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The Types of Vertical Agreements and the Restraints Therein in Terms of Competition Law

In this article we discuss vertical agreements and vertical restraints. In general, vertical restraints are not as harmful as horizontal ones. They can lead to some economic efficiency in production and distribution of goods and services. However, in some cases they may result in restriction of competition on the market. Assessment of legal context of an agreement as well as economic analysis is necessary for the vertical restraints.

Key words: *vertical agreements, vertical restraints, efficiency, restriction.*

1. Introduction

Vertical agreements are agreements between the undertakings which are active on different level of production and distribution chains.[1] Parties to the vertical agreements as a rule are not direct competitors, since they mainly produce complementary products and service and not competing products and service.[2]

Vertical agreements can be concluded on intermediate as well as on final product and service. For example, producer sells product to other undertaking and the latter uses the product as an input for manufacturing different product; in another case, producer sells to wholesaler or retailer final products for reselling to final consumer. It should be noted that the producer can be active on both, production as well as distribution level.

In general, vertical restraints are more competitive benign than horizontal restraints, because they can substantially increase efficiencies. According to the Commission view, certain types of vertical agreements can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings. Namely, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels.[3]

Producer has a few options for selling products:

First, set up its own distribution chain and through it sell goods;

Second, acquire the firm already active in distribution business and through it sell goods;

Third, entrust other companies to sell its products.

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1 *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 629.

2 *Bishop S.,Walker M.*, The Economics of EC Competition Law: Concepts, Application and Measurement, 3rd ed., Sweet & Maxwell, 2010, 188.

3 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 §6, <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32010R0330>, [21.03.2015].

In the first two cases, the producer makes vertical integration and whole chain of production and distribution is carried out only by one company. In the third case, one company produces goods and the other distributes these goods to final consumers. The latter company is an independent undertaking. It can be wholesaler and/or retailer. Therefore, distribution of goods to the final consumers can be carried out by a distributor, dealer and commercial agent.

2. Commercial Agent

Commercial agent might be a legal or natural person. In general, its functions are limited, because it may negotiate agreements and conclude them on behalf of the principal. An agent gets commission based on its sales or fixed amount of salary.[4]

Commercial agent can be subsidiary body, which is integrated part of the principal. It also can be an independent economic operator, which undertakes minor financial and/or commercial risks connected to the sales or fulfillment of the agreement concluded with the third party.[5]

If the agent does not undertake financial and/or commercial risks, or it undertakes insignificant part of the risks, than the agreement concluded between the agent and principal can be qualified as a genuine agency agreement according to Article 101 and the article is applicable to these types of agreements. There are different types of financial and commercial risks. They can be divided into following categories:

First, the risks resulting from the agreements that have been concluded by the agent on behalf of the principal or from the agreement that was negotiated by the agent, such as for example, purchasing of stocks;

Second, the risks stemming from the specific market investments. For example, the agent can be required to make certain investments. Such investments can be in a form of sunk costs, because if the agent stops certain activity, undertaken investment cannot be used for a different activity and sold within important losses.

Third, risks related to different activities on the same market, but the principal requires from the agent to be undertaken. It should be noted that such an activities are not carried out on behalf of the principal, the agent carries them out on its behalf and on its own risk.[6]

In general, in order for Article 101 to be applicable to agency agreement, following circumstances should be taken into account:

- the agent should not acquire ownership of the selling products;
- the agent does not undertakes the expenses of delivery of the goods to the buyer;
- the agent does not stock selling goods on its own expanses and risk;
- the agent does not have liability towards third parties on the loss resulting from sold goods;
- the agent is not responsible for non-performance of the agreement;

4 *Whish R., Bailey D.*, Competition Law, 7th ed., Oxford University Press, 2012, 621.
5 *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 631.
6 Commission Notes, Guidelines on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines vertical_en.pdf>, §14, [21.03.2015].

