CLARIFYING COMPETITION LAW: EU Distribution Agreements and Product Pricing

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Agenda

- Introduction
- The general prohibition
- Pricing
- Selective distribution
- Territory restrictions
- Internet sales
- Conclusion

Introduction

The purpose of this webinar – a brief introduction to pricing and distribution issues in the EU and specifically, the restraints suppliers can impose on distributors and those they cannot with regard to pricing, territory and selling over the internet.

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The Basics

- EU competition law
  - Article 101(1): Prohibition on restrictive agreements
  - Article 101(3): Individual exemption
  - Article 102: Prohibition on abuse of a dominant position
  - Commission Regulation No 330/2010 – The Vertical Agreements Block Exemption

- EU Member States domestic competition laws.
  - Parallel system of competition law for matters which only concern domestic issues.
  - E.g. The UK Competition Act 1998. Chapters I & II mimic the prohibitions in Article 101 and 102 TFEU but apply to purely domestic infringements.

General Prohibition in Article 101 TFEU

- Competition law applies to anti-competitive agreements or business practices between:
  - competitors (horizontal agreements) and/or
  - customer/distributors such as retailers (vertical agreements)

- We will concentrate on areas in which competition law applies to the vertical distribution relationship between suppliers and distributors.

Dangers of non-compliance

- Agreements found invalid
- Regulatory fines
- Bad publicity
- Private damages actions
- Collective actions

Vertical Agreements Block Exemption

- The EU has passed certain safe harbour legislation for distribution agreements called the Vertical Agreement Block Exemption Regulations 2010 (the "**Block Exemption**").

- Provided the parties comply with the conditions of the Block Exemption, certain anti-competitive restrictions in the agreement are fully valid and enforceable notwithstanding the fact they may infringe the broad based prohibition on restrictive agreements in Article 101(1).

- However, the Block Exemption legislation will only apply if both parties have less than a **30%** market share of their relevant market or markets in the EU (or national markets if more applicable) and there must be no hard core restrictions present.

- What are hard core restrictions?

- Effect of non-applicability of the Block Exemption.

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Pricing

The Pricing Prohibition – Resale Price Maintenance

- Under Article 101(1)(a) TFEU, any agreement to fix purchase or selling prices is viewed as a serious infringement of competition law.
- A hardcore restriction – Under Article 4(a) of the Block Exemption it is not permissible for a supplier to dictate the resale price of the goods to their distributor.
- Neither is it lawful to impose upon the distributor a contractual term to ensure that they fix the resale price of any reseller or dealer to whom they sell.

Resale Price Maintenance

- You cannot enforce an RPM policy by indirect means outside the terms of the contract by imposing sanctions for non-adherence to the policy.
- These sanctions can take many forms such as refusing to deal or imposing longer lead times for product deliveries or terminating your distributor's agreement to reinforce an anti-competitive intention.
- Nor can you provide incentives such as bonus payments or allowances for compliance howsoever they are dressed up.

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What amounts to RPM?

- Fixing the distributor's **margin**;
- setting a **maximum discount** which a distributor must apply;
- making **rebates or promotional costs** (or other supply benefits) conditional upon adherence to a given price level;
- **linking** the resale price to that of competitors' products;
- Imposing a most favoured nation clause
- using threats, intimidation or warnings to **coerce a buyer** to comply compliance with the supplier's recommended resale prices;
- **indirect pressure** linked to mechanisms to identify instances of discounting;
- **monitoring** the prices of distributors; and
- obliging retailers to **report** other distributors deviating from the "recommended" price level.

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Recommended Retail Pricing

- Permitted under Article 4(a) of the Block Exemption.
- "…provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties"
- Exercise caution when putting prices on product packaging.
- Case law in Germany suggests wide interpretation of what constitutes "enforcing" RRP

Pricing Cases

DB Apparel

In 2013, The UK Office of Fair Trading started actions against high street clothing retailers Debenhams, John Lewis and House of Fraser and the sports bra manufacturer DB Apparel for fixing the resale price of DB Apparel's 'shock absorber' brand of sports bra. Contractual clause

TTS

In 2012, the German competition authority imposed an agreed fine of €8.2 million on TTS Tooltechnic Systems Deutschland (TTS) for establishing and implementing a resale price maintenance system. TTS sells power tools through a network of specialist stores. TTS pressured these stores verbally to observe the recommended resale price set by TTS. They were threatened with contract suspension and other measures if they deviated from the RRP. These actions amounted to RPM.

