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Collection

HOW TO DEAL WITH VERTICAL RESTRAINTS

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I. INTRODUCTION

1. The following working paper is submitted by AGON PARTNERS[1] for the New York State Bar Association International Section Seasonal Meeting in Vienna in October 2014. It is intended to provide a basis for discussions on the topic of vertical restraints.

2. Vertical restraints have always been and still are a point of great interest within competition law and economics. Not only do various opinions exist about the effects of vertical restraints, but also do different approaches exist in order to deal with these types of agreements. Looking into competition law regimes around the globe and the practice of various competition authorities, a mixed picture can be taken. It seems that vertical restraints still polarize within the competition law community.

3. During the last years, two major concepts about how to deal with vertical restraints found their way into competition law practice. On the one hand, the per-se rule, which leads to an absolute prohibition of vertical restraints regardless of their effects, established itself in various jurisdictions. On the other hand, the rule of reason, which focuses on the effects of vertical restraints, builds the second major concept.

4. This working paper starts with an overview of vertical relations in the economy in general, in particular the types of vertical restraints and their potential economic harm. After that, a closer look will be taken at the two major concepts mentioned above, the per-se rule and the rule of reason. Both approaches will be covered by modeling the method and by demonstrating certain examples. Last but not least some procedural questions regarding vertical restraints will be discussed.

II. VERTICAL RESTRAINTS

A. Agreements

5. Firms interact and stand in relation to each other in different and various ways. The first basic distinction can be made between horizontal and vertical relations:

a) **Horizontal relations/relationships** include all types of relations between businesses on the same stage of production.

b) **Vertical relations/relationships** include all types of relations between businesses on different stages of production (upstream and downstream markets). Vertical relations may also exist within in a single company, e.g. if a company takes over another company that is a player on an up- or downstream market (vertical integration).

B. Coordination

6. Vertical agreements between companies may be concluded for a variety of reasons and lead to different types of collective efficiencies. Not only the size of the company but also the

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sector, resources and many other parameters can be important for the type of coordination between companies.

7. *The resource-based view of companies (RBV)* states that the possession of distinctive resources is “critical” if a firm wishes to attain a competitive advantage.[2] Smaller firms may be particularly pressed or forced to reach beyond their own boundaries to find and control key resources.[3]

8. *Small and medium-sized enterprises (SMEs)* may work together to integrate complementary assets or jointly promote investments in common resources (e.g. logistics infrastructure), which otherwise would be prohibitively costly. The possibility of joint efforts result from various forms of interdependencies between the firms that make the performance of a particular firm dependent on the performance of other firms in the same industry or market domain.[4]

9. *Thomson’s categorization*[5] of interdependencies helps illustrate multiple ways in which coordination between firms can take place and lead to distinct types of collective cies[6]:[7]

a) **The first way** in which activities of firms may be related to each other is that of pooled resources.

aa) In this case, the firms are loosely coupled and choose to be interdependent in order to benefit from resources that one firm alone would not be able to acquire due to scale constraints.

bb) Companies pool their needs to source the provision of scale-efficient resources, for instance, export infrastructure such as roads or ports, accumulate market information and other types of governmental support (such as the promotion of products in foreign markets).

b) **The second way** in which activities of firms may be related to each other is a sequential one.

aa) In the sequential way, one firm’s input *is* another firm's output. This type of interdependence usually occurs among firms in a supply chain, where the performance of an

2 Barney, J. B. 1991. Firm resources and sustained competitive advantage. *Journal of management, 17(1): 99-120*; Miller, D. J. & Shamsie, J. 1996. The resource-based view of the firm in two environments: the Hollywood film studios from 1936-1965*. Academy of management journal, 39(3): 519-543*; Peteraf, M. A. 1993. The cornerstones of competitive advantage: a resource-based view. *Strategic management journal, 14: 179-191*.

3 Dyer, J. H. & Singh, H. 1998. The relational view: cooperative strategy and sources of interorganizational competitive advantage. *Academy of management review, 23(4): 660-680*.

4 Luiz F. Mesquita & Sergio G. Lazzarini, Horizontal and Vertical Relationships in Developing Economies: Implications for SMEs’ Access to Global Markets, *Academy of Management Journal*, 51(2): 359-380, 2008.

5 Thompson, J. D. 1967. Organizations in action: social science bases of administration. NewYork, NY: McGraw-Hill.

6 Lazzarini, S. G., Chaddad, F. R., & Cook, M. 2001. Integrating supply chain and network analyses: the study of netchains. Journal on chain and network science, 1(1): 7-22.; Gulati, R. & Singh, H. 1998. The architecture of cooperation: managing coordination costs and appropriation concerns in strategic alliances. Administrative science quarterly, 43(4): 781-814.

7 Luiz F. Mesquita & Sergio G. Lazzarini, Horizontal and Vertical Relationships in Developing Economies: Implications for SMEs’ Access to Global Markets, *Academy of Management Journal*, 51(2): 359-380, 2008.

activity is dependent on the performance of upstream stages of production (such as supply of components).

bb) This enables firms to attain manufacturing productivity (e.g. inventory and delivery efficiencies) if they coordinate their sequential activities and develop competences to manage their supply chain.

c) **The third way** in which activities of companies may be related to each other is a reciprocal way.

aa) In this way each firm's input is dependent on the other firm's output and vice versa. For example, two or more SMEs are interested in jointly developing new products. They can mutually deploy resources and share their specialized knowledge through simultaneous, recurring interactions.[8]

bb) By combining distinct and complementary resources, SMEs can, for instance, collectively achieve levels/rates of innovation that would be unattainable individually.

10. Therefore, one can distinguish between three major types of efficiencies that SMEs can achieve through the coordination of their efforts: sourcing of collective resources, manufacturing productivity, and product innovation.[9]

C. Types

11. Vertical restraints and their impact on economic welfare have been the subject of many academic discussions. While some believe that vertical agreements differ strongly from agreements between competing firms, and that they only appear when they improve the efficiency of the vertical structure, others believe that any contractual provision that restricts a company's economic freedom – which would be the case for most vertical restraints – can only be harmful and should therefore be banned.[10]

12. The most common vertical restraints can be categorized as follows[11]:

a) **Payment schemes.** A uniform price composes a linear pricing rule according to which the payment is defined in proportion to the quantity bought by the distributor. Several provisions allow firms to deviate from a uniform unit price:

aa) *Non-linear tariffs.* The simplest form of non-linear pricing consists in including a franchise fee, besides the uniform wholesale price. This combination is also called a two-

8 Gulati, R. & Singh, H. 1998. The architecture of cooperation: managing coordination costs and appropriation concerns in strategic alliances. Administrative science quarterly, 43(4): 781-814.

9 Luiz F. Mesquita & Sergio G. Lazzarini 2008, Horizontal and Vertical Relationships in Developing Economies: Implications for SMEs' Access to Global Markets, *Academy of Management Journal*, 51(2): 359-380.

10 Rey Patrick & Vergé Thibaud (2005), The Economics of Vertical Restraints, Conference on "Advances of the Economics of Competition Law".

