Territorial supply constraints
AIM note on the legal aspects /09.04.13

The issue of "Territorial Supply Constraints" introduced in Section 5.7 of the Green Paper is one that has been addressed in detail by EU (and national) competition laws, a central aim of which is to promote the overriding goal of achieving single market integration in Europe. The European Commission and Courts have considered in detail when regulatory intervention is, and is not, warranted in this area, resulting in a clear and comprehensive set of applicable rules. In light of the broad application of competition law in this area, addressing territorial restraints in a possible legislative or non-legislative instrument on unfair commercial practices would create an unnecessary extra layer of rules for European businesses.

The Green Paper suggests that concerns regarding territorial supply constraints might arise in connection with either (1) vertical agreements between suppliers and resellers or (2) unilateral conduct by suppliers. Both are already the subject of clear and considered competition law rules that prohibit territorial restraints that run contrary to EU market integration.

First, agreements that restrict the territory into which or customers to whom a distributor may passively resell goods (i.e., respond to unsolicited requests) are a "hardcore restriction" under Article 101(1) TFEU, carrying potentially heavy fines. (The Green Paper in footnote 53 makes clear that restrictions on active sales by exclusive distributors outside their assigned territories are not considered as territorial supply constraints.) The threshold for finding an "agreement" under Article 101 is low: it is sufficient that the parties have expressed their joint intention to conduct themselves on the market in a specific way. Even where there is no agreement expressing a joint intention, regulators can often bring seemingly unilateral conduct within the ambit of Article 101 by showing that the policy of one party receives the acceptance (or even merely the tacit acquiescence) of the other party. For instance, if after a supplier's announcement of a unilateral reduction of supplies in order to prevent parallel trade, distributors reduce their orders and stop engaging in parallel trade, then those distributors tacitly accept the supplier's unilateral policy. Tacit acceptance may also be deduced from coercion, e.g. where a supplier implements a system of monitoring to penalize distributors that do not comply with its unilateral policy.

It therefore cannot be necessary or sensible to propose new rules preventing suppliers from prohibiting resellers from making passive sales to customers in other countries. Such conduct is already prohibited by Article 101. Retailers are already free to source supplies from non-domestic wholesalers -- suppliers are not allowed to prevent this.

Second, unilateral conduct that has the effect of partitioning markets in Europe may be caught by Article 102 TFEU: where a dominant company refuses to supply wholesalers to impede parallel trade without objective justification, this can be condemned as an abuse of a dominant position. In particular, dominant suppliers may not take actions or impose terms and conditions that discriminate against exporters or apply higher prices for export sales.

In sum, agreements and conduct that might have the effect of dividing the territory of one Member State from another will be closely scrutinized and may be severely punished under Article 101 (on restrictive agreements) or Article 102 (on abusive practices). These rules have been developed -- and limited as appropriate -- by the European Courts over the past four decades. Introduction of new rules based on unfair commercial practices is unwarranted.

Annex to AIM's response to questions raised in Commission Green Paper on Unfair Trading Practices of 31 January 2013:

Summary of EU competition rules governing agreements and practices restricting parallel trade within the EU

A. Article 101 TFEU

Article 101 TFEU prohibits agreements or concerted practices between undertakings that have the object or effect the prevention, restriction or distortion of competition within the EU (Article 101(1)), unless the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress, allows consumers a fair share of the resulting benefit, and does not impose restrictions that are not indispensable to the attainment of these objectives or that permit the parties to eliminate competition in respect of a substantial part of the products in question (Article 101(3)). The Commission has imposed fines on companies that have entered into agreements found to have illegitimately restricted parallel trade within the EU in almost 50 cases.[1]

Agreements and Concerted Practice

Article 101 applies to agreements or concerted practices between independent undertakings.[2] The concept of an agreement has been defined as a concurrence of wills between at least two independent parties that have a common intention to conduct themselves in a certain manner on the market.[3] (It is important to note that a mutual expression of intent is sufficient to establish an agreement, even if there is no formal enforcement mechanism or parties may intend to "cheat" on the agreement.) The form of the agreement is irrelevant, as long as it constitutes the expression of the parties' intention to behave in accordance with its terms.[4] In certain circumstances, measures

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1 *See*, *e.g.*, *PO Video Games*, Case COMP/35.587, Commission decision of October 30, 2002, OJ [2003] L 255/33 ("*Nintendo*") (Commission fined the Japanese video games maker Nintendo and seven of its European distributors €167.8 million for colluding to prevent exports from low-priced countries to high-priced countries).

