

## Vertical 'Hardcore' Restrictions In Europe

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A growing body of case law is emerging at the EU Member State level concerning restraints which are treated as restrictive of competition by "object". As such, they are rarely acceptable under EU competition law. These arise not in horizontal arrangements between competitors but in the context of vertical arrangements between suppliers and retailers.

Some of these cases have involved traditional competition law concerns around resale price maintenance ("RPM") including *Sports Bras* (United Kingdom) and *Cosmetics* (Germany). A related theme is the restriction of online selling in cases such as *Mobility Scooters* and *Online Hotel Booking* (United Kingdom) and *Contact Lenses* (Germany). A further concern relates to information exchange in a vertical agreement where this would be prohibited if the exchange took place between competitors (e.g., *Tobacco*, United Kingdom). This focus on vertical arrangements at the national level may be contrasted with the position of the European Commission ("Commission") which has not issued significant recent decisions in this area.

### RESALE PRICE MAINTENANCE

The Commission has long maintained hostility towards vertical resale price maintenance. This stance is confirmed in its current 2010 Vertical Restraints Block Exemption ("VRBE")<sup>1</sup> and Guidelines on Vertical Restraints ("VR Guidelines")<sup>2</sup> where it notes in the VR Guidelines at paragraph 223 that: "agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are treated as a hardcore restriction. Where an agreement includes RPM, that agreement is presumed to restrict competition and thus to fall within Article 101(1)". However, the Commission accepts in its VR Guidelines at paragraph 225 that RPM may lead to efficiencies in three narrow contexts.

- First, "where a manufacturer introduces a new product, RPM may be helpful during the introductory period of expanding demand to induce distributors to better take into account the manufacturer's interest to promote the product".
- Second, "fixed resale prices, and not just maximum resale prices, may be necessary to organise in a franchise system or similar distribution system applying a uniform distribution format". Thus it considers that a coordinated short term low price campaign (2 to 6 weeks in most cases) will also benefit consumers.
- Third, RPM may limit the effects of free-riding on services investments by retailers. The Commission notes that "the extra margin provided by RPM may allow retailers to provide (additional) pre-sales services, in particular in case of experience or complex products".

On 20 September 2013 the UK Office of Fair Trading ("OFT") announced that it had sent a Statement of Objection to DB Apparel UK Limited ("DB Apparel"), a manufacturer of sports bras, and three UK department stores (Debenhams plc, John Lewis plc and House of Fraser (Stores) Limited).<sup>3</sup> The OFT maintains that between 2008 and 2011, DB Apparel had in force nine RPM agreements with the retailers which set a fixed or minimum resale price in violation of the EU and UK prohibitions on restrictive agreements (Article 101 TFEU and

1 Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, Official Journal L 102, 23.4.2010, p.1-7.

2 Commission notice - Guidelines on Vertical Restraints, Official Journal C 130, 19.05.2010, p. 1.

3 OFT press release 64/13, OFT issues Statement of Objections to sports bra supplier and three UK department stores, 20 September 2013.

Chapter I of the UK Competition Act 1998 ("Chapter I")). The OFT alleges that the agreements were operated on a national basis and concerned multiple products within the Shock Absorber range. The Shock Absorber range is apparently one of the leading UK sports bra brands with a market share of around 15%.

Raising similar issues, the German Federal Cartel Office ("FCO") has fined WALA, a maker of herbal therapies and beauty products, €6.5 million for putting pressure on retailers and using contractual provisions to enforce its recommended resale prices.<sup>4</sup> The authority maintained that since 2003 WALA used a variety of methods to enforce RPM including threatening to exclude retailers that did not comply with the system. WALA committed to remove the offending provisions and to open up distribution on the internet.

### RESTRICTIONS ON ONLINE SALES

The Commission's starting point in its VR Guidelines is that, in principle, every distributor should be allowed to use the internet to sell its products.<sup>5</sup> However, this is subject to specific limitations and the Commission draws a distinction between the types of online selling that can or cannot be restricted in a vertical agreement consistently with EU competition law.

