). The Commission thus applies a ‘double presumption’ of illegality to hardcore restrictions – considering that such restraints are presumed to infringe Article 101(1) and not to satisfy the conditions of Article 101(3).25

a. By Object Restraints are Assumed to Restrict Competition Appreciably

Under Article 101 an agreement whose object or ‘precise purpose’26 ‘reveals in itself a sufficient degree of harm to competition law’27 or a ‘sufficiently deleterious impact on competition’,28 is assumed to restrict competition appreciably29 and to infringe Article 101(1).30 In such cases no assessment of anticompetitive effects is required or permitted.31 Case law stresses that to identify an agreement incorporating object restrictions, ‘regard must be had inter alia to the content of its provisions, the objectives it seeks to ascertain and the economic and legal context of which it forms part’.32

Over the years, jurisprudence has clarified that agreements containing ‘established’ clauses are liable, in principle,33 to be found to pursue a restrictive objective. These include not only horizontal cartel agreements,34 but also certain restraints in vertical agreements, including those which:

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25 Guidelines, para 47 and see nn 54-55 and text.

26 Taking account of its clauses and the legal and economic context in which it operates (see further Section 4), Case C-501/06 P, GlaxoSmithKline n 20, para 58.


30 Article 101(1) prohibits an agreement if either its object or its effect is to restrict competition, Case 56/65, STM n 28.


32 Case C-501/06 P, GlaxoSmithKline n 20, para 58.

33 See n 40 and text.

34 Horizontal collusion to fix prices, limit output, share markets or rig bids or to reduce capacity, see e.g., Case C-209/07 BIDS, [2008] ECR I-8637. See also Case C-67/13 P, CB n 27 and Case C-8/08 T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit [2009] ECR I-4529, paras 36–43
• involve minimum resale price maintenance (RPM – where the supplier specifies the resale price of the product at a fixed or minimum level);\(^{35}\)
• confer absolute territorial protection (ATP) on a distributor or are otherwise aimed at partitioning national markets – ‘in principle, agreements aimed at prohibiting or limiting parallel trade have as their object the prevention of competition …’;\(^{36}\) or
• ban online selling (which reduces the ability of a distributor to sell outside its territory, see Pierre Fabre v Président de l’Autorité de la concurrence\(^{37}\)) and certain selective distribution systems\(^{38}\) (SDSs - an SDS restricts the number or type of dealers and prohibits sales from authorized to non-authorized distributors).

In spite of the flexible nature of the characterization exercise described above,\(^{39}\) the cases dealing with such restraints in distribution agreements have, save in the most exceptional circumstances,\(^{40}\) refused to contemplate the possibility that the context of a case supports a finding that the overarching objective is not to restrict competition but to enhance efficiency of the supply chain to the benefit of the parties and end customers.\(^{41}\)

This group of restraints is thus ordinarily found to restrict competition by object irrespective of (i) the rationale for the incorporation of the restraint, (ii) the intensity of interbrand competition and/or (iii) the degree of market power of the parties (in contradiction to broader statements about its importance made by the Commission in the Vertical Guidelines\(^{42}\)). The approach adopted in these cases contrasts starkly, and is not easy to reconcile, with that taken in other judgments of the EU Courts dealing with vertical agreements, for example, in Delimitis v Henninger Bräu.\(^{43}\) In this case, discussed further below, the CJ accepted that as an obligation imposed on the café proprietor to purchase most of its beer requirements from a brewer entailed advantages for both the supplier and the reseller, the purpose/object of the agreement could not be said to restrict competition. Rather, its effects had to be considered.

As the category of object restraints is not closed, a number of cases arising at the national level have raised the question whether other vertical restraints, such as price relationship

\(^{35}\) See n 82 and text.

\(^{36}\) Case C-501/06, GlaxoSmithKline n 20, para 59. See also e.g., Cases 56 and 58/64, Établissements Consten S.à.R.L. & Grundig-Verkaufs-GmbH v Commission (Consten and Grundig) [1966] ECR 299 (see n 41 and text) and Cases C-403 and 429/08, Premier League Ltd v QC Leisure and Murphy v Media Protection Services Ltd EU:C:2011:631.

\(^{37}\) Case C-439/09, EU:C:2011:277, see n 81 and text.

\(^{38}\) Ibid (holding that SDS restrict competition by object unless objectively justified).

\(^{39}\) See n 32 and text.

\(^{40}\) The two cases both involved licensing of IPRs eg, Case 27/87, Erauw-Jacquery Sprl v La Heshignonne Société Coopérative [1988] ECR 1919, Case 62/79, Coditel v Ciné Vog Films (Coditel I) [1980] ECR 881, but see now the Commission’s Preliminary Report, n 2 (expressing concern about geo-blocking in licences of digital content). This paper does not deal with licensing see n Error! Bookmark not defined..

\(^{41}\) In e.g., the early case of Cases 56 and 58/64, Consten and Grundig n 36 the CJ rejected the parties’ argument that an agreement, incorporating clauses which sheltered the exclusive distributor from all intrabrand competition in France and conferring ATP upon it, was necessary to prevent freeriding and to encourage interbrand competition, see Section 3 below. Instead, focusing on the resulting isolation of the French market, the Court held that clauses that result in the segregation of a national market, and/or in maintaining separate national markets, were liable to restrict competition by object.

\(^{42}\) See n 22 and text.

agreements,\textsuperscript{44} most favoured nation clauses (MFNs)\textsuperscript{45} or clauses preventing members of an SDS selling on certain online marketplaces\textsuperscript{46} or using price comparison engines may additionally be classified as restrictive of competition by object. Some judgments of the CJ may have encouraged such claims by utilising language suggesting that object characterization might be appropriate to restraints which are likely to,\textsuperscript{47} capable of having, or have the potential to have, ‘a negative impact on competition’.\textsuperscript{48} In \textit{Groupement des cartes bancaires v Commission (CB)},\textsuperscript{49} however, the CJ stressed that because a finding that an agreement restricts competition by object exempts the Commission (or other claimant) from its ordinary burden of demonstrating a restriction of competition, the category of object restrictions is a restrictive one;\textsuperscript{50} and must be confined to agreements which obviously harm the proper functioning of competition.\textsuperscript{51}

\textbf{b. By Object Restraints are Presumed not to satisfy the conditions of Article 101(3)}

It is frequently argued that the object category in the EU is distinct from the per se rule in the US. A finding of per se illegality does not allow any justifications for the conduct to be raised, whilst in contrast a finding that an agreement is restrictive of competition by object does not prevent an argument that the agreement satisfies the four criteria\textsuperscript{52} of Article 101(3).\textsuperscript{53} As, however, the EU Commission has adopted the view that vertical restraints falling in the object category, like horizontal cartel activity, constitute ‘hardcore restraints’ which are presumed not to satisfy the conditions of Article 101(3)\textsuperscript{54} (and so are not covered by the Verticals Regulation)\textsuperscript{55} this distinction is arguably more theoretical than real. Indeed

\begin{footnotesize}
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\item \textsuperscript{44} See e.g., the (then) OFT’s decision in \textit{Tobacco} 15 April 2010, decision quashed Case Nos 1160–1165/1/1/10, \textit{Imperial Tobacco Group plc & Ors v OFT [2011] CAT 41}.
\item \textsuperscript{45} See n 143 and text.
\item \textsuperscript{46} See case pending before the CJ, Case C-230/16, \textit{Coty Germany GmbH v Parfümerie Akzente GmbH} and eg the Federal Cartel Office’s (FCO’s) cases involving \textit{Adidas} (June 2014) and \textit{Asics} (August 2015).
\item \textsuperscript{47} Case C-32/11, \textit{Allianz Hungária Biztosító Zrt, Generali-Providencia Biztosító Zrt v. Gazdasági Versenyhivatal EU:C:2013:160}.
\item \textsuperscript{48} Case C-8/08, \textit{T-Mobile}, n 34.
\item \textsuperscript{49} Case C-67/13 P, n 27.
\item \textsuperscript{50} It thus held the GC had erred in its ruling that the category was not to be interpreted restrictively.
\item \textsuperscript{51} See further Section 4.
\item \textsuperscript{52} That: the agreement achieves specified benefits (including ‘improving the production or distribution of goods’ or ‘promoting technical or economic progress’); a fair share of those benefits are passed on to consumers; the agreement does not contain any indispensable restraints; and it does not eliminate competition in respect of a substantial part of the products in question. See Case C-501/06 P, \textit{GlaxoSmithKline} n 20 and see e.g., Vertical Guidelines, para 225.
\item \textsuperscript{53} At first sight it thus seems closer to situations in the US where the courts adopt ‘truncated’ analysis, see e.g., \textit{National Collegiate Athletic Association v Board of Regents of the University of Oklahoma} 466 US 85 (1984).
\item \textsuperscript{54} The Commission’s view is that these hardcore restraints (a) generally fail to create objective economic benefits, (b) do not benefit consumers and/ or (c) are unlikely to be considered indispensable to the attainment of any efficiencies created by the agreement in question (efficiencies generated can ordinarily be achieved by less restrictive means – the indispensability criterion thus seems to incorporate a ‘sliding scale’ meaning that it harder for more severe restraints to satisfy it, see J Faull & A Nikpay (eds), \textit{The EU Law of Competition} (3rd edn, Oxford University Press, 2014), 3.494).
\item \textsuperscript{55} Although, therefore, the foundational premise of the Verticals Reg is that, in the absence of market power, vertical agreements can be presumed to be compatible with Article 101, it does not apply, irrespective of the
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there is extremely limited guidance as to when agreements incorporating object restraints may exceptionally satisfy the four onerous conditions of Article 101(3) in practice and it seems unclear how parties can prove that the beneficial effects of their agreement offset anticompetitive effects which have been assumed, not established. Because serious consequences may follow if an infringement is uncovered, parties generally avoid incorporating these object/hardcore restraints in their agreements and having to advance efficiency justifications for them even if they have no market power and perceive such restraints to be helpful, or indispensable, to the efficient distribution of their products or services.

