ANTITRUST ASPECTS OF EXCLUSIVE DISTRIBUTION AGREEMENTS

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ABSTRACT

This paper analyzes the way in which the antitrust laws of the U.S. the EU assess the legality of exclusive distribution agreements. The main purpose it to evaluate the extent to which the laws of these two jurisdictions can be seen as being in line with the economic theory of exclusive territories. To this end, the paper first lays down what it considers as the most appropriate approach for judging the legality of exclusive territories, identifying a rule of reason as the optimal rule. Compared to this rule, the current U.S. approach, bordering with *per se* legality, is qualified as inappropriate. On the other hand, the paper praises the EU's approach towards non-airtight exclusive distribution agreements, characterizing it as a structured rule of reason. Conversely, the paper criticizes the EU's tough stance towards airtight exclusive distribution agreements, which borders with *per se* illegality. The paper also addresses some enforcement aspects with regards to exclusive distribution agreements. As for the U.S., the emphasis is on the way in which ideology and the existence of treble damages have contributed to the current state of the law of exclusive territories. Regarding the EU, the essential role of the Commission and its views is stressed. Further, the paper argues that, if not followed by a reconsideration of the fining policy, the trend towards facilitating private damages actions in the EU can lead to an inadequate outcome connected to the EU's approach to exclusive territories. Finally, the paper addresses the relationship between exclusive distribution agreements and arbitration. In this respect the paper finds that antitrust issues arising out of an exclusive distribution agreement can be referred to arbitration both in the U.S. and the EU; that the court review of awards dealing with antitrust issues is potentially stricter in the EU than in the U.S., in parallel with the approach that the two jurisdiction have towards the legality of exclusive territories; finally, the law of exclusive territories should be considered as mandatory law in both of the analyzed jurisdictions, with pertinent implications for the arbitral proceedings.

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SUMMARY OF CONTENTS

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ABBREVIATIONS

AAA	American Arbitration Association
APR	Area of primary responsibility
Article 101	Article 101 TFEU
Article 102	Article 102 TFEU
BER	Block exemption regulation
Brussels I	Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ [2001] L 12/1
Clayton Act	Clayton Antitrust Act of 1914, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53
De minimis notice	Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article [101](1) of the [TFEU] (de minimis), OJ [2001] C 368/13
DoJ	U.S. Department of Justice, Antitrust Division
DoJ Vertical Guidelines	U.S. Department of Justice Vertical Restraints Guidelines of 23 January 1985, 50 FR 6263-03
ECJ	European Court of Justice
ECN	European Competition Network
Effect on Trade Concept	Commission Notice - Guidelines on the effect on trade concept contained in Articles [101] and [102] of the Treaty, OJ [2004] C 101/81
EU Vertical Guidelines	Commission Guidelines on Vertical Restraints, OJ [2010] C 130/1

FAA	[U.S.] Federal Arbitration Act of 1925, 9 USC §§ 1-14
FTC	Federal Trade Commission
GC	General Court (previously: Court of First Instance or CFI)
Guidance on 102	Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article [102] of the [TFEU] to abusive exclusionary conduct by dominant undertakings, OJ [2009] C 45/7
Guidelines on 101(3)	Commission Guidelines on the application of Article [101](3) of the Treaty, OJ [2004] C 101/97
Horizontal BER	Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements, OJ [2010] L 335/43
Horizontal Guidelines	Communication from the Commission – Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ [2011] C 11/1
ICC	International Chamber of Commerce
LCIA	London Court of International Arbitration
Merger Regulation	Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ [2004] L 24/1
NAAG	National Association of Attorneys General
NCA	National Competition Authority
NYC	Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention), 330 U.N.T.S. 38

Old Vertical Guidelines	Commission Notice - Guidelines on Vertical Restraints, OJ [2000] C 291/1
Regulation 1/2003	Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles [101] and [102] of the Treaty, OJ [2003] L 1/1
Rome I	Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, OJ [2008] L 177/6
Rome II	Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations ,OJ [2007] L 199/40
RPM	Resale price maintenance
Section 1	Sherman Act Section 1
Section 2	Sherman Act Section 2
Sherman Act	Sherman Antitrust Act of 1890, 15 U.S.C. §§ 1–7
SMEs	Small and medium enterprises
TFEU	Treaty on the Functioning of the European Union, OJ [2008] C 115/47 (The Lisbon Treaty)
Vertical BER	Commission Regulation 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, OJ [2010] L 102/1

1 INTRODUCTION

In general, a manufacturer may distribute his products in three ways: through direct sales to the final customer, through in-house distribution, or through an outside representative. If he opts for an outside representative, one option is to market his products through an exclusive distributor. This type of product distribution raises many interesting legal issues. For example, it can be seen as restricting competition and thereby invoke the application of antitrust laws. Exactly these aspects are at the center of this dissertation's focus.

The dissertation is divided into five chapters. The first chapter represents a theoretical basis for the rest of the paper. At the outset, it contains a discussion about the modes of product distribution. The purpose of this part is to show in what ways a manufacturer can market his product and what are the factors he takes into account when making that decision. In this respect, it is shown in which situations a manufacturer may opt for direct sales of his product; when he may decide to perform distribution through his own employees; and finally, when he may decide to appoint an exclusive distributor. After this, the chapter presents a short introduction to exclusive territories. The aim here is to define what vertical restraints are and why a manufacturer would impose exclusive territories and not some other type of vertical restraint.

The central part of the first chapter belongs to a discussion about the procompetitive and anticompetitive effects of exclusive territories. Further, empirical proof about the impact of exclusive territories is presented. This is all in order to establish what an appropriate rule for exclusive territories should be. Once the most appropriate approach is identified, the rest of the paper could be seen as an attempt of comparing this approach with those prevailing in the U.S. and in the EU.

The second chapter presents the American law of exclusive territories. The chapter first shows how the American approach has evolved over time and how it reached the current state. Apart from purely vertical aspects of exclusive distribution agreements, the chapter also addresses some horizontal aspects. Most notably, it analyzes the influence of the rules on boycott and horizontal cooperation with regards to exclusive territories. Related to this, the chapter also considers the situation where exclusive territories are allocated through a joint venture. Finally, the chapter deals with the doctrine of *stare decisis* and the way in which it has been of relevance for the development of the law of exclusive territories.

The third chapter examines the EU approach to exclusive distribution. Apart from comparing the EU rules with the desired approach laid down in the theoretical chapter, the aim here is also to compare the U.S. developments concerning exclusive territories with those in the EU. Apart from providing an historical overview of the EU law of exclusive distribution, it also analyzes the issues of most importance for exclusive distribution agreements under the present EU legal regime. Most notably, the emphasis is on the strict approach towards the prohibition of parallel trade between Member States, which in effect means an almost outright prohibition of airtight exclusive territories.

The fourth chapter deals with enforcement issues. This aspect is important because in order to be able to correctly understand the substantive law of exclusive territories, one needs to have in mind the procedure surrounding the enforcement of the substantive law. The main enforcement issues in the U.S. are somewhat different from those in the EU; both groups of issues will be addressed in turn. As for the U.S., the focus is on outlining the enforcement structure in an attempt to explain how this structure influenced the current state of the law of exclusive territories. When it comes to the EU part, the goal is to identify the main actors in the enforcement efforts and analyze some recent developments regarding the facilitation of private enforcement.

Finally, the fifth chapter deals with the relationship between exclusive distribution agreements and arbitration. This discussion is significant because of the importance that arbitration has for solving commercial disputes in today's world. Consequently, the dissertation affords attention to certain issues which may arise if an exclusive distribution agreement with antitrust implications ends up before an arbitral tribunal. In this respect, the chapter first determines whether the arbitral tribunal would have the power to decide on the antitrust issues (the issue of arbitrability). If the answer is in the positive, a related question is the level of review that the courts will afford to the awards dealing with antitrust issues. Finally, the chapter addresses the issue of mandatory law and whether the law of exclusive territories can be considered as belonging to this law.

The jurisdictions analyzed in this dissertation were chosen based on the importance that U.S. antitrust law and EU competition law have on the global level, both in general and with regards to the law of exclusive distribution. As noted above, one aspect of the dissertation is to compare the current approaches in these two jurisdictions with the theoretical basis laid down in the first part of the paper. Further, the dissertation also aims at comparing the American law of exclusive distribution with that of the EU. In this comparison the American law is taken as a basis, for two reasons. First, antitrust law in the U.S. developed much earlier than in Europe. In addition, the American approach has had a great influence on the development of EU competition law. This is not only due to the fact that U.S. antitrust had developed at an earlier point in time, but also because of the influence that the American rules on antitrust had on the formation of the European Communities.

Another important aspect of the dissertation is that it affords significant attention to the enforcement aspects. The rationale for this is twofold. First, substantive rules cannot be correctly assessed without considering the procedure that follows them. Consequently, without taking into account the procedural rules, one could not get a clear picture about the state of the law of exclusive territories in a given jurisdiction. An additional reason has to do with the process of comparing the American and EU law. A comparison that involves only substantive rules could be flawed in the sense that it might not fully capture the differences between the two legal systems. Procedural rules can to a great extent modify the perception of substantive rules. Sometimes the substantive law provisions considered as too harsh can be balanced by procedural rules that make enforcement more difficult. This is also important to have in mind with regards to the possible changes in either substantive or procedural law. If only one of the two is changed, the equilibrium in a legal system may be disturbed.

The dissertation to a certain extent represents a review of the current literature on the effects of exclusive distribution agreements. In this respect the paper considers not only the legal literature, but also a significant amount of economic writing. This is an inevitable approach, as economic considerations have played a very important role in shaping the law of exclusive territories. Nevertheless, the paper will show that the current state of the law of exclusive distribution both in the U.S. and in the EU is not based solely on economic theory. Other factors, such as ideology and politics, also play a role. The extent to which this is the case can be best seen by comparing the rule based solely on economic considerations (laid down in the theoretical chapter) with the one that is currently prevailing in the jurisdictions covered (analyzed further in the paper).

2 THEORETICAL UNDERPINNINGS

The purpose of this chapter is to lay out a theoretical basis for the rest of the dissertation. It does so by first diving into the economics of product distribution, with the goal of explaining why a manufacturer would want to opt for exclusive distribution and not some other form of product marketing. The chapter continues by introducing the law of exclusive territories and comparing this type of restraint with some other vertical restraints. Subsequently, a substantial part of the chapter is devoted to presenting the possible procompetitive and anticompetitive effects of exclusive territories. Based on this, the chapter concludes with what this paper considers an optimal antitrust rule for judging the legality of exclusive territories.

2.1 Modes of product distribution

2.1.1 Direct sales

There are certain types of products that a manufacturer can sell directly to consumers, thereby avoiding the levels of wholesale and retail. When faced with a decision whether to market a product directly, the manufacturer takes into account several considerations. One of the most significant ones is whether the product requires point-of-sale or after-sale service.[1] If the product does require such service, the manufacturer should either be prepared to provide the service through his own employees[2] or opt for an outside representative to market the product.[3]

In general, direct sales can be performed in two ways. First, a manufacturer may sell his product directly through the firm's factory branches.[4] However, in today's world direct selling usually occurs through printed catalogs or through the Internet.[5] The Internet is a tool

[1] ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION 1 (2006).
[2] *Id.* at 2.
[3] *Id.* at 1.
[4] *Id.* at 1-2.
[5] *Id.* at 1.

that manufacturers can use not just for advertising their products but also for selling them.[6] By performing sales in this manner a manufacturer can keep his distribution costs at a minimum, as he does not have to set up his own distribution network or use an outside distributor. In addition, the fact that the Internet does not recognize administrative borders makes the number of potential customers virtually unlimited.[7]

Although the volume of Internet sales is constantly on the rise,[8] not all products are suitable for on-line purchase.[9] There are certain goods which consumers prefer to inspect in person before deciding to purchase them. In addition, a manufacturer's Internet sales might endanger his relationship with existing distributors, since they would be bypassed if the manufacturer markets the product directly to final customers.[10] For this reason traditional marketing solutions, such as performing distribution in-house or acting through a distribution representative, are still the most common way of providing goods to consumers.

2.1.2 In-house distribution

2.1.2.1 Advantages of in-house distribution

2.1.2.1.1 Transaction costs

A rational manufacturer would have vertically integrated distribution only if such a solution would be less costly than dealing with a distribution representative. In order to determine which of the two solutions is less expensive, the manufacturer has to take into account the transaction costs of each.[11] One of the greatest contributors to the discussion about transaction costs and the issue of whether a certain function should be performed inside

[6] Richard J. Wegener, *Restricted distribution 2009: thirtysomething Sylvania and the state of nonprice vertical restraints,* SP050 ALI-ABA 43, 123 (2009). For the advantages of selling through the Internet, see Peter Whelan, *Selective distribution in the age of online retail*, E.C.L.R. 2010, 31(1), 26-37, at 29-30.
[7] Wegener, *supra* note 6,. at 124.
[8] *See* Whelan, *supra* note 6, at 30.
[9] Popular consumer goods are more apt for this type of sales than capital and other durable goods. ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION, *supra* note 1, at 1-2.
[10] *See infra* Part 2.1.3.2.3 (about dual distribution).
[11] Transaction costs are costs that parties incur in the process of agreeing and following through on a bargain, such as the expenses of the lawyers required to draft and enforce contracts. N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 211 (2004).

the firm is Ronald Coase.[12] Coase argues that, when deciding whether it would be efficient to perform a certain function in-house, a firm has to take into account the costs of negotiating and concluding a separate contract for each exchange transaction that takes place on the market.[13] This means that a firm will acquire a service in the market rather than perform it on its own only in cases where the costs of doing something in-house are higher than the transaction costs of providing it in the market.

Applied to the issue of distribution, a manufacturer will opt for distribution through an outside representative when the costs of having vertically integrated distribution surpass the transactions costs of dealing with an agent or distributor. In-house distribution may enable the manufacturer to lower the transaction costs since instead of anticipating problems and contracting for their resolution in advance he would be able to adjust for future contingencies as they occur.[14] In addition, under certain conditions a firm may possess coordinating potential that transcends that of the market.[15] This explains why a manufacturer might opt for in-house distribution even if dealing with an outside representative would incur relatively low transaction costs.

Coase also emphasizes that if parties make one contract for a longer period of time rather than several shorter ones, certain transaction costs can be avoided.[16] This is because in a long-term legal relationship parties can avoid the need to (re)negotiate the contract terms, thereby avoiding certain costs. However, although a lasting contractual arrangement can lower the parties' transaction costs it can also expose them to the risk of changed circumstances. The longer the duration of the contract, the higher this risk would be. In

[12] R. H. Coase, *The Nature of the Firm*, ECONOMICA, New Series, Vol. 4, No. 16 (Nov., 1937), pp. 386-405. *See also* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 94, No. 4 (Aug., 1986), pp. 691-719.
[13] Coase, *supra* note 12, at 390-91.
[14] 8 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW 129 (1989).
[15] Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, THE AMERICAN ECONOMIC REVIEW, Vol. 61, No. 2, Papers and Proceedings of the Eighty-Third Annual Meeting of the American Economic Association (May, 1971), pp. 112-123, at 112.
[16] Coase, *supra* note 12, at 391.

addition, there is a reason of legal nature why a long-term distribution agreement may not be a viable solution: the longer the duration of the contract, the more likely it is that it could have anticompetitive effects, meaning that antitrust laws may apply.[17]

It has also been argued that in today's world there is no substantial difference between acquiring a service through an employment contract and acquiring it in the market. For example, Alchian and Demsetz emphasize that most employees are actually employed based on a series of short-term or indefinite length contracts.[18] Consequently, the employer is continually involved in renegotiation of contracts that must be acceptable to both parties, which means that certain transactions costs are inevitable.[19] This means that a manufacturer will not completely avoid transaction costs if he decides to perform distribution in-house – he will still have to "negotiate" with his own employees and come to a contract which would be acceptable to both sides.

2.1.2.1.2 Control

In general, a vertically integrated manufacturer has much greater control over the distribution process than the one that is acting through an outside representative. An integrated manufacturer has complete control over price and other conditions under which a product will be sold.[20] Also, he can to a large extent monitor the performance of his employees involved in the distribution process.[21] Conversely, a manufacturer can exercise only limited control over his agents and distributors.

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[17] *See, e.g.*, Commission Regulation 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, OJ [2010] L 102/1 (Vertical BER), Art. 5(1)(a) (excluding exemption for non-compete obligations exceeding five years). *But see* Louis M. Solomon & Robert D. Joffe, *Exclusive distribution and antitrust,* 53 FORDHAM L. REV. 491, 501 (1984) ("the duration of the franchise is irrelevant to the economic inquiry").
[18] Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, THE AMERICAN ECONOMIC REVIEW, Vol. 62, No. 5 (Dec., 1972), pp. 777-795, at 784.
[19] *Id.* at 777.
[20] RICHARD CHRISTOU, INTERNATIONAL AGENCY, DISTRIBUTION, AND LICENSING AGREEMENTS 868 (2003).
[21] 8 AREEDA & TURNER, *supra* note 14, at 129.

As a result, there is a risk that representatives will not always act in accordance with a manufacturer's interests.[22] In other words, in a relationship between a manufacturer and his representative the moral hazard problem may arise. This problem occurs when one person (the agent[23]) performs a task on behalf of another person (the principal).[24] If the principal cannot perfectly monitor the agent's behavior, the agent tends to undertake less effort than the principal finds desirable.[25] Applied to our discussion, the principal would be a manufacturer, while the agent would be either an agent or a distributor. Since a manufacturer cannot exercise complete control over agents and distributors, the moral hazard problem arises with regards to the effort with which they will promote the manufacturer's product. In order to alleviate the problem, the manufacturer will want to exercise control over them. However, for this he would have to incur certain costs. Consequently, a rational manufacturer would opt for a distribution representative only if those costs are lower than the cost of performing the distribution function in-house.[26]

Regarding control, it has also been argued that an integrated manufacturer is able to respond faster to consumer views.[27] This line of reasoning seems to rely on customers' feedback regarding the product, supposing that it is more likely that such response will reach the manufacturer if distribution is performed by its own employees. However, this does not necessarily have to be the case. In-house distribution employees could lack incentives for the product to be improved, especially if they do not see a clear benefit for themselves out of it. On the other hand, it might be the case that an outside distributor is diligent in informing the manufacturer about the customers' satisfaction with the product.

[22] THOMAS F. CLASEN, INTERNATIONAL AGENCY AND DISTRIBUTION AGREEMENTS (Matthew Bender 1990, Supp. 2009), at 2-4, 2-5.
[23] Here the term "agent is understood as an economic agent and not as an agent in the legal meaning of the word.
[24] MANKIW, *supra* note 11, at 480.
[25] *Id.*
[26] In economic parlance, in-house distribution is not a good solution "where any of the monitoring costs of internal organization through a firm . . . are positive." G. F. Mathewson & R.A. Winter, *An Economic Theory of Vertical Restraints*, THE RAND JOURNAL OF ECONOMICS, Vol. 15, No. 1 (Spring, 1984), at 29.
[27] 8 AREEDA & TURNER, *supra* note 14, at 129.

2.1.2.1.3 Double marginalization

A manufacturer could also opt for in-house distribution in order to avoid the double marginalization problem.[28] The problem can only occur when both a manufacturer and his retailer have significant market power – in that case the retailer will have a different (and higher) profit maximizing price than the manufacturer.[29] On the other hand, if either the upstream or downstream market is competitive the double marginalization disappears, since the competitive market does not lead to price distortion.[30]

Let us briefly consider what happens if both a manufacturer and his retailer have significant market power. Since the essence of monopoly is the ability to set prices above marginal costs,[31] both a manufacturer and a retailer would want to set the price they charge above their own marginal cost. The manufacturer will set the wholesale price above his marginal cost, while the retailer takes this wholesale price as his own marginal cost and sets the retail price above it.[32] This way both the manufacturer and the retailer take into account only their own profit-maximizing price, disregarding the effect that their output restriction will have for the other firm.[33]

Since the demand for the product is determined by the retail price,[34] if the retailer raises the price he charges to the final customer, the demand for the manufacturer's product will decrease. As a result, the manufacturer's revenue will also decline, making both the

[28] In modern economics, the problem seems to have been first discussed by Spengler. *See* Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 58, No. 4 (Aug., 1950), pp. 347-352). For a relatively extensive discussion about double marginalization, see JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 174-75 (1988).
[29] HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY 336 (2005).
[30] Oana Secrieru, *Economic Theory of Vertical Restraints*, JOURNAL OF ECONOMIC SURVEYS, Vol. 20, No. 5 (December 2006), pp. 797-822, at 804.
[31] *See* HOVENKAMP, *supra* note 29, at 12-13.
[32] Secrieru, *supra* note 30, at 804.
[33] James L. Hamilton & Ibrahim Mqasqas, *Double Marginalization and Vertical Integration: New Lessons from Extensions of the Classic Case*, SOUTHERN ECONOMIC JOURNAL, Vol. 62, No. 3 (Jan., 1996), pp. 567-584, at 567.
[34] According to price theory, whenever the price rises, the demand falls. However, consider the so-called Veblen goods, discussed *infra* in Part 2.3.1.6.

manufacturer and the customer worse off.[35] If through vertical integration the manufacturer manages to eliminate transactions with a monopolist retailer, the end result will bring higher profits for the integrating firm and lower prices for consumers.[36] Therefore, vertical integration can be an efficient solution if that would be the way of eliminating the double marginalization problem.

2.1.2.1.4 Legal considerations

Probably the most important legal consideration that may lead a manufacturer to have vertically integrated distribution is the application of antitrust laws.[37] Both in the U.S. and in the EU antitrust laws generally do not apply to conduct inside a vertically integrated firm.[38] Consequently, by performing distribution in-house a manufacturer can to a large extent minimize the effect that antitrust laws have on the way in which he organizes the distribution of his product. This is especially important in the presence of intrusive antitrust legislation, as it could give the manufacturer a strong incentive to vertically integrate.[39]

Another important factor to be taken into account is legislation aimed at protecting agents and distributors. The purpose of such legislation is to make it more difficult for a manufacturer to terminate an agreement with his distribution representatives.[40] The presence

[35] HOVENKAMP, *supra* note 29, at 336.
[36] *Id.* at 335. Although it is counter-intuitive, it seems that one monopoly is better than two monopolies. Therefore, if the retailer is a monopolist, it would be in the interest of consumers that the manufacturer vertically integrates, even if the manufacturer itself is also a monopolist.
[37] *See* RICHARD WHISH, COMPETITION LAW 608 (2009); ALISON JONES & BRENDA SUFRIN, EC COMPETITION LAW 601 (2004).
[38] For the U.S., see: U.S. v. Columbia Steel Co., 334 U.S. 495, 525 (1948) ("[V]ertical integration, as such without more, cannot be held violative of the Sherman Act.") and Copperweld Corp. v. Independence Tube Corp. 467 U.S. 752, 776 (1984) ("[T]he coordinated behavior of a parent and its wholly owned subsidiary falls outside the reach of [Sherman Act Section 1]"). For the EU, see Case 15-74 *Centrafarm BV and Adriaan de Peijper v Sterling Drug Inc.* [1974] ECR 1147, para. 41 (the allocation of tasks as between parent and dependent subsidiary is not subject to Article 101 TFEU scrutiny).
[39] *See infra* Part 5.3.2.
[40] *E.g.*, Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, OJ [1986] L 382/17; [Belgian] Law on the unilateral termination of exclusive distribution agreements of indefinite duration of 1961; [U.S.] Automobile Dealers' Day in Court Act of 1956, 15 U.S.C. §§ 1221-1225 (for a case concerning the Act, see Sherman v. British Leyland Motors, Ltd., 601 F.2d 429 (9th Cir. 1979); for an article assessing the impact of the Act, see Frank Mathewson & Ralph Winter, *The Economic Effects of Automobile Dealer Regulation*, ANNALES D'ÉCONOMIE ET DE STATISTIQUE, No. 15/16, Dynamiques des marchés etstructures industrielles / Market Dynamics and Industrial Structure (Jul. - Dec., 1989), pp.409-426).

of such legislation could make the manufacturer's position less flexible and hence affect his preferred way of doing business. As a result, he could be discouraged from dealing with a distribution representative and rather opt for the in-house option.

2.1.2.2 Disadvantages of in-house distribution

2.1.2.2.1 In-house presence can be costly

Vertically integrated distribution does not necessarily have to be the most efficient solution – establishing a retail network or acquiring an existing one usually involves substantial investment by the manufacturer. Consequently, some firms may lack resources to set up their own distribution.[41] This is especially the case with smaller firms.[42] However, it is an important consideration for bigger companies as well – keeping costs low is an imperative for every firm, regardless of its size.

2.1.2.2.2 Integrated manufacturers bear more risk

One of the main arguments in favor of in-house distribution is that it enables a manufacturer complete control over the distribution process. Consequently, an integrated manufacturer enjoys the entire margin generated by the sale to the end user.[43] However, such manufacturer also assumes all the risk related to distribution, as there is no external third party to share the risk with.[44] Therefore, the larger the risk and uncertainty related to the distribution process, the more likely will the manufacturer opt for a distribution representative.

[41] VALENTINE KORAH & DENIS O'SULLIVAN, DISTRIBUTION AGREEMENTS UNDER THE EC COMPETITION RULES 4 (2002).
[42] Emmanuel P. Mastromanolis, *Insights from U.S. antitrust law on exclusive and restricted territorial distribution: the creation of a new legal standard for European Union competition law*, 15 U. PA. J. INT'L BUS. L. 559, 591 (1995).
[43] CHRISTOU, *supra* note 20, at 868.
[44] *Id.*

2.1.2.2.3 Outside representatives better equipped for distribution

Some authors have argued that a distributor has comparative advantage over a manufacturer when it comes to product marketing.[45] The argument seems to rely on the proposition that specialization makes the distribution process more effective. If a firm concentrates only on distribution, it should know it much better than a firm which is also involved with manufacturing.[46] Consequently, a manufacturer might choose to fully focus on production and leave the distribution to an outside representative specialized for this function.

Similarly, it has been argued that a representative has greater knowledge of the retail market and broader access to customers than a manufacturer.[47] Some authors even suggest that one of the main reasons why firms do not distribute goods themselves is that retailers and wholesalers have specialized information about the market.[48] Familiarity with the local market is particularly an asset in international transactions, where a manufacturer might originate from a completely different cultural setting than his customers. An agent or a distributor could be the manufacturer's tool in overcoming this gap.

Further advantages include a reduction of selling costs, more accurate estimation of output, and the fact that a dealer usually has more expertise in retailing than a manufacturer.[49] Also, a local representative would be able to provide local parts and service, which means that there would be someone on the ground whom customers trust and could hold accountable for their purchases.[50] This is an especially important consideration when it comes to more complex goods, since simple products usually do not require much servicing and customer support.

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[45] GIORGIO MONTI, EC COMPETITION LAW 349 (2007). Some are of opinion that vertical integration has gone out of fashion and that the trend today is for businesses to specialize in the level of the supply chain in which they have real expertise. *See, e.g.*, CHRISTOU, *supra* note 20, at 869.
[46] *See* MANKIW, *supra* note 11, at 283.
[47] *See* CLASEN, *supra* note 22, at 2-1, 2-2.
[48] Patrick Rey & Joseph Stiglitz, *The Role of Exclusive Territories in Producers' Competition*, THE RAND JOURNAL OF ECONOMICS, Vol. 26, No. 3 (Autumn, 1995), pp. 431-451, at 432.
[49] Robert Bork, *The rule of reason and the per se concept: price fixing and market division II*, 75 Yale L. J. 373, 429 (1965).
[50] CLASEN, *supra* note 22, at 2-1, 2-2.

2.1.2.2.4 Diseconomies of scale

The notion of diseconomies of scale is based on the relationship between a manufacturer's average total cost and the quantity of his output. The average total cost and the quantity of output can be related in three ways. First, if a firm's average total cost falls with an increase in output, the firm is facing economies of scale.[51] This means that the more the firm produces the more efficient and competitive it will be. In such circumstances a manufacturer would be inclined to vertically integrate into distribution since that would lower his costs.[52] The second situation is when a firm has constant returns to scale, i.e. when the average total cost remains the same with an increase in output.[53] Here a rational manufacturer could opt either for in-house distribution or for a distribution representative, depending on the circumstances. Finally, if the average total cost rises with an increase in output, diseconomies of scale arise.[54] In the presence of diseconomies of scale, a rational manufacturer would leave the distribution function to an outside representative.[55]

There are several reasons for the emergence of diseconomies of scale. First, as the firm grows larger and more complex, problems in managing the firm may arise.[56] The bigger the firm becomes, the harder it is to manage and adequately allocate its resources. This is due to the problems in coordination, which are inherently present in any large organization.[57] As

[51] MANKIW, *supra* note 11, at 283.
[52] Economies of scale could also have anticompetitive effects. *See* Richard Schmalensee, *Economies of Scale and Barriers to Entry*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 89, No. 6 (Dec., 1981), pp. 1228-1238.
[53] MANKIW, *supra* note 11, at 283.
[54] *Id.* at 283. Diseconomies of scale can be internal and external. Internal diseconomies are connected with the costs inside a single firm, while external diseconomies of scale are concerned with the industry in which the firm is competing. Consequently, external diseconomies of scale exist where a firm's costs per unit of output increase as the size of the whole industry increases, which could for example happen when the industry's growth causes a shortage of raw materials or skilled labor. *See* JOHN SLOMAN, ECONOMICS 129 (2000).
[55] In other words, distribution in-house would not be an efficient solution when "the entrepreneurial capacity of the manufacturer exhibits diminishing productivity." G. F. Mathewson & R.A. Winter, *An Economic Theory of Vertical Restraints*, THE RAND JOURNAL OF ECONOMICS, Vol. 15, No. 1 (Spring, 1984), pp. 27-38, at 29. *See also* OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 163 (1985).
[56] SLOMAN, *supra* note 54, at 128.
[57] MANKIW, *supra* note 11, at 283. One of the first economists to notice this problem was Kaldor. *See* Nicholas Kaldor, *The Equilibrium of the Firm*, The Economic Journal, Vol. 44, No. 173 (Mar., 1934), pp. 60-76, at 68-69. Prior to Kaldor it was generally considered that expansion and efficiency are positively correlated. *See, e.g.,* ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 265 (1920).

the firm grows, it becomes more and more difficult for the management to know what is actually happening throughout the firm.[58] Consequently, the management might become unable to efficiently control the firm's operations.[59] Therefore, if a firm would vertically integrate into distribution, it would be more difficult for the management to control the processes inside the firm, and as a result a decrease in efficiency could arise.

Another possible reason for the emergence of diseconomies of scale could be if the firm's growth causes its workers to become less motivated and hence less productive. This would for example be the case if the expansion would make employees perform repetitive tasks or if employees would feel as an insignificantly small part of a large organization.[60] Good management over the distribution employees could alleviate the problem, but can hardly eliminate it. In addition, small firms often better identify and reward the workers' ability than the large ones,[61] which could be an argument against expanding into the distribution function.

2.1.2.2.5 Economies of scope

One of the reasons why a manufacturer would want to stay out of the distribution process is because distribution is often a relatively low profit activity.[62] This is due to the fact that distribution is sometimes profitable for a distributor only if he deals with a variety of products. In other words, product distribution could be profitable only if it involves the economies of scope.[63] The term "economies of scope" seems to have been coined by Panzar

[58] KORAH & O'SULLIVAN, *supra* note 41, at 4.
[59] GERALD W. STONE, CORE ECONOMICS 187 (2008).
[60] SLOMAN, *supra* note 54, at 128.
[61] Eric Rasmusen & Todd Zenger, *Diseconomies of Scale in Employment Contracts*, JOURNAL OF LAW, ECONOMICS, & ORGANIZATION, Vol. 6, No. 1 (Spring, 1990), pp. 65-92, at 87.
[62] Lee E. Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards,* LAW AND CONTEMPORARY PROBLEMS, Vol. 30, No. 3 (Summer, 1965), pp. 506-529, at 512.
[63] *See* WILLIAMSON, *supra* note 55, at 163.

and Willig.[64] They define it as a situation where "it is less costly to combine two or more product lines in one firm than to produce them separately."[65]

The lower costs arising out of the economies of scope are related to the opportunity of exploiting some of the firm's excess capacity, which becomes possible when there is an input shared by two or more product lines without complete congestion.[66] Related to product distribution, this excess capacity would exist if the distribution infrastructure is not used to the maximum and the distribution network would be able to handle additional products. Consequently, the situation in which the distribution function would be performed in-house could lead to an inefficient outcome, where distribution resources would not be used to their full capacity.

One illustration of economies of scope is the manufacturing of transport equipment.[67] Because of specialized knowledge, a firm producing trucks and cars has a cost advantage in producing buses and tanks.[68] Applied to our discussion, a firm distributing several products might for the same reason have cost advantage over a firm dealing with only one. Another illustration would be a firm with an established marketing department – such a firm can undertake the promotion of a new product at a lower cost than a firm without such department.[69] Similarly, a distributor that already has expertise in selling certain products might have lower costs in marketing a new product than a distributor focusing solely on the new product.

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[64] *See* J. Panzar & R. Willig, *Economies of Scale and Economies of Scope in Multi-Output Production*, econ. disc. paper no. 33, Bell Laboratories (1975).
[65] John C. Panzar & Robert D. Willig, *Economies of Scope*, THE AMERICAN ECONOMIC REVIEW, Vol. 71, No. 2, Papers and Proceedings of the Ninety-Third Annual Meeting of the American Economic Association (May, 1981), pp. 268-272, at 268. In the language of economists, "[w]henever the costs of providing the services of the sharable input to two or more product lines are subadditive . . . the multiproduct cost function exhibits economies of scope." *Id.* The concept of economies of scope should be distinguished from the concept of joint products, i.e. the products that are naturally produced together, such as wool, lamb meat, and mutton. *See* JOSEPH E. STIGLITZ, ECONOMICS 333 (1993).
[66] Panzar & Willig, *supra* note65, at 268.
[67] PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 340 (1989).
[68] *Id.*
[69] STONE, *supra* note 59, at 187.

One of the most well known discussions about the connection between product distribution and the economies of scope has been provided by Scherer and Ross:

> Retailers commonly secure economies of scope by offering the consumer under one roof dozens or even thousands of products, often gathered together from a diversity of manufacturers. It would be prohibitively expensive for the manufacturer of paper towels, crescent wrenches, or antibiotics to establish its own retail distribution facilities in order to control the conditions under which its product is resold to consumers. And even when there is a reasonably close fit between manufacturer product lines and retail outlets' scope, as in automobiles, major appliances, or photo supplies, the two stages require quite different skills, attitudes, and spans of managerial focus, and the advantages of specialization typically require that retailers be kept separate organizationally from their primary suppliers.[70]

This paragraph shows that the nature of the product plays an important role in determining whether in-house distribution is an efficient solution. The more sophisticated the product, the more will a vertically integrated distribution network make sense. On the other hand, if the product is a fairly simple one, a vertically integrated distribution network would probably not be cost effective.

Despite the possibility of achieving the economies of scope, integrated distribution may lead to an inefficient outcome. The quoted paragraph suggests that even if the product is a sophisticated one distribution by a separate entity might still be a better solution, since the manufacturer could lack expertise in distribution. In addition, if a manufacturer would get involved into multi-product distribution, his functional role would be substantially broadened.[71] This could make the management of the firm more difficult, annulling the effectiveness of the economies of scope. In other words, multi-product distribution could lead to the diseconomies of scale.[72]

2.1.2.2.6 Legal considerations

There are several ways in which legal considerations can favor distribution through an outside representative. One legal concern could be that certain jurisdictions simply do not

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[70] F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 542 (1990).
[71] Preston, *supra* note 62, at 512.
[72] See *supra* Part 2.1.2.2.4.

allow foreign manufacturers to market their product directly. This is for example the case in some countries in the Middle East where the use of a local representative is legally required.[73] In other words, if a manufacturer wants to have access to the markets with the said requirement, he has no other choice but to do it through a representative on the ground. Similarly, import regulations often require participation of a local representative in the import procedure,[74] making it virtually impossible for the supplier to market goods in a territory where he does not have an established agent or distributor.

However, of more importance are limitations of a different kind – government contracts frequently specify that foreign suppliers have to be locally represented.[75] The main rationale for such requirement seems to be the protection of domestic businesses. Although all countries are declaratively for unrestrained competition and free trade, almost all governments seem to favor domestic companies in one way or another. This especially seems to be the case in the current economic situation, when the world is still suffering the consequences of the global financial crisis. In order to alleviate the effects of the crisis, many countries have instituted stimulus programs aimed at raising the level of economic activity and propelling economic growth.[76] However, such programs are generally limited to aiding domestic companies; this shows that the declarative support for free trade has significant practical limitations.

Rules on vertical mergers could also be of relevance. Vertical integration into distribution generally enables a manufacturer to avoid the application of antitrust laws, since such laws do not apply to conduct inside a firm.[77] However, this is the case only if integration is achieved by setting up a new distribution system – a manufacturer's decision to acquire an

[73] CLASEN, *supra* note 22, at 2-2, 2-3.
[74] *Id.*
[75] *Id.*
[76] *See, e.g.*, American Recovery and Reinvestment Act of 2009 (Stimulus Bill), PL 111-5, February 17, 2009, 123 Stat 115.
[77] *See infra* Part 2.1.2.1.4.

existing downstream firm might trigger antitrust rules on vertical mergers. Although the rules on vertical mergers are more lenient than on horizontal integration,[78] they can still impede the manufacturer from acquiring an existing distribution network, especially if he has significant market power.

2.1.3 Distribution through an outside representative

2.1.3.1 Agency

2.1.3.1.1 Agency under American law

In American law, agency is defined as "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[79] The key part of this definition is that an agent acts on the principal's behalf. Applied to the issue of product distribution, this means that an agent does not acquire from the manufacturer the goods that he markets. Rather, ownership remains with the manufacturer until it is transferred to the final customer.

American antitrust law has traditionally had a lenient approach towards agency agreements, holding that genuine agency does not represent an agreement in the meaning of Sherman Act Section 1.[80] The determination whether an arrangement represents a genuine

[78] *Compare* Commission Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2008] C 265/6 *with* Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2004] C 31/5. Antitrust has not always favorably looked at vertical integration. One of the first economists to show that vertical integration is usually harmless was Spengler. He noted that "[v]ertical integration . . . does not, as such, serve to reduce competition and may, if the economy is already ridden by deviations from competition, operate to intensify competition." Spengler, *supra* note 27, at 347. This led him to conclude that "vertical integration, if unaccompanied by a competition-suppressing amount of horizontal integration and if conducive to cost and price reduction, should be looked upon with favor by a court interested in lower prices and a better allocation of re-sources." *Id.* at 352.

[79] RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

[80] U.S. v. General Electric Co., 272 U.S. 476, 488 (1926). It could be debatable whether it is justified to have different antitrust treatment for agency and for distributorship. In this respect Posner has noted that "[d]istinguishing between sale and agency may sometimes be helpful in avoiding the absurdity of interpreting the Sherman Act to forbid a firm's sales manager to tell his salesmen what prices to charge." RICHARD A. POSNER, ANTITRUST LAW 154 (1976).

agency was especially important during the *Schwinn* era.[81] Currently the law seems to have different approaches towards price and non-price restraints contained in agency agreements. Following *Continental T. V., Inc. v. GTE Sylvania Inc.*,[82] what matters is that a vertical non-price restraint satisfies the rule of reason, regardless of whether the relationship is an agency or a distributorship. From this it would follow that it is also not of significance whether the agency is genuine. On the other hand, if a manufacturer imposes a resale price restriction upon his dealer, the determination about whether agency is genuine seems to still be of relevance.[83]

2.1.3.1.2 Agency under EU law

Similarly to the definition of agency in the law of the United States, EU law defines an agent as a:

> legal or physical person vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the purchase of goods or services by the principal, or sale of goods or services supplied by the principal.[84]

Therefore, here as well the agent does not acquire the product that is to be distributed, but rather acts on the manufacturer's behalf.

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[81] *See infra* Part 3.2.2.
[82] 433 U.S. 36 (1977).
[83] *See* Valuepest.com of Charlotte, Inc. v. Bayer Corp., 561 F.3d 282, 284 (4th Cir. 2009) (no antitrust liability for resale price maintenance where agency agreement is genuine).
[84] Commission Guidelines on Vertical Restraints, OJ [2010] C 130/1 (EU Vertical Guidelines), para. 12. *See also* Council Directive 86/653/EEC, Art. 1(2) (defining a commercial agent as a "self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of [the principal] . . . or to negotiate and conclude such transactions on behalf of and in the name of that principal.").

Also, EU competition law in the main does not apply to agency agreements.[85] However, this is the case only if an agency agreement is genuine, i.e. if it does not make the agent substantially bear the financial or commercial risk arising out of the agreement.[86] An agreement will generally be considered as agency where property in the contract goods does not vest in the agent, or the agent does not himself supply the contract services.[87] The assessment must be made on a case-by-case basis, and concerning the economic reality of the situation rather than the legal form.[88]

The principal may decide to impose territorial restrictions upon his agent. A limitation on the territory in which the agent may sell the product is generally considered to form an inherent part of the agency agreement, thereby falling outside competition law provisions.[89] Competition law may still apply if the agency relationship is exclusive (i.e. if it prohibits the principal from appointing other agents in a given territory), since an agent is considered a separate undertaking from the principal.[90] However, even in this case it is considered that exclusive agency provisions will only rarely lead to anticompetitive effects[91] and will therefore seldom be condemned.

[85] The Commission had excluded the application of 101(1) to agency agreements already in 1962. *See* Commission Notice on Exclusive Dealing Contracts with Commercial Agents, OJ [1962] 139/2921, para I. ("[C]ontracts made with commercial agents in which those agents undertake, for a specified part of the territory of the common market, to negotiate transactions on behalf of an enterprise, to conclude transactions in the name and on behalf of an enterprise or to conclude transactions in their own name and on behalf of an enterprise, do not fall under the prohibition in Article [101](1) of the Treaty."). The exception was later confirmed by the General Court and the European Court of Justice in a number of occasions. For the ECJ, see for example Joined cases 56 and 58-64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299 (*Consten-Grundig*), at 430. For the GC, see for example Case T-325/01 *DaimlerChrysler AG v Commission of the European Communities* [2005] ECR II-3319, para. 88. *See also* Paul Henty, *Agency Agreements - What are the Risks? The CFI's Judgment in DaimlerChrysler AG v Commission*, EUROPEAN COMPETITION LAW REVIEW, issue 3, volume 2006, pp. 102-107; Emmanuel Dieny, *The Relationship Between a Principal and its Agent in Light of Article 81(1) EC: How Many Criteria?*, EUROPEAN COMPETITION LAW REVIEW (2008), volume 29 , issue 1 , pp. 5-10.
[86] EU Vertical Guidelines, para. 13.
[87] *Id.*, para. 16. *See also id.*, paras. 14-16 (discussing the types of risks relevant for this assessment).
[88] *Id.*, para. 17. What matters is the substance of the agreement – the qualification given to their agreement by the parties or national legislation is not relevant. *Id.*, para. 13.
[89] *Id.*, para. 18.
[90] *Id.*, para. 19.
[91] *Id.*

Finally, it is important to emphasize that even agency agreements that are considered as genuine are not afforded complete immunity from EU competition law. First, agency agreements are not exempted from the prohibition of abuse of dominant position, regardless of whether they are genuine or not. Further, even the exemption from Article 101 is not absolute – the genuine agency safe harbor does not apply if the agreement is used to facilitate collusion between manufacturers.[92]

2.1.3.1.3 Commission business and mediation

Commission business is a relationship in which the commission agent assumes the obligation to perform one or several transactions entrusted to him by the principal, on his own behalf and for the account of the principal.[93] Therefore, in a commission business an agent is entering into legal relationships with the final customer in his own capacity, but for the account of the principal. On the other hand, in regular agency agreements the contract with the third party is concluded on behalf and for the account of the principal.[94] Once the agreement between the principal and the third party has been concluded, the agent's obligations towards the principal cease, unless the parties to the agency agreement stipulated otherwise.

On the other hand, a mediator assumes the obligation to try to find and connect his principal with a person who will negotiate to enter into a contract with him (i.e. with the principal).[95] From this it can be seen that a mediator is only there to connect the principal with a third person, without participating in the execution of the contract, and also without entering into any legal relationship with that third person. Compared to agency and commission business, mediation seems to expose the principal to most risk, since mediators

[92] *Id.*, para. 20. The Guidelines note that this would for example be the case where a number of principals use the same agents while collectively excluding others from using these agents, or when they use the agents to collude on marketing strategy or to exchange sensitive market information between the principals. *Id.*
[93] [Serbian] Law on Obligations of 1978 (as amended), Art. 771(1).
[94] *Id.*, Art. 790(1).
[95] *Id.*, Art. 813.

are generally not assuming any responsibility regarding the contract that is to be concluded with a third person. Consequently, when deciding whether to opt for agency, commission business or mediation, the principal should take into account the level of risk he is willing to assume and the aims he wishes to achieve.

