THE APPLICATION OF ECONOMICS IN COMPETITION LAW CASES

THE ATTITUDE DEMONSTRATED BY THE EC COURT OF JUSTICE AND THE EC COMMISSION

BY

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I. INTRODUCTION

The application of economics by the law courts is traditionally considered to take place within the area of the antitrust and competition law. This seems to be an understandable consequence of the fact that the statutory language directly refers to economic terms such as "monopoly", "competition", "dominant market position", etc. Also the fact that the competition rules to a large extent are directed towards the establishment and upholding of good economic market performance supports the impression that economics is seen as a natural part of the competition law. This paper intends to analyze some central aspects of the extent to which the EC judicial authorities—the Court of Justice in Luxembourg and the EC Commission—draw on economic considerations when applying the competition rules of the EEC Treaty. Some additional remarks on the parallel US American situation will also be offered in order to provide a basis for some comparisons.

The main competition/antitrust rules of the EEC Treaty are to be found in the Articles 85 and 86.

It cannot be questioned that the understanding of *Article 86* is heavily dependent on economic facts. That provision is directed against any *abuse of a dominant position* within a substantial part of the Common Market. Consequently, when applying Article 86 the Court of Justice or the Commission must consider such economic factors as the *market position* of the firm or firms in question (geographically as well as in relation to the product market), *the economic effect of the abuse* (prices, market divisions, product limitations, etc.). Also the extent to which the *trade* between Member States is affected must be considered. Other economic factors are relevant as well.

It is also evident that the possible anti-competitive effect of *mergers* is closely linked to economic factors such as the market position of the firms involved, the accessibility to the markets in question, etc. The restrictions on the EEC authorities to intervene in the merger field are, however, striking, and the—largely political—problems connected with the efforts to establish special legislation are also well known.

This paper will mainly deal with the problems involved in the application of economics in connection with *Article 85*, which stipulates:

A thorough discussion of the points taken up in this paper can be found in my dissertation, *Monopolret og marked*, Copenhagen 1985, pp. 700 ff. (with a summary in English).

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.

Despite the clear interrelation between the provision in quesiton and economic factors the EEC authorities in certain circumstances seem hesitant to apply economics when deciding upon certain Article 85 questions.

The following sections will deal with horizontal contractual restrictions (section II), vertical contractual restrictions (section III), and patent licensing (section IV). In section V comparisons with America will be mentioned.

II. HORIZONTAL AGREEMENTS ON PRICE AND TERRITORIAL DIVISION

A. *The Clear Possibility of Detrimental Economic Effects*

Horizontal price-fixing agreements, rebate cartels, market division agreements, etc., can undoubtedly have very detrimental effects on the market performance normally to be preferred. Price-fixing agreements between competitors might lead to monopoly prices and monopoly profits for the contracting parties. And the same effect may stem from rebate cartels. The consumers may also be seriously hurt by horizontal market division whereby e.g. producers from different Member States agree to stay "at home". Hereby the consumers will be prevented from choosing between competing products, with a monopolistic effect as the ultimate result. Although bad market performance may not always be the consequence of horizontal price agreements or horizontal market division agreements the difficulty in distinguishing the harmless from the harmful is enormous, if at all possible.

B. *The EEC Case Law*

The fathers of the Common Market Treaty therefore undoubtedly attached great importance to price competition. This can be seen from the examples listed in Article 85(1), which clearly states that prices and other trading conditions are normally the most important means of competition.[1] It is first declared that conduct consisting in direct or indirect fixing of prices of purchase or sale or of other trading conditions may violate Article 85.

The important cases about horizontal cartels—*Quinine* and *Dyestuffs*—have clearly demonstrated the Commission's and the Court of Justice's negative opinion of price agreements.

The fixing of prices in order to prevent deteriorating market conditions and supply difficulties was precisely one of the main issues in the *Quinine* case.[2] A substantial surplus production of quinine encouraged the large European manufacturers of quinine to make an association. By agreements and "gentlemen's agreements" they fixed and enforced uniform selling prices, rates of commission, and discounts—within those areas of the Common Market which they had not divided among themselves—and they also jointly made decisions on price changes.

The *Commission* deemed this restriction within the EEC to be particularly

[1] See e.g. Gleiss/Hirsch, *Common Market Cartel Law*, 3rd. Am. ed., Washington D.C. 1981, pp. 93 ff.

[2] *Quinine*, case 41, 44 & 45/69, judgment of 15.7.1970.

important, because the customers had no choice as to quality and because the members of the cartel were the only suppliers of quinine products within the Common Market. If the Commission mentioned these circumstances, it is presumably because it wanted to underline the particularly serious aspects of this violation of Article 85. It included price agreements between the large companies in the trade under an oligopoly whereby competition between the participants was destroyed. According to the Commission, there was no difference in quality between the articles. It was a homogeneous market without product differentiation of any importance. Together these factors created a price-fixing akin to perfect monopoly.

The *Court of Justice* had no opportunity to consider the price agreements. But its fundamental attitude towards them was as hostile as the Commission's.

This opinion was reflected in the *Dyestuffs* case.[3] Ten European manufacturers, who met more than 80 per cent of the demand for dyestuffs of the six EEC countries, had raised the prices of their dyestuffs uniformly and simultaneously in 1964, 1965 and 1967. The *Commission* declared that these price increases constituted concerted practice contrary to Article 85(1), and it imposed fines on the enterprises.

To the *European Court*, the important thing in the case was to decide whether it could unequivocally be ascribed to concerted practice that the prices had been enhanced by uniform rates, or whether it might have happened exclusively as an economic consequence of the market conditions in question.