CIBA

In 2009, the German competition authority fined contact lens provider CIBA Vision Vertriebs GmbH for fixing resale prices on the basis (amongst others) that it telephoned its retailers when they deviated too low from RPM to try and convince them otherwise.

Pride Mobility

The UK Office of Fair Trading issued a statement of objections against Pride Mobility Products Limited, a manufacturer of mobility scooters. The OFT considered that a ban by the manufacturer preventing its distributors from advertising prices on their websites below RRP to be an example of resale price maintenance. Similar to MAP in the US.

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Maximum Pricing

- Also permitted under Article 4(a) of the Block Exemption.
- Legal as long as the maximum price is not in effect in minimum or fixed price.
- The rationale behind this policy is that supplier needs to be able to ensure that their brand is not brought into disrepute by distributors or dealers selling their products at extremely high prices.

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Limited Time Exception-RPM

- Controversial new addition to the Block Exemption, found contained with paragraphs 223-225 of the 2010 Guidelines on Vertical Restraints.

- The Guidelines recognise that companies may plead an efficiency defence to RPM under Art 101(3) and for the introductory period for new products, RPM may induce distributors under ‘competitive pressure’ to make the launch of a new product a success to the benefit of consumers.

- We’ve yet to see a test case for this introductory pricing and the language is sufficiently vague to deter its use. For instance, does this mean the RPM has to be there to instigate a low price to create large sales of the new product or does it mean a uniform or high price to grant sellers a healthy profit margin?

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US Comparison

- ‘Minimum Advertised Price’ - This is a common US pricing policy where distributors are contractually prohibited from advertising a product’s price online below that of the RRP, even though they may well sell the product at a lower price in-store.

- Such a policy is not-transferable to the EU. It would amount to RPM and fall foul of the hardcore restriction in Article 4(a) of the Block Exemption as a fetter upon distributor’s ability to prices goods or services for resale at his discretion.

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Price Relationship Agreements

Tobacco Case (2010) OFT Decision

- Basing the resale price of goods by reference to a competitors' products is RPM
- UK OFT fined two tobacco manufacturers, Imperial Tobacco and Gallaher and 10 retailers (including Asda, Coop, Morrison's and Sainsbury's) £225 million
- Manufacturers had individual arrangements with each retailer whereby retail price of a tobacco brand was linked to that of a competing brand
- OFT concluded it restricted ability of retailers to determine resale prices independently and breached the Competition Act 1998

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Price Relationship Agreements

- CAT Judgment (2011)
  - Upheld appeals by manufacturers and retailers on procedural grounds and the OFT decision was set aside
  - Court did not examine the merits of OFT analysis of the behaviour in question
- Do not enter into agreements or connected practices with retailers whereby the price of your brand is linked to that of your competitors.
- Instead recommend a specific price for your brand without reference to your competitors

Most Favoured Nation Clauses

- Most favoured nation ("MFN") or "best price" clauses are clauses concerned with establishing between an agent and principal or a supplier and a distributor that the receiving party will always get the product or service at the lowest price the supplying company gives to anyone.

- Whilst on the face of it these seem to guarantee good prices for consumers, they can in effect close down a market if the receiving party is dominant in a particular sector with a high market share. No new company trying to enter the market and also sell the suppliers goods will be able to negotiate better rates. The dominant company receiving the deal will have effectively closed down the market to competitors and stifled price competition.

- Legally they fall outside the protections of the Block Exemption as a hardcore restriction and must instead by assessed under Article 101(3) on their appreciable effect on competition.

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MFN Cases

- **On-Line Hotel Booking:-**In January 2014, the OFT accepted binding commitments from **Expedia** and **Booking.com** to alter the way they operated their MFN clauses. The OFT considered the MFN clauses acted as barriers to entry of smaller competitors and limited price competition in the market. However, that case can be distinguished from the present as both the hotel group and the online travel agencies involved were some of the largest players in their respective markets.

- **Amazon:-**Regulatory focus has also focused on **Amazon** for using similar clauses in the UK and Germany. Again Amazon use of the MFN clauses was objectionable due to the very high market shares it had as an online shopping platform.

- **HRS :-**Furthermore, in December 2013, the German Federal Cartel Office prohibited the hotel portal company **HRS** from applying its MFN clause which required HRS's hotel partners to offer their lowest rates on the booking website. The Cartel Office believed MFN clauses created barriers to entry and prevented price competition. HRS had a market share of more than 30%.

