Therefore, it remains to be seen how this will actually play out in practice, as the first settlement decisions are issued and the new Commission pursues its work on a possible private enforcement scheme.

Developments in vertical agreements

BY NIKOLAOS VETTAS*

This article discusses issues related to vertical agreements. I focus on recent developments in the treatment of such agreements by European Commission competition law, including the new vertical agreements Block Exempt Regulation and the accompanying Guidelines that came into effect in June of 2010. The main structure of the old Regulation has been maintained. The general direction of the changes in the Regulation and especially in the Guidelines is in line with a more effects-based and economics-based approach to competition policy that has been adopted gradually in the EC over the last decade as well as with the developments in the United States concerning the treatment of resale price maintenance. However, since it is extremely unlikely that vertical agreements that involve only firms with small market shares will have an anticompetitive effect, the adoption of a de minimis approach for all vertical agreements appears advisable for the future.

* Professor, Department of Economics, Athens University of Economics and Business; Research Fellow, Centre for Economic Policy Research, UK; and Member of the Economic Advisory Group in Competition Policy, European Commission, DG-Competition.

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I. INTRODUCTION

Vertical relations have received increasingly more attention from the view point of competition policy over the last years. One reason is that buyers, as well as sellers, in many important markets are becoming larger and increasing their market power. The vertical agreements reached between such sellers and buyers will play a crucial role in determining the market outcome in the final market and the welfare of the final consumers. A second reason is that the vertical agreements used have become increasingly complex and varied in nature—details in such agreements can often make an important difference. A third reason, in part a result of the first two developments, is that there is increasing recognition among policy makers that most—if not all—types of such agreements are neither completely procompetitive nor completely anticompetitive and that there should be an economics-based evaluation of their implications for the markets and the consumers. Thus, we are moving (albeit only gradually) away from a more formalistic approach that often appears de facto to support the per se legality or illegality of certain types of agreements.

In this article, I discuss some of the fundamental economic issues relating to vertical agreements, focusing on their treatment by Article 101 of the Treaty on the Functioning of the European Union (TFEU), that is, agreements between "upstream" and "downstream" firms that do not necessarily have a dominant position in their markets. In particular, I discuss the new Block Exemption Regulation applicable to vertical agreements that has recently been adopted by the European Commission and the new accompanying Guidelines. Both entered into force on June 1, 2010. I also relate the approach to these vertical agreements to the approaches followed by other aspects of competition law and policy and place them in the broader context of an economics approach. Finally, I suggest that the recent revision of the Block Exemption Regulation (BER) and the Guidelines, while moving in the right direction, have not reached far enough. In particular, I believe that it should have been recognized in the Regulation that it is extremely unlikely—and probably impossible—that there is harm in the market and to consumers as a result of any type of vertical agreement if all the firms involved have a small enough market share, thus essentially favoring a de minimis approach to such agreements. Perhaps, such an approach can be adopted in the future.

The remainder of the article is structured as follows. Section II reviews the relevant legislation and recent changes in regulation and the law applicable to vertical relations. Section III presents a quick introduction to the main economic analysis of vertical relations, explaining the reasons that will make firms engage in some particular form of vertical trade and the positive and negative implications for competition policy. In section IV we turn our attention to the new BER applicable to vertical agreements in the EC and the new accompanying Guidelines. In section V, I present a critical evaluation of this new BER, examining both its positive aspects and also areas where additional improvement relative to the old Regulation could have been possible. Parts of this evaluation draw upon the relevant opinion submitted to the Commission by the ad hoc subgroup of the Economic Advisory Group in Competition Policy. Section VI concludes.

II. VERTICAL RELATIONS AND EC COMPETITION POLICY

A. *The nature of vertical relations*

Vertical relations refer to the relationships between firms that trade with each other along a "chain" that moves from upstream (further away from the final consumer) to downstream (closer to the final consumer). These firms are typically suppliers of goods (or services) and their distributors (wholesalers and retailers) and, more generally, sellers and buyers when the buyers are not the final consumers but purchase intermediate goods for further processing or distribution. In some cases, the firms involved may choose to proceed to a vertical merger. In other cases, the firms maintain their independence. Trade between them may then take a simple form in which a single unit price is arranged (constant per unit of quantity sold, or linear pricing) or the relationship may be a more complex one, in which case the need arises in competition policy to study these vertical agreements more carefully. These include more elaborate pricing schemes, such as two-part tariffs, quantity discounts (or other such forms of nonlinear pricing), royalties and rebates, other forms of vertical restraint, such as resale price maintenance (RPM)

dictating the price at which the buyer will sell the good further down the vertical chain, and various types of exclusivity.[1]

It is important to emphasize that vertical relations in markets refer to completely different economic phenomena than horizontal relations, that is, relations between firms operating in the same market. The obvious and crucial difference is that horizontal mergers or agreements are phenomena that involve the combination of market power. In contrast, along a vertical chain, all trading firms, by their position in the chain, have to cooperate with each other in order for the goods or services to reach the final consumer. A useful analogy, often employed to illustrate this point, is that horizontal relations are between firms that sell "substitute" products, whereas vertical relations are between firms that sell "complementary" products (since all stages of a vertical chain are required for the goods to reach the final consumer).

Horizontal mergers and agreements take place among (direct) competitors and thus have as an immediate implication the direct elimination of a rival firm or an agreement with such a firm; thus, it is reasonable to start the analysis from the *presumption* that competition will be likely harmed, at least at the outset. Vertical mergers and vertical agreements, in contrast, do not take place among competitors in the same market, and, therefore, there cannot be a presumption that competition will be harmed except under specific sets of circumstances. In fact, from an economics analysis viewpoint, a condition for vertical mergers and agreements to be harmful, as far as competition policy is concerned, is that at least some of the firms involved already possess significant market power. Instead, since vertical mergers or agreements are between firms that already cooperate by selling complementary products, an agreement should, in principle, be expected to increase efficiency along a vertical chain. The possible adverse effects to competition emerge indirectly, typically because the change in the form or terms of the vertical relation will adversely affect the horizontal behavior of firms in some market.

[1] Franchise contracts have also emerged as increasingly important in the area of vertical relations. *See, e.g.*, ROGER D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING (2005).

B. *Vertical mergers*

EU competition law examines vertical relations in different contexts. An extreme way in which two vertically linked firms can agree to cooperate is a merger between them. The matter of vertical mergers, like other mergers (or more generally other concentrations[2]), is dealt with in the EC Merger Regulation.[3] It is important to note that the formal Nonhorizontal Merger Guidelines were issued only in November 2007,[4] following a substantial debate as to whether it was really advisable or even possible to issue such guidelines (primarily due to the complexity and variety of nonhorizontal mergers). They complement the Horizontal Merger Guidelines that had been in place since 2004. The need for the 2007 Guidelines emerged because of some well-known and controversial cases in which the practice of the EC was reversed on appeal, in particular *Tetra Laval v. Sidel*[5] and *GE v. Honeywell*.[6] The 2007 Guidelines make it clear that horizontal and vertical mergers are to be approached differently.[7] First, in contrast to

[2] The term also includes an acquisition.