The design of Article 101 thus makes it extremely difficult for parties to an agreement to rebut the presumption of illegality applied to object/hardcore restraints, meaning that such restraints are generally perceived by business to be de facto illegal.

iii. Other Agreements: Safe Harbour and Individual Analysis

The Verticals Regulation provides a broad exemption for agreements involving parties that do not have market power – proxied by use of a 30 per cent market share threshold – and which, as explained above, do not contain hard-core restraints. As the Regulation is directly applicable, and its benefit can only be withdrawn prospectively, it provides legal certainty and operates as an important mechanism for authorising a large group of vertical agreements whose efficiencies are presumed to offset any anticompetitive effects which might arise.

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56 Since the abolition of the notification and exemption system it is rare for competition agencies to conduct detailed analysis of when a vertical agreement may satisfy the conditions of Art 101(3), see e.g., n 150 and text.

57 The pass-on condition of Art 101(3) essentially requires a balancing of anticompetitive and the procompetitive effects of the agreement.


59 Firms sometime fear that the mere tabling of efficiency claims may be considered as an admission that the agreement in question contains severe restraints and is consequently unjustifiable.

60 In Sections 3 and 4 we argue that as this approach is justified by neither economic theory nor experience, it is mistaken and requires change.

61 A category of ‘excluded’ restraints do not benefit from the Verticals Reg, see Art 5, but do not necessarily prevent the agreement from benefiting from the block exemptions, see Jones and Sufrin, n 1, Chap 11.

62 Reg 1/2003 [2003] OJ L1/1, Arts 29(1)(2) and Verticals Reg, recital 15 (see also Art. 6). The Commission, or NCAs, can withdraw its benefit from the agreement which is valid and compatible until then.
Where the Regulation’s conditions are not satisfied, individual examination is required to determine whether an agreement is caught by Article 101(1) (has restrictive effects) and if so whether each of the four conditions under 101(3) is met. Under the modernized regime this has become a question for ‘self-assessment’. As the Commission has not, post-modernization, adopted either an infringement decision involving an analysis of the restrictive effects of a vertical agreement, a non-infringement decision or published a ‘guidance letter’, firms have to rely on jurisprudence which is relatively sparse (and mainly quite old) for such guidance. Some of this jurisprudence is not easy to reconcile with the consumer welfare approach advocated in the Vertical Guidelines.

The 1966 case of STM63 clarified that an assessment of whether an agreement has in fact restricted competition to an appreciable extent requires an appraisal of the agreement in its market context and in the light of the competition which would occur if the agreement in question had not been made. Some judgments of the EU courts, for example, the CJ’s judgment in Delimitis,64 support the view that, consistent with economic analysis, the inquiry must focus on the important question whether or not the agreement, alone or in conjunction with a network of similar agreements, would likely have an appreciable impact on the parameters of competition and allow the parties to exercise market power. The Court stressed the importance of assessing whether the agreement (a beer supply agreement obliging a café proprietor to purchase most of its beer requirements from the brewer) appreciably contributed to a foreclosure of access to the market. This required a definition of the relevant market and an assessment of whether there was a concrete possibility for new competitors to penetrate that market or for existing competitors to expand. The case thus (i) advocates an ‘effects-based’ approach to assess the competitive effects of vertical restraints under 101(1) and (ii) establishes the importance of interbrand competition to the assessment.

Nonetheless, in cases dealing with intrabrand restraints, greater weight has been attached to the importance of the structure of competition and undistorted competition in all market segments (including the distributor level) than to their impact on interbrand competition. This case-law reflects a greater suspicion of restraints on rivalry between a supplier’s dealers than on restraints between a supplier and its competitors, and considers the former to be restrictive of competition unless necessary:

• to facilitate the penetration of a new market by an undertaking through the prevention of free riding on a dealer’s marketing and promotion efforts (see, for example, Société Technique Minière v Maschinenbau Ulm GmbH (STM),65
• to encourage non-price competition between dealers (see, for example, Metro-SB-\Grossmärkte GmbH v Commission (Metro 1)66); or
• to ensure the commercial success of a franchise agreement (Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis (Pronuptia)67).

In other words, in contrast to Delimitis (and the approach taken by the Commission when appraising the impact of vertical mergers, see Section 4 below), the cases governing exclusive distribution, franchising and SDS respectively do not typically inquire whether the

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63 Case 56/65, n 28.
65 Case 56/65, n 28.
agreement has had, or is likely to have, substantial or significant anticompetitive effects, or whether it affects ‘actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability’. Rather, the practice is to characterise the intrabrand restraints as restrictive of competition, unless objectively necessary and proportionate to the legitimate objective, irrespective of whether or not the parties have market power. Accordingly, this approach seems to conflate object and effect and Article 101(1) and 101(3) analysis, as well as missing a critical step in the appraisal, namely, identifying the agreement’s likely impact on competition.

iv. What Policy Drives the Current Approach?

Rather than an articulated concern about diminished intrabrand competition or a high probability of negative effects on prices, the jurisprudence dealing with intrabrand restraints seems to be influenced principally by an inherent anxiety about restraints on rivalry between dealers (given the ‘considerable impact of distribution costs on the aggregate cost price’) particularly those which impact on the single market project, through prohibiting or limiting the opportunities for parallel or cross-border trade and perpetuating price differences between Member States.

The internal market objective thus ‘adds an extra dimension to the analysis of vertical restraints’ and means that arguments which have been found persuasive and decisive in cases such as Delimitis have been disregarded in cases involving intrabrand restraints aimed at partitioning national markets according to national borders or making the interpenetration of

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68 Article 101(3) Guidelines, paras 24-26.

69 The objective necessity function thus seems to perform a combined classification and truncated analysis function. If the restraints are not objectively necessary they are assumed to restrict competition (they are restrictive of competition by object). If they are objectively necessary however they do not restrict competition (by object or effect). The cases do not provide clear guidance however as to how it can be determined whether a restraint is objectively necessary to an agreement, especially as, as has been seen, RPM and ATP are almost never considered to be required to achieve a legitimate purpose such as the penetration of a new market and the elimination of free-riding), see further A Jones and WE Kovacic, ‘Identifying Anticompetitive Agreements in the United States and the European Union: Developing a Coherent Antitrust Analytical Framework’ available at https://ssrn.com/abstract=2919312 or http://dx.doi.org/10.2139/ssrn.2919312.

70 The appraisal does seem to involve some loose form of balancing, or at least consideration, of the agreements potential harms and benefits, so duplicating, or at least overlapping, with the analysis that the Commission states in its Guidelines is reserved for Article 101(3). Indeed, in some cases the balancing conducted under Article 101(1) closely resembles that conducted in free movement cases under the ‘EU rule of reason’, see e.g., Cases C-403 and 429/08, Murphy n 36 and G Monti, ‘Restrants on Selective Distribution Agreements’ (2013) 36 World Competition 489.

71 See e.g., Monti ibid.

72 See nn 129 and 163 and text.

73 Cases 56 and 58/64, Consten and Grundig , n 36, 342-343

74 Case C-501/06 P, GlaxoSmithKline n 20, para. 59.

75 See n 84 and text.

76 Green Paper on Vertical Restraints, n 14, para 70 and see the e-commerce sector inquiry, n 2. See also Z Patki, The Cost of non-Europe in the single Market: Cecchini Revisited An overview of the potential economic gains from further completion of the European Single Market CoNE 1/2014 European Parliamentary Research Service.
national markets more difficult. Indeed, the Commission has stressed that companies should not ordinarily be allowed to create barriers to trade between Member States, to seal off territories ‘hermetically . . . , making interpenetration of national markets impossible’ and so contribute to the cost of ‘not realising’ the EU’s single market objectives. The Court’s judgment in Pierre Fabre, confirming that online selling constitutes a form of passive (not active) selling which can be restricted only in exceptional circumstances, also supports the Commission’s view that, generally, every distributor should be allowed to use the internet to sell its products; ‘the promotion of online sales is extremely important for the internal market in Europe because it broadens the market, improves the choices for customers, and generally speaking, enhances competition’.

The rationale behind the cases holding that a complete elimination of price competition between dealers is restrictive of competition by object is not as clearly spelt out in the Court’s judgments, but may also be driven by concerns that price restraints can lead to segmented markets and increased scope for price discrimination between Member States. Further, the Commission’s view, reflected in the Vertical Guidelines, is that object (and hardcore) categorisation is appropriate as RPM may restrict competition in a number of different ways, in particular through facilitating collusion between suppliers and enhancing price transparency; by eliminating intrabrand price competition; by softening competition between suppliers and retailers; by preventing distributors from lowering sale prices; by lowering pressure on manufacturers’ margins; by foreclosing competitors; and by reducing dynamism and innovation at the distribution level. Section 3 argues, however, that although these may constitute valid theories of harm in some cases, the impact of RPM depends on the overall market circumstances.

3. PROBLEMS STEMMING FROM THE CURRENT FRAMEWORK

A. Overview

Although the modernization programme made great leaps, Section 2 reveals that the more general apprehension about intrabrand restraints has meant that analysis in these cases has not developed to focus on interbrand competition or the efficiencies that might be generated by vertical agreements through aligning the parties’ complementary activities.

77 Cases C-403 and 429/08, Murphy n 36.
79 Green Paper, n 14, para 78. (‘The elimination of barriers to trade may not achieve its objective if producers and/or distributors introduce practices contrary to integration.’)
80 Case C-439/09, n 37.
81 ‘Interview with Dr. Alexander Italianer, Director General for Competition, European Commission’ theantitrustsource April 2011, 1, 6, Guidelines, paras 52-54
83 Unless the supplier is dominant, charging different prices to different customers based on location, customer characteristics or distribution channel is usually a manifestation of competition working well. It may enhance market integration since they incentivise market expansion and entry in new markets even if customers have a lower willingness to pay or competition is already intense.
84 Guidelines, para 224.
In section B below we argue that this approach fails to acknowledge that vertical intrabrand restraints frequently generate efficiencies, that restrictions on intrabrand competition will not necessarily weaken interbrand competition (but rather may strengthen it), that problems stemming from weak interbrand competition cannot generally be solved by increasing intrabrand competition and that consumer demand depends not just on price but on other factors (such as service, quality and image). Although anticompetitive theories for such restraints undoubtedly exist, they need specified circumstances to arise.

Section C maintains that, consequently, the hardline approach to object/hardcore creates a danger of Type I errors. Further, the existing jurisprudence dealing with other restraints does not provide a satisfactory legal framework for assessing the competitive benefits and harms of vertical restraints. EU policy towards such restraints may consequently be harming consumer welfare and efficiency, a core common objective of both the competition and the internal market rules.