2.1.3.2 Distributorship

2.1.3.2.1 Distributorship defined

Distributorship is a relationship between a distributor and a manufacturer where the distributor undertakes to distribute the manufacturer's product in a certain area. Based on the agreement, the reseller obtains the right to buy the product and resell it to others.[96] From this follows one of the key elements of this relationship: a distributor actually buys a product from a manufacturer. At the same time this is the main characteristic that distinguishes a distributor from an agent, since in agency the title to the product remains with the manufacturer until it is transferred to the final customer.

The difference between agents and distributors does not end there. A distributor's role is much more important than that of an agent. A distributor organizes and implements the distribution of products within the assigned territory, in accordance with the distribution agreement.[97] He is mainly independent in choosing the way he will sell the products – it is in his own interest to choose the most effective way of distribution. He is however limited by the distribution agreement, which may contain provisions regulating the distribution process.

[96] Ivor Cary Armistead III, Eric Jaeger, James Pollock & Elisabeth C. Sanghavi, *Distributorships and sales agreements*, CDII MA-CLE 9-1 (2009).
[97] Carolita Oliveros, *International distribution issues: distribution agreements*, SB75 ALI-ABA 739, 742 (1997).

2.1.3.2.2 Agency and distributorship compared

2.1.3.2.2.1 Control

As a result of their similarity, in countries where distribution is not specifically regulated[98] usually the principles of agency apply.[99] However, these two types of arrangements also have a number of differences. One of the main differences is the level of control that a principal has over an agent/distributor. In general, a manufacturer can exercise much stricter control over his agents than over his distributors.[100] Agents may be instructed to charge particular prices, to deal only on particular terms or with limited categories of customers, as well as not to compete in any way with the principal.[101]

On the other hand, such tight control usually cannot be exercised over distributors. This is mainly due to the legal nature of distributorship, which gives a distributor certain autonomy regarding the way he conducts his business. In addition, a manufacturer's attempt to control the retail price or other conditions under which a product is marketed could invoke the application of antitrust laws.

Based on the level of control that a manufacturer exercises over the distribution process, the following hierarchy could be established. Certainly the highest level of control is exercised if distribution is performed in-house – in such a case a manufacturer's control over the way in which his product reaches the market is complete. In the second place would be agency, where a manufacturer also has a lot of say regarding the distribution process. The next in line would be restricted distribution, i.e. a situation where distribution is performed by an outside representative but a manufacturer imposes certain restrictions regarding the distribution process. At the end of the hierarchy would be regular distribution, where a manufacturer does not impose restraints on his distributor.

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[98] This seems to be the case in a majority of jurisdictions. *But see* [Belgian] Law on the unilateral termination of exclusive distribution agreements of indefinite duration of 1961.
[99] CLASEN, *supra* note 22, at 3-6.
[100] *Id.* at 3-11.
[101] D.G. GOYDER, EC COMPETITION LAW 180 (2003).

To make this hierarchy more complete, commission business and mediation can also be included in the hierarchy. In that case commission business would be somewhere between agency and distributorship: an agent acts on behalf of and for the account of the principal; a commission agent on his own behalf but for the account of the principal; a distributor is completely independent and acts on his own behalf and for his own account. Lastly, since a mediator is merely connecting the parties to the sales agreement and is not participating in the execution of the agreement, it is questionable if mediation can be placed in the said hierarchy. In any case, mediation can be said to place the highest level of risk on the manufacturer, since the mediator is not assuming any risk himself.

2.1.3.2.2.2 The passage of title

Another distinction between agency and distributorship is that title to the product passes to a distributor, while it does not pass to an agent.[102] A distributor purchases a product from the principal for his own account, takes title to the product purchased, and then resells it to customers in his territory.[103] On the other hand, agents do not buy the marketed product; they only solicit orders for the principal or participate in the making of agreements on behalf of the principal.[104] They can do so either by introducing the two parties to each other or by actually negotiating and concluding the contract.[105]

The fact that an agent is only an intermediary in concluding the agreement between a manufacturer and the final customer means that the agent is not a party to that contract nor does he have any liabilities under it.[106] The legal relationship is between the manufacturer and the final customer, and does not concern the agent. However, in the case of *del credere*

[102] CLASEN, *supra* note 22, at 3-12.
[103] CHRISTOU, *supra* note 20, at 171. *See also* CLASEN, *supra* note 22, at 3-5.
[104] VALENTINE KORAH & WARWICK A. ROTHNIE, EXCLUSIVE DISTRIBUTION AND THE EEC COMPETITION RULES 279 (1992).
[105] CHRISTOU, *supra* note 20, at 57.
[106] *Id.*

agency the agent can also be liable in connection with the relationship between the manufacturer and the buyer.

In *del credere* agency the agent undertakes to indemnify his principal if the customer whom he finds fails to pay the principal.[107] The agent's obligation to indemnify the principal is not presumed, and hence has to be specifically contracted for.[108] However, it has to be noted that although a *del credere* agent can be liable to the manufacturer, this liability is only secondary. This is opposed to a distributor's liability, which is considered as primary.[109] In other words, the agent's liability does not arise under the contract with the buyer of the product, but under the agreement between the agent and the principal. Consequently, even in the case of *del credere* agency the agent is not liable to the buyer but only to the principal.

2.1.3.2.2.3 Authority to act on behalf of the principal

In general, an agent does have authority to act on behalf of the principal while a distributor does not.[110] A distributor is an independent contractor, and does not bind the principal by his acts.[111] From this it also follows that acts of an agent can often be imputed to the principal, while a distributor's acts can rarely be attributed to the manufacturer.[112] On the one hand, this means that a distributor assumes far more risk than an agent, as he can look to his principal for far less indemnification than an agent could.[113] On the other, a distributor's profit margin is usually higher than the one of an agent, in accordance with the risk.

2.1.3.2.2.4 The level of risk

The risk connected with the distribution process can be divided into two groups: the risk to which an outside representative is exposed to and the risk that a manufacturer

[107] *Id.*
[108] *E.g.*, [Serbian] Law on Obligations of 1978, Art. 801(1) ("An agent shall be liable to the principal for fulfillment of obligations arising from the contract concluded through his mediation, or concluded by his authorization on behalf of the principal, only if he gives a particular written guarantee in that respect.").
[109] CLASEN, *supra* note 22, at 3-5.
[110] *Id.* at 3-9.
[111] CHRISTOU, *supra* note 20, at 173.
[112] CLASEN, *supra* note 22, at 3-1.
[113] CHRISTOU, *supra* note 20, at 172.

undertakes by dealing with an outside representative. An example of the former would be the risk of bad debts, i.e. the risk that the final customer will not fulfill his obligations. As shown, agents are generally not liable under contracts between the principal and the buyer (with a possible exception of *del credere* agency). On the other hand, distributors acquire ownership of the goods from a manufacturer, and they are the ones entering into the contract with the buyer. Consequently, distributors undertake the risk of bad debts on the sales they make, and often assume obligations in relation to warranty claims, maintenance, and advertising.[114]

On the other hand, an example of the risk borne by the manufacturer would be the risk of non-payment by his outside representative. It has been proposed that this risk seems to be greater for the principal dealing with an agent than for the one dealing with a distributor.[115] The reason seems to be that distributors generally undertake bigger investments than agents and hence have more capital from which the debtors (including the manufacturer) could enforce.

Others however argue that more principals have lost money or gone out of business through lack of credit control over their distributors than for any other reason.[116] The principal is taking the credit risk on all of the distributor's customers, without having any control over the extent of the risk which the distributor takes.[117] This is due to the fact that the manufacturer will usually credit the distributor by not asking for the payment right after delivery, but only after the sale to the final customer is made. And if the customer fails to pay to the distributor, the distributor will not be able to pay to the manufacturer.

2.1.3.2.2.5 Compensation

Agents and distributors do not receive the same kind of compensation for marketing a manufacturer's product. On the one hand, an agent receives a commission on each sale that

[114] *Id.*
[115] CLASEN, *supra* note 22, at 3-13.
[116] CHRISTOU, *supra* note 20, at 875.
[117] *Id.* at 876.

he makes on the manufacturer's behalf. On the other hand, distributors get the goods at a discount, and then earn on the margin between the price for which they get the goods from the manufacturer and the price they charge the final customer. The compensation is usually not just of different kind but also of different level – a distributor's profit margin is generally higher than that of an agent. This is understandable, taking into account the greater risk that distributors undertake.[118] This also seems to explain why agents are not as entrepreneurial as distributors.[119] Risk, remuneration, and entrepreneurial spirit are inter-connected: distributors invest more in the placement of the product, thereby their risk is higher, the profit margin as well, and consequently they have more incentive to increase sales than agents do.

2.1.3.2.2.6 Tax treatment

Performing distribution through an agent can have certain tax consequences for a manufacturer, especially if he is marketing his products abroad. Agents are often considered as permanent establishments, which can subject the manufacturer to local taxation (i.e. to taxation of the agent's jurisdiction).[120] This is particularly a problem if it would lead to double taxation. In this context, double taxation would occur if the profit made by the agent would be taxed both by the jurisdiction to which the agent belongs and by the jurisdiction of the manufacturer. In the absence of an agreement on avoiding double taxation, the manufacturer should consider whether dealing with an agent could expose him to additional tax liability.

2.1.3.2.3 Exclusive distributorship

Party autonomy is a fundamental principle of contract law. Consequently, when a manufacturer decides to market his product through a distributor, parties to the distribution agreement can tailor the agreement the way that best suits their needs.[121] The choice of the

118 CLASEN, *supra* note 22, at 3-14.
119 JONES & SUFRIN, *supra* note 37, at 598.
120 CLASEN, *supra* note 22, at 3-2.
121 CHRISTOU, *supra* note 20, at 211-12.

parties will depend on several factors, such as the level of control the manufacturer wants to exercise, the capital he wishes to commit to it, his experience and his need for the energy and commitment of local entrepreneurs.[122] As a result, distributorship can take many forms.

Generally speaking, distribution agreements can be divided into two groups: on the one side would be agreements that do not contain restraints on the distribution process, while on the other would be those that do. This paper is mainly concerned with the latter group, since that is where exclusive distribution agreements belong to. In this respect it is of great importance to determine the notion of exclusive distribution.

There seems to be a certain degree of confusion about the meaning of the term "exclusive distribution".[123] Unless noted otherwise, an exclusive distribution agreement for the purposes of this dissertation refers to the legal relationship in which a manufacturer grants to his distributor an exclusive right of sales in a specified territory. In other words, an exclusive distribution agreement is defined as an agreement that contains an exclusive territories clause, regardless of whether the territorial protection is absolute or not, and regardless of whether exclusive territories are coupled with some other form of vertical restraints.

Related to the definition of exclusive distribution is the concept of dual distribution. This form of distribution exists where a manufacturer sells a product to an independent

[122] 8 AREEDA & TURNER, *supra* note 14, at 2.
[123] First, the term is used in order to denote the legal relationship in which a manufacturer grants to his distributor an exclusive right of sales in a specified territory. *See* Solomon & Joffe, *supra* note 17, at 491. Some authors consider that apart from allotting an exclusive sales area the term "exclusive distribution" also encompasses allotting an exclusive customer group. *E.g.*, JOANNA GOYDER, EU DISTRIBUTION LAW 66 (2005). The European Commission seems to be on this track as well. *See* EU Vertical Guidelines, para. 51. The term exclusive distribution is also used to describe the arrangement where a distributor promises a supplier to refrain from handling the goods of competing suppliers. *See* Solomon & Joffe, *supra* note 17, at 495. However, the described arrangement is what this paper calls "exclusive dealing" or "single branding". Further, some authors define exclusive distributorship as the relationship which combines both exclusive territories and exclusive dealing. Oliveros, *supra* note 97, at 744. Finally, sometimes the term "exclusive dealing" is used to describe what this paper considers as exclusive distribution. *See*, *e.g.*, Case 5/69 *Franz Völk v S.P.R.L. Ets J. Vervaecke* [1969] ECR 295, paras. 5-7.

distributor but also sells directly to customers in the distributor's area.[124] The situation may cause some problems in the relationship between the manufacturer and the exclusive distributor, since the latter's profits could diminish by the manufacturer's action. In an empirical study, Fein and Anderson examine the effect that the manufacturer's direct selling has on his relations with his distributors. They find that the more the manufacturer is involved in direct selling, the more he will be obliged to offer exclusive territories, in order to appease his distributors.[125]

Dual distribution invokes some important legal issues. On the one hand, such a relationship has horizontal elements, as the manufacturer is competing with the distributor in the downstream market. However, dual distribution is also a vertical relationship, as the manufacturer and the distributor belong to different market levels. This ambiguity has some important legal aspects, since it might not be clear if restraints arising out of dual distribution should be considered as horizontal or vertical. Despite the ambiguity, it would seem that "[o]n balance, dual distribution supports a vertical characterization more than a horizontal one."[126] Both U.S.[127] and EU[128] law seem to be along this line, i.e. they consider dual distribution as a vertical arrangement.

[124] 8 AREEDA & TURNER, *supra* note 14, at 78.
[125] Adam J. Fein & Erin Anderson, *Patterns of Credible Commitments: Territory and Brand Selectivity in Industrial Distribution*, THE JOURNAL OF MARKETING, Vol. 61, No. 2 (Apr., 1997), at 32.
[126] Tyler A. Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way out?*, 67 VA. L. REV. 1457, 1511-12 (1981).
[127] *See, e.g.,* U.S. Department of Justice Vertical Restraints Guidelines of 1985, 50 FR 6263-03 (DoJ Vertical Guidelines), at 6265 ("[T]he fact that a supplier also engages in distribution does not make a restraint 'horizontal.'"); Ryko Mfg. Co. v. Eden Services, 823 F.2d 1215, 1230-31 (8th Cir. 1987) (dual distribution not a horizontal relationship); International Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904, 906 (6th Cir. 1989).
[128] *See* Vertical BER, Art. 2(4); EU Vertical Guidelines, para. 28.

2.2 Introduction to exclusive territories

2.2.1 Notion and types of vertical restraints

Vertical agreements could be defined as agreements between firms at different levels in the production or distribution chain.[129] A typical vertical agreement would be the one which is at the center of this paper's attention – the relationship between a manufacturer and a distributor. The market in which a manufacturer is competing is usually referred to as the upstream market, while the market in which a distributor operates is referred to as the downstream market. Determining whether an arrangement is horizontal or vertical could be of great practical importance, as antitrust laws generally have a more lenient approach towards the latter.

Not all vertical agreements are at the same time considered as vertical restraints. Generally speaking, every agreement restrains the parties to a certain extent. However, in order to be considered as a vertical *restraint*, a vertical agreement has to go beyond merely describing the product characteristics and quantities in which it is to be supplied.[130] In other words, vertical restraints are vertical arrangements that restrict the conditions under which firms may purchase, sell, or resell the contracted products,[131] and thereby represent a restriction of competition.[132] Whether a vertical agreement will contain a vertical restraint depends mainly on the market structure and the division of bargaining power between the

[129] E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 217 (1998). For example, in EU law vertical agreement is defined as "an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services." Vertical BER 2010, Art. 1(a). Conversely, horizontal agreements would be agreements concluded between undertakings competing at the same market level.

[130] Silke Neubauer & Jeremy Lever, *Vertical restraints, their motivation and justification*, E.C.L.R. 2000, 21(1), 7-23 (2000), at 7.

[131] U.S. Department of Justice Vertical Restraints Guidelines of 23 January 1985, 50 FR 6263-03 [withdrawn] (DoJ Vertical Guidelines), at 6264.

[132] Vertical BER, Art. 1.

parties.[133] Finally, it is important to note that a vertical agreement may contain more than one type of vertical restraints.[134]

In general, vertical restraints could be divided into two groups: those limiting competition among distributors of the same manufacturer; and those limiting the buying conduct of distributors.[135] Since they limit competition among distributors of the same brand, restraints belonging to the former group are referred to as intrabrand restrictions. On the other hand, vertical restraints belonging to the latter group are usually referred to as interbrand restrictions, as they affect the distributor's ability to purchase other brands.

Intrabrand restraints could be further divided into price and non-price restraints. Price restraints limit the distributor's freedom to set the retail price and could arise in the form of minimum or maximum resale price maintenance (RPM). Non-price intrabrand restraints are typically divided into territorial and customer limitations; the former limit the area in which the distributor can market the product, while the latter constrain the distributor regarding the type of customers he is supposed to deal with.

A manufacturer will impose customer restraints in situations where he prefers to sell directly to certain customers. A typical customer restraint is a major account program, where a manufacturer identifies customer accounts that are serviced and sold by his sales force.[136] A manufacturer may for example initiate the program if a customer is national in scope and distributors are regional or local, or if customers require servicing or technical assistance that cannot be effectively provided by distributors.[137] This is often the case with the government

[133] Secrieru, *supra* note 30, at 819.
[134] For example, a manufacturer can impose exclusive territories on the wholesale level and RPM on the retail level. Another combination could be between an exclusive territory and an exclusive dealing clause.
[135] *See* William S. Comanor, *Vertical arrangements and antitrust analysis*, 62 N.Y.U. L. REV. 1153 (1987).
[136] John F. Cady, *Reasonable Rules and Rules of Reason: Vertical Restrictions on Distributors*, THE JOURNAL OF MARKETING, Vol. 46, No. 3 (Summer, 1982), pp. 27-37, at 28.
[137] *Id.*

or corporations operating at the national level, since those customers purchase large quantities and involve low selling and delivery costs.[138]

Another type of intrabrand restraint is selective distribution. In such a system a supplier selects his dealers based on some criteria and permits each of them to sell only to final buyers or other dealers in the selective distribution network.[139] The supplier may select his dealers on either qualitative or quantitative basis. In the former case the dealers are selected on the basis of some objective criteria, such as the level of training or services provided by sales personnel.[140] On the other hand, when using quantitative criteria the supplier is more explicitly limiting the number of dealers in a certain area, for example by fixing the number of dealers.[141] Basically, exclusive distribution can be seen as an extreme form of selective distribution, where the number of distributors in a certain territory is fixed to only one.

Although this paper mainly deals with intrabrand restraints, a short description of interbrand restraints is also of relevance. Typical interbrand restraints would be tying and exclusive dealing. Tying is an arrangement where a condition of the sale of one product the seller requires the buyer to purchase a second product from him.[142] However, of more importance for our discussion are exclusive dealing (or single branding[143]) arrangements. These are arrangements where a buyer promises to buy its requirements of one or more products exclusively from a particular supplier.[144] Related to distribution, exclusive dealing would be present if a distributor would undertake not to deal with the manufacturer's rivals, i.e. with producers of other brands. Exclusive dealing is especially important since it is often

[138] Note, *Restricted channels of distribution under the Sherman Act*, 75 HARV. L. REV. 795, 817 (1962).
[139] *See* KORAH & O'SULLIVAN, *supra* note 41, at 7-8.
[140] EU Vertical Guidelines, para. 175.
[141] *Id.*, para. 175.
[142] POSNER, *supra* note 80, at 171.
[143] *See* EU Vertical Guidelines, para. 129.
[144] HOVENKAMP, *supra* note 29, at 436. *See also* DoJ Vertical Guidelines at 6264.

combined with exclusive distribution, and for this reason will be analyzed in more detail further in this chapter.[145]

2.2.2 Exclusive territories defined

The strictest form of vertical territorial restraints is the imposition of exclusive territories. In such an arrangement a manufacturer grants to his distributor exclusivity within a geographical area.[146] Exclusive territories are present in a variety of industries, including newspaper distribution,[147] audio components, hearing aids, sailboats, soft drinks, and beer.[148] Exclusive territories generally do not exist in isolation – a manufacturer usually organizes the distribution of his products through a network of exclusive territories, with each distributor having his own territory.[149] Consequently, exclusive distribution agreements usually contain two clauses.

By the first clause, a manufacturer undertakes not to use other distributors within the exclusive territory.[150] Here it could be disputable whether the manufacturer is precluded from making the sales himself, i.e. whether the agreement allows dual distribution. In order to avoid confusion, the parties are advised address this issue in their agreement. The second clause limits the distributor's sales outside of his exclusive territory.[151] Here a distinction can be made between airtight and non-airtight exclusive territories.

Exclusive territories are airtight if the distributor is completely precluded from making sales outside his territory. On the other hand, in non-airtight arrangements the distributor is only precluded from making active sales outside of the assigned territory, i.e. he is prohibited

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145 *See infra* Part 2.2.5.
146 Secrieru, *supra* note 30, at 798.
147 *Id.*
148 Tim R. Sass & David S. Saurman, *Mandated Exclusive Territories and Economic Efficiency: An Empirical Analysis of the Malt-Beverage Industry*, JOURNAL OF LAW & ECONOMICS, Vol. 36, No. 1 (Apr., 1993), pp. 153-177, at 153.
149 J. GOYDER, *supra* note 123, at 70.
150 Santiago González-Hernando, Víctor Iglesias & Juan A. Trespalacios, *Exclusive territories and performance dimensions in industrial distribution channels*, INDUSTRIAL MARKETING MANAGEMENT, Volume 34, Issue 5, (July 2005), at 536.
151 *Id.*

from soliciting customers outside the territory. Airtight exclusive territories are considered as more pernicious, as they completely eliminate intrabrand competition within a certain territory. As will be shown below, this classification is especially important in the EU, since EU competition law affords substantially different approach to airtight and non-airtight distribution agreements.

Territorial restraints can also take other, less extreme forms. For example, a distribution agreement may contain a location clause, which restricts the distributor's operation to a specific physical site.[152] In other words, a distributor may operate only from a location approved by the supplier. This clause is less restrictive than the imposition of exclusive territories as it does not completely eliminate intrabrand competition – in the presence of a location clause customers can still travel to any location they desire.[153]

Similarly, a manufacturer may assign his distributors the areas of primary responsibility (APR). The similarity with exclusive distribution is that APR also consists of assigning territories to distributors.[154] However, the difference is that APR less strictly divides the territories between the distributors. In the presence of APR the distributor is expected to concentrate on sales in the territory assigned to him.[155] In case he makes a sale outside his territory, he is usually required to compensate the distributor in whose territory the sale is made (profit pass-over).[156] On the other hand, in exclusive distribution agreements a distributor is not only *expected* but also *obliged* to limit his sales to the assigned territory – invading the areas assigned to other distributors' areas is generally treated as a breach of contract.

[152] Cady, *supra* note 136, at 28.
[153] *Id.*
[154] *Id.*
[155] *Id.*
[156] *Id.*

2.2.3 Some rationale behind exclusive territories

One reason why a manufacturer would opt for exclusive distributorship is if the jurisdiction in which he wishes to market the product so requires. This is for example the case with Bahrain, where it is required that trade intermediaries have an exclusive appointment.[157] However, such a requirement is an exception rather than the rule. Consequently, the motivation behind exclusive territories has to be of primarily economic nature.

Since demand for a product rises with a decrease in price, it could be expected that a manufacturer would not be interested in limiting competition among his distributors.[158] Unrestrained competition between distributors would lead to the lowest retail price and increased demand.[159] From this follows that the imposition of exclusive territories inherently brings with it certain costs, since a distributor protected from intrabrand competition will have an incentive to raise the price above the competitive level.[160] However, the fact that manufacturers use exclusive territories despite these costs shows that the deployment of exclusive territories also brings certain benefits for the manufacturer.

Perhaps the most persuasive explanation of why manufacturers impose exclusive territories and vertical restraints in general has been offered by Mathewson and Winter. They note that a manufacturer would be inclined to impose restrictions on resale prices or locations when the conditions in the retail market are not consistent with conventional competition.[161] Imperfect competition generally arises due to the fact that retail markets are spatially differentiated and retailers have a role in informing consumer about products.[162] In such a setting and taking into account the principal-agent problem, vertical restraints are necessary

[157] CLASEN, *supra* note 22, at 11-14.
[158] *See* Cady, *supra* note 136, at 30-31.
[159] Cady, *supra* note 136, at 30-31.
[160] *Id.* at 31.
[161] Mathewson & Winter, *supra* note 55, at 28.
[162] *Id.*

for maximization of the manufacturer's profits.[163] Therefore, in these circumstances unrestrained competition between distributors is not anymore in the manufacturer's interest. This is explained by the presence of three externalities – one vertical and two horizontal.[164]

The vertical externality arises because the distributor does not completely appropriate the increase in profits that results from his additional efforts in promoting the product: a part of the increase would flow to the manufacturer.[165] In order to appropriate a larger part of the profits, the distributor will be inclined to increase the retail price. This in turn could lead to the double marginalization problem, since the manufacturer and the distributor would have a different profit-maximizing price.[166] In addition, the vertical externality would discourage the distributor from investing in advertising and other forms of product promotion,[167] with the end result that both the manufacturer and the distributor are worse off.[168]

The two horizontal externalities have as their effect an increase in demand that other distributors face. The first one is a horizontal externality with advertising spillovers.[169] Its effect is similar to the effect of the vertical externality, the difference being that here the positive externalities arising from advertising accrue not to the manufacturer but to other distributors: a proportion of advertising messages from one outlet increases demand at other outlets.[170] In the presence of this externality the distributor will be discouraged from promoting the product. This would in turn lead to a decrease in demand, making both the distributor and the supplier worse off.

The other horizontal externality is a pecuniary externality, which reduces the distributor's incentive to raise the retail price.[171] By raising the retail price the retailer would

[163] *Id.*
[164] *Id.* at 32.
[165] *Id.*
[166] *Id.*
[167] *Id.*
[168] *See infra* Part 2.3.1.1.
[169] Mathewson & Winter, *supra* note 55, at 32.
[170] *Id.* at 33.
[171] *Id.* at 32.

confer a positive externality on other retailers. Consumers can be expected to buy the product from retailers who charge a lower price, and if one retailer would raise the price consumers would buy the product from retailers who charge the lower price.[172] In other words, by raising the price the retailer would cause a decrease in the demand he is facing and an increase in the demand that his competitors are facing. Therefore, the vertical externality (pushing for an increase in price) and the horizontal pecuniary externality (pushing against an increase in price) have opposite effects on the retail price, and which one will prevail depends on which one is dominant.[173]

A manufacturer could eliminate these three externalities by integrating vertically. This would for example be a good solution when the manufacturer's margin is very large and the quantity of desired dealer services is also very large and not easily measurable.[174] However, vertical integration could be costly and lead to another set of problems.[175] For this reason a manufacturer could try to eliminate the externalities by deploying exclusive territories.[176] This way the manufacturer would be able to resolve some of the problems that are also tackled with vertical integration, but without the shortcomings of the full vertical integration.

In a way, restrictive distribution agreements represent the middle ground between independent dealings (no control) and vertical integration (complete control).[177] This is also the case with exclusive distribution agreements. Empirical studies have shown that the use of exclusive territories is closely connected with a manufacturer's desire to exercise control over the distribution process. For example, Frazier and Lassar demonstrate that the more the

[172] *Id.*
[173] *Id.*
[174] Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, JOURNAL OF LAW AND ECONOMICS, Vol. 31, No. 2 (Oct., 1988), pp. 265-297, at 292. Klein and Murphy offer the example of perfume and cosmetics manufacturers, who often use their own employees when performing product demonstrations. *Id.*
[175] *See supra* Part 2.1.2.2.
[176] *See* Secrieru, *supra* note 30, at 798-99.
[177] Preston, *supra* note 62, at 506. *See also* Alan J. Meese, *Price theory and vertical restraints: A misunderstood relation,* 45 UCLA L. REV. 143, 186 (1997) ("[T]he choice between complete reliance on the market and complete integration is not a happy one. Minimum resale price maintenance and exclusive territories are examples of partial integration – a middle ground between these two unhappy choices.").

manufacturer needs to closely coordinate the distribution process with the distributor, the more willing he will be to grant exclusive territories.[178] This is because an exclusive distributor will have more incentive to be receptive towards the manufacturer's coordination efforts than a non-exclusive one.[179] Along the same line, Iglesias, Trespalacios, and Vázquez find that the supplier can exert more influence over the distribution process if the distribution agreement is exclusive, i.e. in such a case the distributor will be more willing to accept the manufacturer's interference.[180]

In a later paper, Winter further elaborates the rationale behind vertical restraints.[181] He notes that the incentive for vertical restraints flows from three characteristics of retail markets. First, the role of services provided by retailers is to reduce consumers' opportunity costs of obtaining a product.[182] Second, retailers are differentiated because of location and the time it takes consumers to travel or search among stores.[183] And third, consumers are heterogeneous in their opportunity costs of time.[184] In order to attract consumers, each retailer then selects the mix of price and service that he finds most optimal for his profits.[185]

Since consumers who switch between retailers are generally those with low time-costs, retailers are more likely to engage in price than in non-price competition among each other.[186] Compared with the optimal mix of the price and services (i.e. the mix that would maximize the combined profits of the manufacturer and the retailer), unrestrained retailers rely too much on low prices instead of high service to attract consumers.[187] Vertical restraints

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[178] Gary L. Frazier & Walfried M. Lassar, *Determinants of Distribution Intensity*, THE JOURNAL OF MARKETING, Vol. 60, No. 4 (Oct., 1996), at 42.
[179] *Id.*
[180] Víctor Iglesias, Juan A. Trespalacios & Rodolfo Vázquez, *Effects of Exclusivity Agreements on Supplier's Control Over Marketing Channels,* JOURNAL OF MARKETING CHANNELS, Vol. 7(4) 2000, at 75.
[181] Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, THE QUARTERLY JOURNAL OF ECONOMICS, Vol. 108, No. 1 (Feb., 1993), pp. 61-76.
[182] *Id.* at 62.
[183] *Id.*
[184] *Id.*
[185] *Id.*
[186] *Id.*
[187] *Id.* at 63.

could correct this distortion and encourage dealers to provide an adequate level of product-related services.[188] More specifically, exclusive territories can be used to correct the distortion by eliminating the inter-retailer margin and cross-elasticities.[189]

Although exclusive territories can be used in order to resolve the externalities described above, this type of restraint may cause another set of problems. If a manufacturer has a dominant position in the upstream market, granting exclusive territories could lead to the problem of double marginalization.[190] This is due to the fact that in the presence of exclusive territories a distributor has monopoly with regards to the selling of the manufacturer's product. And as shown above, two monopolies in a vertical structure may lead to an inefficient outcome.[191] In such circumstances exclusive territories can lead to higher prices in the downstream market, thereby decreasing total welfare and hurting consumers.[192] Therefore, by trying to internalize horizontal externalities, the manufacturer could be magnifying the vertical externality.[193] In order to solve this problem, the manufacturer can combine exclusive territories and RPM – he could first grant exclusive territories and then impose maximum RPM on his exclusive distributors.[194]

2.2.4 Exclusive territories and resale price maintenance

Exclusive territories and RPM[195] both belong to the group of intrabrand restraints and can both be used in order to resolve externalities arising out of the distribution process. For this reason it could be interesting to compare these two types of restraints and assess to what

[188] *Id.* at 62.
[189] *Id.* at 64.
[190] *See* MASSIMO MOTTA, COMPETITION POLICY 309 (2004) ("[B]y reducing competition downstream, e.g. by assigning exclusive territories to retailers, . . . the double marginalization problem is aggravated and welfare is reduced.").
[191] *See infra* Part 2.1.2.1.3.
[192] Rey & Stiglitz, *supra* note 48, at 431.
[193] *See id.* at 432 ("Earlier proponents of the legalization of exclusive territories have argued that there must be significant public-good aspects of distribution to justify a producer's granting an exclusive territory, since in the absence of such efficiency benefits, producers are harmed by 'double marginalization' because retailers, with limited competition, will charge a greater markup over the wholesale price, meaning that the producer is hurt by the reduced sales.").
[194] *See* MOTTA, *supra* note 190, at 308. In the alternative, the manufacturer could simply set the wholesale price equal to marginal cost and thus eliminate the vertical externality. Secrieru, *supra* note 30, at 802.
[195] Unless otherwise noted, in this section by RPM we mainly refer to minimum RPM.

extent they can be used as substitutes. A related issue is whether a different legal treatment for these two types of restraints is appropriate.

According to one view, exclusive territories and RPM have the same effect on competition. For example, Bork argues that these two restraints represent economic equivalents, i.e. that they have the same economic impact and the same relation to competition and consumer welfare.[196] This approach relies on the reasoning that exclusive territories protect a distributor from competition, which in turn inevitably affects the distributor's margin and the resale price.[197] In other words, although exclusive territories are a non-price restraint, they inevitably have an effect on the retail price. This line of argument has led some authors to conclude that exclusive territories and RPM generally serve the same purposes[198] and hence should be accorded the same legal treatment.[199]

Conversely, there are also opinions that exclusive territories and RPM are not necessarily substitutes.[200] According to this approach, the best proof that these two restraints do not have the same effect is the fact that some manufacturers impose RPM rather than exclusive territories, even though the former is generally afforded better treatment by antitrust laws.[201] In line with this, some argue that RPM can enable manufacturers more control over the distributors than exclusive territories[202] and that accordingly a legal asymmetry between exclusive territories and RPM is justified.[203]

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196 ROBERT H. BORK, THE ANTITRUST PARADOX 280 (1993).
197 William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 984 n.6 (1985).
198 ROGER D. BLAIR & DAVID L. KASERMAN, LAW AND ECONOMICS OF VERTICAL INTEGRATION AND CONTROL 183 (1983); Mathewson & Winter, *supra* note 55, at 28.
199 *See, e.g.*, Mathewson & Winter, *supra* note 55, at 28. BLAIR & KASERMAN, *supra* note 198, at 183.
200 *See, e.g.*, Patrick Rey & Jean Tirole, *The Logic of Vertical Restraints*, THE AMERICAN ECONOMIC REVIEW, Vol. 76, No. 5 (Dec., 1986), pp. 921-939, at 922.
201 David W. Boyd, *Resale price maintenance or dealer exclusive territories? Toward a theory of product distribution,* AMERICAN ECONOMIST, Vol. 40 Issue 2 (Fall 1996), at 86; Michael Waterson, *On Vertical Restraints and the Law: A Note*, THE RAND JOURNAL OF ECONOMICS, Vol. 19, No. 2 (Summer, 1988), at 293.
202 Waterson, *supra* note 201, at 296.
203 *Id.* at 297.

Both exclusive territories and minimum RPM can be used in order to ensure that distributors provide an adequate level of product-related services. In certain situations exclusive territories can be said to have some advantages over RPM, and vice versa. For example, exclusive territories seem to be more efficient than RPM when it comes to eliminating the potential for inter-distributor free-riding.[204] This is because in case of exclusive territories intrabrand competition inside a certain area is completely eliminated, while in the presence of RPM some degree of competition between distributors still exists.

Further, exclusive territories seem to be more flexible than RPM when it comes adjusting to the changes in local conditions. In case of a low demand, the manufacturer can achieve the economies of scale and scope by assigning large territories and broad product spans to his distributors.[205] Conversely, such adjustment is not possible with RPM.[206] Finally, exclusive territories can be used in order to avoid an inefficient equilibrium arising out of a more than optimal number of retailers in a certain area.[207] By assigning exclusive territories to his distributors a manufacturer may be able to dictate the equilibrium, which is something that RPM cannot achieve.[208]

On the other hand, minimum RPM could be more effective than exclusive territories when it comes to preventing arbitrage. If imposed over all distributors, RPM could destroy the incentive for customers to seek a lower price elsewhere, which is something that cannot be achieved by exclusive territories.[209] In addition, RPM could enable a manufacturer more control over interbrand competition in the downstream market.[210] This is because in the absence of RPM some retailers who see marginal revenue in excess of marginal cost will start

[204] Klein & Murphy, *supra* note 174, at 280.
[205] SCHERER & ROSS, *supra* note 70, at 559.
[206] *See id.* (if the price and distributor margins are set too high, entry by new distributors will be encouraged, which can result in squeezing individual dealers to inefficiently small scales).
[207] Waterson, *supra* note 201, at 295.
[208] *Id.*
[209] *Id.* at 294.
[210] *Id.* at 294-95.

price-cutting, even in the presence of exclusive territories.[211] This could lead to a decrease in prices and the situation in which some territories are not served.[212] In other words, RPM may control interbrand price rivalry, while exclusive territories cannot.[213]

One of the factors that influence the choice between exclusive territories and RPM is the market level at which the restraint is to be imposed. In this respect exclusive territories are more apt for the wholesale level, while RPM is better equipped for the retail level.[214] This is due to the fact that it is generally impractical to grant retailers exclusive territories, since these territories would have to be uneconomically large in order to have the market power needed for solving the inter-dealer free-rider problem.[215]

The choice between exclusive territories and RPM also depends on the level of uncertainty in the downstream market. Rey and Tirole show that in the presence of cost uncertainty the manufacturer will prefer exclusive, while in the presence of demand uncertainty the manufacturer would rather opt for RPM.[216] Finally, the choice between exclusive territories and RPM depends on the life cycle of the product – the longer the life cycle, the worse is the residual free riding problem, which would incline towards exclusive territories.[217]

Based on the above, it can be concluded that there certainly is a difference between exclusive territories and RPM. It seems without doubt that exclusive territories and RPM do differ to a certain extent, as they can be used in different circumstances and for addressing different problems. Both of these restraints have certain advantages as well as drawbacks and the manufacturer's decision about which restraint to use will depend on the circumstances of

211 *Id.*
212 *Id.*
213 *Id.*
214 Klein & Murphy, *supra* note 174, at 280.
215 *Id.* at 282.
216 Rey & Tirole, *supra* note 200, at 937.
217 Boyd, *supra* note 201, at 87.

each particular case.[218] However, a substantially different legal standard for these two types of restraints does not seem justified.

2.2.5 Exclusive territories and exclusive dealing

Regardless of whether it is called exclusive dealing or single branding, the obligation accepted by the distributor not to handle competing goods can often be found in exclusive distribution agreements.[219] This is because the territorial restraint (i.e. the distributor's exclusivity in a certain area) can be regarded as consideration for exclusive dealing.[220] Territorial exclusivity protects primarily the distributor, since it insulates him from intrabrand competition in his territory. On the other hand, exclusive dealing is chiefly in the manufacturer's interest, since he can rely on the fact that the distributor will not handle goods of other manufacturers.

As a result, a distribution agreement that contains both a territorial restraint and an exclusive dealing clause could represent the best solution for the parties. Empirical studies confirm this. For example, Anderson and Weitz show that the grant of exclusive territories is seen by a distributor as a manufacturer's commitment to the distribution relationship.[221] This in turn gives an incentive to the distributor to show his commitment by being more willing to agree to an exclusive dealing clause.[222]

Unlike exclusive territories, aimed at curbing intrabrand free-riding, exclusive dealing tackles interbrand free-riding. An example of interbrand free riding would be when a dealer having an ongoing supply relationship with one supplier sells a second brand at the same location, thereby taking advantage of facilities or goodwill contributed by the supplier of the

[218] Klein & Murphy, *supra* note 174, at 280.
[219] SCHERER & ROSS, *supra* note 70, at 558.
[220] 8 AREEDA & TURNER, *supra* note 14, at 143.
[221] Erin Anderson & Barton Weitz, *The Use of Pledges to Build and Sustain Commitment in Distribution Channels*, JOURNAL OF MARKETING RESEARCH, Vol. 29, No. 1 (Feb., 1992), at 27.
[222] *Id.*

first brand.[223] The supplier of the first brand would certainly not look at such a situation benevolently, since no firm would want to finance a distribution network for its competitors.[224]

Another form of interbrand free-riding has to do with advertising. When investing in advertisement, a manufacturer expects to increase the sale of his product. If the arrangement between him and the dealer is not exclusive, the dealer may substitute the advertised product with a similar but unadvertised brand.[225] This would discourage the manufacturer from making the promotion investments in the first place, because he would know that dealers could use the investments in order to sell rival products.[226] Conversely, exclusive dealing gives the dealer a strong incentive to promote the contracted good, since the dealer cannot make money on any other brand.[227]

Exclusive dealing also solves the problem of defining the efforts that the dealer is supposed to undertake with regards to product promotion – the dealer in an exclusive dealing arrangement will give his best efforts, since it is in his interest to do so.[228] On the other hand, when a distributor carries competing brands, he gives the appearance of endorsing them all, and becomes a less credible advocate for any of them.[229]

Exclusive dealing can also be used to prevent the hold-up problem.[230] Once a manufacturer makes a distribution-related investment, the distributor may attempt to "hold up" the manufacturer. The distributor could do so by threatening to cease with distributing the manufacturer's products, which would cause the manufacturer to suffer a capital loss on its investments. Under an exclusive dealing arrangement this problem would be avoided,

[223] HOVENKAMP, *supra* note 29, at 434.
[224] R.M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 128 (1983).
[225] H.P. Marvel, *Exclusive Dealing*, JOURNAL OF LAW AND ECONOMICS, Vol. 25, No. 1 (Apr., 1982), at 7.
[226] B. Klein, *Exclusive Dealing as Competition for Distribution "On the Merits"*, 12 GEO. MASON L. REV. 119, 138 (2003).
[227] EINER ELHAUGE & DAMIEN GERADIN, GLOBAL ANTITRUST LAW AND ECONOMICS 502 (2007).
[228] ROBERT SCOTT & JODY KRAUS, CONTRACT LAW AND THEORY 329 (2007).
[229] Steuer, *supra* note 224, at 125.
[230] Klein, *supra* note 226, at 135.

since the distributor would not be able to sell any competing goods, and therefore his threat would be more difficult to realize.

A manufacturer will opt for exclusive dealing only if his brand is strong.[231] Otherwise, his decision in that direction might not be rational from a business perspective. If a manufacturer enters into an exclusive dealing arrangement with his distributor, it means that in the distributor's retail outlet the consumer will be able to find only the manufacturer's brand of the product in question. In other words, the consumer will decide to go to the retailer only if he specifically wants the manufacturer's brand, and not any other. And if the manufacturer's market share is small, the number of such buyers will not be great. For this reason, for a manufacturer with a small market share it may be better to allow his dealer to carry other (more popular) brands as well, since that way he can increase the number of potential buyers of his product.

In addition, it is not clear what would be the dealer's incentive to accept exclusive dealing if the manufacturer has a small market share. The dealer would probably prefer to be able to sell the goods of other manufacturers as well, since it is not likely that he would earn enough profit by selling exclusively a little know brand. Empirical studies confirm this. For example, Fein and Anderson show that in highly competitive product categories neither side will limit its options – distributors will tend not accept exclusive dealing, and manufacturers will be reluctant to grant exclusive territories.[232]

Therefore, an arrangement that combines exclusive territories and exclusive dealing could be an optimal solution for a distribution relationship, since it can advance both the supplier's and the distributor's interests. However, as it restricts both intrabrand and interbrand competition, the combination of these two arrangements could be considered as

[231] Marvel, *supra* note 225, at 10.
[232] Fein & Anderson, *supra* note 125, at 32.

more pernicious than each of them is individually.[233] Consequently, the parties to such an agreement should take into account that their relationship could come under an increased scrutiny by antitrust laws.

2.3 Potential impact of exclusive territories

2.3.1 Justifications

2.3.1.1 Elimination of free-riding

One of the most often mentioned justifications for exclusive distribution is that it enables a manufacturer to eliminate the free-rider problem. Generally speaking, a free rider is someone who receives a certain benefit but avoids paying for it.[234] Related to the issue of distribution, two types of free-riding could occur: interbrand and intrabrand. Interbrand free-riding exists when a distributor uses the facilities provided by one manufacturer in order to market products of some other supplier. This form of free-riding is usually tackled by exclusive dealing.[235] On the other hand, intrabrand free-riding would occur when a distributor of a certain brand invests in the promotion of that brand, while other distributors of the same brand also benefit from the promotion efforts. A manufacturer may solve this problem by assigning exclusive territories.