[3] Council Regulation 139/2004, Control of Concentrations between Undertakings, 2004 O.J. (L 24/1).

[4] European Commission, Guidelines on the Assessment of Nonhorizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings, 2008 O.J. (C 265).

[5] Case M 2416, Tetra Laval v. Sidel , 2004 O.J. (L 38/13), on appeal, Case T-5/02, Tetra Laval v. Comm'n, 2002 E.C.R. II-4381, 5 C.M.L.R. 1182 (2002), on further appeal, Case C-12/03P, Comm'n v. Tetra Laval BV, 2005 E.C.R. I-987, 4 C.M.L.R. 573 (2005).

[6] Case M 2220, GE v. Honeywell Int'l Inc., 2004 O.J. (L 48/1), on appeal, Cases T-209/01, Honeywell Int'l Inc. v. Comm'n, 2005 E.C.R. II-5527, 4 C.M.L.R. 652 (2006) and T-210/01 Gen. Elec. Co. v. Comm'n, 2005 E.C.R. II-5575, 4 C.M.L.R. 686 (2006).

[7] *See* European Commission, Directorate General-Competition, Economic Advisory Group for Competition Policy (EAGCP), *Non-Horizontal Merger Guidelines: Ten Principles* (Aug. 2006) (prepared by Marc Ivaldi et al.) ("[P]otential competitive harm in non-horizontal mergers may arise through a change in supply or buyer strategies or availability of products. These can indirectly affect the cost or demand of rival firms, and so their pricing, ultimately having an impact on consumers. Such indirect effects can certainly impede effective competition, but they do require a particularly careful

horizontal mergers, nonhorizontal mergers do not have as an effect an increase in market concentration and are unlikely to lead directly to increased market power for the combined parties. Second, vertical mergers provide greater scope for efficiency gains. Still, competitive harm in vertical mergers is possible: it cannot be direct but only indirect, and the means by which such harm may occur typically require a change in the strategies of the involved parties, the merged parties, or other competing firms. The possibilities for harm include input or customer foreclosure, access to commercially sensitive information, and other noncoordinated effects, as well as coordinated effects, whereby horizontal coordination among firms is more likely following the merger.[8]

A merger is clearly an extreme means of vertical cooperation between firms. Now we turn our attention to looser forms of such cooperation, via vertical agreements. From an economics perspective, since these agreements represent a less drastic change in the market structure they cannot be as harmful as a corresponding merger, as every type of behavior that is supported by an agreement could also be replicated within the merger. At the same time, however, the efficiencies that one might expect as a result of a merger typically do

analysis in order to justify a likelihood of harm. In particular, the implication here is that *equilibrium* analysis in oligopoly markets with scenarios both pre and post merger has to be conducted."). *See also* Simon Bishop, Andrea Lofaro, Francesco Rosati & Juliet Young, The Efficiency-Enhancing Effects of Non-Horizontal Mergers (Report to the Enterprise and Industry Directorate-General, European Commission, 2005); Jeffrey Church, The Impact of Vertical and Conglomerate Mergers on Competition (Report for the Directorate General for Competition, 2004); and Nikolaos Vettas & Frago Kourandi, *On the Economics of Non-Horizontal Mergers*, *in* THE MODERNIZATION OF THE EU COMPETITION LAW 477–94 (Ioannis Lianos & Ioannis Kokkoris eds., 2010).

[8] An important recent vertical merger case in which the 2007 Guidelines were tested was that between TomTom and TeleAtlas, which was cleared without requiring any remedies on May 14, 2008, after an extensive phase II investigation. The EC stated that its in-depth investigation assessed whether this vertical integration would significantly impede competition, in particular given the strong position of TomTom in the market for personal navigation devices and the duopoly market for digital maps. Following an investigation of the likely foreclosure incentives, it was shown that the merger was unlikely to result in consumer harm, even before considering expected efficiencies.

not exist when firms remain independent and simply trade on the basis of some set of agreements.

C. *Agreements under Article 102 TFEU*

If vertical agreements involve firms that are judged to have a dominant position in the market (at the upstream or the downstream level or both), then Article 102 of the TFEU, formerly Article 82 EC Treaty, becomes applicable. I do not discuss such agreements in this article, as they fall into the more general category of abuse of dominance, which has already been the topic of significant study and debate. However, it is important to note that their appropriate treatment is not without controversy. There has been a long and active review of Article 82 and broad discussion for several years,[9] leading to the publication of the Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings.[10] Moving away from a more formalistic approach to abusive practices, two of the points that have received significant attention are that Article 82 should protect "the competition but not the competitors" and that an economics-based approach (highlighting the likely effects of the various practices) is important when analyzing possible abuses.

D. *Agreements under Article 101 TFEU and the revised Vertical Agreements Block Exemption Regulation*

Vertical agreements (as well as other agreements, of course) may be subject to the law, even when they do not involve a firm with dominant position in its markets. Article 101 TFEU (formerly Article 81 Treaty EC)[11]

[9] A public consultation took place following the publication in 2005 of the DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses.

[10] *See* European Commission, 2009 O.J. (C 45/7).

[11] Article 101 of the Treaty on the Functioning of the European Union (formerly Article 81 Treaty EC) states that "the following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition

becomes applicable for such cases.[12] Overall, the modernization of Article 81 has responded to the growing concerns that the Commission should move away from the view of restrictions to competition as restrictions to economic freedom and toward focusing on the efficiency effects of the practices under consideration.[13] An important development in the area of vertical relations was the publication on December 22, 1999, of Commission Regulation on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices (Regulation of Vertical Agreements).[14] This BER was meant to provide a safe harbor to firms with less than a thirty percent market share and was accompanied by the relevant Guidelines on Vertical Restraints.[15]

The 1999 BER and Guidelines on Vertical Restraints have received significant attention. They have been heralded as the first of a new generation of block exemption regulations and guidelines inspired by a more economic and effects-based approach and have since been followed in other areas of competition policy. The core of this approach is that, in order to reach an assessment about a vertical agreement, its potential effects on the market should be analyzed. It has been generally recognized that there were significant advantages in placing agreements within a group exemption and that the previous system of narrow block exemptions was too formalistic and not based on economic considerations. Specifically, this broader exemption has been viewed as a significant improvement over the notification system under which companies had to notify their agreements to the Commission in order to obtain an exemption

within the internal market . . . ," and then proceeds to descriptions of such agreements.

[12] For an analysis, see RICHARD WHISH, COMPETITION LAW ch. 16 (2009).

[13] See EKATERINA ROUSSEVA, RETHINKING EXCLUSIONARY ABUSES IN EU COMPETITION LAW ch. 8 (2010).

[14] European Commission, Regulation on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, 1999 O.J. (L 336/21).

[15] European Commission, Guidelines on Vertical Restraints, 2000 O.J. (C 291/1).