11 Rey, Patrick and Jean Tirole (1986). "The Logic of Vertical Restraints." American Economic Review, 76, 921-939.

part tariff. Another simple form of non-linear tariffs includes progressive rebates on the quantity bought by the distributor (quantity discounts).[12] [13]

bb) *Royalties.* Royalties are another type of payment, based on the distributor's sales measured either in units or in revenues. In contrast to linear or non-linear wholesale tariffs, royalties do not only depend on the quantity bought from the manufacturer but also on the quantity that is actually sold by the distributor. Royalties may even depend on the sales of other goods by the distributor, which effectively allows the manufacturer to impose a tax on the rival's products.[14]

cc) *Different payment structure.* Different payment structures can affect in a direct way the share of the joint profit between the producer and the distributor. However, they also indirectly affect the "terms" or "targets" (retail prices, promotional effort, etc.) that determine the joint profit.[15]

b) **Provisions affecting resale**. Provisions limiting the distributor's freedom to conduct its business in the downstream market exist in various forms. They often target resale prices as well as other criteria:

aa) *Resale price maintenance (RPM).* Resale price maintenance is a measure by which the producer imposes the final price that is charged to consumers, effectively restricting the distributor's freedom of setting its own resale prices. This restriction may consist of several variants: maximum retail prices (price ceiling), minimum prices (price floor), recommended retail prices (RRPs) or advertised prices.[16]

bb) *Quantity fixing.* With this measure the manufacturer or one of the parties specifies the quantity to be bought and resold by the retailer/the next downstream company. Quantity fixing consists of either quantity forcing, where a purchase of a minimum quantity is imposed, or of quantity rationing, where a purchase of a maximum quantity is defined. Quantity forcing is equivalent to a price ceiling, and quantity rationing is equivalent to a price floor, as far as the demand for a particular product is known (and if it depends only on the final price).

cc) *Tie-in.* If a manufacturer imposes on the distributor an obligation to purchase additional goods or services on top of the goods, which the distributor initially intended to buy, the

12 Regarding the possibility to enforce the restrictions one can state that it is sufficient to observe who carries the manufacturer's products to enforce a franchise fee provision. More general non-linear prices may be more difficult to enforce if arbitrage is possible: e.g. if the manufacturer is unable to monitor the quantity sold by each retailer, the distributors might then be able to get a higher rebate by pooling their orders.

13 Rey Patrick & Vergé Thibaud (2005), The Economics of Vertical Restraints, Conference on "Advances of the Economics of Competition Law".

14 The effectiveness of royalties is dependent on the ability of the manufacturer to monitor the distributor's sales; Rey Patrick & Vergé Thibaud (2005), The Economics of Vertical Restraints, Conference on "Advances of the Economics of Competition Law".

15 Rey Patrick & Vergé Thibaud (2005), The Economics of Vertical Restraints, Conference on "Advances of the Economics of Competition Law".

16 Price cuts can also be non-monetary concessions such as free delivery.

respective provision is called a "tie-in". One particular type of tying is full-line forcing, which requires the distributor to market the manufacturer's full range of products.[17]

c) **Exclusivity clauses.** Exclusivity agreements or clauses can limit either only the distributor's or both parties' rights. In exclusive dealing agreements, the distributor typically agrees not to take part in any other business or businesses that compete with the manufacturer's business.

aa) *Exclusive purchasing*. In this variant of exclusivity the distributor agrees to buy all goods exclusively from the manufacturer.

bb) *Territorial exclusivity*. This measure may limit the "territory" (either by defining a geographical limitation that a distributor is allowed to sell the manufactures products to. In return, the manufacturer commits itself to ensure territorial exclusivity, in particular not to allow any other distributor to serve customers in this territory, which effectively eliminates intra-brand competition. A difference can be made between the prohibition of "active sales": Sales made by actively approaching individual customers inside another territory, and "passive sales": Sales in response to unsolicited requests from individual customers of another territory.[18]

cc) *Customer exclusivity*. This measure may limit a specific segment of the market such as specific distribution channels (e.g. distribution through mail rather than through retail stores) or a particular group of customers (small or large businesses, individual customers or business clients) (small or large businesses, individual customers or business clients) that a distributor is allowed to sell the manufactures products to.

13. The above list is non-exhaustive. Other vertical restraints may consist of a manufacturer's commitment to a minimum quality, specific advertising or technical support, or a distributor's commitment to a specific level of promotional effort or customer services (e.g. after-sales services).

1. Hard core restrictions

14. So-called hard core restrictions are seen by most jurisdictions as being particularly damaging and as normally not producing any beneficial effects. Therefore they are usually deemed to infringe competition law.[19]

15. Hard core restrictions are also referred to as black clauses and prevent the particular agreement from benefiting from a block exemption. They can only be exempted on the basis of an individual assessment.[20]

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17 The enforcement of tie-in implies that the manufacturer can verify the range of goods actually carried by the distributor. The equivalence between price and quantity controls dminishes if the distributor can sell to or buy from other distributors.

18 Enforcing territorial provisions usually is rather difficult: though it is relatively simple to set the number of outlets in a given territory, it may be more difficult to control whether a distributor is competing outside its territory.

19 Institute of Competition Law, www.concurrence.com/Droit-de-la-concurrence/Glossaire-des-termes-de/Hard-core-restrictions visited on 11th August 2014.

a) **USA.** Under the Sherman Act, price fixing and market segmentation are frequently referred to as hard core restraints.[21]

b) **EU.** The EU's Block exemption regulation (BER) for vertical supply and distribution agreements[22] contains a legal definition of hard core restrictions:[23]

aa) *Resale price maintenance (RPM)*. Suppliers (Producers, manufacturers) are not allowed to fix the (minimum) price at which distributors can resell their products. In particular, price floors (as mentioned above) are regarded as hard core restrictions.

bb) *Exclusivity clauses*. Suppliers are not allowed to impose restrictions concerning the territory into which the buyer may sell or restrictions concerning the customers to whom the buyer may sell the manufacturer's products ("passive sales"). This restriction refers to market partitioning by territory or by customer. The aim of this rule is that distributors remain free to decide where and to whom they sell. However the BER contains exceptions to this rule, which, for instance, enable firms to apply an exclusive distribution system or a selective distribution system ("active sales").

cc) *Selective distribution*. Selective distribution is addressed in two ways:

i. Selected distributors who are prohibited to sell to unauthorized distributors may not be restricted concerning sales to end-consumers.

ii. The appointed distributors must remain free to sell or purchase the contract goods to or from other appointed distributors within the network of the producer.

dd) *Supply of spare parts*. A manufacturer of spare parts and a buyer of these parts, who incorporates the spare parts into its own products, may agree on clauses that restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers.

2. Others

16. Other types of restrictions are not considered to be severe restrictions of competition because it is not as likely that they cause harm to consumers as it is with hard core restrictions. Some examples are: the manufacturer commits itself to a minimum quality, specific advertising or technical support, the buyer commits itself to specific customer services, non-linear tariffs or even quantity fixing.

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20 Motta Massimo/ Rey Patrick/ Verboven Frank/ Vettas Nikos, Hardcore restrictions under the Block Exemption Regulation on vertical agreements: an economic view. (Authors are members of the Economic Advisory Group on Competition Policy at the Directorate General for Competition, European Commission.

21 Bork Robert H., The Rule of Reason and the Per Se Concept: Price Fixing and Market Divisions, The Yale Law Journal, Vol. 74, No. 5 (1965), pp. 775-847, p. 776.

22 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.

23 Rules applicable to firms, Summaries of EU legislation. http://europa.eu/legislation_summaries/competition/firms/cc0006_en.htm visited on 11th August 2014.

17. **EU.** In order to apply the BER to these types of restriction, however, there are two more requirements to be fulfilled: one requirement concerns a market share and the other one relates to three specific restrictions (as set out below).

a) *Market share.* The requirement concerning a market share cap of 30% states that a vertical agreement is only covered by the BER if the market share of both the supplier and the buyer of products or services do not exceed 30%:

- For the supplier, the relevant market share is the share on the relevant supply market, i.e. on the market on which it sells the products or services.
- For the buyer, the relevant market share is the share on the relevant purchase market, which means the market on which the buyer purchases the products or services.

b) *Specific restrictions.* The other requirement relating to three specific restrictions applies to all vertical restraints other than the hard-core restraints mentioned above.