The free-rider problem was noticed as early as the fifteenth century, in the context of monopolistic rights granted to companies for long distance trade.[236] However, when it comes to vertical restraints, the problem seems to have been first introduced into economic analysis by Lester Telser.[237] According to Telser, a manufacturer limits competition among dealers in order to assure that they provide adequate services. Although in his analysis Telser mainly

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[233] *See* EU Vertical Guidelines, para. 162.
[234] MANKIW, *supra* note 11, at 226.
[235] *See infra* Part 2.2.5.
[236] Mervyn Martin, *Sole distribution agreements in the context of the general principles of free trade and competition*, 35 SYRACUSE J. INT'L. L. & COM. 77, 82 (2007).
[237] Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, JOURNAL OF LAW AND ECONOMICS, Vol. 3, (Oct., 1960), pp. 86-105.

focuses on resale price maintenance, the results he reached are also valid in the context of exclusive territories. This is how Telser describes the essence of the free-rider problem:

> A customer, because of the special services provided by one retailer, is persuaded to buy the product. But he purchases the product from another paying the latter a lower price. In this way the retailers who do not provide the special services get a free ride at the expense of those who have convinced customers to buy the product. As a result few or none of the retailers offer the special services the manufacturer thinks necessary to sell his products.[238]

Therefore, in such a situation an inefficient equilibrium would occur – the distributor that was providing special services would stop doing so and sales of the product would decline, making both the manufacturer and the potential customer worse off.[239]

The essence of the free-rider problem is connected with a market imperfection which arises due to a conflict between a distributor's short-run and long-run interest.[240] In the short run a distributor would be inclined towards cutting the sales services he provides in order to be able to charge a lower price and thereby increase his sales.[241] However, other distributors can be expected to take the same path and shirk on the provision of product-related services. As a result, the distributed brand would become less competitive and there would be a decrease in overall sales, to the detriment of all dealers and of the manufacturer.[242] In order to avoid this outcome, the manufacturer could make a distributor exclusive for a certain territory. The purpose of such restraint is to make sure that the business unit that provided certain sales effort gets the benefit when such sales occur.[243] In other words, the goal would be to internalize the horizontal externality with spillovers.[244]

Apart from free-riding on actions taken by other distributors, a distributor may also attempt to free-ride on the manufacturer's reputation. The potential for this type of free-riding

[238] *Id.* at 91.
[239] Lester G. Telser, *Why should manufacturers want free trade II?*, JOURNAL OF LAW AND ECONOMICS, Vol. 33, No. 2 (Oct., 1990), pp. 409-417, at 409-410.
[240] Luc Gyselen, *Vertical Restraints in the Distribution Process: Strength and weakness of the free rider rationale under EEC competition law*, 21 CML REV., pp. 647–668 (1984), at 649.
[241] *Id.*
[242] *Id.*
[243] Bork, *supra* note 49, at 436.
[244] *See infra* Part 2.2.3.

exists where consumers cannot detect pre-sale services that influence product quality.[245] This would for example be the case with products that have limited shelf life, such as beer.[246] In that case a distributor would have an incentive to avoid performing certain pre-sale services that influence the quality of the product, such as providing adequate storage and assuring that there is adequate rotation of the product.[247] He would do so if he would calculate that the short-run profit he would gain by engaging into such practices would be higher than the future loss of sales due to deterioration in the manufacturer's reputation.[248] From the manufacturer's point of view, one way of solving this problem would be to grant the distributor an exclusive territory. This would enable the distributor to earn quasi-monopoly profits and make him less prone towards engaging in shirking activities.[249]

Related to the issue of free-riding on the supplier's reputation is the observation that the free-rider problem is even more pronounced in the presence of dual distribution.[250] As shown above, dual distribution is a situation where a manufacturer distributes part of his products on his own and another part through a distribution network. In this situation there would be a potential for free-riding by distributors. Manufacturer-owned outlets do not have an incentive to engage into free-riding since a fall in sales will directly harm the manufacturer's profits.[251] On the other hand, independent dealers can assume that the manufacturer-owned outlets will have a strong incentive to provide product-related services even if other dealers do not, which could give an incentive to independent dealers to engage into free-riding practices.[252]

[245] Klein & Murphy, *supra* note 174, at 273.
[246] *Id.*
[247] *Id.*
[248] *Id.* at 274.
[249] *Id.*
[250] HOVENKAMP, *supra* note 29, at 490.
[251] *Id.*.
[252] *Id.*.

An important issue is which goods are generally prone to free-riding. In general, goods can be divided into two large groups: convenience and shopping goods.[253] Convenience goods are the goods with relatively low price for which the buyer does not usually shop around and buys them at the nearest available store, such as food, cigarettes, toothpaste.[254] On the other hand, shopping goods are relatively expensive items in the purchase of which the consumer is likely to invest more effort and compare brands, deferring the purchase for a considerable time and perhaps traveling considerable distances before making his decision.[255] Although it is not always easy to classify a good into one of these two groups, the classification can be instructive with regards to the analysis at hand.

In this light, it would seem that an exclusive distribution arrangement makes sense only for shopping goods. It generally will not be in a manufacturer's interest to impose exclusive territories with regards to convenience goods, since the sales volume of such goods is directly related to the number of distribution points at which these products are available.[256] In case the distribution process is performed without the use of vertical restraints, a product will be available in all outlets where the consumer is willing to pay the cost of getting it there, reflected in the product's price.[257] On the other hand, the analysis changes with regards to shopping goods. This is because in the sale of shopping goods what matters is not (only) the number of distribution points, but also the product-related services performed at these points. Consequently, in order to ensure the provision of these services in the sale of shopping goods a manufacturer may decide to deploy exclusive territories.[258]

Empirical studies confirm the relationship between the nature of a good and the use of exclusive territories. As practice has shown, manufacturers are especially keen on imposing

253 *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 795.
254 *Id.*
255 *Id.*
256 Cady, *supra* note 136, at 32.
257 *Id.* at 32.
258 *See* Bork, *supra* note 49, at 446.

this type of restraint when the product involved is expensive and complicated and requires certain investments by the dealer.[259] Related to this, Frazier and Lassar empirically examine the relationship between exclusive territories and distribution intensity.[260] They find that the more a manufacturer positions his brand as high quality and the higher his target focus is, the more likely he will be to grant exclusive territories.[261]

Apart from the nature of a product, the level of trade also influences the way in which the product will be distributed. This is because there are goods for which exclusive arrangements do not make sense at the retail level, but can be reasonable at the wholesale level.[262] An example would be the distribution of tobacco and alcoholic beverages.[263] Although tobacco and alcoholic beverages might not be considered as shopping goods in the above meaning, it is not rare that the manufacturer of these goods appoints an exclusive distributor for the product at the wholesale level. As shown above, exclusive territories are generally more apt for the wholesale level, while some other restraints (such as RPM) seem to be a better solution at the retail level.[264]

Finally, a word of caution is needed with regards to the free-rider argument. Although the argument offers a powerful justification for the imposition of exclusive territories, it is debatable how often free-riding actually occurs in practice. The empirical significance of the free-rider problem seems to be modest.[265] A number of products are simple consumer

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[259] *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 806.
[260] *See* Frazier & Lassar, *supra* note 178. They define distribution intensity as "the extent to which a manufacturer relies on numerous retailers in each trade area to carry its brand." *Id.* at 40.
[261] *Id.* at 40-41. They define target focus as "the extent to which a manufacturer concentrates on a narrow spectrum of the general market". *Id.* at 41.
[262] *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 803.
[263] *Id.*
[264] *See infra* Part 2.2.4.
[265] *See* F.M. Scherer, *The Economics of Vertical Restraints*, 52. ANTITRUST L.J. 687, 692 (1983) ("[T]he free rider theory can carry only very limited weight. It is true in some cases. But in a large class of cases it just does not fit the real world."). *See also* George A. Hay, *The Free Rider Rationale and Vertical Restraints Analysis Reconsidered*, 56 ANTITRUST LJ. 27, 35 (1987); Willard F. Mueller, *The Sealy Restraints: Restrictions on Free Riding or Output?*, 1989 WIS. L. REV. 1255 (1989); Robert L. Steiner, *Sylvania Economics - A Critique*, 60 ANTITRUST L. J. 41 (1991).

products for which special services are not needed. In such cases the argument that vertical restraints are imposed in order to curb the free-rider problem does not stand.[266]

If the service that the distributor is providing is not prone to free-riding and a vertical restraint is still employed, it is likely that the purpose behind the restraint is anticompetitive.[267] This is because in a setting where there are no services prone to free-riding there would probably be more variety in distribution services without vertical restraints than in their presence.[268] Consequently, if exclusive territories are used despite the fact that the product is a simple one, this could be a signal that there is an anti-competitive reason for imposing the restraint.

2.3.1.2 Wider sales margins and lower monitoring costs

An important effect of exclusive territories is that they provide wider sales margin to distributors than it would be the case with a non-exclusive appointment.[269] Exclusive territories achieve this by eliminating nearby retailers, lessening the possibility that some of the gain from the supply of desired services will accrue to other retailers.[270] A wider margin gives an incentive to distributors to have larger inventories and invest more in advertising and promotional activities, all of which benefits the manufacturer.[271] By establishing exclusive territories a manufacturer is transferring the burden of monitoring unauthorized intrabrand competition on a distributor, since as a monopolist in his area the distributor has all the incentive to police his territory.[272] As a result, both the manufacturer and the distributor will be better off in light of increased sales, while consumers will benefit through better product support.

[266] Wegener, *supra* note 6, at 71.
[267] Comanor, *supra* note 135, at 1157.
[268] *Id.*
[269] SCHERER & ROSS, *supra* note 70, at 558.
[270] Klein & Murphy, *supra* note 174, at 265-66.
[271] SCHERER & ROSS, *supra* note 70, at 558.
[272] Philip C. Zerrillo, Jon M. Flemming & Angela McKee, *Vertical territory and customer resale restrictions: a new rule of reason approach*, 22 J. CORP. L. 705, 711 (1997).

If a distributor is protected from intrabrand competition and is hence able to earn above competitive profits, he will be reluctant to lose that privilege. Consequently, he will be motivated to eagerly promote the product and comply with the manufacturer's suggestions and interests.[273] This way the moral hazard problem arising out of the manufacturer-distributor relationship could be mitigated – the privilege of continued future dealing with the manufacturer could be seen a bond for the distributor's performance.[274] Therefore, by ensuring high profits to the distributor, the manufacturer is paying for the opportunity to influence the distribution process.[275]

In other words, by providing a distributor the opportunity of having higher profit margins, the manufacturer can solve the problem of monitoring the distributor's efforts.[276] In this respect exclusive territories can be used in order to decrease the short-run gain to nonperforming dealers and increase the long-run gain to performing dealers.[277] The former aim exclusive territories achieve by reducing each dealer's demand elasticity, since dealers in the exclusive distribution system possess individual market power.[278] The second aim is achieved by assuring quasi-monopoly profits to distributors, making the termination costly.[279]

Apart from lessening the distributor's incentive to engage in free-riding activities, a higher profit margin can also help the manufacturer recruit the best dealers in the area.[280] The

[273] *Id.*
[274] Victor P. Goldberg, *The free rider problem, imperfect pricing, and the economics of retailing services*, 79 NW. U. L. REV. 736, 749 (1984).
[275] *Id. See also* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 68-69 (2007) ("[T]he wages of labour vary accordingly to the small or great trust which must be reposed in the workmen. The wages of goldsmiths and jewellers are everywhere superior to those of many other workmen, not only of equal, but of much superior ingenuity, on account of the precious materials with which they are intrusted. We trust our health to the physician: our fortune and sometimes our life and reputation to the lawyer and attorney. Such confidence could not safely be reposed in people of a very mean or low condition.").
[276] *See* Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 89, No. 4 (Aug., 1981), pp. 615-641, at 617-18 ("[W]ider sale margin for the distributor, that is market prices above competitive prices, can be a means of making firms not cheat on promises to sell high quality output.").
[277] Klein & Murphy, *supra* note 174, at 267.
[278] *Id.* at 280.
[279] *Id.*
[280] Goldberg, *supra* note 274, at 749.

prospect of supra-competitive profits is a good way of attracting dealers of superior ability[281] who can be expected to achieve higher sales for the manufacturer's product.[282] By being able to choose the most capable dealer the manufacturer can also minimize his credit risk, since he can choose the most solvent dealer for a certain area.[283] Also, an experienced dealer can give the manufacturer a good estimate regarding the product demand, so that the manufacturer can plan his production accordingly.[284]

One might ask why the distributor would use extra profits in order to provide after-sale services instead of retaining the difference. According to Posner, an exclusive dealer would rather provide those services than pocket the difference between a high price and the cost of distribution with little service since otherwise the manufacturer will reassign the territory to another dealer.[285] Related to this, Iglesias, Trespalacios, and Vázquez empirically examine the effect of exclusive territories on contractual performance in exclusive distribution agreements.[286] They show that in exclusive distribution arrangements both the manufacturer and the distributor have a higher role performance.[287] In other words, when a distribution relationship is exclusive, each side sees the other side's performance in a more positive light than it is the case in a non-exclusive distributorship.

Despite these arguments justifying the use of exclusive territories, there are also views that the adequate provision of special services could be ensured even without the deployment of this type of restraint. For example, one argument is that products and services could be

[281] SCHERER & ROSS, *supra* note 70, at 558.
[282] *See* Baker, *supra* note 126, at 1519 (the most important reason why manufacturers grant exclusive distributorships is to recruit better distributors).
[283] *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 805.
[284] *Id.* at 805.
[285] Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, THE UNIVERSITY OF CHICAGO LAW REVIEW, Vol. 45, No. 1 (Autumn, 1977), at 4.
[286] González-Hernando, Iglesias & Trespalacios, *supra* note 150.
[287] *Id.* at 541. This leads the authors to conclude that exclusive distribution agreements are efficiency-enhancing and do not significantly decrease competition. *Id.* at 542.

priced separately.[288] This way it would be possible to directly match the income from a special service with the costs incurred in providing the service. In other words, there would be no free-rider problem and hence no need to impose exclusive territories as a means of curbing the problem.

However, such a solution would not be practical, as it would require setting up a system which would enable charging customers for the product-related service they obtain.[289] This would entail at least two problems. First, such a system could seem complicated and turn away potential customers from making the purchase of the product (and the services) in the first place. In addition, the operation of the system would not be costless, which means that the costs incurred on its maintenance would have to be born by the manufacturer and the distributor, making the distributed brand less competitive in the market.

Another argument is that instead of imposing intrabrand restraints a manufacturer can simply contract for the appropriate level of special services.[290] In such a case the distribution agreement would stipulate what services and for what compensation the distributor will perform the special services.[291] The manufacturer would then monitor the distributor's compliance with the agreement and refuse to pay for services not adequately performed.[292] Therefore, according to this proposal the provision of special services would be directly monitored, without the need for exclusive territories as a means of ensuring indirect control.

However, this solution would also be coupled with significant costs, which would surpass the costs related to negotiating and enforcing an exclusive distribution agreement.[293] It would be extremely difficult for the manufacturer to measure the amount of effort that the distributor is putting into promotion of the product. And even if that sort of control would be

[288] William S. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1430 (1968).
[289] Telser, *supra* note 237, at 92.
[290] *See* Meese, *supra* note 177, at 191.
[291] *Id.*
[292] *Id.*
[293] *Id.*

possible, an explicit contract regarding this performance would not be made because it would be prohibitively expensive to measure and specify the breach in a way that would be satisfactory to a court.[294] For this reason, rather than relying on a third-party enforcer, it might be better to rely on private enforcement by threat of termination of the contract.[295]

In addition, a manufacturer can be expected to use exclusive territories only if it is otherwise difficult to measure the distributor's performance. If there is a feasible and cheap way to objectively measure the output, explicit contractual solutions with government enforced penalties can actually be a better solution.[296] Related to this, an empirical study by Dutta, Heide, and Bergen shows that the imposition of exclusive territories is closely connected with transaction costs – the more difficult it is for the manufacturer to monitor the observance of exclusive territories, the less likely it is that he will deploy them.[297]

Although they enable a manufacturer to lower the costs of monitoring contract performance, exclusive territories are not a completely costless mechanism. For example, the manufacturer must determine the optimal size of exclusive territories, select distributors, supervise distributor compliance, and in some cases resolve disputes among distributors.[298] Nevertheless, it would still be easier for the manufacturer to monitor the observance of exclusive territories than it would be to observe whether the distributor is actually providing the special services.[299] In the former case it would be easier and less costly for the manufacturer to attribute responsibility to the breaching distributor.[300]

Another cost for the manufacturer is the cost of monitoring whether a distributor violates other distributors' territory. The observance of exclusive territories will be also

[294] Klein & Murphy, *supra* note 174, at 267-68.
[295] *Id.*
[296] Klein & Leffler, *supra* note 276, at 634.
[297] Shantanu Dutta, Jan B. Heide & Mark Bergen, *Vertical Territorial Restrictions and Public Policy: Theories and Industry Evidence*, THE JOURNAL OF MARKETING, Vol. 63, No. 4 (Oct., 1999), at 131.
[298] Cady, *supra* note 136, at 31.
[299] *See* Telser, *supra* note 237, at 94.
[300] WILLIAMSON, *supra* note 55, at 187.

monitored by the distributors themselves, since it can be expected that distributors will swiftly report to the manufacturer any crossing of territorial lines.[301] Related to this, a study shows that even with wider sales margins distributors might still have an incentive to sell beyond their assigned territories, which is a practice usually referred to as bootlegging.[302] However, the manufacturer will not punish all violations but will rather tolerate certain level of bootlegging.[303] When deciding whether to react to bootlegging, the manufacturer can be expected to take into account the importance of the product-related services, the effect that bootlegging has on the distributor's margin, as well as the manufacturer's commitment to the relationship with the bootlegging distributor.[304]

Finally, it is important to mention that some of the aims described in this and previous section could also be achieved by another type of intrabrand restraint – selective distribution. Similarly to the deployment of exclusive territories, a supplier will generally opt for selective distribution if his product requires pre-sale services.[305] The purpose behind establishing a selective distribution system is to limit price competition and rather focus on non-price aspects, such as pre-sale services or the location from which the product is sold.[306] By limiting price competition the supplier wants to exclude discounters from his distribution network,[307] since otherwise they would be able to free-ride on pre-sale services provided by other distributors.[308]

Based on this, one of the differences between an exclusive and selective distribution system would be that in the latter some of the aims are achieved more directly. While in the case of exclusive territories a supplier can be seen as granting exclusive territories as

[301] BORK, *supra* note 196, at 291.
[302] Shantanu Dutta, Mark Bergen & George John, *The Governance of Exclusive Territories When Dealers Can Bootleg*, MARKETING SCIENCE, Vol. 13, Issue 1 (Winter 1994), at 83.
[303] *Id.* at 84.
[304] *Id.*
[305] KORAH & O'SULLIVAN, *supra* note 41, at 7-8.
[306] *Id.* at 85.
[307] MONTI, *supra* note 45, at 370.
[308] JONES & SUFRIN, *supra* note 37, at 641.

compensation in the process of recruiting sufficiently competent dealers, selective distribution system perform this in a more direct manner. By setting the criteria based on which distributors may become part of the network, the manufacturer is making sure that only dealers with a certain degree of competence will be distributing his product. Therefore, in certain cases a manufacturer may decide that a selective distribution system is a better solution than the use of exclusive territories, especially if the law treats the latter more harshly.

2.3.1.3 Facilitating new entry

Although they can be beneficial even for products already established in the market, exclusive territories are especially useful for new products. When a product is new, it needs extensive promotion in order to gain foothold in the market.[309] This can only be provided if a distributor knows that other distributors will not free ride on his efforts,[310] i.e. if he knows that others will not be able to benefit from activities related to the market development before he recoups the costs of undertaking those efforts.[311] For this reason, if the initial distributor does not have an exclusive appointment, an inefficient outcome would arise: there would be a potential market for the product but none of the distributors would develop it because of the fear of free-riding.[312] Since a manufacturer might lack the resources needed for developing the market potential, without exclusive territories potential demand could go unsatisfied.[313]

Another reason why exclusive territories are especially useful in the context of a new entrant is because in such a case consumers are more likely to demand post-sale services as

[309] *E.g.*, Ioannis N. Kessides, *Advertising, Sunk Costs, and Barriers to Entry*, THE REVIEW OF ECONOMICS AND STATISTICS, MIT Press, vol. 68(1), pages 84-95 (February 1986), at 87 ("While [incumbents'] further participation in the market is not without risks, it can be reasonably assumed that their continued operation with established products exposes them to a smaller peril than the new entrant with an untested product and no consumer experience.").
[310] 8 AREEDA & TURNER, *supra* note 14, at 511-12.
[311] Cady, *supra* note 136, at 32.
[312] *Id.*
[313] *Id.*

an assurance of the quality of the product[314] and it has been shown that exclusive distribution is a way of ensuring that these services are indeed provided.[315] At the same time, it will be more difficult for a new entrant to find distributors willing to invest in product-related services than it would be for an already established supplier.[316] The use of exclusive territories can assist a new entrant in overcoming this problem.

Apart from the fact that a new entrant is in greater need of guaranteeing post-sale services than a firm already established in the market, a new entrant is also in a greater need of advertising in order to gain foothold in the market.[317] Taking into account that one of the main reasons for a manufacturer to enter into an exclusive arrangement with a distributor is to ensure that the distributor will provide adequate advertisement of the manufacturer's product, exclusive distributorship can be seen as a means of overcoming barriers to entry and making the market more competitive. Consequently, it seems that the law should be particularly lenient towards exclusive territories when they are imposed by a new entrant or with regards to distribution of a new product.[318]

2.3.1.4 Expanding market coverage

A manufacturer could also impose exclusive territories in order to expand his market presence.[319] In accordance with the law of diminishing returns, the profits a distributor can earn by serving additional customers will diminish as his efforts expand.[320] As a result, he will tend to limit his sales efforts to the more profitable customers or products.[321] If a manufacturer has an interest that a distributor carries his entire product line or that he serves all customers in a certain area, the manufacturer could grant the distributor an exclusive

[314] Kurt A. Strasser, *Vertical Territorial Restraints after Sylvania: A Policy Analysis and Proposed New Rule*, DUKE LAW JOURNAL, Vol. 1977, No. 4 (Oct., 1977), at 808.
[315] *See infra* Part 2.3.1.1.
[316] Strasser, *supra* note 314, at 808.
[317] *See* MANKIW, *supra* note 11, at 381 ("[A]dvertising allows new firms to enter more easily because it gives entrants a means to attract customers from existing firms.").
[318] 8 AREEDA & TURNER, *supra* note 14, at 511-12.
[319] *See* Cady, *supra* note 136, at 34.
[320] *Id.*
[321] *Id.*

territory.[322] In this case the manufacturer's rationale is that distributors can earn extra profits on sales to that part of the market most easily reached and then use the extra profits in order to subsidize sales efforts to less profitable customers or sales of less profitable products in the manufacturer's product line.[323] Iglesias, Trespalacios, and Vázquez empirically test this proposal and find that in the presence of exclusive territories the distributor is more willing to carry a larger percentage of the manufacturer's total items.[324]

Exclusive territories can especially be used for obtaining market coverage in the context of differentiated products.[325] In such a setting a manufacturer may use available market power to increase sales and profits.[326] Due to the market power arising out of a differentiated brand, the retail price may be set somewhat above the level charged by competitors.[327] In that case there would be a distinction between low-cost buyers (i.e. buyers that are easily reached or are particularly attracted to the brand) and high-cost buyers (i.e. buyers that are harder to sell to because they are more costly to reach or because they are more price sensitive).[328] In order to maximize his profits, a manufacturer could first raise the price he charges to the distributor above the market level, and then extract higher profits from low-cost buyers without losing sales to the high-cost buyers.[329] The second step (extracting higher profits from low-cost buyers) is made possible by the imposition of exclusive territories.[330]

[322] *Id.*
[323] *Id.*
[324] Iglesias, Trespalacios & Vázquez, *supra* note 180, at 75.
[325] Cady, *supra* note 136, at 33. *See also* Meese, *supra* note 177, at 189 (market power arising out product differentiation less worrisome than market power connected with a dominant position: "to the extent that market power flows from the existence of product differentiation, the presence of such differentiation suggests that minimum RPM and exclusive territories, for instance, are vehicles for reducing transaction costs, and thus are the result of the kind of contractual negotiation process described above, a process unrelated to the exercise of that power.").
[326] Cady, *supra* note 136, at 33.
[327] *Id.*
[328] *Id.*
[329] *Id.*
[330] *See id.*

Cady shows that the use of exclusive territories to expand market coverage for brands with substantial market power may lead to a misallocation of resources and a reduction in consumer welfare.[331] This will happen if distributors are induced to make the product available to those who would not buy it if they were charged the full marginal cost of distribution.[332] In such a situation low-cost buyers would subsidize high-cost buyers.[333] In the absence of vertical restraints, distributors expand coverage only as long as marginal revenues exceed marginal costs, which is the optimal solution with regards to an efficient allocation of resources.[334]

Conversely, a manufacturer with substantial market power might prefer a more costly distribution when it would lead to an increase in product demand.[335] In the presence of exclusive territories distributors are protected from intrabrand competition and can charge higher prices to all buyers without fear that another distributor will charge a lower price.[336] The distributors can then use these extra profits in order to subsidize sales to high-cost buyers.[337] This way the additional costs of distribution are spread over all buyers, the result being a benefit for some buyers and higher prices for all.[338] Therefore, in the presence of significant market power, the deployment of exclusive territories could lead to a misallocation of resources and thereby justify antitrust law intervention in condemning such an arrangement.[339]

[331] *Id.* at 34.
[332] *Id.*
[333] *Id.*
[334] *Id.*
[335] *Id.*
[336] *Id.*
[337] *Id.*
[338] *Id.*
[339] *See Restricted channels of distribution under the Sherman Act, supra* note 138, at 833-34 (“Market share is also independently relevant. As it increases, the manufacturer's use of distribution restrictions becomes more difficult to justify. In the first place, a substantial share of the market indicates widespread consumer acceptance of his brand, and this advantage should make his franchise more attractive and so reduce the need for an exclusive on the part of his dealers and distributors. Moreover, as the market share of one manufacturer becomes larger, the importance to consumers of having some choice between competing sellers of the same brand increases . . . Furthermore, there is perhaps less interest in increasing a large manufacturer's ability to compete

2.3.1.5 *Specialized information*

Rey and Tirole offer another justification for the imposition of exclusive territories, one which applies even in situations where product-related services are not of much relevance.[340] They argue that under certain conditions exclusive territories make a better use of decentralized information than unrestricted distribution or RPM.[341] The downstream market is characterized by two types of uncertainty: demand uncertainty and retail-cost uncertainty. Demand uncertainty depends on factors such as consumer tastes and demographics, while retail-cost uncertainty is determined by technological changes, wages and input prices.[342] Rey and Tirole show that in the presence of cost uncertainty exclusive territories are the optimal strategy for a manufacturer. This is due to the fact that in an exclusive distribution system each distributor has a monopoly in his territory and is able to choose the correct response to a retail-cost shock.[343]

In the presence of information asymmetries, exclusive territories enable the better informed party to make marketing decisions based on its superior information.[344] If the distribution process is not restrained, the market price is basically the price set by the manufacturer, since competition among distributors will bring prices down to the level set by him.[345] Such a situation might not be the optimal profit-maximizing strategy, since a manufacturer generally has less information about the market than his distributors do.[346] On the other hand, if a manufacturer grants exclusive territories to his distributors, they would then be able to adjust their pricing to the conditions in the market.[347] Consequently, by

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against its rivals – as by permitting a territorial restriction, for example – than in aiding a small manufacturer to do so.").

340 Rey & Tirole, *supra* note 200.
341 *Id.* at 928.
342 Secrieru, *supra* note 30, at 806.
343 Rey & Tirole, *supra* note 200, at 928.
344 Dutta, Heide & Bergen, *supra* note 297, at 123.
345 *Id.*
346 *Id.*
347 *Id*.

granting an exclusive territory a manufacturer can benefit from the exclusive distributor's informational superiority.[348]

In accordance with Rey and Tirole, Dutta, Heide, and Bergen find that firms are more likely to deploy exclusive territories when their distributors have better information about market conditions.[349] In this respect they also note that this does not necessarily have to be beneficial for consumers, as allowing pricing flexibility under information asymmetry may require some consumers to pay a higher price.[350] To illustrate this point, they offer the example of a car dealer's ability to learn information from a customer at the point of sale.[351] By evaluating the true value of a car to the customer, the dealer can segment customers based on their willingness to pay, thereby achieving higher profits both for himself and for the manufacturer.[352] However, this will be possible only if the distributor has an exclusive appointment – otherwise other dealers will compete away any margins the salespeople could obtain.[353] This is also a good example of how a practice that maximizes the manufacturer's and distributor's profits does not have to be in the interest of consumers, which is a topic that will be further addressed below.[354]

2.3.1.6 Quality certification

Another argument that applies even in the absence of services prone to free-riding is that a distributor might be endorsing a product by the mere fact that it is carrying it. This argument seems to have been first developed by Marvel and McCafferty.[355] They note that retailers are responsible not just for warehousing products obtained from suppliers – they

[348] Rey & Tirole, *supra* note 200, at 928.
[349] Dutta, Heide & Bergen, *supra* note 297, at 131.
[350] *Id.*
[351] *Id.* at 123.
[352] *Id.*
[353] *Id.*
[354] *See infra* Part 2.3.2.8.
[355] Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, THE RAND JOURNAL OF ECONOMICS, Vol. 15, No. 3 (Autumn, 1984), pp. 346-359. Although Marvel and McCafferty developed the argument related to RPM, it is submitted that it can also serve to justify exclusive territories.

choose to market those products that will most likely appeal to their clientele.[356] By offering a certain product the retailer is showing that the product is in accordance with his overall reputation and thereby certifies the product's quality.[357] Consequently, as long as consumers regard some dealers as having superior abilities to certify the characteristics of a product, such certification will be valuable to manufacturers.[358]

A number of consumers are ignorant regarding the characteristics of a product and will rely on a distributor to certify the products' quality.[359] Consequently, a manufacturer could find it optimal to grant an exclusive territory to a distributor that is known for having high standards when it comes to choosing products it sells.[360] This way the manufacturer would enable the distributor wider margins and this could serve as compensation for ensuring that the distributor stocks the manufacturer's products.

Related to this is the argument that having only one dealer for a certain area may derive a certain prestige for the manufacturer.[361] This is especially the case with expensive products, since customers might be opting for a certain product because of its aura of exclusivity. This aura could be the result of a high price. In this respect consider the so called Veblen effect, i.e. the phenomenon where the demand for a good is increases with an increase in price.[362] Connected to this, the fact that only a single, well equipped dealer can distribute the product can also help the manufacturer to appeal to high class consumers.[363]

Related to prestige, instead of using exclusive territories a manufacturer may also opt for establishing a selective distribution system. In other words, a supplier may use selective

[356] *Id.* at 348.
[357] *Id.*
[358] *Id.* at 347.
[359] Comanor, *supra* note 135, at 1158.
[360] *See* Goldberg, *supra* note 274, at 744.
[361] *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 805.
[362] H. Leibenstein, *Bandwagon, Snob, and Veblen Effects in the Theory of Consumers' Demand*, The Quarterly Journal of Economics, Vol. 64, No. 2 (May, 1950), pp. 183-207, at 189.
[363] *See Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 805.

distribution in order to create an aura of exclusivity surrounding the product.[364] Selective distribution will generally be used with regards to the distribution of branded products,[365] one reason being that non-branded products are not connected with exclusivity. In this respect selective distribution is often used in the sale of expensive perfumes, since these products greatly rely on an image of exclusivity.[366] Therefore, if the law treats selective distribution more leniently than it treats exclusive distribution, a manufacturer aiming to create an aura of exclusivity may rather opt for a selective rather than for an exclusive distribution system.

2.3.1.7 Lowering the costs of distribution

Exclusive territories can also be beneficial if they lower the costs of distribution. Matsumura shows two ways in which this could happen.[367] First, exclusive territories could be used to avoid the duplication of entry costs.[368] In general, a distributor entering a local market has to incur an entry cost.[369] If a distributor enters two local markets, he has to incur entry costs twice.[370] On the other hand, if a manufacturer decides to impose exclusive territories and thereby divide the downstream markets, economies of scale could arise.[371] As a result, the duplicated entry costs facing distributors could be avoided.[372]

Apart from avoiding the duplicated cost of entry, exclusive territories could be used in order to minimize transportation costs related to the distribution process.[373] This could be achieved by eliminating inefficient competition between downstream firms. In an industry consisting of numerous independent local markets, each downstream firm pays transportation

[364] JONES & SUFRIN, *supra* note 37, at 641.
[365] EU Vertical Guidelines, para. 174.
[366] J. GOYDER, *supra* note 123, at 107.
[367] Toshihiro Matsumura, *Consumer-benefiting exclusive territories*, CANADIAN JOURNAL OF ECONOMICS, Vol. 36, pp. 1007-1025, (November 2003).
[368] *Id.* at 1008.
[369] *Id.*
[370] *Id.*
[371] *Id.*
[372] *Id.*
[373] *Id.* at 1008-09.

costs to ship products to each of the local markets.[374] If two downstream firms locate at the opposite side of some relevant region, an exclusive distribution system could lower the transportation costs.[375]

In general, it can be expected that the transportation cost increases with the increase in distance between a market and the location of the firm.[376] Without exclusive territories, the less efficient firm (i.e. the firm furthest from the market) also sells in each market.[377] As a result, the average transportation cost of the two downstream firms is higher than the cost of the more efficient firm.[378] On the other hand, in an exclusive distribution system each downstream firm is the monopolist in markets near its location, so distributors will not be able to serve distant markets.[379] This will reduce the costs for the manufacturer and in turn lead to lower prices for consumers.[380]

In this respect, consider also the concept of natural monopoly. A market is a natural monopoly if the entire market demand can be satisfied at lowest cost by one firm rather than by two or more.[381] In the field of distribution natural monopoly exists if the distribution process would be least costly when performed by only one firm. In such a case the imposition of exclusive territories would be an optimal solution, since the exclusive distributor would effectively be a monopolist in the exclusive territory. For example, one U.S. court justified the grant of exclusive territories in the field of newspaper distribution on the grounds that the situation represented a natural monopoly.[382]

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[374] *Id.*
[375] *Id.* at 1009.
[376] *Id.*
[377] *Id.*
[378] *Id.*
[379] *Id.*
[380] *Id. See also* Tatsuhiko Nariu & David Flath, *Vertical Control of Cournot Wholesalers in Spatial Competition: Exclusive Territories? Or Maximum Retail Price Stipulations?*, REVIEW OF MARKETING SCIENCE, Vol. 3 (2005) (showing that the same effect could be achieved by imposing maximum RPM).
[381] RICHARD A. POSNER, NATURAL MONOPOLY AND ITS REGULATION 1 (1999).
[382] Newberry v. Washington Post Co., 438 F.Supp. 470, 474 (D.C. Cir. 1977) ("[C]ompetition simply would not have been profitable for the dealers. In areas in which subscribers are widely scattered, the costs of service are very high in relation to the profits to be gained; in high-density areas an established dealer with years of

2.3.1.8 Health and safety considerations

Apart from strictly economic reasons, there are some other situations in which exclusive territories could prove to be beneficial. For example, a dealer could be making sales from a location that is too remote to instruct consumers regarding the proper use of the product and to monitor the product's quality.[383] In addition, a dealer could engage in "dumping" spoiled or excess inventories to the areas of other dealers.[384] Such actions would result in harming both the consumers and the dealer in whose territory the sale is made. They would also harm the manufacturer – if a product is marketed in a way which harms the product's reputation, sales will decrease, and as a result both the manufacturer and the distributors will be worse off. In order to avoid such an outcome, the manufacturer can establish an exclusive distribution system. This way he can make sure that the dealers' locations are properly assigned and customers properly served.

2.3.2 Concerns

2.3.2.1 Private v. general interest

Although an exclusive distribution agreement potentially provides a number of benefits for the parties that enter into it, it does not necessarily mean that society will be better off in the presence of such an arrangement. This is due to the fact that in certain situations a discrepancy between private and general interest could occur. One of the authors who wrote about this issue is Ronald Coase. According to Coase, certain actions may lead to a divergence between private and social net products.[385] In other words, although a particular conduct increases the individual's welfare it also decreases the welfare of society.[386]

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effective service in the area would face lower costs than any dealer attempting to enter. Thus each dealer territory had aspects of a natural monopoly arising from the fact that the territories specified in the dealer contracts were tailored with efficient delivery in mind and had long been worked by competent dealers.").

[383] 8 AREEDA & TURNER, *supra* note 14, at 507-08.

[384] *Id.*

[385] R. H. Coase, *The Problem of Social Cost*, JOURNAL OF LAW AND ECONOMICS, Vol. 3, (Oct., 1960), pp. 1-44.

[386] *See* 8 AREEDA & TURNER, *supra* note 14, at 522. *See also* WILLIAMSON, *supra* note 55, at 373("efforts to monetize consumers' surplus can yield net private gains and net social losses if the transaction costs that attend those efforts are substantial").

This happens due to the existence of externalities, i.e. negative external effects on third parties.[387] In the presence of externalities individuals enjoy the benefits of entering a contract but do not realize the full extent of the social consequences of their actions.[388] Applied to our discussion, although an exclusive distribution agreement may be efficient from the perspective of the parties that sign it, public intervention may be appropriate due to the externalities on the consumers.[389] Consequently, when evaluating the impact of exclusive territories account should be taken not just of whether such an arrangement is beneficial for the manufacturer and distributor, but also what effect the arrangement has on third parties. In other words, exclusive distribution agreements that maximize the profits of the manufacturer and distributor do not necessarily have to maximize the general welfare or be in the interest of consumers.[390]

2.3.2.2 Advertising and barriers to entry

Exclusive territories and advertising are closely connected. In general, advertising makes sense only for differentiated products, i.e. products for which a manufacturer can charge a price above marginal cost.[391] Since products subject to exclusive distribution are typically of that kind,[392] an exclusive distributor will have an incentive to invest in advertisement in order to attract more buyers.[393] What is more, it has been shown that perhaps the main justifications for the deployment of exclusive territories is that such arrangements ensure that distributors provide the adequate level of advertising.[394] Nevertheless, it could be arguable whether this aspect of exclusive distribution should be

[387] Zvika Neeman, *The Freedom to Contract and the Free Rider Problem*, JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION 15 (1999), pp. 685-703, at 685.
[388] *Id.* at 686.
[389] Rey & Tirole, *supra* note 200, at 932.
[390] *See* Rey & Stiglitz, *supra* note 48, at 445-47. *See also* Barbara G. Katz, *Territorial Exclusivity in the Soft Drink Industry*, THE JOURNAL OF INDUSTRIAL ECONOMICS, Vol. 27, No. 1 (Sep., 1978), at 95.
[391] MANKIW, *supra* note 11, at 380.
[392] *See supra* Part 2.3.1.1.
[393] *See* MANKIW, *supra* note 11, at 380.
[394] *See supra* Part 2.3.1.1.

considered as procompetitive or not, since there is no consensus whether advertising as such is socially desirable.

Economic theory used to view advertising as a harmful activity. The prevailing view was that advertising is a major barrier to true competition and efficient service to consumers.[395] This is because the main effect of advertising is that it decreases the elasticity of demand facing the advertised product.[396] It also increases the perception of product differentiation and makes buyers less concerned with price differences among similar goods.[397] As a result, the advertising firm is able to charge a price over marginal cost.[398] Apart from the price increase, advertising was seen as artificially creating a perception of differences between various brands, which was seen as a wasteful activity.[399] The opponents of advertising also argued that in many industries product differentiation leads to higher barriers to entry[400] and facilitates oligopoly.[401]

The perception of advertising started to change in the 1960s, to a large extent due to the influence of the Chicago School.[402] One of the first ones to emphasize the procompetitive sides of advertising was Telser.[403] He noted that advertising is an important source of information and as such a means of entry into a market.[404] According to Telser, direct

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[395] Lester G. Telser, *Advertising and Competition*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 72, No. 6 (Dec., 1964), pp. 537-562, at 537. For an early proposition that advertising is a wasteful activity, see Nicholas Kaldor, *The Economic Aspects of Advertising*, THE REVIEW OF ECONOMIC STUDIES, Vol. 18, No. 1 (1950 - 1951), pp. 1-27.

[396] Telser, *supra* note 395, at 559.

[397] MANKIW, *supra* note 11, at 381.

[398] *Id.*

[399] Posner, *supra* note 285, at 4.

[400] Martin B. Louis, *Vertical Distribution Restraints after Sylvania: A Postscript and Comment,* MICHIGAN LAW REVIEW, Vol. 76, No. 2 (Dec., 1977), at 270.

[401] *Id.* To this argument Telser responds that this does not have to mean that reduced competition is a result of advertising. Rather, in competitive industries firms can be discouraged from advertising if they would expect to obtain only a fraction of the fruits of advertising. Telser, *supra* note 395, at 537.

[402] *See infra* Part 2.4.2.

[403] *See* Posner, *supra* note 285, at 4 (“One reason why Telser's analysis was not more influential [in the 1960s] is that many economists viewed the presale services encouraged by resale price maintenance and cognate nonprice restrictions as of dubious value to consumers.”).

[404] Telser, *supra* note 395, at 558. *See also id.* at 541 (“there are some kinds of advertising that are . . . essential to competition – [such as] information on seller identity and reliability, price and terms of sale, and instruction on the use of the product.”).

advertising by manufacturers and special services provided by distributors are to a certain extent substitutes.[405] According to his view, product promotion performed by distributors is superior to what he calls “impersonal” advertising by manufacturers.[406] If the law is hostile towards the use of exclusive territories, free-riding between distributors could occur, which will in turn lead to a decrease in the amount of product promotion performed by dealers.[407] In order to overcome the legal obstacles, the manufacturer would then be forced to increase his advertising efforts and thereby overcome a decline in product promotion by distributors.[408]

Telser’s arguments were later confirmed in an empirical study by Mixon and Upadhyaya.[409] In examining the influence that the legal regime afforded to exclusive territories has on advertising, they find that when exclusive territories are made illegal intrabrand competition will cause special services such as local advertising to diminish.[410] In such circumstances the manufacturer would have to step in with his own advertising effort.[411] They conclude that the manufacturer’s ability to effectively provide advertising locally is inferior compared to a local dealer.[412]

Apart from Telser’s arguments, other justifications for advertising began to be introduced. For example, some authors added that consumers often lack information about the price and quality of the goods they are buying, suggesting that advertisement may help overcome this deficiency.[413] Along this line was also a study conducted by Benham.[414] He examined the prices of eyeglasses across the U.S. and the extent to which the difference in

[405] Telser, *supra* note 237, at 95.
[406] *Id.*
[407] *See id.* at 91.
[408] *Id.* at 95.
[409] Franklin G Mixon, Jr. & Kamal P Upadhyaya, *Advertising as Special Service Provision under Non-price Vertical Restraints: Exclusive Territories in Beer Distribution*, Applied Economics, vol. 28(4) (April 1996), pp. 433-39.
[410] *Id.* at 438.
[411] *Id.*.
[412] *Id.*
[413] Phillip Nelson, *Information and Consumer Behavior*, THE JOURNAL OF POLITICAL ECONOMY, Vol. 78, No. 2 (Mar. - Apr., 1970), pp. 311-329, at 311.
[414] Lee Benham, *The Effect of Advertising on the Price of Eyeglasses*, JOURNAL OF LAW AND ECONOMICS, Vol. 15, No. 2 (Oct., 1972), pp. 337-352, at 338.

prices was related to advertising. He focused on the eyeglasses market, as that was the market in which the effect of advertising could be best observed. This was due to the fact that some of the states completely prohibited advertising of eyeglasses, while others allowed it with more or less restrictions. By comparing the prices in the states which allowed advertising with those that prohibited it, Benham wanted to test the then prevailing proposition that advertising leads to higher prices for consumers.