(discontinued in 2004). Yet, other specific provisions, e.g., those related to the use of the particular market share threshold and the black-listing of certain types of agreements, have been criticized by some commentators.[16]

In anticipation of the expiration of the BER in May 2010, the Commission carried out a review process beginning in the spring of 2008 and a public consultation process which resulted in the promulgation on April 20, 2010, of the new Commission Regulation on the Application of Article 101(3) TFEU to Categories of Vertical Agreements and Concerted Practices.[17] Along with the new Guidelines on Vertical Restraints,[18] the new BER came into force on June 1, 2010.[19]

In general, guidelines have the goal of reducing legal uncertainty for the parties by making the treatment of a case more predictable, increasing the consistency among decisions in different cases, and leading to better coordination among decisions of the national competition authorities of the Member States. The guidelines relevant to vertical agreements play a particularly important role because a large number of such cases tend to be decided at the national level, which increases the risk of very different approaches. In fact, since the Regulation of Vertical Agreements, there have been only few EC decisions specifically on vertical restraints.

The developments related to the recent revision of the vertical BER are discussed in detail in sections IV and V of this article.

E. *Motor vehicle sector regulation*

BERs exempt categories of agreements that comply with their provisions from the EU ban on restrictive business practices contained in

[16] *See, e.g.*, Valentine Korah, *The New EC Vertical Restraint Block Exemption*, INTERECONOMICS, Jan./Feb. 2002, at 4–11.

[17] Commission Regulation, Application of Article 101(3) of the TFEU to Categories of Vertical Agreements and Concerted Practices, 2010 O.J. (L 102/1).

[18] Commission Regulation, Guidelines on Vertical Restraints, 2010 O.J. (C 130/1) [hereinafter 2010 Guidelines].

[19] *See* European Commission, http://ec.europa.eu/competition/antitrust/legislation/vertical.html.

Article 101. Within vertical agreements, of particular interest is the BER for the motor vehicle sector. The previous Regulation was adopted in 2002 and was due to expire on May 31, 2010. Thus, following a consultation process, the Commission adopted new rules for this sector. Specifically, the Commission Regulation on the Application of Article 101(3) of the TFEU to categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector along with the accompanying Supplementary Guidelines on Vertical Restraints in Agreements for the Sale and Repair of Motor Vehicles and for the Distribution of Spare Parts for Motor Vehicles were introduced.[30] The new rules came into force on June 1, 2010, as concerns the repair and maintenance markets, will come into force on June 1, 2013, with regard to the vehicle sales markets, and will be valid until May 31, 2023.

This sector-specific Regulation deals with agreements between vehicle manufacturers and their authorized dealers (the primary market), and repairers and spare parts distributors (the after-market). Overall, it was judged that, while the old Regulation may have worked well and has in general benefited the market by increasing competition, the conditions in the sector had changed, and thus a modified approach was in order. Therefore, the Regulation moves toward a more liberal approach, and this transition will be completed in 2013.

Regarding the aftermarket, according to the Commission announcement on May 27, 2010, "the new rules will increase competition in the market for repair and maintenance by improving access to technical information needed for the repairs and by making it easier to use alternative spare parts. They will allow the Commission to tackle manufacturers' abuse of warranties when they request that cars are serviced only in authorized garages. The new rules will also reduce distribution costs for new cars by eliminating overly restrictive rules."[31]

[30] European Commission, http://ec.europa.eu/competition/sectors/motor_vehicles/legislation/legislation.html.

[31] Press Release, European Commission, Commission Adopts Revised Competition Rules for Motor Vehicle Distribution and Repair (May 27, 2010), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/619&type=HTML.

According to the new rules, agreements between car manufacturers and authorized repairers each with above a 30% market share threshold will no longer be block exempted, aligning the rules with the general framework of the Regulation on the Application of Article 101(3) TFEU to Categories of Vertical Agreements mentioned in section II.D. With this revision, it is expected that it will be easier for the Commission to tackle possible abuses, such as the refusal to grant independent repairers access to technical information, and that it will increase competition between authorized and independent repairers. The new rules also strengthen repairers' access to alternative spare parts, and car manufacturers are no longer able to make the warranty conditional on having the oil changed or other car services provided only by authorized garages.

Regarding the distribution system in the motor vehicle sector (the primary market), it was decided that it was already operating in a competitive enough way for several years, with low prices and profit margins for the firms in the sector and benefits for the consumers. The old sector-specific rules were probably judged to be creating an unnecessary straitjacket that prevented car manufacturers from organizing their distribution systems optimally. In fact, many commentators have criticized the old regulation as too restrictive, in particular with respect to its provisions regarding multibranding and additional sales outlets, claiming that they have had significant and adverse unintended consequences to the market. In their opinion, interbrand competition has become more intense due to technological or demand reasons, whereas the implications of the old Regulation have been harmful.[32] Regardless of whether one believes that the distribution market has become more competitive because of or despite the old Regulation, the Commission has now aligned the rules applicable to motor vehicle distribution with those that apply to distribution agreements in other sectors, treating the distribution of cars like any other market, but with a three-year transition period to allow dealers to adapt. This represents a simplification in the rules and liberalization in the market; the current distribution model will continue

[32] For an analysis along these lines, see Gregory M. Pelecanos, *Europe's Reform of the Regulatory Framework of Motor Vehicle Distribution*, CPI Antitrust J., June 2010.

to be exempted in most cases, but certain ineffective sector-specific restrictions were eliminated. It is expected that in the market we will see diverse networks in which multibrand dealers will co-exist with dealers exclusively promoting the brands of a single manufacturer.

F. *The U.S. front*

Although this article focuses on recent developments in vertical agreements in the EC, the developments on the other side of the Atlantic cannot be ignored. Of particular interest in the comparison between the two systems is whether certain practices have to be viewed as hardcore violations of the law. In particular, as will be discussed in detail below, resale price maintenance (RPM), which determines a minimum or fixed price, belongs to the black-listed practices in the Regulation on the Application of Article 101(3) TFEU to Categories of Vertical Agreements, and even for firms with a very small market share the burden of proof is reversed: the accused party has to provide evidence regarding the procompetitive effect of its practice, or the agreement may be viewed as illegal. In 2007, the U.S. Supreme Court in *Leegin*[23] overturned its almost century-old *Dr. Miles*[24] decision that declared minimum RPM to be per se illegal.[25]

Certainly, the *Leegin* decision should not have come as a surprise to anyone, given the debate among policy makers and economists about this issue at least since the 1970s and the understanding, shared among many, that the per se illegality of RPM was creating more problems than it was solving. As will also be discussed below, RPM can be viewed as having a net anticompetitive or procompetitive effect, depending on the particular market conditions in which it is implemented. One way to present the *Leegin* decision is to argue that the Supreme Court's logic in its landmark *Sylvania*

[23] Leegin Creative Leather Prods., Inc v. PSKS, Inc., 551 U.S. 877 (2007).