- **Ebooks :-**The leading and perhaps the highest profile case on MFN clauses recently has been the Ebooks distribution case in the US. **Apple** switched publishers over to an agency distribution model allowing the publishers to have total control of the selling prices for EBooks. Apple's use of MFN imposed on the publishers also led to consumers paying higher prices for EBooks compared to normal printed versions. This case also had parallel proceedings before the EU Commission. Apple agreed to remove the MFN clauses from its contracts.

- Movement towards restriction by object? The future danger to companies.

Best EU Pricing Strategy

- Play by the rules – the Courts and regulators will take a purposive approach to enforcing EU law
- Have genuine RRP policy
- Maximum pricing
- Explore the possibility of fixed pricing for a limited time for new products. Caution is needed
- Brand advocacy combined with the consistent message that product pricing is a matter for the distributors
- Don’t enter into price relationship agreements
- Seek detailed legal advice before entering into agreements with MFN clauses

Information Exchange

- Direct or indirect exchange of sensitive commercial information between competitors usually infringes Chapter I Competition Act 1998
- Sensitive commercial information includes current price information, output sales information and cost information

Guidance:

- **DO NOT** exchange commercially sensitive information with your competitors
- You can discuss current retail prices, profit margins, wholesale prices with an individual retailer
- Ensure you make clear at all times resale prices are a matter for that retailer alone
- **DO NOT** discuss future pricing intentions of the retailer or other retailers' prices with that retailer
- If sensitive matters are raised by retailer, stop conversation and make clear only talk about permitted issues

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Selective Distribution

Selective Distribution

- **What is a Selective Distribution Network**?
- A formal distribution model to adopt when companies wish to supply products to certain dealers who meet objective qualitative (and in some cases quantitative) criteria.
- **Why have a Selective Distribution Network?**
- Often recommended to clients who wish to retain qualitative control over their dealers to help try and avoid their products being sold at rock-bottom prices by cut price distributors.
- **What Products are eligible?**
- Not suitable for all products
- Complex or technical products e.g. computers, audio/TV ,cell/mobile phones
- Luxury products e.g. perfumes, cosmetics, jewellery.
- **Constructing a Selective Distribution Network**
- Nature of goods
- Setting qualitative criteria
- Criteria do not go beyond what is necessary

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Examples of Qualitative Criteria

- Examples of permitted qualitative criteria:
  - Suitably trained staff
  - To sell the products in a specialised shop or display
  - Providing an after-sales service which is compliant with the product warranty
  - Ban on sale of down market goods in proximity

- Examples of quantitative criteria which would be permitted:
  - Buying a minimum quantity of goods
  - Achieving a particular turnover
  - Maintaining minimum stock

Territorial Restrictions

General Territorial Prohibition

- Often a major issue alongside pricing for suppliers wishing to protect distributors in certain markets from others
- Unlike in the United States, rarely can you provide absolute territorial protection for an exclusive distributor
- Unique feature of EU competition rules is that they not only apply conventional antitrust rules, but also seek to promote single market integration within the EU
- Conduct which has the effect of dividing the territory of one member state from another can result in serious penalties

General Territorial/Customer Exclusivity Prohibition

- In general, there is a hardcore prohibition against a supplier:
  - Restricting distributors selling into a specified territory or customer group
  - Imposing restrictions which impede the supply of goods by a distributor located in one member state to a customer located in another member state
- Market partitioning by territory or customer group
- An agreement that merely grants exclusive distribution rights but does not confer absolute territorial protection may not fall within the prohibition – although selective distribution may not be combined with exclusive distribution

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Types of Territorial and Customer Restrictions

- Direct obligations
  - Obligation not to sell or supply certain customers or territories
  - Obligation to refer orders from those customers to other distributors
  - Export bans
- Indirect measures aimed at inducing compliance/monitoring
  - Refusal or reduction of bonuses or discounts
  - Termination of supply
  - Price discrimination – higher price for exported products
  - Failure to provide EU-wide guarantee service

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Important Exceptions in the Block Exemption

- Restrictions on <u>active</u> sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer
  - However, restrictions on passive sales -- sales by a distributor in response to unsolicited orders outside the territory of the distributor – are not permitted
  - General advertising and promotion not directed to a specific customer or territory, including marketing over the internet are generally considered to be passive selling