The Court held that the enterprises had co-operated continuously in making the three price increases. It added that

> Although every producer is free to change his prices, taking into account in so doing the present or foreseeable conduct of his competitors, nevertheless it is contrary to the rules on competition contained in the Treaty for a producer to cooperate with his competitors, in any way whatsoever, in order to determine a coordinated course of action relating to a price increase and to ensure its success by prior elimination of all uncertainty as to each other's conduct regarding the essential elements of that action, such as the amount, subject-matter, date and place of the increases.[4]

Notably the last-mentioned of the Court's general comments expressly states that competitors' price agreements are forbidden. The Court's pronouncements underline the importance of price competition and the Court's condemnation of attempts at restricting trade by illegal means.

It is obvious that the Quinine and Dyestuffs cases did not contain any

[3] *Dyestuffs*, case 48–49 & 51–57/69, judgment of 14.7.1972.
[4] The *ICI* case (one of the Dyestuffs case) ground 118.

elements which seriously favoured an approval of the price arrangements concerned.

Also horizontal agreements on market division have been looked upon without mercy. In the *Zinc* case[5] the *Court of Justice* upheld the decision of the Commission. A contract of sale contained a clause by which a Belgian purchaser committed himself to exporting the purchased zinc to Egypt. The *Commission* held that the clause restricted competition. It limited the purchaser's freedom of marketing the product where he wanted to, and it enabled the two producers who were parties to the agreement to prohibit parallel imports within the Common Market. Thus the particular purpose of these clauses was to protect the German market, which was most sensitive owing to its high price level. The export clauses were primarily intended to forestall reexportation of the goods into the countries of origin in order to maintain a double price system in the Common Market, thus impairing competition within the EEC.

Furthermore, in several cases the Commission has condemned horizontal market-sharing agreements.[6] However, these cases have not contributed independent viewpoints, but confirmed clearly the Commission's hostile attitude towards horizontal market division. The Commission never considered allowing the agreements e.g. because of the parties' weak positions in the market.

The Common Market's administration of horizontal price or market division agreements shows that, in general, the European Commission and Court have not held them to be favourable. Although the EEC rules have another point of departure than the American antitrust rules, the European Community's attitude must be considered to be parallel to that of America, where they are considered to be prohibited *per se*.[7]

III. VERTICAL CONTRACTUAL RESTRICTIONS

Vertical contractual restrictions have a different competitive effect than horizontal restraints. The characteristic feature of vertical agreements is that they

[5] *Zink*, case 29 & 30/83, judgment of 28.3.1984.

[6] Cast-iron and Steel Rollers, 17.10.1983, OJ L 317/1; Supexie, 23.12.1970, ABL L 10/12 (the original wording of the contracts); Fine Papers, 26.7.1972, ABL L 182/24; Cementregeling voor Nederland, 18.12.1972, ABL L 303/7; Tinned Mushrooms, 8.1.1975, OJ L 29/26; White Lead, 12.12.1978, OJ L 21/16 (it was pointed out that it was not justified although the market continued to diminish).

[7] See P. Ulmer, in 4 *The International Review of Industrial Property*, pp. 387, 388 (1973): "The only two types of agreements clearly being regarded as unlawful under Art. 85 by the Commission are thus price-fixing agreements between competitors on the one hand, and market sharing devices ...". This conclusion arrives shortly after Ulmer has mentioned "a catalogue of per se illegal restrictions of competition".

After having referred to horizontal price agreements and also certain other horizontal agreements, Barry E. Hawk, *United States, Common Market and International Antitrust: A Comparative Guide*, New York 1979, p. 502, notes: "... the Commission has evolved a per se-type approach toward some of the hard-core restraints, just as United States courts have done".

have been entered into by parties not in competition with each other, such as e.g. between manufacturers and dealers. A distinction should be made between vertical price restrictions and non-price restrictions. Within the EEC a very important issue in respect of non-price restrictions is whether the restriction is territorial or not.

A. *Vertical Price Restrictions*

Normally resale price maintenance (RPM) is not accepted in the national law systems in Europe. The consequence of this has been that cases on RPM on the Community level have been relatively few.

From recent Common Market practice, reference must be made to the *AEG* case.[8] The AEG group had tried to exercise considerable influence on their dealers' resale prices either directly or indirectly and in this connection it had tried to avoid delivering to discount houses and other dealers who might be expected to undercut the high price level characterizing the sale of the AEG products. A fine was imposed on AEG which was fully approved by the European Court.

In the *VVVB/VBVB* case[9] an agreement was made between the association of enterprises in the Dutch book trade and the association of the enterprises in the Belgian book trade which published and distributed books in Dutch. Almost all publishers, wholesalers, booksellers, importers of books and book clubs were members of either of the two associations. The agreement imposed an obligation to sell books which were published in one country and sold in another at retail prices fixed by the publishers in the exporting country. It was held that the collective vertical price-fixing, which applied to sale across the border, violated Article 85(1). On the other hand, the Commission explicitly refrained from making a decision as to whether the collective vertical price maintenance systems which were used by the associations within their own country were legal.[10]

The Commission made a thorough analysis of the question whether the exemption rules in Article 85(3) could be invoked, but rejected this idea, explaining that the price was an essential factor to many consumers when considering whether to buy a product—which also was true in the case of books—and that the consumers did not get a fair share of the advantages which were created by the agreement between the associations. The European Court upheld the decision.

[8] *AEG-Telefunken* v. *Commission*, case 107/82, judgment of 6.1.1984.
[9] *VVVB/VBVB*, case 43 & 63/82, judgment of 17.1.1984.
[10] See now also the Court of Justice in *Association des Centres distributeurs E. Leclerc* v. *Thouars Distribution*, case 229/83, judgment of 10.1.1985.

In the case of recommended resale prices, Article 85(1) probably may be applied as such prices are the result of a "concerted practice".