B. THE ECONOMIC LOGIC OF VERTICAL RESTRAINTS

i. Aligning supplier and dealer incentives

Vertical restraints are frequently incorporated in distribution agreements. Some older surveys suggest that the most common restraint is RPM (when not prohibited by law). A more recent report prepared by Oxera and Accent demonstrates that in the UK businesses, with or without market power, employ a wide range of vertical restraints, the most common being selective and exclusive distribution agreements (which often exclude online retailers or platforms). In addition, many manufacturers specify recommended retail prices to their retailers, in some cases accompanied by recommended ranges of discounts.

This raises the question of why firms would wish to incorporate such vertical restraints in the agreement, especially if the manufacturer wishes to sell as much of its product as possible. The key answer is that restraints within a supply chain provide the opportunity to eliminate production or distribution inefficiencies in the chain, to deal with externalities and align suppliers’ and retailers’ incentives. Another way to achieve these aims is through vertical merger. Vertical restraints, however, offer the prospect of achieving them through contracting, whilst maintaining independence to contract with multiple parties and allowing for greater specialisation and the opportunity to reap economics of scale, scope and learning.

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85 See also e.g., E Iacobucci and RA Winter, ‘European Law on Selective Distribution and Internet Sales: An Economic Perspective’ (2016) 81(1) Antitrust Law Journal 47.
86 See n 20 (‘the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumer’).
89 Presumably chosen to comply with EU competition law rules.
90 Some manufacturers merely specify RRP, whilst others take active measures to ensure that the retailers priced at or close to the RRP (in terms of level of prices or ranges of discounts).
effects at each level of the supply chain. This leads to greater social welfare and more dynamic competition.\(^91\)

Although vertical restraints may harm competition,\(^92\) in general suppliers have no incentive to restrict the scope of their distribution networks. Rather, vertical restraints provide the opportunity to ensure that both contractual parties invest in the relationship. In normal circumstances, therefore, the object of restraints in vertical agreements is likely to be to achieve an efficient price and output level, not to restrict either intrabrand or interbrand competition. Indeed, most of the relatively few relevant empirical studies support the view that pro-competitive theories underpin the use of vertical restraints, including RPM and exclusive distribution.\(^93\) Further, the widespread adoption of vertical restraints (where legal), by suppliers and distributors which do not have market power, clearly suggests that in many cases the objective pursued is to resolve supply chain inefficiencies rather than to restrict competition.

The procompetitive effects of vertical restraints thus rest on two propositions. First, a simple price contract may leave retailers with inadequate incentives to provide sales and service effort in their various dimensions. Second, contracts with vertical restraints can restore or at least enhance and align those incentives.\(^94\) Vertical restraints may therefore be necessary to eliminate a double-marginalisation problem,\(^95\) to encourage relationship-specific investments (for example in brand-image),\(^96\) to ensure retailers have optimal incentives to invest in

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91 Different vertical contracting practices can sometimes be used for addressing a given inefficiency in vertical relationships. In practice, however, depending on the fine details of the situation at hand, perceived risks and market conditions, in some scenarios one particular vertical restraint is likely to be optimal.

92 See Section 3.B.iii.


95 Various types of vertical restraints, including maximum RPM (price ceilings) and as two-part tariffs (by introducing alternative means of sharing the profits), can be used to increase efficiency by removing the coordination failure in the more exceptional circumstance which occurs when a manufacturer and its retailer both enjoy market power. In the absence of such restraints, both parties will exploit their market power ignoring the impact of this price increase on the other party’s profit leading to retail prices that are not only above costs, but also above the desirable level for the vertical structure as a whole.
services necessary to encourage consumer demand for a product, to launch a new product\textsuperscript{97} or to signal the quality of a product\textsuperscript{98} without risk of other retailers free-riding on their efforts.

For example, retailers can raise consumer demand for a product and expand sales by offering services that improve information, convenience or quality for end customers. A rich literature explains that a number of vertical restraints, including RPM, exclusive dealing, territorial restrictions or selective distribution, may be used as mechanisms to allow suppliers to elicit optimal service levels.\textsuperscript{99} The risk of free-riding is particularly high where retailers cannot separate aspects of retail service that build demand for the manufacturer’s product from other retail activities and/or they cannot ‘sell’ the former to consumers or the manufacturer, on a stand-alone basis. Often, transaction costs as well as economies of scope in retailing prevent the separation and sale of brand specific retail services. Vertical restraints may also be designed to prevent retailers from lowering retail prices in circumstances where they simply

\begin{footnotesize}
\textsuperscript{96} Contracts are generally incomplete and future actions by either party may not be observable. This means it is not possible to cover all contingencies that may occur or to condition all relevant decisions to be taken by each party (on price, quantity, product characteristics, etc.) on verifiable variables (including, possibly, announcements by the parties, e.g. concerning their valuations, costs, etc.). Moreover, there are many investments which lose most of their value outside a particular relationship, because they are tailored and dedicated to a particular partner (for instance, a franchise devotes important investments to carry and promote a particular brand or a firm may design its machinery to work with a particular intermediate good or input). In such cases, the risk that the relationship may break down will generally lead to an under-investment problem. If a retailer fears that its promotion efforts to establish a brand’s image might next year benefit another shop located in the same area and carrying the same brand, it will think twice before investing heavily in such an activity. Likewise, a manufacturer will be deterred from investing in assets which might improve a distributor’s performance if the latter is likely to switch to other brands. Vertical restraints e.g., exclusive territories and exclusive dealing mitigate the risk of such opportunistic behaviour (a firm getting out of the relationship after the partner has made specific investments into it) and the resulting underinvestment.

\textsuperscript{97} When a manufacturer requests a distributor to carry a new product line, it exposes the distributor to a certain amount of risk, e.g., with respect to the necessary market development effort. By deploying territorial restrictions or using a SDS, the manufacturer may be able to reduce this risk and ensure that the risk is allocated optimally between suppliers and distributors. This increases the chances that new products will be developed in the first place.

\textsuperscript{98} Customers may have only imperfect information regarding the quality or other unobservable characteristics of a product, especially in the case of new products. In that case, the identity or specific actions of the retailer may provide a useful signal. For example a supplier may prefer to distribute through a store, which has a reputation for stocking high quality products. This implicit certification activity by retailers involves costs (for example, locating the store in an upmarket district of town and employing suitable assistants). Hence, retailers may be unwilling to stock products if they are being sold at lower prices by outlets, for example discount outlets or internet distributors, which would undermine the exclusivity and quality image they are promoting. This argument may justify distributing only through ‘selected’ stores, which meet specified quality criteria, and refusing to supply the product to discount stores, supermarkets or certain internet distributors.

\textsuperscript{99} See e.g., n 94. In their absence, retailers may choose a service level which is lower than optimal for both the supplier and end-consumers. This is because when choosing the optimal amount of service effort, the retailer will only take into account its own benefits and will ignore the benefits of increased sales for the upstream supplier from the expansion of retail sales. Although the benefits of retailers’ services accrue both to the retailer and the supplier (who makes a positive margin when retail sales expand), the costs of service may be borne solely by the retailer. In addition retailer efforts may not be directly observable or verifiable by the supplier and cannot be enforced contractualy.

\end{footnotesize}
attract customers from competing retailers, but without increasing output or the brand manufacturer’s profits.\textsuperscript{100}

It is true that relatively little literature deals with the impact of vertical restraints in the internet age where e-commerce has rapidly transformed distribution and retailing methods – numerous products are now sold online or through platforms and price comparison websites exist to facilitate consumers’ buying choices. The growth of e-commerce not only facilitates market access,\textsuperscript{101} but it increases price transparency and lowers search costs, enabling customers to instantaneously obtain and compare product and price information online, and to switch swiftly from one channel (online/offline) to another. Nonetheless, e-commerce also creates new challenges to ensure that manufacturers’ and retailers’ incentives remain aligned.

Even if, therefore, in-store services are becoming less important as e-commerce develops and consumers invest time on-line to learn about the product, in some cases consumers continue to rely on retail services – for example in the case of complex products, experience goods, or one off purchases of durable goods. In such cases the risk of free-riding can be exacerbated by e-commerce\textsuperscript{102} – a consumer can simply visit a brick-and-mortar store to ask questions, to try, view or test a product, and then make the purchase online.\textsuperscript{103}

Although internet distributors may also provide extensive product information and customer reviews on their websites\textsuperscript{104} two factors make free riding by internet retailers a potentially greater problem than free riding in the reverse direction:

- First, much of the effort of the brick-and-mortar retailers takes the form of a per customer cost, while online retailers are more likely to incur fixed costs in providing support;

- Second, because the promotional effort of a brick-and-mortar retailer consists of personal interaction between customers and sales consultants, it is much more difficult to verify it directly.\textsuperscript{105}

Further, although online competition offers opportunities for small and large firms alike to enter and expand into new markets, to introduce new products, innovative services and to test new ideas and markets at a fraction of the transaction costs of the past and has transformed the retail experience giving consumers access, with low search costs, to a wide array of online distributors across a wider geographic scope, the increase in price competition may

\textsuperscript{100} Although the manufacturer may be indifferent to where the purchase takes place, each individual retailer might be discouraged from investing in promotional activities. This typically hurts both the manufacturer and also consumer welfare.

\textsuperscript{101} E.g., smaller retailers may, with limited investment efforts, become visible and sell products to a large customer base and in multiple Member States through marketplaces.

\textsuperscript{102} See e.g., Vertical Restraints: New Evidence from a Business Survey n 88 (finding that vertical restraints have offered ways to manage the competitive impact of increased e-commerce in many sectors, in particular by preventing free-riding and maintaining the pre- and after-sales service quality and protecting brand image) and D Carlton and J Chevalier, ‘Free Riding and Sales Strategies for the internet’ (2001) 49 Journal of Industrial Economics 441.

\textsuperscript{103} Commission’s Preliminary Report, n 2, 8.

\textsuperscript{104} E.g, a consumer may compare smartphone prices and characteristics in an online retailer but then purchase the preferred brand in a nearby physical shop.