2 *See* Case 107/82 *AEG v Commission* [1983] ECR 3151, ¶ 38; Joined Cases 25/84 and 26/84 *Ford and Ford Europe v Commission* [1985] ECR 2725, ¶ 21; and Case T-43/92 *Dunlop Slazenger v Commission* [1994] ECR II-441, ¶ 56; Case T-41/96 *Bayer v Commission* [2000] ECR II-3383, ¶ 66.

3 *See* Case 41/69 *ACF Chemiefarma v Commission* [1970] ECR 661, ¶ 112; Joined Cases 209/78 to 215/78 and 218/78 *Van Landewyck and Others v Commission* [1980] ECR 3125, ¶ 86; and Case T-7/89 *Hercules Chemicals v Commission* [1991] ECR II-1711, ¶ 256.

4 *See* Case 41/69 *ACF Chemiefarma v Commission* [1970] ECR 661, ¶ 112.

adopted or imposed in an apparently unilateral manner have been regarded as constituting an agreement within the meaning of Article 101. In those cases, the Commission and the Community courts have considered whether such "unilateral" conduct has received the "tacit acquiescence" of independent companies.[5]

A concerted practice has been defined as a form of coordination where at least two independent parties, without having reached the stage where an agreement properly so-called has been concluded or a precise plan of action established, "*knowingly substitute practical cooperation between them for the risk of competition*."[6] In other words, Article 101(1) has been interpreted as prohibiting "*any direct or indirect contact [...] the object or effect whereof is [...] to influence the conduct on the market of an actual or potential competitor*."[7] In certain specific circumstances, the existence of a concerted practice has been inferred on the basis of, *inter alia*, evidence of complaints made by one party in connection with competition to which its products were exposed and subsequent accommodating conduct by the other party.[8]

In *Pioneer*, for example, the Commission found that Pioneer and some of its European exclusive distributors had engaged in two separate concerted practices directed at preventing imports of Pioneer equipment from Germany and the United Kingdom into France. In its decision, which was subsequently confirmed on appeal by the European Court of Justice,[9] the Commission based its findings on: (1) evidence of repeated complaints about parallel imports by Pioneer's exclusive distributor for France (where prices were higher); (2) a meeting organized by the supplier and attended by the French distributor as well as by the distributors of the "exporting" countries (Germany and the U.K.), at which the issue of parallel trade had been apparently discussed; (3) a number of communications showing an intention to monitor and prevent parallel imports of Pioneer equipment into France; and (4) the subsequent adoption by the Germany and U.K. distributors of measures directed at preventing parallel trade (including a refusal to deliver products intended for export and communications to certain large resellers containing "*unequivocal requests to cease exporting Pioneer equipment*").[10] In reaching its conclusions, the Commission cited the Court's statement in *Suiker Unie* according to which "*if an economic operator accepts the complaints made to him by another operator in connection with the competition to which the products manufactured by the former*

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5 Case T-41/96 *Bayer AG v Commission* [2000] ECR II-3383, ¶ 71, upheld on appeal in Joined Cases C-2/01 P and C-3/01 P *Bundesverband der Arzneimittel-Importeure eV and Commission v Bayer AG* [2004] ECR I-[0000], ¶¶ 96 to 103. *See also* Joined Cases 32/78, 36/78 to 82/78 *BMW Belgium and Others v Commission* [1979] ECR 2435, ¶¶ 28 to 30; Case 107/82 *AEG v Commission* [1983] ECR 3151, ¶ 38; Joined Cases 25/84 and 26/84 *Ford and Ford Europe v Commission* [1985] ECR 2725, ¶ 21; Case 75/84 *Metro v Commission* (Metro II) [1986] ECR 3021, ¶ 72; Case C-70/93 *BMW v ALD* [1995] ECR I-3439, ¶ 16.