B. *Vertical Non-Price Restrictions*

Non-price restrictions in vertical contractual arrangements have taken up a major place in the Commission's handling of competition law from the very beginning of the EEC. Within this area it is, however, striking that the endeavour to create and uphold a large common and integrated market has played an important role and that this aim seems to have overridden all other—and also important—needs. The case law on vertical territorial division must be carefully scrutinized.

1. *Territorial Division*

One of the most striking features of the Common Market's attitude towards territorial division is that this division has not only been opposed in horizontal agreements, but its existence in vertical arrangements has also been criticized —in an apparently merciless way—by the Commission and the Court. The reason seems to be that the provisions of the Treaty in relation to the customs union and the ban on quantitative restrictions are closely connected with the competition rules. The *Grundig* case[11] led to this strict attitude.

a. *The Grundig Case.* In its decision from 1964, the Commission refused to grant exemption in this case in pursuance of Article 85(3). It was held that an agreement about the sole distribution in France of Grundig products, radios, type-recorders etc., infringed Article 85(1) and was consequently unlawful. The sole distribution agreement imposed on the sole distributor, Consten, a ban on selling competing goods from other manufacturers. It also committed the manufacturer to secure total protection of Consten's territory—as the manufacturer had done in relation to other dealers. Grundig was not allowed to make direct or indirect supplies to other purchasers in France. An export ban was on the other hand imposed on Consten.

The *Commission* did not try to determine the degree of competition between Grundig and other producers' products. On the contrary, the Commission rejected the parties' argument that the manufacturers were competing so keenly that the territorial protection given to Consten could not possibly lead to a restriction of competition. The Commission was of the opinion that it was

[11] *Grundig* v. *Commission*, case 56 & 58/64, judgment of 13.7.1966.

superfluous to compare Grundig's market position with that of other manufacturers of tape-recorders etc., which would be inter-brand competition.

But when addressing the Community Court[12] the Commission stated as a supplementary viewpoint that the seriousness of the discussed restriction on competition was due to the particular nature of the market in which the Grundig products were sold. It was in fact characterized by a small number of competitors on the manufacturing level and by a high degree of specialization of the articles sold. During the procedure in the European Court, the Commission also made a comparison between Grundig products and similar products made by Philips. These circumstances had, however, not been mentioned in the Commission's decision.

The *Community Court* upheld, nevertheless, the Commission's decision in 1966[13] despite Advocate-General Roemer's proposal to quash it. The Court underlined that an agreement between a manufacturer and a dealer the objective of which was to establish national trade barriers between the Member States might be incompatible with the basic purposes of the Common Market. The principle of freedom of competition applied to the entire economy and to any form of competition. The Commission had therefore done nothing wrong in omitting to examine the consequences that the agreement had on competition between identical products of different brands. It sufficed to consider whether competition had been restricted in connection with the sale of Grundig products.

And the Court concluded—on this basis of course—that this was in fact the result of absolute territorial protection.

b. Assessment of the Grundig Court Decision. The Court's interpretation of Article 85 in this respect is not convincing. There seems to be no cogent reason for considering "the priciple of freedom of competition" to have been infringed by absolute territorial protection. And that the purpose was to restrict the sale of Grundig products was not necessarily the equivalent of "restraint of trade"; a different interpretation of Article 85 could have been made according to which it was total competition between radios etc., which the agreement had as its "object or effect" to restrict. Thus there are hardly any formalities which would have prevented the Court from interpreting Article 85 differently.[14] Such an interpretation would have resulted in a considerable, real improvement of the actual market results. This will be discussed later on.

[12] See to this e.g. E. Steindorff and K. Hopt, in 15 *American Journal of Comparative Law*, pp. 811, 819 ff. (1967).

[13] The extent of the prohibition was narrowed.

[14] It is important to stress this fact since the ensuing discussion in section 3 below does not deal with judicial policy to such an extent that the results of the discussion might be considered uninteresting because they are barred by formalities incompatible with the Treaty.

It was, however, significant that the Court wanted to put special emphasis on the establishment of a big common market, and that it was on its guard against restrictions which might obstruct the attainment of this objective. This and subsequent decisions amount almost to a *per se* prohibition rule[15] in that a territorial division is highly criticized except when made by minor agreements. Before discussing the expediency of this judicial attitude a few references will be made to the judicial development after the Grundig case.

c. Subsequent Judicial Development.[16] The Grundig case has become a cornerstone in European antitrust law, and the Commission's subsequent practice has largely been based on the Court's decision. The Commission and the Court itself have explicitly referred to the Grundig case on several occasions.

Briefly, it can be recalled that the *Commission* has intervened on several occasions against vertical arrangements directed at protecting the area of one country. Other interventions have been made against obstacles to export to two or more Member States. Protection of areas by means of price or rebate systems have also been attacked. Dealer arrangements combined with higher prices for products for export have been found to be contrary to Article 85. And where agreements have been connected with the threat of terminating the delivery of goods being resold for export, the Commission normally intervenes. Guarantees which are limited to only one country have been evaluated as indirect export bans.

A characteristic feature of these cases has been that *the market conditions* —such as concentration of enterprises, product differentiation and barriers to entry—*are not evaluated as elements of importance for the decisions.*

Also the *Court of Justice* has in cases concerning vertical territorial arrangements abstained from evaluating competition between products from different manufacturers. The mention of a few examples should be sufficient.

[15] See e.g. Ivo Van Bael, in *Revue suisse du droit international de la concurrence*, 10 (1980), pp. 39, 45: "Grundig stands for a virtual per se prohibition of what in EEC antitrust parlance is known as absolute territorial protection"; and, in the same respect, W. Alexander, *European Competition Policy*, Leyden 1973, p. 84.