\textsuperscript{105} In addition, the manufacturer could use fixed fees to compensate online retailers who provide information or promotion-laden sites. Fixed fees cannot be effectively used to compensate brick-and-mortar retailers for the effort they dedicate to each customer.
come at the expense of other parameters of competition, in particular, quality, brand and innovation. The Commission’s Preliminary Report on e-commerce (made in the context of its e-commerce inquiry),\textsuperscript{106} acknowledges that although price is considered as the key competitive factor among retailers, the significance of quality and brand image considerations is stressed by manufacturers as the most important feature of interbrand competition. E-commerce thus presents renewed challenges for manufacturers to ensure that they can keep control over, and protect, the image, reputation and positioning of their brand in the mid- to long term and maintain a consistent quality of pre and after sales service.

These developments and challenges are fuelling new distribution practices and restraints relating to internet sales, for example, online RPM, MFNs and bans on selling on certain online platforms/ market places.\textsuperscript{107} Although much remains to be learned about the competitive effects of such arrangements, it is clearly possible that those mechanisms seek to protect brand image, combat counterfeiting, limit the effect of free-riding and encourage investment in the provision of customer services. For example, a manufacturer that constrains the percentage of sales that can be made via the internet may simply be adjusting the mix of its price and non-price demand variables (image investment, for example) just as if it were adjusting these variables directly.

The Commission’s Preliminary Report recognises that e-commerce is having a profound effect on manufacturers’ distribution strategies:

a) First SDSs are used more widely. These allow manufacturers to (i) better maintain a coherent brand image across offline and online sales (ii) avoid free riding between the two channels and (iii) offer a certain degree of protection against the sale of counterfeit products;

b) Second, manufacturers are integrating vertically into online distribution. E-commerce (i) significantly lowers the transaction costs of reaching a wide customer base, (ii) facilitates adapting and communicating new prices to customers in response to changing competitive conditions (iii) and gives the manufacturer greater control over brand image. According to the Commission’s Preliminary Report, 64 per cent of manufacturers have launched their own websites within the last ten years;

c) Third, manufacturers are increasingly pursuing an omni or multi-channel strategy. For differentiated products, in particular durable goods that represent an important share of consumer expenditure, manufacturers want to ensure that technical features, innovations and other important product characteristics are appropriately explained and presented to consumers. The environment for such services can be created both in brick-and-mortar shops and online. Consumers nowadays make use of both channels and switch between channels to collect information, compare offers, and ultimately make a purchase. An increased proportion of sales is generated via the manufacturers’ own retail activities, both online and offline.

These developments suggest that the relative importance of intra-brand versus inter-brand competition is evolving, manufactures are seeking to tighten its control over the reputation of its brand by integrating vertically into online sales and using SDS. These market developments may reduce intra-brand competition but intensify inter-brand competition.

\textbf{ii. Even ‘object/hard core’ restraints have procompetitive potential}

\textsuperscript{106} See n 2.

\textsuperscript{107} See n 143 and text.
A supplier is unlikely unilaterally to want to shield its dealers from intrabrand competition through territorial or price restraints unless it wishes to encourage sales and service efforts by dealers. Otherwise the effect would be to reduce sales in the downstream market and reduce supplier profits.\footnote{108} Even in the case of the most severe object or hardcore restraints on intrabrand competition, therefore, procompetitive justifications may be the driving economic motive for their use.

For example, SDSs and a number of vertical restraints may be required to deal with the problem that retail promotional activities confer a positive externality on both suppliers and other retailers. Without such restraints, a given retailer will likely invest too little in promotion, both because other retailers and the supplier will free-ride on its efforts and because it can itself free-ride on the efforts of others. One way to induce retailers to provide optimal levels of service, sales effort or advertisement for the vertical chain is to establish a minimum sales price. In particular, RPM may incentivize distributors to increase promotion efforts (for example to introduce a new brand or to enter a new market) where it is too difficult or costly for a manufacturer to exactly specify in a contract what a distributor should do to increase sales. With retail price competition for the product eliminated, retailers compete with each other for sales by offering valuable retail service to consumers. Retailers may use RPM-protected margins to safeguard investment in promotion and retail services store reputation.

Exclusive rights of sale in a given territory to a single dealer, or a group of dealers, may also allow the manufacturer to ensure that dealers in different areas do not free ride on another dealer’s investment. Territorial exclusivity also induces the optimal level of investment in the relationship with the supplier and may allow the manufacturer to certify its product quality by granting territorial exclusivity to a retailer with the desired reputation.

Territorial exclusivity can be reinforced through contractual provisions preventing other retailers and/or the manufacturer from selling into it – whether through active and/or passive selling. The dichotomy drawn in the EU between active and passive selling (or qualified and absolute territorial protection)\footnote{109} detracts from the core issue which should be how these restraints impact on competition. From an economic perspective the form of the ‘sale’ makes little difference. Absent supply chain inefficiencies, a supplier ordinarily benefits from competition between retailers and is likely to want them to compete and rely on all available distribution channels, including the internet. Indeed the Commission’s Preliminary Report in its ongoing e-commerce sector inquiry\footnote{110} acknowledges that there may be procompetitive motives for online sales restrictions.

### iii. Theories of harm

Despite their propensity to produce efficiencies, it is uncontroversial that vertical restraints may create conditions in which the intensity of price or interbrand competition is softened, collusion (upstream or downstream) is facilitated, or anticompetitive foreclosure occurs.

\footnote{108} Although therefore dealers are protected from intrabrand competition, their ability to raise retail prices or skimp in the provision of services will be constrained if competition at the manufacturer level is sufficiently strong.

\footnote{109} See n 55 and text.

\footnote{110} See n 2.
Further, that alterations resulting from vertical restraints may ‘fail to reflect the preferences of infra-marginal consumers, the interests of consumers in general may not be served.’

Economic concerns about RPM, for example, derive from the fact that it gives the manufacturer power over retail price, eliminates intrabrand price competition between retailers and sets a price floor on resale prices – so, without RPM, prices would be lower. Indeed, theory indicates that RPM may facilitate collusion – either at supplier or dealer level – or lead to foreclosure of suppliers or innovative and discounting retailers. For example: RPM may make manufacturer collusion more stable by making it easier to detect deviations from a collusive strategy and reducing incentives for deviation; retailers may induce a manufacturer to ‘impose’ RPM, to support their collusion and to prevent deviations from the strategy; a supplier may use RPM to exclude competitors from the market by offering retailers a higher margin as a ‘payment’ for their willingness not to deal with competitors; or a retailer may demand RPM from its supplier(s) to exclude discounting competitors or new entrants from their market.

Similarly, territorial restraints or restraints on online selling may have anticompetitive consequences through exclusion or collusion: a retailer that is well-established may obtain territorial exclusivity and prevent competing retailers (or online retailers) from gaining access to a key good; such restraints may facilitate collusion between suppliers (through market sharing) and/or soften upstream competition between them, or facilitate collusion at the retail level.


113 Customer foreclosure takes place when the vertical restraint is likely to foreclose upstream rivals by restricting their access to a sufficient customer base.

114 Input foreclosure takes place when vertical restraint is likely to raise the costs of downstream rivals by restricting their access to an important input.

115 Cartels are less stable if cartel members cannot observe wholesale prices and retail prices fluctuate – it is hard to distinguish between fluctuations due to cost changes in downstream market and those due to individual deviations by cartel members. RPM eliminates this retail price deviation and thus leads stability.

116 See e.g., Case 1022/1/03, JIB Sports plc v Office of Fair Trading [2004] CAT 17 (Judgment on Liability).

117 Suppose e.g., that competing manufacturers distribute their products through distinct retail networks. If they maintain strong intrabrand competition within their retail networks, then the retail price of each product will closely reflect the evolution of the wholesale price for that product; as a result, the situation resembles one of direct, face-to-face competition between the manufacturers. If instead manufacturers reduce intrabrand competition by e.g., assigning exclusive territories to their distributors, these distributors will have more freedom for setting their prices: and typically the retail price for one product will then (at least partially) respond to increase in rival manufacturers’ wholesale prices, thereby encouraging the retailers to raise their
When considering theories of harm the crucial difference between horizontal\textsuperscript{119} and vertical restraints must, however, be borne in mind; in particular that in the case of the latter, increased dealer services resulting from the restraints may increase demand for the supplier’s products and interbrand competition will typically constrain and impede supra-competitive pricing by firms. For example, a product sold at a retail price limited by RPM would continue to compete with the products of other suppliers (as well perhaps as other brands supplied by the same supplier). If there are, for example, 20 suppliers of a relevant product, each accounting for five per cent of the market, and one supplier were to use RPM, consumers could easily switch among the alternative brands. In such circumstances, the price restraint would not generally injure competition or consumers.

Even in the case of ATP and RPM, therefore, these theories of harm must be analysed carefully. Whether such anticompetitive effects are possible, or merely theoretical, depends upon the specific circumstances of the case, the degree of interbrand competition, the nature and scope of the restraint in question, whether restraints are dealer or retailer led and the availability of alternative means to internalise vertical inefficiencies, including vertical integration.\textsuperscript{120} For example, RPM will only work as a foreclosure strategy by a supplier if the retailers bound to the manufacturer via RPM agreements comprise a sufficiently large share of the relevant market. The theory of harm is untenable where upstream competitors and new entrants retain access to the market via competing retailers or alternative channels of distribution. Input foreclosure also is plausible only if the supplier has a significant degree of market power in the input market and the input represents a significant cost factor or is an otherwise critical component for dealers.

Similarly, the use of RPM does not automatically imply that collusion can be sustainable, let alone that RPM itself induces collusion. A set of particular circumstances need to be present for collusion to emerge and to remain sustainable. Indeed, a collusion theory will generally be implausible in industries that do not feature at the very least a tight oligopoly with high barriers to entry and, most likely, homogenous products (where non-price competition is difficult to control).\textsuperscript{121} Rather, a level of market power upstream and downstream is required and the intrabrand restraints must facilitate firms in reaching an understanding on the terms of prices. In sum, assigning exclusive territories to retailers could be an effective way for a manufacturer to commit itself to a ‘friendlier’ behaviour vis-à-vis its rivals, which may encourage that rival to charge higher prices.

\textsuperscript{118} In an extreme case with a monopoly manufacturer and a set of retailers who, absent the territorial restrictions, would otherwise compete, territorial restrictions could enforce a market division arrangement similar to explicit collusion between the retailers.