[24] Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

[25] For further analysis and references, see, for example, Andrew I. Gavil, *Resale Price Maintenance in the Post-*Leegin *World: A Comparative Look at Recent Developments in the United States and European Union*, CPI ANTITRUST J., June 2010; Jay L. Himes & Morissa Falk, *Just What the Doctor Ordered: A Second Opinion for Vertical Price-Fixing*, CPI ANTITRUST J., Jan. 2010.

decision,[26] in which it was established that nonprice intrabrand restrictions should be judged under a rule of reason, was then extended to maximum price-fixing restraints,[27] and has now been extended to minimum price restraints as well. However, there is still some controversy regarding precisely how RPM should be treated in practice, even following the Supreme Court *Leegin* decision, and how the pros and cons of this vertical restraint should be considered. In particular, it is unclear how RPM will be dealt with by the various states, and a number of states seem poised to continue to treat RPM-related practices as per se illegal.[28]

III. THE BASIC ECONOMICS OF VERTICAL RELATIONS

Before proceeding to a description and evaluation of recent changes in the treatment of vertical agreements in the EC, it is useful to review some of the basic economics arguments in this area. The presentation here is necessarily very brief.[29]

A. *Vertical chains and double marginalization*

We can think of the linked firms along a vertical chain as the producer and the retailer, or the buyer and the seller, or more

[26] Cont'l TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

[27] State Oil Co. v. Khan, 522 U.S. 3 (1997), *overturning* Albrecht v Herald Co., 390 U.S. 145 (1968).

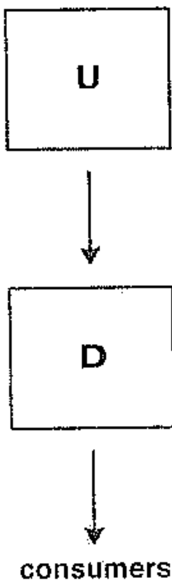
[28] *See, e.g.*, Leiv Blad & Bryan Killian, *A Civil Conflict: Can the States Overturn* Leegin?, CPI ANTITRUST J., Jan. 2010; David Olsky, *State Enforcement of Resale Price Maintenance Prohibitions After* Leegin: *Policy Without Principle*, CPI ANTITRUST J., Jan. 2010.

[29] For more comprehensive reviews and other presentations, see, for example, MASSIMO MOTTA, COMPETITION POLICY 302–410 (2004); Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, *in* 3 HANDBOOK OF INDUSTRIAL ORGANIZATION 2145 (Marc Armstrong & Robert Porter eds., 2008); Patrick Rey & Thibaud Vergé, *The Economics of Vertical Restraint*, *in* HANDBOOK OF ANTITRUST ECONOMICS 353–90 (Paolo Buccirossi ed., 2008); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS, *supra*, at 391–414; Vincent Verouden, *Vertical Agreements: Motivation and Impact*, *in* 3 ISSUES IN COMPETITION LAW AND POLICY 1813 (ABA Section of Antitrust Law 2008); and Vettas & Kourandi, *supra* note 7, at 482–90.

abstractly as the upstream and the downstream firm. Vertical chains differ in many ways: whether there are two or more stages before reaching the final consumer, whether firms are vertically separated (independent) or vertically integrated (one firm that operates both upstream and downstream, with the goal of maximizing its joint profit), and whether trade is exclusive (with an exclusive supplier or exclusive buyer or both) or more than one firm is actively trading at each stage.

Under vertical separation and linear pricing (i.e., using a constant per unit price), vertical separation leads to higher final product prices than those we would have under vertical integration (VI). Let us consider a simple vertical market structure with one upstream firm (*U*) and one downstream firm (*D*), like that in figure 1, where, for simplicity, we assume that there are only two stages. Firm *U*'s product is sold to firm *D*, which in turn (re)sells to final consumers (possibly after some further processing).

Figure 1



This basic double marginalization argument relies on the assumption that each firm is independent of the other, in the sense that it seeks to maximize its own profit. The fundamental result that one obtains in the equilibrium of this model, a well-known result, is that this process of double marginalization leads to prices for the final consumers that *exceed* the prices they would face under a vertically integrated monopoly.[30] Since the monopoly profit is by definition the maximum profit possible in a market, we also find that, under vertical separation, the aggregate profits (for *D* and for *U* combined) will be *below* the profit for the VI case. Thus, in this case, vertical separation with linear pricing hurts both the consumers and the firms, while vertical integration will benefit all parties. The underlying logic is that the firms fail to internalize the vertical externality that exists in their pricing (in particular, the *U* firm partly ignores the influence that an increase in its own price will have on the final price).

It follows that one solution to the double marginalization problem is vertical integration.[31] This would take the market structure considered here to a simple monopoly that covers both stages of the market. Importantly, however, this problem can also be solved if a pricing scheme other than linear pricing is used, such as a two-part tariff arrangement. Under such an arrangement, if the marginal price is set at the competitive level (cost) and the fixed fee is set just below the total monopoly profit, then we can replicate the exact monopoly solution, without having a formal vertical integration arrangement. Another way to solve the double marginalization problem in this case would be some vertical restriction, in particular RPM, that would fix the final market price at the monopoly level. Also note that the situation changes if we allow the *D* firm to have the price setting (or bargaining) power against both the final consumers and the *U* firm. In such a setting, only one profit margin can be applied and there is no additional distortion. Likewise, bargaining between the *U* and the *D* firm would modify the argument.

[30] *See* Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. POL. ECON. 347 (1950).

[31] Vertical integration may, of course, have many other positive and negative effects. The topic has been studied extensively in economics, both analytically and empirically since the seminal work of Ronald R. Coase, *The Theory of the Firm*, 4 ECONOMICA 386 (1937).

B. *Pro- or anticompetitive*

Starting in the United States, the early treatment of vertical restrictions in the law was focused on form and took the rather simplistic view that restraints of all types reduced independence in the market, most likely foreclosing seller access to customers or key inputs. The conclusion of this logic was that these restraints should not be allowed. In particular, the imposition of minimum RPM by an upstream firm was viewed as almost the same as horizontal price fixing (a view that, as discussed above, was not formally overturned in U.S. case law until recently).

In the 1960s the Chicago school drastically changed the debate. It originated a line of reasoning that applies neoclassical economic theory to vertical restraints and has brought some economic discipline to the overall analysis. As competition is determined within markets and not across markets, only horizontal restraints, not vertical ones, can reduce it. The specific implication for vertical restraints like RPM is that the focus of competition policy should be on protecting and promoting interbrand competition rather than being preoccupied with intrabrand competition. In addition, when manufacturers reduce their own choices through vertical restrictions (e.g., by eliminating price, quality, or location competition among retailers) the benefits from countervailing efficiencies must exceed the costs from the reduced competition; otherwise the manufacturer would not have created such a set of restraints. Specific efficiencies that may emerge as a result of vertical restrictions consist primarily of internalizing externalities (e.g., double marginalization) and eliminating moral hazard problems between manufacturers and retailers.

