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The Rule on Restrictive Agreements and Vertical Intra-brand Restraints

Csongor István Nagy

Markets and the Law

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CSONGOR ISTVÁN NAGY
University of Szeged and Budapest University of Technology and Economics, Hungary

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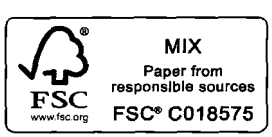

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EU regulations

Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. OJ [1999] L 336/21.

Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector. OJ [2002] L 203/30.

Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. OJ [2003] L 1/1.

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Commission Regulation (EU) No 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. OJ [2010] L 102/1.

Commission Regulation (EU) No 461/2010 of 27 May 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 in the motor vehicle sector. OJ [2010] L 129/52.

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Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (de minimis). OJ [2001] C 368/13.

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Guidelines on vertical restraints. OJ [2010] C 130/1.

Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements. OJ [2011] C11/1.

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. OJ [2010] C 138/16.

US guidelines

Federal Trade Commission (FTC) and Antitrust Division of the U.S. Department of Justice (DOJ) Guidelines for Collaborations Among Competitors, April 2000.

List of abbreviations

1/2003/EC Regulation	Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. OJ [2003] L 1/1.
AG	Advocate General
Article 81	Article 81 of the Treaty Establishing the European Community (equivalent of Article 101 between 1 May 1999 and 1 December 2009)
Article 85	Article 85 of the Treaty establishing the European Community (equivalent of Article 101 before 1 May 1999)
Article 101	Article 101 of the Treaty on the Functioning of the European Union*
BER	Commission Regulation (EU) No 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. OJ [2010] L 102/1.
CFI	Court of First Instance (as from 1 December 2009: General Court)
Commission	European Commission
DoJ	United States Department of Justice
ECJ	Court of Justice (before 1 December 2009: Court of Justice of the European Communities)
FTC	Federal Trade Commission
GC	General Court (before 1 December 2009: Court of First Instance)
Guidelines on Article 101(3)	Guidelines on the application of Article 81(3) of the Treaty. OJ [2004] C 101/97.

* In the book the new numbers introduced by the Treaty of Lisbon will be used, which are applicable as from 1 December 2009. Nevertheless, the original texts of the quotations remain unchanged.

Guidelines on Horizontal Cooperation Agreements	Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements. OJ [2011] C 11/1.
Guidelines on the Assessment of Technology Transfer Agreements	Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements. OJ [2004] C 101/2.
Guidelines on Vertical Restraints	Guidelines on vertical restraints. Official Journal C 130, 19.05.2010, p. 1
MVBER	Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector. OJ [2002] L 203/30.
New MVBER	Commission Regulation (EU) No 461/2010 of 27 May 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 in the motor vehicle sector. OJ [2010] L 129/52.
Notice on Agreements of Minor Importance	Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*). OJ [2001] C 368/13.
Old BER	Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. OJ [1999] L 336/21.
Old Guidelines on Horizontal Cooperation Agreements	Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements. OJ [2001] C 3/2.
Old Guidelines on Vertical Restraints	Guidelines on vertical restraints. OJ [2000] C 291/1.
RPF	Resale Price Fixing
RPM	Resale Price Maintenance

Section 1	Section 1 of the Sherman Act
Section 2	Section 2 of the Sherman Act
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
TTBER	Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements. OJ [2004] L 123/11.

Contents

Chapter I
Introduction

Competition law is probably the most globalized field of law, certainly because it uses the same world-language: economics. Nevertheless, under the surface of superficial unity, competition laws diverge very significantly in terms of legal thinking, analytical structure and allocation of burden of proof. This book demonstrates, through the example of vertical intra-brand restraints, how the treatment of restrictive agreements in the world's two leading competition law jurisdictions differs, and evaluates comprehensively the two regulatory patterns from this comparative perspective.

'Antitrust policy toward vertical restraints is the biggest substantive issue facing antitrust',[1] the most controversial question being the treatment of intra-brand restrictions. While economic common sense suggests that the most important competition problems are triggered by inter-brand restrictions, where the reseller's freedom is restricted in how to deal with competing brands, and intra-brand restraints, where the reseller's freedom is restricted in how to deal with the brand concerned, are less harmful, it is intra-brand restraints that are subject to the harshest treatment: from vertical agreements solely, intra-brand restraints have figured on the list of hardcore restrictions.