\textsuperscript{119} But see n 123 and text.

\textsuperscript{120} Vertical Restraints: New Evidence from a Business Survey n 88 (noting that the impact on consumers from having vertical restraints would depend on the type of restraint, the position of the relevant parties and the market context. In some cases removing restrictions would be likely to lead to some short-term price reduction and may increase availability for consumers, but that this could be at the cost of lower quality (or lower perceived quality) and service, and lower availability in the longer term).

\textsuperscript{121} The collusion mechanism must be robust to countervailing buyer power or new entry and expansion by non-coordinating firms. A retailer collusion story is not convincing in many scenarios. Under this theory retailers induce a manufacturer to ‘impose’ RPM, to support their collusion and to preclude deviations for the strategy. Retailers (possessing monopoly power) thereby delegate both the implementation and the enforcement of the cartel to the manufacturer. One problem with this theory is that such collusion may be undermined by non-price rivalry between dealers. Another is that the manufacturer would be worse off under the agreement and its sales would be reduced. Where they are used as a mechanism to facilitate explicit (as opposed to tacit) collusion, cartel enforcement may follow.
coordination and in monitoring and punishing deviations. Where collusion could be monitored and enforced through other more effective and less conspicuous means, it would seem unlikely that RPM would be chosen by the participants as the mechanism to do so.

A further antitrust concern is that although e-commerce is an important driver of price transparency and price competition, certain online practices or restraints relating to online selling may raise competition concerns. For example, in its Preliminary Report, the Commission noted that price-tracking software, which is becoming more prevalent and sophisticated, is allowing both retailers and manufacturers to track online retail prices. This creates a possible risk that the software can be used as a mechanism for facilitating or strengthening collusion between retailers or enabling manufacturers to monitor and enforce retailers’ compliance with their particular pricing policies (especially if manufacturers have integrated into retailing). In addition, although price comparison sites and online market places may at first sight enhance transparency and competition, recent theory and practice indicate that the reality may be more complex. Not only may price comparison sites reduce incentives for consumers to shop around, but suppliers may pay or incentivise price comparison sites to place their offerings high in the ranking or use such sites as an advertising platform. They may therefore lead to customers paying higher prices.

C. A CONTINUED RISK OF ERRORS AND LACK OF CLARITY AS TO HOW FULL ARTICLE 101 ANALYSIS IS TO BE CONDUCTED?

i. Overinclusive Rules in the EU?

Most antitrust systems rely on rules of illegality (or presumptions of illegality) to condemn some behaviour. Such rules serve important ends, particularly the attainment of procedural economy and the clear prohibition, and deterrence, of patently anticompetitive behaviour. In such circumstances, the administrative savings may outweigh the cost of small false positives

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122 Half of responding retailers stated that they track the online prices of competitors. Of these, 67% used automatic software programmes. 78% of these software users would then adjust their own prices to those of their competitors. The Commission found that most retailers adjusted their prices manually, but a ‘significant number’ used both manual and automatic price adjustments, whilst about 8% only used automatic adjustments. Some manufacturers were also engaging in tracking the online retail prices of their products sold by distributors (approximately 30% did so systematically and others on a more specific basis) and 38% of these manufacturers used price-tracking software.

123 Rather than providing perfect competition so that retailers can, and do, respond unilaterally and competitively to pricing developments in the marketplace, such software may increase transparency and, consequently, reduce the incentive to deviate from a collusive strategy and make it easier and quicker to detect those that do deviate, Preliminary Report, n 2, paras 549-555 and see e.g., A Ezrachi and ME Stucke Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy (Harvard University Press, 2016). See also e.g., the UK’s Competition and Markets Authority (CMA) decision in Trod Ltd: Posters and Frames, 12 August 2016 (in this case an agreement between online sellers not to undercut each other’s prices was implemented using automated repricing software which the parties configured to give effect to the illegal cartel).

124 Savvy consumers can use them to hunt down the best available deal. Firms, worried of losing customers, feel an obligation to improve their offerings all the time. See e.g., the CMA market study of digital comparison tools, launched 29 September 2016.


126 Although no conduct is prohibited per se in the EU, object/hardcore restraints are perceived to be virtually illegal per se and to be strongly discouraged, see nn 54-58 and text.
and exceed the efficiencies that can be derived from moving to a more comprehensive antitrust analysis. It is crucial, however, if such rules are not to sacrifice economic benefits generated by practices with ambiguous competitive effects, that they should be founded upon a sound understanding, from theory, evidence and experience, that the practice in question typically imposes harm. They should be reserved for manifestly anticompetitive which is most unlikely to produce offsetting benefits or redeeming efficiencies. The mere theoretical possibility that a particular agreement may restrict should not suffice.

This is an important point, which emphasises the link between antitrust rules and standards, and between ‘restrictions by object’ and ‘restrictions by effect’ in EU competition law, and makes it clear that they should not reflect two totally separated analytical approaches but should be joined by unifying concepts. In each case the analysis (the decision to place an agreement in the object category or the appraisal of restrictive effects) must be referable to a theory of harm and, in particular, to the question of whether the agreement can be expected to lead to a situation with market-wide increased price/reduced output, compared with a no-agreement counterfactual. Without such a theory, the crucial question of whether the agreement is restrictive or enhances economic efficiency cannot be addressed.

In accordance with this reasoning, many systems apply rules or presumptions of illegality to condemn horizontal cartel arrangements. In CB, for example, the CJ explained that as such agreements may ‘be considered so likely to have negative effects, in particular on the price, quantity or quality of the goods and services, that it may be considered redundant, for the purposes of applying Article [101(1)], to prove that they have actual effects on the market...’ emphasis added.

It has been seen that in the EU a number of vertical restraints have also been characterized as object or hardcore restraints – including RPM, ATP, bans on online selling and certain SDS – and that there is debate as to whether some ‘other’ new vertical restraints (especially certain online practices) also fall within this category. The discussion in Section B suggests, however, that economic theory does not support general conclusions that vertical restraints are either ‘good’ or ‘bad’ for welfare. Rather its consensus is that the effect of vertical restraints is ambiguous; they may either increase or decrease efficiency, depending on the context of the case. As a matter of pure economics, therefore it suggests that it may not justified (as it is for cartel agreements) to assume harm to competition and/or to presume that they have no redeeming efficiencies or involve restraints unnecessary (or disproportionate) to the

127 See e.g., I Ehrlich & RA Posner, ‘An Economic Analysis of Legal Rulemaking’ (1974) 3 J Legal Stud. 257, 258 (using the term ‘standard’ to refer to ‘a general criterion of social choice,’ such as a mandate to promote ‘competition’ and the term ‘rule’ to refer to a more precise statement that circumscribes the assessment of factors relevant to a decision according to the standard), L Kaplow ‘A Model of Optimal Complexity of Legal Rules’ (1995)11 J. L. Econ & Org. 150 and Jones and Kovacic, n 69.

128 Case C-67/13 P, n 27. See also discussion at nn 173-179 and text.

129 ibid, para 51.

130 We note that the economics literature has focused on models that abstract from potentially important factors in order to isolate certain other factors in tractable, intuitive models. For example, the literature on non-price retailer decisions typically assumes upstream monopoly, abstracting from the effects of upstream rivalry. The practical implication is that models have not been developed that combine all the factors that might be relevant in the most reasonable model. The economic literature does not offer off-the-shelf models or analysis that applies to the broad range of circumstances that emerge in practice.


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achievement of efficiencies – the presumption of illegality lacks a solid foundation in economic principles. Indeed as the probabilities assigned to positive and negative outcomes of vertical restraints remain contested and the frequency and magnitude of positive or negative effects remain largely unexplored, especially in the online world, the current formalistic framework may be emasculating debate on this issue. Further, the new realities of a more globalized, technology driven and digitalized competitive environment may suggest that the approach is outdated and requires adjustment. An approach that allows for some consideration of case specific facts thus seems to be crucial.

If this is correct, the strict stance against vertical restraints is likely to be leading to Type I error risks (which are not offset by administrative savings) and to be deterring agreements which may result in efficiencies in distribution and/or help firms to penetrate new markets. Although the cost to society of such deterrence is unseen and, hence difficult to quantify, economic theory warns that this cost may in fact be substantial. Suppliers may prefer to avoid the risk of an antitrust infringement by finding other mechanisms to achieve their objectives – for example, by choosing not to release products in some EU markets where pricing would need to be lower (if this created a risk of undermining the firm’s position in higher priced markets) or by vertically integrating instead. Such solutions might forego the use of independent distributors, result in reduced intra and interbrand competition and/or result in a reduction in e-commerce. Indeed, it has been seen that the Commission’s Preliminary Report confirms that manufacturers are seeking tighter control over distribution through vertical integration and/or the conclusion of SDS. It seems possible therefore that a system designed to promote and protect intra-brand competition may in fact be undermining it.

The risk of Type I errors may be particularly acute if the rules developed in the pre-internet age are simply extended into the online world. It is still relatively early days for online commerce which has injected doses of high adrenaline into retail distribution across the EU. The interaction of online and offline sales is leading to creative destruction, trial and error and all kinds of experimentation with new business models (for example, through mobile apps) and supply chain practices which infuse intense dynamic competition and stimulate innovation. The rigid approach to vertical restraints may, therefore, be constraining such dynamism and market participants from entering into vertical arrangements that stimulate interbrand competition, and counteract concentration of market power or collusion.

132 Iacobucci and Winter, n 85, 63.
135 See e.g., COMP/30.228, Distillers (Red Label) [1983] OJ C245/3.
136 If suppliers are driven towards vertical integration and ownership of their online distribution channel, the ability and incentives of independent distributors/retailers to enter or remain in the market is limited. Further, the ability for small manufacturers to access more efficient or specialised distributors is reduced meaning that they may also have to vertically integrate online and sell directly through their own web page or an online marketplace. But this often entails very high costs and is liable to harm consumers.
137 See also e.g., Cases 56 and 58/64, Consten and Grundig n 36, (some years after the decision Grundig acquired Consten and a number of its exclusive dealers, see V Korah and D O’Sullivan Distribution Agreements Under the EC Competition Rules (Hart Publishing, 2002), 62).
Although it is recognised that the Commission has wider e-commerce policy objectives, wishes to encourage internet use across the EU and to respond to consumers’ frustrations about impediments to their making cross-border transactions via the internet, it is submitted that competition law is not the appropriate tool to address such concerns. Further, sight should not be lost of the fact that the overarching objective of the internal market project is not free movement of goods and services as such, but efficiency.  