Salzman, in 13 *International Lawyer*, pp. 47, 73 (1979), on the contrary, rejects the possibility of speaking of *per se* rules relating to vertical territorial agreements in connection with the Common Market. He bases his viewpoint on the exceptions made, like the notices of minor agreements in particular and the (possible) admission of a need for gaining a foothold on new markets. He furthermore cites the fact that American law has indicated possible exemptions in connection with profit-pass-over, primary responsibility and location clauses. Salzman's judgment is wrong in the present author's opinion. The first two exemptions are clearly defined although they may raise doubts about the interpretation. The last potential exemption concerns American law and not Common Market law. Therefore the present author does not accede to Salzman's characterization of this particular aspect of Common Market law.

[16] An intensive documentation of these cases is presented in Fejø, *Monopolret og marked*, pp. 290–311.

For instance, in the *Nungesser* case[17] the Court of Justice referred to its usual practice—citing the Grundig ruling—according to which absolute territorial protection with a view to control or restrict parallel imports is in violation of the Treaty, because it leads to or keeps up artificially divided national markets.[18] Although the Commission, when deciding, had only noted that exemption could not be granted as the requirements of Article 85(3) were not met, the Court upheld the Commission's decision in this respect. It may be said that the Court does not make heavy demands on the Commission's ability to demonstrate that the requirements of Article 85(3) have not been fulfilled.

However, the Court's decision in the *Pioneer-Hi-Fi* case[19] from 1983 may give rise to the question as to whether the Court is still of the opinion that absolute territorial division in vertical arrangements is unconditionally against Article 85.

In that case the Commission had imposed very high fines in order to encourage enterprises not to divide the Common Market through export bans.

But the Court took up a discussion of the market shares held by the contracting parties. The contracting parties had claimed that their market shares were not sufficient for their conduct to be regarded as capable of affecting trade between Member States within the meaning of Article 85 of the Treaty. The Court rejected this point of view.

It seems, however, that the Court's considerations should not be regarded as the expression of a new interest in evaluating market shares of the contracting manufacturers' products, when evaluating the legality of vertical territorial division. The discussion undertaken by the Court of Justice was only limited to the problem whether this case did fall under the category of agreements normally described as agreements of minor importance.

The Court itself expressly referred to the leading case on agreements of minor importance.[20] And the Court did not take up the question whether territorial division might be acceptable because the products from this manufacturer might compete with similar products from other manufacturers.

A case illustrating this can be found in the *Distillers*,[21] where the parties, alhough they seemed to have weighty arguments at their disposal, did not succeed in convincing the Commission. The case was about the sale of products from the Distillers group to its customers in the UK.

The Commission held that Article 85 had been violated. Different prices were quoted for exactly the same articles depending on whether the British

[17] *Nungesser* v. *Commission*, case 258/78, judgment of 8.6.1982.
[18] Ground 61.
[19] *Pioneer* v. *Commission*, case 100–103/80, judgment of 7.6.1983.
[20] *Voelk* v. *Vervaecke*, case 5/69, judgment of 9.7.1969.
[21] *Distillers* v. *Commission*, case 30/78, judgment of 10.7.1980.

distributors resold them in the UK or in another country in the EEC. The effect of the price terms was that Distillers' British distributors were charged one price for spirits which were intended for export to other EEC countries and another price when spirits were to be resold to consumers on the domestic market.

It was proved during the proceedings that, in 1975, the price of a product intended for export to Common Market countries and quoted to a British dealer was 99 per cent higher than the price of the same product when intended for consumption in the UK. In 1977, the difference was 92.7 per cent.

But the interesting feature of this case was that Distillers admitted that the price terms should protect the sole distributors in the other EEC countries against competition from dealers who bought from Distillers' British distributors and resold for consumption in the sole distributors' territories. This was done in order to incite the sole distributors to make efforts on the continental market. Another reason was the very low prices of whisky on the British market owing, in particular, to the strong position of the breweries as buyers and distributors of spirits.

The Commission accepted Distillers' argument, but refused to believe that it was particularly necessary to protect the appointed sole distributors in the other Common Market countries.

It is especially important to note that the Commission, without any substantiation, refused to examine whether competition existed between Distillers' products and the whisky brands, gin brands etc. of other manufacturers. Another point worth noting is that the Commission refrained completely from considering whether the Distillers' spirits were competing with other spirits such as e.g. rum or brandy. However, Distillers had drawn the Commission's attention to the fact that in France excise duties on whisky were almost twice as high as on rum owing to discriminatory and protective legislation and, furthermore, that whisky in the continental EEC countries only had a small share of the total spirits market, and that it had to make efforts to gain ground vis-a-vis aquavit, brandy, etc. In addition, whisky was not a common drink in these countries. The same applied, to a greater degree, to Distillers' other products—gin, vodka, etc. Sole distributors were therefore very important to secure entrance to the continental markets and for the necessary sales promotion of the said products. Distillers asserted that the sales promotion undertaken by the sole distributors almost totalled the extra amount which had to be paid when Distillers' products were bought with a view to export.

The case was brought before the *Court of Justice*. But Distillers had previously stopped the sale of Johnnie Walker, Red Label and the Dimple Haig whiskies in the UK. Distillers had simultaneously applied to the British authorities for permission, when selling to its dealers in the UK, to increase the prices of

several other whisky brands to the price which its continental sole distributors paid. But the authorities concerned permitted only half of these price increases in relation to some of the whisky brands. Distillers announced that it would market a new whisky brand, John Barr, which was to replace Johnnie Walker. It was produced at one of the Johnnie Walker distilleries in the characteristic square bottles which are connected with Johnnie Walker at authorized higher prices. Distillers claimed before the Court that these sales and price changes, resulting in fewer and more expensive products from Distillers to British customers, were the outcome of the Commission's decision.