A post-Chicago view has been developed parallel to the emergence of game theory as the language for industrial organization analysis in the 1980s. It has been shown that vertical integration and contractual restrictions can have anticompetitive outcomes, by changing the commitment power and the strategies available to the firms. Of primary interest is foreclosure and the effect on the flow of information among firms, especially under product differentiation. Starting from an early stage when vertical restraints were viewed as harmful, and then another stage when they were viewed as not

harmful, the current status of academic research and practice alike offers a more explicitly balanced approach that takes into account how a particular vertical agreement may be expected to influence competition and consumer. Vertical mergers, in particular, should be viewed as anticompetitive only in an indirect way and under specific scenarios and sets of circumstances.

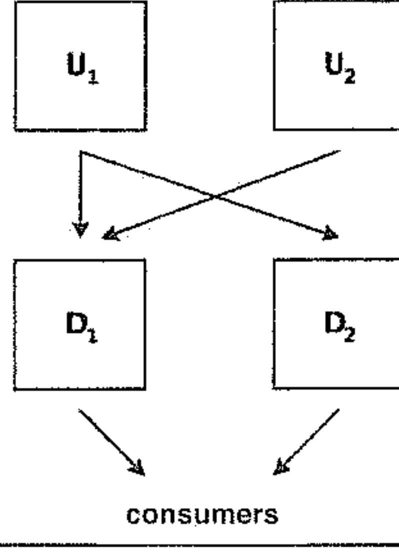
C. *Multiple suppliers and distributors*

In most markets, of course, one encounters vertical structures much richer than the simple one-supplier-and-one-distributor chain. Typically, in addition to the basic vertical externality discussed above, we also have a horizontal externality that takes the form of interbrand oligopolistic competition. This emerges when one supplier trades with more than one distributor. In such cases, strategic interaction between distributors, as well as between suppliers and distributors, matters. A nonlinear pricing scheme or some vertical restraint could be effective for "softening" competition in the final market and maximizing the supplier's profit. In the case of a two-part tariff, the wholesale price level may control the horizontal externality and soften competition between the distributors, while profit may be taken in the form of a fixed fee. RPM or resale restrictions (under which the supplier may limit where or how two distributors can compete with each other) could also lead to higher downstream prices and upstream profit.

The picture becomes much richer when there is both interbrand and intrabrand competition, such as when there are two or more suppliers trading with two or more distributors. Some of these trading agreements can be exclusive and others not, while the products may also be differentiated or not. In figure 2, we assume there are two large upstream and two large downstream firms.

Controlling the horizontal externality among distributors may not be as important a consideration for a supplier as competition with the rival supplier.

Figure 2



D. *Quality and specific investments*

Consumers care not only about prices, but also about the availability, quality, and variety of products. These other aspects typically depend on actions taken by all the parties along the vertical chain, and assuring a particular quality or level or variety requires the effective collaboration of these various parties. If this collaboration cannot be assured, then product quality will be below the optimal level, not only from the viewpoint of final consumers but also of the entire vertical chain. When a supplier who attempts to establish a high quality reputation and brand name for his product can reach final consumers only through a distribution system, then it is reasonable that both price and nonprice elements of the distributors' operations may have to be controlled. "Spillovers," or informational externalities, play a crucial role here. As the cost of assuring high quality is not fully internalized by each independent distributor, the market will tend to provide suboptimal quality. Since vertical integration may be an extreme and costly solution, e.g., due to high

administrative costs, other appropriate measures, specified in vertical agreements, will have to be taken to solve the problem.

A closely related issue is that of specific investments by suppliers or distributors. The effective supply of a product or service to the final consumer often requires investments that are specific to the particular pair of transacting supplier and distributor, offering again a rationale for vertical integration or vertical restrictions to neutralize the threat of opportunistic behavior by either party.

E. *RPM*

In line with the analysis above, RPM creates both anticompetitive and procompetitive effects.[32]

One possible anticompetitive effect of RPM is the solution to the commitment problem of a monopolist: if a monopolistic supplier reduces the wholesale price charged to one distributor to allow that distributor to expand its market share, even when this hurts rival distributors of the same product, the supplier will reap less than full monopoly profits. Market-wide RPM that is acceptable to all parties could solve this problem by preventing this type of opportunistic behavior on the part of the supplier. RPM may also soften competition when two or more suppliers sell their products to two or more distributors, creating interlocking relationships. RPM might also facilitate collusion, either among suppliers or among distributors. In particular, collusion among suppliers may be easier to achieve because RPM can offer an accurate means of monitoring deviations from the collusive agreement.

Turning to its procompetitive effects, RPM can help protect or encourage necessary specific investments by preventing opportunistic or free-riding behavior among distributors. It may also signal the quality of products or help establish a price reputation and overall brand image for the supplier's products.

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[32] *See* European Commission, Directorate General-Competition, Economic Advisory Group for Competition Policy (EAGCP), *Hardcore Restrictions under the Block Exemption Regulation on Vertical Agreements: An Economic View* (2010) (prepared by Massimo Motta, Patrick Rey, Frank Verboven & Nikolaos Vettas) [hereinafter 2010 EAGCP BER Report].

F. *Resale restrictions and price discrimination*

Resale restrictions that limit the markets in which a certain distributor can operate are often essential for the implementation of a supplier's price discrimination strategy across markets or groups of consumers. In order to price discriminate across consumers, firms need to prevent arbitrage, in other words, buying in parts of the market where prices are low and reselling where prices are high. Thus, to study the effects of territorial or other resale restrictions, one has to more fundamentally study the implied price discrimination. Economic analysis has shown that price discrimination has ambiguous effects on welfare and that the final net effect of price discrimination depends on several key variables, including the relative importance of the different types of consumers and the product characteristics. In particular, when there are no distributional concerns, a necessary condition for price discrimination by a single supplier to improve welfare is that total sales (quantity) of the product increase. Also, allowing rival oligopolistic firms to price discriminate typically leads to more intense competition among them. As a result, territorial or other resale restrictions will have mixed welfare results from an economics point of view.

IV. THE 2010 VERTICAL AGREEMENTS BLOCK EXEMPTION REGULATION AND GUIDELINES

A. *The 1999 Vertical Block Exemption Regulation*

The 1999 BER[33] established that Article 81(1) does not apply to vertical agreements in which the supplier does not hold more than a thirty percent market share.[34] As mentioned above, the issuing of the BER and of the accompanying *Guidelines on Vertical Restraints* has been rightly viewed as the introduction of an effects-based approach into the EC competition law on agreements. Economic analysis suggests that vertical agreements are likely to harm welfare only if the firms using them possess substantial market power. Therefore, competition authorities should not use their scarce resources to monitor vertical agreements entered into by firms with limited market power, and such firms should benefit from a safe harbor that guarantees the legality of their vertical agreements. As stated in the 2010 EAGCP BER Report, "since firms with small market shares are unlikely to enjoy substantial market power, and since—unlike the latter—the former can be measured with relative ease, it makes sense from an economic point of view to exempt from article 81(1) vertical agreements by suppliers with a market share below a certain threshold."[35]

Article 4 of the 1999 BER also stated that the exemption should not apply to some vertical agreements that the Commission considered harmful. These blacklisted or hardcore clauses include, in particular, RPM (more precisely resale price fixing and minimum resale price maintenance) and vertical clauses that aim at restricting active sales from one territory to the other. Vertical agreements containing such hardcore restrictions were not exempted from the application of Article 81(1), even if the firms concerned held an arbitrarily small market share, since the Commission's de minimis Notice does not apply to such hardcore restrictions.[36] In addition, it follows from the accompanying 1999 Guidelines that individual exemption of vertical agreements containing such hardcore restrictions is also unlikely thus imposing de facto a regime very close to per se prohibition for these blacklisted restrictions.