- The BER imposes specific conditions on three vertical restraints:
  i. Non-compete obligations during the contract;
  ii. Non-compete obligations after termination of the contract;
  iii. The exclusion of specific brands in a selective distribution system.
- When the specific conditions for clauses containing one or more of these three types of restraints are not fulfilled, these vertical restraints, respectively clauses, are excluded from the exemption by the BER. Nevertheless, the BER is still applicable to the remaining parts of the vertical agreement if that part can operate independently from the non-exempted Article.

D. Economics

18. Vertical coordination often was and still is subject of economic analysis. The emphasis usually focuses on coordination problems within a given vertical structure (i.e. between a producer and its retailer(s)) rather than the interaction with other vertical structures.

19. The vertical structure as a whole faces a number of decision variables: while some restrictions affect the joint profit (retail prices, quantity sold to consumers, selling efforts and so on), the way this joint profit is shared between the different parties (wholesale price, franchise fee, royalties) is affected by others.

20. Generally the decentralization of the decision variables that affect the joint profit (the “targets”) to the retailers can cause inefficiencies since they create externalities which have to be correctly accounted for. In this situation, vertical restraints can be used as means to coordinate and restore the efficiency of the vertical structure. However, this does not necessarily

mean that it is in the consumers' best interest to eliminate or correct these externalities although they increase efficiencies.[24]

21. Vertical restraints can be used to earn profits. This may happen by increasing economic efficiency (by sharing infrastructure or innovation costs etc.) or by reducing competition and exercising more market power. Therefore the next section of this paper explains the concept and the economics of market power (1.) before it continues with demonstrating the basics of economics of vertical restraints (2.).

1. Market power

22. The abuse of market power or monopoly power can harm consumers, competitors, other companies (downstream and upstream markets) and the whole economy.[25]

23. Most judicial definitions treat market power and monopoly power as more or less identical. Nevertheless they leave unclear whether they are precisely the same and, if they are not, which is the lesser degree of anticompetitive harm. Usually these definitions focus on pricing issues, but leave unclear associated issues, in particular whether anticompetitive power includes the ability to prevent prices from falling or the power to exclude competition.

24. Basically market power and monopoly power can be treated as qualitatively identical. However, one has to recognize explicitly that anticompetitive power can be exercised by two methods, namely either by raising one's own price or by raising competitors' costs. These two methods correspond to the "power to control price" and "power to exclude competitors" distinction which is expressed in the "Du Pont"-formulation. In any case, both methods reduce consumer welfare.[26]

25. A company which is not constrained by competition from a sufficient number of equally efficient existing and potential competitors can profitably raise prices or prevent prices from falling in two ways:

a) *Stiglerian market power.* The company may raise or maintain prices above the competitive level directly by limiting its own output (control price). This is called the Stiglerian or classical market power.[27]

b) *Bainian market power.* The company may raise prices above the competitive level or prevent it from falling to a lower level by raising its rivals' costs and thereby causing them to restrain their output (exclude competition). Accusations like this are usually the

[24] Rey Patrick & Vergé Thibaud (2005), The Economics of Vertical Restraints, Conference on "Advances of the Economics of Competition Law".

[25] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 27 n.46 (1984).

[26] Krattenmaker Thomas G./ Lande Robert H./ Salop Steven C., Monopoly Power and Market Power in Antitrust Law, Georgetown Law Journal 1987. Landes & Posner, Market Power in Antitrust Cases, 94 HARV. L. REV. 937,977 (1981); R. Posner & F. Eastbrook, antitrust: Cases, economic notes and other materials 348 (2nd ed. 1981).

[27] Hovenkamp, Antitrust Policy After Chicago, 84 Mich. L. Rev. 213, 260-83 (1985); Stigler G., The Organization of industry (1968).

basis of most cases in which a company is claimed to have harmed competition by foreclosing or excluding its competitors.[28] This method is called the Bainian market power.[29]

26. The economic harm of Stiglerian market power may be illustrated by the following example.

a) Let us assume there is a hypothetical market for hypothetical goods called “things”. There are no good substitutes for “things” and only one single company A produces “things”.

b) In this constellation, company A will have the ability to exercise Stiglerian monopoly power by reducing its output and raising its price, and therefore the market price, to a monopoly level.

c) Consumer welfare and allocative efficiency are sacrificed because the firm foregoes sales to consumers who would be willing to buy “things” at a price above the cost of production but who are unwilling to buy at the monopoly price set by company A.[30]

27. Bainian market power leads to economic harm as well, as illustrated by the following example.

a) Suppose 100 companies with identical, rising supply curves produce “things” and each company produces an equal amount. Further, a second product called “objects” is a good substitute for “things” and vice versa.

b) If the producers of “things” significantly raise the cost of manufacturing “objects”, they will remove all “objects” from the market. As the increased cost of “objects” leads producers to shrink their output, the price of “things” will rise.

c) The producers of “things” will benefit since their outputs and market shares increase. Their total profits rise, but consumers cannot buy “objects” at all as well as they cannot buy “things” at a lower competitive price anymore. The companies producing “things” in this example exercise Bainian market power and consumer welfare and allocative efficiency are both reduced.[31]

28. To sum up, in economics, market power is usually described as the power to raise prices above the competitive level (in the short run marginal cost, in the long run average total cost). This means that a company may influence the price at which it can sell by changing its output and that by charging a price above the competitive level the company is able, at least in the short run, to obtain more profit than under normal competition.[32]

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28 Krattenmaker & Salop, Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power over Price, 96 YALE L.J. 209 (1986), 211-30.

29 Bain J., Industrial Organization 324-30 (1959), Bork R., The Antitrust Paradox 66 (1978).

30 Krattenmaker & Salop, Anticompetitive Exclusion: Raising Rivals‘ Costs to Achieve Power over Price (1986), at 279-81; Krattenmaker Thomas G./ Lande Robert H./ Salop Steven C., Monopoly power and market power in antitrust law.

31 Krattenmaker Thomas G./ Lande Robert H./ Salop Steven C., Monopoly power and market power in antitrust law.

32 Peeperkorn Luc, The Economics of Verticals, Competition Policy Newsletter 1998, nr. 2, June.

2. Inter-brand and intra-brand

29. *Inter-brand competition.* Differentiated products develop and compete on the basis of brands or labels: Coca Cola vs. Pepsi, Levi vs. GWG jeans, Gucci bags vs. Dolce & Gabbana bags, Mars vs. Snickers etc. are a few examples of inter-brand competition. Buyers may be willing to pay a higher price or make more frequent purchases of one branded product over another. Briefly, inter-brand competition is competition between different brands.

30. *Intra-brand competition.* Intra-brand competition is competition among retailers or distributors of the same brand. Intra-brand competition may be on price or non-price terms. For example, a Gucci bag may be sold at a lower price in a discount or specialty store as compared to a department store but without the advantages in services that a department store provides. In this constellation the advantages in services constitute intra-brand non-price competition. Some producers maintain uniform retail prices for their products and prevent intra-brand price competition through business practices such as RPM, in order to stimulate intra-brand non-price competition if it will increase sales of their product.[33]

31. According to economics theory competition concerns can only arise if there is insufficient inter-brand competition i.e. if there is a certain degree of market power:

a) The fiercer inter-brand competition, the more likely it is that vertical restraints have a negative effect or at least a net positive effect.

b) The weaker inter-brand competition, the more likely it is that vertical restraints have a net negative effect.

32. This implies that the same vertical restraint can have different effects depending on the market structure and on the market power of the company applying the vertical restraint.