- the agent is not obliged indirectly or directly to carry out investments in stimulating sales;
- the agent does not carry out market specific investments in equipments, premises or training of the staff;
- the agent does not carry out other activities, which are required by the principal on the relevant market, except the case, if the expanses is reimbursed by the principal.[7]

The list is not exhausted. If the agent incurs one or more risks and/or costs, the agreement between agent and principle will not be qualified as an agency agreement. In the opinion of the EU Commission, each case should be assessed according to circumstances presented in it and account should be taken the economic reality of the situation rather than the legal context of the agreement.[8]

The Commission ascertains that exclusive agency agreement in general does not have anti-competitive effect. However, if single branding agreement and post-term non-compete clause are integrated in exclusive agreement, it may breach Article 101 if it will have foreclosure effect.[9]

The agency agreement can be subject to Article 101 regulation, if it stimulates tacit collusion, even if the principal bears appropriate financial and commercial risks. For example, if several principals use the same agents while collectively excluding others from using these agents or if they use the agents to collude tacitly on market strategy or to share sensitive market information among principals.[10]

3. Main Types of Vertical Agreements

In practice, there are following vertical agreements:

a. single branding agreement, in which case distributor is obliged to obtain certain or whole amount of products from only one producer, which may cause certain efficiency in distribution. However, according to the Commission's opinion, these agreements or network of the similar agreements may unite outlets and foreclose market for rivals.

Foreclosure has a greater effect, the more are market shares of the participating undertakings and the more is duration of non-compete clause.

The Commission thinks that single branding agreements in general have anticompetitive nature, though after studying the details of the case they might be exempted on the basis of Article 101.3.[11]

b. exclusive distribution agreement gives immunity to distributors on a certain territory. They are not allowed to carry out active as well as passive sales in other distributors' territories. The Commission has a skeptical view on exclusive distribution agreement, especially in case if it also includes absolute territorial protection.

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[7] Commission Notes, Guidelines on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines vertical_en.pdf>, §16.
[8] Ibid, §17.
[9] Ibid, §19.
[10] Ibid, §20.
[11] *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 665.

In the Court's view, exclusive distribution agreement does not restrict competition if the producer enters on a new market and, thereby, substantial investments are necessary to incur.[12]

In general, the Commission ascertains that exclusive distribution agreements limit sales on the different exclusive territories, decrease intra-brand competition and results in market partitioning, which may lead to price discrimination. If all distributors or most of them use exclusive agreements, then competition is decreased and tacit collusion can be easily reached on both, distribution and production levels. It can also lead to foreclosure of the market. The larger the producer's market share, the bigger is limitation of intra-brand competition.[13]

In the Commission's view, in general, foreclosure problem does not arise if the exclusive distribution agreement is not combined with single branding provision.[14]

c. selective distribution system. If the supplier wants to create the image of its products and/or to ensure that the sales are accompanied by specific service terms, it can choose this system. In this case, the supplier selects retailers on the basis of quantity or quality (level of service, level of storage, etc.) and/or location.

In order to be in conformity with competition rules, selective distribution should meet following criteria:

- characteristics and/or features of the product/service should necessitate selective distribution system;
- distributors should be selected on basis of objective qualitative criteria (for instance, size of building, appropriate qualification of the staff), provided they are publicly announced and not used in an discriminative manner against some of the distributors;
- the criteria should not require more than it is necessary for the service/goods.[15]

In the Commission's view, if there is the network of such agreements on the market, than there is high possibility that the competition on the market could be limited.

D. Agreement on Allocation of Space within the Trade Area. The supplier, in view of entry to the trade area, shall in advance pay the distributor for allocation of the space within the trade area of the latter. The fee, as a rule, is fixed and single. In certain events, based on the hereby Agreement, the anti-competitive foreclosure of the market for other distributors may take place, requiring involvement of the competition agencies.[16]

E. Agreement on Management of Products of Certain Category. Based on the Agreement, the distributor shall entitle the supplier on marketing of the products of a certain category, including of the similar category provided by other suppliers. On the hereby basis, the supplier is empowered to influence the disposition of the products and the marketing of products in general in a particular store. In certain cases, similar agreements may entail anti-competitive foreclosure of the market for