Recently, this field experienced sweeping changes. In 2007, a highly divided US Supreme Court, in a four-to-five judgment, overruled a century-old precedent: since then RPF has been subjected to an effects-analysis (rule of reason) on this side of the Atlantic; nonetheless, the treatment of RPF seems to have remained rather intact in the EU, notwithstanding some changes in the Commission's style. Accordingly, the foregoing developments have entailed a remarkable divergence between the two empires of antitrust and RPF has remained 'one of the most controversial areas of competition law and policy'.[2]

Likewise, US antitrust law treats territorial exclusivities laxly, while in the EU absolute territorial protection is chased with fire and sword, albeit restrictions on active promotion (relative territorial protection) are, similarly, subject to effects-analysis. Nonetheless, the purpose of market integration (single market imperative) is said to justify this deviation from sound economics in the EU.

1 Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 University of Chicago Law Review 229, 229 (2005).

2 *OECD Policy Roundtable* 2008 on *Resale Price Maintenance*, DAF/COMP (2008) 37, (2009) 9.

Besides the divergence between the two sides of the Atlantic, there is a tension also between mainstream economics and EU competition law; a tension that had been present also in US antitrust law before 2007.

The backbone of the book comprises of the detailed comparison of EU competition and US antitrust law. 'Antitrust law is an American tradition, as should always be remembered when comparisons are made and guidance is sought for the European law. Comparative law in this area is more than a fascinating intellectual game; it is a valuable tool; and indeed to the European lawyer an essential one.'[3] Economics serves an important role when evaluating the results of the comparative analysis.

The book's structure rests on two pillars: the analysis of the rule on restrictive agreements (Chapters II-IV) and the specific examination of the economics and the law of vertical intra-brand restraints (Chapters V-VII). The book ends with the final conclusions (Chapter VIII).

In the first part of the book, the structure of the rule on restrictive agreements will be considered in the context of vertical intra-brand restrictions. It would be an over-simplification of the problem if the query were reduced to the question whether intra-brand restraints are subject to an outright prohibition or to an effects-analysis. The constituent elements of this rule embrace the concept of agreement and the substance of the prohibition.

Chapter III deals with the notion of agreement, which has a pivotal role as the threshold question of the prohibition on restrictive agreements. A narrow grasp of agreement may enable the unilateral maintenance of prices and of exclusive territories, thus turning the rule on RPF and territorial protection upside down. On the other hand, a too wide notion of agreement may subject genuine unilateral conduct to the application of rules addressed to coordinated behaviour.

As a matter of practice, in US antitrust law the abolition of RPF's *per se* illegality had already been an accomplished fact in 2007, when in *Leegin* the Supreme Court overruled the *per se* illegality rule of *Dr. Miles*: the Supreme Court's holding in *Monsanto* (1984) effectively enabled producers to maintain prices by establishing that the concept of RPF agreement does not cover situations where a producer terminates price-cutters because of discounting, even if this happens after non-discounting dealers' complaining to the producer.

It will be demonstrated that the *Colgate* doctrine of US antitrust law is at variance with the sound economic considerations of vertical intra-brand restraints. In *Colgate*, the Supreme Court established that all traders have the natural right to select their business partners and, hence, to announce in advance the conduct they expect on the part of their dealers and to unilaterally terminate the non-complying ones. The exclusion of the foregoing plights from the ambit of agreement enables producers with some bargaining power to maintain resale prices unilaterally, while

3 René Joliet, The Rule of Reason in Antitrust Law; American, German and Common Market Laws in Comparative Perspective 191 (1967).

the most fundamental proposition of vertical restraints is that they raise problems only if the producer has market power.

The other constituent element of this architecture is the substance of the rule on restrictive agreements, which is analysed in Chapter IV. In EU competition law the bifurcation of Article 101 envisages a two-step analysis with different focuses: Article 101(1) contains a general prohibition on restrictive agreements, while Article 101(3) contains an exception (individual exemption). On the other hand, though the statutory language of Section 1 of the Sherman Act suggests a monistic approach, the rule of reason analysis is also structured. In both regimes, the burden of proof is allocated in the analytical phases differently.