**ii. Lack of guidance on individual analysis**

It has been seen in Section 2 that because of the substantial reliance on both the category of object restraints by the Commission, and NCAs, in their infringement decisions, reliance on the de minimis principle and the Verticals Regulation (by firms), and the paucity of Article 267 references from national courts, the question of how of how individual analysis of vertical agreements is to be conducted under Article 101(1)(3) arises relatively rarely before the EU courts. There has therefore been no steady flow of cases emerging before the EU courts which has allowed them to develop and hone the case-law in this area. Consequently, a lack of clarity continues to shroud the questions of exactly how the parts of Article 101 work together and when, historic concerns manifest in the jurisprudence about restraints on rivalry and internal market integration, prevail over analysis based on an assessment of the impact of the conduct on economic efficiency and the welfare of consumers in the EU. Further, there is a shortage of guidance on how assessment is to be conducted in relation to the new vertical models of distribution and practices that have been emerging online (subjects of the Commission’s e-commerce sector inquiry), such as agency arrangements, online RPM, parity clauses, restrictions on inclusion in price comparison tools and marketplace restrictions. This ambiguity is compounded by the fact that it has been the NCAs, not the Commission, that have to date taken the lead in this area and that they have sometimes struggled to act consistently with one another and, so, to adopt a uniform interpretation of EU competition law. These perceived differences in the interpretation and

138 See n 86 and text.  
139 The last infringement decision adopted by the Commission in relation to a vertical agreement under Article 101 was in 2005, COMP/36.623, Peugeot [2006] OJ L173/20, but see n 2.  
140 Case C-345/14, SIA ‘Maxima Latvija’ v Konkurences padome EU:C:2015:784 and Case C-230/16, Coty, n 46.  
141 The Verticals Regulation, although creating valuable legal certainty, also clouds the relationship between its two parts. Indeed, the Commission’s Vertical Guidelines offer no explanation as to why such a broad overarching block exemption is necessary if, as seems probable, many (or even most?) agreements satisfying its conditions are, given the parties’ lack of market power and the absence of ‘severe’ restraints within the agreement, unlikely to have a restrictive effect on competition (and so to infringe Article 101(1)).  
142 Agency agreements fall outside Art 101(1) entirely in certain circumstances (even if the agreement contains hardcore restraints), broadly where the agent bears no risks (i.e. all commercial risks are covered by the principal), see Guidelines, paras 14-15 and Case C-217/05, Confederación Española de Empresarios de Estaciones de Servicio (CEES) v Compañía Española de Petróleos SA [2006] ECR I-11987. In spite of the major importance characterization of the agreement has for competition law assessment the question of when an agency agreement exists is not easy to determine. The nature of the relationship could impact on the necessity or effect of the vertical restraints.  
143 E.g., with regard to MFNs used in relation to online hotel booking, the German NCA adopted decisions finding both that HRS’ and Booking.com’s MFNs infringed competition law (both German and EU), continuing proceedings against the latter, even after other NCAs, closed investigations subject to commitments, see generally N Varona and A Hernadez Canales, ‘Online Hotel Booking’, CPI Antitrust Chronicle May 2015. The Commission and relevant NCAs formed a working group to evaluate to monitor the effects of the different solutions adopted and to consider if there is a need to look at this sector again. See also n 58 and text.
application of EU law across jurisdictions create challenges for business and may even deter firms with the aspiration to expand within and to benefit from the internal market from selling in some Member States.

It is appropriate therefore that the Commission now seems poised to act in this rapidly expanding area of e-commerce—what is crucial, however, is that it establish a coherent methodology as to how these practices should be appraised as well as seeking to collect data which will provide evidence as to how vertical restraints are impacting on markets in practice. The Commission, which retains a central role in EU competition law enforcement, should therefore prioritise cases of wider EU relevance and with a high precedent potential. In particular, it should concentrate on decisions, which can be tested before the EU courts, which set out a framework for identifying anticompetitive agreements which distort interbrand competition and harm consumers and distinguishing them from benign and procompetitive arrangements (and not just seek to rely on the fact that it contains object/hardcore restraints). Further, if it adopts commitments decisions it should consider putting in place mechanisms which measure how changes made impact on markets in practice. More broadly, the Commission should also reconsider the current system reflected in the Verticals Regulation and Guidelines and ensure that these are updated to bring them more closely in tune with economic thinking and business realities.

4. SOME PROPOSALS FOR CHANGE: AN EVOLUTION IN ARTICLE 101 APPRAISAL

A. THE NEED TO DEVELOP A MORE FLEXIBLE AND NUANCED FRAMEWORK FOR VERTICAL AGREEMENTS

The sections above have demonstrated that, in spite of improvements in relation to the working and operation of the Verticals Regulation, a number of the problems identified in relation to the pre-modernized framework in fact persist, including:

(i) overly broad application of Article 101(1) and, in particular, overreliance on presumptions of illegality through dependence on, and seeking to expand, the object category which creates a risk of Type I errors;
(ii) legal uncertainty about how common contractual provisions should be analysed; and
(iii) reliance on block exemptions (to reduce legal uncertainty);

all of which continue to eliminate and de-emphasize ‘what should be the heart of’ the system—substantive (economic) analysis of the overall competitive effects of a given vertical agreement. Further changes thus seem to be required to realise the Commission’s modernization aspirations and to ensure that the Article 101 analytical framework better reflects the economics of vertical restraints and that the different categories of analysis are linked by uniform concepts underpinning EU competition law.

This paper thus proposes both: (a) an evolution in approach to the assessment of when an agreement is restrictive of competition by object; and (b) an analytical framework, based on mainstream economic thinking, for the individual assessment of agreements under Article 101. The latter will play a more significant role if the scope of the object category is curtailed and would push the modernization process to its logical conclusion.

144 In its Preliminary Report it expressed concern about the burgeoning number of SDSs being operated, especially ones which exclude or restrict online, or certain online, sellers, or incorporating RPM provisions or restrictions on cross-border trade and see n 2.

145 See n 13 and text.
In order to achieve the evolution required, it seems crucial that the Commission should bring a series of carefully chosen cases which will provide the springboard for the EU courts to develop and clarify the law in the way proposed. If it does not do so, there is a risk that inconsistent approaches will be adopted by NCAs and national courts as they struggle to reconcile the various strands of jurisprudence to new and complex practices.

**B. Refining the Object Category**

i. Is refinement really required?

It has been argued in Section 3 that the approach to object restraints may be deterring procompetitive or competitively neutral agreements. Techniques could be adopted to mitigate the harshness of the current approach and to reduce the risk of false positives, for example, through:

(a) careful prioritisation of cases (public enforcement agencies could decide not to pursue a case unless the practice seems likely to produce significant anticompetitive effects);

(b) greater individual use of Article 101(3) to ‘except’ agreements generating efficiencies from the Article 101(1) prohibition, in particular through the Commission adopting non-infringement decisions under Article 10 of Regulation 1/2003;\(^{146}\) or

(c) removal of the list of hard-core restraints from the Verticals Regulation.\(^{147}\)

It is submitted, however, that none of these options are ideal.

First, some NCAs are understood to prioritize vertical cases in the way suggested, for example, deciding not to bring RPM cases where no anticompetitive effects appear to exist.\(^{148}\) It is submitted, however, that as this approach deviates from the clear rule set out in the law it leads to uncertainty and is effectively tantamount to acceptance that the approach is wrong.\(^{149}\) This uncertainty is exacerbated by the fact that it is certainly not followed by all NCAs, some of which are not able to prioritize and/or have taken robust action against RPM, territorial restraints and restraints on online selling. Firms may therefore feel compelled to follow the strictest approach adopted or create different commercial strategies across Europe to the detriment of the single market. Further, as prioritization does not impact on the law, parties to such agreement remain exposed to private litigation alleging an infringement of Article 101.

Secondly, we acknowledge that a flurry of non-infringement decisions providing clear guidance on the application of Article 101(3) to agreements incorporating ‘object’ restraints seems unlikely. Not only are NCAs not permitted to adopt non-infringement decisions,\(^ {150}\) but

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146 See e.g., D Bailey, ‘Reinvigorating the Role of Article 101(3) under Regulation 1/2003’ (2016) 81 Antitrust Law Journal 111. Although commitments decisions, see n 6, have been used to deal with agreements that the Commission might have ‘exempted’ in the past, they do not involve a finding of infringement or non-infringement.

147 See n 55 and text.


149 The legal uncertainty and difficulties generated by the Commission’s publication of a set of prioritisation guidelines in relation to Article 102 are well known. Not only are the guidelines inconsistent with the law, but there is a lack of clarity as to when exactly the Commission will follow them.

the Commission’s internal incentives are not designed to dedicate resources to adopting this kind of decision. Further, it has been seen that a particularly acute problem is that it is seems difficult to use Article 101(3) (as currently drafted and interpreted) effectively to weigh the beneficial effects of an agreement against its anticompetitive ones, in circumstances where the latter have not been assessed in any way but simply assumed.151

Thirdly, removing the list of hard-core restraints would lead to a perceived rule of virtual per se legality for these practices where parties’ market shares do not exceed 30 per cent and make it more difficult to sanction conduct which, in certain circumstances, could facilitate collusion between suppliers or dealers or have foreclosure effects which are not offset by redeeming efficiencies. This might arguably create a chance of Type II errors – an underinclusive rule which sometimes tolerates conduct that in fact is competitively destructive.

