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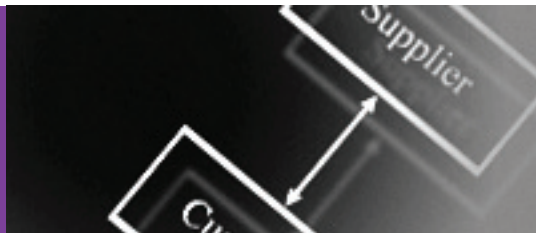
Conference on Vertical Restraints

(Brand Owners/Retailers/Internet)



Key Event Information

Date
Thursday
20 November 2008

Registration
12:00 p.m.

Lunch
12:30 p.m.

Programme
12:30 p.m. - 5:00 p.m.

Cocktails
5:00 p.m.

Location
Hilton Hotel
Boulevard de
Waterloo 38
1000 Brussels

Programme

Thursday 20 November 2008

Registration: 12:00 p.m.

Lunch: 12:30 p.m.

Keynote Speaker
Andrei Gurin, *European Commission, DG Competition*

Panel I: 2.00 p.m. to 3.15 p.m. (Brand Owners and the Internet)
Andres Font-Galarza, *Partner, Mayer Brown* - Moderator
Benoît Durand, *Partner, RBB Economics*
Richard Nash, *Senior Manager EU Public Affairs, eBay*
René Plank, *Special Counsel, bpv Hügel Rechtsanwälte*
Lou Schapiro, *Deputy General Counsel, The Estée Lauder Companies Inc.*
David Stalibrass, *Senior Economist, OFT, UK*
Gregg Svingen, *Advisor, The Centre*

Break: 3.15 p.m. to 3.45 p.m.

Panel II: 3.45 p.m. to 5:00 p.m. (Brand Owners and Retailers)
Kiran Desai, *Partner, Mayer Brown* - Moderator
Juan Briones, *Partner, e-Konomica*
Dr. Salome Cisnal de Ugarte, *Director European & Regulatory Affairs, Whirlpool Europe*
Juan Espinosa, *Deputy Director, Comisión Nacional de la Competencia, Spain*
Catriona Hatton, *Partner, Hogan & Hartson*
Paul Lugard, *Antitrust Counsel, Philips International B.V.*
Anita Lukaschek, *Federal Competition Authority, Austria*

Cocktails: 5:00 p.m. onwards

For break-out business room please ask at registration desk

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Panel 1 – Brand Owners and the Internet

The panelists comprised various experts in the field of antitrust policy ranging from economists to lawyers and company representatives. As during the conference Chatham House rules applied, the following text will not refer to specific companies' or persons' views.

After a short introduction by the moderator the panelists were asked in two rounds to individually present their point of view with regard to the revision of the EC Vertical Agreements Block Exemption Regulation (VBER)[1]

From the perspective of the online retailers, the first contribution laid out how online retailing had given individuals the opportunity to set up small businesses with little financial means, which is an ongoing and increasing trend. The advantages the internet gives to the consumer were outlined, ranging from lower prices to more information and real cross-border trading. Especially, the panelist continued, new products coming into the market find suitable online distribution channels. However, he noted that the development of this system could be hampered by a restrictive interpretation of the current set of legal rules such as those included in the VBER, although this must not be interpreted as a position against selective distribution.

A representative of the brands manufacturers outlined how important brands are and what actually constitutes the "brands' DNA". The panelist stressed that it is vital for luxury brands manufacturers to preserve the value of their brands which

1 Commission Regulation (EC) N0 2790 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L336 of 29.12.1999, p.21-25.

in consequence means that they need to have a say on how their products are being distributed. On this point, it was underlined that certain products, such as cosmetics or para-medical products, require by their very nature selective distribution systems. The panelist added that selective distribution systems empower consumers, increasing consumers' choice. Nevertheless, most brands owners do not oppose internet retailing (**and some would include the appropriate "pure players"**) as long as certain conditions/quality standards are met in a comparable way that they need to be met in physical points of sale. In this regard, it was mentioned that many luxury products were already being sold online and that internet sales increased materially over the last years. As long as the internet players can preserve and protect the brand equity, the internet can be a "brand-enhancing" asset. The panelist considered that the internet is still evolving and that at present, brand manufacturers' and authorized selective distributors' websites are best positioned to provide online shoppers the service and personal touch those shoppers expect when purchasing at physical points of sale within a selective distribution network.

To preserve the already working distribution systems and thereby to guarantee innovation, especially in the cosmetics sector, the current rules need to be maintained and clarified. The brands industries' panelist concluded, warning of the risks of an un-regulated "wild-west" on the internet.