The Commission also cites examples of what it regards as hardcore restrictions of passive sales which, if included in a distribution agreement, would result in the unavailability of exemption under the VRBE:

- agreeing that the (exclusive) distributor shall prevent customers located in another (exclusive) territory from viewing its website or shall put on its website automatic rerouting of customers to the manufacturer's or other (exclusive) distributors' websites;
- agreeing that the (exclusive) distributor shall terminate consumers' transactions over the internet once their credit card data reveals an address that is not within the distributor's (exclusive) territory;
- agreeing that the distributor shall limit a proportion of overall sales made over the internet;
- agreeing that the distributor shall pay a higher price for products intended to be sold by the distributor online than for products intended to be sold offline.<sup>6</sup>

On 5 August 2013 the OFT announced its decision finding that a manufacturer of mobility scooters, Roma Medical Aids Limited ("Roma"), and seven of its online retailers had infringed Chapter I.<sup>7</sup> The OFT found two prohibited practices in that Roma had (1) prohibited online sales by retailers and (2) prohibited online advertising by retailers of prices. The OFT considered that the arrangements were incapable of exemption. Roma had not provided compelling arguments or evidence that the prohibitions met the exemption conditions and, in particular, it had not established that the prohibitions were necessary to prevent free-riding.

With similar reasoning, the FCO has fined CIBA Vision €11.5 million for restricting online sales of its contact lenses and applying illegitimate pressure on resellers to comply with its recommended resale prices.<sup>8</sup> The practices found by the FCO to amount to infringements concerned agreements between CIBA Vision and its customers prohibiting online trading. The agreements also prohibited the sale of certain types of contact lenses through e-Bay.

<sup>4</sup> Bundeskartellamt press release, fine imposed on WALA Heilmittel GmbH for vertical price fixing practices involving Dr Hauschka cosmetics products, 31 July 2013.

<sup>5</sup> Paragraph 52, VR Guidelines.

<sup>6</sup> Paragraph 52, VR Guidelines.

<sup>7</sup> Roma-branded mobility scooters: prohibitions on online sales and online price advertising, OFT decision CE/9578-12, 5 August 2013.

<sup>8</sup> Bundeskartellamt press release, Bundeskartellamt imposes fine on CIBA Vision, 25 September 2009.

The application of competition law to online selling has not been straightforward. On 31 January 2014<sup>9</sup> the OFT announced that it had accepted commitments from Booking.com, Expedia and InterContinental Hotels Group to address the OFT's concerns relating to restrictions on the ability of online travel agents (OTA) to offer discounts for room only hotel accommodation bookings. Of particular note, under the commitments OTAs and hotels that deal with the three parties to the commitments will be able to offer discounts off the headline room-only rates provided that customers sign up to the OTA or hotel membership scheme. The final settlement appears to be more of a compromise allowing the OTAs to engage in further discounting reflecting that the OFT did not view the restrictions as hardcore.

### INDIRECT INFORMATION EXCHANGE

The Commission has identified that the indirect flow of information in the context of a vertical relationship may present competition concerns where this emulates the type of exchange which would be problematic as between competitors. In the VR Guidelines the Commission comments that such "agreements may facilitate collusion between distributors when the same supplier serves as a category captain for all or most of the competing distributors on a market and provides these distributors with a common point of reference for their marketing decisions."<sup>10</sup>

The Commission also notes at paragraph 55 of its Horizontal Cooperation Guidelines that information exchange that takes place "indirectly through a common agency (for example, a trade association) or a third party such as a market research organisation or through the companies' suppliers or retailers" may present competition concerns.<sup>11</sup>

In April 2010 the OFT announced that it had fined two tobacco retailers and ten retailers a total £225 million for their infringement of Chapter I.<sup>12</sup> The OFT found that each manufacturer had entered into agreements with the retailers pursuant to which the price of tobacco was connected with that of a competitor brand. The OFT concluded that the arrangements were anti-competitive by object. The OFT considered that the agreements between each manufacturer and each retailer limited the freedom of each retailer to determine its retail prices independently of competitors. A number of appeals have been brought by the parties claiming that the OFT erred in finding that the object of the arrangements was restrictive of competition.