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[12] The Guidelines on Vertical Restraints, §61.
[13] *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 666.
[14] The Guidelines on Vertical Restraints, §155.
[15] The General Court's Judgment: T-19/91, §5, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61991TJ0019>, [27.05.2015].
[16] Guideline of the EU Commission on Vertical Agreements, §203-205.

competing suppliers and result in restriction of competition. Particularly, the result can be achieved when the supplier is entitled to influence the marketing decisions of the distributor, restrict the distribution of the products by the competing supplier or put them under unfavorable disadvantage.[17]

F. According to the Franchise Agreement, the franchiser shall delegate the intellectual property rights under the license to the franchisee. The Franchise Agreement covers usages of sundry trade-marks and know-how or usage and distribution of goods or services. As a rule, the franchiser renders commercial and technical services to the franchisee within validity of the Agreement. The franchising system allows the franchisee making his/her independent business by means of the brand name and know-how of the franchiser.

According to the Franchise Agreement, the franchisee shall pay the franchiser for usage of the intellectual property rights of the latter. Proper functioning of the franchising system requires each franchisee to meet the uniform commercial standards established by the franchiser as in terms of consumers, all trade units of the franchise shall meet the same standard. Correspondingly, the franchiser shall be authorized to require the franchisee to meet the uniform standards. Besides, the franchiser shall ensure protection of own intellectual property rights by means of the Agreement. Hence, the EU Competition authorities have declared that establishment of restraints of the categories, envisaged in view of establishment of uniform standards and protection of intellectual property rights does not breach the Article 101. However, in opinion of the Commission, if the Franchise Agreements contain the restraints envisaging division of the markets or maintenance of the resale prices, they shall be subject to application of the Article 101. The hereof restraints, in exceptional cases, may meet the criteria provided by the Article 101.3.[18] At that, it is as well noteworthy that provision of the guideline principles on the price does not imply restraint of competition.

The Franchise Agreements often contain various restraints – the provisions on selected distribution, non-compete and exclusive distribution – which shall not be considered as violation of Article 101.

According to the EU Competition Authorities, the restraints limiting the franchisee to open the store of similar nature within validity of the Agreement or within the reasonable term upon expiry thereof without the consent of the franchiser shall not restrict competition if they appear necessary to protect know-how under the Agreement.

Besides, the franchiser is entitled to lodge the demands as follows to the franchisee to:

1. Use the methods and know-how of the franchiser;
2. According to the directives by the franchiser, open and arrange sale areas;
3. Obtain consent of the franchiser prior to delegation of the franchising;
4. Sell the products solely supplied by the franchiser;
5. Obtain consent of the franchiser on all commercials.[19]

[17] Guideline of the EU Commission on Vertical Agreements, §209-210.
[18] *Whish R., Bailey D.*, Competition Law, 7th ed., Oxford University Press, 2012, 646.
[19] *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 675.

4. Regulation 330/2010[20]

In 2010, the European Commission developed the Regulation #330/2010 on n the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. Same year, the Commission has also developed the guideline on application of the hereof Regulation.[21]

According to the Regulation, the vertical agreement means the agreement or the concerted practice between two or more economic agents, who deriving from the objective of the agreement or the concerted practice, hold activity on the different stages of manufacture and distribution. The vertical agreements contain the terms allowing the parties purchasing, selling or reselling the certain goods or services. Deriving from the context of Article 101, the Agreement signed with the final consumer shall not be considered as the vertical agreement as the Article shall be applies to the agreement or concerted practice between two or more economic agents and the decisions of the associations of the economic agents.[22]

The Regulation developed by the Commission declares the vertical agreements between the economic agents as legal on the basis of Article 101.3 if the Agreements meet the requirements provided by the Regulation.

The Regulation shall not be applied to the vertical agreements signed between the competing economic agents. However, exemption shall be applied to the bilateral vertical agreements between the competing economic agents.