Important Exceptions in the Block Exemption

- Restrictions on distributors in a selective distribution system selling to unauthorised distributors within the territory reserved by the supplier to operate that system
  - However, territorial restrictions on resale of the products by the selective distribution dealer to end-users is prohibited
  - Dealers in a selective distribution systems should be free to sell both actively and passively to all end-users and to purchase from any authorised dealer

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Important Exceptions in the Block Exemption

- Restrictions on sales by wholesalers to end-users – can be active and passive
- Certain restrictions on purchasers of components for incorporation into another product, preventing them from reselling the components to competitors of the supplier

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The Limited Time Exception -Territory

- Vertical Guidelines issued by the Commission also recognise that there may be times when certain normally hardcore territorial or customer restrictions may not be caught or may be justified under an individual exemption – which must be self-assessed by the supplier, subject in the final analysis to a decision of the courts
- For example, where substantial investments are necessary to first sell a new brand or sell an existing brand in a new territory, restrictions on passive sales by other distributors into the new territory which are necessary to permit the new distributor to recoup its investment may not be caught by the prohibition during the first 2 years

Internet Sales

Internet Sales

- In principle, distributors must be allowed to sell via the internet
- A ban on selling on the internet is regarded as a passive sale ban, even if the use of a website may have effects beyond the territory or customer group of a distributor
- But concerns over “free riding,” particularly for technical and luxury products – where a customer goes into the store and tries out the product, then purchases it online, as well as extra costs of bricks and mortar, continue to be raised

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Internet Sales

- To the extent that promotion on the internet leads to active selling into another distributor's exclusive territory or customer group, that can be restricted
  - E.g., online ads specifically addressed to certain customers, territory-based banners on third party websites, paying a search engine or online advertisement provided displayed specifically to users in a certain territory
- But offering different language options on a website does not, in and of itself change the passive character of such selling

Internet – Hardcore restrictions

- Agreements that an exclusive distributor will:
  - prevent customers located in another exclusive territory to view its website or automatically routing customers to the manufacturer's or other exclusive distributors' websites
  - terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's exclusive territory

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Internet – Hardcore restrictions

- Agreements that a distributor will limit its proportion of overall sales made over the internet
  - although without limiting online sales, a supplier may require a certain absolute amount (value or volume) of sales in-store to ensure efficient operation of a physical shop – same for all or individually tailored
- Agreements that the distributor will pay a higher price for products to be resold by the distributor online than off-line
  - although the supplier may agree with the buyer a fixed fee (that does not vary by increase in off-line turnover) to support off-line or online sales efforts

Internet Sales – Quality Standards

- Particularly relevant for selective distribution
- Requiring the distributor to have a bricks and mortar shop alongside that of an internet sales site for admission to the system
- Quality standards and conditions for use of third party websites – e.g., requiring that customers not visit a website hosted by a third party through a site carrying the name of or logo of the third party platform provider

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Can Sales on Online Marketplaces be Prohibited?

- Difference between, say, a platform provider selling in its own name, where it is a normal distributor and online marketplaces such as EBay and Amazon Marketplace or other auction platforms
- Some companies would rather sales of their products were kept off auction websites to uphold the image and sales quality of their products
- Is the ability to do this limited to high-quality branded products that qualify for selective distribution qualitative criteria?

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Can Sales on Online Marketplaces be Prohibited?

- Recent German cases suggests that only justifiable in such cases
  - But beware inconsistent distribution -- in one case, the supplier also distributed through a discount chain that did not maintain similar standards as would be required for a selective distribution system, so auction website no more detrimental
  - German Federal Cartel Office also raises doubts about the ability to prohibit use of auction platforms, especially if the excluded platform is of high quality

Conclusions

- EU competition rules for distribution are stricter in many ways than the US model
  - Resale price maintenance and pricing policy issues are a problematic area where strict adherence to the law is crucial
  - MFN clauses should be carefully analysed before use, particularly by those with high market shares
- Some products may be suitable for protections under a selective distribution network and should be considered when appropriate as a means of controlling quality of distribution

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Conclusions

- Unlike the US, absolute territorial protection is generally prohibited, but some territorial restrictions are permitted, such as restrictions on active marketing into exclusive territories
- Partitioning of the EU market is generally hardcore no-no
- Internet sales cannot be banned outright but can be limited in certain circumstance and may be required to adhere to quality standards
- Exercise caution and consistency when limiting sales to auction or marketplace websites.

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