III. PER-SE RULE

A. Concept

33. The per-se rule is a judicially created principle of antitrust law, which states that a trade practice violates the law (e.g. Sherman Act), if the practice is in restraint of trade, regardless of whether it actually harms anyone.[34] If a particular conduct is subject to the per-se rule, "it is presumed to be illegal without elaborate inquiry as to the precise harm it may have caused or the business excuse for its use."[35]

34. Under a per-se rule, the Court's evidential inquiry ends with the determination that a contract or agreement falls in one of the determined categories of per-se illegality. Any such contract or agreement is presumably anticompetitive.

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33 OECD, Glossary of statistical terms, http://stats.oecd.org/glossary/detail.asp?ID=3153 visited on 11th August 2014.
34 US Legal, http://definitions.uslegal.com/p/per-se-rule visited on 11th August 2014.
35 Vakerics Thomas, Antitrust Basics, New York: Law Journal Press, 2011, § 1.03 (4).

35. Per-se rules may be a very useful tool to help conserve an authorities' time and resources, but the U.S. Supreme Court has set a high standard for establishing such rules, requiring “considerable experience with the type of restraint at issue” and “demonstrable economic effect rather than… formalistic line drawing.”[36]

B. USA

36. According to the Sherman Act, violations can take one of two forms – either as a per-se violation or as a violation of the rule of reason: Section 1 of the Sherman Act defines certain business practices as a per-se violation. As described, this means that the act in question requires no further inquiry into the practice’s actual effect on the market or the intentions of those individuals who engaged in the practice.[37]

37. Section 1 of the Sherman Act prohibits “every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce.” It has been recognized for some time now that a strict, literal reading would result in the illegality of every agreement between two or more firms because an agreement necessarily prevents one party’s competitors from gaining the business of the other party to the deal.[38] Therefore the Court found it necessary to use a “rule of reason” when conducting a Sherman Act Section 1 analysis in order to assess whether an agreement would actually promote or suppress competition under the Act.[39]

38. The development of antitrust jurisprudence in the U.S. has seen the creation and abrogation of the described presumptions due to judicial experience and dynamic and changing market conditions. While the court declared vertical territorial and customer restriction “per-se” illegal in 1967, it overruled that holding only ten years later by substituting a rule of reason analysis:[40]

a) With this overruling in GTE Sylvania began a trend of the Court’s revisiting many of its per-se rules in search of concrete empirical justifications. Thirty years after this case, it held that minimum resale price maintenance would be subject to the rule of reason and not anymore to the per-se treatment which had been applied to that conduct for nearly a century.[41]

b) Since a full-scale analysis of all relevant market conditions and factors surrounding an agreement is costly and needs a lot of time, the Supreme Court held that certain types of conduct (e.g. price fixing) inherently restrains competition in an unreasonable way and therefore must be prohibited per-se.[42]

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[36] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877, 887 (2007).

[37] Legal Information Institute, Cornell University Law School, “Antitrust”. www.law.cornell.edu/wex/antitrust visited on 11th August 2014.

[38] Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 66 (1911).

[39] United States v. Am. Tobacco Co., 221 U.S. 106, 179 (1911).

[40] U.S. v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) overruled by Cont’l T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

[41] Leegin 551 U.S. at 907, overruling Dr. Miles Medical Co. v. John D. Park & Sons So., 220 U.S. 373 (1911).

[42] United States v. Socony-Vacuum Oil Co., 310 U.S. 150. 223 (1940).

39. Per-se prohibitions remain present in U.S. antitrust jurisprudence, for example horizontal price fixing, geographic market division, customer allocation, output reduction, group boycotts. However the Court has stated explicitly that it is favoring a nuanced approach in applying per-se prohibitions. The Supreme Court shows with this approach that it is on guard against excessive formalism and therefore avoids the use of presumptions whenever possible. Further, the Supreme Court demonstrates that it is willing to overrule unnecessary presumptions and their corresponding per-se rules if they are no longer justifiable.[43]

C. EU

40. The Treaty on the Functioning of the European Union ("TFEU") in Article 101 takes a different approach from the Sherman Act in its rules against anticompetitive behavior:

a) The first part of Article 101 is similar to Sherman Act Section 1 by prohibiting "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."

b) The subsections a-e provides examples of five types of behavior that explicitly fall within Article 101(1): (a) price fixing; (b) output controls; (c) market allocation; (d) applying dissimilar conditions to similar transactions; and (e) tying.

41. The aforementioned list is not exhaustive and the examples may imply that per-se rules explicitly exist within Article 101(1). Article 101(3) exempts agreements, decisions and concerted practices that, "prevent, restrict or distort competition but also contribute to production or distribution while benefitting consumers so long as they do not impose indispensable restrictions on competition or allow the involved undertakings to later eliminate competition".[44] Thus taking subsections (1) and (3) together, there is actually no room for the Court of Justice of the European Union (CJEU) to use per-se rules in Article 101 because it contains both a prohibition and an explicit basis for exemption.[45]

42. The CJEU is operating within a different institutional framework in the EU than the Supreme Court in the U.S. The three countries which contributed prominently to the drafting of the Treaty of Rome (which was the first version of what is now the TFEU) were France, Germany and the Netherlands. All of them are civil law countries. This fact suggests that there is – compared to U.S. case law – little room for judicial developments of per-se rules that fall outside the text of the Treaty in CJEU competition jurisprudence.

a) *CJEU*. Therefore it is a natural consequence that the CJEU tends to a static interpretation of Article 101, as the court operates under and within the determined objectives embodied by the TFEU's provisions. Although CJEU opinions refer to earlier cases as rule of law, the Court typically relies on long-standing interpretations of the Treaty.

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43 California Dental Ass'n v. F.T.C., 526 U.S. 756, 779 (1999), quoting Nat'l Collegiate Thletic Ass'n v. Bd. Of Regents of Univ. of Oklahoma, 468 U.S. 85 at 104 (1984).

44 Consolidated Version of the Treaty on the Functioning of the European Union Article 101, 2008 O.J. C 115 at 88-89.

45 Vesey Caleb, Per se Rules in U.S. and EU Antitrust/Competition law. New York Law School, www.eucomplaw.com/comparing-eu-and-us-competition-law/per-se-rules visited on 11th August 2014.

b) *Supreme Court.* The Supreme Court's interpretation of the Sherman Act, is more cyclical as it does not operate under the same or even under similar fixed objectives. The Supreme Court operates in a broader range of interpretive authority. This allows it to respond and adapt to market trends and changes as well as to economic theories and resulting in rules of law that change over time.

43. Nonetheless, it is necessary for the CJEU to interpret Article 101's prohibition of agreements "which have as their object… the prevention of competition." As mentioned above, the CJEU has the authority to set general principles of law in response to a referral of a member state. The Court often refers to and relies on its prior cases and experience in infringement by object cases in order to remain consistent in its interpretation of Article 101:

a) *Beef Industry.* The interpretation of Article 101 includes the often recurring quote from the *Beef Industry* decision which states that "certain forms of collusion between undertakings can be regarded, by their very nature, as being injurious to the proper functioning of normal competition."[46]

b) *T-Mobile*. In *T-Mobile*, Advocate General (AG) Kokott went further than this longstanding commonly recurring theme by using the term "per-se prohibition". She justified herewith the standard in part by noting the benefits of legal certainty for undertakings and conservation of enforcement and judicial resources.[47]

c) The unilateral information exchange in *T-Mobile* may have been deemed to have an anticompetitive object under the standard imposed by the Beef Industry case. The inquiry of the ECJ concerning the actual effects of such an agreement would however end in a similar way as would the one of a Supreme Court per-se analysis. The use of the term "per-se" in an EU competition decision is a marked development.

d) *Expedia.* The advocate general (AG) of the CJEU reverted back to the *Beef Industry* language regarding the justification to prohibit "certain forms of collusion" in a recent decision regarding the French Autorité de la Concurrence's regulation of a joint venture between the online ticketing agent, Expedia, and rail operator, SNCF.[48] The CJEU in this case was answering the question of whether member states are bound to follow the 10% market share *de minimis* standard determined in Council Regulation (EC) No.1/2003. In this case, once again the CJEU found that "there is no need to take account of the concrete effects of an agreement once it appears that it has as its object the prevention, restriction or distortion of competition."[49]

44. Though the term "per-se" did not make another appearance in this opinion, it seems the Court ruled in favor of the per-se type thinking rather than undertaking a rule of reason analysis.