It is submitted that Article 101(1) centres around the competitive process (rivalry), while Article 101(3), centres around productive efficiency. On the other hand, Section 1 uses a monistic analysis focusing on the agreement's effects on consumer welfare.

The structure of Article 101, if properly construed, minimizes the risks of false positives and false negatives, because it allocates the burden of proof according to the agreement's probable effects on consumer welfare. Nevertheless, the construction of Article 101, as applied in practice, is inconsistent, as it blurs the borderline between the focuses of Article 101(1) and Article 101(3). In practice, these two focuses are not clearly distinguished and the analysis under the bifurcated Article 101 is often blurred.

It is submitted that the position that the treatment of RPF in US antitrust law after *Leegin* is, more or less, in line with the treatment in EU competition law – because here the parties have always been able to argue that the agreement meets the requirements of Article 101(3) – is inconsistent with the realities of Article 101: in the rule of reason the plaintiff has to present a *prima facie* case before the burden of proof shifts to the defendant at all, while RPF is condemned under Article 101(1) automatically; object type agreements have never had a realistic chance under Article 101(3); defendants bear a heavier burden of proof under Article 101(3) as compared to the American rule of reason, where the perception is that if substantiated justifications come up, courts tend to decide for the defendant.

The second part of the book examines specifically the economics of vertical intra-brand restraints (Chapter V) and contrasts it with their treatment in US antitrust and EU competition law (Chapters VI and VII). It goes beyond mere contrasting and grasps the conundrum of vertical intra-brand restraints in the context of the architecture of the rule on restrictive agreements: should justifications be considered under Article 101(1) or 101(3)? The Supreme Court's judgment in *Leegin*, where RPF's *per se* condemnation was overruled, also raises a novel point of analysis, especially because it reveals the 'economic views' of the judiciary: while economic scholarship is replete with efficiency theories of intra-brand restraints, one of the most important questions is which will be the 'economics of the courts', i.e. which theories will become part of the effects-analysis before US courts.

It will be argued here that the current treatment of vertical intra-brand restraints in EU competition law, which regards RPF and absolute territorial protection as

almost *de facto* falling foul of Article 101, is not in accord with sound economics; economic analysis suggests that such restraints may have both pro- and anti-competitive effects, while EU competition law treats RPF and absolute territorial protection as restraints that are always or almost always harmful. In US antitrust law all intra-brand restraints are subjected to the effects-analysis of the rule of reason.

The treatment of absolute territorial protection in EU competition law is heavily influenced by the purpose of market integration (single market imperative), especially by the notion that private enterprises should not be allowed to rebuild national borders, which were lifted by the common market rules; nevertheless, this approach of EU law is misguided. The argument that European citizens have the natural right to purchase wherever they want in the common market does not justify the outright ban on absolute territorial protection on the wholesale level. Furthermore, since territorial protection seems to be the most efficient method of penetrating new markets, the foregoing ban may even impede market integration. Namely, the outright prohibition of absolute territorial exclusivity is a missing brick in the wall of territorial protection that in some markets can make the entire building crumble. In certain cases, the possibility of restricting active sales does not provide adequate protection against free-riding by parallel traders, which, in fact, execute the active sales themselves.

The final conclusions are summarized in the third part of the book (Chapter VIII). There is an emerging criticism against the almost *de facto* outright prohibition of RPF and absolute territorial protection in the EU, which was reinforced by the *Leegin* judgment. Nevertheless, the rising substantive analysis of vertical intra-brand restraints in EU competition law seems to be misplaced; there is a danger that all analysis related to RPF and absolute territorial protection will be done under Article 101(3). While the advantages of vertical intra-brand restraints relate normally to the enhancement of the competitive process, Article 101(3) centres on (productive) efficiency. Furthermore, the most pressing argument for RPF and absolute territorial protection is that if the producer has low market share and the practice is not widespread, the vertical intra-brand restraint is simply not capable of having any anti-competitive impact; this argument certainly fits the *de minimis* concept of Article 101(1) but has no place under Article 101(3).