As the Commission presumes, mainly vertical restraints in terms of competition entail problems only upon insufficient competition on one or morestages of the trade, that is, in case of certain market power on the levels of supplier or a seller, or both.[23] The primary goal of the Competition Law is to create and maintain the competitive conditions between the economic agents. According to the Commission, the competition is necessary between the brands (inter brand). If the brands encounter effective competition, reduction of competition within the brand (intra brand)(that is, sales between the distributors of the same brand) will not entail negative impact on the consumer.[24] At that, the Commission underlines that in this case, it does not imply the market power of the economic agents required under the Article 102, i.e. the market power in the vertical agreements may be less than required in case of a dominant economic agent on the basis of Article 102.[25]

Vertical restraints envisage restriction of certain rights of one or both parties of the agreement. Mainly, the vertical agreements provide the restraints of the following nature:

1. Restriction of prices and other trade conditions in which the agent/distributor is entitled to sell goods or services;

[20] The Regulation №330/2010 on Application of the Part Three of the Article 101 of the Treaty on the Functioning of the European Union to the Vertical Agreements and Agreed Practice, <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32010R0330>, [21.03.2015].

[21] See Guidelines of the EU Commission on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf>, [21.03.2015].

[22] Ibid, §25.

[23] Ibid, §6.

[24] Ibid, §102.

[25] Ibid, §97.

2. Restriction of the territory beyond which the agent/distributor is prohibited from sale of goods or services;
3. Restriction of the customers, to whom the agent/distributor is entitled to sell goods or services.

The vertical agreements enjoy the exemptions prescribed under the Regulation solely in the event if the market shares of the parties of the agreements do not exceed the amount stipulated under the Regulation. In line with the Article 3 of the Regulation, the vertical agreements shall be exempted from restraints in the event if the market shares of the supplier and the buyer in the respective markets do not separately exceed 30%. However, the vertical agreements shall not be exempted in the event if containing any of the hardcore restraints provided under the Article 4 of the Regulation. It is noteworthy that the Resolution of the Government of September 1, 2014 N526, envisaging exceptions from the restraints of the agreements restricting competition, also contains the 30%-upper limit for exemption of the vertical agreements from the restraints stipulated under Article 7 of the Law[26].

According to the Commission, in case of existence of the parallel networks to the similar restraints on the market, exceeding 50% of the relevant market, the risk of significant reduction of competition is evident. The Regulation #330/2010 shall not be applied to the hereof vertical agreements.[27]

Article 4 of the Regulation describes following types of hardcore restrictions:

The first restraint concerns the selling price of goods and services.Namely the supplier is not entitled to set the minimal selling price for goods and services to the distributor or fix the resale price. However, the supplier is entitled to establish the maximal price or give price guidelinesprovided that it shall not be equal to the fixed or the minimal price by means of pressure or various impetuses.

The second restraint concerns the territory purposed to serve the area for sale of goods or services or the customers to whom the distributor/dealer is to sell the goods or services. The hereof restraint may neglect one of the most important objectives of EU – single market inasmuch as the supplier may allocate the single European market amongst various distributors. The latters shall be entitled to independently decide the sale area and the buyers of their goods and services.The hereof restraint envisages few exceptions, namely, the supplier is empowered to:

– Restrict active sales for the distributor on the exclusive territory or to the exclusive customer reserved for the supplier or allocated by the supplier to a different distributor/dealer;
– Restrict sale of the goods by the buyers to the end users operating onwhole level;
– Restrict sales by the members of the selective distribution system on the allocated area to unauthorized distributors;
– Restrict sale of the components by the distributor/dealer provided for production of another type of goods to the customers inclined to use them for manufacture of the competitive products.

[26] See the Resolution of the Government №526 on “Exception from Prohibitions of the Agreement on Restriction of Competition”, 8, <http://competition.ge/ge/page2.php?p=4&m=199>, [31.05.2015].

[27] See the Regulation №330/2010 “On Application of the Part Three of the Article 101 of the Treaty on the Functioning of the European Union to the Vertical Agreements and Agreed Practice, 6, <http://eur-lex.europa.eu/legal-, content/EN/ALL/?uri=CELEX:32010R0330>, [21.03.2015].

In line with the third restraint, the suppliers shall not restrict the members of the selective distribution system at the same time being the retail traders from active or passive sale of goods or services to the end users. However, they shall be prohibited from sale of goods or services to unauthorized distributors.