A EU Member State competition authority official expressed the view that there are advantages for consumers arising out of the internet. He noted that, according to studies undertaken by his authority, the convenience of online shopping was the greatest advantage, followed by the wider range of choice, lower prices and greater availability of product information. At the same time, he noted that there were still impediments to increased use of the internet by consumers. For instance, consumers are concerned about the security of online transactions, privacy issues, delivery of the purchased goods and the quality of the purchasing process. In his opinion this all came down to the question of trust of the consumer in the online market. In the UK alone for example the lack of trust in online shopping may have resulted in consumers not using the internet and thus losing out on a potential £200 million per year of benefit. In addition to these benefits, the panelist acknowledged the disruptive forces of the internet, including a democratization and selective anonymization of the purchasing process, and changes to the cost bases of firms. He accepted that these may have a particular impact on luxury products. However, when deciding whether to intervene his favored policy objective was to maximize the competition in business models rather than products, since it is from business model innovation that the greatest productivity benefits are likely to arise. He noted that costs also had to be taken into account, both in terms of errors and the public and private costs of enforcement. In the issue at hand he suggested a wait-and-see approach, though stressed it was his personal opinion and did not necessarily reflect that of his authority.

A private practice lawyer outlined the current rules and legal specifics of a potential revision of the VBER. While the current rules seemed to be working well, certain clarifications and adaptations would be needed especially with regards to the online markets. Most notably the current rules consider internet sales to be passive sales, something which due to technological developments and new business strategies has become more and more questionable (examples of the use of unsolicited emails, websites specially targeted for exclusive territories were used). Nevertheless, the lawyer still saw the internal market goal as valid and a central element of the future rules. With regard to a possible adaptation of the respective Commission guidelines on vertical restraints, the lawyer highlighted that these changes risked not being efficient since national courts tended to neglect guidelines and turn to the legal rules only. In consequence changes should – if needed – also be made to the regulation itself. A senior economist was asked which stance he would take up on a potential revision of the current VBER. In his response he stated how difficult the economic assessment of competition rules and in particular of the vertical restraints was. The current guidelines, he continued, are vague regarding why actually limiting online sales is anti-competitive. Limiting online sales can increase prices and reduce choice but also higher prices are consistent with increased consumer welfare in terms of valuable services for instance - though he acknowledged there was a question whether all consumers needed those additional services. In his view it is still not clear whether selective distribution systems tend to be beneficial for the consumer or work to the consumers' detriment. In this respect there are studies supporting both views, which is why economists struggle to give a final judgment. The new guidelines should clarify which effect online retailing could have and whether online retailing would reduce the rent the producers and established distributors share. For him, on the one hand, it may be considered a *priori* that restricting online sales may be anticompetitive but the legislator should clarify why. On the other hand, the primary goal for brand owners is to show that restricting online sales is not detrimental for the consumer mainly in terms of price and that it might be even advantageous. Acknowledging that there are arguments both for and against vertical restraints, he suggested that the truth could be somewhere in the middle.

A public affairs practitioner stepped back to take a broader policy view on the matter. He outlined that the disruptive impact of online commerce can generate opportunities as well as challenges. One overarching theme that is likely to reappear in the context of vertical restraints is the co-existence between the desire for accessibility that the ubiquity of the internet implies and exclusivity that sellers require, when they wish to protect particular aspects of their products, whether reputation, quality or other. He emphasized the need for rules to be adapted that take into account the evolving and quickly changing business world, without de-legitimizing either existing or nascent business models. In his view, the concept of online sales and sales platforms appeared to be beneficial for consumers while still requiring policy makers to ensure a fair balance that is acceptable to the greater business community and consumers during a time of technological and economic change.

Panel 2 – Brand Owners and Retailers

The panelists comprised various experts in the field of antitrust policy ranging from economists, national competition authority officials to lawyers and company representatives. As during the conference Chatham House rules applied, the following text will not refer to specific companies', institutions' or persons' views.

After a short introduction by the moderator the first question was posed to an industry representative regarding how to deal in a potential revision of the VBER with the issue of buyer power. The industry representative explained that the European Commission (EC) had already taken a more economic approach when the VBER was adopted in 1999. However he questioned whether this fully reflects the current economic insights. He also outlined that buyer power can have negative effects for consumers and in particular that economic papers had shown that private labels, by putting pressure on suppliers, ultimately could lead to less innovation and lower investments. Therefore, he added, a mere addition to the respective guidelines may not be sufficient but changes to the regulation itself are needed.

A second company representative was asked whether last year's US Supreme Court ruling in *Leegin* could mean abandoning the concept of hardcore restraints. She briefly described the judgment that overruled the long standing *per se* prohibition of resale price maintenance (RPM) in the US since economic evidence had shown that in fact the RPM could be pro-competitive. Furthermore, non-economic reasons had also contributed to this outcome. She stated that the old *per se* approach was out-dated and too formalistic and that there were already ways to circumvent minimum prices. In addition, she noted that the restrictions falling outside the exemption of the VBER were only presumed to have anti-competitive effects but that these are rebuttable with substantive arguments. However, she concluded, that the risk of fines remains high, as overall impression of a prohibition of RPM prevails – a fact that the EC needs to take into account in its review. In this respect the first industry representative added that the EC now appears more reluctant than before to follow the US Supreme Court. This may be because the US Supreme Court's *Leegin* judgment failed to address a number of potential anticompetitive affects as a result of resale price maintenance. He highlighted that companies, as well as consumers may benefit from a more flexible approach in this respect.