Chapter II
Contextual concepts: the devil is in the context? The structure of the rule on restrictive agreements

In this chapter the architecture of the rule on restrictive agreements of EU competition and US antitrust law will be analysed and compared primarily in the context of vertical arrangements.

The structure of Article 101

In EU competition law the basic substantive rules of restrictive agreements are embedded in Article 101, which reads as follows.

> Article 101
> 1. The following shall be prohibited as incompatible with the common 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 within the common market, and in particular those which:
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
> 2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.
> 3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
> – any agreement or category of agreements between undertakings,
> – any decision or category of decisions by associations of undertakings,
> – any concerted practice or category of concerted practices,

> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In the following, the general rule on restrictive agreements will be analysed in accordance with its conceptual elements. The notion of inter-state trade ('may affect trade between Member States'), despite being a very important rule of jurisdiction, is not examined here. Disregarding the requirement of inter-state trade, Article 101 contains the following conceptual elements:

1. Concept of agreement (agreements, decisions by associations of undertakings and concerted practices).
2. Substance of the rule on restrictive agreements (all agreements that are anti-competitive are, in principle, prohibited).
   - The distinction between agreements anti-competitive by object and anti-competitive by effect.
   - General prohibition on restrictive agreements:[1] anti-competitiveness (prevention, restriction or distortion of competition) – what is the content that must not be agreed to according to the general prohibition on restrictive agreements?
   - The system of exemption (cooperation is sometimes more efficient than competition): individual exemption, block exemptions.[2]

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1 *Cf.* the German concepts of '*Kartellverbot*' and '*Freistellung*', where, in principle, all agreements restricting competition are prohibited (*Kartellverbot*) but may be exempted under certain circumstances (*Freistellung*). In this book the term 'rule on restrictive agreements' embraces both the general prohibition on restrictive agreements and the notion of exemption, while the term 'general prohibition on restrictive agreements' parallels the meaning of the German term '*Kartellverbot*'.

2 The Commission had legal monopoly to grant individual exemptions under Article 101(3) for several decades. Accordingly, Article 101(3) had no direct effect and its application was not automatic. Nevertheless, Regulation 1/2003/EC abolished the notification system and the Commission's legal monopoly and conferred direct effect on Article 101(3), see Regulation 1/2003/EC, Article 1(1)-(2). Accordingly, as from 1 May 2004, there is an *ex lege* individual exemption system in force, i.e. agreements meeting the requirements of Article 101(3) are *ipso iure* exempted, 'no prior decision to that effect being required'. Regulation 1/2003/EC, Article 1(1)-(2).

The structure of Section 1

In US antitrust law, the basis of the rule on restrictive agreements is Section 1 of the Sherman Act.

> Section 1
> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.[3]

The conceptual structure of US antitrust law's rule on restrictive agreements is more sparely built than that of EU competition law. First, in US antitrust law there is no system of exemption but all exceptions to the general prohibition on restrictive agreements are to be found within the body of Section 1. Second, US antitrust law, as applied in the judicial practice, does not distinguish between 'object' and 'effect' restraints but the dividing line is between the categories of *per se* illegality and rule of reason. The sharpness of the dividing line has recently been eroded by the Supreme Court's introduction of the so-called 'quick look' (abbreviated or truncated rule of reason), according to which the defendants get a very limited chance to submit justifying arguments even if the agreement mirrors the features of one of the categories of agreements that are treated as *per se* illegal, and courts are ready to have a quick look at the proffered justifications. If the latter seem to give the impression of being plausible, a full-blown rule of reason may follow, where, however, the defendant bears the burden to prove pro-competitive effects, the anti-competitive ones being assumed.

Section 1 of the Sherman Act contains an 'inter-state commerce' clause too; nevertheless, similarly to EU competition law, this clause will not be covered by the forthcoming analysis.

The structure of Section 1 is to be conceptualized as follows:

1. Concept of agreement (contract, combination, conspiracy).
2. General rule on restrictive agreements.
   - *Per se* rules and rule of reason.
   - The structure and balancer of rule of reason analysis.
   - The concept of 'quick look'.

3 15 USC 1.