### COMMENT

#### RPM - the Holy Grail?

The fact that the practice is treated as restrictive by object raises the evidential burden on the parties to substantiate any efficiencies flowing from RPM. It appears that the authorities would need to be convinced, at the very least, that there were no less restrictive means of achieving the claimed benefits of RPM. This is evident in the OFT's Mobility Scooters infringement decision where it thought that there were other methods available which could be used to incentivise retailers and without dulling price competition between them.

#### When Will Restrictions On Online Sales Be Permitted?

One area that continues to attract interest relates to the differentiation between "luxury" and other goods. While the new VRBE exempts selective distribution "regardless of the

<sup>9</sup> Hotel online booking: Decision to accept commitments to remove certain discounting restrictions for Online Travel Agents, 31 January 2014, OFT1514dec.

<sup>10</sup> Paragraph 211, VR Guidelines.

<sup>11</sup> Communication from the Commission - Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, Official Journal C11, 14.1.2011, p. 1.

<sup>12</sup> OFT decision Case CE/2596-03: *Tobacco*, 15 April 2010.

nature of the product concerned", the VR Guidelines state that, where the characteristics of the product do not require selective distribution, or do not require the applied criteria, such as for instance the requirement for distributors to have one or more brick and mortar shops or to provide specific services, such a system does not generally bring about efficiency effects to offset what the Commission describes as "a significant reduction in intra-brand competition".<sup>13</sup> While certain luxury or branded products might be candidates for efficiency and other justifications for restrictions which would be hardcore in other contexts, it appears that the competition authorities are reluctant to allow such restrictions on the mere assertion of the need for a personalised sales service.

### Multiple Pricing Policies

These cases highlight the risks of managing multiple distribution pricing policies which can be challenged from a number of competition law perspectives, especially where restrictions on online sales are concerned. In the WALA case, for example, the FCO considered that the fact that online sales restrictions were involved made it more likely that the resale price recommendations operated as enforced RPM.

### Relationship With Horizontal Coordination

Despite the vertical nature of the practices considered, the competition authorities have raised concerns that interaction between suppliers and retailers may lead to unlawful concerted action at the horizontal level. The FCO was alerted to this risk in the CIBA Vision case and considered this to be a risk if all the resellers follow the price recommendations and rely on their competitors to follow. It appears that the FCO would not require proof of direct contact between resellers in such instances.

This reasoning has parallels with the approach developed by the UK OFT to address the indirect flow of information between competitors via a common trading partner. The phenomenon has been described variously as 'A-B-C information exchange' or 'hub and spoke collusion'. The UK Court of Appeal has been satisfied that A, B and C can be seen as parties to a single infringement as opposed to independent vertical agreements:

"if (i) retailer A discloses to supplier B its future pricing intentions in circumstances where **A may be taken to intend that B will make use of that information** to influence market conditions by passing that information to other retailers (of whom C is or may be one), (ii) **B does, in fact, pass that information to C** in circumstances where C may be taken to know the circumstances in which the information was disclosed by A to B and (iii) **C does, in fact, use the information** in determining its own future pricing intentions" (emphasis added).<sup>14</sup>

Interestingly, when the OFT made its infringement decision in Tobacco it decided not to pursue allegations relating to the indirect exchange of information on future retail prices. The OFT considered that the information in its possession was insufficient to sustain a finding of infringement on that basis.

### CONCLUSION

It is clear from the cases at national level that the authorities will take action where they believe that there is a clear case of infringement of the traditional prohibitions on RPM and restricting passive sales, albeit in an online world. However, there is a distinct creep of concepts borrowed from horizontal collusion into the vertical sphere. This means that suppliers and retailers should be slower to conclude that price restrictions concluded in an EU distribution arrangement would automatically benefit from the more benevolent competition law approach that is typically associated with vertical agreements.

<sup>13</sup> Paragraph 176, VR Guidelines.

<sup>14</sup> Cases 102/1/1/03 and 1022/1/1/03, *JJB Sports plc v Office of Fair Trading; Allsports Limited v Office of Fair Trading* [2004] CAT 17, paragraph 141.