Therefore, it should be emphasized that the combination of the Treaty and the 1999 BER implied the following regarding the treatment of vertical agreements. Firms with a market share much higher than thirty percent, in the region above fifty percent, are very likely to be found to have a dominant position in their market and, thus, their actions (including vertical agreements with suppliers or

[33] Council Regulation 1215/1999 Amending Regulation 19/65 on the Application of Article 81(3) to Certain Categories of Agreements and Concerted Practices, 1999 O.J. (L 148/1).

[34] In addition, agency agreements in which the principal firm and not the agent bears any contract-specific risks and costs (such as the costs of specific investment for completing the task assigned under the contract or the financing of stocks) fall outside Article 81(1).

[35] 2010 EAGCP BER Report, *supra* note 32, at 1.

[36] European Commission, Notice on Agreements of Minor Importance which Do Not Appreciably Restrict Competition under Article 81(1) (de minimis), 2001/C 368/07.

distributors) fall within Article 102. For firms with market shares between thirty and fifty percent, the 1999 BER offers no protection, and the vertical agreement may fall within Article 101(1). This does not constitute a presumption that a given vertical agreement represents a violation of the Treaty, but simply than it is not automatically exempted. Firms with market shares below thirty percent will benefit from the 1999 BER, assuming that the vertical agreement does not fall within a list of the hardcore blacklisted restrictions.[37]

B. *The 2010 Block Exemption Regulation—general description*

Because the 1999 BER was due to expire in May 2010, the European Commission started the relevant review process in the spring of 2008. A draft of the new rules was published in July 2009 and the general reaction was that the new rules succeeded in reducing compliance costs and bureaucracy, while ensuring that consumers benefit from choice and price competition. Eventually, the Commission announced the 2010 Block Exemption Regulation (2010 BER)[38] and the new accompanying Guidelines (2010 Guidelines)[39] in spring 2010. The new rules came into force on June 1, 2010, and will be valid until 2022, with a one-year transitional phase. It is fair to say that the changes in the 2010 BER have been rather limited; in fact they can be described as proceeding to a modernization of the BER where that was needed, as well as offering some needed clarifications.[40] According to the April 20, 2010, announcement of the Commission,

> [t]he Regulation and accompanying Guidelines take into account the development, in the last 10 years, of the Internet as a force for online sales and for cross-border commerce, something that the Commission wants to promote as it increases consumer choice and price competition. The basic

[37] In addition, for firms with market share below fifteen percent, the de minimis notice will be applicable, but only when the agreement does not include any of the Article 4 hardcore restrictions.

[38] 2010 O.J. (L 102/1).

[39] 2010 Guidelines, *supra* note 18.

[40] For a discussion of the 2010 BER, see Magdalena Brenning-Louko, Andrei Gurin, Luc Peeperkorn, & Katja Viertiö, *Vertical Agreements: New Competition Rules for the Next Decade*, 6 Antitrust Chron., Summer 2010.

> principle remains that companies are free to decide how their products are distributed, provided their agreements do not contain price-fixing or other hardcore restrictions, and both manufacturer and distributor do not have more than a 30% market share. Approved distributors are free to sell on the Internet without limitation on quantities, customers' location and restrictions on prices.[41]

It adds that

> [d]istributors should be free to satisfy consumer demand, whether in brick and mortar shops or on the Internet. The rules adopted [. . .] will ensure that consumers can buy goods and services at the best available prices wherever they are located in the EU while leaving companies without market power essentially free to organise their sales network as they see best.[42]

C. *Applicability of the 2010 BER*

The most significant change in the 2010 BER is that, for a vertical agreement to fall under the block exemption, it is no longer enough that the seller's relevant market share not exceed thirty percent, but the market share of the associated buyer also may not exceed thirty percent in the same market. This change reflects the increased recognition among policy makers and economists that vertical contracts are not shaped by sellers alone. A buyer with significant, even if not dominant, market power may be able to impose certain types of vertical agreements that will have an anticompetitive effect.

There have also been two additional, relatively minor, changes in the scope of 2010 BER. First, vertical agreements between competitors were, as a rule, treated the same as horizontal agreements and were not generally covered under the 1999 BER except under certain restrictive conditions or in the case of nonreciprocal agreements. The 2010 BER puts in place some stricter conditions: it has removed the rule that an agreement would be exempt under the 2010 BER if the turnover of a competitor who acted as a distributor was below

[41] Press Release, European Commission, Commission Adopts Revised Competition Rules for Distribution of Goods and Services (Apr. 20, 2010), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/445.

[42] *Id.*

€100 million. Also, an agreement now falls under the 2010 BER only in cases of dual distribution, when the buyer is active only in the distribution market, whether for products or services. (The requirement did not previously apply to services.) Second, for agency agreements to be considered genuine and therefore outside the scope of Article 101(1), the principal must bear the costs and the risks not only of the specific agreement but also those related to other activities that it requires the agent to undertake in the same market.

D. *Blacklisted restrictions*

As in the 1999 BER, article 4 of the 2010 BER contains a list of restrictions that are blacklisted. If such a restriction is included in a vertical agreement in any way, no part of the vertical agreement can benefit from the 2010 BER. These are considered hardcore violations that represent serious restrictions of competition, and the presumption in EC law is that they should be prohibited.

Specifically, for these blacklisted restrictions there is a double presumption (regardless of the market shares of the firms involved). According to paragraph 47 of the Guidelines, placing a restriction in the hardcore category has two specific and significant consequences: the restriction presumptively falls within the scope of prohibited agreements under Article 101(1) as having actual or likely negative effects; and it presumptively does not satisfy the justification standards of Article 101(3). This means that once a hardcore restriction is established, the agreement is presumptively anticompetitive and presumptively unjustifiable.

Still, as was also true under the 1999 BER, it is recognized that this double presumption is rebuttable and the parties can bring forward evidence that the positive effects of the agreement under examination outweigh the presumed negative effects, both of which must be precisely assessed by the Commission. Clearly, however, in such cases the usual order of moves in bringing forward evidence is reversed, and the parties are required to explain not only why the restriction does not have anticompetitive effects but also to demonstrate its procompetitive effects.

The Article 4 blacklist includes RPM and nonprice resale restrictions.

Regarding RPM, it should be emphasized that it is minimum price maintenance and fixed price maintenance that are considered hardcore restrictions, while recommending a resale practice to a reseller or requiring the reseller to respect a maximum resale practice is not considered a hardcore restriction. The 2010 Guidelines offer a detailed exposition about evidence that could be put forward in PRM cases. Specifically, paragraph 224 of the 2010 Guidelines describes various ways in which RPM may restrict competition, whereas paragraph 225 states that justifications will be considered and that the possible efficiencies will be assessed under Article 101(3).