Finally, and crucially, it is submitted that these techniques do not deal with the root of the problem that these vertical restraints may not harm competition at all and may offer significant scope for efficiencies suggesting that it is not always appropriate to characterize them as restrictions of competition by object in the first place.

ii. Identifying Object Restrictions – the importance of the characterization process

In the US, since it has been accepted that the Sherman Act is a consumer welfare prescription,152 there has been a concern that categories of antitrust analysis adopted when interpreting Section 1 Sherman Act should not become conclusions, displacing the fact-specific analysis in which antitrust law is supposed to be engaging.153 In the context of vertical agreements, this sentiment has led to a move away from reliance on per se rules. In three landmark cases dealing with vertical intrabrand restraints, Continental TV, Inc v GTE Sylvania,154 State Oil v Khan,155 and Leegin Creative Leather Products Inc v PSKS, Inc,156 the Supreme Court overturned previous rulings holding customer and territorial restraints,157 maximum RPM,158 and minimum RPM159 were illegal per se. It held that as (i) per se rules are appropriate only for restraints that always or almost always tend to restrict competition, have manifestly anticompetitive effects, and lack any redeeming virtue; and (ii) the market impact of vertical intrabrand restrictions are complex because of their ability simultaneously to reduce intrabrand competition and to stimulate interbrand competition and bring about distribution efficiencies, the competing effects resulting from such a restraint should be analysed under the rule of reason. Indeed in Leegin160 the majority161 accepted that because

151 See Section 2.B.ii above.
152 See e.g., Reiter v Sonotone Corp 442 US 330, 343 (1979).
159 Dr Miles Medical Co v John D Park & Sons Co 220 US 373 (1911).
the economics literature was ‘replete’ with procompetitive justifications for a manufacturer’s use of RPM rule of reason was required.

The arguments set out so far in this chapter could provide support for a similar change of approach in the EU – and for recognition that neither theory nor experience suggest that these vertical restraints reveal in themselves a sufficiently obvious harm to competition or to the internal market. The reality, however, is that it seems unlikely that the EU Courts could be persuaded that such a reversal is required.\(^{162}\) Rather, a long line of cases indicates that although EU courts have not, as was done in \(CB\),\(^{163}\) articulated concerns that such agreements pose a high probability of negative effects on prices etc, they have demonstrated anxiety that these practices may harm competition through limiting important competition/rivalry between dealers and, crucially, erecting private barriers to cross-border trade inimical to the internal market objective. Further, the Commission’s view seems, like the dissenting minority in \textit{Leegin},\(^{164}\) to be that efficiency arguments may not exist in reality as frequently as theory suggests (how often does the opportunity for free-riding really arise) and that RPM at least does create a high risk of collusion and foreclosure; in the absence of convincing empirical data suggesting otherwise, therefore, it is unlikely to be convinced that a wholesale change is necessary.\(^{165}\) An abandonment of this starting position on ATP, RPM and bans on online selling might therefore be argued to create Type II error risks given the budget limits constraining the activities of ECN members.\(^{166}\) The starting position on ATP, RPM and bans on online selling thus appears entrenched and, given the ardent defence made of it, seems unlikely to be overturned. Although there is no formal system of precedent in the EU, the CJ generally strives for consistency,\(^ {167}\) preferring to develop the law on a more incremental basis.

It has been seen, nonetheless, that the case-law is clear that agreements should be held to be restrictive of competition by object only where an analysis of the purpose of the agreement, taking account of both its clauses and the context in which it operates, reveals a sufficiently deleterious impact on competition.\(^ {168}\) The category of object restraints is not therefore as simple as constituting a definitive and clear list. The list of ‘established’ vertical restraints

\(^{161}\) Roberts CJ and Scalia, Thomas, and Alito JJ joined in the Opinion.

\(^{162}\) See e.g., Jones, \textit{Left Behind by Modernisation} n 24. But see the appeal to the CJ, Case C-413/14 \textit{P}, from the GC’s judgment in Case T-286/09, \textit{Intel EU:T:2014:547}, where the CJ is being asked to reconsider a long-established presumption of illegality applicable in relation to loyalty rebates incorporated in contracts with dominant firms.

\(^{163}\) Case C-67/13 \textit{P}, \textit{CB} n 27, para 51.

\(^{164}\) Justice Breyer, writing for the minority, noted that US history provided empirical support for the view that RPM led to considerably higher retail prices and that economists generally concurred on this point (see also MacKay and Smith, n 93). In contrast, he found no satisfactory answer to the question as to when and how often benefits, such as the prevention of free-riding, were likely to occur and considered that courts would have extreme difficulty in identifying instances in which benefits were likely to outweigh harm. As antitrust law should be informed by economics but could not always replicate economists’ (sometimes conflicting) views, he concluded that it would sometimes be acceptable to provide a rule of per se unlawfulness to a business practice which could at times produce benefits. See also e.g., \textit{Peeperkorn} n 112 and Pitofsky, n 112.

\(^{165}\) See n 93 and ibid.


\(^{167}\) See e.g., A Arnull, ‘Owning up to Fallibility: Precedent and the Court of Justice’ (1993) 30 \textit{CMLRev} 247.

\(^{168}\) Case 56/65, n 28, 249.
simply provides an illustration of agreements/restraints whose purpose may be considered to be highly likely to be sufficiently deleterious – because of their impact on competition and the single market context. The purpose and the context of the agreement could therefore make it clear that even established restraints are not restrictive of competition by object. In *CB*\(^{169}\) the CJ stressed that the category of object restraints is inappropriate for cases where a more detailed market analysis is required to assess the impact of the agreement, for example, cases involving complex measures, cases where experience\(^{170}\) with the restraint is limited or cases where there is a plausible efficiency justification for the conduct (in that case the horizontal cooperation was argued to be designed to ensure the success of the carte bleu system, in particular through combating free-riding and balancing issuing/acquisition activities).\(^{171}\) In these latter situations, negative effects cannot be considered so likely to make assessment of effects redundant.\(^{172}\)

In line with *CB*, horizontal cooperation agreements with the potential to have mixed effects on competition – even those containing price or output restraints – do not fall within the object category\(^ {173}\) unless they do not truly concern, for example, joint research and development, production, or joint purchasing, but serve as a tool to engage in a disguised cartel.\(^ {174}\) Logic, and case-law, requires that a similar ‘characterization’ exercise be carried out in relation to vertical restraints: meaning that RPM, territorial restraints and SDS plausibly necessary to the pursuit of a legitimate procompetitive objective should not be found to restrict competition by object.\(^ {175}\) In *Murphy*,\(^ {176}\) the CJ accepted that a broadcasting licensing agreement containing territorial limitations aimed at partitioning national markets, would not be regarded as restrictive by object where other circumstances falling within its economic and legal context justified the finding that such an agreement is not liable to impair competition and in *Pierre Fabre*\(^ {177}\) the CJ held that a SDS incorporating a ban, or *de facto* ban, on internet selling necessarily restricted competition (and restricted competition by object) unless objectively justified (it constituted a proportionate measure to achieve a legitimate aim\(^ {178}\)). New restraints should also not be added to the object category unless theory or experience justifies a finding that the clauses and context reveal a high probability of anticompetitive effects.

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\(^{169}\) Case C-67/13 P, *CB* n 27.

\(^{170}\) The importance of experience was also stressed by the CJ in Case C-286/13 P, *Dole Food Co Inc and Dole Fresh Fruit Europe v Commission (Dole)* EU:C:2015:184, para 115. See also the Opinion of Wathelet AG in Case C-373/14, *Toshiba Corp v Commission* EU:C:2015:427.

\(^{171}\) The CJ referred the matter back to the GC which found that the agreement infringed Art 101 – the free-riding arguments had not been substantiated, Case T-491/07, EU:T:2016:379.


\(^{173}\) See e.g., Commission’s Horizontal Cooperation Guidelines, paras 128, 160–161, and 205–206.

\(^{174}\) See n 173.

\(^{175}\) This should be a distinct exercise to the objective necessity analysis currently advocated in the cases, see nn 65–71 and text.

\(^{176}\) Cases C-403 and 429/08, *Murphy* n 36, para 139.

\(^{177}\) Case C-439/09, n 37.

\(^{178}\) The CJ held that the aim of maintaining a prestigious product image could not be relied upon to provide any objective justification for such a clause.
The problem of an overly expansive object category could therefore be addressed through a careful characterization process – a close examination of the agreement’s purpose, content and context before it is determined whether object or effects analysis is appropriate. This may appear a minor, and obvious (following CB), development, but yet its effect, if followed, would be radical. To date there is no case involving an ordinary vertical agreement (rather than an intellectual property (IP) licensing agreement) in which the Commission (or Court) has been prepared to accept on the facts that either ATP or RPM is not restrictive of competition by object. Rather, in practice, the jurisprudence generally just presumes that such restraints are not justified and inevitably lead to consumer harm.

Decision-takers need therefore to become more willing to accept that object categorisation is not appropriate where the parties raise a plausible efficiency justification for RPM or territorial/customer restraints (bringing the practice into line with the approach set out by the CJ in CB). If there is a convincing efficiency story, the claimant should be required to demonstrate actual or likely restrictive effects before the parties are required to provide a robust justification of the efficiencies within the Article 101(3) forum.

C. A Clearer Framework for Effects Analysis

i. Developing the legal framework

If the breadth of the object category is more realistically limited, the Commission (and other claimants) will, more frequently, be required to demonstrate likely restrictive effects before the parties can be required to demonstrate efficiencies within the Article 101(3) forum.

Although concern about the open-textured nature of full antitrust analysis has often led decision-takers to shy away from adopting it and an anxiety that it will become tantamount to a rule of per se legality (given the difficulty it presents for claimants) leading to the possibility of Type II errors, the EU administrative framework provides a flexible forum for the Commission to develop an administrable and workable framework for an assessment of vertical restraints which need not be an expensive, excessively complex or time-consuming task. If advanced in this way through decisions, which are reviewed on appeal, it would allow the law to evolve and provide greater clarity of structure for NCAs and national courts to follow in subsequent cases. Indeed, some systems have developed structured forms of analysis often employing burden shifting frameworks to organize the evaluation of theories of harm and supporting evidence (in agreements, mergers, and monopolization cases). In the US, in particular, there has been a detectable movement away from analysis based on the classification of conduct into specific categories, and a movement toward a more concept-

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179 See n 40.

180 In some cases, where the agreement has been in place for some time, it may possible to show also actual anticompetitive effects

181 Case C-67/13P, CB n 27, para 52.


183 See eg in the US, United States v VISA USA, Inc 344 F3d 229, 238 (2d Cir. 2003) (agreements); United States v Microsoft Corp 253 F.2d 34 (D.C. Cir. 2001) (per curiam) (monopolization); United States v Baker Hughes Inc 908 F.2d 981 (D.C. Cir. 1990) (merger).
based approach, which focuses on: market power, the theory of harm, proof of adverse effects and assessment of countervailing efficiencies.