The fourth restraintcalls on the suppliers not to restrict the distributors on various levels of trade from inter-trade.

The fifth restraint covers supply of the spare parts. The manufacturer and the buyer of the spare parts, using the hereof parts for manufacture of own products, shall not be restricted or prohibited from sale of the spare parts to the end users, independent repairers or service providers.[28]

Other than the hereof hardcore restraints, the Regulation provides the list of so-called grey restraints (excluded restrictions), inclusion of which into the vertical agreements will not automatically entail non-application of exemption stipulated under the Regulation. The hereof restraints shall be detailed examined and if they are detected to excessively restrict competition, then the agreements will be prohibited. The part one of the Article 5 of the Regulation provides the following excluded restraints:

1. Non-competearticle, which shall not last for indefinite period or the term of which shall not exceed five years. At that, as the Commission considers, the obligation of non-competition, subject to be automatically extended for more than five years, is envisaged to last for indefinite period.
2. The condition directly or indirectly binding the buyer not to produce, buy, sell or resell the certain goods or services upon termination of the agreement;
3. The condition directly or indirectly binding the member of the selective distribution system not to sell the brands of any of the competing supplier.

The time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer.[29]

Exemption stipulated under the Regulation towards the obligations envisaged in the second paragraph shall apply in the event of consideration of the terms as follows:

- The obligation is related to the goods and services competing with the contractual goods and services;
- The obligation is limited within the premises purposed for the activity of the buyer within validity of the agreement;
- The obligation is necessary for protection of know-how delegated by the supplier to the buyer;
- The period of the hereof obligations is restricted with the period of one year upon expiration of the agreement.[30]

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[28] Ibid, 4.

[29] Ibid, 5.2.

[30] Ibid, 5.3.

5. The Guideline of the Commission on Vertical Restraints[31]

As the Commission declares, Article 101 aims to ensure that economic agents do not conclude agreements, including the vertical agreements, restricting competition on the market in prejudice of the consumer. Estimation of vertical restraints is as well important in the context of achievement of the integrated market. As the Commission supposes, market integration enhances competition within EU and gives benefits to the consumers. Correspondingly, the companies shall not be able to create private barriers amongst the Member States when the state barriers are successfully eliminated.[32]

Other than group exemption envisaged under this Regulation, the vertical agreements enjoy so-called de minimis rule. According to the hereof rule, the paragraph one of the Article 101 shall not apply to the vertical agreements which are concluded between non-competing economic agents and the individual market share thereof exceed 15% taking the fact into account that the agreement does not envisage any of the hardcore restraints. It is noteworthy that if the individual market share of the parties of the vertical agreement exceeds 15%, it does not automatically breach the paragraph one of the Article 101. The hereof agreements still may not have significant effect on trade between the member states or may not significantly restrict competition. Hence, the Commission presumes that it is necessary to conduct analysis of the vertical agreements in legal and economic context.[33]

In view to ensure agreement between the economic agents deriving from the context of the Article 101, the parties shall express joint intention to act on the market in certain directions. The form of expression of an intention does not matter as it is a reliable expression of intentions of the parties. And in the event when no clear agreement exists on meeting of wills, as the European Court of Justice declares, the Commission shall prove that unilateral policy of one party has obtained tacit acquiescence of another party. In the event of vertical agreements, there are two ways to express tacit acquiescence towards unilateral policy. The first may derive from the rightsgranted under the preliminarily concluded general agreement. For instance, the provisions of the preliminarily concluded general agreement authorize the party to subsequently adopt the certain unilateral policy binding for another party. Correspondingly, tacit acquiescence to the hereof policy may derive on the basis of the hereof provisions. The second way is that in the event of absence of the hereof clear consent, the Commission is entitled to endorse the fact of tacit consent. First of all, the Commission shall demonstrate that one party needs anexpressed or tacit cooperation from another party for implementation of the unilateral policy thereof. Besides, the Commission shall prove that another party has been implementing the hereof requirements by means of establishment of unilateral policy in practice. For instance, if after declaration of unilateral reduction of supply by the supplier aimed at evasion of parallel trade, the distributors have immediately reduced orders and ceased to participate in the parallel trade. In this event, it implies that the distributor expressed tacit consent to the unilateral policy of a supplier. However, if the distributor continues parallel trade or finds new solutions for the parallel trade, it means that the distributor rejects the unilateral policy of a supplier. Often, the

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31 See EU Commission Guideline on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf>, [21.03.2015].