Similar to RPM, regarding resale restrictions, the 2010 BER generally does not cover agreements that restrict the buyer's ability to sell in some territories and to some consumers the goods or services that the agreement refers to. However, there are a number of important exceptions under which such restrictions are not considered hardcore, as they were in the 1999 BER. The two most important ones are systems of exclusive distribution and selective distribution. Regarding exclusive distribution, a supplier is allowed to protect his exclusive distributor from active sales by other distributors in the specified exclusive territory or consumer group. The 2010 Guidelines also clarify that the exclusive distribution exception applies even when the supplier himself is also selling directly to customers in the territory or consumer group otherwise treated as exclusive for some distributor. However, a restriction on passive sales, that is, responding to unsolicited requests from customers from within the specified territory or consumer group would be considered a hardcore restriction. Regarding selective distribution, the BER allows suppliers to have a selective distribution system where distributors are selected according to some specified criteria.

The 2010 Guidelines pay particular attention to the matter of online sales, since the rules about resale restrictions presented above apply to both online and traditional store sales. Once distributors have been authorized, they must be free to sell on their Web sites as they do in their traditional shops and physical points of sale. For selective distribution, this means that manufacturers cannot limit the quantities sold over the Internet or charge higher prices for products to be sold online. The 2010 Guidelines offer more clarification and

details regarding the distinction between active and passive sales for exclusive distribution. For instance, terminating a transaction or rerouting consumers to another sales method after they have entered credit card details that show a different country (or area) address is considered a restriction in passive sales and is not accepted.

V. A CRITICAL EVALUATION OF THE 2010 BLOCK EXEMPTION REGULATION AND GUIDELINES[43]

The 2010 BER has maintained the same architecture as the 1999 BER: it can be described as offering a modernization and some needed clarifications. The fundamental approach of both BERs to allow firms with less than a certain market share to use vertical agreements as they wish has appeared to be working effectively and is not expected to create problems in the market in the future. Keeping the relevant market share threshold at thirty percent appears satisfactory as well, since firms with sizeable market power do not automatically benefit from an exemption, even if their market share is not typically associated with dominance. At the same time, it ensures that firms with very little market power enjoy legal certainty when they trade with other small firms.

Proceeding now to some crucial details, as discussed in the previous section, the changes in the 2010 BER can be described along three dimensions.

First, the 2010 BER offers a clarification of and a modified approach to particular issues of implementation that had emerged as problematic during the decade when the 1999 BER was in force. The most important of these changes is that the benefit of the block exemption no longer depends only on the supplier's market share, but also on the market share of the buyer: neither of these two market shares can now exceed thirty percent for the block exemption to apply. This seems to be, in principle, a reasonable approach given that in some markets buyers are as powerful as, or even more powerful

[43] Parts of the analysis here parallel parts of the 2010 EAGCP BER Report, *supra* note 32. Of course, this article is completely separate from that report, and my co-authors have no responsibility for the way I represent some of the points made therein.

than, sellers and that vertical restraints need not generally be led by the suppliers. Strong buyers can also use their market power to impose anticompetitive vertical restraints. From a practical viewpoint, of course, accurately calculating the market share of a buyer may not always be easy or even feasible for a seller (as it may crucially depend on market definition), and from this point of view the modification is expected to limit the scope of the 2010 BER and decrease its applicability in particular cases.[44]

Another such change deals with restrictions on the use of the Internet for trade, which, of course, has increased dramatically since the 1999 BER. This change seems reasonable and the 2010 BER and the 2010 Guidelines now describe in more detail how one can distinguish between active and passive sales in the case of Internet sales.[45] Thus, assuming that one does wish to distinguish between active and passive sales, the revision appears useful because online sales are becoming increasingly more important. Yet, one could comment that from an economics viewpoint it is not really clear why active and passive sales should be treated differently, since both have the same effect, which is to lead to more uniform prices across markets. Further, whether in a particular market price uniformity or price discrimination implies higher consumer welfare may depend crucially on market conditions, including the actions and reactions of other firms. As a result, it may be more appropriate to move away in the future from the active versus passive sales distinction, which may be too formalistic and to some extent arbitrary in many cases. Instead, it may be preferable to use a more effects-based approach according to which the treatment of firms that use territorial restrictions would depend on the market share they hold and the possible efficiency justifications associated with such restrictions. It should be clear,

[44] In the draft Regulation proposed as a basis for the consultation, it was suggested that, to better reflect market power, the buyer market share relevant for the Regulation should not be calculated in the same market as that of the seller but calculated in the buyer's downstream market. However, in practice it would have been quite difficult for a seller to be able to accurately assess its buyers' downstream market shares and the adopted rule indeed appears to be a more reasonable solution.

[45] *See* 2010 Guidelines, *supra* note 18, ¶¶ 51–55.

however, that the treatment of territorial restrictions in EC competition law, including the active versus passive sales distinction in the 2010 BER, is not based on pure economic efficiency grounds only, but also serves the EC objective of promoting market integration, and this is the perspective from which this provision should be examined.

Second, the 2010 BER has moved further and more decidedly ahead relative to the 1999 BER, more fully acknowledging the efficiency gains that could flow from all types of vertical restraints, including these in the hardcore list. In particular, the language in the 2010 Guidelines generally appears closer than the previous version to the view that firms should be free to select their own distribution strategies, including the use of various kinds of vertical agreements, and that consumers can benefit from these, especially when firms do not have high market power. This is clearly a step in the right direction.

Regarding RPM, and relative to the 1999 BER, the 2010 BER appears to be making a step towards more fully acknowledging the potential efficiency gains that can follow from this practice, somewhat similar to the recent trends in the United States. Paragraph 224 of the 2010 Guidelines presents details about the various anticompetitive uses of RPM, including a consideration of the source of the restraint, the market power of the firm or firms imposing it, and the degree to which RPM is used widely in an industry. It also describes additional ways in which RPM can be anticompetitive, such as dampening competition and diminishing pressure on manufacturers' margins, turning its attention at this point to intrabrand competition.[46] Paragraph 107 of the Guidelines, in contrast, details a broad range of positive effects that can flow from vertical restraints. Section 2.10 specifically addresses RPM and paragraph 225 more narrowly describes its possible advantages, to be assessed under Article 101(3). Thus, on the one hand, the fact that the potential efficiencies of RPM can be considered under Article 101(3) appears to be a more tolerant attitude towards RPM. On the other hand, as described above, the usual order of bringing forward evidence is reversed, and it is the parties that have to provide evidence for the procompetitive effects of agreements that involve RPM.