Upon analyzing the relevant data, Benham found that the states which allowed advertising had substantially lower prices of eyeglasses than those that prohibited it.[415] Based on this, he concluded that advertising can be beneficial for competition as it improves consumers' knowledge and lead to lower prices.[416] Consequently, he criticized restrictions on advertising for making it more difficult for new firms to enter the market.[417] This is especially important in the context of exclusive distribution, since exclusive territories can be particularly beneficial if used by a new entrant.[418]

Although Benham's arguments seem persuasive, it does not mean that the discussion about the impact of advertising has been settled. For example, some other studies have shown that advertising actually leads to higher prices.[419] This could be explained by the fact that the impact of advertising depends on the type of the advertised product. For products regarding which consumers have to rely on memory to generate brand names for consideration, advertising may lead to a decrease in prices.[420] Conversely, when consumers rely on point-of-purchase information rather than memory in order to choose the brand, the net effect of

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[415] *Id.* at 352. The study showed that limitations on advertising increased the prices from 25 to more than 100 percent. *Id.* at 344.
[416] *Id.* at 338, 349.
[417] *Id.* at 351. He also emphasized that such restrictions can be an instrument for achieving price discrimination. *Id.*
[418] *See supra* Part 2.3.1.3.
[419] Paul W. Farris & David J. Reibstein, *How Prices, Ad Expenditures and Profits are Linked*, Harvard Business Review 57 (November-December 1979), pp. 173-184 (an empirical study showing that advertising actually leads to a price increase).
[420] A. Mitra & J.G. Lynch, Jr., *Advertising Effects on Consumer Welfare: Prices Paid and Liking for Brands Selected*, MARKETING LETTERS, Volume 7, Number 1 (January 1996), pp. 19-29, at 27.

advertising will be to increase prices paid.[421] From this perspective, it is not surprising that studies of different industries came to different conclusions about the impact of advertising.[422] In addition, even if advertising is not harmful as such, it could become harmful if used excessively. This could also be the result of the use of exclusive territories. As Rey and Stiglitz note, exclusive territories may lead to excessive advertising, thereby lowering the producer's profits.[423]

Overall, the role of advertising seems to be positive. Empirical studies have shown that in most industries rather being a barrier to entry advertising actually facilitates entry.[424] It could be said that advertising is beneficial since it provides information about the existence of alternative products and their price-quality characteristics.[425] This in turn reduces consumers' search costs and decreases their brand loyalty and inertia.[426] If advertising is seen as a beneficial activity, then the use of exclusive territories as a means of encouraging distributors' promotional efforts is also looked at benevolently. In this light, by contributing to product differentiation exclusive distribution would help consumers satisfy their need to have distinctive products.[427]

2.3.2.3 Special services may be over-supplied

Even if it is beyond doubt that the distributor services encouraged by the deployment of exclusive territories are beneficial, a problem may arise if these services are over-supplied. Comanor offers an example of how this can happen. He notes that consumers of a particular product can be divided into two groups: ignorant and knowledgeable.[428] Ignorant consumers are those that do not know enough about the product, and hence value the product

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[421] *Id.*
[422] *See, e.g.,* Carol Horton Tremblay & Victor J. Tremblay, *The Impact of Cigarette Advertising on Consumer Surplus, Profit, and Social Welfare*, CONTEMPORARY ECONOMIC POLICY 13(1) (January 1995), pp. 113-124 (showing that advertising decreases consumer welfare in the cigarette industry).
[423] Rey & Stiglitz, *supra* note 72, at 446.
[424] Kessides, *supra* note 309, at 93.
[425] *Id.* at 84.
[426] *Id.*
[427] *See* MONTI, *supra* note 45, at 354.
[428] Comanor, *supra* note 197, at 992.

information and are willing to pay for it.[429] On the other hand, knowledgeable consumers are those that do not need additional information about the product and are hence not prepared to pay for it.[430]

Since ignorant consumers will be the marginal ones, the manufacturer might impose vertical restraints in order to provide the extra information about the product to them.[431] The marginal buyer is the buyer who would leave the market first if the price were any higher,[432] and consequently the one whose preferences are decisive regarding the market price of a product. For this reason, the manufacturer will adjust the price and the amount of services with the preferences of the ignorant consumer. As mentioned, knowledgeable consumers do not need extra information about the product, and the more there are such consumers the more likely it is that those special services will be over-supplied in relation to the consumer optimum.[433]

Comanor's arguments do seem to have some grounds. However, it is arguable how often the situation he describes actually occurs in practice. In addition, an over-supply of services could be a problem only in case the supplier is a monopolist in the upstream market.[434] Otherwise, the problem described by Comanor would be corrected by the market forces. This would happen because those consumers that do not value extra effort would simply stop buying that product and rather opt for a product which does not contain extra services.[435] Therefore, although situations where product-related services would be over-supplied do happen, in most cases the problem is self-correcting. In other words, over-supply of services should not be of serious antitrust concern.

429 *Id.*
430 *Id.*
431 *Id.*
432 MANKIW, *supra* note 11, at 139.
433 Comanor, *supra* note 197, at 992.
434 MOTTA, *supra* note 190, at 316.
435 *Id.*

2.3.2.4 Deterring new entry

Another concern related to the use of exclusive territories is that this type of restraint can be used in order to prevent new firms from entering a market. On the one hand, a restriction of competition through vertical integration can have only a limited impact on competition in the downstream market. In general, a manufacturer cannot expand his market power in the upstream market even if he manages to completely eliminate interbrand competition in the downstream market.[436] This is due to double marginalization and the fact that only one full monopoly return can be taken from a series of vertically related activities.[437] However, there are views that in order to secure its upstream market position a dominant firm may try to extend its monopoly to the downstream market. This way the firm would raise the costs of its upstream rivals, since it would be more costly for them to organize the distribution of their products.[438] To this end, the upstream monopolist could also use exclusive territories.

In order to raise the costs of distribution incurred by his rivals, a dominant manufacturer may deploy exclusive territories in the downstream market.[439] This is especially the case if the exclusive distribution agreement also contains an exclusive dealing provision.[440] In that case the prospective entrant would have no existing distribution channels available, meaning that in order to enter the market he would need to establish his own distribution network. This way he would be forced to operate at both market levels, which would increase his costs of entry.[441] As a result, the manufacturer's (upstream) rivals might

[436] Bork, *supra* note 49, at 402.
[437] *Id.* at 402-03.
[438] For an overview of the raising rivals' costs doctrine, see Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 318-23 (2001).
[439] Steven C. Salop & David T. Scheffman, *Raising Rivals' Costs*, THE AMERICAN ECONOMIC REVIEW, Vol. 73, No. 2, Papers and Proceedings of the Ninety-Fifth Annual Meeting of the American Economic Association (May, 1983), pp. 267-271, at 268; Dutta, Heide & Bergen, *supra* note 297, at 125.
[440] *See* Salop & Scheffman, *supra* note 439, at 267 ("If there are scale economies or other entry barriers in retailing, exclusive dealing arrangements can raise small rivals' costs of distribution.").
[441] SULLIVAN & HARRISON, *supra* note 129, at 178.

not be able to access the downstream market, since the exclusive arrangement could foreclose a significant part of the market.

However, the theory of raising rivals' costs should not be extended too far. The mere fact that an arrangement raises competitors' costs does not mean that antitrust law should intervene. Sometimes there is no violation even if the exclusive arrangement completely forecloses competitors. This would be the case if the firm is so efficient that it drives competitors out of business.[442] Therefore, it should not be the purpose of antitrust laws to interfere with arrangements that lower a firm's costs, even if the impact of reduced costs is to exclude those unable to match the cost reductions.[443]

Apart from raising rivals' costs, Rey and Stiglitz show another way in which exclusive territories could deter new entry. They show that an exclusive distributor is likely to have a tougher response to entry than a non-exclusive one.[444] This is due to the fact that an exclusive distributor does not take into account the effect of a decrease of his own price upon the producer's profits in other territories, and could therefore engage into a strategy of deterring new entrants.[445] In the alternative, the new firms would also need to offer exclusive territories to their distributors, or otherwise they would not be able to attract competent dealers.[446]

2.3.2.5 Facilitating horizontal collusion

Another concern related to the use of exclusive territories is that they can be a vehicle for facilitating cartels. Firstly, exclusive territories can be used for collusion in the upstream market.[447] Manufacturers can use exclusive territories in order to effectively divide markets

[442] PHILLIP AREEDA & HERBERT HOVENKAMP, FUNDAMENTALS OF ANTITRUST LAW 18-28 (2004, Supp. 2009).
[443] *Id.*
[444] Rey & Stiglitz, *supra* note 48, at 446.
[445] *Id.*
[446] Dutta, Heide & Bergen, *supra* note 297, at 125.
[447] HOVENKAMP, *supra* note 29, at 453.

among themselves,[448] thereby reducing the possibility of cartel cheating.[449] Cartel members have a strong incentive to cheat, and hence one of the main problems with the enforcement of cartel agreements is monitoring whether cartel members are complying with the agreement.[450] In case all members of the cartel use exclusive distribution arrangements with their distributors, the possibility of cheating will be significantly reduced.

By imposing exclusive territories on retailers, a cartel of manufacturers may be able to monitor prices and number of sales at the retail level.[451] In this case the rivals will know that each of them is primarily responsible for the retail price of his product.[452] Consequently, cheating can be detected by observing retail prices.[453] Cartelization is even more likely if exclusive territories are combined with exclusive dealing arrangements, since then market division among manufacturers will be even more fortified.[454] However, the cartel will work only if the combined market power of its participants reaches monopoly power and if all cartel members are using exclusive territories.[455]

Apart from manufacturers, distributors could also use exclusive territories in order to cover up their horizontal collusion. Retailers could be interested in dividing territories among themselves since that way each of them would become a monopolist in his own territory.[456] For this reason the division of territories would remove many of the incentives to cheat as well as make the detection of cheating easier.[457] For the colluding retailers it would be better if exclusive territories are imposed by the manufacturer, since he would be better able to monitor the system.[458] In addition, the law treats vertical restrictions more favorably than

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448 Posner, *supra* note 285, at 7.
449 HOVENKAMP, *supra* note 29, at 453.
450 Strasser, *supra* note 314, at 823.
451 HOVENKAMP, *supra* note 29, at 453.
452 Louis, *supra* note 400, at 824.
453 *Id.*
454 *Id.* at 826.
455 HOVENKAMP, *supra* note 29, at 453-54.
456 *Id.* at 450.
457 *Id.*
458 *Id.*

horizontal ones,[459] and an exclusive distribution system seemingly established by a manufacturer would be treated much more leniently than a horizontal agreement on market allocation.

Despite these concerns, it should be noted that the problem of distributor cartelization is realistic only under certain conditions: the manufacturer instituting the exclusive distribution system has to be a monopolist in the area where the retailer is operating;[460] the restriction has to be used by a very high percentage of the manufacturers in the market;[461] and the retailers subject to the territorial restraint need to have sufficient market power.[462] However, even if these conditions would be satisfied, it is not clear why manufacturers would want to organize a downstream cartel and allow the distributors to earn monopoly profits.[463] Rather, a manufacturer could earn more by selling to additional retailers or establishing its own retail network.[464]

Taking this into account, it can be concluded that under certain circumstances exclusive territories can be used as a means of covering up horizontal collusion. Nevertheless, instances when this would be the case seem to be quite rare. Consequently, the concern of cartelization should not significantly contribute to the law's strictness with regards to the legality of exclusive distribution. This is especially due to the fact that horizontal cartelization is a separate antitrust offense and one for which antitrust authorities are much more interested in pursuing.

2.3.2.6 Higher prices and lower output

One of the concerns arising out of the use of exclusive territories is that this practice can lead to an increase in prices and a reduction in output. These concerns are connected not

459 *Id.*
460 *Id.* at 449.
461 *Id.*
462 *Id.*
463 *See* Telser, *supra* note 239, at 417.
464 HOVENKAMP, *supra* note 29, at 450.

only with the deployment of exclusive territories, but also with the use of other intrabrand restraints. As will be shown in this section, the effect that exclusive distribution has on prices and output is ambiguous, since defining what constitutes output can be subject to a debate.

Among the first authors to emphasize the anticompetitive potential of intrabrand restraints were Gould and Yamey. In a debate with Bork, they argued that intrabrand restraints can lead to higher price and reduced output.[465] With regards to this, it should be noted that exclusive territories could cause a price increase only if a market is characterized by imperfect competition. This would for example be the case if products are differentiated. When products are not differentiated (that is if they are perfect substitutes), a distributor would not be able to raise the price above the competitive level. This is due to the fact that in case of any rise in the price consumers would switch to competing products.[466] On the other hand, if the product is differentiated, the distributor would be able to raise the price to a certain extent. The extent to which he would be able to do so depends on the elasticity of demand and consumers' readiness to switch to competing products.[467]

The effect that the price increase has on welfare is inconclusive. On the one hand, even if exclusive territories cause a price increase, it does not mean that their effect is negative. Actually, a price increase naturally follows from the imposition of exclusive territories: the main idea behind this type of restraint is to put the distributor in a position to charge a higher price.[468] With regards to this, Bork argues that even if an intrabrand restraint leads to higher price and fewer sales of the physical product, it does not mean that consumers are worse off.[469] According to Bork, the distributor's efforts also count as an economic output.[470] Consequently, in the presence of a vertical restraint the consumer is offered not just

[465] J. R. Gould & B. S. Yamey, *Professor Bork on vertical price fixing*, 76 YALE L. J. 722, 723 (1967).
[466] *Restricted channels of distribution under the Sherman Act*, *supra* note 138, at 832-33.
[467] *Id.* at 833.
[468] Scherer, *supra* note 265, at 694.
[469] BORK, *supra* note 196, at 296.
[470] *Id.*

a physical product, but a product which on the one hand consists of the same physical product and on the other also contains the information and other services supplied by the distributor.[471] In other words, even if exclusive territories lead to higher prices and lower output in physical terms, antitrust should not be concerned with this type of restraint since consumers are getting the product that they want.

As a response to Bork, Scherer shows that under certain circumstances exclusive territories can in fact harm consumers. Scherer emphasizes that when judging the impact of exclusive territories one should look not only at a single manufacturer, but at the market as a whole.[472] He notes that as a result of the higher margins created by exclusive territories the market may become overly fragmented, since additional firms will try to enter the market and take advantage of the higher margins.[473] Consequently, the economies of scale could be lost, making a reduction in efficiency likely to occur.[474]

In addition, the effect of exclusive territories is even more ambiguous if the practice is deployed by a large number of manufacturers. In this case it is likely that instead of raising the overall demand, some degree of the competitors' service efforts will cancel each other out.[475] The more this happens, the more likely will it be that efficiency is actually reduced,[476] i.e. that the cost of the restraint exceeds the gain to consumers.[477] Therefore, the more widespread the use of exclusive territories, the less choice consumers have between low prices/low service and high prices/high service.[478] And if the upstream market is highly concentrated, it is even more likely that the manufacturers will pursue a high-price/high-margin strategy.[479]

471 *Id.*
472 Scherer, *supra* note 265, at 703.
473 *Id.*
474 *Id.*
475 *Id.* at 704.
476 *Id.*
477 *Id.* at 703.
478 *Id.* at 704.
479 *Id.*

Scherer's analysis has some important policy implications. First, unlike what Bork argues, there do seem to be plausible situations in which exclusive territories could harm consumers. Consequently, there are situations where antitrust should be rightly concerned about this practice. Secondly, when judging the legality of exclusive territories one should take into account the extent to which that type of restraint is deployed throughout the industry. In addition, the level of concentration in the upstream market should also be considered – if that level is high, there is a strong possibility that the restraint will lead to a decrease in efficiency.

The effect that exclusive territories have on prices and output has been subject to several empirical studies. Probably the most well known are the studies focusing on the beer market in the U.S. They are especially interesting taking into account the legal status of exclusive territories in beer distribution at the time when the studies were conducted: almost all states allowed the imposition of exclusive territories (some even mandated the use of this type of restriction), while Indiana was the only state of the Union which prohibited exclusive territories. This environment was ideal for this type of examination and in a way could be compared with the research by which Benham examined the effect of advertising on the price of glasses.[480]

In general, the studies of the beer market could be divided into two groups – those that found exclusive territories harmful[481] and those that found them beneficial.[482] What is common for the studies is that they all found that the presence of exclusive territories leads to

[480] *See supra* Part 2.3.2.2.
[481] *See* John W. Jordan & Bruce L. Jaffee, *The Use of Exclusive Territories in the Distribution of Beer: Theoretical and Empirical Observations*, 32 ANTITRUST BULL. 137 (1987); W. Culbertson, *Beer-Cash Laws: Their Economic Impact and Antitrust Implications*, 34 ANTITRUST BULL. 209 (1989); W. Patton Culbertson & David Bradford, *The price of beer: Some evidence from interstate comparisons*, INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION, Volume 9, Issue 2, 1991, pp. 275-289.
[482] *See* Sass & Saurman, *supra* note 148; Mixon & Upadhyaya, *supra* note 409; Tim R Sass & David S Saurman, *Efficiency Effects of Exclusive Territories: Evidence from the Indiana Beer Market*, ECONOMIC INQUIRY, vol. 34(3), July 1996, pp. 597-615; Tim R. Sass & David S. Saurman, *Mandated Exclusive Territories: Efficiency Effects and Regulatory Selection Bias, in* 10 ADVANCES IN APPLIED MICROECONOMICS 55 (Michael R. Baye & Jon P. Nelson eds., 2001).

higher prices. However, where the studies diverge is the effect that the higher prices have on the wellbeing of consumers. In other words, in accordance with the division in economic theory, empirical research also offers ambiguous results.

According to Jordan and Jaffee, if all brewers would stop using exclusive territories, intrabrand competition would be increased, which would in turn lead to lower prices of beer and more uniform terms of sale.[483] They also argue that exclusive territories should be allowed only with regards to products where pre-purchase free-riding on special services could occur, noting that beer is not such a product.[484] Finally, they conclude that exclusive distribution territories have a negative effect, since they lead to significantly higher prices for retailers and consumers alike.[485] Culbertson's findings are along the same line. He shows that in states with exclusive territories consumers are likely to pay about 11 cents more for a six-pack of beer[486] which leads him to conclude that exclusive territories have a negative impact on consumer welfare.[487]

Sass and Saurman also establish that exclusive territories lead to higher prices.[488] However, they argue that higher prices alone are not sufficient to judge whether this practice is anticompetitive – both the efficiency and anticompetitive theories predict that the use of exclusive territories increases prices.[489] Apart from the price-increase, the authors also establish that exclusive territories increase the demand[490] and reduce the retail supply[491]. They conclude that the net effect of exclusive territories is an increase in consumer prices but

483 Jordan & Jaffee, *supra* note 481, at 163.
484 *Id.* at 164.
485 *Id.*
486 Culbertson, *supra* note 481, at 226.
487 *Id.* at 229.
488 Sass & Saurman (1993), *supra* note 148, at 162.
489 *Id.* at 163.
490 *Id.* at 171.
491 *Id.* at 172.

no significant change in total output.[492] They argue that consumers as a whole are not worse off because the costs of the price increase are accompanied by additional value.[493]

In a later article, the same authors suggest additional evidence that exclusive territories are not anticompetitive. They observe that Indiana's prohibition of exclusive territories had significantly and permanently reduced the equilibrium quantity of beer sold in the state by 6 percent per year.[494] From this they conclude that exclusive territories lead to an increase in both consumer surplus and total surplus.[495]

Finally, in 2001 Sass and Saurman further corroborate their findings.[496] They find that in the presence of exclusive territories beer consumption is higher between 3 % and 11 %, which leads them to conclude that exclusive territories not only increase the total output but also enhance the consumer surplus.[497]

2.3.2.7 Softening upstream competition

The very purpose of exclusive territories is to reduce (or even eliminate) intrabrand competition in the downstream market. Therefore, the fact that exclusive distribution leads to a reduction in intrabrand competition would not be sufficient to raise serious antitrust concerns. However, Rey and Stiglitz show how this type of restraint could also affect the level of competition in the upstream market,[498] i.e. how it could have a negative effect on interbrand competition.

If the upstream market is characterized by imperfect competition, a manufacturer can use exclusive territories in order to reduce the level of interbrand competition, thereby raising

[492] *Id.* at 174.
[493] *Id.*
[494] Sass & Saurman (1996), *supra* note 482, at 614.
[495] *Id.* at 614. However, Sass and Saurman leave open a possibility that if a significant number of consumers are inframarginal then both consumer welfare and total output could be reduced. *Id.*
[496] *See* Sass & Saurman (2001), *supra* note 482.
[497] *Id.* at 57.
[498] Patrick Rey & Joseph Stiglitz, *Vertical restraints and producers' competition*, EUROPEAN ECONOMIC REVIEW, Elsevier, vol. 32(2-3) (1988), pp. 561-568. The argument is further developed in Rey & Stiglitz, *supra* note 48. *See also* James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, *Vertical antitrust policy as a problem of inference*, INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION 23 (2005), pp. 639– 664, at 645.

his price and profits.[499] This could happen in the following way. By granting an exclusive territory to a distributor, a manufacturer is making the distributor a monopolist in the assigned territory. As a result of the market power, the distributor becomes less sensitive to price competition and is for this reason less likely to pass on to consumers the manufacturer's price reductions.[500] In turn, the manufacturer would have a lower incentive to reduce his price in the first place, since that reduction might not lead to a decrease in the retail price.[501]

This example shows that a consequence of reduced price competition in the downstream market could be a reduction of interbrand price competition in the upstream market.[502] This proposition has also been empirically confirmed. In accordance with Rey and Stiglitz, a study conducted by Dutta, Heide, and Bergen has found that manufacturers are more likely to assign territorial restrictions when they face competition, which in turn could lead to reduced interbrand competition.[503] Therefore, although the primary effect of exclusive territories is on intrabrand competition, they also have an impact on interbrand competition, and should therefore not be completely left outside antitrust's reach.

2.3.2.8 Price discrimination

Apart from concerns based on anticompetitive effects that flow directly from the use of exclusive territories, this type of restraint may also raise antitrust concern as it serves to aid some other practices deemed harmful. In this respect it is important to address the issue of price discrimination, since exclusive territories can be used in order to facilitate this practice.[504] This is especially the case with airtight exclusive territories, since they can assist the supplier engaging in price discrimination to significantly curb the potential for arbitrage. The link between exclusive territories and price discrimination is especially important since

[499] Rey & Stiglitz, *supra* note 498, at 567.
[500] *See id.* at 563.
[501] *See id.*
[502] Dutta, Heide & Bergen, *supra* note 297, at 124.
[503] *Id.* at 131.
[504] 8 AREEDA & TURNER, *supra* note 14, at 522; HOVENKAMP, *supra* note 29, at 455.

the role that exclusive territories have in enabling price discrimination can have a significant impact on the way a certain jurisdiction treats this type of restraint.

At the outset, it is important to determine what is actually meant by price discrimination. In this respect it should be noted that not every price difference is at the same time price discrimination – price discrimination occurs only when two or more similar goods are being sold at prices with different ratios to their marginal cost.[505] Once price discrimination is defined in this manner, the next step is to determine the conditions needed for price discrimination to be viable.

In order for price discrimination to be profitable for a seller, certain conditions need to be satisfied. First, the seller must have a certain degree of market power.[506] If a firm does not have market power, it would need to sell below the prevailing price in order to sell as much as it wants.[507] By selling below the prevailing price the firm would sacrifice profit.[508] This means that in order to profitably engage in price discrimination, a manufacturer should either have a dominant position or have a brand for which there is significant consumer preference.[509] Second, the seller would need to devise a system of segregating customers into groups with different price elasticities.[510] And third, he must eliminate opportunities for arbitrage, i.e. resale by low-price customers to high-price customers.[511] Exclusive territories may assist in satisfying the third condition, and that is where the connection between exclusive territories and price discrimination is most direct.

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505 Daniel J. Gifford & Robert T. Kudrle, *The law and economics of price discrimination in modern economies: time for reconciliation?*, 43 U.C. DAVIS L. REV. 1235, 1239-40 (2010).
506 SCHERER & ROSS, *supra* note 70, at 489.
507 *Id.*
508 *Id.*
509 Peter C. Carstensen, & Richard F. Dahlson, *Vertical restraints in beer distribution: a study of the business justifications for and legal analysis of restricting competition*, 1986 WIS. L. REV. 1, 22-23 (1986).
510 SCHERER & ROSS, *supra* note 70, at 489.
511 *Id. See also* Gifford & Kudrle, *supra* note 505, at 1243 (arguing that the third condition is actually the most important one, because the possibility of arbitrage would eventually equalize the price levels in different markets).

Probably the most well known discussion about price discrimination is the one by Pigou.[512] He identifies three types or degrees of price discrimination. In first-degree price discrimination, each customer is charged the maximum amount he is willing to pay for a unit of the product sold.[513] Price discrimination of this kind removes consumer surplus in totality and does not lead to any deadweight loss.[514] This is perfect price discrimination and is rarely feasible in real life.[515] On the other hand, a seller is engaging in second-degree price discrimination if he is setting two or more prices for a product depending on the amount purchased.[516] This system favors buyers who require larger amount of the product and can sometimes lead to an allocative inefficiency.[517]

Finally, in third-degree price discrimination a seller first identifies separate market segments with different levels of demand elasticity and then sets a price for each segment, in accordance with the segment's demand elasticity.[518] Third-degree discrimination is the most widely used of the three, and also the one with the most ambiguous welfare implications.[519] At the same time, this is also the type this paper is mainly concerned with.

In the case of a difference in price elasticity between two geographically separated markets, a manufacturer may find it profitable to make sales at different rates of return to customers in different territories. The difference in price elasticity could originate from different levels of competition in different geographic areas. In some areas there may be more sellers, and there competition is higher and demand more elastic.[520] Consequently, the firm willing to engage in price discrimination would seek to decrease its prices in those more

[512] A. C. PIGOU, THE ECONOMICS OF WELFARE 275-89 (1948).
[513] *Id.* at 279.
[514] Gifford & Kudrle, *supra* note 505, at 1241.
[515] *Id.*
[516] PIGOU, *supra* note 512, at 279.
[517] This would happen if goods would not be allocated to their highest valued uses. Gifford & Kudrle, *supra* note 505, at 1241.
[518] PIGOU, *supra* note 512, at 279. The main difference between second-degree and third-degree discrimination is that the latter uses some direct signal about demand, while the former differentiates indirectly between consumers, based on their choice between different packages. TIROLE, *supra* note 28, at 135.
[519] SCHERER & ROSS, *supra* note 70, at 495.
[520] Sass & Saurman, *supra* note 148, at 158.

competitive areas while maintaining higher prices in other locations.[521] The difference in price elasticity could also be the result of some historical circumstances, which would seem to be the case with regards to different price elasticities across different EU Member States.[522]

The system of discrimination would work in the following way. The first step for the manufacturer would be to geographically divide his consumers based on their price elasticity.[523] After that, he would charge different prices based on that elasticity.[524] This means that in the areas with higher elasticity the price would be lower than in the areas with low elasticity, since in the former case consumers would be more likely to switch to a competing product. Of relevance for our discussion, the manufacturer could appoint exclusive distributors for different territories and then charge different prices in each of them. Exclusive territories are important in this respect because they can prevent arbitrage[525] – without exclusive territories a distributor from an area with lower prices would transship to the area with higher prices.

The welfare effects of third-degree price discrimination on output are ambiguous. On the one hand, Joan Robinson has shown that it may lead to a decrease in output.[526] Others have pointed out additional instances when price discrimination can be harmful. For example, Posner shows how price discrimination could be profitable for a monopolistic seller.[527] In this respect he notes that if the law allows price discrimination the manufacturer will have an incentive to increase his investment in achieving a monopoly position.[528] Since the costs of creating and maintaining a monopoly are non-negligible, the presence of price discrimination

[521] *Id.*
[522] *See infra* Part 4.6.
[523] Carstensen & Dahlson, *supra* note 509, at 22.
[524] *Id.*
[525] *See* J.A. Kay, *Vertical restraints in European competition policy*, EUROPEAN ECONOMIC REVIEW 34 (1990), pp. 551-561, at 555.
[526] JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 188-95 (1965).
[527] Richard A. Posner, *Exclusionary Practices and the Antitrust Laws*, THE UNIVERSITY OF CHICAGO LAW REVIEW, Vol. 41, No. 3 (Spring, 1974), pp. 506-535, at 510-13.
[528] *Id.*

can lead to misallocation of society's resources.[529] Along the same line, Williamson examines the connection between price discrimination and transaction costs.[530] He finds that price discrimination, especially the costs of arbitrage, may lead to an increase in transaction costs.[531] Consequently, even if the manufacturer can increase his output based on the discrimination, the increase in transaction costs will reduce the gains from such increase.

However, under certain conditions price discrimination may also lead to an increase in output, making it beneficial in terms of allocative efficiency.[532] Schmalensee shows how this could happen.[533] He analyzes a setting in which two markets have different price sensitivity: one with low demand elasticity (the strong market) and another with high demand elasticity (the weak market). He shows that third-degree price discrimination will produce a net efficiency loss unless it leads to an increase in output.[534]

In the presence of the strong and weak market, the supplier may sell without price discrimination and charge a uniform price in both markets. In the alternative, he may sell at a lower price in the weaker market and at a higher price in the stronger market. Schmalensee shows that if third-degree price discrimination leads to the weaker market being served that would not be served without discrimination the practice can actually increase total output.[535] However, not every output increase will prevent a net efficiency loss – the increase of output arising out of the lower price in the weaker market has to exceed the decrease in sales in the strong market, since in the strong market each unit of the product is valued more.[536]

Also worth considering is the situation in which a manufacturer finds it profitable to sell his product at different prices to consumers located in different territories. If price

[529] *Id.*
[530] OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES 11-13 (1983).
[531] *Id.*
[532] WHISH, *supra* note 37, at 749.
[533] Richard Schmalensee, *Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination*, THE AMERICAN ECONOMIC REVIEW, Vol. 71, No. 1 (Mar., 1981), pp. 242-247.
[534] *Id.* at 243.
[535] *Id.* at 245.
[536] *Id.* at 246.

discrimination is prohibited, the supplier will charge a single price in both markets. Compared to the situation with price discrimination, consumers in the weak market will be worse off and consumers in the strong market will be worse off. This basically means that preventing price discrimination leads to the redistribution of income from consumers in the high-elasticity group towards those in the low-elasticity group.[537] In practice this would most often mean a transfer from poorer consumers to richer ones,[538] since the low elasticity groups are generally the richer consumers.[539] In addition, the prohibition of price discrimination may be particularly damaging if it leads to the closure of the weak market,[540] which would happen if the weak market would not be able to bear the uniform price which would form in the absence of price discrimination. As for the supplier, he would in any case be better off if price discrimination would be allowed, since he can always charge the uniform price in each market.[541]

Certain forms of price discrimination are prohibited both in the U.S. and in the EU. However, the positive law analysis in the following chapters will address only price discrimination under EU law. On the one hand, the interest of American antitrust law in price discrimination seems to be in decline,[542] in the context of exclusive territories or otherwise. On the other hand, this is not the case in the EU. Mainly because of single market considerations, EU competition law is very much concerned with the prevention of arbitrage in the form of restricting parallel trade between Member States. Consequently, due attention will be afforded to this issue in the relevant part about EU approach to exclusive distribution.[543]

[537] TIROLE, *supra* note 28, at 139.
[538] WHISH, *supra* note 37, at 749. *See also* TIROLE, *supra* note 28, at 139 (by charging a uniform price the supplier effectively “robs Peter to pay Paul”).
[539] TIROLE, *supra* note 29, at 139.
[540] *Id.*
[541] *Id.* at 137-38.
[542] *See* Gifford & Kudrle, *supra* note 505, at 1271 (“few plaintiffs successfully recover under the Robinson-Patman Act [i.e. the act that prohibits price discrimination]”).
[543] *See infra* Part 4.6.

2.4 *Exclusive territories and efficiency*

2.4.1 Efficiency, welfare, and goals of antitrust

The legal status of exclusive distribution to a large extent depends on the assessment of the impact that exclusive territories have on economic efficiency. This assessment is not straightforward, as it can entail several problems. At the outset, there is no consensus on the notion of efficiency and the way in which it is supposed to be measured. In addition, since there are different types of efficiency, at least theoretically exclusive distribution could be efficient according to the standards of one type of efficiency and not efficient in accordance with the standards of another. Finally, the legality of exclusive territories is significantly influenced by the welfare standard adopted by the given jurisdiction, which is again connected with the approach that a legal system has towards efficiency.

It is generally considered that economic efficiency consists of two elements: allocative efficiency and productive efficiency.[544] Allocative efficiency is connected with the welfare of society as a whole[545] and is achieved when the goods are allocated to those buyers that value them most.[546] It is achieved only if price equals marginal cost.[547] In case the marginal cost of production is below what consumers are ready to pay, society's resources are misallocated – in that case both the producer and consumer would be better off if the resources were reallocated to producing an extra unit of the good.[548] Similarly, allocative inefficiency is also present if the marginal cost is greater than what consumers are willing to pay for the unit – in this case total surplus would be increased by a reduction in output.[549]

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[544] Some authors add another type of efficiency, referred to as dynamic or innovation efficiency. *E.g.*, MOTTA, *supra* note 190, at 55; WHISH, *supra* note 37, at 5; Joseph F. Brodley, *The economic goals of antitrust: efficiency, consumer welfare and technological progress*, 62 N.Y.U. L. REV. 1020, 1025 (1987). According to Motta, "dynamic efficiency . . . refers to the extent to which a firm introduces new products or processes of production." MOTTA, *supra* note 190, at 55.
[545] HOVENKAMP, *supra* note 29, at 75.
[546] Brodley, *supra* note 544, at 1025.
[547] SIMON BISHOP & MIKE WALKER, THE ECONOMICS OF EC COMPETITION LAW: CONCEPTS, APPLICATION AND MEASUREMENT 25 (2010).
[548] *Id.*
[549] *Id.*

Under the conditions of perfect competition a producer cannot affect the market price by limiting his output, and hence a rational manufacturer will not limit it.[550] In that case allocative efficiency is achieved, since consumers can obtain the amount of goods they require at the price they are prepared to pay.[551] However, the analysis changes if a market is not perfectly competitive. A monopolist, unlike a producer in a competitive market, can increase his profits by restricting output.[552]. Since a monopolist charges a price that is too high for given production costs,[553] his actions would lead to allocative inefficiency.

The way of evaluating allocative efficiency entails its own set of problems, since there is no uniform rule about how this type of efficiency is to be measured. One of the most well known standards for evaluating allocative efficiency is the one proposed by Pareto. According to Pareto, an assignment of resources is efficient if no alternative assignment will make at least one person better off without making at least one person worse off as well.[554] However, Pareto efficiency is difficult to achieve in real life and for this reason an alternative has been offered under the name "potential Pareto efficiency".[555] Under this measure, a change is efficient as long as the gainers gain enough to fully compensate the losers.[556] In other words, the total value placed on the gains has to exceed the total value placed on the losses.[557]

Unlike allocative efficiency, which is concerned with society as a whole, productive efficiency mainly has to do with an individual firm. Productive efficiency represents a ratio of a firm's output to its inputs.[558] In the presence of productive efficiency, goods are

[550] WHISH, *supra* note 37, at 5.
[551] *Id.*
[552] *Id.*
[553] MOTTA, *supra* note 190, at 45.
[554] HOVENKAMP, *supra* note 29, at 75.
[555] *Id.*
[556] *Id.*
[557] *Id.*
[558] *Id.* at 74-75.

produced using the most cost-effective combination of available resources.[559] In other words, if productive efficiency is achieved then as little of society's wealth is expended in the production process as necessary.[560] This will be the case under perfect competition because any firm that does not produce at the lowest possible cost will operate at a loss and eventually be forced to exit the market.[561] Conversely, in the presence of a monopoly productive inefficiency could arise – a monopolist may operate at a higher cost than it would be the case in a competitive market.[562] This could primarily occur for two reasons: first, managers in a monopolistic firm have less incentive to make effort;[563] and second, in a monopolistic market there will be no selection among firms based on their efficiency, as is the case in competitive markets.[564]

If allocative and productive efficiency are achieved, society's wealth is maximized.[565] If a practice would enhance both allocative and productive efficiency, there would be no ambiguity about its contribution to economic efficiency. Nevertheless, there are certain actions that enhance productive efficiency and at the same time lead to allocative inefficiency.[566] The imposition of exclusive territories could be one such action. It has been shown that in the presence of fixed costs exclusive territories may lead to avoiding the duplicated costs of entry.[567] However, the presence of a number of firms generally leads to more competition and lower prices, which all contributes to consumer surplus and allocative efficiency.[568] Therefore, exclusive territories can at the same time lead to an increase in productive efficiency and to a decrease in allocative inefficiency.[569]

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[559] Brodley, *supra* note 544, at 1025.
[560] WHISH, *supra* note 37, at 5.
[561] BISHOP & WALKER, *supra* note 547, at 25.
[562] MOTTA, *supra* note 190, at 45.
[563] *Id.* at 47.
[564] *Id.*
[565] WHISH, *supra* note 37, at 4.
[566] *See* HOVENKAMP, *supra* note 29, at 75.
[567] *See supra* Part 2.3.1.3.
[568] MOTTA, *supra* note 190, at 51.
[569] *Id.*

Although the distinction between allocative and productive efficiency is important, the two notions are on a high level of abstraction. For this reason, in terms of practical significance the distinction between different welfare standards could be of more relevance. I

In general, social welfare (also referred to as total surplus) consists of consumer surplus and producer surplus.[570] Each consumer has his own valuation for the good he buys, and the surplus of each consumer represents the difference between his valuation and the price he needs to pay in order to obtain the good.[571] Consequently, consumer surplus is the aggregate surplus of all consumers.[572] Similarly, the surplus of each individual producer is the profit he makes by selling the good, and producer surplus is the sum of all profits obtained by producers in the industry.[573]

When it comes to welfare maximization, the goal of antitrust policy could be twofold: to maximize total surplus or to maximize consumer surplus.[574] Although the two standards often lead to the same result,[575] the use of exclusive territories seems to be exactly a situation where the differences between the two standards could lead to a different outcome. As shown above, under certain conditions price discrimination (made possible by exclusive territories) may maximize total welfare while at the same time decreasing consumer surplus.[576] Consequently, an antitrust policy which puts an emphasis on total surplus would generally not object to the use of such a practice, while a policy which at its center puts consumer surplus could for this reason look unfavorably at the practice. In addition, the studies of the

[570] *Id.* at 18.
[571] *Id.*
[572] *Id.* at 28.
[573] *Id.* at 18. Producer surplus is the excess of what the extra goods could be sold for above the cost of producing them. *Id.* at 28
[574] There does not seem to be an antitrust policy which would (openly) favor producer surplus in relation to total surplus and consumer surplus.
[575] Daniel A. Crane, *The economics of antitrust enforcement, in* ANTITRUST LAW AND ECONOMICS 1, 2 (Keith N. Hylton ed., 2010).
[576] MOTTA, *supra* note 190, at 19.

beer market described above show that the use of exclusive territories leads to higher prices for consumers, which may or may not negatively affect the consumer surplus.[577]

As a result, for a proper assessment of the legality of exclusive territories it is important to have in mind the welfare standard predominant in the antitrust jurisdiction at hand. However, before the analysis proceeds to the current antitrust policy in the U.S. and EU, it is important to turn to the theoretical bases of the policy in these two jurisdictions.

2.4.2 The Chicago School

In order to correctly comprehend the current status that exclusive territories enjoy in legal and economic theory as well as in positive law, it is of great importance to consider the teaching of the Chicago school of antitrust analysis. It is considered that the school started to emerge in the 1950's with the work of Aaron Director, then professor at the University of Chicago School of Law.[578] In essence, Director's greatest contribution to antirust is that he applied price theory on antitrust policy.[579] Following Director, the basic approach of the Chicago School has been that antitrust analysis should be based on general economic theory rather than on traditional industrial organization.[580]

The proponents of the Chicago approach argue for an unobtrusive antitrust policy – their view is that apart from explicit price-fixing and large horizontal mergers there are not many practices antitrust law should be concerned with.[581] Consequently, the Chicago School is known for its lenient approach towards exclusive territories and vertical restraints in general. The first step in the development of the school's approach towards vertical restraints was Ward Bowman's analysis of tying arrangements. According to Bowman, one of

[577] *See supra* Part 2.3.2.6.
[578] Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 925 (1979). Among the early followers of the Chicago concept, Posner includes Bowman, Bork, McGee, and Telser. *See also* R. H. Coase, *Law and Economics at Chicago*, JOURNAL OF LAW AND ECONOMICS, Vol. 36, No. 1, Part 2, John M. Olin Centennial Conference in Law and Economics at the University of Chicago (Apr., 1993), pp. 239-254.
[579] Posner, *supra* note 578, at 928.
[580] *Id.* at 933-34.
[581] *Id.* at 933.

Director's early followers, a firm does not have an incentive to facilitate monopoly in vertically related markets since an upstream monopolist cannot achieve additional monopoly profits by extending its monopoly into the downstream market.[582] The next step was to extend this analysis from tying to vertical integration in general.[583]

According to this view, the product and its distribution are complements, meaning that an increase in the price of distribution would lead to an increase in the price of the product, and as a result the demand will fall.[584] Consequently, the purpose behind vertical integration has to be an increase in efficiency and is hence to be deemed procompetitive.[585] Yet another step was to extend this rationale from vertical integration to vertical restraints. The approach was first applied to the analysis of resale price maintenance and later to other types of vertical restraints, including exclusive territories.[586]

The rationale for a lenient approach towards vertical restraints goes as follows. Since there is only one profit to be derived from the sale of a particular product, a rational manufacturer would not allow its distributors to have higher profit margins than necessary for effective distribution.[587] The law should therefore rely on the manufacturer's rationality.[588]

582 Ward S. Bowman, Jr., *Tying arrangements and the leverage problem*, 67 YALE L.J. 19, 21 (1957).
583 Posner, *supra* note 578, at 927. *See also* Robert Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, THE UNIVERSITY OF CHICAGO LAW REVIEW, Vol. 22, No. 1 (Autumn, 1954), pp. 157-201.
584 Posner, *supra* note 578, at 927.
585 *Id. See also id.* at 936 ("The thinking was that if, for example, supplier *A* acquires all of his retail outlets, *B*, in order to compete, will have to open his own chain of outlets. This, in turn, will make *B*'s entry more costly. The steps in this analysis are illogical, however, and evidence of monopolization by such means scant or nonexistent. *A* will find it very costly to buy more outlets than he needs. *B*, on the other hand, will not have to open his own outlets to enter; if his entry is anticipated, the outlets will be there to greet him.").
586 *Id.* at 927.
587 *See* Baker, *supra* note 126, at 1511.
588 *See* Frank H. Easterbrook, *Vertical agreements and the rule of reason*, 53 ANTITRUST L.J. 135, 146 (1984) ("[W]e must ask why a (sane) manufacturer ever sets up a system of distribution in which the *dealer* obtains the benefits of higher prices.").

Producers should be free in deciding what kind of vertical restraints they will deploy[589] - the best check on the manufacturers' conduct is the market.[590]

Such an approach logically leads to the conclusion that vertical non-price restraints should be *per se* legal.[591] For example, Easterbrook has suggested that distribution restraints should not be a subject of serious antitrust attention, since they rarely have anticompetitive effects.[592] Even if in some instances certain anticompetitive effects can be imagined, it is not easy for courts to distinguish between beneficial and harmful effects of vertical restraints.[593] And as he notes, "most of the time it is better not to try than to try and fail."[594] As will be shown below, this rationale has had a great impact on the U.S. approach towards exclusive territories.[595]

Apart from the analysis directly concerning vertical restraints and thereby exclusive territories, there are some other parts of the Chicago teaching that also contributed to a lenient approach towards exclusive distribution. One such aspect is the school's benevolent approach towards advertising. The followers of the Chicago approach do not consider advertising as a barrier to entry, as was the prevailing view before the school emerged.[596] What is more, advertising is seen as an action that furthers competition. Advertising and other presale services are procompetitive, since they reduce the consumer's search costs and can actually make the promoted brand cheaper than the non-promoted ones.[597] Here as well the Chicago approach relies on rationality, this time the consumer's rationality: a rational consumer will

[589] Zerrillo, Flemming & McKee, *supra* note 272, at 706.
[590] See Easterbrook, *supra* note 588, at 141 ("Every manufacturer may sell what it wants and charge what the traffic will bear. Other manufacturers, perhaps using less chocolate per pound or employing more efficient manufacturing, may sell different goods and charge less. This is competition. Consumers will choose.").
[591] *See id.* at 151 ("No plausible story of restricted dealing shows how it could help manufacturers at the expense of consumers."). For a lenient approach towards vertical restraints, see also: BORK, *supra* note 196, at 225-45; POSNER, supra note 80, at 196-201.
[592] Easterbrook, *supra* note 588, at 135.
[593] *Id.* at 135-36.
[594] *Id.* at 136.
[595] *See infra* Part 3.4.1.
[596] Posner, *supra* note 578, at 930.
[597] *Id.* at 938.

pay more for one brand than for another only if the former is cheaper or better.[598] Such an approach towards advertising indirectly also justifies the imposition of exclusive territories, since one of the main goals of deploying this restraint is to ensure that a distributor properly advertises the distributed product.[599]

Another aspect relevant for the assessment of exclusive distribution is the school's approach towards price discrimination. In this respect paradigmatic is Bork's analysis. He is of opinion that exclusive territories should never be of concern in the light of price discrimination.[600] He argues that the imposition of exclusive territories does not depend on the presence of different revenue-maximizing prices.[601] Firstly, if the markets *are* separated by transportation costs, these costs will hinder the possibility of price discrimination.[602] On the other hand, if the markets *are not* separated by transportation costs, then the imposition of exclusive territories is pointless – the presence of exclusive territories does not prevent the supplier's rivals in the lower-price market from selling in the higher-price market.[603] In other words, in such a case exclusive territories would not be needed for preventing arbitrage, since arbitrage is made unprofitable by transportation costs. Consequently, Bork concludes that "[t]he law simply should not concern itself with price discrimination in any context."[604] Taking into account the significance that the deployment of exclusive territories has with regards to viability of price discrimination,[605] the lack of concern concerning the anticompetitive effects of price discrimination certainly additionally contributed to the lenient approach towards exclusive distribution.