32 Ibid, §7.

33 Ibid, §9.

supplier uses the monitoring and fining system to enforce the implementation of own unilateral policy. In this event, according to the level of coercion, the fact of tacit consent can be established.[34]

As the Commission declares, when considering the vertical agreements to define possible significant restriction of competition deriving from the context of the Article 101 as a result thereof, we need to analyze following factors:

– The nature of the agreement;
– The market shares of the parties of the vertical agreements;
– The market shares of the competitors;
– The market power of the buyers of the goods stipulated under the agreement;
– Entry barriers;
– Maturity of the market;
– Trade level;
– Nature of the product;
– Other factors.

6. Basic Restraints Provided in the Vertical Agreements

a. Restriction on determination of the resale price

As we have already mentioned above, Article 4 of the Regulation prohibits determination of the resale price by the supplier and allows the distributor independently defining the resale price. Namely, the hereof Article prohibits conclusion of the vertical agreement envisaging direct or indirect fixation of the price or setting the minimal sale price. The resale price may be maintained by indirect means. For instance: if the supplier determines the distribution margin or the maximal amountof discount.[35]

It is noteworthy that according to the Commission, determination of a maximal price by the supplier or indication to the recommendation prices is not to be considered as breach of the Article 101 as a rule.

As the Competition Agency states, maintenance of the resale price may entail negative outcomes as follows:

The first – by enhancing transparency of the price, the suppliers may conclude the secret agreement on the market;

The second – eliminateintra-brand competition and facilitation to the secret agreement between the distributors/dealers;

The third – reduction of competition between the supplier and/or retail traders, especially when the suppliers use the same distributors for their products and maintenance of the resale price concerns them all or majority of them;

The fourth – impediments to all or certain distributors in reduction of the resale price, that is, it entails indirect increase of the price;

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[34] Ibid, §25.

[35] See the EU Commission Guidelines on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf>, §48, [21.03.2015].

The fifth – the resale price may be maintained by the supplier equipped with the market power in order to prevent the competitors to enter the market. The suppliers with the market power may offer the increased margin to the distributors for possible win of the distributors over to serve to any of the certain brands.

The sixth – possible reduction of dynamics and innovation on the distribution level. Restricting the price between various distributors, maintenance of the resale price may hinder more effective retail traders to enter the market and/or obtain sufficient amount of goods at lower price. Besides, it may impede or hinder creation or enlargement of the format of distribution, based on lower prices.[36]

b. Restraints on the Territory and the Customers

The second prohibition of the Article 4 of the Regulation envisages restriction of the right of the seller to himself/herself define the territory for sale and/or the buyer of the goods and services. The hereof restraint contradicts as with the prohibitions of the Article 101 of the Competition Law so with one of the most important objectives of EU – creation of single market stipulated under Article 26 of the Treaty on the Functioning of the European Union.[37]

The EU Commission is particularly skeptical to the exclusive distribution agreements granting absolute territorial protection to the distributors. For instance, the supplier peculiarly obliges the distributors not to sell the goods to the certain customers or not to sell beyond the defined territory and thus, to submit the orders to the respective distributors.