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46 Case C-209/07 Beef Industry Development Society and Barry Brothers [2008] ECR I-0000 ('BIDS'), paragraph 16.

47 Case C-8/08 T-Mobile Netherlands BV and Others v. Raad van bestuur van de Nederlandse Mededingingsauteriteit [2009] ECR I-04529. AG Opinion, paragraph 43.

48 Case C-226/11 Expedia, Inc. v. Autorité de la Concurrence and Others [2012] ECR 0000, paragraph 36.

49 Id. At paragraph 35 citing Joined Cases 56/64 and 58/64 Consten and Grundig v. Commission [1966] ECR 299; Case C-272/09 P KME Germany and Others v. Commission [2011] ECR I-0000, paragraph 65; and Case C-389/10 P KME Germany and Others v. Commission [2011] ECR I-0000, paragraph 75.

45. In the EU the development of the law on vertical restraints has been strongly influenced by the goal of assuring market integration among the nations of Europe.

46. However, vertical agreements are generally considered less harmful than horizontal agreements. Therefore, vertical agreements may be exempted from the prohibition on anti-competitive agreements through the Vertical Agreements Block Exemption (Commission Regulation 330/2010).

D. Germany

47. The German Act against Restraints of Competition (ARC) was enacted in May 1998 and entered into force in January 1992. One of the main objectives of the revision was the harmonization with EU competition law. The influence of EU law on Member States' laws has grown steadily, especially in the area of competition law. It has been argued that equal opportunities for all competitors in the EU single market could not be sufficiently provided as long as structural and substantive differences between German and EU antitrust law remain. In particular, German industry criticized competitive disadvantages compared to foreign companies.

48. To bring the ARC into line with EU law standards, several rules have been assimilated:

a) Prohibitions on cartels, the abuse of a market-dominating position, and recommendations were explicitly introduced;

b) A supplementing general exemption (§ 7 ARC);

c) Pre-merger-notification; and

d) Harmonization of the definition of mergers by introducing the „acquisition of control" in § 37 (1) No. 2 ARC.

49. German competition law distinguished between horizontal and vertical restraints. While horizontal restraints were generally prohibited, vertical restraints in the form of exclusive dealing agreements were in general, subject to the supervision of the cartel authorities, but contractual restrictions on a party's freedom to determine prices or contractual terms concluded with third parties were directly prohibited by law.

a) RPM is prohibited in German law (§ 14 ARC). Such agreements are null and void – which follows from general civil law rules. Due to cultural policy objectives there is an exemption for books and other publications.

b) Restrictive licenses concerning intellectual property rights and know-how are mainly subject to block exemptions in EU competition law. These provisions have been partly adapted to EU law.

50. Concerning vertical restraints other than RPM, the supervisory powers of the cartel authorities have been simplified. The cartel authority has the competence to declare agreements between firms for the sale of goods or commercial services to be void. The authority may for-

bid the implementation of new, similar agreements, insofar as they impose on one of the parties:

a) Restrictions concerning its freedom to use the supplied goods, other goods or commercial services,

b) Restrictions regarding the purchase of other goods or commercial services from, or their sale to, third parties,

c) Restrictions as to the sale of the supplied goods to third parties,

d) Obligations to accept goods or commercial services that are not necessarily related to the subject-matter of the agreements.

51. A decision of the cartel authority requires that such restrictions substantially impair competition in the market for these or other goods or commercial services. Tying agreements and other vertical restraints are not prohibited per-se. Nevertheless, they may fall under § 19 or § 20 ARC if they are subject to the behavior of a market-dominating company. Furthermore, if such agreements have an effect on trade between Member States, they may fall under Article 101 TFEU.

a) Recommendations like suggested retail prices, are prohibited by the ARC (§ 22 (1)) if they circumvent prohibitions that are laid down in the ARC or rulings through uniform conduct. § 22 (2) and (3) ARC then exempt several types of recommendations.

b) Non-binding price recommendations that are issued by a company for the resale of its branded goods are exempted by § 23 ARC, if these goods are in price competition with similar goods of other manufacturers. This rule only applies if the recommendations are expressly designated as non-binding, and economic, social or other pressure may not be exerted to enforce them.

c) Unilateral acts irrespective of market power, such as boycotts and refusals to deal, are integrated in the ARC in § 21 ARC. § 21 (2) and (3) ARC prohibit different kinds of coercion of other firms, especially to threaten or cause harm, or to promise or grant advantages to other enterprises for the purpose of inducing them to adopt conduct which the ACR prohibits from being the subject-matter of a contractual commitment.

E. Austria

52. The Austrian Federal Competition Authority (ACA) was established in 2002. Its duty is to ensure a well-functioning competition market in Austria. The ACA is an investigative body only and does not have any decision-making powers.

a) Inspections can be conducted only following a search warrant handed down by the Austrian Cartel Court. If the agency wishes to pursue undertakings for competition law infringements, it has to apply to the Cartel Court which is composed of panels with two professional judges and two lay judges. The lay judges are representatives of the

Chamber which is dealing with the affected market (e.g. Chamber of Commerce, the Chamber of Labor or the Chamber of Agriculture, etc.).

b) Within the EU, the core competition framework was set out in Regulation 1/2003 ("Reg 1/2003") which foresees a system of parallel competences within which the European Commission ("EC") and the National Competition Agencies ("NCA") apply the competition rules regulated in Article 101 and 102 Treaty on the Functioning of the European Union ("TFEU").

c) Just like other EU and non-EU NCAs, Austria also has an enforcement priority in vertical restraints since several years. In 2013, the ACA applied in total for fines in the amount of € 26 Million. A major part of these fines involve vertical restraints cases in several industry sectors.

53. Under Austrian Law as under EU law, price fixing can be an effect of vertical restraints, i.e. a hard core restriction which infringes the ban on cartels as set forth in Article 101 (1) of the TFEU and the corresponding paragraph 1 Austrian Cartels Act 2005. In particular, vertical restraints related to pricing are generally considered so harmful that no "safe-harbor" exemption applies to them even if the market share threshold is not attained. This approach is comparable with the ruling of the U.S. Supreme Court in Dr. Miles v. Park & Sons (1911), where the Court established that a resale minimum price is per-se illegal.

54. However, vertical restraints may operate at any stage of the supply chain and are prevalent in all kind of markets. The ACA often deals with contractual vertical constraints between manufacturers and/or their distributors and retailers.

a) *Food retail market.* Recent cases often concern the food retail market, which is a highly concentrated market with a relevant economic market power on the retailer's (distributor´s) side. In this relation RPM is a frequently referred topic. The ACA's experience with the use of minimum price RPM, is that it is usually used to restrict competition and protect market position.

b) *Online.* The significant growth and development in online commerce brought up new resources for market failure which relate to the topic of vertical restraints. Information over-kill, quality information asymmetries and the potential 'free-riding' problem raise the use of vertical restraints by market players. In some cases vertical agreements are used between seller and internet platforms to set prices and to avoid lower prices than at the point of sale in the shop.

c) *Territory.* Additionally, the ACA locates problems in exclusive distribution and exclusive territory agreements which may be linked with price fixing. Manufacturers seek to protect exclusive distributors by placing additional vertical restrictions on competing suppliers´ ability to sell online, or sell outside their home territory.