[598] *Id.*
[599] *See supra* Part 2.3.2.2.
[600] Solomon and Joffe argue that exclusive distribution neither enable nor promote price discrimination. Solomon & Joffe, *supra* note 17, at 500 n.39.
[601] BORK, *supra* note 196, at 295.
[602] *Id.*
[603] *Id.*
[604] *Id.*
[605] *See supra* Part 2.3.2.8.

Of relevance for the discussion about exclusive territories are also the school's views on the goals of antitrust enforcement. This is because based on this analysis it could be established what welfare standard the school favors. At least considering the work of Robert Bork, it would seem that the favored standard is total surplus. In addition, the Chicago approach seems to be that, apart from an increase in economic efficiency understood as an increase in total surplus, antitrust policy should not be concerned with any other goal.

According to Bork, the legislative history of the Sherman Act shows that the sole value the Act aims to protect is the maximization of consumer welfare.[606] However, it is important to emphasize that Bork's understanding of consumer welfare does not correspond to consumer surplus as identified above.[607] In Bork's understanding "consumer welfare" is actually synonymous with total output,[608] since in his understanding for the drafters of the Sherman Act "restraint of trade" was synonymous with "restriction of output".[609] From this he draws the conclusion that the goal of the Act is to promote efficiency and prevent restrictions of output.[610]

With regards to the relationship between allocative and productive efficiency, Bork apparently does not favor any of the two: he proposes that in case there is a conflict between allocative and productive efficiency one should look at net efficiency gains.[611] Similarly, by

[606] Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, JOURNAL OF LAW AND ECONOMICS, Vol. 9, (Oct., 1966), pp. 7-48, at 10. *See also* BORK, *supra* note 196, at 52 ("Competition, for the purposes of antitrust analysis, must be understood as a term of art signifying any state of affairs in which consumer welfare cannot be increased by judicial decree.").
[607] *See supra* Part 2.4.1.
[608] *See* BORK, *supra* note 196, at 90 ("Consumer welfare is greatest when society's economic resources are allocated so that consumers are able to satisfy their wants as fully as technological constraints permit."); *id.* at 90 ("Consumer welfare . . . is merely another term for the wealth of the nation."). *See also* HOVENKAMP, *supra* note 29, at 77 ("consumer welfare principle . . . is predicated on the observation that *everyone* is a consumer.").
[609] Bork, *supra* note 606, at 16.
[610] *Id.* at 26 ("Congress' position with respect to efficiency cannot be explained on any hypothesis other than that consumer welfare was in all cases the controlling value under the Sherman Act.").
[611] BORK, *supra* note 196 at 91 ("The whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare."). This would seem to show that Bork adopts "potential Pareto efficiency" as the relevant standard, although he uses the term "consumer welfare". *See* HOVENKAMP, *supra* note 29, at 77 ("Many people who probably believe that maximizing allocative efficiency should be the exclusive goal of antitrust, *state* that

proposing a total output standard Bork is seemingly being neutral regarding the way in which the society's wealth is distributed.[612] However, this neutrality seems to be only superficial. By choosing the total surplus standard Bork is practically favoring producers, at least in the context of exclusive territories. Since exclusive territories are deployed by a producer and not by a consumer, it seems evident that they would not be used if they would not be in the producer's interest. Consequently, an antitrust policy that is apparently neutral and favors only total surplus in effect favors producers.

Finally, apart from substantive law the Chicago School has also expressed its views regarding antitrust procedure. In this respect, the school does not look favorably at suits brought by competitors. The view is that competitors have a wrong incentive to sue, since they are those that are injured by a firm's competitive practices.[613] Consequently, competitor suits should be largely dismissed and private enforcement should be limited to consumers.[614] As will be shown, this has had an influence on standing and other aspects of antitrust litigation, the trend being to curb the level of private enforcement.[615]

Another procedural aspect of relevance for our discussion is the issue of arbitrability of antitrust disputes. Even if this connection is not direct, it seems that there is at least an indirect relationship between the Chicago School approach to antitrust and the arbitrator's ability to resolve antitrust disputes. The connection could be implied from the school's generally non-interventionist approach and belief in party autonomy. More precisely, the view that arbitrators should be able to decide on antitrust issues could be seen as an extension of the doctrine that the state should stay out of antitrust enforcement as much as possible.

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the goal of antitrust should be to maximize the welfare of consumers. Spoken in such terms, the goal sounds very attractive and certainly less technical than 'potential Pareto efficiency'.").

612 BORK, *supra* note 196, at 90 ("Antitrust has nothing to say about the ways prosperity is distributed or used.").

613 *See* HOVENKAMP, *supra* note 29, at 63.

614 *Id.*

615 *See infra* Part 5.1.2.

2.4.3 The Freiburg School (Ordoliberals)

Although the Freiburg School of Ordoliberals does not have as comprehensive an approach towards exclusive territories as the Chicago School has, the development of the EU law of exclusive territories could not be properly understood without considering the ordoliberal teaching. The teaching developed during the 1930s and 1940s at the University of Freiburg and can be said to have two main elements. First, the economic system should allow all individuals to participate in the market without being constrained by the economic power of others.[616] In addition, the market needs to be regulated to a certain extent, since an unregulated market does not guarantee economic freedom.[617] The regulation should be performed through an effective and dependable legal framework aimed at preventing the creation and misuse of private economic power.[618]

Ordoliberals afford special attention to rivalry, and do not look favorably at excluding somebody from the market, even when the exclusion does not harm consumers.[619] Taking into account that the main effect of exclusive distribution agreements is to eliminate competition (i.e. rivalry) between distributors of the same brand, it could be assumed that ordoliberals would have a problem with the deployment of exclusive territories. Related to this is the Freiburg School approach to freedom. Ordoliberals recognize the freedom to enter a market as a fundamental freedom, and exclusive agreements can be seen as restraining this freedom.[620] In other words, in the case of exclusive agreements there could be a conflict

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616 MONTI, *supra* note 45, at 23.
617 *Id.*
618 DAVID GERBER, LAW AND COMPETITION IN TWENTIETH CENTURY EUROPE: PROTECTING PROMETHEUS 235 (1998).
619 VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE 79 (2007). Although rivalry is not the primary goal of modern EU competition law, remnants of the ordoliberal approach are present in EU law even today. In one of its guidelines the Commission considers rivalry as an "essential driver of economic efficiency, including dynamic efficiencies in the shape of innovation". Commission Guidelines on the application of Article [101](3) of the Treaty, OJ [2004] C 101/97 (Guidelines on 101(3)), para. 105.
620 *See* KORAH, *supra* note 619, at 104.

between efficiency and economic freedom,[621] and it seems that ordoliberals would give priority to the latter.

Ordoliberals also argue for the dispersion of economic power and strive for an economy consisting to the largest degree possible of small and medium enterprises.[622] They believe that the concentration of private economic power necessarily threatens the competitive process[623] and that the primary goal of competition law should be to eliminate such concentrations or at least reduce their harmful effect.[624] As a result, ordoliberals perceive the concentration of economic resources as an evil unto itself and are against monopolies as such.[625] Since a manufacturer imposes exclusive territories in order to make each distributor a monopolist in his area, this is another aspect of the ordoliberal teaching which could be interpreted as unsympathetic towards exclusive distribution agreements.

Although ordoliberals consider a competitive economic system as necessary for the prosperity of the society,[626] their focus is more on humanist values than on efficiency or other purely economic concerns.[627] Even though efficiency may be a result of economic freedom, it is not the aim of ordoliberalism.[628] For ordoliberals a state of inefficiency coupled with freedom is better than a totalitarian but efficient state of affairs.[629] Therefore, this is unlike Bork's approach in the sense that there are other values apart from efficiency that should be taken into account when shaping an antitrust policy. What is more, ordoliberals would seem to give even more weight to some other values, such as freedom, than to efficiency.

In addition, the ordoliberal understanding of efficiency and welfare distribution does not correspond to the one adopted by Bork. Unlike Bork, ordoliberals are also concerned

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621 MOTTA, *supra* note 190, at 24.
622 GERBER, *supra* note 618, at 240.
623 *Id.* at 251.
624 *Id.*
625 *Id.* at 240.
626 *Id.* at 232.
627 *Id.* at 239.
628 MONTI, *supra* note 45, at 23.
629 *Id.*

about how efficiency gains are distributed – priority should be given to consumers.[630] Therefore, in contrast to the total surplus standard connected with the Chicago School, the Freiburg School would be leaning more towards the consumer surplus standards. This is potentially of great significance for the law of exclusive territories, especially taking into the situations where exclusive distribution would lead to an increase in total surplus and a decrease in consumer surplus.[631] In other words, in order to satisfy the ordoliberal standard it would not be sufficient that an exclusive distribution agreement brings net efficiency gains – the gains would have to be such that make consumers better off.[632]

2.5 Towards an appropriate rule for exclusive territories

In general, there are three possible approaches that substantive antitrust law can adopt towards exclusive territories: *per se* illegality, *per se* legality, and a rule of reason. In the first situation exclusive territories are outright prohibited, without even considering possible justifications for deploying this type of restraint. On the other hand, exclusive territories are *per se* legal if the law does not contain any prohibition on the imposition of this type of restraint. Finally, if exclusive territories are judged under a rule of reason, the antitrust enforcer is supposed to weigh the pro and anticompetitive aspects of the arrangement and decide on its legality depending on which aspects prevail. As will be shown, each approach has advantages as well as drawbacks.

The choice of an appropriate rule for exclusive territories is deeply connected with the issue of efficiency of the legal system as a whole. A legal system should be devised in a way that minimizes the total costs of anticompetitive practices that escape condemnation, competitive practices that are condemned or deterred, and the system itself.[633] In other words, an enforcement system is optimal if it minimizes the occurrence of enforcement errors. An

[630] *See* G. Monti, *Article 81 EC and Public Policy*, (2002) CMLREV 1057-99, at 1061.
[631] *See supra* Part 2.4.1.
[632] In this respect, consider the exemption process under Article 101(3) TFEU. *See infra* Part 4.3.2.2.2.
[633] Easterbrook, *supra* note 588, at 158.

enforcement error when a conduct with negative welfare effects is wrongly allowed is usually referred to as a "false positive" (Type I error), while an error when a behavior that would have increased welfare is condemned is called a "false negative" (Type II error).[634] Therefore, false positives lead to over-deterrence, while false negatives lead to under-deterrence.[635] Neither over-deterrence nor under-deterrence serves properly the goals of antitrust law, and the choice between a rule of reason and a *per se* rules should be directed at minimizing both.[636]

Perhaps the main advantage of *per se* illegality is that it offers simplicity.[637] In addition, such a rule reduces legal uncertainty,[638] decreases the danger of distorted decisions in antitrust cases,[639] and is a way of bypassing information and knowledge problems connected with the antitrust enforcer.[640] *Per se* illegality of exclusive territories basically eliminates litigation transaction costs as well as the costs of monitoring by enforcement agencies.[641] Nevertheless, *per se* illegality brings with it some other costs.

Most importantly, under *per se* illegality manufacturers and consumers cannot obtain the benefits of exclusive territories.[642] In this chapter it has been shown that there is a number of ways in which the deployment of exclusive territories can be beneficial for a manufacturer

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[634] Arndt Christiansen & Wolfgang Kerber, *Competition policy with optimally differentiated rules instead of "per se rules vs rule of reason"*, 2 J. COMPETITION L. & ECON. 215, 225 (2006).
[635] Steven C. Salop, *Exclusionary conduct, effect on consumers, and the flawed profit-sacrifice standard*, 73 ANTITRUST L.J. 311, 314 (2006).
[636] The Chicago School approach is that the cost of false positives is higher than that of false negatives – the former is usually self-correcting. *See, e.g.*, Fred S. McChesney, *Talking about my antitrust generation: competition for and in the field of competition law*, 52 EMORY L.J. 1401, 1412 (2003) ("The cost of Type II errors (failing to penalize anticompetitive contracts and practices) will be low, as long as barriers to entering markets plagued by suspected anticompetition are also low. As prices rise because of anticompetitive contracts or practices, new entrants emerge to alleviate or even eradicate the problem. Letting the guilty go free in antitrust is generally a self-correcting problem.").
[637] *Sylvania*, 433 U.S. at 50 n.15. The Court however acknowledged that on the other hand *per se* rules also bring rigidity and that hence they should not be used in all circumstances. *Id.* at 50 n.16.
[638] *See* Christiansen & Kerber, *supra* note 634, at 219.
[639] *See id.* at 220. *See also id.* at 235 ("[T]he advantages of applying (differentiated) rules instead of deciding on a case-by-case basis rely primarily on the insight that competition authorities and courts are imperfect decision-makers, who produce a certain share of wrong decisions.").
[640] *See id.* at 220.
[641] Cady, *supra* note 136, at 29-30. *See also* Comanor, *supra* note 197, at 1001 ("In the interests of judicial economy . . . it may be more expeditious to set general policy standards, even though they will sometimes lead to improper results.").
[642] Cady, *supra* note 136, at 29-30.

as well as for consumers, and a *per se* approach would prevent these subjects from enjoying these benefits. In addition, if procompetitive aspects of exclusive territories outweigh the anticompetitive ones, the rule of *per se* illegality could cause a decrease in allocative efficiency.[643] Finally, *per se* illegality could increase the total cost of the antitrust system due to an increase in litigation costs arising out of frivolous suits against legitimate practices.[644]

In today's legal and economic theory there does not seem to be support for *per se* illegality of exclusive territories, even though in the past there had been suggestions in this direction, for example by Comanor.[645] However, even Comanor eventually revised his position, and is now proposing some sort of a rule of reason with regards to the legality of exclusive territories.[646] By emphasizing certain anticompetitive aspects of exclusive territories commentators like him do not anymore propose that exclusive territories should be *per se* illegal, but rather give reasons why this practice should not be treated as *per se* legal.[647]

Diametrically opposite from *per se* illegality would be an approach that would never object to the use of exclusive territories. This is to a large extent the view of the Chicago School, which has led to proposals that this type of restraint should be *per se* lawful.[648] The positive side of this approach would be the avoidance of situations where an efficient conduct would be condemned. However, such an approach would also have significant drawbacks. As shown in this chapter, apart from significant procompetitive aspects, under certain circumstances exclusive territories can also have some harmful effects. A rule of *per se*

[643] *Id.*
[644] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877, 895 (2007).
[645] *See* Comanor, *supra* note 288.
[646] *Compare* Comanor, *supra* note 288 (arguing for *per se* illegality) *with* Comanor, *supra* note 197 (accepting some sort of rule of reason).
[647] *See, e.g.*, Comanor, *supra* note 197, at 998; Scherer, *supra* note 265, at 706.
[648] *See, e.g.*, BORK, *supra* note 196, at 288 ("Every vertical restraint should be completely lawful."); Solomon & Joffe, *supra* note 17, at 525 ("Exclusive distribution should be *per se* lawful under the antitrust laws.").

legality would ignore the potentially harmful effects of exclusive territories, and the more these effects would be pronounced, the larger would the social cost of the rule be.

Taking into account the shortcomings of *per se* illegality and *per se* legality, it would seem that the appropriate rule for exclusive territories is a rule of reason.[649] By weighing the procompetitive and anticompetitive sides of an exclusive distribution agreement, a rule of reason would have the potential to minimize the possibility of enforcement errors. This however does not mean that the application of a rule of reason would not bring with it a separate set of problems.

Firstly, it is one thing to weigh pro- and anticompetitive effects on a theoretical level, and another thing to do it with regards to a particular agreement.[650] In addition, the process of balancing these effects is not costless. As has been rightly noted, the main disadvantage of a rule of reason approach is that it leads to difficulties in application and increases the administrative costs of enforcement.[651] However, there are ways in which these difficulties could be if not completely avoided then at least mitigated. Perhaps the best way to avoid the difficulties in application while still preserving some degree of flexibility is making clear guidelines for applying the rule of reason.[652] This is often referred to as a structured (or structural) rule of reason.[653]

Based on the above, it is submitted that the appropriate rule for judging the legality of exclusive territories is a structured rule of reason. Such a rule would give the enforcer certain

[649] *E.g.*, MONTI, *supra* note 45, at 351; Kay, *supra* note 525, at 559; Rey & Tirole, *supra* note 200, at 922.
[650] *See* Posner, *supra* note 285, at 20 (economic theory more functional for deciding whether a type of conduct deserves a *per se* or rule of reason treatment than it is for balancing in a particular case).
[651] *See, e.g.*, Robert Pitofsky, *The "Sylvania" Case: Antitrust Analysis of Non-Price Vertical Restrictions*, COLUMBIA LAW REVIEW, Vol. 78, No. 1 (Jan., 1978), at 2 ("A standard under which all circumstances are weighed, and violations found only upon demonstration of specific anticompetitive effects, may sound sober and moderate, but in the real world has little deterrent effect, produces trials of inordinate length and expense, and often undermines antitrust enforcement."); Easterbrook, *supra* note 588, at 155 (noting that "[w]hen everything is relevant, nothing is dispositive" and that because of this businesses might have difficulties in planning their conduct).
[652] *See* Cady, *supra* note 136, at 30.
[653] *See* Louis, *supra* note 400, at 267 (a structural rule of reason is one "under which market structure factors are examined to predict anticompetitive effects but evidence of actual effects, which could fill many volumes, is largely ignored.").

guidelines which would assist him in overcoming the vagueness of a full-blown rule of reason analysis, while at the same time preserving the possibility for some balancing. Since the deployment of exclusive territories could cause anticompetitive concern only in the presence of market power,[654] the first step in this structured analysis would be determining whether the parties to an exclusive distribution agreement possess market power. If the answer would be in the negative, the analysis would generally stop there, and the agreement would not be condemned. If there would be market power, the enforcer would proceed to balancing the procompetitive and anticompetitive effects of the agreement.

In performing the balancing test, some of the following factors should be taken into account. Firstly, the enforcer should determine the type of the product. If the product is not a shopping good, the purpose behind the agreement could be anticompetitive, since exclusive distribution generally does not make sense for convenience goods.[655]

Secondly, the market level where exclusive territories are imposed should be observed. Since exclusive territories are generally more apt for the wholesale level, if they are imposed at the retail level this may be a sign that the purpose behind the agreement is actually retailer collusion.[656]

Thirdly, if exclusive territories are used by a new entrant into a market, the agreement will most likely be procompetitive, and should be looked at benevolently.[657]

Fourthly, it should be observed whether the deployment of exclusive territories is coupled with an exclusive dealing clause. If it is, the anticompetitive potential of the agreement could be heightened,[658] and in that case a heightened level of scrutiny would be appropriate.

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[654] *See supra* Part 2.3.1.4.
[655] *See supra* Part 2.3.1.1.
[656] *See supra* Part 2.3.2.5.
[657] *See supra* Part 2.3.1.3.
[658] *See supra* Parts 2.2.5, 2.3.2.4, 2.3.2.5.

Fifthly, the enforcer should determine whether the market in which exclusive territories are used is characterized by a parallel network of such agreements. If it is, then the positive effects of exclusive territories are likely to cancel each other out,[659] which would be an argument against upholding the agreement.

Finally, it should be noted that the above list should not be exhaustive – the enforcer should also look at other aspects of the agreement that may either bring procompetitive efficiencies[660] or cause anticompetitive harm.[661]

[659] *See supra* Part 2.3.2.6.
[660] *See supra* Part 2.3.1.
[661] *See supra* Part 2.3.2.

3 EXCLUSIVE DISTRIBUTION IN U.S. LAW

This chapter presents the American law of exclusive territories. The goal is twofold: to compare the law with the proposed rule laid down in the theoretical chapter and to provide the basis for a comparison with the EU law of exclusive distribution. To this end the chapter first examines the statutory framework applicable to exclusive distribution. Before proceeding to the assessment of the positive law, the chapter provides a historical overview of the U.S. approach towards exclusive distribution. Apart from the strictly vertical aspects of exclusive territories, the chapter also analyzes the legality of exclusive territories arrangements that have both vertical and horizontal aspects (joint ventures). Finally, in order to provide a basis for an assessment of the stability of the current approach to exclusive distribution, the chapter considers the *stare decisis* principle.

3.1 The legal framework

3.1.1 The main sources of law

In general and with regards to exclusive distribution, the most important source of U.S. antitrust law is the Sherman Antitrust Act.[662] As agreements that restrain trade, exclusive distribution agreements are generally challenged under Section 1 of the Act.[663] In addition, when used by a dominant firm exclusive territories can also be challenged under Section 2.[664] Finally, the practice can also be challenged under Section 5 of the Federal Trade

[662] Sherman Antitrust Act of 1890, 15 U.S.C. §§ 1-7.
[663] Sherman Act Section 1 proscribes "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations." 15 U.S.C. § 1.
[664] Sherman Act Section 2 condemns "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations." 15 U.S.C. § 2. "The law of distribution and marketing practices intersects with the law of monopolization when dominant firm distribution strategies are challenged." Andrew I. Gavil, *Exclusionary distribution practices by dominant firms: striking a better balance*, 72 ANTITRUST L.J. 3, 23 (2004). *See, e.g.*, McDaniel v. Greensboro News Co., 1984-1 Trade Cases P 65,792 (4th Cir. 1983); Cowley v. Braden Industries, Inc., 613 F.2d 751 (9th Cir. 1980).

Commission Act,[665] which has been interpreted as encompassing all conduct that could fall under the Sherman Act.[666]

Since these statutes are phrased in a very abstract and vague manner, for an assessment of the law of exclusive territories it is also necessary to consider the relevant case-law. In this respect especially significant are the cases decided by the U.S. Supreme Court and to a certain extent also the decisions of lower courts. However, before analyzing the decisions about the legality of exclusive territories, the objectives of the American antitrust will be briefly discussed.

3.1.2 Goals of enforcement

In order to better understand the current state of the law of exclusive territories, it is useful to briefly examine the goals of American antitrust enforcement. Since the Sherman Act is silent regarding its objectives, it has been left to the courts to determine what these objectives are. In this respect, the Supreme Court's position would seem to be that the primary (if not only) objective of antitrust enforcement is the furtherance of consumer welfare.[667] However, the problem with such determination is that the term "consumer welfare" is ambiguous. On the one hand, it could be equated with the consumer surplus standard.[668] On the other hand, the term could also be understood in the meaning assigned to it by Robert Bork, which could be characterized as a total surplus standard.[669]

In addition, it is not clear whether the adoption of Bork's concept of consumer welfare would permit taking into account some additional objectives of antitrust enforcement. Based on the relevant case-law, the Court's position with regards to this issue cannot be

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[665] Federal Trade Commission Act of 1914, 15 U.S.C §§ 41-58. Section 5(a)(1) of the Act declares as unlawful all "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C § 45(a)(1).
[666] FTC v. Cement Institute, 333 U.S. 683, 694 (1948) ("[A]ll conduct violative of the Sherman Act may likewise come within the unfair trade practice prohibitions of the Trade Commission Act.").
[667] *E.g.*, *Leegin*, 551 U.S. at 902 (noting that antitrust laws are supposed to protect competition and consumer welfare).
[668] *See supra* Part 2.4.1.
[669] *See supra* Part 2.4.2.

determined with absolute certainty. On balance it would seem that the Court has sided with Bork, especially taking into account the decisions where the Court has referred to his work when discussing the purpose of the Sherman Act.[670] However, in some other decisions the Court has at least left open a possibility that the Sherman Act is about something more than what Bork argues for.[671]

Accordingly, the view that the sole objective of the Sherman Act is the furtherance of the total surplus standard cannot be accepted uncritically. In this respect some authors argue that when enacting the Act Congress did not have in mind only total surplus, but also efficiencies that flow directly to consumers.[672] In other words, the claim is that the economic goal of antitrust can be seen as an increase in total output subject to the condition that consumers receive a fair share of it.[673] Although there are no Supreme Court decisions directly supporting this view, certain cases could be seen as tacitly supporting the standpoint that the primary goal of the Act is to protect consumers.

In this respect, some commentators[674] have primarily pointed to Supreme Court decisions in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*[675] and *Eastman Kodak Co. v. Image Tech. Servs., Inc.*[676] In both cases the Court condemned practices that seemed to harm consumers. In *Aspen* consumers lost a package which they seemed to like, while in *Kodak* it

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[670] *See* Reiter v. Sonotone Corp., 442 U.S. 330, 342 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'") (citing Bork); National Collegiate Athletic Ass'n v. Board of Regents of National Collegiate Athletic Ass'n v. Board of Regents of University of Oklahoma, 468 U.S. 85, 107 (1984) (*NCAA*) (quoting *Reiter*, the Court identified consumer welfare as a fundamental goal of antitrust law and emphasized the role of allocative efficiency).

[671] In one case the Supreme Court expressly indicated that antitrust is more than just economic efficiency, criticizing a Court of Appeals for casting aside "a century of understanding that [American] antitrust laws are designed to safeguard more than efficiency and consumer welfare." Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 360 (1990) (*ARCO*). The criticized Court of Appeals decision expressly adopted Bork's view, stating that "[c]onsumer welfare is maximized when economic resources are allocated to their best use" and that "allocative efficiency is synonymous with consumer welfare". Rebel Oil Co. v. Atl. Richfield Co., 51 F.3d 1421, 1433, 1444 n.15 (9th Cir. 1995).

[672] *E.g.*, Robert H. Lande, *Wealth transfers as the original and primary concern of antitrust: the efficiency interpretation challenged*, 34 HASTINGS L.J. 65, 110 (1982); Salop, *supra* note 635.

[673] *See* Brodley, *supra* note 544, at 1023.

[674] Gavil, *supra* note 664, at 18-19.

[675] 472 U.S. 585 (1985).

[676] 504 U.S. 451 (1992).

was found that Kodak's after-sale service was of lower quality and higher prices than that offered by independent service providers.[677] Along the same line, the Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*[678] stated that conduct that leads to an increase in price could be condemned even if economic theory claims that such an arrangement is harmless.[679] Taking into account that a price increase is something that is most directly connected with harming the interests of consumers, *Brooke Group* could be read as furthering the consumer surplus position.

Nevertheless, taking into account *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[680] the significance of *Aspen Skiing*, *Eastman Kodak*, and *Brooke Group* should not be overstated. First, in discussing antitrust laws' approach towards the legality of vertical restraints the Court referred not only to consumers' but also to manufacturers' interest.[681] In addition, the Court clarified that a price increase is not on its own sufficient for condemning a vertical agreement, as the main rationale behind vertical arrangements is precisely to allow the distributor to charge a price higher than it would be possible without the restraint.[682] Therefore, *Leegin* would stand for the proposition that a price increase is not enough in order to condemn a conduct and that the interests of the consumers are not more important than those of the manufacturers. Related to the issue of exclusive distribution, this would lean

[677] Gavil, *supra* note 664, at 18-19.
[678] 509 U.S. 209 (1993).
[679] *Id.* at 229 ("However unlikely [the possibility that a certain conduct will produce anticompetitive effects] may be as a general matter, when the realities of the market and the record facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability.").
[680] 551 U.S. 877 (2007).
[681] *See Leegin*, 551 U.S. at 902 (noting that antitrust laws prohibiting certain vertical restraints hamper "competition and consumer welfare because manufacturers are forced to engage in second-best alternatives and because consumers are required to shoulder the increased expense of the inferior practices.").
[682] *See id.* at 895 ("Respondent is mistaken in relying on pricing effects absent a further showing of anticompetitive conduct."); *id.* at 896-97 ("Many decisions a manufacturer makes and carries out through concerted action can lead to higher prices. A manufacturer might, for example, contract with different suppliers to obtain better inputs that improve product quality. Or it might hire an advertising agency to promote awareness of its goods. Yet no one would think these actions violate the Sherman Act because they lead to higher prices. The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want. The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices."). On the other hand, price increase could lead to the condemnation of a *horizontal* arrangement. *See id.* at 893.

towards the total surplus standard, and tip the scale in favor of the legality of exclusive territories.

3.1.3 Forms of analysis

In the American antitrust system there are two main ways in which an alleged antitrust injury can be analyzed: the *per se* rule and the rule of reason.[683] Under the *per se* rule, the court will condemn a certain conduct as soon as it establishes that the conduct actually took place, without even giving a chance to the defendant to offer procompetitive justifications for his conduct.[684] A conduct is judged under *per se* illegality when it is such that it can never or almost never have procompetitive justification.[685] In that case the use of a *per se* rule contributes to the efficiency of enforcement.[686] However, as shown above, the use of per se rules also has serious drawbacks, especially with regards to a practice such as exclusive distribution.[687]

On the other hand, the rule of reason is reserved for practices that are considered as less pernicious. If a practice is judged under the rule of reason, the court is supposed to examine procompetitive and anticompetitive aspects of the conduct and decide on the legality

[683] In *NCAA* the Court stated that "there is often no bright line separating *per se* from Rule of Reason analysis". 468 U.S. 104 n.26. There are other types of analysis as well, such as quick look and truncated rule of reason, or structural rule of reason. However, at this point we will concentrate on the two mentioned types of analysis.
[684] The beginning of the rule of reason is usually connected with Judge Taft's opinion in *Addyston Pipe*, where he refused to set sail on a sea of doubt. U.S. v. Addyston Pipe & Steel Co., 85 F. 271, 283-84 (6th Cir. 1898).
[685] *See* Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1, 19-20 (1979) (*BMI*) ("[I]n characterizing [a] conduct under the *per se* rule, our inquiry must focus on whether the effect and . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy – that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.").
[686] *See* Northern Pac. Ry. Co. v. U.S., 356 U.S. 1, 5 (1958) ("[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."); U.S. v. Container Corp. of America, 393 U.S. 333, 341 (1969) ("Per se rules always contain a degree of arbitrariness. They are justified on the assumption that the gains from imposition of the rule will far outweigh the losses and that significant administrative advantages will result. In other words, the potential competitive harm plus the administrative costs of determining in what particular situations the practice may be harmful must far outweigh the benefits that may result. If the potential benefits in the aggregate are outweighed to this degree, then they are simply not worth identifying in individual cases.").
[687] *See supra* Part 2.5.

based on which of the two aspects prevails.[688] However, it remains an open question how exactly this inquiry is to be performed.[689] What is clear is that although the rule of reason envisages a balancing test, it does not mean that the defendant can use any reasonable argument in order to justify a certain conduct. Most notably, the defendant cannot argue that competition itself is unreasonable.[690]

The determination about whether a certain conduct is to be judged under the rule of reason or should rather be afforded *per se* analysis is very important, since it can to a large extent determine the outcome of antitrust analysis.[691] Today the rule of reason can be considered as a "default" rule of antitrust analysis.[692] However, this has not always been the case – until the 1960s antitrust enforcement relied primarily on *per se* rules.[693] Under the influence of the Chicago School, the Supreme Court slowly started leaning towards the rule of reason, with *Sylvania* generally considered as a watershed decision in this respect.[694] That has led to the current situation in which only hard-core horizontal restraints are still governed by *per se* prohibitions.[695]

The more extensive use of the rule of reason is sometimes connected with the wider use of economics in antitrust, since this type of analysis leaves more space for the application of economics in judging a particular case.[696] However, the use of *per se* rules does not completely exclude the use of economics – a *per se* rule can also be based on economic

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688 It is generally considered that the rule of reason was born with the Supreme Court's decision in *Standard Oil*, where the Court held that the Sherman Act prohibits only undue or unreasonable restraints of trade. Standard Oil Co. of New Jersey v. U.S., 221 U.S. 1, 89 (1911).
689 *See infra* Part 3.3.
690 *See* National Soc. of Professional Engineers v. U. S., 435 U.S. 679, 696 (1978) ("[T]he Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable [since that] would create the "sea of doubt" on which Judge Taft refused to embark in *Addyston*, and which [the Supreme] Court has firmly avoided ever since.").
691 Baker, *supra* note 126, at 1459.
692 *See* Business Electronics Corp. v. Sharp Electronics Corp. 485 U.S. 717, 726 (1988) (noting that there is a presumption in favor of a rule-of-reason standard).
693 Christiansen & Kerber, *supra* note 634, at 218.
694 *Id.*
695 Robert Pitofsky, *Antitrust at the turn of the twenty-first century: A view from the middle*, 76 ST. JOHN'S L. REV. 583, 587-88 (2002).
696 Christiansen & Kerber, *supra* note 634, at 219.

considerations.[697] Be that as it may, this chapter will show that the Supreme Court has not been consistent with regards to the standard for judging the legality of exclusive territories, which to an extent could be contributed to the changing role of economic theory in antitrust analysis.

3.2 The early cases

3.2.1 White Motor

Compared to some other areas of American antitrust, the law of exclusive territories started to develop relatively late. This could be explained by the fact that enforcement agencies initially did not express much interest in pursuing this type of restraint – in the period between 1890 and 1948 the DoJ did not challenge a single instance of exclusive territories.[698] The DoJ also did not challenge other types of vertical territorial restraints and even if they did arise in private litigation, the courts generally found them legal.[699]

However, in 1948 the DoJ reversed its position and announced that it deemed certain vertical restraints, including airtight exclusive territories, as illegal *per se*.[700] Although the DoJ then started challenging practices involving airtight exclusive territories, there were no court judgments on the issue – defendants were rather opting to enter into a consent decree than go to trial.[701] About the same time, the FTC also started challenging exclusive territories

[697] *See id.* at 236-37.
[698] Cady, *supra* note 136, at 29.
[699] The courts for example upheld the imposition of exclusive franchises, i.e. a restraint where a manufacturer agrees with one or more of his distributors that he will not appoint another distributor or sell his product to any other outlet within an assigned territory. Richard W. McLaren, *Territorial restrictions, exclusive dealing, and related sales distribution problems under antitrust laws*, 11 PRAC. LAW. 79, 81 (1965). *See, e.g.*, Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942); Cole Motor Car Co. v. Hurst, 228 Fed. 280 (5th Cir. 1915); Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.); Schwing Motor Co. v. Hudson Sales Corp., 138 F.Supp. 899 (4th Cir. 1956).
[700] Pitofsky, *supra* note 651, at 5-6.
[701] THEODOR BANKS, DISTRIBUTION LAW (1999, Supp. 2006), at 4-290. Between 1948 and 1963 the DoJ was involved in at least sixteen prosecutions of exclusive territories, each of them ending in a consent decree. Warren S. Grimes, *From Schwinn to Sylvania to Where? Historical Roots of Modern Vertical Restraints Policy*, *in* ANTITRUST STORIES 145, 151 (Eleanor M. Fox & Daniel A. Crane eds., 2007).

clauses.[702] Therefore, it was only a matter of time before the issue of exclusive territories would reach the Supreme Court.

The first such case was *White Motor Co. v. U.S.*[703] The dispute involved a truck manufacturer, White Motor, that imposed certain territorial restraints upon its distributors.[704] The manufacturer was dealing through a network of around 300 dealers, all of whom entered into the same type of exclusive distributorship agreement.[705] The typical territorial restraint read as follows:

> Distributor is hereby granted the exclusive right, except as hereinafter provided, to sell during the life of this agreement, in the territory described below, White and Autocar trucks purchased from Company hereunder . . . Distributor agrees to develop the aforementioned territory to the satisfaction of Company, and not to sell any trucks purchased hereunder except in accordance with this agreement, and not to sell such trucks except to individuals, firms, or corporations having a place of business and/or purchasing headquarters in said territory.[706]

As can be seen, this is an exclusive territory provision, with the distributor agreeing to limit its sales to the territory described in the distribution agreement. In return, the distributor is granted the sole right of selling in the territory, meaning that no other distributor can interfere with his area of responsibility.

The DoJ challenged this practice, arguing that the truck manufacturer and its distributors engaged in an unlawful combination and conspiracy in violation of the Sherman Act.[707] Consequently, the DoJ moved for a summary judgment that would condemn the truck manufacturer's territorial and customer restraints as well as vertical price fixing as illegal *per*

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[702] The first occasion where the FTC challenged the imposition of exclusive territories was *In re* Snap-On Tools, 59 F.T.C. 1035 (1961). The FTC condemned the practice as *per se* illegal. *Id.* at 10-12. However, on appeal the Court of Appeals for the Seventh Circuit decided that the rule of reason is a more appropriate legal standard for exclusive territories, and consequently upheld Snap-On Tools's territorial restrictions. Snap-On Tools Corp. v. F.T.C., 321 F.2d 825, 833 (7th Cir. 1963).
[703] 372 U.S. 253 (1963).
[704] The company also introduced some customer restraints on its distributors, as well as fixed the price at which they would resell the trucks to final customers. However, since of our interest are mainly territorial restraints, we will keep our focus on the part of the decision dealing with this type of restraints.
[705] *White Motor,* 372 U.S. at 280.
[706] *Id.* at 255-56.
[707] U.S. v. White Motor Co., 194 F.Supp. 562, 564 (6th Cir. 1961) (District Court *White Motor*).

se.[708] The District Court granted the motion.[709] White Motor appealed and the case reached the Supreme Court. White Motor did not challenge the price fixing part of the summary judgment, but only the part regarding territorial and customer restraints. Consequently, the issue before the Court was whether the territorial and customer restraints imposed by White Motor are suitable for a summary judgment or rather require a full trial.

The Court in *White Motor* was not sure how to assess the legality of exclusive territories. Case-law on the topic was very limited, and economic literature on the subject was also not that extensive. One option that the Court could have chosen in deciding about the legality of exclusive territories was to make a parallel between this type of restraint and some other conduct, the legality of which had already been decided. On the one hand, the Court could have relied on the cases dealing with resale price maintenance.[710] In the alternative, the Court could have made a parallel between horizontal and vertical divisions of territory.[711] In either case the outcome would have been the same – exclusive territories would have been condemned as *per se* illegal.

However, the Court chose a third way. It did not say that exclusive territories are to be *per se* legal, nor even that they should be judged under the rule of reason. What is more, it even did not exclude the possibility that this type of restraint deserves to be treated as *per se* illegal.[712] The Court merely acknowledged that it is not clear whether vertical territorial restrictions are harmful for competition or not.[713] Consequently, the Court found that a

[708] *Id.* at 564.
[709] *Id.* at 588.
[710] *See* Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911); U.S. v. Colgate & Co., 250 U.S. 300 (1919).
[711] When referring to horizontal territorial division, the Court cited Timken Roller Bearing Co. v. U.S., 341 U.S. 593 (1951). The case involved a market division agreement between three competitors concerning the manufacture and sale of antifriction bearings.
[712] *White Motor,* 372 U.S. at 263 ("Horizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition. A vertical territorial limitation may or may not have that purpose or effect.").
[713] *White Motor,* 372 U.S. at 261 ("[W]e know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.").

summary judgment was not appropriate and that the legality of customer and territorial restrictions should be determined in a trial on the merits.[714]

In arguing that the case deserves a trial on the merits, White Motor emphasized the importance of vertical restraints for its ability to effectively compete in the market, especially against larger companies.[715] It put forward the free-riding argument, emphasizing that the grant of exclusive territories is necessary in order to obtain maximum sales in a given area.[716] This can be seen as the first instance where a party tried to use the free-rider argument before the Supreme Court in order to justify the imposition of a vertical restraint. However, at that time this argument was not as widely accepted as today. Telser's article about free-riding had been published a few years earlier,[717] but the doctrine had not yet been embraced by the courts. Consequently, the Court in *White Motor* refused to either accept or refute the free-rider argument.

In other words, the Court in *White Motor* effectively avoided engaging into an economic analysis of vertical territorial restraints. However, even the mere reference to economics was unacceptable for some of the Justices: the dissent criticized White Motor's use of economic arguments in order to justify its distribution policy, noting that "[a]ll of [White Motor's] statements are economic arguments or business necessities none of which have any bearing on the legal issue."[718] From today's perspective this view seems somewhat peculiar, since modern antitrust policy is not imaginable without the use of economics.

The dissent had another peculiar point, which is that vertical restraints are just as pernicious as horizontal ones, if not even more.[719] The argument for this view was that price-

[714] *Id*. However, there was no new trial in this case. After the Supreme Court rendered its decision, the truck manufacturer entered into a consent decree according to which it agreed to abandon its distribution practices and dispose of the described territorial and customer restraints. *See* 1964 Trade Cas. (CCH) H 71,195.
[715] *White Motor,* 372 U.S. at 256.
[716] *Id.* at 256-57.
[717] *See* Telser, *supra* note 237.
[718] *White Motor,* 372 U.S. at 279 (Clark, J., dissenting).
[719] *Id.* at 279-80.

fixing agreements are harder to police than vertical territorial divisions, and hence horizontal agreements are more easily breached.[720] Although the majority opinion did not explicitly say anything about vertical restraints' potential for anticompetitive effects as compared to horizontal ones, today it is widely accepted that horizontal agreements are more pernicious than the vertical ones.[721]

Similarly, the dissent considered the elimination of intrabrand competition just as pernicious as the elimination of interbrand competition. The argument was that the Sherman Act does not distinguish between the elimination of interbrand and intrabrand competition – both are violating the law.[722] In other words, the elimination of competition inherently violates the Sherman Act regardless of its potential procompetitive justifications. From this it follows that the dissent was practically arguing for *per se* illegality of vertical territorial restraints. As will be shown, this would soon become the view of the Court's majority.

All in all, from the standpoint of the theoretical framework developed above,[723] the Court's decision in *White Motor* could be characterized as neutral. Although the Court acknowledged that exclusive territories could have both procompetitive and anticompetitive effects, it successfully avoided getting into a deeper economic analysis about this type of restraint. Therefore, *White Motor* cannot be seen as either endorsing or condemning the use of exclusive territories, but only as (correctly) recognizing that the impact of this type of restraint is complex and cannot be determined at a summary stage.

3.2.2 Schwinn

Taking into account that *White Motor* did not decide on the legality of exclusive territories but merely concluded that a trial on the merits is required, the law on the issue remained unsettled. For this reason it was only a matter of time when the Court would

720 *Id.*
721 *E.g.*, State Oil Co. v. Khan, 522 U.S. 3, 14 (1997) ("Vertical restraints are generally more defensible than horizontal restraints.").
722 *White Motor,* 372 U.S. at 281 (Clark, J., dissenting).
723 *See supra* Part 2.5.

address the issue again. The opportunity for this arose in another landmark case concerning the legality of exclusive distribution – *U. S. v. Arnold, Schwinn & Co.*[724]

Schwinn was a bicycle manufacturer with a relatively significant market share. In 1951 its share was 22.5 % of the national market, while in 1961 the share dropped to 12.8 %.[725] The company was primarily selling its bicycles through wholesale distributors, who then supplied a large number of retailers.[726] The number of wholesalers was limited, and each wholesaler was assigned an exclusive territory.[727] The wholesalers then supplied franchised dealers, the number of which was also limited in each of the areas mentioned above, and each retailer was designated only a certain location.[728]

The government challenged these practices before a District Court in Illinois, arguing that they were in violation of the Sherman Act.[729] The District Court ruled on some points in favor of the plaintiff and on some points in favor of the defendant. The government appealed the District Court's ruling and the case eventually reached the Supreme Court. Consequently, the issue before the Supreme Court was the type of analysis to be applied to the vertical distribution restraints employed by Schwinn.[730]

In analyzing the restraints, the Court emphasized that the issue was not the impact of the restrictions on interbrand competition, but rather the legality of intrabrand restrictions.[731] In this light the Court was addressing the argument that Schwinn's practices should be lawful since they were effective, i.e. that intrabrand restrictions allowed Schwinn to compete in the market more effectively. The Court found that the fact that the intrabrand restraints were effective did not make them legal, since horizontal cartels also bring efficiencies to their

[724] 388 U.S. 365 (1967).
[725] *Schwinn,* 388 U.S. at 368.
[726] *Id.* at 369.
[727] *Id.* at 371.
[728] *Id.* at 370. For a justification of Schwinn's practices, see WILLIAMSON, *supra* note 55, at 183-88.
[729] U. S. v. Arnold, Schwinn & Co., 237 F.Supp. 323 (7th Cir. 1965) (District Court *Schwinn*).
[730] Before the lower court the DoJ was arguing for *per se* illegality of Schwinn's practices. However, in the case before the Supreme Court the DoJ changed its stance, asking the Court to find Schwinn's practices illegal under the rule of reason.
[731] *Schwinn,* 388 U.S. at 369-70.

members, but that does not make such agreements legal.[732] This reasoning does make sense to the extent that individual and general interests do not necessarily coincide.[733] However, this does not mean that the conclusion to which the Court in *Schwinn* arrived is economically sound.

After conducting its analysis, the Court found that the legality of distribution restraints depends on whether the dominion over the distributed good stays with the manufacturer or rather passes to the distributor. If the dominion does stay with the manufacturer, then the legality of the restraints is to be judged under the rule of reason.[734] If, on the other hand, it passes, then such limitations are to be considered as illegal *per se*.[735] Therefore, rather than engaging in an economic analysis about the potential impact of exclusive territories when deciding about the legality of the restraint, the Court made a formal distinction based on the transfer of ownership.