Absolute territorial protection implies prohibition of export of goods by the distributors. The EU Case Law provides various examples of absolute territorial protection, including various models of the following territorial restrictions, namely:

– Export is permitted if the consent is obtained from the supplier or the supplier has been notified;
– When the goods are supplied to the distributor and the invoice provides "export prohibited";
– Insufficient goods are supplied to the distributor to prevent export of goods;
– Bonuses shall not be counted from the exported goods;
– The supplier has returned the exported goods;
– Supplied goods have the mark allowing identification of parallel import;
– The warranty is restricted with the territory of the member state where the goods have been acquired;
– Double price has been used for export prohibition;
– The distributor is required to deliver to the supplier the documents of the customer from other territory;
– The supplier menaces to terminate the agreement or actually terminates the agreement with the dealer or the distributor selling the goods beyond the allocated territory;
– The foreign customers are required to pay the deposit to the supplier unlike the local customers.[38]

[36] Ibid, §224.
[37] See *Mota M.*, et al, Hardcore Restrictions Under the Block Exemption Regulation on Vertical Agreements: An Economic View, <http://ec.europa.eu/dgs/competition/economist/hardcore_restrictions_under_BER.pdf>, 5, [05.04.2015].
[38] *Jones A., Sufrin B.*, EU Competition Law Text, Cases, and Materials, 4th ed., Oxford University Press, 2011, 655-656.

It is noteworthy that the hereof prohibition contains sundry exclusions, including prohibition of active sales on the exclusive territory or to the exclusive customers. As the Commission considers, the distributors and the dealers may be prohibited from active sales on other territory or to other customers, however they shall not be prohibited from passive sales as a rule.

Active sales imply active approach to the customers, for instance sending of the direct letters, including undesirable, without the demand by the customer e-mails; active approach to the custommers of a certain group or to the customers on the defined territory via internet or by other means.[39]

Passive sales imply sales implemented in response to the demands by the individual customers, including provision of the hereof customers with goods and services. General commercials aired on TV or uploaded at the internet, reaching other distributors exclusive territories or the group of customers shall be considered as passive sales.[40]

Nowadays, internet allows the traders to establish relations with various and more customers. Generally, having the web-site is considered to be the passive sales form. It is a reasonable mechanism as the customers are capable to establish relations with the distributors via the internet. If the customer visits the web-site of the distributor, contacts the distributor and orders the goods, including delivery, it is also considered as passive sales.[41]

The Commission is skeptical to the restrictions established for the distributors, envisaging prohibitions of passive sales. The following types of restrictions of passive sales can be found in practice:

The first – the distributor is prohibited from allowing the customers from the exclusive territory of another distributor visiting his/her web-site, or the web-site will automatically redirect the hereof customers to the web-site of the respective distributors;

The second – the exclusive distributor shall be imposed with the obligation to terminate internet transactions with the customers after detection of discrepancy of the credit card address with the exclusive territory of the distributor;

The third – the parties of the vertical agreement agree that internet sales shall not exceed the certain amount of total sales;

The fourth – the distributor shall be assigned to set higher price to the internet transactions.[42]

7. Negative Outcomes of Vertical Restraints

According to the Commission, the hereof restrictions provided in the vertical agreements may entail the negative outcomes as follows:

The first – increase market entry barriers for other suppliers or buyers and subsequently foreclose for them market;

The second – reduce competition between the supplier and the competitors thereof and/or allow them concluding the secret agreements as a result of reduction of inter-brand competition between the brands;

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[39] See EU Commission Guidelines on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf>, §51, [21.03.2015].

[40] Ibid.

[41] Ibid, §52.

[42] Ibid.

The third – reduce competition between the distributors/dealers and their competitors and/or allow the distributors/dealers of same brand conclude the secret agreement;

The fourth – threat to one of the most important objectives of EU – integration of European market.

8. Objective Necessity of Hardcore Restraints

The hardcore restraints shall not be particularly prohibited under the Article 101 if they are objectively necessary for implementation of the agreements of certain nature, namely:

The first -it is objectively necessary to ensure that a public ban on selling dangerous substances to certain customers for reasons of safety or health is respected.[43]

The second – the distributor represents new type of goods to the market or introduces existing brand to the new market and he/she has committed substantial investment for entry and development of the market. In this event, naturally the distributor shall not conclude the agreement with the supplier failing to protect his/her interests. According to the Commission, in such cases, other distributors may be prohibited from active and passive sales on the respective territory to the existing customers or to the group of the customers allocated for the distributor during the first two years;[44]

The third – In the case of genuine testing of a new product in a limited territory or with a limited customer group and gradual introduction thereof to the market, the distributors may be prohibited from active sales beyond the hereof territory or the group of customers on the first stage;[45]