The Court did not comment on these arguments at all. Instead, it declared that the price terms infringed Article 85(1), which Distillers had conceded. As Distillers had made no statutory notification of the price terms which introduced the dual pricing system in 1975, exemption could not be granted in pursuance of Article 85(3) and the Commission's decision was therefore confirmed.

The Court made consequently no contribution to the clarification of the question whether Distillers' argument for the protection of sole distributors against parallel import might have been justified, among other things because of Distillers' position on the continental markets for spirits. May one make the guess that not all the judges involved shared each other's opinion on this issue, and that they may have discussed the various opinions? These discussions, if any, did not influence the outcome of the case as the decision was based on formalities only. Some evidence of this hypothesis may be seen in Advocate General Warner's proposal to follow the Commission—because Distillers had not notified its price conditions—which proposal the Court eventually accepted. But Warner had previously said that he did not believe that the Commission's decision could be upheld substantively. For Warner thought that, on the whole, Distillers' analysis of the difference between market conditions in the UK and in other Member States was convincing, whereas the Commission's argument had been weak.

It is interesting that the decision of the Commission was in fact not founded on the criticism of the figures presented by Distillers, but on condemnation of the dual price system as such. So, when addressing himself to the Court, Advocate General Warner could say that "It is significant that the Decision, whilst setting out detailed facts and figures on many other points, says nothing about sole distributors' actual costs".

The crucial point in the evaluation of the contents of the Distillers case is that the Commission seems to have taken no real position on the reasons which Distillers gave for their costs. What Distillers actually pleaded was that competition was keen on the Continent. It was again supported by Advocate General Warner, as he said that "the Commission appears to be saying that it

does not care whether or not [Distillers'] products are distributed in continental Member States; that observance of its own policy as to parallel imports is more important. That that was the Commission's approach, an approach which is, in my opinion, incompatible with a proper exercise by the Commission of its discretion under Article 85(3), seems to be confirmed by ...".[22] The Commission would not examine the actual circumstances but considered this sacred principle only.

d. Summary of the Common Market Attitude Towards Territorial Restrictions. Both the Grundig decision and ruling as well as the subsequent practice of the Commission and the Court have consistently refused to allow enterprises to establish absolute territorial protection by means of agreements between the suppliers and the distributors. The Commission has never accepted cases of absolute territorial division, not even export deterrents. Nor has it accepted other measures to create absolute territorial division. Despite the fact that the Commission in theory has indicated[23] that absolute territorial protection might be allowed temporarily, especially in order to enable small undertakings to gain a foothold on a market, exemption has not been granted in any case. This is conspicuous, because the Commission, as pointed out, does not generally attach any importance to the market position of the enterprises or to the competing products. The Commission confines itself to proving the existence of agreements etc. on absolute territorial protection in relation to the products concerned. When such agreements have been demonstrated they have been considered to be infringements of Article 85 and to be incapable of exemption.

2. *Other Non-price Restrictions*

The EEC authorities' prohibition of territorial division agreements, which has been outlined above, clashes with the attitude of the same authorities towards non-territorial vertical restrictions. For in connection with the latter restrictions, the authorities have been more flexible and positive, and they have been more willing to consider the market position of the contracting parties as well as the actual and potential competition of other products. Restraints on customers within Common Market law have been examined especially in cases where selective distribution systems have been maintained. But other vertical restraints which have not caused territorial division have generally been accepted. A brief account of the Court's attitude towards *selective distribution* should be sufficient.

[22] See to this Ivo Van Bael, in *Revue suisse du droit international de la concurrence*, 10 (1980), pp. 39, 50.

[23] *Premier rapport sur la politique de la concurrence* (1972), p. 58.

The European Court has been favourable to selective distribution systems from the very first time it dealt with this type of distribution, i.e. in the *Metro* case.[24] The Commission had given negative clearance as well as granted exemption pursuant to Article 85(3) in connection with SABA's selective distribution system. The enterprise "Metro" was dissatisfied because it had not been made an authorized dealer by SABA, and it brought the Commission's decision before the Court claiming that it should be nullified. But the contention was not upheld. The Court spoke approvingly of the Commission's decision:

> On this view the Commission was justified in recognizing that selective distribution systems constituted, together with others, an aspect of competition which accords with Article 85 (1), provided that resellers are chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises and that such conditions are laid down uniformly for all potential resellers and are not applied in a discriminatory fashion.[25]

This statement clearly shows that vertical restraints in the form of selective distribution are acceptable if the quoted requirements are met. Although the Court had previously indicated the possibility that several manufacturers might offer a varied line of production with a high degree of substitutability, at least in the consumers' eyes, such inter-brand competition seemed not to be a requirement for the Court's acceptance of a selective distribution system. But the Court has subsequently dealt with this issue. The quoted passage has been repeated by the Court in two of the Perfumers cases, *Lancôme*[26] and *L'Oreal*,[27] and in the latter case it added as a further interpretation in relation to Common Market law:

> In order to determine the exact nature of such "qualitative" criteria for the selection of re-sellers, it is also necessary to consider whether the characteristics of the product in question necessitate a selective distribution system in order to preserve its quality and ensure its proper use, and whether those objectives are not already satisfied by national rules governing admission to the re-sale trade or the conditions of sale of the products in question. Finally, inquiry should be made as to whether the criteria laid down do not go beyond what is necessary.