Although *Schwinn* adopted a hostile approach towards exclusive territories, it did not completely exclude the possibility for a manufacturer to have only one dealer in a certain territory. According to the Court:

> a manufacturer of a product other and equivalent brands of which are readily available in the market may select his customers, and for this purpose he may 'franchise' certain dealers to whom, alone, he will sell his goods [Citing *Colgate*]. If the restraint stops at that point-if nothing more is involved than vertical 'confinement' of the manufacturer's own sales of the merchandise to

[732] *Id.* at 374-75 ("Schwinn sought a better way of distributing its product: a method which would promote sales, increase stability of its distributor and dealer outlets, and augment profits. But this argument, appealing as it is, is not enough to avoid the Sherman Act proscription; because, in a sense, every restrictive practice is designed to augment the profit and competitive position of its participants. Price fixing does so, for example, and so may a well-calculated division of territories.").
[733] *See supra* Part 2.3.2.1.
[734] *Schwinn,* 388 U.S. at 380 ("Where the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer, it is only if the impact of the confinement is 'unreasonably' restrictive of competition that a violation of s 1 results from such confinement, unencumbered by culpable price fixing.").
[735] *See id.* at 379 ("[W]here a manufacturer sells products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results."); *id.* at 382 ("Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred-whether by explicit agreement or by silent combination or understanding with his vendee-is a *per se* violation of s 1 of the Sherman Act.").

> selected dealers, and if competitive products are readily available to others, the restriction, on these facts alone, would not violate the Sherman Act.[736]

Therefore, the Court's reasoning seems to have been that a manufacturer can decide to whom he will sell his products, but he cannot limit the distributor's freedom when it comes to selling outside of the assigned territory. This could be read as saying that even during the *Schwinn* era the law seems to have recognized some procompetitive sides of exclusive territories, even if only non-airtight ones. However, it is arguable if in this case there is a restraint at all – the situation could also be seen as the manufacturer's right to conduct business with whomever he wishes.

Against the theoretical framework presented above,[737] the outcome of *Schwinn* could be characterized as inappropriate. The *Schwinn* Court largely disregarded the procompetitive effects of exclusive territories, prohibiting this type of restraint across the board. The Court's focus on intrabrand competition is not defensible from an economic point of view – it will be shown further in the paper that later it became widely accepted that a restriction of intrabrand competition may actually lead to an increase in interbrand competition.[738] And if the Court's decision contained anything that could be characterized as efficiency-enhancing, then it has to do with the simplicity in application that is inherent to every *per se* rule. However, the costs arising out of the impossibility of achieving the procompetitive potential of exclusive territories seem to by far outweigh potential gains in administrative efficiency, especially taking into account that the outcome of the case led to what can be characterized as an inefficient vertical integration.[739]

Before turning to the next Supreme Court case dealing with vertical territorial restraints, the dissent in *Schwinn* will be briefly addressed. The dissent mainly focused on the efficiency-enhancing side of Schwinn's distribution restraints, emphasizing that the best

[736] *Id.*. at 376.
[737] *See supra* Part 2.5.
[738] *See infra* Part 3.3.
[739] *See infra* Part 5.3.2.

justification for Schwinn's distribution practices is that they actually produced results in the form of Schwinn's increased market share.[740] The dissent also criticized the majority's distinction based on the fact whether the dominion over products passed or not. On the one hand, it noted that this distinction undermines the importance of independent franchisers, since distribution restraints introduced upon them are considered as *per se* illegal.[741] On the other hand, it argued that there is no substantial difference between the two situations distinguished by the majority, i.e. when the title passes and when it does not.[742] It will be shown, in the course of several years the views of the dissent would become the prevailing view in the Supreme Court.

3.3 *Sylvania*

When it comes to the law of exclusive territories, *Continental T. V., Inc. v. GTE Sylvania Inc.*[743] is probably the most important Supreme Court decision to date. The facts of the case can be summarized as follows.

Sylvania was a television manufacturer facing declining sales nation-wide. In order to improve business, the manufacturer imposed certain location restrictions on its franchisers. These restrictions meant that Sylvania would limit the number of franchisers serving a certain territory. In other words, each franchiser could sell only from the location assigned to it by Sylvania. These restrictions were not exclusive territories, since Sylvania could appoint more than one franchiser per area. It was also not an exclusive dealing arrangement, since the franchisee was able to sell the products of competing television manufacturers. The restrictions helped Sylvania improve its business and increase its share of the national market from between 1 and 2 % to about 5 %.

[740] *Schwinn,* 388 U.S. at 384 (Stewart, J., dissenting). However, as the majority (correctly) noted, not everything that is in the interest of the individual is at the same time legal from the antitrust point of view.
[741] *Id.* at 388.
[742] *Id.* at 393.
[743] 433 U.S. 36 (1977).

Continental was one of Sylvania's franchised retailers for the region of San Francisco, serving the Sacramento area. Taking into account Sylvania's share of the national market, Continental seemed to be quite successful in the franchising business.[744] Nevertheless, at a certain point Sylvania decided to introduce a new franchisee in the Sacramento area, just one mile from Continental's store. Continental objected to this, but Sylvania nevertheless proceeded with its plan and the new franchisee was appointed.

This caused the relations between Continental and Sylvania to deteriorate and eventually led to a court dispute, with Continental challenging Sylvania's location restrictions as violating the antitrust laws. Relying on *Schwinn*, the District Court condemned the restrictions as *per se* unlawful.[745] The defendant appealed. The Court of Appeals distinguished Sylvania's location restrictions from the territorial restrictions imposed by Schwinn and reversed the District Court's decision, finding that Sylvania's restrictions should be judged under the rule of reason.[746] Following the Court of Appeals' decision, Continental filed for certiorari and the case ultimately reached the Supreme Court.

The issue before the Court was which type of analysis should be afforded to vertical non-price restraints. In light of *Schwinn*, the Court first found that title had passed from Sylvania to Continental, and that in order to determine if the *per se* rule applies it was necessary to establish whether the restrictions in *Sylvania* are basically the same as the ones employed by Schwinn.[747] In other words, the preliminary issue was whether *Sylvania* was distinguishable from *Schwinn*.

After finding that the cases were not distinguishable,[748] the Court proceeded to the analysis of whether the principle of *stare decisis* prevents it from overruling *Schwinn*. The Court recognized that *Schwinn* is supported by the principle, but still concluded that the need

[744] Sylvania's market share in Sacramento exceeded 15% in 1965.
[745] GTE Sylvania Inc. v. Continental T.V., Inc., 1974-1 Trade Cases P 75,072 (9th Cir. 1974).
[746] GTE Sylvania Inc. v. Continental T. V., Inc., 537 F.2d 980 (9th Cir. 1976).
[747] *Sylvania,* 433 U.S. at 45-46.
[748] *Id.* at 46.

for clarifying the law of vertical non-price restraints justifies reconsidering even such a recent precedent.[749] Consequently, the Court turned to the substance of the dispute, i.e. whether vertical non-price restraints are to be governed by the rule of reason or by *per se* illegality.

The Court first determined what these types of analysis actually mean,[750] concluding that *Schwinn*'s *per se* rule towards vertical non-price restrictions does not satisfy the *per se* illegality standard.[751] It then engaged itself in analyzing Sylvania's distribution practices. At the outset, it recognized that the imposed restraints do have certain anticompetitive effects, as they reduce the level of intrabrand competition.[752] However, as opposed to *Schwinn,* which focused on *intra*brand competition, the majority in *Sylvania* recognized that intrabrand restraints could be beneficial as they promote *inter*brand competition.[753]

The Court noted that vertical non-price restraints are especially justified for manufacturers that are entering a market, since they can induce retailers to invest in the promotion of a product unknown to the consumer.[754] In addition, the majority emphasized that these restraints are also useful for manufacturers who have already established their position in the market, since they can be facilitated in order to promote the product and provide after-sale service.[755] It was also acknowledged that such restraints can be used in order to prevent free-riding[756] and allow a manufacturer to keep his distribution costs at a minimum.[757]

Apart from these efficiency-related issues, the Court also noted some other reasons why a manufacturer would want to control the distribution process. For example, the Court

[749] *Id.* at 47. *See also infra* Part 3.6.
[750] *Sylvania,* 433 U.S. at 50.
[751] *Id.* at 54.
[752] *Id.*
[753] *See also Khan,* 522 U.S. at 15 ("the primary purpose of the antitrust laws is to protect interbrand competition").
[754] *Sylvania,* 433 U.S. at 55.
[755] *Id.*
[756] *Id.*
[757] *Id.* at 56 ("[M]anufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products.").

noted that due to developments in law, "society increasingly demands that manufacturers assume direct responsibility for the safety and quality of their products."[758] The Court also acknowledged that on certain occasions it may be justifiable for a manufacturer to impose restraints related to the distribution process in order to alleviate the danger of physical harm to consumers.[759]

At the end of its analysis, the Court turned to the transfer of dominion distinction inaugurated by *Schwinn*. In this respect the Court concluded that the difference between sale and non-sale transactions should not be of relevance for judging the legality of vertical non-price restraints.[760] Consequently, the Court found that vertical non-price restraints should be judged under the rule of reason, regardless of whether dominion to the goods passes on the distributor or not.[761] The Court therefore concluded that vertical non-price restraints do not satisfy the standard of *per se* illegality and overruled *Schwinn*.[762] Consequently, for the purposes of our discussion the most important effect of the *Sylvania* decision is that exclusive territories, even the airtight ones, are to be judged under the rule of reason.

The approach taken by *Sylvania* potentially represents the most appropriate framework for the analysis of exclusive territories. On the one hand, it recognizes that exclusive territories have significant procompetitive potential and that *per se* prohibition thereof is not appropriate. On the other hand, it also recognizes that under certain conditions this type of restraint can have anticompetitive effects, which are to be addressed under the rule of reason. However, the problem with *Sylvania*'s approach is that it did not give clear

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758 *Id.* at 55 n.23.

759 *Id.* at 55. In this respect the Court cited Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir. 1970). The case involved a beauty care manufacturer that set certain customer-related restraints to its distributors. The manufacturer's practices were challenged by one of its wholesale distributors as violating the Sherman Act. However, the Court of Appeals upheld the manufacturer's practices since it found that by the practices the manufacturer was "protecting the public from injury and itself from liability." *Tripoli*, 425 F.2d at 939. *See also supra* Part 2.3.1.8.

760 *Sylvania,* 433 U.S. at 57.

761 *Id.* at 57-58.

762 *Id.* at 58. On remand, District Court for Northern District of California applied the rule of reason to Sylvania's territorial restraints, found they were reasonable, and dismissed Continental's claim. Continental T.V., Inc. v. GTE Sylvania Inc., 461 F.Supp. 1046 (9th Cir. 1978).

guidelines on how this rule of reason should be applied, which later turned out to be a major obstacle towards properly assessing the impact of exclusive territories.[763]

Apart from shifting the legal status of exclusive territories from *per se* illegality to an analysis under the rule of reason, another significant aspect of *Sylvania* is its approach towards intrabrand restrictions. As shown above, *Schwinn* was hostile towards limitations of this type of competition, finding a restriction of intrabrand competition sufficient for condemnation without even considering the impact on interbrand competition.[764] On the other hand, *Sylvania* recognized that restrictions of intrabrand competition may actually lead to enhancing interbrand competition. In addition, it also recognized that we should look not only at interbrand competition – antitrust should protect both interbrand and intrabrand competition.

In order to understand the importance of *Sylvania* for American antitrust, it should be realized that the significance of this case goes beyond the law of exclusive territories. For example, *Sylvania* has been seen by some as the ruling where the Court adopted the Chicago School approach to antitrust analysis.[765] Along the same line, others have suggested that the decision brought a change to the antitrust narrative when it comes to distribution: following *Sylvania* antitrust policy stopped viewing manufacturers merely as potential antitrust infringers, but also recognized the legitimacy of their own interests compared to those of consumers.[766]

Another aspect of *Sylvania* of relevance for our discussion is that the decision could be seen as a step towards embracing Bork's concept with regards to the goals of antitrust enforcement. Citing Bork, the Appellate Court in *Sylvania* specifically singled out consumer

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[763] *See infra* Part 3.4.1.
[764] *See supra* Part 3.2.2.
[765] Jan Peeters, *The Rule of Reason Revisited: Prohibition on Restraints of Competition in the Sherman Act and the EEC Treaty*, THE AMERICAN JOURNAL OF COMPARATIVE LAW, Vol. 37, No. 3 (Summer, 1989), at 531.
[766] Gavil, *supra* note 664, at 30. *See also id.* at 30 (Following *Sylvania*, "[s]uppliers [are] no longer viewed as impersonal and bullying corporate giants [but as subjects whose interests are] in fact aligned with those of consumers.").

welfare as the only goal of the Sherman Act.[767] The Supreme Court in the same case was not as explicit, but the statement that "[v]ertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products"[768] could be read as emphasizing allocative efficiency over other values.[769] Along the same line is the part of Justice White's concurring opinion, according to which the Sherman Act is concerned only with economic efficiency.[770]

However, some other parts of the *Sylvania* decision may imply that certain goals other than consumer welfare should also be taken into account. For example, the Court criticized *Schwinn* from the viewpoint that it is not in the interest of small businesses. In this respect the Court noted that a distinction based on whether title has passed harms small businesses, since it "creates an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of independent businessmen."[771] This remark may open up the question to which extent the Court in *Sylvania* actually adopted the Chicago School concept of economic efficiency being the sole objective of antitrust enforcement, or perhaps the interests of small businesses should also play a role in shaping the antitrust policy.

In accordance with its significance, *Sylvania* has received a lot of attention in legal and economic theory. Although commentators have generally praised *Sylvania*, some have been critical of the decision. One of the leading critics of the ruling and its lenient approach towards vertical restraints has been professor Pitofsky. Despite acknowledging that *Sylvania*'s approach to economic analysis represented a step forward compared to *Schwinn*, he criticized the balancing approach put forward by the decision for ignoring the potential

[767] *Court of Appeals Sylvania*, 537 F.2d at 1004 n.39 ("A study of the legislative history of the Sherman Act 'establish(es) conclusively that the legislative intent underlying the Sherman Act was that courts should be guided exclusively by consumer welfare and the economic criteria which that value premise implies.'") (citing Bork).
[768] *Sylvania,* 433 U.S. at 54.
[769] Douglas H. Ginsburg, *Judge Bork, consumer welfare, and antitrust law*, 31 HARV. J.L. & PUB. POL'Y 449, 451 (2008).
[770] *Id.* at 451. Citing Bork, Justice White talks of the view that the Sherman Act is "directed solely to economic efficiency". *Sylvania,* 433 U.S. at 69 (White, J., concurring).
[771] *Sylvania,* 433 U.S. at 57 n.26.

anticompetitive effects of vertical non-price restraints.[772] Similarly, another author called it a "toothless legal standard" which provides "a blank check for coercion and exclusionary behavior by powerful dealers openly policed by manufacturers."[773] Others have warned that antitrust should not "naively embrace the view that dominant firms can do no harm."[774] Although some of this criticism may be excessive, in the following section it will be shown that the vague standard laid down by *Sylvania* did lead to some problems in application.

3.4 Post-Sylvania developments

3.4.1 The Sylvania rule of reason

3.4.1.1 Before the Supreme Court

Even though *Sylvania* envisaged that exclusive territories should be judged under the rule of reason, it did not specify how this test is to be performed.[775] It succinctly stated that "[u]nder th[e] rule [of reason], the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[776] Since *Sylvania* is the last Supreme Court case to date dealing directly with the legality of exclusive territories, the lower courts have been largely left on their own when it comes to formulating with more precision the rule of reason standard for exclusive territories. To this end, of useful guidance are some Supreme Court cases discussing the rule of reason in general terms.

[772] Pitofsky, *supra* note 127, at 37-38.
[773] Mark E. Roszkowski, *The sad legacy of GTE Sylvania and its "rule of reason": the dealer termination cases and the demise of Section 1 of the Sherman Act*, 22 CONN. L. REV. 129, 134 (1989).
[774] Gavil, *supra* note 664, at 80.
[775] Following the ruling, a number of articles have been written on the topic, suggesting possible solutions. *See, e.g.*, Easterbrook, *supra* note 588; Eugene F. Zelek, Jr., Louis W. Stern & Thomas W. Dunfee, *A Rule of Reason Decision Model after Sylvania*, CALIFORNIA LAW REVIEW, Vol. 68, No. 1 (Jan., 1980), pp. 13-47, at 46-47; Strasser, *supra* note 314, at 834-840; Posner, *supra* note 285, at 19. Pitosfsky, *supra* note 651, at 34-37.
[776] *Sylvania,* 433 U.S. at 49.

With regards to the structure of the rule of reason, the Court was probably most instructive in *Board of Trade of City of Chicago v. U.S.*[777] The case offered what is considered as a classic statement of the rule of reason:

> 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. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.[778]

Another helpful decision is *U.S. v. Columbia Steel Co.*[779], where the Court described the rule of reason in the following way:

> In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market. We do not undertake to prescribe any set of percentage figures by which to measure the reasonableness of a corporation's enlargement of its activities by the purchase of the assets of a competitor. The relative effect of percentage command of a market varies with the setting in which that factor is placed.[780]

As can be seen, these cases do give at least some guidance about how the rule of reason should be applied. However, they still do not tell us much about how a court is supposed to assess the legality of exclusive distribution agreements. For this reason, in assessing the law of exclusive territories in the wake of *Sylvania* the lower court decisions applying the rule of reason also. However, before turning to lower court decisions, it is worthwhile to reflect on *Leegin*'s contribution to the rule of reason for exclusive territories.

[777] 246 U.S. 231 (1918).
[778] *Id.* at 238.
[779] 334 U.S. 495 (1948).
[780] *Id.* at 527-28.

Although *Leegin* was concerned with the legality of minimum resale price maintenance,[781] some parts of the Court's analysis could also be indicative for the law of exclusive territories. Most notably, in the course of its analysis the Court emphasized the similarity between vertical price and non-price restraints, comparing the impact of minimum RPM with that of exclusive territories. According to the Court, due to their resemblance, a differential legal treatment for these two types of restraints is not justified.[782] Based on this, the Court's guidance regarding the application of the rule of reason to price restraints could also be useful for our discussion about exclusive territories.

When laying down the factors for assessing the legality of minimum RPM, the Court in *Leegin* primarily focused on three factors: the number of manufacturers using the practice,[783] the source of the restraint,[784] and the market power of the manufacturer employing the restraint.[785] *Mutatis mutandis*, all of these factors could also be applied to exclusive territories. Consequently, it is submitted that based on *Leegin* the said assessment would be conducted in the following way.

First, the larger the number of manufacturers in an industry use exclusive territories, the larger the likelihood that anticompetitive effects may arise.[786] If a territorial restraint was

[781] On balance, the Court found that the anticompetitive potential of vertical price restraints is not such to justify the application of per se illegality and overruled *Dr. Miles*. Consequently, in the wake of *Leegin* all vertical restraints are analyzed under the rule of reason. However, this change did not come abruptly, as the Supreme Court was gradually deconstructing the rule of per se illegality with regards to RPM. The degradation of *Dr. Miles* started with *ARCO*, where the Court held that vertical maximum price fixing has to be predatory in order to be considered as against Sherman Act Section 1. *ARCO*, 495 U.S. at 331. Consequently, it was only a matter of time when the Court would lift the per se illegality of maximum price-fixing altogether. This happened in *Khan*, which held that maximum price fixing should not be per se illegal but should rather be analyzed under the rule of reason. *Khan*, 522 U.S. at 22.
[782] *Leegin,* 551 U.S. at 903-04 ("A manufacturer can impose territorial restrictions on distributors and allow only one distributor to sell its goods in a given region. Our cases have recognized, and the economics literature confirms, that these vertical nonprice restraints have impacts similar to those of vertical price restraints; both reduce intrabrand competition and can stimulate retailer services . . . The same legal standard (*per se* unlawfulness) applies to horizontal market division and horizontal price fixing because both have similar economic effect. There is likewise little economic justification for the current differential treatment of vertical price and nonprice restraints.").
[783] *Id.* at 897.
[784] *Id.* at 897-98.
[785] *Id. at* 898.
[786] *See id.* at 897.

imposed at the initiative of distributors, there is a greater likelihood that the restraint facilitates downstream collusion; conversely, if the restraint was imposed by a manufacturer, anticompetitive effects are less likely.[787] Finally, if both a manufacturer and a distributor lack market power, exclusive territories should not be of serious antitrust concern.[788]

However, the problem with the guidance provided by *Leegin* is that it came thirty years after the Court's ruling in *Sylvania*,[789] leaving the lower courts without much assistance in the meantime. As will be shown, by then the lack of guidance by the Supreme Court had already exerted its influence on the development of the law of exclusive territories towards the *per se* legality of this type of restraint.

3.4.1.2 Before the lower courts

Faced with a lack of clear guidance from the Supreme Court, the lower courts have had a chance to give more structure to the rule of reason envisaged by *Sylvania*. Taking into account lower court decisions, the following approach could be said to have emerged. At the threshold, plaintiff challenging exclusive territories has to establish the defendant's market power.[790] This can be done either by showing that the defendant has a large market share or that his products are differentiated.[791] With regards to this, it should be noted that the bulk of post-*Sylvania* cases on the legality of exclusive territories end at this point – when the defendant lacks market power, the courts generally dismiss the claim.[792] However, if the plaintiff shows that the defendant possesses market power, a three-step procedure ensues.

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[787] *See id.* at 897-98.
[788] *Id.* at 898.
[789] *Sylvania* was decided in 1977 and *Leegin* in 2007.
[790] Graphic Products Distributors, Inc. v. ITEK Corp., 717 F.2d 1560, 1568 (11th Cir. 1983). For Judge Posner's discussion about the relevance of market power, see Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982).
[791] *Graphic Products,* 717 F.2d at 1570. In light of market power, some courts have also considered barriers to entry and the price sensitivity of the market. *See, e.g.*, State of N.Y. by Abrams v. Anheuser-Busch, Inc., 811 F.Supp. 848, 873 (2d Cir. 1993).
[792] *See, e.g.*, JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc., 698 F.2d 1011, 1017 (9th Cir. 1983) (market share between 2.3 % and 4.2 % "too small for any restraint on intrabrand competition to have a substantially adverse effect on interbrand competition"). If a manufacturer has a small market share, the court usually grants a summary judgment for the defendant. *See, e.g.*, Assam Drug Co., Inc. v. Miller Brewing Co., Inc., 798 F.2d 311,

First, the plaintiff has to show an anticompetitive effect, i.e. that the restraint harmed interbrand competition.[793] When it comes to anticompetitive effects, the courts have focused on the effects on *inter*brand competition. However, they also take into account the extent to which *intra*brand competition is restrained. In several cases the courts have noted the larger anticompetitive potential of airtight exclusive territories as opposed to non-airtight ones, since the former completely eliminate intrabrand competition while the latter only reduce it.[794]

If an anticompetitive effect has been established, the defendant then has a chance to offer a procompetitive justification for the restraint.[795] In the post-*Sylvania* period defendants have offered a number of justifications for the use of exclusive territories. Among the accepted justifications are the following: exclusive territories enabling maximum market penetration;[796] the deployment of exclusive territories lowering the costs of distribution;[797] exclusive territories securing efficient and uninterrupted delivery;[798] the presence of exclusive territories allowing distributors to maintain a proper stock of goods;[799] exclusive territories leading to the elimination of inter-dealer free-riding with regards to promotion of goods[800]

317 (8th Cir. 1986) (based on a market share of 19.1 %, the court found that "[b]ecause a showing of market power is a threshold requirement to challenging a vertical nonprice restraint, a defendant who establishes, in accordance with the rules governing summary judgment, that it lacks market power a fortiori establishes that no genuine issue of material fact exists and is entitled to entry of judgment in its favor as a matter of law."); Ryko Mfg. Co. v. Eden Services, 823 F.2d 1215, 1232, 1240 (8th Cir. 1987) (summary judgment granted where supplier's market share was between 8 % and 10 %). *But see* State of N.Y. by Abrams v. Anheuser-Busch, Inc., 673 F.Supp. 664, 668 (2d Cir. 1987) (with regards to market shares of 8% and 5%, the court found that "[m]arket share alone in the beer industry does not reflect the potential for anticompetitive results").

[793] *Graphic Products,* 717 F.2d at 1571.

[794] *E.g.*, *Graphic Products*, 717 F.2d at 1574 ("complete elimination of intrabrand competition differs qualitatively from merely lessening it"); *Anheuser-Busch*, 811 F.Supp. at 875 ("With the continued presence of transshipping, intrabrand competition was not eliminated, although it was quite predictably temporarily reduced. Such a situation is dramatically different from ones in which all intrabrand competition is completely eliminated.").

[795] *Graphic Products,* 717 F.2d at 1571 at 1572.

[796] *Newberry*, 438 F.Supp. at 475.

[797] *Id.*; Donald B. Rice Tire Co., Inc. v. Michelin Tire Corp., 483 F.Supp. 750, 760 (4th Cir. 1980).

[798] *Newberry*, 438 F.Supp. at 475.

[799] *Cowley*, 613 F.2d at 755.

[800] *Id.*; *Michelin*, 483 F.Supp. at 757; *Anheuser-Busch*, 811 F.Supp. at 876.

and services;[801] exclusive territories encouraging investment by distributors;[802] exclusive territories facilitating quality control.[803]

Finally, if there has been a showing of market power and of an anticompetitive effect and the defendant has had a chance to offer a procompetitive justification for the deployment of exclusive territories, the court performs a balancing test. The purpose of the test is to compare which of the aspects of the agreement prevail – procompetitive or anticompetitive ones.[804] However, it has to be noted that in the post-*Sylvania* period this balancing has rarely occurred in practice.[805] And even if the analysis does get to the balancing stage, defendants generally prevail, even if the defendant has significant market power.[806] Actually, it seems that there have been only two post-*Sylvania* cases where a plaintiff has successfully challenged exclusive territories: *Eiberger v. Sony Corp. of America*[807] and *Graphic Products Distributors, Inc. v. ITEK Corp.*[808]

In *Eiberger*,[809] the plaintiff was a terminated distributor and the defendant was a manufacturer of dictating machines. The distributor asserted that the sales system established by the manufacturer amounted to exclusive territories and was in violation of Sherman Act Section 1. The manufacturer had 12 % of what the court characterized as an oligopolistic market. The disputed distribution system was set up in order to prevent inter-dealer free-riding, i.e. to prevent distributors not offering post-sale repair services free-riding on the

[801] *Michelin*, 483 F.Supp. at 758; Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1201 (6th Cir. 1982).
[802] *Anheuser-Busch*, 811 F.Supp. at 876.
[803] *Michelin*, 483 F.Supp. at 756.
[804] *Graphic Products,* 717 F.2d at 1571 at 1578.
[805] Douglas H. Ginsburg, *Vertical restraints: de facto legality under the rule of reason*, 60 ANTITRUST L.J. 67, 76 (1991). *See also* Gavil, *supra* note 664, at 72-73 ("For the most part, litigated cases turn on the absence of sufficient evidence of anticompetitive effects (inefficiencies) or of business justifications (efficiencies). One would be hard pressed to find a reported instance in which a court actually attempted to 'balance' both.").
[806] For example, in *Newberry* defendant prevailed even if he was a "near-monopolist". 438 F.Supp. at 475. In *Cowley* defendant's market share was between 70 % and 80 %, but its restraints were upheld. For other cases where the court performed balancing: *Michelin* (market share between 20 % and 25 %); *Davis-Watkins* (market share between 11 % and 18 %); *Anheuser-Busch*, 811 F.Supp. 848 (1993) (market share 39 %).
[807] 459 F.Supp. 1276 (2d Cir. 1978).
[808] 717 F.2d 1560 (11th Cir. 1983).
[809] Eiberger v. Sony Corp. of America, 459 F.Supp. 1276 (2d Cir. 1978).

efforts of those who performed such services. However, the court did not accept this justification, finding that the arrangement failed to satisfy the rule of reason envisaged by *Sylvania*.

As mentioned, the other plaintiff victory was *Graphic Products*. Here as well the plaintiff was a terminated dealer while the defendant was a manufacturer of graphic equipment and supplies. The distributor challenged the manufacturer's distribution system, which consisted of exclusive territories as well as some other vertical restraints. The manufacturer had a substantial share of the market, amounting to between 70 % and 75 %. Taking into account the manufacturer's large market share, the presence of product differentiation, and the fact that the deployed exclusive territories were airtight, the court found the imposition of exclusive territories illegal. The court reached this outcome as it found that the possible procompetitive sides of the agreement (an optimal territorial allocation of distributors and enhanced market penetration) were outweighed by a reduction in interbrand competition.[810]

If one disregards *Eiberger*, which on its facts was probably wrongly decided,[811] the only reported case that resulted in striking down the use of exclusive territories is *Graphic Products*. Taking this into account, it would seem that the American courts are ready to condemn exclusive territories arrangements only when such a practice is used by a dominant manufacturer, especially if the product is differentiated. In addition, if the exclusive distribution arrangement is airtight, the chances are greater that the agreement will be found illegal. In this light, the main consequence of *Sylvania* seems to be that firms without market

[810] *Graphic Products*, 717 F.2d at 1578.
[811] *See Anheuser-Busch*, 811 F.Supp. at 850 (critical of *Eiberger*); Ginsburg, *supra* note 805, at 72 ("The plaintiff seems to have prevailed in [*Eiberger*] only because the court erred.").

power are practically free from antitrust liability when it comes to deploying exclusive territories.[812]

This conclusion seems to be valid not only for exclusive territories but also with regards to other vertical non-price restraints. According to a recent study on the application of the rule of reason, "[c]ourts dispose of 97% of cases on the grounds that there is no anticompetitive effect [and] balance in only 2% of cases."[813] What is more, even if the court does reach the balancing part, it is very likely that the defendant will win. Consequently, it is indeed difficult for a plaintiff to prevail in cases related to vertical non-price restraints.[814] It can even be said that vertical non-price restraints have effectively become legal *per se*,[815] which could be seen as a victory for the Chicago School.[816] In other words, the outcome of *Sylvania* could be characterized as returning responsibility for policing vertical business practices to market forces.[817]

Finally, despite the fact that in applying the *Sylvania* rule of reason the courts rarely come to the balancing stage, it is worthwhile to briefly reflect on the influence that the welfare standard adopted by the antitrust policy could have on judging the legality of exclusive territories. If it is presumed that the standard favored by the Supreme Court is

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[812] *E.g.* Ginsburg, *supra* note 805, at 67 ("[N]on-monopolists have been effectively freed from antitrust regulation of vertical nonprice restraints."); Hovenkamp, *supra* note 29, at 486 ("The rule of reason has come close to creating complete nonliability for vertical nonprice restraints."); William F. Baxter, *The viability of vertical restraints doctrine*, 75 CAL. L. REV. 933, 936 (1987) ("[T]hose practices subject only to the rule of reason will rarely, if ever, be found illegal if a plaintiff or enforcement agency must carry the burden of showing that human welfare is reduced by this particular use of the particular restriction in this particular set of markets at this particular time."); ANTITRUST LAW AND ECONOMICS OF PRODUCT DISTRIBUTION, *supra* note 1, at 156 ("The practical effect of [*Sylvania*] was to bestow a presumption of legality on . . . nonprice vertical restraints."); Jean Wegman Burns, *Vertical restraints, efficiency, and the real world*, 62 FORDHAM L. REV. 597, 616 n.86 (1993) ("Maxwell Blecher summed up the attitude of the plaintiffs' bar when he said that when dealers come to his office with prospective vertical restraint cases, 'we give them a cold cup of coffee, validate their parking, and get them out pretty quickly.'").

[813] Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 6 GEO. MASON L. REV. 827, 828 (2009).

[814] *See, e.g.*, Ginsburg, *supra* note 805, at 68 ("[W]ith few exceptions, defendants win under GTE Sylvania.").

[815] Gavil, *supra* note 664, at 8 n.30.

[816] Roszkowski, *supra* note 773, at 158.

[817] Ginsburg, *supra* note 805, at 76.

Bork's concept of consumer welfare,[818] which is actually a total surplus standard,[819] then proving the illegality of an exclusive territories arrangement becomes even more difficult. This would mean that for the defendant it would be sufficient to show that the use of exclusive territories does not lead to a net loss in welfare, regardless of how the gains are distributed. In other words, for the legality of an exclusive territories arrangement it would not be needed that the arrangement brings an increase in consumer surplus. Taking into account that a rational manufacturer would want to deploy exclusive territories only if it is beneficial for him, the total welfare standard in actual fact favors manufacturers, even though it is allegedly neutral with regards to the way in which efficiency are distributed.

3.4.2 Other possible challenges of exclusive territories

3.4.2.1 Boycott

As shown in the previous section, under the *Sylvania* rule of reason it has become virtually impossible for an antitrust plaintiff to successfully challenge the use of exclusive territories. Nevertheless, plaintiffs may have other avenues of challenging this type of restraint. If the imposition of an exclusive territory could be characterized as an antitrust violation other than a vertical non-price restraint, the plaintiff may still have a chance in prevailing. This would especially be the case if that other restraint is afforded *per se* illegality. For example, an interesting question is whether the use of exclusive territories could be characterized as a boycott.

Regarding boycott, the classic case is *Klor's, Inc. v. Broadway-Hale Stores, Inc.*[820] The case involved a dispute between Broadway-Hale, a chain of department of stores, and Klor's, a retail store in San Francisco located just next to one of Broadway-Hale's outlets. At the core of the dispute was Klor's allegation that Broadway-Hale formed a conspiracy with a number of manufacturers of home appliances and their distributors with the purpose of

[818] *See supra* Part 3.1.2.
[819] *See supra* Part 2.4.2.
[820] 359 U.S. 207 (1959).

boycotting Klor's. In essence, the Supreme Court condemned the conspiracy as *per se* illegal (i.e. even without a showing of anticompetitive harm), specifically emphasizing the collective character of the boycott.[821]

In order to properly understand what actually happened in *Klor's*, the underlying question is why manufacturers would conspire with one of their retailers (Broadway-Hale) against another retailer (Klor's). Hovenkamp has suggested that this could have something to do with free-riding: as a discounter, Klor's was actually free-riding on Broadway-Hale's promotion efforts and was terminated when Broadway-Hale complained to the manufacturers.[822] Related to this, an important question is whether antitrust law would also see a boycott where an exclusive distributor would be terminated based on another distributor's complaint to the manufacturer.

In this respect, consider the Supreme Court's decision in *Monsanto Co. v. Spray-Rite Service Corp.*[823] The case involved a dispute between Monsanto, a manufacturer of chemical products, and Spray-Rite, one of its distributors in the market of herbicides. In order to increase sales, Monsanto at one point decided to make a change in its distribution policy. The manufacturer started assigning areas of primary responsibility to its distributors and giving them incentives to invest in personnel training. Therefore, Monsanto was trying to improve the level of product-related services provided by its distributors.

Spray-Rite was a discount seller and supposedly Monsanto was not satisfied with its sales efforts. Consequently, Spray-Rite's distribution agreement was terminated. It seems that this happened following complaints to Monsanto by other distributors that Spray-Rite was free-riding on their promotional efforts. Following the termination, Spray-Rite decided to

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821 *Id.* at 212-13 ("This is not a case of a single trader refusing to deal with another nor even of a manufacturer and a dealer agreeing to an exclusive distributorship [but rather] a wide combination consisting of manufacturers, distributors and a retailer.").
822 HOVENKAMP, *supra* note 29, at 203.
823 465 U.S. 752 (1984).

bring an antitrust suit, alleging that the termination was a result of a conspiracy between Monsanto and some of its distributors. The case eventually reached the Supreme Court.

The issue before the Court was whether a complaint by a distributor to a manufacturer upon which the manufacturer terminates a distribution agreement with another distributor is sufficient for finding a conspiracy within the meaning of the Sherman Act. The Court found that such a situation is not sufficient for establishing an antitrust conspiracy, since a manufacturer "has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently."[824]

Accordingly, evidence that a distributor was terminated based on other distributor's complaint to the manufacturer is not enough for illegality. Rather, evidence has to be such that it "tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."[825] Taken together with *Klor's*, *Monsanto* would stand for the proposition that a manufacturer has the right to terminate a dealer even following a complaint from another dealer, as long as there is a possibility that the complaining distributor(s) and the manufacturer were acting independently.

Related to our discussion, following *Monsanto* a manufacturer has the right to terminate his exclusive distributor, even if the termination is a result of a complaint by other exclusive distributors. As has been shown, under certain conditions an exclusive distributor has a strong incentive to violate other distributors' territory, and in that case the distributor whose territory would be affected would be very much interested in reporting the violation to the manufacturer.[826] If such a complaint would be seen as an antitrust conspiracy, the effectiveness of policing exclusive territories would greatly suffer. In this respect *Monsanto* gives manufacturers more freedom regarding the way they organize their product distribution and enables them to have their exclusive territories policed effectively. With regards to

[824] *Id.* at 761.
[825] *Id.* at 764.
[826] *See supra* Part 2.3.1.2.

Monsanto's practical effect, its outcome has even more narrowed the possibility for a successful challenge of exclusive territories.[827]

Connected with the issue of boycott, another relevant case is *NYNEX Corp. v. Discon, Inc.*[828] The crux of this case is that individual refusal to deal is not *per se* illegal – there has to be anticompetitive harm in order to make it illegal. In *NYNEX*, the Court made the distinction with *Klor's* mainly by emphasizing that *Klor's* involved a horizontal agreement between manufacturers, while in *NYNEX* the refusal to deal was of vertical nature (between a supplier and a potential customer).[829] Related to vertical distribution restraints and the issue of free-riding, *NYNEX* would stand for the proposition that an individual supplier can cut off a free-riding distributor without infringing antitrust laws, in accordance with each firm's freedom to decide with whom it will do business.[830] In other words, *NYNEX* further strengthened the holding of *Monsanto* with regards to a manufacturer's right to cut off a distributor.

3.4.2.2 Horizontal collusion

Related to boycott, exclusive territories can also be challenged as being a result of horizontal collusion.[831] In this respect, consider *Business Electronics Corp. v. Sharp Electronics Corp.*[832] Similar to *Monsanto*, *Business Electronics* addressed the dividing line between horizontal and vertical agreements and whether there is conspiracy in the meaning of the Sherman Act if a manufacturer terminates a price-cutting distributor based on another distributor's complaint.[833] The Court confirmed that in such a case conspiracy does not exist since otherwise it would mean that:

[827] *See* Roszkowski, *supra* note 773, at 183-86 ("[A]fter Monsanto, most dealers have lost vertical cases on summary judgment or directed verdicts.").
[828] 525 U.S. 128 (1998).
[829] *Id.* at 136.
[830] Related to refusal to deal, consider also *Colgate*, 250 U.S. 300.
[831] *See, e.g.*, Package Shop, Inc. v. Anheuser-Busch, Inc., 675 F.Supp. 894 (3d Cir. 1987) (The case concerned exclusive distribution of beer. Retailers alleged a horizontal conspiracy between distributors the purpose of which was to allocate territories among themselves. The defendants won at the summary stage.).
[832] 485 U.S. 717 (1988).
[833] Same as *Monsanto*, *Business Electronics* also dealt with the dividing line between price and non-price restrictions, but as noted, after *Leegin* this distinction is not of much relevance. This, however, does not mean

> a manufacturer that agrees to give one dealer an exclusive territory and terminates another dealer pursuant to that agreement, or even a manufacturer that agrees with one dealer to terminate another for failure to provide contractually obligated services, exposes itself to the highly plausible claim that its real motivation was to terminate a price cutter.[834]

The Court also touched upon the issue of which agreements are to be considered as horizontal. In other words, the question was whether in order to be considered as horizontal an agreement has to be the product of horizontal collusion or if it is enough that some of its anticompetitive effects are horizontal.[835] The Court correctly concluded that "all anticompetitive effects are by definition horizontal effects"[836] and that consequently "a restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement."[837] Related to this is the question of whether dual distribution should be regarded as a horizontal or as a vertical arrangement. In the light of *Business Electronics*, it would seem that the American law stands on the proposition that vertical characterization is more proper.

Finally, regarding the dividing line between horizontal and vertical agreements, another case worth considering is *U.S. v. General Motors Corp.*[838] The case represents a classical example of inter-dealer free-riding. The dispute involved the distribution of Chevrolet cars in the Los Angeles area. General Motors (GM), the producer of Chevrolet cars, performed distribution in this area through a network of dealers. Although these dealers were not exclusive, they were bound by a location clause, meaning that they could perform sales only from a specific location.

that price and non-price restraints are to be analyzed in the completely same way, but only that both of them are to be judged by the rule of reason. However, as noted, the content of the rule of reason for the two types of restraints can be different.

[834] *Business Electronics*, 485 U.S. at 728.
[835] *Id.* at 730 n.4.
[836] *Id*.
[837] *Id*.
[838] 384 U.S. 127 (1966).

Problems started to arise when certain dealers started selling to discount houses, who were then selling those cars to final consumers at prices lower than what was officially priced. This way the dealers' efforts in providing special services to customers were undermined and they started losing business. More precisely, all authorized GM dealers were under an obligation to service Chevrolet cars under the warranty, regardless of where the car was bought. In other words, if somebody bought a car from a discounter, he could go to any authorized dealer for a free repair under the warranty. This of course made a number of dealers dissatisfied, and, organized in dealer associations, they started complaining to the manufacturer demanding that something should be done about the discounters.

In response, GM obligated all of its dealers to stop selling to the discounters. However, this agreement had to be policed, since the dealers were not assigned exclusive territories and hence had a strong incentive to sell to discounters. In response, a private investigator was hired to make sham purchases of cars for discounters. The fact that this activity was not costless[839] shows an important aspect of exclusive territories – in an exclusive distribution system the dealers would be policing each other.[840] These efforts seemed to be successful, and selling to discount houses eventually ceased. However, the government challenged this as a conspiracy in restraint of trade.

Even though the distribution agreements at hand did not contain exclusive territories but only location clauses,[841] the severity of the territorial restraint was not an issue before the Supreme Court. Rather, the Court focused on the legality of the agreement between the dealers and GM.[842] In this respect the Court found that "[e]limination, by joint collaborative

[839] *Id.* at 137.
[840] This does not mean that the use of exclusive territories would be the only appropriate solution in order to solve the free-rider problem in this context. For example, it would seem that a selective distribution system would also be a proper solution, and perhaps even less restrictive than the use of exclusive territories.
[841] *General Motors*, 384 U.S. at 130.
[842] *Id.* at 139-40.

action, of discounters from access to the market is a *per se* violation of the Act."[843] This case is interesting because despite the Court's subsequent embracement of the free-riding theory, *General Motors* still seems to be good law. In other words, if dealers act among each other and with a manufacturer in order to eliminate free-riding, this would be condemned as a *per se* violation of the Sherman Act.[844] However, taking into account the currently prevailing approach towards the free-rider argument, it may be expected that the Court would be more receptive to defendants in *General Motors* types of cases.

Finally, taking into account the dealer-termination cases described above, the law on the issue could be summarized as follows. A manufacturer has the right to terminate a distributor following another distributor's complaint, as long as he does so independently.[845] However, whenever in the termination process there is some horizontal aspect, the law is likely to find the conduct illegal. This would for example be the case if a refusal to deal would be the result of a scheme involving a complaining distributor and a group of manufacturers (such as the one in *Klor's*, i.e. the horizontal aspect is the relationship between the manufacturers). The law would also condemn the situation where the complaining distributors first discuss the complaint among themselves and then turn to the manufacturer (such as the one in *General Motors*, i.e. the horizontal aspect is the relationship between the distributors).

3.5 Allocation of exclusive territories through a joint venture

As shown, the use of exclusive territories that does not involve horizontal aspects has come close to the status of *per se* legality in American antitrust law. An antitrust plaintiff will find it very difficult to prevail under the *Sylvania* rule of reason, even if the defendant possesses substantial market power.[846] However, if a plaintiff is able to demonstrate that a

[843] *Id.* at 145.
[844] *See id.* at 143.
[845] *See Monsanto*, *Business Electronics* and *NYNEX*.
[846] *See supra* Part 3.4.1.

conduct is connected with some sort of horizontal collusion at the upstream or downstream level, there is still a chance that the law would strike down the practice.[847] Therefore, the determination on whether a practice should be characterized as vertical or as horizontal could be crucial for its legality.

However, if an agreement contains both horizontal and vertical elements, classifying it into one of the two groups is not always a straightforward task. One such arrangement with mixed horizontal and vertical effects is the allocation of exclusive territories through a joint venture. In such an arrangement, a group of competitors would form a joint venture, after which the joint venture would grant its members exclusive territories with regards to the distribution of a certain product. As can be seen, the nature of this arrangement is ambiguous. On the one hand, it has horizontal elements, since participants in the joint venture are competing at the same market level. On the other hand, the arrangement also has a vertical aspect – the joint venture could be seen as an entity separate from its members, and the deployment of exclusive territories performed by the joint venture could therefore be seen as vertical.