The fourth – if the supplier has been incurredsubstantially higher costs ononline transactions, he/she may set higher prices for the hereof agreements.[46]

9. Efficiencies Stemming from Vertical Restraints

According to *Steven Mahinka,* the vertical restraints may be necessary in view of achievement of the objectives of legal commercial activity.[47] According to the EU Commission, the restraints provided in the vertical agreements may facilitate to solution of the problems as follows:

The first – establishing the vertical restraints, the supplier may eliminate the problem of so-called "free riding" amongst the distributors. For instance, one distributor may have the pre-sale service envisaging usage of the vehicle for sale by the potential buyer in view of testing. The buyer may enjoy the hereof service from one distributor to test the vehicle but subsequently buy the same model and brand vehicle from another distributor at lower price due to absence of the pre-sale service. In this event, the second distributor is considered to be a "free rider" as he/she enjoys free of charge the pre-sale service offered by the first distributor. For solution of the hereof problem, the supplier may bind all the distributors under the agreement to render effective service to the potential buyers prior to conclusion of the agreement.

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[43] See EU Commission Guidelines on Vertical Restraints, <http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf>, §60.

[44] Ibid, §61.

[45] Ibid, §62.

[46] Ibid, §64.

[47] *Mahinka S.*, Vertical Restraints as Exclusionary Practices: Current Issues in Regulated and Deregulated Industries, Antitrust Law Journal, Issue 58, 1989-1990, 58.

The second – in view of introduction of goods or services by the distributor to the new territory, he/she may need to invest on the hereof territory, refund of which might be related to certain risks. Deriving from the hereof circumstances, the distributor needs territorial protection for a certain period of time to manage temporarily set higher price to levy from the investments.

The third – in some sectors, the retail traders sell only "high-quality" products. Sale of goods via the hereof traders may be beneficial when introducing new products to the market. In the event, if initially the supplier fails to restrict sales of own goods via the brand shops, introduction of newly manufactured product may be put under risk. In this event, establishment of the restraints for a short period may be justified, such are exclusive or selective distribution. The limited period shall allow introduction of new product to the market but not so long as to hinder large-scale dissemination.

The fourth – sometimes, the suppliers or distributors/dealers may be required to ensure customer-oriented investment. For instance, the manufacturer of the components may be required to create new device to meet particular requirements of his/her customers. In this event, the manufacturer shall not invest unless particular supply conditions are stipulated under the agreement.

The fifth – the vertical restraints may facilitate to the scale economy in distribution. If the supplier wants to enjoy scale economy and sale own production on a lower the retail price, he/she may entrust sales to a limited number of the distributors. In this view, he/she may use exclusive distribution and require from the retail traders to buy the particular amount of goods or use selective distribution with the similar requirements.

The sixth – the vertical restraints may develop uniformity and standardization of quality. Namely, the vertical agreements may create the brand image in the event if the particular measures of uniformity and quality standardization will be established for the distributors, which will increase the level of trust of the end consemers to the brand and increase sales. It can be achieved by means of selective distribution and franchising.[48]

10. Conclusion

Deriving from the above-mentioned, the restraints provided in the vertical agreements contain certain risks in terms of competition. Despite that the agreements of the hereof type compared to the horizontal restraints bear less harmful effects for the competition, they still need particular attention of the Competition Agencies. Competition Law mainly attaches attention to the vertical agreements if the competition between the brands (inter-brand competition) – or between the suppliers is restricted on the market. The EU Commission is particularly skeptical for the vertical agreements concerning fixation of the resale prices or allocation of markets/customers. At that, it is noteworthy that in case of certain objective reasons, the vertical restraints may be exempted from the prohibitions. According to the European Competition authorities, the vertical agreements shall be subject to the thorough economic and legal analysis to define whether they restrict competition on the market. Studying the vertical agreements, we shall take various factors into account, including the circumstances such are the market shares of the parties of the vertical agreements, the market shares of the competitors thereof, existence of barriers to entry, maturity of the market etc.

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[48] Ibid, §107.