An official of the EU institutions, giving his personal view, acknowledged that the EC faces an important choice in its review, either following the *Leegin* ruling or rethinking its current approach to adapt it more to economic views. He noted that companies always had the opportunity to come up with evidence rebutting competition concerns but in his experience they had declined to try to justify RPM even if they had to pay subsequently a significant fine. In his view, the effects, however, were often negative which is why the EC established a "*hard core*" prohibition approach to RPM. With regard to RPM, the European official saw both arguments for and against. To proceed,

however, he stressed, the EC needed to be convinced of pro-competitive effects of RPM and would remain sceptical that RPM was essential to achieve claimed benefits given that the alleged efficiencies could in principle be obtained by using other less restrictive means in terms of price competition. Moreover, he added that not all vertical restraints were the same and could therefore not be treated similarly. He concluded that a clarification was possible referring to instances where RPM had positive effects such as preventing loss leading or when entering a new market.

Asked about the need for rebalancing the power of retailers in a revision of the regulation, a national competition authority representative confirmed that this was being analyzed but that so far, there had been no proof of harm to consumers with regard to buyer power. In his opinion, the VBER is not the right format to address this question. Relaxing the regulation to the advantage of the retailer would however be worrying according to the national competition official. He concluded that maybe increasing the 30% market share threshold could be an option. He concluded that maybe taking into account both the buyer's and the seller's market share as regards the 30% threshold could be a more effective option.

Commenting on the question of RPM a second national competition official explained that in her country such cases were rare although in France and in the Czech Republic there had been decisions taken in this regard. Since the application of EC competition law is decentralized, the second national competition official stressed the increased need for a coherent policy, further convergence and efficient enforcement in Europe. She added that too many differing approaches were taken towards this by the national authorities in Europe.

An economist elaborated on the economics view of the issues at hand. He laid out the evolution the academic discourse had taken with the result that until today there was no prevailing view on whether vertical restraints had pro or anti-competitive effects. Empirical studies, however, had revealed that vertical restraints could have positive effects, which ultimately depended on the functioning of the respective market. In this respect, he mentioned the exclusive distribution of beer in France that had shown positive efficiency effects, in the sense that when exclusivity was prohibited the sales of beer actually fell. In the case of Levi's jeans, however, the opposite had been the case - ending of exclusivity and RPM had led to expanded sales. He concluded that further research was needed and that *per se* prohibitions should be abandoned and replaced with a set of framework rules.

With regard to amendment of the VBER and the exemptions applying to selective distribution a private practice lawyer put emphasis on the legal uncertainty produced by the current guidelines. She outlined that an exemption is assumed if for example a new or complex product is concerned or if the product's quality is difficult to assess before consumption. In this respect, the new guidelines should give more guidance to avoid a difficult case by case assessment. The first industry representative added

territorial protection and parallel trade restrictions were slightly less problematic than RPM, especially if new products were concerned. He further noted that companies and authorities needed more flexibility to identify cases of concern. The second industry representative pointed out that the rationale for the respective Art. 4 prohibitions of the VBER was the Single Market. Moreover, she warned that one must be careful when extrapolating the *GlaxoSmithKline* ruling to other markets and products. The economist added that there were sometimes conflicting interests and that the VBER might not be the right tool for achieving an integrated market. The private practice lawyer concluded that it would be positive to mention in the guidelines that RPM could be allowed in certain cases.

The moderator asked whether the 30% market share threshold could be swapped for a type of HHI test. In her response the second national competition authority official pointed out that the threshold had proven to be useful although the market share was difficult to assess. Furthermore, she added, the threshold should be brought in line with other rules such as the *de minimis* Notice but she did not exclude that there might be a more sophisticated test. The HHI test, however, is in her opinion more useful in the case of mergers than in vertical restraints cases. The second national competition official subscribed to that adding that he would opt for rethinking the current VBER black lists. Both the legal and the economics experts supported this view while the second national competition official voted for keeping the current scheme since she favored the possibility for companies to still rebut competition concerns. The second industry representative concluded that a further review would be necessary to ultimately decide this.

A comment from the audience pointed out that the VBER was actually a concession for large companies and that the question came finally down to the burden of proof. A participant of the first panel added from the audience that if the EC decided to soften the block exemption, it had to show at the same time that it did have the intention to withdraw the exemption in certain cases if appropriate. A possibility that it is in the VBER but that according to his knowledge has never been used. Asked about how detailed the new guidelines should be, an official of the EU institutions responded that the current guidelines were precise enough although there was room to improve the presentation. To his knowledge both national authorities and particularly stakeholders preferred more detailed guidelines for the purposes of the required self assessment of their agreements.