As shown, the vertical aspect of this arrangement most probably would not represent a problem from the legal point of view.[848] However, the law may be very much concerned with the horizontal part of the practice. as it could be seen as an agreement on horizontal market division. Since the early days of the Sherman Act, agreements between competitors the purpose of which is the division of markets have been considered as illegal *per se*.[849] This is because market allocation can be seen as just another form of horizontal price-fixing, as it

[847] *See supra* Part 3.4.2.2.
[848] *See supra* Part 3.4.1.
[849] *See* Addyston Pipe & Steel Co. v. U. S., 175 U.S. 211 (1899) (territorial market division between competitors illegal *per se*). *See also* Arizona v. Maricopa County Medical Society, 457 U.S. 332, 344 n.15 (1982) (market division illegal per se); Palmer v. BRG of Georgia, Inc., 498 U.S. 46, 49-50 (1990) (horizontal agreements on market allocation illegal per se, “regardless of whether the parties split a market within which both do business or whether they merely reserve one market for one and another for the other.”).

necessarily has an effect on the price charged by the firms engaging in the market division.[850] What is more, market division can be seen as even more pernicious than price-fixing, as it significantly reduces the possibility for cartel cheating.[851] Therefore, it is interesting to consider how the law would treat a situation where a group of competitors organize a joint venture which then grants its members exclusive territories.

In this respect, consider *U.S. v. Sealy, Inc.*[852] Initially, Sealy was a manufacturing company involved in the production of mattresses. However, at one point it got out of the manufacturing business and instead started granting exclusive territorial licenses to local mattress manufacturers. The purpose behind the exclusive licenses was probably to avoid the free-rider problem. In the absence of an exclusive appointment, a manufacturer would not have an incentive to develop the brand in his area if he knew that other members of the scheme would be able to free-ride on his efforts.

There were around 30 local manufacturers in this scheme, each of them having a relatively small share of the market. Taken together, their market share was around 20 %. Eventually, the manufacturers acquired substantially all of Sealy's stock and established practically complete control over Sealy's board of directors and executive committee.

In this light, the territorial licenses actually meant that the mattress manufacturers among themselves divided territories in which they had an exclusive right to sell mattresses under the "Sealy" name. For this reason the arrangement had both vertical and horizontal implications. On the one hand, the relationship between Sealy and the manufacturers could be

[850] *See* U.S. v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940) ("[T]he machinery employed by a combination for price-fixing is immaterial. Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.").

[851] HOVENKAMP, *supra* note 29, at 153.

[852] 388 U.S. 350 (1967). The case was decided in the *Schwinn* era, i.e. before *Sylvania*. However, even following *Sylvania Sealy* is good law, since *Sylvania*'s scope was limited to vertical non-price restraints, and *Sealy* involved a horizontal agreement.

characterized as vertical. On the other hand, as Sealy was controlled by the manufacturers, the grant of exclusive licenses could also be interpreted as horizontal market division.

The Court struck the arrangement as *per se* illegal. In the Court's view, the horizontal aspects were prevailing,[853] since the manufacturers were directly in charge of Sealy's operations.[854] The Court noted that when it comes to horizontal territorial division there is no "necessity for an inquiry in each particular case as to their business or economic justification, their impact in the marketplace, or their reasonableness."[855] In other words, *Sealy* would mean that the free-rider argument cannot be used in order to justify horizontal allocation of exclusive territories, even if parties to the agreement do not possess market power.[856]

The arrangement in *Sealy* also involved price-fixing – apart from allocating exclusive territories, the manufacturers also agreed on the price at which the mattresses would be sold. However, the Court in *Sealy* refused to get into a discussion about whether the territorial allocation itself was unlawful. Rather, it found it sufficient that in the case before it a combination of restraints existed, including price-fixing.[857] Consequently, this was to be addressed in another landmark case, *U.S. v. Topco Associates, Inc.*[858]

The facts of *Topco* are somewhat similar to those of *Sealy*. Topco was an association of 25 small and medium-sized supermarket chains operating throughout the United States. The market share of the participating chains ranged from 1.5 % to 16 %, with the average being around 6 %. Similar to Sealy, Topco was also some sort of a joint venture. The participating chains owned all of Topco's common stock, and the board of directors and the

[853] *Sealy*, 388 U.S. at 352 ("If we look at substance rather than form, there is little room for debate. These must be classified as horizontal restraints.").
[854] *Id.* at 353.
[855] *Id.* at 357-58.
[856] *See* Posner, *supra* note 285, at 9-10 ("Without exclusive territories, one member of the group could take a free ride on the goodwill created by another member who promoted the Sealy name in his territory. The prospect of free-riding would reduce the incentive of each member to promote the Sealy name vigorously.").
[857] *Sealy*, 388 U.S. at 357.
[858] 405 U.S. 596 (1972).

executive committee were run by the association members. This way the association members had full control over Topco's operations.

The main purpose of the association was to act as a purchasing cooperative, since the association could get products at lower prices than the individual chains. Each member operated independently, i.e. there was no pooling of earnings, management, or advertising resources. In addition, the members of the association had created a "Topco" private label of groceries, the sale of which seemed to be quite profitable.[859] The association was granting its members exclusive rights to market the "Topco" brand in particular territories. In other words, individual chains were granted exclusive territories with regards to the brand, presumably in order to eliminate the free-rider problem.

The Court struck down this arrangement, finding that the fact that intrabrand competition (i.e. competition with regards to the products bearing the "Topco" label) was restricted was sufficient to find a violation of the Sherman Act.[860] Taking into account that the case was decided during the *Schwinn* era, such an outcome is not surprising. The Court did not accept Topco's defense that the arrangement was necessary in order to allow its members to compete with large supermarket chains at the national level, finding instead that the arrangement was horizontal in nature and therefore *per se* illegal.[861] This way the Court explicitly extended *Sealy*, finding that horizontal territorial limitations are *per se* violations of the Sherman Act even if not coupled with price-fixing.[862]

In response to the judgment, Topco gave up exclusive territorial protection and instead deployed less restrictive territorial restraints. These included areas of primary

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[859] *See* Peter C. Carstensen & Harry First, *Rambling Through Economic Theory: Topco's Closer Look*, *in* ANTITRUST STORIES 171, 176 (Eleanor M. Fox & Daniel A. Crane eds., 2007) ("[T]he house brand [is] usually more profitable to the chain store because of the combination of low acquisition price and limited promotional expenditure.").

[860] *Topco*, 405 U.S. at 603.

[861] *Id.* at 608.

[862] *Id.* at 609 n.9. The Court's decision has received some criticism among commentators. For example, Korah criticized it on the grounds that the association probably helped small supermarkets to compete with larger chains. Korah, *supra* note 619, at 294.

responsibility and profit pass-overs.[863] Although the government challenged the use even of these less restrictive restraints, their deployment was approved by a District Court[864] and by the Supreme Court.[865] Based on this, it may be concluded that the described horizontal cooperation is not illegal *per se* after all – although horizontally allocated exclusive territories are prohibited, firms could still use some less restrictive territorial restraints.

Taking into account this line of cases, it seems disputable to what extent horizontal territorial allocation is still considered as *per se* illegal. On the one hand, in *Palmer v. BRG of Georgia, Inc.*[866] an apparent horizontal allocation of territories was struck as *per se* illegal. On the other hand, some lower courts have suggested that *Sealy* and *Topco* do not represent good law anymore. For example, in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*[867] Judge Bork noted that:

> to the extent that *Topco* and *Sealy* stand for the proposition that all horizontal restraints are illegal *per se*, they must be regarded as effectively overruled [by Supreme Court cases such as Broadcast Music, Inc. v. Columbia Broadcasting System,[868] *NCAA,*[869] and Northern Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.[870]].[871]

The Court's dicta in *Leegin* seem to support this argument. According to *Leegin*, "[a] horizontal cartel among competing manufacturers or competing retailers **that decreases output or reduces competition in order to increase price** is, and ought to be, *per se* unlawful."[872] The Court here can be interpreted as saying that horizontal cooperation is not always *per se* illegal, but only if it has an anticompetitive effect such as a decrease in output or an increase in price. Therefore, the Court's decision in *Leegin* could open up the door

[863] Carstensen & First, *supra* note 859, at 198.
[864] 1972 WL 669 (N.D.Ill.), 1973-1 Trade Cases P 74,391.
[865] 414 U.S. 801.
[866] 498 U.S. 46 (1990).
[867] 792 F.2d 210 (1986).
[868] 441 U.S. 1 (1979) (*BMI*).
[869] 468 U.S. 85 (1984).
[870] 472 U.S. 284 (1985).
[871] *Rothery Storage*, 792 F.2d at 226.
[872] *Leegin,* 551 U.S. at 893 (emphasis added).

towards a less strict approach towards horizontal collusion that does not result in output reduction or price increase.

Consequently, if the Supreme Court decided to reexamine *Sealy* and *Topco*, chances are that it would not prohibit such arrangements as illegal *per se*. Rather, if it was that the allocation of territories through a joint venture actually led to an increase in total output and reduced prices, it could be expected that the Court would uphold such an arrangement. Therefore, this is another example of how it is becoming more and more difficult for an antitrust plaintiff to prevail in a case involving exclusive territories, even where the arrangement involves some sort of horizontal cooperation.

3.6 Stare decisis in antitrust cases

As shown earlier in the chapter, the Supreme Court's stance towards the legality of exclusive distribution has changed over time. At times these changes were quite abrupt, as the Court was ready to completely change its view in the course of only a few years. For example, four years after the Court in *White Motor* acknowledged that it lacked sufficient knowledge about the effects of vertical non-price restraints, *Schwinn* found that the use of these restraints is to be *per se* illegal. Similarly, ten years later the Court made another U-turn, finding in *Sylvania* that the restraints do not satisfy the *per se* standard after all, and should therefore be judged under the rule of reason.[873] For this reason, in order to be able to anticipate the possibility of future changes in the law of exclusive territories, a discussion about the principle of *stare decisis* is appropriate.

In essence, the principle of *stare decisis* means that a court will follow its previous rulings unless certain circumstances require the precedent to be overruled.[874] There are two

[873] According to Grimes, *Schwinn* is the shortest lived Supreme Court precedent since the enactment of the Sherman Act. Grimes, *supra* note 701, at 145.
[874] The term is a short version of Latin "*stare decisis* et non quieta movere", which means "[t]o stand by things decided, and not to disturb settled points." BLACK'S LAW DICTIONARY 1443 (8th ed. 2004). *See also* JONATHAN SWIFT, GULLIVER'S TRAVELS 232 (2005) ("It is a Maxim among . . . Lawyers, that whatever hath been done before, may legally be done again: And therefore they take special Care to record all the Decisions formerly

types of *stare decisis*: vertical and horizontal. Vertical *stare decisis* is the obligation of lower courts to adhere to the precedents of higher courts, while horizontal *stare decisis* is a court's duty to conform with its own precedents.[875] The current analysis is mainly concerned with the latter. In other words, the aim is to analyze the extent to which the Supreme Court feels bound by precedents in the area of antitrust.

S*tare decisis* has two forms: a strict and a liberal version. While the strict version *binds* judges to follow precedents, under the liberal version judges generally have the duty to conform to precedents but can override this duty if there is a strong reason for it.[876] The U.S. Supreme Court applies the liberal version of the principle.[877] In other words, although the Court in several occasions emphasized the importance of abiding to precedents,[878] it has also recognized that the principle of *stare decisis* is not a rigid one.[879] Therefore, the Supreme Court can and does depart from its previous decisions. However, it is not clear which circumstances justify the Court to do so.[880]

With regards to this, it is important to consider justifications for the existence of the *stare decisis* principle. One of the justifications is that the principle is supposed to provide reliance and stability.[881] For this reason, when it wishes to overrule a precedent, the Court usually tries

made against common Justice and the general Reason of Mankind. These, under the Name of Precedents, they produce as Authorities to justify the most iniquitous Opinions; and the Judges never fail of decreeing accordingly.").

[875] SAUL BRENNER & HAROLD J. SPAETH, STARE INDECISIS 1 (1995).

[876] *Id.*

[877] *Id.*

[878] *E.g.*, Payne v. Tennessee, 501 U.S. 808, 847 (1991) ("[F]idelity to precedent is fundamental to 'a society governed by the rule of law'."); *Khan,* 522 U.S. at 20 ("[*Stare decisis* reflects] a policy judgment that in most matters it is more important that the applicable rule of law be settled than that it be settled right.").

[879] *E.g.*, Helvering v. Hallock, 309 U.S. 106, 119 (1940) ("*[S]tare decisis* is a principle of policy and not a mechanical formula of adherence to the latest decision."); *Payne*, 501 U.S. at 810 ("Although adherence to the doctrine of *stare decisis* is usually the best policy, the doctrine is not an inexorable command.").

[880] According to Justice Scalia, a precedent is to be overruled if the following conditions are satisfied: "(1) its foundations have been 'ero[ded]' by subsequent decisions, (2) it has been subject to 'substantial and continuing' criticism, and (3) it has not induced 'individual or societal reliance' that counsels against overturning." Lawrence v. Texas, 539 U.S. 558, 587 (2003) (Scalia, J., dissenting).

[881] For example, some have praised the principle as it "allows people to be able to enter trade with each other with confidence, and to take the capricious element out of law and to give stability to a society." William O. Douglas, *Stare Decisis*, COLUMBIA LAW REVIEW, Vol. 49, No. 6 (Jun., 1949), at 736. Other justifications include the promotion of values such as efficiency, continuity of the law, fairness, and legitimacy. BRENNER & SPAETH, *supra* note 875, at 2.

to show that the precedent has not caused reliance. For example, the Court in *Sylvania* justified overruling *Schwinn* noting that *Schwinn* itself represented an abrupt change in the Court's policy, and that therefore reliance cannot be invoked with regards to its overruling.[882] Based on this, an important factor in deciding whether a precedent is apt for overruling is the extent to which other subjects have relied on it.

Connected with reliance, another important factor is the time that has passed since the precedent was decided. In this respect, it is interesting that a short time span is sometimes used as an argument for and sometimes as an argument against overruling a precedent. For example, in *Lawrence v. Texas* Justice Scalia expressed his surprise regarding the Court's readiness to reconsider a decision rendered "a mere 17 years ago".[883] However, in another occasion the same Justice justified the overruling of a precedent by noting that "the opinion is only two decades old, and eliminating it would not upset expectations."[884] This does not mean that only Justice Scalia is inconsistent when it comes to the application of *stare decisis*. Rather, his remarks seem to be a paradigm of the Court's incoherent dealing with the issue.

This general observation is also valid for the field of antitrust. For example, it has been shown how quickly the Court overruled *White Motor* and *Schwinn*. On the other side of the spectrum, in *Leegin* the Court overruled *Dr. Miles*, an almost century-old precedent.[885] This all shows that, if anything, the principle of *stare decisis* may be even more inconsistent in the field of antitrust than in some other areas. In other words, no matter how toothless *stare decisis* policy is in general, it is even more so when it comes to antitrust law.[886]

There seem to be two main reasons for this. Firstly, this is because Congress' intention behind such a broad provision as the Sherman Act was to give courts a broad

[882] *Sylvania,* 433 U.S. at 47. With regards to this, Posner supported the Court's decision, noting that "[t]he only people who relied to their detriment on the *per se* rule laid down in Schwinn were the plaintiffs in Sylvania-type cases" and that *stare decisis* was not barring the decision to be overruled. Posner, *supra* note 285, at 5.
[883] *Id. at 586*.
[884] Montejo v. Louisiana, 129 S.Ct. 2079, 2089 (2009).
[885] *Dr. Miles* was decided in 1911 and *Leegin* in 2007.
[886] *Khan,* 522 U.S. at 20.

mandate in applying it.[887] Secondly, antitrust is inherently connected with economics, and changes in the economic theory may justify a change in antitrust rules. For example, in analyzing whether *Schwinn*'s *per se* rule justifies *per se* illegality standards,[888] *Sylvania* noted that whatever was "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today."[889] Similarly, according to the Court in *Business Electronics*, "[t]he term 'restraint of trade' in the statute, like the term at common law, refers not to a particular list of agreements, but to a particular economic consequence, which may be produced by quite different sorts of agreements in varying times and circumstances."[890] This enables the courts to determine the content of the law, in accordance with the economic circumstances of their time.

Therefore the view seems to be that the meaning of the Sherman Act evolves over time, together with developments in economic theory. The fact that antitrust laws are so dependent on economics explains why developments in antitrust are often more dynamic than in other fields of law and also why it can be argued that the strength of the *stare decisis* doctrine is even more disputable when it comes to antitrust cases. This opens up the question of using economic theory in the course of developing and implementing an effective antitrust policy.

In order to justify the overruling of *Schwinn*, *Sylvania* emphasized that *Schwinn* had been the subject of wide scholarly criticism.[891] However, relying on scholars in order to justify a court decision can sometimes be problematic, as their opinion may change over time. Consider for example Posner and the fact that the Court in *Sylvania* is citing him as an

[887] *Id.*
[888] *Sylvania,* 433 U.S. at 51.
[889] *Id.* at 54 n. 21.
[890] *Business Electronics*, 485 U.S. at 731. The Court also noted that "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential. It invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890". *Id.*
[891] *Sylvania,* 433 U.S. at 48-49.

authority throughout the opinion.[892] Interestingly, Posner initially briefed and argued the *Schwinn* case for the government.[893] This shows that there is a great amount of fluidity in economic theory, and what was argued in the past may later turn out to be incorrect. This additionally contributes to the increased volatility of antitrust laws and additionally dilutes the *stare decisis* principle in the antitrust sphere.

Based on the above, it can be concluded that the *stare decisis* principle would not be an obstacle if the Supreme Court wanted to change its position with regards to the legality of exclusive territories. If the Supreme Court decided to overrule *Sylvania*, it would find a way to justify this and *stare decisis* would not represent an obstacle in that respect. Therefore, at least from the *stare decisis* point of view, the rule laid down in *Sylvania* is not cast in stone and it may be subject to change in the future. However, taking into account the current set-up of the Court, a (dramatic) change in the law of exclusive territories does not seem likely.

3.7 Assessment

Since its inception, the American approach towards the legality of exclusive distribution has not been consistent. Initially, the Supreme Court was not certain which approach to adopt. In *White Motor* the Court was only able to decide that the issue of the legality of vertical non-price restraints is not suitable to be decided at the summary stage but rather deserves a trial on the merits. Compared to the suggested rule laid down above, this approach could be characterized as neutral, as it neither condemns nor exonerates the deployment of exclusive territories.

However, not long after that the *Schwinn* Court decided that vertical non-price restraints are to be subject to *per se* illegality. Compared to the proposed optimal rule, the approach taken by the Court in *Schwinn* could be characterized as pronouncedly inappropriate. This is due to the fact that it fails to acknowledge the procompetitive effects arising out of the use of

[892] *E.g.*, *Sylvania,* 433 U.S. at 49 n.13; *Id.* at 52 n.18; *Id.* at 54 n.21.
[893] *See* Posner, *supra* note 285, at 2.

exclusive territories, condemning this type of restraint across the board. In addition, the approach solely focuses on intrabrand competition, finding a restriction of this type of competition sufficient for a finding of an antitrust violation. Finally, this approach equally condemns non-airtight as well as airtight exclusive territories, making no distinction with regards to the extent to which intrabrand competition was restrained i.e. eliminated. Therefore, the *Schwinn* approach is clearly inapt and was justifiably overruled.

The standard of analysis proposed by *Sylvania* has the potential to be closest to the approach identified as optimal. By ruling that the legality of vertical non-price restraints is to be judged under the rule of reason, *Sylvania* opened the door for assessing both the procompetitive and anticompetitive potential of exclusive territories. However, a significant deficiency of *Sylvania* is that it did not lay down in more detail how the assessment under the proposed rule of reason is to be performed. Due to the vagueness of this concept, the lower courts were faced with uncertainty in its application and were looking for shortcuts in order to make the assessment more efficient from the administrative point of view.

The end result is that unless a defendant possesses substantial market power, it is very difficult for a plaintiff to prevail in an antitrust suit with regards to the deployment of exclusive territories. In other words, the current state of the law of exclusive territories could be characterized as *de facto per se* legality. Compared with the approach identified as optimal, *per se* legality is inappropriate, as it does not take into account the potential anticompetitive effects arising out of the deployment of exclusive territories.

However, compared to the *Schwinn* era, the *Sylvania* and its aftermath would nevertheless seem to be a step forward. First, although prevailing under the *Sylvania* rule of reason is far from easy from a plaintiff's point of view, it is still possible, especially if the defendant has a very large share of the market. And as shown in the theoretical chapter, the situation where the firm using exclusive territories has a substantial market share is when the use of exclusive territories could be characterized as most pernicious. In addition, the *Sylvania* approach leaves the regulation of vertical non-price restraints to the market forces; although this is not the most apposite approach in all aspects, its advantage is that it does offer some degree of simplicity.

Following *Sylvania*, it has become difficult to successfully challenge the imposition of exclusive territories not only as a vertical distribution restraint but also as some other antitrust violation. Taking into account a series of Supreme Court decisions, it is now very difficult to characterize the termination of a distribution agreement as a boycott. At the moment it seems that one of the rare avenues an antitrust plaintiff may use in order to prevail in a case concerning the use of exclusive territories is if he manages to establish that the case involved some sort of horizontal collusion, at either upstream or downstream level. However, even with regards to horizontal collusion the law is tilting away from *per se* illegality and towards the rule of reason. This could be a sign that after an effective antitrust deregulation in the area of vertical restraints what follows is a similar process with regards to horizontal cooperation – in the context of exclusive territories and otherwise.

4 EXCLUSIVE DISTRIBUTION IN EU LAW

The purpose of this chapter is to present the EU's approach towards exclusive territories and compare it with what the theoretical chapter identified as the most appropriate rule for judging the legality of this type of restraint. In addition, the chapter performs a comparative analysis between the EU law of exclusive territories and that of the U.S. during different periods of time. In order to achieve this, the chapter lays down the EU's legal framework in the context of exclusive distribution and gives an overview of the most important cases in this field. The analysis affords special attention to the Single Market imperative and the impact that it has had on the way in which the EU treats the legality of exclusive distribution agreements.

4.1 The legal framework

4.1.1 The main sources of law

Since the establishment of the European Communities (now: the European Union), the most important source of EU competition law have been certain provisions initially found in the Treaty Establishing the European Economic Community of 1957 (the Rome Treaty).[894] Article 85 of the Treaty dealt with agreements restricting competition, while Article 86 prohibited the abuse of dominant position. In a way, the former could be seen as a counterpart of Sherman Act Section 1, while the latter could be compared with Sherman Act Section 2.[895] This similarity is no coincidence, as U.S. antitrust law greatly influenced the emergence of EU competition law.[896] However, as will be shown in this chapter, in the field of exclusive

[894] 298 U.N.T.S. 11.
[895] However, an important difference should be noted as well, as the Sherman Act provision refers to monopolization while the TFEU speaks of abuse of dominant position. The difference between the two expressions could have some significant implications, such as the difference between market shares needed for finding an infringement.
[896] In this respect Gerber describes how some American scholars had an essential role in drafting competition law provisions in the Treaty establishing the European Coal and Steel Community of 1951 (the Treaty of Paris, 261 U.N.T.S. 140), which was later used as a basis for competition law provisions in the Rome Treaty. GERBER, *supra* note 618, at 337-42.

distribution this influence was not as significant as it may have been with regards to some other aspects of EU competition policy.

The Treaty of Amsterdam[897] amended and renumbered certain parts of the Rome Treaty and among the renumbered provisions were those dealing with competition law. Accordingly, Articles 85 and 86 became Articles 81 and 82 respectively. Finally, following the adoption of the Treaty on the Functioning of the European Union[898] the two provisions are now Articles 101 and 102.[899] Despite these changes, the content of the said provisions has remained practically the same as in the original Treaty of Rome.[900] Nevertheless, there are authors who suggest that some changes brought by the TFEU could be seen as reinforcing the goal of market integration,[901] which may be of significance for the way in which EU law approaches the legality of exclusive distribution agreements.[902]

If entered into by a dominant firm, an exclusive distribution agreement may infringe Article 102 TFEU.[903] However, this type of agreement is generally challenged under Article

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[897] OJ [1997] C 340/1. Prior to that, the Treaty on European Union (the Maastricht Treaty, OJ [1992] C 191/1) renamed the Treaty of Rome to the Treaty establishing the European Community (the EC Treaty).
[898] OJ [2008] C 115/47 (The Lisbon Treaty or the TFEU).
[899] Unless noted otherwise, this paper uses the TFEU numbering.
[900] The only change seems to be regarding terminology, as the expression "common market" has been replaced by "internal market".
[901] *See* Laura Parret, *Shouldn't we know what we are protecting? Yes we should! A plea for a solid and comprehensive debate about the objectives of EU competition law and policy*, EURO. C.J. 2010, 6(2), pp. 339-376, at 367 ("[T]he disappearance of the reference to competition in the list of objectives [of the Treaty]: the only references are to the internal market, and the notorious Protocol 27 explicitly subordinates competition policy to the internal market.").
[902] *See infra* Part 4.6.
[903] *E.g., Maschinenbau* at 248; *Consten-Grundig* at 339. Although Articles 101 and 102 in certain instances overlap, the standards of their application somewhat differ. According to D.G. Goyder, there are six main distinctions between Articles 101 and 102: 1) for 102 violations there is no need to show that there was an agreement; 2) the chief difficulty in 102 cases is to accurately define the relevant markets to which the dominance, and such exercise is not that important for 101 cases, especially when restriction of competition is by object; 3) 102 provides no sanction of automatic voidness of the prohibited conduct, however the offending clauses may be declared void by courts of Member States; 4) there is no such thing as 102(3), the same goes with block exemptions; 5) unlike breach of 101, breach of 102 does not necessarily have to involve restriction of competition – an 'exploitative' conduct suffices for the infringement; and 6) under 102 the focus is on the action of the dominant company, regardless of its intent to restrict competition (whereas for 101 there is effect/object dichotomy). D.G. Goyder, *supra* note 1o1, at 324-25. In addition, the market share needed for finding an infringement under 101(1) is lower than for establishing dominance under Article 102. *See infra* Part 4.3.2.2.1. Finally, there is also a difference when it comes to the consequences of infringing these two provisions – if an agreement infringes Article 101, both (or all) of the parties to the agreement will have committed an infringement, while in case of Article 102 it is only the dominant firm that is responsible for the infringement. Whish, *supra* note 37, at 674.

101 of the Treaty[904] and for this reason this paper mainly focuses on this provision. Article 101 consists of three paragraphs. The first paragraph prohibits "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market." Therefore, a person alleging an infringement of Article 101(1) has to prove that there is: 1) some form of collusion, 2) which restrains competition, 3) and which may affect trade between Member States.[905]

The second paragraph proclaims that agreements or decisions described in Article 101(1) are automatically void.[906] As for this issue, it may be disputable whether the voidness refers to the agreement as a whole or only to its part which is not in accordance with competition law. The ECJ has clarified that the voidness relates only to the part of the agreement infringing Article 101, and not necessarily to the entire agreement.[907] This automatic nullity means that an agreement infringing Article 101(1) and which does not benefit from the exemption of 101(3) has no effect as between the parties to it, nor can it be set up as a defense by third parties.[908]

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[904] For the proposition that Article 101(1) applies not only to horizontal but also to vertical agreements (including exclusive distribution agreements), see Case 56-65 *Société Technique Minière (L.T.M.) v Maschinenbau Ulm GmbH (M.B.U.)* [1966] ECR 235, at 248, and *Consten-Grundig* at 339.

[905] KORAH & O'SULLIVAN, *supra* note 41, at 57.

[906] On the other hand, the Sherman Act does not contain any provision with regards to the voidness of illegal agreements. As a result, a party is not released from an obligation arising out of an agreement in violation of the Sherman Act if the obligation itself does not infring the Act. *See* D.R. Wilder Mfg. Co. v. Corn Products Refining Co., 236 U.S. 165, 174-75 (1915); Kelly v. Kosuga, 358 U.S. 516, 520-21 (1959). *See also* Clifford A. Jones, *A New Dawn for Private Competition Law Remedies in Europe? Reflections from the US*, *in* EFFECTIVE PRIVATE ENFORCEMENT OF EC ANTITRUST LAW 95, 101-02 (Claus-Dieter Ehlermann & Isabela Atanasiu eds., 2003).

[907] The Court has held that the nullity prescribed by 101(2) applies only to those parts of the agreement affected by the prohibition. *Maschinenbau* at 250. In other words, the Court has adopted a severability approach – the nullity would apply to the agreement as a whole only when the parts that infringe Article 101(1) are not severable from the agreement itself. For U.S. law see American Indus. Fastener Corp. v. Flushing Enterprises, Inc., 362 F.Supp. 32, 41 (6th Cir. 1973) (upon finding the illegal territorial restrictions severable from the rest of the contract, the court allowed other claims with regards to the agreement).

[908] D.G. GOYDER, *supra* note 101, at 138.

Finally, the third paragraph offers the possibility of exemption from the application of Article 101(1) to agreements, decisions and practices that satisfy certain conditions.[909] Exclusive distribution agreements can often benefit from the exemption laid down in this provision, either individually or through group exemption laid down in block exemption regulations. Consequently, Article 101(3) will be paid additional attention further in this chapter.

With regards to the EU enforcement in the field of exclusive distribution, a threshold question is the applicability of EU competition law. Basically, the main issues are whether an exclusive distribution agreement may affect trade between Member States and whether it can do so to an appreciable extent. This section mainly focuses on the former,[910] i.e. it outlines the ways in which an exclusive distribution agreement may affect trade between Member States.

At the outset, this would be the case if the supplier and the exclusive distributor come from different Member States, as this seems to be a clear example of a cross-border economic activity.[911] However, an exclusive distribution may invoke the application of EU competition law even if the parties are coming from the same Member State.[912] First, if an exclusive distribution agreement contains a prohibition of parallel trade, it is inherently capable of

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[909] Third paragraph notes that 101(1) may be declared inapplicable in the case of:
"– any agreement or category of agreements between undertakings,
– any decision or category of decisions by associations of undertakings,
– any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

[910] For an assessment of appreciability, see Commission Notice - Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, OJ [2004] C 101/81, paras. 44-57.

[911] *See* Effect on Trade Concept, para. 21 ("The requirement that there must be an effect on trade 'between Member States' implies that there must be an impact on cross-border economic activity involving at least two Member States.").

[912] *See* Case 63/75 *SA Fonderies Roubaix Wattrelos v Société nouvelle des Fonderies A. Roux and Société des Fonderies JOT* [1976] ECR 111.

affecting trade between Member States.[913] In addition, an agreement may also have this effect if it is not airtight, and even if it covers only part of a Member State.[914]

What is more, an exclusive distribution agreement may be capable of affecting trade between Member States even if it involves third countries. This could generally happen in one of the two contexts. On the one hand, this would be the case if a supplier from the EU concludes a reciprocal exclusive distribution agreement with a competitor from outside the EU.[915] On the other hand, this would be possible in a situation involving a supplier from the EU and an exclusive distributor from a third country, if the agreement prohibited resale to the EU.[916] However, such an agreement would be deemed as being capable of affecting trade only if there was an appreciable price difference between the two markets[917] and if the volume of sales of the contracted product was not negligible in the relevant market inside the EU.[918]

By listing some examples of practices which are considered as prohibited,[919] Article 101 offers more guidance than Sherman Act Section 1. Nevertheless, the provision still does not say exactly how the legality of exclusive distribution agreements is to be appraised. For this reason, an assessment of the EU law of exclusive distribution also requires an analysis of the relevant case-law. In addition, as EU competition law is characterized by a number of secondary legislation of relevance for the law of exclusive distribution, these are also

[913] *See* Effect on Trade Concept, para. 16.
[914] *See id.*, paras. 89-92.
[915] *See* 85/618/EEC *Siemens/Fanuc* OJ [1985] L 376/29 (a reciprocal exclusive distribution agreement between a Japanese and a German supplier).
[916] *See* Effect on Trade Concept, para. 108.
[917] *Javico*, para. 24
[918] *Id.*, para. 26.
[919] The paragraph states that it is prohibited to "(a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

addressed in this chapter. However, in order to properly understand the relevant case-law and legislation, a reflection on the goals of EU competition law is necessary.

4.1.2 Goals of enforcement

It has been shown above that the American antitrust policy at the center of its focus puts Chicago-style economic efficiency, arguably considering it as the only goal of antitrust enforcement.[920] The situation in Europe differs in at least two respects. First, the European understanding of how efficiency gains are to be distributed does not seem to match the one prevailing in the U.S. In addition, EU competition law also strives to accomplish some other aims apart from the maximization of efficiency.

As opposed to the U.S. antitrust law, which has arguably adopted the total surplus standard, in EU competition law the manner in which the gains from efficiencies are to be distributed is of relevance. More precisely, the gains received by consumers are given priority. To this end, Article 101(3) TFEU specifically stipulates that a conduct will be exempted only if consumers receive a fair share of the improvement. The interest of consumers is emphasized in other places as well.[921] Consequently, although there have been no Commission or Court decision explicitly saying this, it would seem that the EU has adopted a net consumer welfare standard as the basis of its competition policy.[922] This should not be confused with "consumer welfare" in the way Chicago scholars understand the term – as shown above, the Chicago understanding of "consumer welfare" could be more correctly described as a total surplus standard.[923]

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[920] *See supra* Part 3.1.2.
[921] *See* EU Vertical Guidelines, para. 7 ("The objective of Article 101 is to ensure that undertakings do not use agreements . . . to restrict competition on the market to the detriment of consumers."; Guidelines on 101(3), para. 13 ("The objective of Article [101] is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources."); Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ [2004] L 24/1, Art. 2(1)(b) (when assessing a concentration the Commission should take into account "the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition").
[922] MOTTA, *supra* note 190, at 19-20.
[923] *See supra* Part 2.4.2.

Apart from a different understanding about how efficiency gains are to be distributed, another difference between EU and U.S. antitrust policies is that the former aims to achieve not only efficiency but also some other goals. The main reason for this distinction is that, unlike the Sherman Act, which is a stand alone statute, EU competition law provisions are part of a wider document. This means that the competition law provisions in the TFEU have to be interpreted with having other parts of the Treaty in mind,[924] which is not the case with the Sherman Act.

With regards to the values protected by the TFEU, of most relevance for the law of exclusive distribution is the significance that the Treaty affords to the single market. The integration of the Member States' markets into a single European market is one of the main goals of the EU and thereby also of EU competition law.[925] The importance of market integration is such that it often overrides some other objectives. In certain cases, including with regards to the implementation of exclusive distribution agreements, market integration and efficiency may conflict.[926] When there is a conflict between the interests of an individual firm and the issue of market integration, EU competition law has shown a tendency to favor the latter.[927] This has had a great influence on the legal treatment of exclusive distribution

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[924] Case 6-72 *Europemballage Corporation and Continental Can Company Inc. v Commission* [1973] ECR 215, para. 22 ("[When applying Article 102 TFEU] one has to go back to the spirit, general scheme and wording of Article [102], as well as to the system and objectives of the [TFEU].").

[925] In its decisions the ECJ has repeatedly emphasized the importance of the single market. For example, in one occasion the Court noted that "[t]he requirement … that competition shall not be distorted implies the existence on the market of workable competition, that is to say the degree of competition necessary to ensure the observance of the basic requirements and the attainment of the objectives of the Treaty, in particular the creation of a single market achieving conditions similar to those of a domestic market". Case 26-76 *Metro SB-Großmärkte GmbH & Co. KG v Commission* [1977] ECR 1875, para. 20. The importance of the Single Market has also been emphasized by the Commission. For example, in its Guidelines on 101(3) the Commission notes that "the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumers". Guidelines on 101(3), para. 13. Similarly, EU Vertical Guidelines note that "[m]arket integration enhances competition in the European Union [and consequently] [c]ompanies should not be allowed to re-establish private barriers between Member States where State barriers have been successfully abolished". EU Vertical Guidelines, para. 7.

[926] See MOTTA, *supra* note 190, at 23 ("[P]romotion of market integration is a political objective which is not necessarily consistent with economic welfare.").

[927] WHISH, *supra* note 37, at 23.

agreements in EU law, since this type of agreement could be seen as a means of fragmenting the single European market.[928]

Apart from protecting the single market, EU competition law is also focused on some other objectives. Based on the relevant parts of the TFEU,[929] EU competition policy also seems to promote environmental[930] and employment policies.[931] However, of more relevance for the discussion about exclusive distribution is the EU's focus on promoting the interests of small and medium enterprises.[932] This goal is ranked high, since the importance of small and medium firms is mentioned in the TFEU itself.[933] In addition, the Commission has a special, more lenient, approach to exclusive distribution agreements in the context of SMEs.[934]

Finally, EU competition law tends to emphasize the importance of rivalry, which can be connected with the influence that the ordoliberal ideas had in the formation of EU competition law.[935] For example, in one of its guidelines the Commission explicitly identifies

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928 *See infra* Part 4.6.

929 *See* TFEU, Arts. 191-193 (regarding the protection of environment); TFEU, Art. 147(2) ("The objective of a high level of employment shall be taken into consideration in the formulation and implementation of Union policies and activities.").

930 Some examples of environemental considerations being taken into account when exempting agreements based on Article 101(3) TFEU: 2000/475/EC *CECED* OJ [2000] L 187/47 (lowering energy consumption); 94/322/EC *Exxon/Shell* OJ [1994] L 144/20 (lowering consumption of energy and waste emission); 94/986/EC *Philips-Osram* OJ [1994] L 378/37 (lowering waste emission).

931 The TFEU explicitly states that "[t]he objective of a high level of employment shall be taken into consideration in the formulation and implementation of Union policies and activities". TFEU, Art. 147(2). In one case the Court exempted an agreement for its favorable impact on employment, finding that the agreement "improves the general conditions of production, especially when market conditions are unfavourable, [and therefore] comes within the framework of the objectives to which reference may be had pursuant to Article [101(3)]". Case 26-76 *Metro SB-Großmärkte GmbH & Co. KG v Commission* [1977] ECR 1875, para. 43. In another case the Court noted that "the provision of employment comes within the framework of the objectives to which reference may be had pursuant to Article [101](3)". Case 42/84 *Remia BV and others v Commission* [1985] ECR 2545, para. 42. At least in one case the Commission granted exemption based *inter alia* on the fact that the agreement was supposed to create jobs and further market integration. 93/49/EEC *Ford Volkswagen* OJ [1993] L 20/14, para. 36.

932 KORAH, *supra* note 619, at 293. *Compare with Leegin*, 551 U.S. at 906 (enforcement of antitrust laws should look at consumer welfare, not at the interests of small businessmen).

933 According to the TFEU, in ensuring that the conditions necessary for the competitiveness of the Union's industry exist, the Union and the Member States should aim at "encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, **particularly small and medium-sized undertakings**." TFEU, Art. 173(1) (emphasis added).

934 *See* Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article [101](1) of the [TFEU] (de minimis), OJ [2001] C 368/13 (*De minimis* notice), para. 3; EU Vertical Guidelines, para. 11.

935 Some peculiarities of EU competition law – the insistence that consumers get a fair share of a rise in efficiency, protection of rivalry and a preferential treatment for SMEs, seem to have their roots in the teaching

rivalry with as an aim of EU competition law.[936] The ECJ seems to be along the same line. In a recent decision the Court found that:

> like other competition rules laid down in the Treaty, Article [101 TFEU] aims to protect not only **the interests of competitors** or of consumers, but also the structure of the market and, in so doing, competition as such. Consequently, for a finding that an agreement has an anti-competitive object, it is not necessary that final consumers be deprived of the advantages of effective competition in terms of supply or price.[937]

This passage is important for at least two reasons. First, by noting that consumer harm is not a prerequisite for the finding of an infringement of Article 101, the passage casts doubt on the proposition that consumers are at the center of EU competition policy. In addition, the Court here explicitly states that one of the aims of Article 101 is to protect the interests of competitors, which is in contrast to the prevailing view in the U.S.[938]

Related to our discussion, this could be of relevance with regards to some enforcement aspects, especially concerning the right of a party to an exclusive distribution agreement to initiate a suit against the other contract party.[939] Additionally, it may be of significance when assessing the possibility of Article 101(3) exemption for an exclusive distribution agreement.[940] Therefore, although EU competition law does seem to afford more

of the Freiburg School. Ordoliberal ideas significantly influenced the early development of EU competition law, since the leading German representatives in the founding of the European Communities were closely associated with ordoliberalism. Gerber, *supra* note 618, at 263. Further, the Germans were major supporters of the inclusion of competition law provisions into the Treaty of Rome, and that way Articles 85 and 86 to a great extent expressed the ideas of ordoliberalism. *Id.* at 264.

[936] *See* Guidelines on 101(3), para. 105 ("Ultimately **the protection of rivalry** and the competitive process is given priority over potentially pro-competitive efficiency gains which could result from restrictive agreements. The last condition of Article 81(3) recognises the fact that **rivalry** between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the shape of innovation. In other words, the ultimate aim of Article [101] is to protect the competitive process.") (emphasis added). *See also* Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, OJ [1983] L 173/5, recital 18 (refering to reseller's commercial freedom).

[937] Joined cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the European Communities* (C-501/06 P) *and Commission of the European Communities v GlaxoSmithKline Services Unlimited* (C-513/06 P) *and European Association of Euro Pharmaceutical Companies (EAEPC) v Commission of the European Communities* (C-515/06 P) *and Asociación de exportadores españoles de productos farmacéuticos (Aseprofar) v Commission of the European Communities* (C-519/06 P) [2009] ECR I-09291, para. 63 (emphasis added).

[938] *Compare with* Brown Shoe Co. v. U.S., 370 U.S. 294, 320 (1962) ("[T]he legislative history [of the Clayton Act] illuminates congressional concern with the protection of competition, not competitors.").

[939] *See infra* Part 5.2.2.3.3.

[940] *See infra* Part 4.3.2.2.2.

attention to interests of consumers than U.S. antitrust law, the extent to which this is the case is not completely clear.

4.1.3 Forms of analysis

Before proceeding to the cases dealing with the legality of exclusive distribution agreements, another important issue to consider are the forms of analysis existing in EU competition law. Similarly to the *per se* – rule of reason dichotomy in the U.S., EU competition law also recognizes two types of analysis of the legality of restrictive agreements. Namely, EU law makes a distinction between agreements that have a restraint of competition as their object from agreements that have a restraint of competition as their effect.

On the one hand, the restriction of competition by object can be compared with the *per se* rule in U.S. law, since in both situations a practice automatically infringes Article 101(1).[941] However, an important difference between the American and European concept is that EU competition law offers the possibility of exemption even with regards to practices that have the restriction of competition as their object.[942] If an agreement restricts competition by its object, it only means that there is no need for economic analysis under Article 101(1), but the agreement's procompetitive effects could still be claimed under Article 101(3).[943] Nevertheless, in practice agreements restricting competition by their object rarely meet the criteria for exemption laid down in 101(3).[944] An exclusive distribution agreement coupled

[941] *Consten-Grundig* at 342 ("For the purpose of applying Article [101](1), 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.").
[942] *E.g.*, Case T-17/93 *Matra Hachette SA v Commission* [1994] ECR II-595, para. 85 ("[I]n principle, no anti-competitive practice can exist which, whatever the extent of its effects on a given market, cannot be exempted, provided that all the conditions laid down in Article [101](3) of the Treaty are satisfied.").
[943] Joined cases T-374/94, T-375/94, T-384/94 and T-388/94 *European Night Services Ltd (ENS), Eurostar (UK) Ltd, formerly European Passenger Services Ltd (EPS), Union internationale des chemins de fer (UIC), NV Nederlandse Spoorwegen (NS) and Société nationale des chemins de fer français (SNCF) v Commission* [1998] ECR II-3141, para. 136.
[944] *See* Guidelines on 101(3), para. 46.

with a prohibition of parallel imports is generally considered as infringing EU competition law by its object.[945]

On the other hand, an agreement that does not have a restriction of competition as its object could be found to infringe Article 101(1) if it has an effect of restricting competition. Although there are significant differences between the two, in a way this type of analysis could be compared with the rule of reason in American law.[946] With regards to our discussion, it is important to note that EU competition law generally considers non-airtight exclusive distribution agreements as restraining competition by their effect.[947]

4.2 The early cases

4.2.1 The context

In order to be able to properly comprehend the early EU cases on exclusive distribution, one needs to take into account the context in which they were decided. For this reason it is important to consider some of the legislation relevant at that time, especially since the trends set at this period have had a great influence on the way modern EU competition law treats exclusive distribution agreements.