This general expression of the Court's acceptance of selective distribution systems may, on the whole, be seen as support of the Commission's practice

[24] *Metro SB-Grossmärkte GmbH* v. *Commission*, case 13/77, judgment of 25.10.1977.
[25] Ground no. 21.
[26] *Lancôme* v. *Etos*, case 99/79, judgment of 10.7.1980. See also *Salonia* v. *Poidomani*, case 126/80, judgment of 16.6.1981.
[27] *L'Oreal* v. *De Niewe Amck*, case 31/80, judgment of 11.12.1980.

within this field. For in several cases the Commission approved of selective distribution systems which did not involve export bans, either when selling to the authorized dealers or to the consumers. Furthermore, selection of distributors was based on objective and qualitative criteria. If subjective selection of undesirable dealers has been made for quantitative reasons and the selection has been allowed, this has only been possible because the Commission has made the selective practice of the enterprises in question subject to close supervision. But selective distribution combined with export bans or deterrents is not allowed.[28]

It is important to note that all the Commission's decisions on selective distribution have been founded on facts. Besides, it seems that the previous decisions have only been made in relation to undertakings which competed keenly with other manufacturers and which had only relatively small market shares. In contrast to the Commission, the Court's positive attitude towards selective distribution is of a more general nature. When selective distribution agreements do not hinder exports, they seem to be judged quite differently from vertical agreements on territorial division. When evaluating selective distribution agreements in principle, the authorities tend to consider competition from rival products. They are also likely to permit restraint of trade which may doubtless greatly restrict the distribution of the manufacturer's products. The reason is, of course, that the authorities have realized that competition is no static phenomenon, but on the contrary that its intensity and nature may change—which is presumably an advantage—depending on the products and market structures in question. The fact that selective distribution has been widely accepted by the Common Market authorities may indicate that, within this field, the objective is "workable competition" with its inherent imperfect market conditions.[29] For it is undeniable that free competition may be seriously obstructed by selective distribution.[30]

It can be concluded that agreements on customer and other vertical restrictions which do not divide the Common Market into Member States or other territories are widely accepted by the European Court and Commission. These authorities have been very understanding when enterprises and trades have wanted and needed such agreements in order to restrict distribution, establish channels of distribution and prevent unauthorized distribution. Although the authorities have intervened against such agreements, the intervention resulted from careful studies of the economic conditions relating to the contested

[28] See now also Commission *Regulation* 123/85 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements.

[29] See e.g. the Court of Justice in the *Metro* case, ground no. 20.

[30] Cf. J. E. Ferry, in 2 *European Competition Law Review*, pp. 209, 213 (1981); see also J. S. Chard, in 7 *European Law Review*, p. 83 (1982).

agreement, which eventually have led to the conclusion that the agreements restricted competition. It is striking that the evaluation of these agreements usually includes contemplation of market conditions, e.g. the degree of enterprise concentration, any existence of substitutes from competing manufacturers, the possibility of new manufacturers' entry into the market. The difference between the attitude towards these restrictions and that towards vertical territorial restraints is conspicuous.

3. *Evaluations*

If an evaluation of the EC authorities' handling of vertical non-price restrictions should be taken up one could take the economic market forces as a starting point.

a. It must be seen as a natural task for EEC competition policy to do whatever is possible to ensure that the market conduct of the enterprises leads to *good market performance.* This overall attitude also seems to be the basis for the EEC authorities' own approach when not dealing with territorial division. And there is no doubt that market performance can be influenced by vertical restrictions.

Economic considerations of the influence of vertical territorial restrictions on market performance can be summarized in three primary points:

1) the concentration of enterprises,
2) the degree of product differentiation, and
3) barriers to entry to markets.

If a market—for instance the market for a specific and important pharmaceutical—has only *one manufacturer*, he is a *monopolist.* If he gives the right to distribute his products for the entire market—for instance the world market—to only one distributor, this distributor will be able to act as a monopolist towards his customers. This usually entails poor market performance. The market is concentrated and the dealer can achieve a monopoly profit. Indeed he can differentiate towards different buyers and hereby achieve an optimal (monopoly) profit for each and every place he sells the product. This situation is of course undesirable from society's point of view and should be prohibited, if possible, by competition rules. If the *monopolist manufacturer* on the other hand *gives the right to distribute to many enterprises*, this can establish a market having considerable resemblance to perfect competition on the level of the distributors.

Another situation exists where *many manufacturers* produce *products* that, in the view of the buyers, are *similar*, such as salt, table-knives, kitchen tools, etc., and

each single manufacturer *gives the right to distribute* his products *to one distributor* for a specified area, for instance one country, and grants the distributor absolute territorial protection. In this case there is no competition between products from this manufacturer—each distributor has absolute territorial protection. But between the dealers there will exist competition for customers who buy the standard products from the different manufacturers, unless the dealers have made agreements among themselves.

It will also be of importance for market performance if the products from the different manufacturers are not—in the eyes of the buyers—seen as similar or standard *products* but as *differentiated.* In the situation with differentiated products these products will not compete on an equal footing in the eyes of the consumers. But if price differences are too big or if other conditions are too unequal, consumers will change from one product to another.

The third dimension of market structure is characterized by the *degree of barriers to entry* to the market. Here, interest is concentrated on those possibilities which exist for enterprises to penetrate a given market either from other markets or as new enterprises.

b. Other economic arguments might however also be of interest. One cannot overlook the fact that absolute territorial protection of dealers by manufacturers is often defended by the argument that this protection has the *purpose of encouraging the distributors to engage in sales promotion activities or to supply services etc.* necessary for an effective marketing of the products. And in my view, many products, such as cars, photographic equipment, glasses, quality watches, etc., need special service and repair facilities, and the quality of such services has influence on the manufacturer's goodwill and, in connection with this, on his product's ability to compete. This higher level of service could not be upheld with "free riders" or "parallel import" from "pirates". Dealers would thus be reluctant to invest in expensive sales promotion and so on, because they might fear the threat of competition from importers supplying the same product without services and consequently not being subject to expensive costs in connection with sales and after-sales service. This argumentation can often be seen as the real reason for wanting to have vertical territorial restraints or other non-price vertical restraints. But there are situations where the purpose of territorial restraints is not to encourage the dealers to invest in sales promotion etc. An important problem then is whether the monopoly authorities—in Europe primarily the EC Commission—are able to distinguish vertical restrictions with the exclusive purpose of encouraging the dealers to engage in sales promotion, from those restrictions that do not have this purpose. The task consists mainly of evaluating whether those products over which a distributor has been given absolute territorial protection, are so unique in the eyes of

the buyers that the distributor can act as a monopolist, or whether the buyers are inclined to see the products from this distributor's manufacturer as substitutable with other manufacturers' products. This task can be difficult, but it is far from impossible. Indeed, the EC authorities have, in other cases than distributor agreements with absolute territorial protection, evaluated different manufacturers' products as possibly competing with each other. Thus, the Commission does not in principle deny the possibility of comparing different manufacturers' products and brands with each other.