55. This shows that new forms of vertical restraints are emerging and the line seems to become blurred between legal and illegal vertical restraints.

56. The ACA also works with information and educational work to promote precaution instead of aftercare. For example, it recently published a practical guideline for undertakings concerning vertical price maintenance. The guideline was written based on discussions with inter alia the European Commission, the Austrian unions and Austrian chambers. The final document helps Austrian undertakings to self-evaluate whether their business practices are in line with competition laws or not. SME's, especially who may not be able to afford legal assistance, have asked for a helping guideline.[50]

IV. RULE OF REASON

A. Concept

57. Almost 100 years ago Justice Brandeis stated "every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition"[51].

58. In order to determine if a restraint promotes or suppresses competition, courts should look at the facts that are specific to the business, the situation before and after the constraint was put in place, and the nature of the restraints as well as their actual or probable effect.

59. As some practices constitute anticompetitive behavior and at other times encourage competition within the market, the court applies a totality of the circumstances test. This test allows the court to ask whether the challenged practice promotes or suppresses market competition. Courts often find intent and motive relevant in predicting future consequences during a rule of reason analysis. If the case is ambiguous, a presumption exists in favor of the rule of reason.[52]

60. The rule of reason analysis seeks to balance the pro- and anticompetitive effects of an agreement or a clause against each other (the absence or presence of either is not predictive of the outcome).

B. USA

61. As mentioned above the Court overruled in GTE Sylvania a long lasting practice and began a trend of revisiting many of its per-se rules in search of concrete empirical justifications. Thirty years after this case, the Court held that minimum resale price maintenance would be subject to the rule of reason and not anymore to the per-se treatment which had been applied to that conduct for nearly a century.[53]

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50 On the basis of Mr. Theodor Thanner's presentation at the NYSBA International Section Meeting 2014 in Vienna.
51 Board of Trade of Chicago v. United States, 246 U.S. (1918).
52 Legal Information Institute, Cornell University Law School, "Antitrust". www.law.cornell.edu/wex/antitrust visited on 11th August 2014.
53 Leegin 551 U.S. at 907, overruling Dr. Miles Medical Co. v. John D. Park & Sons So., 220 U.S. 373 (1911).

62. As illustrated, certain practices became over time unlawful per-se under the Supreme Court's interpretation of the Sherman Act. On the other hand, business conduct that was not presumptively unlawful was evaluated and analyzed under the rule of reason to determine whether, on balance, the conduct at issue should be condemned.

63. However, it became more and more obvious that some of the per-se treatment deserved this label of a "per-se prohibition" while others did not. For such conduct that has categorically unambiguous competitive effects, per-se rules are appropriate.[54] The economic understanding of some conduct has improved over the years and some per-se rules have been replaced by rule of reason analysis.[55]

64. The lower courts undermined the force of some unfortunate precedents of some Supreme Court opinions that went too far in condemning particular practices that might be pro-competitive or at least neutral. Lower courts "affirmed" these cases by drawing the "distinction without a difference".[56] Finally this attracted the Supreme Court's attention and it reconsidered several precedents of per-se rules including boycotts[57], vertical price restraints[58] and vertical non-price restraints.[59]

65. Today, U.S. courts analyze each of these practices under the rule of reason. Agreements unreasonably affecting or eliminating competition are violations of Section 1 of the Sherman Act. Agreements that are not found to have a negative effect on competition are not violations of Section 1 of the Sherman Act.

C. UK

66. Since 1 May 2004 the Office of Fair Trading (OFT) has the power to apply and enforce Articles 101 and 102 of the TFEU Treaty in the United Kingdom. The OFT also has the power to apply and enforce the Competition Act 1998. Private enforcement actions can be brought by affected individuals to the Chancery Division of the High Court.

67. Substantive decisions of the OFT (or sectorial regulators) are subject to appeal to the Competition Appeal Tribunal (CAT) on questions of both fact and law.

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54 Hovenkamp, The Antitrust Enterprise, 115-16 (2005).

55 Gavil Andrew I, Kovacic William E., Baker Jonathan B., Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy 358 (2002).

56 e.g., Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1978) (describing the meaningless distinction made by the Court in Schwinn); see also Khan v. State Oil Co., 93 F.3d 1358 (7th Cir. 1996) (Posner, J.).

57 Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co., 472 U.S. 284 (1985) (correcting a popular misconception that boycotts were illegal per se); FTC v. Ind. Fed'n of Dentists, 476 U.S. 477 (1986) (declining to treat the refusal to deal as per se unlawful); Joseph P. Bauer, Per Se Illegality of Concerted Refusals to Deal: A Rule Ripe for Reexamination, 79 COLUM. L. REV. 685 (1979) (criticizing the per se treatment of boycotts).

58 Concerning maximum resale pricing, State Oil Co. v. Khan, 552 U.S. 3 (1997), overruled Albrecht v. Herald Co., 390 U.S. 145 (1968). Generally: Roger D. Blair & John. E. Lopatka, Albrecht Overruled—at Last, 66 ANTITRUST L.J. 537 (1998) (providing a legal and economic analysis of maximum resale pricing); Roger D. Blair & John E. Lopatka, The Albrecht Rule After Khan: Death Becomes Her, 74 NOTRE DAME L. REV. 123 (1998) (same). Concerning minimum resale price restraints, Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007), overruled Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). Generally: Symposium, Antitrust Analysis of Resale Price Maintenance After Leegin, 55 ANTITRUST BULL. 1 (2010) (describing the controversy spawned by the Leegin decision).

59 Concerning non-price vertical restraints, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1978), overruled United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). Robert Bork, Vertical Restraints: Schwinn Overruled, 1977 SUP. CT. REV. 171 (celebrating the Sylvania decision).

68. In the UK, vertical agreements are generally not seen as behavior which raises competition concerns. If one or more of the parties possesses market power on the relevant market or if the agreement forms part of a network of similar agreements, it may be considered as giving rise to competition concerns. Vertical restraints are subject to standard competition law and are therefore contained in the Competition Act 1998. The 'Chapter I prohibition' mirrors Article 101, while the 'Chapter II prohibition' mirrors Article 102.[60]

a) Generally, there is no per-se rule in UK competition law, other than in respect of excluded agreements. Agreements that satisfy the conditions stipulated in the Vertical Agreements Block Exemption (or which would satisfy them were they to have an effect on trade between member states) are deemed lawful without a full analysis of their impact on competition.

b) Formerly, all vertical restraints contained in agreements between non-dominant firms were considered to be per-se lawful, except those that involved price-fixing. The reason for this position was that they were the subject of an exclusion order under section 50 of the Competition Act. However, this position has now changed and all vertical agreements fall under domestic competition law.[61]

c) A vertical agreement that does not benefit from Block Exemptions may still not be prohibited if it falls under the legal exception regime, which was introduced by the Modernization Regulation. The term "legal exception regime" means that an agreement that falls within Article 101(1) but which satisfies the conditions set out in Article 101(3) shall not be prohibited. Such an agreement is valid as long as the conditions in Article 101(3) are satisfied.

69. The Competition Act mirrors this approach: an agreement that falls under the Chapter I prohibition but which fulfills the conditions set out in section 9(1) of the Act may not be prohibited. Such an agreement is valid and enforceable as long as the conditions in section 9(1) are satisfied.

70. Article 101(3) requires four conditions which must all be met: Any agreement/decision or concerted practice

a) Must contribute to improving the production or distribution of goods or to promoting technical or economic progress,

b) Must allow consumers a fair share of the resulting benefit,

c) May not impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives,

d) May not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

60 Andrew Scott, The UK Approach to Vertical Restraints of Competition, Report to the XVIIth International Congress of Comparative Law, July 2006, p.1.