6 Case 48/69 *ICI v Commission*, [1972] ECR 619, ¶ 64.

7 Joined Cases 40-48, 50, 54-56, 111, 113 and 114/73 *Coöperative Vereniging "Suiker Unie" UA and others v Commission* ("Suiker Unie") [1975] ECR 1663, ¶ 174.

8 *See Suiker Unie*, ¶ 283, and Case IV/29.595, *Pioneer Hi-Fi Equipment*, Commission decision of December 14, 1979, [1980] L 60/21 ("*Pioneer*"), confirmed on appeal in Joined Cases 100-103/80 *SA Musique Diffusion and others v Commission* [1983] ECR 1825 ("*Musique Diffusion France*"). *See* also Case 86/82 *Hasselblad (GB) Limited v Commission* [1984] ECR 883.

9 *See Musique Diffusion France*.

10 *See Pioneer*, ¶¶ 48-49, and *Musique Diffusion France*, ¶ 62.

operator expose the latter, the conduct of the operators concerned amounts to a concerted practice."[11]While both the Commission and the Court considered the arguments set forth by the accused companies as to the existence of alternative explanations for some of the actions taken, they eventually rejected such arguments on the facts.[12]

Independent Undertakings

Article 101 applies only to agreements between independent undertakings, and not to undertakings that form a single economic entity.[13] The Community courts have determined that a company and its subsidiaries form a single economic entity if the subsidiaries "*do not enjoy real autonomy in determining their course of action in the market, but carry out the instructions issued to them by the parent company controlling them*."[14]

Legitimate vs. Illegitimate Territorial Restrictions

Restrictions on a purchaser's ability to resell goods outside of a given territory are a form of "vertical restraint" that has the potential to infringe Article 101(1).[15] The EU competition rules recognize that not all territorial restraints restrict competition, and even when such restraints do restrict competition, they often produce sufficient pro-competitive benefits to qualify under Article 101(3) for exemption from the Article 101(1) prohibition. For example, a common problem in distribution models is that distributors tend to reduce their investments in promoting the manufacturer's goods if competing distributors can take advantage of promotional activities without incurring any of the costs. In such cases, although territorial restrictions reduce competition between the manufacture's distributors (intra-brand competition), they actually intensify competition between different manufacturers' brands (inter-brand competition).[16] Provided that there is sufficient competition at the manufacturing level,

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11 *See Pioneer*, ¶ 72, and *Suiker Unie*, ¶ 283.

12 *See Pioneer*, ¶¶ 63-73, and *Musique Diffusion France*, ¶¶ 56-57. The German distributor alleged that its refusal to fulfil an order for products intended for export (which it had initially accepted) was the consequence of normal business considerations and contractual constraints, rather than part of an unlawful concerted practice aimed at preventing parallel trade. In particular, the distributor claimed, *inter alia*, that the order was not fulfilled because of insufficient stocks. However, the Court noted that, since it was not disputed that the German distributor could have delivered a large part of the goods ordered without really jeopardizing its stocks, it could not be explained why it had made no offer to make partial deliveries and had not contacted Pioneer with a view to trying to obtain the rest of the ordered goods (*Musique Diffusion France*, ¶ 56). Furthermore, both the Commission and the Court emphasised the chronology of the relevant events. In particular, they noted that the refusal "*came only about one week after the meeting [...] during which parallel imports were discussed*" (*Pioneer*, ¶ 70) and, based on available evidence, seemed to be strictly connected with the French distributor's complaints.

13 *See* Case 22/71 *Béguelin Import v GL Import Export* [1971] ECR, 949; Case 15/74 *Centrafarm v Sterling Drug* [1975] ECR 1147; Case C-73/95 *Viho v Commission* [1996] ECR I-5457.