c. A third factor when evaluating the EEC competition law in the area here under discussion may be seen in *the objective of the Treaty*. It cannot be disputed that a drive towards *market integration* plays a very important role in the behaviour of the European Court of Justice and the Commission. It is, therefore, natural to pose the question as to whether vertical restraints counteract market integration. The question might be put this way: Will the European authorities' strict attitude towards absolute territorial restrictions lead to new barriers against the establishment and upholding of a common market?

Only a few arguments can be advanced here. If, for instance, a German manufacturer does not have the strength to penetrate a new market, e.g. France, without absolute territorial protection of his dealer, this will probably lead to the result that the German manufacturer will not want to try this penetration. Consequently, the already established enterprises on the French market will keep this market to themselves. The potentially penetrating German enterprise, in other words, will not bring new products to the French market. In this situation, the prohibition against absolute territorial protection results in a barrier to the objective of establishing a common market. Or, to look at it the other way round: If absolute territorial protection were accepted by law, it would have led to the introduction on the French market of those products from the German manufacturer which the protected distributor would have distributed in France.

Thus, absolute territorial protection for a dealer on a new market can have the consequence on that market that already established enterprises would meet competition from the new product. The effect can well be that they turn to lower prices, with better market performance for the consumers as a result. Another possible effect of absolute territorial protection, which had the purpose of assisting penetration of a new market, could even be that a new demand for this type of product could be established or developed. Enterprises already established on that market might not have tried to create such a demand earlier because the competition in that area was modest and did not give any encouragement to spend money on sales promotion and the like in order to increase the demand. But, thanks to absolute territorial protection, a

new or increased demand for this category of products could draw more attention to this kind of goods in the supply from other European countries. The consequence of this would be that the trade between the European Member States would increase and that the establishment of the Common Market would in fact be supported by vertical absolute territorial division.

Another argument might be advanced. If dealers of this manufacturer's products in other areas already have invested in sales promotion, introduction costs, and so on, and are now well established there, it could be very dangerous for a sole distributor for a new area if he were not allowed absolute territorial protection against those other dealers. It may well be that distributors from neighbouring areas have not themselves been able to penetrate this new market because of barriers to entry. But once a new sole distributor for that area introduces the manufacturer's product, they can take advantage of this distributor's efforts if he is not protected.

d. The points of view discussed here concerning absolute territorial protection take on a new dimension when they are connected with a consideration of market forces. Enterprises integrated in a group are, broadly speaking, outside the reach of the antitrust rules of the EEC Treaty when they enter into inter-enterprise agreements. They are allowed to fix prices and divide markets, through absolute territorial protection or otherwise, while relatively small companies cannot act similarly without the risk of being prosecuted for acting against the EEC Treaty. A *consequence of this may well be a concentration of enterprises by means of company mergers in order to evade the antitrust rules of the EEC Treaty*—an unwanted consequence in society's point of view because it entails undesirable market performance.

IV. PATENT LICENSING AGREEMENTS

A few remarks should be made concerning the treatment of patent licensing agreements in the European Common Market as an illustration of the need for the application of economic theories in the judicial process. A field-of-use restriction may be taken as an example.

In the EEC, field-of-use restrictions are *always accepted*—by group exemption from the prohibition rule of Article 85 of the Treaty. This is seen from the Commission's Regulation 2349/84 on patent licensing agreements Article 2 Section 1 No. 3, where it is stated that exemption is given for: "an obligation on the licensee to restrict his exploitation of the licensed invention to one or more technical fields of application covered by the licensed patent".

The Commission has evaluated that this clause is generally not restrictive of competition. The same goes for many other clauses.

This is a dangerous path to embark on. Contrary to the opinion of the EEC Commission, field-of-use restrictions—and many other clauses exempted by Regulation 2349/84—might be very harmful to free competition.

A field-of-use restriction can have the consequence of a territorial limitation, as a price restriction or as a tying clause.

A field-of-use restriction has the consequence of a territorial limitation if, for instance, the licensee is limited in the licence agreement to using the patent only to produce commercial cameras, while the application of consumer cameras may be the dominating situation in France. In that situation the licensee will be prevented from competing on the French market with his products.

A field-of-use restriction acts as a price restriction if it prevents the licensee from cost-reducing mass production.

And a field-of-use restriction may have the character of a tying clause it if restricts the application of the invention in the way that the licensee is forced to incorporate a component where the licensor is the only source of supply.

These simple examples clearly illustrate that the restricting effect of, for instance, field-of-use restrictions in patent licensing agreements may be closely related to the surrounding economic circumstances. But the EEC treatment of such restrictions has been totally disconnected from the relation to economic market forces. This is regrettable. Also in the patent licensing field there is a strong need for taking economic market forces into consideration when handling competition law. The group exemption regulation largely ignores this fact.