61 Andrew Scott, The UK Approach to Vertical Restraints of Competition, Report to the XVIIth International Congress of Comparative Law, July 2006, p. 6.

71. The wording of section 9(1) is similar to that of Article 101(3) except that its application is not limited to goods.

72. The UK Exclusion Order in section 50 of the Competition Act excludes vertical agreements (as defined in the UK Exclusion Order) from the application of the Chapter I prohibition.

73. The UK Exclusion Order mainly applies to the same types of agreements as the Block Exemption due to its intention to follow closely the treatment of vertical agreements in the EU. However, the UK Exclusion Order has only one 'hard core' restriction: an agreement which includes a price-fixing restriction cannot benefit from the exclusion.

74. The important issue is the effect on competition and not the form of a particular vertical restraint. The first step in the analysis of a vertical restraint is usually an assessment in order to find out whether one or more firms participating in the agreement have market power. If this is the case, the restraint may have anti-competitive effects if its effect is to foreclose at least a substantial part of a market to competition, to dampen competition and/or to create obstacles to market integration (Articles 101 and 102).

75. When assessing whether a firm possesses market power the OFT considers the strength of any competitive constraints, which include:

a) Existing competitors – their market shares, and the movement of respective shares over time;

b) Potential competition – the scope for new entry;

c) Buyer power – the strength of negotiating position enjoyed by customers;

d) The extent of control of prices or other market conditions by governmental economic regulation. Such regulation may limit the capacity for a firm to exploit market power.

76. Vertical restraints can lead not only to anti-competitive effects (in the presence of market power) but they may also produce economic benefits, especially through:

a) Promoting efficiencies,

b) Promoting non-price competition,

c) Promoting investment and innovation.

77. The OFT may take positive effects into account if they satisfy the conditions for exemption stipulated in section 9 of Chapter I, or where they found a claim of 'objective justification' for the purposes of the Chapter II prohibition.

78. The Enterprise Act 2002 came into force in 2003 making some significant changes to UK competition law.

a) *Constitutional changes*. The Director General of Fair Trading has been abolished by the Enterprise Act and a corporate board of the Office of Fair Trading (OFT) has been established instead. The goal of the OFT is to enforce competition and consumer protection laws. The Competition Commission Appeal Tribunal, which was previously an arm of the Competition Commission, became the Competition Appeals Tribunal which is completely independent from the Competition Commission.

b) *Appeals*. The Competition Appeals Tribunal hears appeals against OFT and Competition Commission decisions in merger and market investigation cases. The appeals are dealt with on a judicial review basis. Certain other decisions of the OFT and other regulators are also open to appeal to the Competition Appeals Tribunal under the Competition Act and the Enterprise Act.

c) *Merger control*. The rules on merger control were substantially amended by the Enterprise Act 2002. The Secretary of State was removed from the decision making process on mergers. Decisions are taken at the first stage by the OFT and, if there are competition concerns, at the second stage by the Competition Commission.

d) *Investigating markets.* The power of the Competition Commission to investigate into a monopoly situation has been repealed. The Enterprise Act gives instead the OFT and some regulators the ability to refer markets to the Competition Commission for investigation, if there are reasonable grounds to suspect that a feature or combination of features of a market prevents, restricts or distorts competition.

e) *The cartel offence*. The provision about the criminal cartel offence received a great deal of attention. An individual who dishonestly agrees with one or more other persons that at least two undertakings at the same level of business fix prices, limit supply, limit production, divide supply, divide customers or rig bids, can be sanctioned by a maximum sentence of imprisonment of 5 years and/or an unlimited fine if tried on indictment. The criminal cartel offence can’t be committed by undertakings.

f) *Disqualification of directors*. The OFT can apply to the court for a Competition Disqualification Order disqualifying an individual from being a director if the company of which the individual is a director has breached Competition law.

g) *Actions for damages*. Where there is a finding of anti-competitive behavior then an affected individual may proceed in the Competition Appeals Tribunal, instead of proceeding in the normal courts. Certain designated consumer bodies will be entitled to apply for rights to bring damages claims on behalf of named individual consumers.

h) *Consumer protections*. The OFT has power to approve consumer codes which have the object of safeguarding or promoting the interests of consumers, if the organization can demonstrate that the code is working properly.

i) *Super complaints*. Certain designated bodies representing consumers, are entitled to make super complaints to the regulators, including the OFT. The consumer body may act if it considers that a market, or a feature of it, is significantly harming the interests of a consumer. The OFT has to respond in a period of 90 days.

D. Switzerland

79. In Switzerland, two types of vertical restraints are by law presumed to eliminate effective competition and may be punished with fines:

a) Agreements on fixed or minimum resale prices,

b) Agreements in distribution contracts on absolute territorial protection.

80. These types of restrictions (Article 5(4) CartA) are considered unlawful, but the presumption of an elimination of competition can be rebutted. They can also be justified by reasons of economic efficiency, even if they significantly affect competition.

81. Firms that are participating in these two types of restrictions may be punished with fines if the presumption of elimination cannot be rebutted and, in the practice of the Competition Commission (COMCO) if the presumption of an elimination of competition can be rebutted, but the vertical restriction significantly affects competition and cannot be justified on grounds of economic efficiency.

82. Other vertical agreements that significantly affect competition in a particular market are seen as unlawful, unless they're justified on grounds of economic efficiency (Article 5(1) CartA). Therefore, there is actually an efficiency test to be undertaken and not a rule of reason analysis. According to Article 5(2) CartA an agreement is deemed to be justified by reasons of economic efficiency if:

a) It is necessary in order to reduce production or distribution costs, improve products or production processes, promote research into or dissemination of technical or professional know-how, or exploit resources more rationally;

b) Such an agreement will not in any way allow the enterprises concerned to eliminate effective competition.

83. According to Article 6(1) CartA, the criteria which have to be satisfied by vertical agreements affecting competition in order to be justified, in general, on grounds of economic efficiency, may be determined by way of ordinances or communications (for example, for agreements on research and development or on specialization).[62]

84. One of the topics in the current discussions regarding a revision of the CartA was a per-se prohibition of certain comportments.[63] It was argued that a per-se prohibition is an important step towards harmonization with EU law. However, companies often dislike this argument as the involved reversal of evidence is a great burden which brings SME's in particular into difficulty due to a lack of resources.

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[62] Global Competition Review, Getting the Deal through – Vertical Agreements, p. 268.

[63] The revision of the CarA in Switzerland failed in October 2014, the per-se rule was not implemented.

V. PROCEDURE

A. Burden of proof

85. *Per-se rule*. Under the per-se rule a plaintiff only has to prove the fact of the existence of the conduct to prevail because the deleterious effects of that conduct were presumed without further inquiry. Since there is no further inquiry, the defendant has no possibility to bring in reasons which justify its behavior or to prove that the conduct in question is in fact pro-competitive.

86. *Rule of reason.* Applying the rule of reason, the court decides after an in depth analysis which considers the totality of all relevant circumstances. This test allows the court to ask whether the challenged practice promotes or suppresses market competition. The defendant may bring in business or economic reasons which can justify the conduct in question. On the other hand the plaintiff has to prove that the defendant's behavior actually suppresses market power.

B. Sanctions

87. While in the U.S. one can be sanctioned by prison for an infringement of Competition law, the European Union and Switzerland can "only" sanction such infringements with financial fines.