14 *See* Case C-73/95 *Viho v Commission* [1996] ECR I-5457, ¶ 16.

15 Commission Notice, Guidelines on Vertical Restraints, OJ [2010] C 130/1, ¶¶ 50-51.

16 *Id.*¸ ¶107.

the restrictions will normally benefit consumers.[17] However, where there is insufficient competition between manufacturers, territorial restrictions – in particular absolute

territorial restrictions – may reduce intra-brand competition without an offsetting increase in inter-brand competition, and may in some cases serve to restrict inter-brand competition (in particular where there is already active or tacit collusion among manufacturers).

EU competition rules therefore distinguish between "active" (solicited) and "passive" (unsolicited) sales. In essence, suppliers that have given territorial exclusivity to distributors may limit each distributor's freedom to engage in "active" sales outside of its respective territory, are unlikely to harm competition and consumers unless the manufacturer commands a high market share, and provided that customers are not prevented from searching out better prices in different sales territories. EU competition law therefore closely scrutinizes restrictions on "passive" selling, i.e., "responding to unsolicited requests from individual customers, including the delivery of goods or services to such customers."[18] The notion of "territorial restraints" as defined in the Green Paper "as a prohibition for suppliers to sell to resellers, which by themselves seek to source from the supplier"[19] falls squarely within this concept.

Restrictions on passive selling are restrictions by object, and in most cases are considered "hard core" restrictions that are incapable of exemption under Article 101(3). However, EU competition law does recognize that, in some circumstances even restrictions on passive sales may ultimately benefit consumers and therefore legal.[20]

The principle that EU consumers should be able to buy goods from the cheapest source anywhere in the EU leads in particular to the need to protect trading by intermediaries that buy from a manufacturer to sell on to consumers, thereby competing either directly with the manufacturer's own sales arm or with the manufacturer's approved dealer network. The term "parallel trading" refers to such trading across frontiers by intermediaries, often operating outside "authorised" channels of distribution. Many of the cases arising under the rules on competition are concerned with the right of "parallel importers" to sell goods between Member States, and heavy penalties have been imposed on suppliers that have acted to restrict or prevent such trade. The Court of Justice has therefore held that agreements intended to limit parallel trade constitute "restrictions by object" that infringe Article 101(1).[21] Following are specific examples of conduct that has been found to infringe Art. 101(1):

- Agreeing to limit all exports and/or to prohibit or limit "passive" sales;[22]
- Requiring distributors to refer non-domestic customers to "local" suppliers;[23]

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17 *Id.*, ¶153 ("the loss of intra-brand competition can only be problematic if inter-brand competition is limited")

18 Guidelines on Vertical Restraints, OJ [2010] C 130/1, ¶ 50.

19 Green Paper, fn. 53.

20 *See* Guidelines on Vertical Restraints, ¶56 (situations where passive sales restrictions are not considered a hard core restriction) and ¶¶ 60-62 (situations where passive sales restrictions are hardcore restrictions, but capable of individual exemption).

21 Joined Cases C-501/06 P et al. *GlaxoSmithKline Services Unlimited v. Commission* [2009] ECR I-929.

22 *Nintendo*, ¶ 264.

23 *Nintendo*, ¶ 112.

- Agreeing to boycott, discriminate against, or limit sales to parallel traders;[24]
- Instructing distributors not to supply customers thought likely to export product to other EU countries;[25]
- Conditioning supply on customers' agreeing to an absolute ban on exports;[26]
- Exercising pressure on distributors not to export product, by, for example, monitoring exports;[27]
- Requiring distributors to raise prices so as to eliminate any economic interest in parallel imports;[28]
- Agreeing to different prices depending on whether the likely destination of the goods was within or outside a territory;[29] and
- Prohibiting resellers in a selective distribution network from making sales over the Internet.[30]

Defences

Purely unilateral measures to limit parallel trade, such as unilaterally limiting the volumes supplied to distributors who engage in parallel trade, do not constitute agreements they therefore do not infringe Article 101(1).[31] However, as discussed below, they may violate Article 102 if implemented by a dominant firm.