If the Commission were to bring a number of carefully targeted effect cases in this way, they could provide the foundation for new Vertical Guidelines, the perception of effects analysis as unmanageable and disorderly could be quelled, and resources could be concentrated on developing the Article 101 structure – rather than the limits of the by object category – to determine how:

- anticompetitive effects in terms of parameters of competition can be identified under Article 101(1) (departing from the objective necessity test set out in some cases); and
- procompetitive effects identified under Article 101(3) can be balanced against the anticompetitive effects identified under Article 101(1).

ii. Assessing and balancing anti- and procompetitive effects

In merger cases DGComp routinely conducts analysis which requires identification of the likely impact of a merger on the main parameters of competition (likely anticompetitive effects through foreclosure or coordinated effects and countervailing factors) and efficiencies. In the context of Article 101 an analogous assessment\(^{184}\) can be developed to determine whether (i) the conditions exist either for one of the parties to exercise market power or for effective collusion (by suppliers or retailers) to be sustained, (ii) the agreement in some way maintains, enhances or facilitates the exercise of that market power; and, if so, whether (iii) the restraints are indispensable to achieve efficiencies which align incentives and stimulate interbrand competition and which are likely to be passed-on to consumers and offset the harm suffered (Article 101(3)).

The enquiry under Article 101(1) should therefore focus first on the question of whether the agreement is likely to enable or facilitate the exercise of market power – not on the objective necessity of the restraints.\(^ {185}\) Where a vertical structure faces vigorous competition from both other brands and other retailers, there is less potential for any type of vertical restraint to reduce competition or economic efficiency. As strong competition at each level fosters efficiency of both supply and distribution services, minimal analysis should be required in cases involving firms with small market shares operate in upstream and downstream markets which are not concentrated. Development of the internet, in particular, has expanded the opportunity for inter-brand competition in many markets. Where, in contrast, vertical restraints are incorporated in agreements between firms operating in less competitive markets\(^ {186}\) (oligopolistic ones or where one of the firms is dominant), there is greater risk that they may be used to reduce competition or economic efficiency; closer antitrust scrutiny is consequently warranted.

In certain circumstances there may be evidence of actual harmful effects resulting from an implemented agreement. In other cases, anticompetitive effects should be established through indirect evidence, economic reasoning and an assessment of indicators of market performance and the economic and legal context in which the agreement takes place. In conducting such analysis it makes sense to benchmark it against that conducted in relation to vertical mergers – where there is vertical integration between the supplier and dealer(s). Like

\(^{184}\) Arguably, a merger assessment is more complex since it is typically forward looking.

\(^{185}\) See Section 3.B.iii.

\(^{186}\) Competition in the market as a whole is what matters here, and not intrabrand competition as such.
vertical mergers, vertical restraints can eliminate intrabrand competition without directly impacting on (interbrand) competition between two rivals competing in the same relevant market. As unlike full integration, however, vertical restraints typically allow (even promote) a certain degree of intrabrand competition (for example on service), logic suggests that restraints should not be treated more severely under Article 101 than vertical mergers under the EU merger rules. Thus the same concepts and methodological approaches should be used, taking account of the different ex ante and ex post nature of the review. This would eliminate any ‘concentration privilege’ and ensure that both mergers and agreements are only considered anticompetitive if they are likely to result in consumer harm.187

As in the case of vertical mergers, therefore, it should be assessed, as a first step, whether the use of vertical intrabrand restraints etc is likely to result in input or customer foreclosure or coordination. Here the factors discussed in Section 3.B.iii are crucial. This approach would bear resemblance to the methodology proposed by (then) Assistant Attorney General Christine Varney188 for US courts to appraise RPM under the rule of reason, post-Leegin.189 She suggested that a plaintiff seeking to establish RPM infringes Section 1 Sherman Act of 1890 would have to demonstrate one of four theories of harm:

1. RPM used by manufacturers to identify cheating on a price-fixing agreement;
2. RPM used to organise a retailer cartel by coercing manufacturers to eliminate price cutting;
3. RPM used by a dominant retailer to protect it from retailers which better distribution systems and lower cost structures therefore forestalling innovation and distribution; or
4. RPM used by a manufacturer with market power to give retailers an incentive not to sell the products of small rivals or new entrants.

Further, she noted, reflecting concerns of the Leegin court and economists, that particularly careful scrutiny of RPM would be merited if RPM was used widely by manufacturers or if the retailer, rather than the manufacturer was the source of the restraint (RPM is more likely to be anticompetitive when it results from retailer coercion).190

Where likely restrictive effects are established the burden shifts to the parties to establish procompetitive effects resulting from the agreement under Article 101(3). For example, that by internalising double mark-ups, by preventing free riding, encouraging investment in customer services, permitting a cost effective alternative to service contracts, facilitating market entry for new firms and brands or otherwise aligning the incentives of the parties, the

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187 See e.g., C Esteva Mosso, n 9.

188 C Varney, ‘Antitrust Federalism: Enhancing Federal/State Cooperation’ Remarks for the National Association of Attorneys General, Columbia Law School, 7 October 2009. See also n 189 and FTC’s modification of an order in Nine West, see http://www.ftc.gov/opa/2008/05/ninewest.shtm.

189 In Leegin, Justice Kennedy stated that three factors would be particularly important to the inquiry of anticompetitive effects in RPM cases: (1) the number of manufactures making use of the practice (careful scrutiny would be necessary if many competing manufactures adopted the practice); (2) the source of the restraint (harm to competition would be more likely to arise if RPM were introduced as a result of retailer pressure perhaps to facilitate a retailer cartel or supporting a dominant, inefficient retailer. In contrast a manufacturer’s interest in efficient distribution would ordinarily be aligned with that of the consumer); and (3) whether the manufacturer or retailer has market power. ‘If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers … And if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets.’ Leegin, 551 US 877, 898 (2007).

190 See n 116 and text and Iacobucci and Winter, n 85, 63.
agreement is likely to enhance the ability of the firms to act procompetitively for the benefit of consumers, thereby counteracting the adverse effects on competition which the agreement might otherwise have.\textsuperscript{191}

A particularly difficult hurdle for those relying on Article 101(3) in the EU to overcome, however, is the ‘indispensability’ criterion which requires a showing that the restrictions are indispensable to the achievement of the efficiencies, while allowing consumers a fair share of them. Although it is clear that restrictions are not indispensable, if efficiencies can be achieved by other practicable or less restrictive means\textsuperscript{192} or if they are not reasonably necessary to produce the efficiencies there is limited guidance on how this condition applies in practice.

5. CONCLUSIONS

Neither modern economic theory nor empirical evidence support arguments either that vertical intrabrand restraints are inherently suspicious or always improve efficiency and enhance welfare.\textsuperscript{193} Rather the economic literature reviewed in this Chapter indicates that such restraints tend to produce efficiencies and that, although they can give rise to anticompetitive outcomes, this is likely only in certain circumstances.

It has been seen, nonetheless, that although vertical restraints on interbrand competition frequently fall outside of Article 101(1) and/or benefit from the safe harbour of the Verticals Regulation, a combination of factors has led to intrabrand restraints being treated more harshly. Many such restraints are simply assumed to restrict competition and are excluded from the benefit of the Verticals Regulation meaning that their incorporation in a vertical agreement remains extremely risky, even for firms which hold very limited market power and in markets where interbrand competition is intense. Others are subject to an uncertain appraisal under Article 101 which focuses more closely on the necessity of the restraints contained within the agreement than its overall impact on competition.

The current regime appears therefore to be out of kilter with the economics underpinning vertical restraints and the Commission’s public statements about competition law and policy. The approach is also at odds, and hard to reconcile, with merger policy where it tends to be assumed that vertical mergers offer scope for efficiencies, and where a range of relevant factors, not just a contractual clause in isolation, are analysed to determine the likely impact of such mergers on the main parameters of competition (price, output, quality, innovation, etc.). Such mergers are not condemned without a robust theory of likely unilateral or coordinated effects being established.

This paper has considered how best to align EU law with mainstream economic thinking. The economics could be relied upon to support the view that (a) vertical intrabrand restraints should never be found to restrict competition by object, or even (b) that all vertical restraints, including price and territorial restraints, should be presumptively legal when incorporated within an agreement between parties which do not have market power. It has been seen, however, that the EU policy towards RPM, ATP and bans on online selling is deep-rooted and acute concern has been articulated about the possible risks to competition and the internal market objective that result from reduced intrabrand competition, market partitioning and

\textsuperscript{191} See e.g., the Commission’s Non-Horizontal Merger Guidelines [2008] OJ C 265/6, para 52.

\textsuperscript{192} Case C-68/12, ProtimonopolýEU:C:2013:71 and see nn 52-54 and text.

\textsuperscript{193} See e.g., Posner n 94.
price discrimination between Member States. Further, that expansion of the law in this way might create unacceptable risks of Type II errors.

This paper has, consequently, called for a more gradual, but nonetheless, significant change to be developed in the jurisprudence, through (i) the adoption of a more realistic approach to categorization – a greater willingness to consider plausible efficiency justifications before finding that a vertical restraint is restrictive of competition by object – and (ii) clearer guidance as to how agreements incorporating intrabrand restraints are to be analysed under Article 101. It has been argued that such evolution is likely to be dependent upon the Commission being prepared to take more vertical cases which could be used to develop and clarify the law in this important area through reasoned decisions and increased flow of cases and appeals before the EU courts.

If the Commission, EU courts, NCAs and national courts become more willing to analyse economic theory, experience and context both when deciding whether a vertical agreement should be characterized as restrictive of competition by object and/or when assessing its mixed effects, the seeds for the development of a more consistent and coherent framework for antitrust analysis will be planted. In addition, in line with modernization ambitions, further steps would be taken away from analysis based on historic categories, towards a more concept-based approach, focusing on market power, the theory of harm, proof of adverse effects and assessment of countervailing efficiencies. This would pave the way for the Guidelines and Verticals Regulation to be reviewed and revised in a way which will provide lucid guidance for firms competing online and offline at all levels of the supply chain.