88. **USA.** In the U.S. the Department of Justice (DoJ) has exclusive federal governmental authority to enforce the Sherman Act, while it shares the federal authority to enforce the Clayton Act with the Federal Trade Commission (FTC) and other agencies.

a) Nevertheless it is rather unusual for the DoJ to seek criminal penalties in the area of vertical restraints. The Sherman Act confers upon the DoJ the authority to proceed against violations by criminal indictment or by civil complaint. The DoJ may seek to obtain from the courts injunctive relief "to prevent and restrain violations" of the acts in question (Sections 1, 2 and 4 of the Sherman Act, Section 15 of the Clayton Act).

b) Following Section 14A of the Clayton Act, the US acting through the DoJ may also bring suit to recover treble damages suffered by the US as a result of antitrust violations.

c) In the U.S., restraints can be sanctioned by prison. For example, executives at the auction houses Sotheby's and Christie's agreed to limit the inducements they would use to convince sellers to use their services. In this case, the DoJ sought criminal prosecution of the auction houses and the individuals who worked for them. The settlement of the government's criminal claim against Sotheby's included a fine of US $45,000,000 on Sotheby's and a one-year prison sentence on Sotheby's controlling shareholder, Alfred Taubmann.

89. **EU.** On the other hand, the EU has sanctioned several infringements of Competition Law with high fines.

a) The highest fines were imposed in the TV and computer monitor tubes case in 2012 (total fine of 1 470 515 000 Euro), in the Car glass case in 2008 (total fine of 1 189 896 000 Euro), in the Euro interest rate derivatives (EIRD) in 2013 (total fine of 1 042 749 000 Euro) and in the Automotive bearings case in 2014 with a total fine of 953 306 000 Euro.

b) Prison is not foreseen as a sanction for competition law infringements in the EU law. EU competition law exclusively focuses on infringements of competition law by undertakings. The basic amount of the fine will be related to a proportion of the value of sales, depending on the degree of gravity of the infringement, multiplied by the number of years of infringement. The maximum sanction is 10 % of the total turnover worldwide in the preceding business year of the undertaking or association of undertakings participating in the infringement.

c) However, regarding criminal sanctions a number of EU Member States increasingly focus on individual liability for competition law infringements, particularly cartels. For example, in Austria and Germany, individuals can be sanctioned with prison for entering into bid-rigging arrangements[64] and in France, individuals can face fines of up to EUR 75,000 and prison for up to four years[65].[66] And in the UK individuals who are guilty of the criminal cartel offence in the UK can face up to five years in prison, unlimited fines and be disqualified as directors for up to fifteen years[67].

90. Another aspect is the possibility of class action, treble damages and other procedural means in the U.S. legal system. A company which infringes U.S. competition law is very often facing class actions and treble damage claims which can easily reach the amount of the fine that has been imposed by the courts. Even though in some EU member states class actions are possible they never reach the amount and impact of class actions in the U.S.

C. Leniency program

91. A Leniency programs define rules for granting reductions in penalties to firms or individuals involved in cartels, in exchange for discontinuing participation into the practice and for providing an active cooperation in the investigation of the enforcement authorities. First

[64] Stefan Thomas, Germany : The role of criminal and administrative sanctions in German competition law-enforcement, 15 septembre 2006, Bulletin e-Competitions, September 2006, Article N° 13325 ; Christina Hummer, The Austrian Parliament issues new leniency provision covering criminal sanctions, 1er janvier 2011, Bulletin e-Competitions January 2011, Article N° 33579.

[65] Eric David, The French criminal supreme court upholds sentences inflicting prison, fines and damages for bid-rigging ("Le Havre lighting"), 22 October 2003, e-Competitions Bulletin October 2003, Article N° 13709 ; Eric David, A French court overturned criminal sentences on the grounds that the undertakings did not play a decisive role and that the collusion did not produce a significant effect (AP-HP), 2 mai 2002, Bulletin e-Competitions Criminal sanctions, Article N° 37896.

[66] Keith Jones and Farin Harrison, Criminal Sanctions: An overview of EU and national case law, e-Competitions National Competition Laws Bulletin, N° 64713, p. 3.

[67] Marie-Charlotte Rouzier, The UK Office of Fair Trading issues the first imprisonment and director's disqualification orders against individuals prosecuted for criminal cartel (Marine Hoses Cartel), 11 juin 2008, Bulletin e-Competitions Criminal sanctions, Article N° 23567 ; Maria Kamnaki, The UK OFT secures the first ever criminal convictions against individuals for cartel offences : A milestone in antitrust enforcement (Marine Hoses Cartel), 11 juin 2008, Bulletin e-Competitions June 2008, Article N° 20497.

adopted in 1978, these schemes were reformed in 1993 in the US and are now operated in a broad set of countries, including the EU.[68]

92. If a company involved in antitrust violations and fulfills the requirements determined in the pertinent legal act, it may benefit from the leniency program. Both the U.S. and the EU regulations admit the possibility of granting penalty discounts to firms (or individuals) reporting before or even after a formal investigation has been opened. This possibility is given in cases of horizontal restraints as well as in cases of vertical restraints. Generally the possibility of leniency programs is given under both the per-se rule and the rule of reason.

D. Compliance

93. In some jurisdictions, if a company which is involved in (vertical) restraints, can prove that it had seriously attempted to prevent violations of antitrust law by implementing a specific compliance program, it may benefit from a reduction of sanctions.

94. Theoretically, since the existence of leniency programs has only effect on the calculation of the sanctions, it does not depend on whether the restraint falls under a per-se violation or under the rule of reason.

95. However it is not likely that a company can prove serious efforts in implementing a tailored compliance program if the company's contracts are in fact found to be violating antitrust law. Since a compliance program includes an examination of existing contracts, it is supposed to detect clauses that are regarded as problematic under antitrust aspects.

VI. CONCLUSION

96. Although at first sight there appears to be a marked difference between the jurisdictions with per-se rule and the rule of reason, in practice the distinction is not as clear and evident as it might seem.

97. Changing markets must surely require a continuous adaption of the applicable rules. Therefore it is necessary that antitrust law leaves room for a dynamic application of its rules.

98. *Vertical agreements*. Vertical agreements are usual in most businesses. Restraints to a certain extent are of their very nature/are inherent. However there are different types of vertical restraints which have a more or less heavy impact on competition. This is generally recognized by all jurisdictions and is taken into account when a court has to deal with vertical restraints.

99. *Tendencies*. The different systems in the U.S. (case law) and in the EU imply a greater flexibility and more dynamic approach in the U.S.

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68 The European Commission adopted a regulation on LP's in 1996, and reformed it in 2002. In the European Union member states a LP is in use in Belgium, Cyprus, the Czech Republic, Finland, France, Germany, Hungary, Ireland, Latvia, Lithuania, Luxemburg, the Netherlands, Slovakia, Sweden and the United Kingdom. Other relevant experiences include Canada and Korea. On LP regulation in the OECD countries see OECD (2002), Fighting Hard-Core Cartels.

a) **U.S.** Generally the U.S. system is a little more liberal and leaves more space for a “free market”. One of the most important rulings in U.S. competition law might be GTE Sylvania in which the Supreme Court overruled its long lasting practice (Leegin).

b) **EU.** In the EU there is a tendency of harmonization and towards regulatory measures. The focus lies on a free European market which requires a great extent of harmonization and equal national competition law in order to guarantee a certain legal framework. Companies should be enabled to operate in all European countries without facing different national competition laws in each country. Therefore the EU chose a quite restrictive approach to vertical restraints in Article 101 TFEU. Block exemptions are an appropriate way to take into account the procompetitive effects of vertical restrictions. However, in practice, especially SME’s often struggle with the system of Block exemptions.

100. A dynamic and flexible approach in competition law matters is opposed to the need for firms to have legal certainty. To balance these conflicting interests might be one of the greatest challenges regarding the “battle of per-se rules versus the rule of reason”.