As discussed above, agreements to limit parallel trade will infringe Article 101(1), but may still be legal if they satisfy the criteria for exemption under Article 101(3).[32] In effect, this requires demonstrating that the measure generates efficiencies or other benefits that customers will enjoy, and that the measures do not unduly restrict competition. These criteria are applied strictly. For example, the following types of justification have been found insufficient to satisfy Article 101(3): (1) ensuring quality control;[33] (2) maintaining product integrity;[34] and (3) ensuring "orderly and rational marketing."[35]

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24 *See, e.g.*, Case 107/82 *AEG v Commission* [1983] ECR 3151, ¶ 38.

25 *See, e.g.*, *Pioneeer* and Case IV/31.503 *Konica*, Commission decision of December 18, 1987, OJ [1988] L 78/34.

26 *See, e.g.*, *Pioneeer* and Case IV/32.026 *Bayo-n-ox*, Commission decision of December 13, 1989, OJ [1990] L 21/71; Case COMP/36.653 *Opel Nederland*, Commission decision of December 20, 2000, OJ [2001] L 59/1.

27 *See, e.g.*, *Tipp-Ex*, Case IV/31.192, Commission decision of July 10, 1987, OJ [1987] L 222/1; Case 279/87 *Tipp-Ex v Commission* [1990] ECR I-261; *see also* Commission Notice, Guidelines on Vertical Restraints, OJ [2000] C 291/1, ¶ 49.

28 *See, e.g.*, *Tipp-Ex*, Case IV/31.192, Commission decision of July 10, 1987, OJ [1987] L 222/1; Case 279/87 *Tipp-Ex v Commission* [1990] ECR I-261.

29 *See e.g.*, *GlaxoSmithKline Services Unlimited v. Commission.*

30 *See e.g.*, Case C-439/09 – *Pierre Fabre Dermo-Cosmétique v. President de l'Autorité de la concurrence*, not yet reported.

31 *See e.g.*, Joined Cases C-2/01 P and C-3/01-P *Bundesverband der Arzneimittel-Imperteure v. Bayer*, [2004] ECR I-64.

32 *Id.*

33 Case 27/76 *United Brands v Commission* [1978] ECR 207, ¶¶ 86 and 159.

34 *Bayer Dental*, OJ [1990] L 351/46, ¶¶ 5 and 15.

35 *Teacher & Sons*, OJ [1978] L 235/20, II.2. *See* too *The Distillers Company*, OJ [1978] L 50/16, III.2.2.

B. Article 102 TFEU

Article 102 TFEU prohibits unilateral conduct by dominant companies that is abusive because it has an appreciable adverse effect on competition in the EU. A dominant undertaking has been defined as an undertaking having "*the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.*"[36]

The Commission's application of Article 102 has generally focused on practices that have been shown, in light of the market context, to result in an anti-competitive effect on inter-brand competition – usually an exclusionary impact on a dominant firm's competitors.[37] In a number of instances, however, the Commission has fined dominant companies for conduct found to have restricted intra-Community trade and intra-brand competition.[38]

Refusal to Supply

All firms, including dominant firms, are generally free to deal with whom they wish. However, it is well established under Article 102 TFEU that dominant companies may, in certain limited circumstances, be required to deal with third parties with whom they do not wish to enter into or continue contractual relations.

Typically, refusals to supply that have been found to constitute an abuse under Article 102 have been addressed to competitors of the dominant company, *i.e.*, exclusionary refusals to supply having the direct effect of driving a competitor out of, or preventing it from entering, a market. These include: (1) the interruption of supply to a company of an input/raw material needed in order to be present in a downstream market where such company is in competition with the dominant company;[39] and (2) a refusal to deal for the first time with a company that would become a competitor of the dominant company in a downstream market (refusal to access to an essential facility[40] or to license intellectual property).[41]

Refusals to supply have also been found to be abusive in cases where the refused customer does not compete with the supplier. The earliest cases involved refusals that

36 *Hoffmann-La Roche*, [1979] ECR 461, ¶ 38. *See also Michelin*, [1983] ECR 3461, ¶ 30.