V. COMPARISONS WITH AMERICA

There is a striking difference between US case law on *vertical non-price restraints* and the parallel European case law. Also in the field of patent licensing agreements the situation is totally different. In *1967* the US Supreme Court stated in the *Schwinn* decision[31] that "where a manufacturer sells products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results. And ... the same principle applies to restrictions of outlets with which the distributors may deal and to restraints upon retailers to whom the goods are sold ... Such restraints [are] so obviously destructive of competition that their mere existence is enough".

This Supreme Court decision was, broadly speaking, very similar to the European situation after the Grundig Court decision from 1966.

But the inferior courts and a very impressive amount of writing did not like

[31] *US* v. *Arnold, Schwinn & Co.*, 388 US 365 (1967).

the Schwinn judgment. The lower courts avoided, when possible, using the *per se* prohibition against vertical territorial restrictions, for instance by distinguishing later cases from the Schwinn decision.

And many writers criticized the Supreme Court's statement on vertical territorial restrictions for not taking into consideration the potential competition from other manufacturers and other market conditions that might lead to an acceptable performance.

Ten years after the Schwinn decision, in 1977, the Supreme Court overrules the Schwinn decision in the *Sylvania* case.[32] The Supreme Court underlined the complexity of the influence on the market that could stem from vertical restrictions. Vertical restrictions were widely spread in the American economy, and—said the Supreme Court—there was considerable scientific and judicial support for accepting their economic use. In the case before the Supreme Court there had been no proof that vertical restrictions had or could have a "pernicious effect on competition".

The Sylvania decision has had the effect that all vertical restraints, except vertical price restrictions, fall under the rule of reason. This implies that vertical territorial restraints are not in themselves contrary to antitrust laws but must be evaluated in the context of the economic circumstances on the market. This also implies the possibility of acceptance of vertical agreements giving absolute territorial protection. This is contrary to the situation in Europe.

If one looks at the American attitude towards *resale price maintenance* (RPM), on the other hand, case law has been very firm since the beginning of this century. As early as 1911, the Supreme Court decided[33] against RPM, and several later court decisions have reiterated the *per se* prohibition against vertical price restrictions.

During the last few years, however, an intensive debate has emerged. Especially since President Reagan took office, both the Department of Justice's Antitrust Division and the Federal Trade Commission have taken the position that the *per se* prohibition against resale price maintenance should not be upheld. Drawing heavily on the writing and thinking of the so-called *Chicago school*, especially the Department of Justice has advanced the argument that a manufacturer using RPM normally will do so, not in order to increase resale prices, but in order to encourage his dealers to promote his product in a way that he expects will be advantageous for competition against other manufacturers. This is an argument drawing on inter-brand competition.

[32] *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 US 36 (1977).
[33] *Dr. Miles Medical Co.* v. *Park & Sons Co.*, 220 US 373 (1911).

In the *Monsanto-Spray-Rite* case,[34] decided in 1984, the Supreme Court on the other hand resisted the attacks on its earlier *per se* prohibition against RPM and upheld that rule, contrary to the arguments brought forward by the Antitrust Division.

One cannot be sure, however, that the debate on this point has ended in the United States.

In the *US practice*, field-of-use restrictions—and many other restrictions in patent licensing agreements—fall under the *rule of reason*. They may be evaluated as good, or they may be evaluated as bad and in consequence forbidden —depending on the economic environment.

VI. CONCLUSIONS

Horizontal restraints of competition in the form of price-fixing agreements or market-division agreements encompass such detrimental potentials that they do not escape the hostility of the EC authorities. The impossibility of distinguishing the harmless from the harmful seems to be the decisive argument for not accepting them. This EC attitude runs along the same lines as those expressed by the American Supreme Court position, which has been to declare them to be illegal *per se*. This position should be endorsed.

Where *vertical price restraints* are imposed on the dealers one of the most important—if not the most important—forms of competition is eliminated. The arguments for accepting resale price maintenance are also usually not convincing. The American experience in this respect supports this point of view.

Of special interest is a comparison between the EEC treatment of vertical restraints that do not have to do with price or territory, and the EEC treatment of *vertical territorial restrictions*. The authorities are much inclined in the direction of accepting certain restrictions after an evaluation of the context of the surrounding market conditions, when price or territory is not involved. The difference between this view and the way absolute territorial division is treated is striking.

If one asks what is to be learned from the US experience in this area, one of the most impressive phenomena is the flexibility and open-mindedness with which non-price vertical restrictions are met. And the willingness expressed by the Supreme Court to reevaluate its own earlier stand on vertical territorial restrictions must also give rise to reflection.

American court decisions—even judgments from the Supreme Court—do not, of course, have any direct influence on the European Court of Justice.

[34] *Monsanto Co.* v. *Spray-Rite Service Corp.*, 104 US 1464 (1984).

But the reasoning behind the judgments may impress and may prove convincing in cases with similar content. It should not be forgotten that the European competition rules to a large extent can trace their origins back to the US antitrust laws.

The arguments developed in the United States concerning vertical territorial restrictions ought to be considered in Europe, even though our tradition attaches special importance to the role of competition rules in contributing to market integration and unification.

Let one thing be clear: Territorial division—even when accomplished by vertical agreements—may often be very detrimental to competition and to the establishment of a common market.

But it would not be all that surprising if the future should reveal a more open attitude towards territorial division when market conditions indicate that there is a well-founded need for the protection of distributors, for a limited or unlimited period of time.

The period of rejection of absolute territorial protection in the phase of building up the European Common Market and its competition law may well be replaced by a new era where consideration of the elements of market economy forces may supplement the traditional—legalistic—way of thinking.

Group exemption granted without dependence on economic market forces might be a dangerous path to take. The Commission Regulation on *patent licensing agreements* from 1984 seems to ignore the importance of economic surroundings on clauses in licensing agreements to a degree that might interfere with the harmonious technological development of the European Common Market.