Third, despite the more balanced and open approach towards the procompetitive effects of vertical agreements signalled by the 2010 Guidelines, the 2010 BER continues to place on the blacklist a number of vertical restraints that are considered hardcore, including minimum and fixed price RPM and other resale restrictions. It would have been worth considering a change in this policy that would have allowed small firms to use any type of vertical agreement whatsoever when trading with other small firms.[47] Regarding RPM, it is known by theoretical analysis and empirical studies in economics that it can have both anticompetitive and procompetitive effects. However, anticompetitive effects require a supplier endowed with considerable market power. Therefore, such effects are unlikely if suppliers (and possibly also their buyers) have small enough market shares. Overall, it does not seem that allowing firms with small market shares to engage in RPM would incur significant competitive risks.

The 2010 EACGP BER Report provides details on this point and reaches the following specific recommendation:

> [W]e would favour a change in the BER as follows. The presumption that RPM is welfare detrimental and that it is unlikely that an exemption would be granted even to firms enjoying less than 30% market share should be replaced by a statement that "the larger market power the stronger should be the demonstrated efficiency gains" with a concrete rule that states: (1) the de minimis rule applies also for RPM (i.e., a firm with less than 15% market share can engage in RPM); (2) for a firm with a share above 15%, the burden of proving that RPM will have beneficial effects on competition is resting upon it; (3) it is unlikely that a firm with a share in excess of 30% will be able to show that RPM will have a net beneficial effect.[48]

This recommendation could easily be modified by specifying similar thresholds for the buyer involved in the agreement (consistent

[46] 2010 Guidelines, *supra* note 18. This approach is to be contrasted with the dominant view in the United States that interbrand competition should be a primary concern of competition law. *See* Cont'l TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

[47] During the discussions that preceded the 2010 BER, some Member States indeed raised questions as to whether or not RPM should continue to be treated as a hardcore violation.

[48] *See* 2010 EACGP BER Report, *supra* note 32, at 4.

with the revision in the 2010 BER regarding market shares). A revision of the 2010 BER along these or similar lines in the future, essentially placing RPM under the de minimis rule, would be a further step in the right direction and also contribute to the convergence between EC and U.S. competition policies.[49] A very similar argument and recommendation can be made regarding the territorial restrictions that are also still generally blacklisted under the 2010 BER.[50]

Finally, and in addition to this de minimis treatment of all vertical agreements recommended for future changes in the 2010 BER, perhaps the time has come in the EC for approaching RPM from a viewpoint other than a strong presumption about its anticompetitive nature. Currently, it is not clearly laid out by the Commission why it believes RPM is so detrimental to competition that it should be treated as a hardcore restriction and that the usual order in bringing forward evidence should be reversed. Clearly, there is a presumption by the Commission that in each RPM case competition is restricted in at least one and possibly more ways. Certainly, RPM can have serious enough anticompetitive effects (even when the parties involved are not dominant). However, I believe that the preferable approach would be to spell out precisely why RPM has an anticompetitive effect before one turns to an efficiency justification. Of course, if one assumes that "the immediate effect of RPM is that all or some distributors are prevented from lowering their sales price for that particular brand,"[51] then RPM is always going to have some detrimental effects. However, such a position, by essentially focusing on protecting intrabrand competition independently from interbrand competition, does not

[49] For further analysis along the same argument for a de minimis treatment of RPM, see Yves Botteman & Kees J. Kuilwijk, *(Minimum) Resale Price Maintenance under the New Guidelines: A Critique and a Suggestion*, CPI INT'L J., June 2010.

[50] If the two firms involved are so small that a merger between them would be uncontested, it is not clear why any other agreements between them should be viewed as presumptively anticompetitive.

[51] Brenning-Louko, Gurin, Peeperkorn & Viertiö, *supra* note 40, at 6. For an analysis of RPM practices, see also Luc Peeperkorn, *Resale Price Maintenance and its Alleged Efficiencies*, 4 EUR. COMPETITION L.J. 201, 206–07 (2008).

take into consideration how changes in the overall strategies of the firms involved, directly or indirectly, could affect consumer welfare. In other words, what is the overall effect of using RPM in a particular market? Specifically, whether or not RPM or other such restrictions can be used will also crucially affect the wholesale prices that will emerge in the market, the quality and variety of the products or services supplied, and, therefore, the effects on intrabrand competition cannot be evaluated independently from the effects on interbrand competition.

VI. CONCLUSION

This article has briefly discussed issues related to vertical agreements. Vertical agreements (and vertical relations more generally) operate fundamentally differently from horizontal agreements. Vertical agreements are expected to have anticompetitive effects only under specific sets of circumstances and, at the same time, they are expected to generate significant efficiency gains. Further, if certain types of agreements are not allowed between two firms that do not have significant market power, a useful benchmark for efficiency comparison is offered by the vertical integration alternative that they have between them.

My main focus has been the treatment of vertical agreements by the European Commission within the more general context of competition policy. The recently revised 2010 BER, which exempts from Article 102 TFEU most types of vertical agreements between firms that do not have too high a market share, is useful and in general moves in the right direction. In addition to addressing specific problems and questions that have emerged in the application of the 1999 BER over the last decade, the 2010 BER is in general in line with the more economics-based approach that is gaining some ground in the EC (in particular, moving in the same general direction as the new nonhorizontal merger guidelines and the economic approach to Article 102) and also with recent developments in the United States concerning the treatment of resale price maintenance (in particular, the Supreme Court's 2007 decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*).

However, in my opinion, the 2010 BER has not reached far enough. Since it is extremely unlikely that vertical agreements will have an anticompetitive effect when they involve only firms with small enough market shares, an extension of the de minimis rule even to agreements that are currently viewed as hardcore under the 2010 BER would be a useful step forward and would also bring the EC policy closer to the recent U.S. practice. One hopes that such a modification will be adopted in the future.

Guidance on abuse in Europe: The continued concern for rivalry and a competitive structure

BY PHILIP MARSDEN* AND LIZA LOVDAHL GORMSEN**

Both the United States and the EU allegedly protect the competitive process through an effects-based approach to the analysis of exclusionary abuses. Importantly though, each jurisdiction starts from a different end of the spectrum. The article finds that while U.S. antitrust appears to protect the competitive process to enhance consumer welfare in the form of allocative and productive efficiency, EU competition law protects the structure of competition to protect rivalry. When applying Article 102 TFEU, the European Commission and the courts rely on two presumptions that hearken back to Ordoliberalism. The existence of dominance creates a presumption of harm to the structure of competition (foreclosure), and that harm to the structure of competition in turn creates a presumption of likely harm to consumers (anticompetitive foreclosure). These presumptions are apparent in case law as well as the Commission's Guidance Paper on Article 102. This article concludes that despite having the same aim, there is still a trans-Atlantic divide about how best to protect the competitive process.

* British Institute of International and Comparative Law.

** London School of Economics and King's College London.

AUTHORS' NOTE: *This article develops themes raised in Philip Marsden,* Monopolization: What is Behind the Trans-Atlantic Divide?, in CHALLENGES IN THE ENFORCEMENT OF ARTICLE 82 *(Federico Etro & Ioannis Kokkoris eds., 2010) by in particular tracing further evidence of Ordoliberal thought in current enforcement practice and case law.*

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