37 *See, e.g.*, Joined Cases 6 and 7/73 *ICI and Commercial Solvents v Commission* [1974] ECR 229, ¶ 25 ("*Commercial Solvents*").

38 *See, e.g.*, Joined Cases 40 to 48, 50, 54 to 56, 111, 113 and 114/73 *Suiker Unie and others v Commission* [1975] ECR 1663, ¶¶ 396 *et seq.* (a sugar refinery threatened to stop sugar supply unless distributors complied with its restrictive export policy); Case 226/84 *British Leyland v Commission* [1986] ECR 3263, ¶ 24 (British Leyland refused to issue type certificates for vehicles that had been re-imported to the UK from the continent; the Court held that this refusal manifested "*a deliberate intention* […] *to create barriers to re-importations*" in order to protect approved distributors).

39 *See, e.g., Commercial Solvents*.

40 *See, e.g., Sea Containers v Stena Sealink – Interim measures*, OJ [1994] L 15/8, and *Port of Rodby*, OJ [1994] L 55/52.

41 *See, e.g., Magill TV Giude/ITP, BBC and RTE*, OJ [1989] L 78/43, confirmed on appeal in Case T-69/89, *Radio Telefis Éireann (RTE) v Commission* [1991] ECR II-485, Case T-70/89, *British Broadcasting Corporation and BBC Enterprises Ltd (BBC) v Commission* [1991] ECR II-535, and Case T-76/89, *Independent Television Publications Ltd (ITP) v Commission* [1991] ECR II-575, and further confirmed in Joined Cases C-241/91 P and C-242/91 P, *RTE and ITP v Commission* [1995] ECR I-743.

were addressed to distributors and retailers with a view to punishing them for or preventing them from dealing with competitors of the dominant company.[42]

More recently, the Court of Justice addressed a dominant company's refusal to supply undertakings that were engaged in parallel trade within the EU. In *Sot. Lelos kai Sia* v. *GlaxoSmithKline*,[43] the practice before the Court was the refusal by a pharmaceuticals company to fill orders by Greek distributors who were engaged in parallel trade, to the extent that those orders exceeded the amounts necessary to meet the needs of Greek customers by more than a specified margin. The case was an Article 234 EC referral from the Athens Court of Appeals, which asked whether a refusal to fully meet orders for the purpose of restricting parallel trade was abusive *per se*, and, if not, by what criteria the refusal should be assessed. The Court of Justice found that such refusals were not abusive *per se*.[44] It affirmed that dominant companies may not refuse to meet the *ordinary* orders of an existing customer for the sole reason that a portion of that order was likely to be resold in a different EU Member State. However, the Court reiterated that even dominant companies may "*counter in a reasonable and proportionate way the threat to its own commercial interests potentially posed*" by the parallel trader.[45] Such measures could include, for example, refusing to supply orders that are disproportionate to the quantities previously sold by the distributor to supply the needs of the market in its Member State, taking into account some margin for sales growth.

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42 *See, e.g.*, Case 27/76, *United Brands v Commission* [1978] ECR 207 ("*United Brands*"); *BBI/Boosey & Hawkes – Interim measures*, OJ [1987] L 286/36.

43 Joined Cases C-486/06 to C-478/06, [2008] ECR I-7139.

44 In his opinion, Advocate-General Colomer argued strongly against finding that such refusals to supply should be considered abusive *per se*, noting that consumers can sometimes benefit from the practices of dominant companies. The positive and negative consequences for consumers and other operators in the market should therefore be considered on a case-by-case-basis. *Sot. Lelos kai Sia* v. *GlaxoSmithKline* (Opinion of Advocate-General Colomer), ¶¶ 71-75.

45 [2008] ECR I-7139, ¶ 71.