The drafters of the Rome Treaty had in mind the need for adopting legislation which would regulate EU competition law in more detail than the pertinent articles of the Treaty.[948]

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945 *See Consten-Grundig*; Case 19/77 *Miller International Schallplatten GmbH v Commission* [1978] ECR 131; Case C-279/87 *Tipp-Ex GmbH & Co. KG v Commission* [1990] ECR I-261; Vertical BER, Art. 4(b) (prohibition of passive sales a hardcore restriction). *See also* Guidelines on 101(3), paras. 20-23 (hardcore restrictions generally considered as restricting competition by their object).

946 The extent to which the EU law has adopted (or should adopt) the American-style rule of reason has been much discussed in literature. *See, e.g.,* RENE JOLIET, THE RULE OF REASON IN ANTITRUST LAW (1967); Brenda Sufrin & Richard P. Whish, *Article [101] and the rule of reason*, 7 YEARBOOK OF EUROPEAN LAW 1 (1987); Georgios I. Zekos, *Antitrust/Competition Arbitration in EU versus U.S. Law*, JOURNAL OF INTERNATIONAL ARBITRATION, Volume, 25 Issue 1 (2008), pp. 1-29; Valentine Korah, *The rise and fall of provisional validity - the need for a rule of reason in EEC antitrust*, 3 NW. J. INT'L L. & BUS. 320 (1981); Pietro Manzini, *The European rule of reason-crossing the sea of doubt*, E.C.L.R. 2002, 23(8), 392-399; Ernst Steindorff, *Article [101] and the rule of reason*, 21 COMMON MARKET LAW REVIEW 639 (1984).

947 *See* Case 56/65 *Société Technique Minière (L.T.M.) v Maschinenbau Ulm GmbH (M.B.U.)* [1966] ECR 235.

948 According to the original Article 87(1) of the Rome Treaty, "[w]ithin three years of the entry into force of this Treaty the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, adopt any appropriate regulations or directives to give effect to the principles set out in Arts. 85 and 86."

The first piece of legislation to that purpose was Council Regulation 17/62,[949] which for more than four decades[950] represented the basis of antitrust enforcement in the EU. The regulation envisaged that all agreements for which the parties wanted to seek Article 101(3) exemption had to be notified to the Commission.[951] Subject to review by the ECJ, the Commission had the sole power to grant these exemptions.[952] In addition, the Regulation gave the Commission the right to grant negative clearance for agreements which in its opinion did not fall under Article 101(1).[953]

Although the authorities of the Member States were competent to apply Article 101(1), only the Commission could grant Article 101(3) exemptions.[954] This solution extended the range of decisions falling under the Commission's exclusive jurisdiction and to a large extent prevented the concurrent jurisdiction of national courts and authorities.[955] Perhaps the Council believed that such a solution was necessary in order to insure consistent and conservative interpretations of EC competition law,[956] which was especially important in those early days of the Community. However, this solution had also caused certain problems in practice, as the Commission soon became flooded by notifications for exemption.[957]

One of the suggested solutions for this problem was the introduction of an American-style rule of reason into EU competition law. This would have meant that the weighing of pro

[949] EEC Council: Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, OJ [1962] 13/204.
[950] I.e. prior to the adoption of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles [101] and [102] of the Treaty, OJ [2003] L 1/1. For a more detailed discussion about the Regulation, see *infra* Part 5.2.1.
[951] Regulation 17/62, Art. 4(1).
[952] *Id.*, Art. 9(1).
[953] *See id.*, Art. 2.
[954] *See* Regulation 17/62, Art. 9(3). Member States were also authorized to apply Article 102, but this is not of relevance for the current discussion, as the possibility of exemptions does not apply to 102.
[955] Ernst Steindorff & Klaus Hopt, *European Economic Community-The Grundig-Consten Case, a Landmark Decision of the European Court of Justice on Common Market Antitrust Law*, THE AMERICAN JOURNAL OF COMPARATIVE LAW, Vol. 15, No. 4 (1966 - 1967), pp. 811-822, at 821.
[956] Note, *International Law. Treaties. Application of Antitrust Law under the Treaty of Rome. Etablissements Consten & Grundig-Verkaufs-GmbH v. Commission of the European Economic Community, 2 CCH Comm. Mkt. Rep. 8046 (Ct. of Justice of the European Communities, July 13, 1966)*, HARVARD LAW REVIEW, Vol. 80, No. 7 (May, 1967), pp. 1594-1600, at 1598.
[957] Only one year following the adoption of Regulation 17/62 the Commission had received notifications of over 35,000 agreements. MONTI, *supra* note 45, at 397.

and anticompetitive aspects of an agreement would take place already at the stage of determining whether the agreement infringes 101(1).[958] Had this system been introduced, the assessment about the agreement's impact on competition would have been moved from 101(3) to 101(1). In such a case parties could implement an agreement without notifying it and the Commission would get involved only if the implemented agreement results in inefficiencies.[959] However, since the Commission and the ECJ had not adopted this approach, the early cases need to be considered in the light of the notification system in force at that time.

4.2.2 Cases before the Commission

The Commission had discussed and decided cases concerning exclusive distribution as early as 1964. Actually, it could be said that the law of exclusive distribution emerged before any other aspect of EU competition law.[960] This is in contrast with the situation in the U.S., where, compared to some other fields of antitrust, the law of vertical restraints developed relatively late. The main reason for this discrepancy is the importance that EU competition law affords to market integration, and the imposition of exclusive territories could be seen as hampering this process. On the other hand, American antitrust law emerged when the U.S. market was already integrated; consequently, rather than on market integration, the Sherman Act was focused more on abuses of economic power by large concentrations.[961] Despite these differences, it is interesting that the law of exclusive territories started developing at approximately the same time on both sides of the Atlantic: the Supreme Court decided *White Motor* in 1963, while the first Commission decisions on the legality of exclusive territories came in 1964.

[958] *See* Case T-112/99 *Métropole télévision (M6), Suez-Lyonnaise des eaux, France Télécom and Télévision française 1 SA (TF1)* v Commission [2001] ECR II-2459, para. 68.
[959] MONTI, *supra* note 45, at 30.
[960] KORAH & O'SULLIVAN, *supra* note 41, at 59.
[961] Carl H. Fulda, *Antitrust in the European Economic Community*, 41 TEX. L. REV. 391, 393-94 (1963).

Some of the first Commission decisions on exclusive distribution[962] included: *Grosfillex-Fillistorf*[963] (granting a negative clearance to an exclusive distribution agreement on the grounds that the effect of the agreement was outside of the EC); *Grundig-Consten*[964] (refusing to exempt an exclusive distribution agreement prohibiting parallel trade); *D.R.U.–Blondel*[965] (exempting an exclusive distribution agreement not prohibiting parallel trade); *Hummel-Isbecque*[966] (exempting an exclusive distribution agreement not prohibiting parallel trade); *Maison Jallatte S.A.*[967] (exempting an exclusive distribution agreement not prohibiting parallel trade). These cases are important because they established certain principles which can be said to have survived until the present day.

First, right from the start the Commission has had a relatively balanced approach towards exclusive territories, as it did not consider them illegal *per se*. In this respect the early EU cases could be seen as being in line with the American approach of the time, since *White Motor* also refused to condemn vertical territorial restraints as *per se* illegal. However, the Commission seems to have gone deeper into the substance than the Supreme Court. *White Motor* did not say that vertical restraints should not be judged under *per se* illegality. Rather, it merely concluded that a summary decision was not appropriate and that a trial on the merits should be held.

The second principle that can be inferred from the early Commission decisions is the Commission's tough stance towards exclusive distribution agreements prohibiting parallel trade between Member States. Although it may be disputable how justifiable this approach

[962] For a summary of the early Commission case-law on exclusive distribution, see Steindorff & Hopt, *supra* note 955, at 814-15.
[963] 64/233/EEC *Grosfillex-Fillistorf* OJ [1964] 58/915.
[964] 64/566/EEC *Grundig-Consten* OJ [1964] 161/2545.
[965] 65/366/EEC *D.R.U.-Blondel* OJ [1065] 131/2194.
[966] 65/426/EEC *Hummel-Isbecque* OJ [1965] 156/2581.
[967] 66/5/EEC *Maison Jallatte S.A.* OJ [1966] 3/37.

is,[968] the Commission has kept pursuing it ever since. As will be shown in the next section, a similar approach has also been adopted by the ECJ.

4.2.3 ECJ cases

4.2.3.1 Maschinenbau

The first ECJ decision dealing with the legality of exclusive distribution agreements was a 1965 ruling in *Maschinenbau.*[969] The facts of the case can be summarized as follows.[970]

Maschinenbau was a producer of industrial mechanization from Germany, and L.T.M. was its exclusive dealer for the territory of France. The exclusive distribution agreement between the parties did not prohibit parallel imports – L.T.M. could sell Maschinenbau's products in other countries and Maschinenbau's German wholesalers could sell Maschinenbau's products in France.

At one point Maschinenbau delivered six bulldozers to L.T.M., which the French company claimed were defective. Consequently, L.T.M. sued Maschinenbau for breach of contract before the Tribunal de Commerce de la Seine. After the Seine court dismissed the suit, L.T.M. appealed to the Paris Court of Appeals, arguing that the distribution agreement infringed Article 101 TFEU. In accordance with what is now Article 267 TFEU,[971] the Paris Court made a reference to the ECJ.

The Paris Court basically asked ECJ two questions.[972] First, it inquired about the legality of an exclusive distribution agreement that does not prohibit parallel imports from other Member States and has not been notified to the Commission pursuant to Regulation 17/62. Secondly, the French court asked if the expression "automatically void" in Article 101(2) TFEU means that the whole agreement containing a clause prohibited by Article

[968] *See infra* Part 4.6.
[969] Case 56/65 *Société Technique Minière (L.T.M.) v Maschinenbau Ulm GmbH (M.B.U.)* [1966] ECR 235.
[970] The facts are based on: Steindorff & Hopt, *supra* note 955, at 815-16.
[971] Then Article 177 EC.
[972] *Maschinenbau* at 247:

101(1) is void, or whether it is possible for the nullity to be limited to the prohibited clause alone.

At the outset, the ECJ found that an exclusive distribution agreement that has not been notified does not automatically infringe Article 101(1).[973] However, the Court noted that such agreements are also not *per se* legal, as they may infringe Article 101(1) due to a particular factual situation or to the severity of the clauses protecting the exclusive dealership.[974] In describing how the legality of exclusive distributions is to be assessed, the Court hinted an economic approach. The Court noted that in assessing whether an agreement restricts competition one should consider competition within the actual context in which it would occur in the absence of the agreement.[975]

According to the Court, factors to be considered in this respect include the nature and quantity of the products covered by the agreement, the market position of the parties to the agreement and whether the agreement is of isolated nature or is part of a series of agreements.[976] The Court especially mentioned that of relevance is whether the imposition of exclusive territories is necessary for penetrating a new market.[977] The severity of the clauses protecting the exclusive dealership should also be taken into account, especially whether they contain a prohibition of parallel imports.[978]

Therefore, the Court confirmed what the Commission decisions had established prior to that – exclusive distribution agreements are not illegal *per se*, nor they are legal *per se*.[979] Rather, their anticompetitive potential has to be assessed taking into account the surrounding circumstances, with a special emphasis on possible prohibition of parallel imports.

[973] *Id.* at 248.
[974] *Id.*
[975] *Id.* at 250.
[976] *Id.*
[977] *Id.*
[978] *Id.*
[979] *But see* JOLIET, *supra* note 946, at 173 (arguing that the early Commission decisions were not in accordance with *Maschinenbau* as they did not undertake the market analysis later prescribed by the Court).

4.2.3.2 Consten-Grundig

Although *Maschinenbau* was the first, *Consten-Grundig* is generally considered as the most important ECJ decision regarding exclusive distribution. The facts of the case can be summarized as follows.[980]

In 1957, the German firm Grundig entered into an exclusive distribution agreement with the French firm Consten. According to the agreement, Consten was to be the exclusive distributor of certain Grundig products[981] for the territory of France. In addition, Consten agreed not to sell competing products of other manufacturers (an exclusive dealing clause). Consten also undertook to advertise Grundig products in France and maintain a warranty and repair service for Grundig products.

According to the contract, Consten agreed not to sell Grundig products outside of France. Similarly, Grundig prohibited its other distributors to sell their products inside of Consten's area of responsibility, i.e. inside of France.[982] Therefore, the distribution agreement imposed an airtight exclusive territory involving a prohibition of parallel trade between Member States. The territorial protection was strengthened by an agreement about selling under the trademark GINT (which stands for Grundig International), as all Grundig products sold in France were to have the mark "GINT" together with the "Grundig" trademark. This way it was easier for the parties to observe if a product was intended for the French market or was rather the result of parallel import from other markets.

As a result of this arrangement, Consten managed to significantly increase Grundig's sales in France. This was despite the fact that prices charged by Consten were higher than those charged for Grundig products in Germany. However, problems started in 1961, when

[980] The facts are based on: Note, *supra* note 956; Lawrence F. Ebb, *The Grundig-Consten Case Revisited: Judicial Harmonization of National Law and Treaty Law in the Common Market*, UNIVERSITY OF PENNSYLVANIA LAW REVIEW, Vol. 115, No. 6 (Apr., 1967), pp. 855-889; Steindorff & Hopt, *supra* note 955.
[981] The products included radios, television sets, tape recording, and similar equipment.
[982] Grundig had similar arrangements with distributors in France as well as with its wholesalers in Germany.

certain French firms started buying Grundig products from dealers located in Germany and then selling those products in France for a price lower than Consten's.

One such firm was U.N.E.F. Following this development, Consten brought a suit against U.N.E.F. before the Commerce Court of the Seine, alleging that U.N.E.F. engaged in acts of unfair competition.[983] Following the court's decision in favor of Consten, U.N.E.F. appealed to the Paris Court of Appeals. U.N.E.F. also made a filing with the European Commission alleging that the agreement between Grundig and Consten violated what is now Article 101 TFEU. Pending decision by the Commission, the Paris Court of Appeals stayed its proceedings.

Acting upon U.N.E.F.'s complaint, the Commission found that the agreement between Consten and Grundig was indeed in violation of EU competition rules.[984] In short, the Commission found that the exclusive agreement between Grundig and Consten violated Article 101(1), that conditions for exemption laid down in 101(3) were not fulfilled, and that Grundig and Consten cannot prevent third parties from importing Grundig products into France. The Commission also found that the distribution agreement between Consten and Grundig was void in its entirety. Consten and Grundig then appealed to the ECJ, seeking the annulment of the Commission's decision. Apart from finding that the Commission erred in declaring that the whole distribution agreement was void and not only the parts violating Article 101(1),[985] the Court dismissed the appeal.

In assessing the legality of the arrangement between Grundig and Consten, the Court limited its analysis to the effect that the arrangement had on intrabrand competition. In other words, the Court ignored possible positive effects that the introduction of a new brand would

[983] According to the French law of the time, anyone knowing of the existence of an exclusive territory was under a duty to refrain from invading that territory, and a violation of this duty represented an act of unfair competition. Note, *supra* note 956, at 1594.
[984] 64/566/EEC *Grundig-Consten* OJ [1964] 161/2545.
[985] *Consten-Grundig* at 344.

have on interbrand competition in the French market.[986] What is more, the ECJ even questioned whether the alleged procompetitive effects of exclusive territories improve interbrand competition at all. In this respect the Court emphasized the negative effects of product differentiation – the more product differentiation there is, the more the upstream competition will be diminished.[987]

The applicants in *Consten-Grundig* suggested that, prior to declaring Article 101(1) applicable, the Commission should have considered the economic effects of the disputed contracts on interbrand competition.[988] However, the Court rejected such an approach. According to the Court, although interbrand competition is generally more noticeable than the intrabrand one, it does not mean that an agreement restricting intrabrand competition will avoid the prohibition of Article 101(1) merely because it might increase interbrand competition.[989] Consequently, the Court held that an agreement that distorts competition in the Common Market infringes 101(1), and no possible favorable effects of the agreement could save it from the prohibition of this provision.[990] In other words, the Court rejected the U.S. style rule of reason analysis in the light of 101(1) – if an agreement distorts competition that is sufficient for it to be prohibited, even if it has certain efficiency-enhancing sides.

The Court also upheld the part of the Commission's decision not to grant 101(3) exemption to the arrangement at hand. In this respect the applicants emphasized some efficiency-enhancing aspects of their agreement, noting that the Commission did not take those aspects into account when deciding not to grant a 101(3) exemption. They argued that the prohibition of airtight exclusive territories would have several negative effects. For example, they argued that in the absence of airtight exclusive territories the exclusive

[986] KORAH & O'SULLIVAN, *supra* note 41, at 61.
[987] *Consten-Grundig* at 343.
[988] *Id.* at 342. The Court refers to interbrand competition as "competition between similar products of different makes". *Id.*
[989] *Id.*
[990] *Id.* at 343.

distributor would not be in a position to engage in advance planning;[991] that the appropriate provision of guarantee and after-sales service would be endangered and that as a result the manufacturer's reputation would suffer;[992] that entering a new market would be hindered;[993] and that in the absence of absolute territorial protection the exclusive distributor's efforts would be discouraged due to free-riding by parallel importers.[994] However, the Court rejected all these arguments and upheld the Commission's reasoning.[995]

Perhaps the most important aspect of the decision is the Court's emphasis on the single market. In this respect the Court noted that "[a]n agreement between producer and distributor which might tend to restore the national divisions in trade between member states might be such as to frustrate the most fundamental objectives of the Community."[996] This has led some authors to note that *Consten-Grundig* focused EU antitrust law more on the problem of economic integration than on the promotion of economic competition in general.[997] Although a lot of time has passed since the ECJ rendered *Consten-Grundig*, a similar conclusion would seem to be valid even today.

As mentioned, the Court explicitly rejected the free-rider argument proposed by the applicants, concluding that the presence of intrabrand competition actually stimulates dealers' efforts.[998] This part of the decision has been criticized on the grounds that it did not take into account the risk and investment that Consten undertook when agreeing to promote Grundig products in France.[999] According to this argument, Consten's sunk costs were especially risky taking into account that the distribution agreement with Grundig was concluded in 1957

[991] *Id.* at 348.
[992] *Id.* at 349.
[993] *Id.*
[994] *Id.*
[995] *Id.* at 348-49.
[996] *Id.* at 340.
[997] Note, *supra* note 956, at 1600.
[998] *Consten-Grundig* at 343.
[999] KORAH, *supra* note 619, at 76.

while trade quotas inside the EC were abolished only in 1961.[1000] This means that Consten was supposed to invest in the promotion of Grundig products even though there was uncertainty with regards to obtaining import licenses.[1001] With regards to this, some commentators have noted that the Court's finding in effect means that a free-rider is considered as a hero.[1002]

As *Consten-Grundig* was decided only three years after *White Motor*, it could be interesting to compare these two cases.[1003] The connection between the two decisions is even more interesting considering the fact that Karl Roemer, Advocate General in *Consten-Grundig*, explicitly turned the Court's attention to *White Motor*. Roemer argued that the Commission's analysis of the arrangement between Grundig and Consten was flawed, as it failed to adequately analyze the relevant interbrand competition.[1004] However, as noted, the ECJ found that the elimination of intrabrand competition can in itself be sufficient for an infringement of 101(1), refusing to consider possible advancement of interbrand competition. On the other hand, by not condemning an arrangement that eliminated intrabrand competition, *White Motor* could be seen as at least implicitly recognizing the importance of interbrand competition.

Apart from *White Motor*, *Consten-Grundig* could also be compared with *Schwinn*. At first glance, there is not much similarity between the two cases - *Schwinn* held that exclusive territories are *per se* illegal, while *Consten-Grundig* was less far-reaching. Nevertheless, what connects these two cases is their approach towards the relationship between intrabrand and interbrand competition. Both decisions held that the fact that intrabrand competition has been

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[1000] *Id.* at 60.
[1001] *Id.*
[1002] Gyselen, *supra* note 240, at 649 ("The free rider rationale . . . is conceptually antithetical to the parallel imports rationale. Parallel imports may indeed give rise to free rides from one exporting dealer on the promotional or servicing efforts of one local dealer. In the Commission's eyes, however, the free rider is a hero because his sales foster the free movement of the brand within the common market and thus contribute to market integration.").
[1003] For a comparison between *White Motor* and *Consten-Grundig*, see GUILIANO AMATO, ANTITRUST AND THE BOUND OF POWER 48-50 (1997).
[1004] Ebb, *supra* note 980, at 858.

restricted is sufficient to find a violation, regardless of possible procompetitive justifications. Therefore, *Schwinn* and *Consten-Grundig* adopted the same approach towards the restriction of intrabrand competition: both cases found that the restriction of intrabrand competition is sufficient for a violation of antitrust laws, regardless of possible gains that the restriction brings to interbrand competition.

Nevertheless, an important difference between Schwinn and *Consten-Grundig* are the legal consequences of their findings. As mentioned, in the U.S. there is no such thing as Article 101(3) – both pro and anticompetitive aspects of an agreement are judged at the same stage. Therefore, despite finding that restriction of intrabrand competition leads to an infringement of 101(1), the ECJ's decision in *Consten-Grundig* still left a possibility for such an arrangement to be exempted at 101(3) stage. On the other hand, a similar finding by the Supreme Court in *Schwinn* had as a result a *per se* prohibition of exclusive territories, since American law does not recognize the possibility of exemption once it has been found that an agreement infringes Sherman Act Section 1.

Based on the above, it can be concluded that the combined effect of *Maschinenbau* and *Consten-Grundig* was the following: non-airtight exclusive distribution agreements are afforded some sort of a rule of reason, and based on the circumstances of the case they can be either legal or illegal; on the other hand, exclusive distribution agreements affording absolute territorial protection to the exclusive distributor are subject to what could be characterized as a *per se* prohibition. Although some elements of this approach have changed since the time when these two cases were decided, the basic elements have remained the same.

This stability of the law of exclusive distribution could be explained by mainly two reasons. On the one hand, this would be due to the single market objective of EU competition law, explicitly mentioned in the Treaty. On the other hand, this could be connected with the ECJ's reluctance to overrule its own decisions. Even though the EU legal order does not have a formal system of precedent as the U.S. does,[1005] the ECJ would seem to be even more bound to its previous decision than it is the case with the U.S. Supreme Court.[1006] The combined effect of these two considerations has been a relative stable approach towards the legality of exclusive distribution agreements in the EU – EU competition law has not had significant and sudden changes in the way it treats exclusive territories as has been the case in the U.S.

4.3 Developments after Consten-Grundig

4.3.1 The significance of block exemptions

Following *Maschinenbau* and *Consten-Grundig*, perhaps the main trait of EU approach towards exclusive distribution agreements have been group exemptions granted by the Commission. The legal basis for these exemptions is contained in Council Regulation 19/65,[1007] which empowers the Commission to issue group 101(3) exemptions for certain types of agreements. At the time of the adoption, the main goal of this regulation was to enable the Commission to ease the congestion arising out of a large number of notifications pursuant to Regulation 17/62. However, it should be noted that the group exemptions did not lose on their importance even when the notification system established by Regulation 17/62 was abolished.

With regards to exclusive distribution agreements, the Commission issued its first block exemption in 1967, contained in Regulation 67/67.[1008] Although in its title it mentioned only exclusive dealing, Regulation 67/67 also covered what this paper considers as exclusive

[1005] *See supra* Part 3.6.
[1006] Alison Jones, *Completion of the revolution in antitrust doctrine on restricted distribution: Leegin and its implications for EC competition law*, 53 ANTITRUST BULL. 903, 956 (2008). *See also* Anthony Amull, *Owning up to Fallibility: Precedent and the Court of Justice*, 30 CMLREV 247, 248 (1993) ("[The ECJ] is not bound by its previous decisions but in practice it does not often depart from them."). According to Amull, the same applies to the General Court, even where its decisions have been upheld by the ECJ. *Id.* at 262.
[1007] Regulation No 19/65/EEC of 2 March of the Council on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices, OJ [1965] 36/533.
[1008] Regulation No 67/67/EEC of the Commission of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements, OJ [1967] 57/849.

distributorship.[1009] The regulation followed *Consten-Grundig* in that it did not afford exemption to absolute territorial protection.[1010] It also did not exempt reciprocal exclusive distribution agreements, i.e. arrangements where manufacturers would appoint each other as exclusive distributors for different territories.[1011]

The main shortcoming of this block exemption was that it did not take into account economic considerations, the most important being the market power of the parties to the exclusive distribution agreement. As long as an agreement would satisfy the eight elements prescribed by the BER,[1012] it would be exempted regardless of the market position of the parties. With regards to the comparison with the U.S., the block exemption was adopted one month before the Supreme Court decided *Schwinn*, i.e. it was valid throughout the *Schwinn* era. During that period the EU law of exclusive distribution was actually less strict than that of the U.S. – while *Schwinn* condemned the use of exclusive territories across the board, the EU approach had a comparable approach only with regards to exclusive distribution agreements containing a prohibition of parallel trade.

In 1983 the Commission started replacing Regulation 67/67 with a new set of block exemptions. Of most relevance for our discussion, that year the Commission adopted a block exemption regulation dealing solely with exclusive distribution agreements.[1013] The new regulation did not bring many changes into the law of exclusive distribution, apart from the fact that it was more detailed than Regulation 67/67. It was also formalistic in the sense that in assessing the legality of an exclusive distribution agreement it did not take into account economic considerations. This was the first block exemption following the Supreme Court's

[1009] *Id.*, Art. 1(1).
[1010] *See id.*, Art. 3(b).
[1011] *See id.*, Art. 3(a).
[1012] *See* D.G. GOYDER, *supra* note 101, at 170.
[1013] Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article [101](3) of the Treaty to categories of exclusive distribution agreements, OJ [1983] L 173/1. The other two were Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article [101](3) of the Treaty to categories of exclusive purchasing agreements, OJ [1983] L 173/5 and Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85 (3) of the Treaty to categories of franchise agreements, OJ [1988] L 359/46.

decision in *Sylvania*, and it might have been expected that the regulation would make a move towards a more economic and less formalistic approach towards vertical restraints. However, this did not happen, to the disappointment of many observers.

In general, the three regulations were widely criticized. Perhaps the most persuasive and well-reasoned criticism came from Professor Barry Hawk.[1014] He attacked the regulations on several grounds. First, he argued that the Commission was applying Article 101(1) too broadly, condemning even agreements with little or no anticompetitive effects.[1015] He also criticized the notification system, noting that it mostly serves to increase transaction costs, and therefore should be abolished.[1016] In addition, he criticized the Commission's formalism and instead proposed that distribution agreements should be judged on the basis of their economic impact rather than on the basis of their form.[1017] Taking into account this and other criticism, a new block exemption was eagerly anticipated.

The next block exemption came in 1999, in the form of Regulation 2790/1999.[1018] This regulation brought significant changes compared to the previous block exemptions and marked the Commission's new approach towards vertical restraints. To start with, unlike the preceding block exemptions, Regulation 2790/1999 applied to all vertical agreements, including those pertaining to exclusive distribution. In addition, the block exemption for the first time mentioned market shares needed for finding an infringement of Article 101(1),[1019] thereby making an important step towards aligning the EU law of exclusive territories with the findings of economic theory.

It can be said that the 1999 regulation accomplished what the previous one failed to do – introduce the *Sylvania*-style analysis into EU competition law. However, the system

[1014] Barry E. Hawk, *System Failure: vertical restraints and EC competition law*, CML REV. 32: 973-989 (1995).
[1015] *Id.* at 974.
[1016] *Id.* at 984.
[1017] *Id.* at 986.
[1018] Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ [1999] L 336/21.
[1019] *See id.*, Art. 3.

established by the regulation was much more structured than the one offered by *Sylvania*. This is mainly thanks to the fact that together with the block exemption regulation the Commission issued its Guidelines on Vertical Restraints.[1020] This document was drafted in a less formal manner than the regulation, providing explanations about the law of vertical restraints as well as an economic rationale behind certain legal rules. In a way, the guidelines could be seen as a roadmap for a structured rule of reason, something which *Sylvania* failed to deliver.

In this respect it is interesting to reflect upon the legal significance of guidelines issued by the Commission. Although these guidelines are not legally binding on the ECJ or national courts,[1021] they are still of great practical significance. First, the ECJ has emphasized that although the Commission's guidelines "may not be regarded as rules of law which the administration is always bound to observe, they nevertheless form rules of practice from which the administration may not depart in an individual case without giving reasons that are compatible with the principle of equal treatment."[1022] Therefore, the guidelines create reasonable expectations that the Commission will act in a certain way.

The importance of the Commission's guidelines is further strengthened by the essential role the Commission has in the enforcement of EU competition law. Private antitrust enforcement in the EU is still at an early stage of development – the crux of the enforcement efforts remains with the Commission.[1023] Therefore, if the Commission does not consider an arrangement illegal, it is likely that the agreement will not be challenged at all. Finally, the

[1020] Commission Notice - Guidelines on Vertical Restraints, OJ [2000] C 291/1. The Commission also issued some sort of guidelines in 1984, but those were more formalistic, in accordance with the block exemptions then in force. *See* Commission notice concerning Commission Regulations (EEC) No 1983/83 and (EEC) No 1984/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution and exclusive purchasing agreements, OJ [1984] C 101/2.
[1021] Jones, *supra* note 1006, at 958.
[1022] Case C-397/03 P, para 91. *See generally* LINDA SENDEN, SOFT LAW IN EUROPEAN COMMUNITY LAW 235-90 (2004) (discussing the legally binding force of guidelines and other soft law in the EU).
[1023] *See infra* Part 5.2.

Commission has a right to withdraw the benefit of exemption from the Vertical BER,[1024] and the Guidelines could assist in predicting when this could happen.

4.3.2 Block exemption 2010

4.3.2.1 The application of the block exemption

The current block exemption that applies to exclusive distribution agreements is contained in Commission Regulation 330/2010.[1025] The purpose of the regulation is to define types of vertical agreements that generally satisfy the conditions for exemption laid down in Article 101(3) and to collectively exempt them from the application of Article 101(1). The Regulation should be read in conjunction with the Commission's Guidelines on Vertical Restraints from 2010.[1026]

The Regulation adopted the approach of presumed legality of vertical restraints, including exclusive territories, as it proclaims that Article 101(1) TFEU does not apply to vertical agreements.[1027] However, this does not mean that the use of exclusive territories is *per se* legal in EU law[1028] - further in the text the Regulation enumerates exceptions to this general rule. In other words, instead of specifically giving the benefit of exemption to certain types of vertical agreements, the Vertical BER first exempts all vertical agreements and then lists the types of agreements which are excluded from the exemption. This is in accordance

[1024] *See* Regulation 1/2003, Art. 29(1); Vertical BER, Recital 13. Exemption can also be withdrawn by an NCA. *See* Regulation 1/2003, Art. 29(2).
[1025] Commission Regulation 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, OJ [2010] L 102/1 (Vertical Block Exemption Regulation or Vertical BER).
[1026] Commission Guidelines on Vertical Restraints, OJ [2010] C 130/1.
[1027] Vertical BER, Art. 2(1).
[1028] It is interesting to consider this provision in light of Posner's expectation that the tendency is to make vertical restraints legal *per se*. *See* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, THE UNIVERSITY OF CHICAGO LAW REVIEW, Vol. 48, No. 1 (Winter, 1981), pp. 6-26.

with the Commission's view that vertical restraints can have both procompetitive[1029] and anticompetitive effects.[1030]

Most notably, the exemption does not apply to exclusive distribution agreements entered into by firms having a substantial share of the market. Namely, the Regulation exempts only agreements where the supplier's and buyer's market shares do not exceed 30 % of the relevant market.[1031] Compared to the previous BER from 1999, the novelty is that the buyer's market share is also of relevance, due to the rising importance of buyer power.[1032]

This approach is proper, taking into account that it has been shown that exclusive distribution agreements entered into by firms that lack market power can rarely if ever cause anticompetitive effects.[1033] Nevertheless, it should be noted that EU competition law may condemn even an agreement entered into between parties that lack significant market power, if the agreement contains a hardcore restriction. Therefore, the lack of market power does not completely exempt an agreement from EU competition law's reach.

Of most relevance for our discussion, the exemption provided by the Vertical BER does not apply to exclusive distribution agreements that contain a prohibition of active sales.[1034] This generally in line with *Consten-Grundig*[1035] and represents the continuation of the Commission's hostile approach towards agreements that prohibit parallel trade between Member States. However, from this it does not follow that absolute territorial protection is to

[1029] As possible positive effects of vertical restraints the Guidelines *inter alia* list solving the free-rider problem, entering new markets, solving the hold-up problem, achieving economies of scale in distribution, remedying capital market imperfections. EU Vertical Guidelines, para. 107.
[1030] As possible negative effects of vertical restraints the Guidelines list the following: raising barriers to entry, reduction of interbrand competition, reduction of intrabrand competition, the creation of obstacles to market integration. EU Vertical Guidelines, para. 100.
[1031] Vertical BER, Art. 3(1).
[1032] *See* Secrieru, *supra* note 30, at 814; MONTI, *supra* note 45, at 372; P. Dobson, R. Clarke, S. Davies & M. Waterson, *Buyer Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, 1 JOURNAL OF INDUSTRY, COMPETITION AND TRADE 247 (2001).
[1033] *See supra* Part 2.3.1.4.
[1034] Vertical BER, Art. 4(b)(i).
[1035] Thise seems to be the case even though *Consten-Grundig* does not recognize the distinction between the prohibition of active and passive sales.

be regarded as illegal *per se* – there are certain instances in which EU competition law may exempt even airtight exclusive territories.[1036]

Further, there are situations where the exemption does not apply only to certain specific obligations contained in an exclusive distribution agreement, while the rest of the agreement is eligible for exemption. In such cases the exemption is withdrawn only with regards to the parts of the agreement considered as illegal. An example would be an exclusive distribution agreement that contains an exclusive dealing clause the duration of which is indefinite or exceeds five years.[1037] This reflect the view that the longer the duration of the exclusive dealing arrangement the higher the possibility that there will be anticompetitive effects in the market.[1038]

Finally, under certain conditions the Commission may declare the block exemption inapplicable. Based on the Vertical BER, the Commission could do so where more than 50 % of the market is covered by exclusive distribution agreements.[1039] This reflects the view that the more widespread the use of exclusive territories, the more likely it is that the positive effects will cancel each other out.[1040] Additionally, the Commission may withdraw the exemption in all other cases where it finds that an exclusive distribution agreement has effects incompatible with Article 101(3).[1041] In the case of withdrawal, the Commission bears the burden of proof that the agreement does not satisfy the conditions for exemption.[1042]

4.3.2.2 Assessment when the block exemption does not apply

4.3.2.2.1 Article 101(1) analysis

The assessment of the legality of an exclusive distribution agreement generally consists of the following steps. At the outset, it is necessary to establish the market shares of

[1036] *See infra* Part 4.4.
[1037] Vertical BER, Art. 5(1)(a).
[1038] *See supra* Part 2.2.5.
[1039] *See* Vertical BER, Art. 6.
[1040] *See supra* Part 2.3.2.6.
[1041] *See* Regulation 1/2003, Art. 29(1); Vertical BER, Recital 13.
[1042] EU Vertical Guidelines, para. 77.

the supplier and the distributor.[1043] If the relevant market shares do not exceed the thresholds set by the Vertical BER, nor does the agreement contain a hardcore restriction, the agreement will generally be exempted.[1044] However, even if the market shares do exceed the prescribed thresholds, that does not mean that the agreement will unavoidably be illegal. Unless it contains hardcore restrictions of competition, there is no presumption that an exclusive distribution agreement exceeding the market share threshold set by the BER will fall within the scope of Article 101(1) or fail to satisfy the conditions of Article 101(3).[1045] In other words, even firms with substantial market power can try to show that their exclusive distribution agreements should not be condemned.

If an agreement does not satisfy the conditions for block exemption, it is then necessary to assess if it falls within Article 101(1).[1046] If the supplier and distributor do not possess sufficient market power, an exclusive distribution agreement may fall outside 101(1) even if the conditions for group exemption are not met. In this respect it may be disputable what degree of market power leads to a possible infringement of Article 101(1). According to the Commission, the degree of market power that is generally needed for establishing an infringement under Article 101(1) is lower than the degree of market power required for establishing dominance in the light of Article 102.[1047] This opens up the question of the market share needed for establishing that a firm possesses a dominant position in the market.

[1043] *Id.*, para. 110(a). At this point we will not go further into the issue of how relevant product and geographic market are determined. *See* Commission notice on the definition of the relevant market for the purposes of Community competition law, OJ [1997] C 372/5.
[1044] EU Vertical Guidelines, para. 110(b).
[1045] *Id.*, para. 96.
[1046] *Id.*, para. 110(c). According to the Vertical BER, there is no presumption that vertical agreements exceeding the 30% threshold are either caught by Article 101(1) of the Treaty or that they fail to satisfy the conditions of Article 101(3) of the Treaty. Vertical BER, Recital 9.
[1047] EU Vertical Guidelines, para. 97.

According to the Commission, dominance is not likely if the undertaking's market share is below 40 %.[1048] If competitors are not able to effectively constrain the conduct of a dominant undertaking, this percentage can be even lower.[1049] However, it should be emphasized that market share is not the only relevant factor – the Commission will not come to a final conclusion as to whether or not a case should be pursued before all the relevant factors are taken into account.[1050] These factors include relevant market conditions, particularly the dynamics of the market and the extent to which products are differentiated.[1051]

With respect to dominance, the relevant ECJ and GC case-law should also be considered. Based on this, very large market shares are generally considered as a sufficient proof of dominance.[1052] If a firm has more than 50 % of the relevant market, it is generally presumed that it is dominant.[1053] Finally, it should be noted that the lowest market share sufficient for dominance in ECJ and GC case-law has been 39.7 %.[1054] Taking all this into account, dominance is not likely if the firm’s market share does not exceed 40 %. Therefore, the situation where parties to an exclusive distribution agreement have a market share of between 30 % and 40 % represents a gray zone, i.e. it is not clear whether there is sufficient market power for an infringement of Article 101(1).

If an exclusive distribution agreement exceeds the market share threshold set by the Vertical BER and there is sufficient market power for an infringement of Article 101(1), the

[1048] Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article [102] of the [TFEU] to abusive exclusionary conduct by dominant undertakings, OJ [2009] C 45/7 (Guidance on 102), para. 14.
[1049] *Id.*, para. 14.
[1050] *Id.*, para 15.
[1051] *Id.*, para. 13.
[1052] *See* Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] ECR 461, para. 41 (“[A]lthough the importance of the market shares may vary from one market to another the view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time … is by virtue of that share in a position of strength.”).
[1053] Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR 3359, para. 60.
[1054] Case T-219/99 *British Airways plc v Commission* [2003] ECR 5917.

next step is to establish whether the agreement has the effect of restricting competition..[1055] According to the Commission, some of the factors relevant for this assessment are the nature of the agreement, the market position of the parties, the market position of competitors, the market position of the buyers of the contract products, entry barriers, the maturity of the market, the level of trade, and the nature of the product.[1056] These factors are then further elaborated with regards to exclusive distribution agreements.

According to the Guidelines, the loss of intrabrand competition arising out of an exclusive distribution agreement can only be problematic if interbrand competition is limited.[1057] In this respect, the stronger the position of the supplier, the more serious the loss of intrabrand competition is.[1058] The market position of the supplier's competitors should also be considered. In general, the presence of strong competitors means that a reduction in intrabrand competition is outweighed by sufficient interbrand competition.[1059] However, this will not always be the case. If the number of competitors becomes rather small and their market position is rather similar, the risk of horizontal collusion increases.[1060]

The guidelines also address the situation where different suppliers appoint the same exclusive distributor in a given territory, commonly referred to as multiple exclusive dealership. In this respect the Guidelines note that interbrand competition may be substantially restricted if a dealer is granted the exclusive right to distribute two or more important competing products in the same territory.[1061] This is because in such a situation if one producer cuts the wholesale price for its brand, the exclusive retailer will not be eager to

[1055] EU Vertical Guidelines, para. 97.
[1056] *Id.*, para. 111.
[1057] *Id.*, para. 153.
[1058] *Id.*
[1059] *Id.*, para. 154.
[1060] *Id.*
[1061] *Id.*

transmit this price cut to the final consumer, since that would reduce the exclusive retailer's sales made with other brands.[1062]

Since exclusive distribution restricts intrabrand competition, foreclosure of other suppliers generally arises only when the arrangement is combined with exclusive dealing (i.e. single branding), an interbrand restraint.[1063] However, the Guidelines note that even if combined with single branding, exclusive distribution could have anticompetitive effects only when the single branding is applied to a dense network of exclusive distributors with small territories or in case of a cumulative effect.[1064] Otherwise, the combination of exclusive distribution and single branding may be pro-competitive, as it can increase the incentive for the exclusive distributor to focus its efforts on the particular brand.[1065]

Nevertheless, an exclusive distribution agreement may foreclose other distributors even if it does not contain an exclusive dealing clause. According to the Guidelines, foreclosure of other distributors may become an issue where an exclusive distributor possesses buying and market power.[1066] This is especially if the exclusive territory is large, or in the case of multiple exclusive dealership.[1067]

Apart from the combination with exclusive dealing, exclusive territories could also be combined with selective distribution. In this respect it may be disputable whether in the context of selective distribution a supplier may make a commitment that he will supply only one dealer in a certain area. The old guidelines from the year 2000 allowed for this

[1062] *Id.*
[1063] *Id.*, para. 155.
[1064] *Id.*, para. 161.
[1065] *Id.* On the other hand, the Guidelines consider exclusive sourcing as more pernicious than single branding. According to the Guidelines, the combination of exclusive distribution with exclusive sourcing increases the possible competition risks of reduced intra-brand competition and market partitioning which may facilitate price discrimination in particular. *Id.*, para. 162. This is because exclusive sourcing eliminates possible arbitrage by the exclusive distributors, which are prevented from buying from other distributors in the system. *Id.* Consequently, chances for the supplier to limit intrabrand competition by applying dissimilar conditions of sale to the detriment of consumers are enhanced, unless the combination allows the creation of efficiencies leading to lower prices to all final consumers. *Id.*
[1066] *Id.*, para. 156.
[1067] *Id.*

possibility, under the condition that active and passive selling was not prohibited anywhere inside the selective distribution system.[1068] However, the new Vertical Guidelines exclude this possibility, making a combination of exclusive and selective distribution a hardcore restriction.[1069] Therefore, in this respect the new Vertical Guidelines are stricter than the previous ones, which can be criticized as preventing a supplier from tailoring a distribution system according to his needs.[1070]

The Guidelines also point out the difference in anticompetitive potential of exclusive distribution depending on the level of trade at which it is imposed. According to the Guidelines, anticompetitive potential is more pronounced regarding exclusive distribution at the retail than at the wholesale level, especially if the exclusive territories are large.[1071] However, this is not always the case. In the presence of multiple exclusive dealerships(i.e. where different suppliers appoint the same exclusive distributor in a given territory) possible anticompetitive risks are higher at the wholesale level.[1072]

Finally, the Guidelines also address the relevance of the maturity of the market and the nature of the product that is subject to exclusive distribution. The maturity of the market is important in the sense that a reduction in intrabrand competition and price discrimination are generally a more serious problem in a mature market than in a dynamic and growing market.[1073] On the other hand, the nature of the product is not particularly relevant for the assessment of the possible anti-competitive effects of exclusive distribution.[1074] However, this factor could be of relevance at the next stage, i.e. for an assessment of possible efficiencies in the light of 101(3).

[1068] Guidelines on Vertical Restraints, OJ [2000] C 291/1 (*Old Vertical Guidelines*), para. 53. *See also id.*, para. 162 (a combination of exclusive distribution and selective distribution exempted if active selling in other territories is not restricted).
[1069] EU Vertical Guidelines, para. 57.
[1070] *See* Mario Velez, *Recent developments in selective distribution*, E.C.L.R. 2011, 32(5), 242-247, at 244.
[1071] EU Vertical Guidelines, para. 159.
[1072] *Id.*, para. 160.
[1073] *Id.*, para. 158.
[1074] *Id.*, para. 163.

4.3.2.2.2 Article 101(3) analysis

If an agreement exceeds the 30 % threshold set by the Vertical BER and does fall under 101(1), it is then necessary to assess if it satisfies the conditions for individual exemption laid down in Article 101(3).[1075] Therefore, even agreements that do not satisfy the conditions for group exemption can still benefit from an individual exemption. In this respect especially important are the Commission's Guidelines on 101(3),[1076] which pertain to the application of this provision in general. In addition, also to be considered are the relevant parts of the Vertical Guidelines, which concern more directly the exemption of exclusive distribution agreements. In general, there are three conditions that need to be satisfied in order for 101(3) to apply.

First, efficiencies arising out of the agreement need to be established.[1077] Regarding exclusive distribution agreements, the Vertical Guidelines note that the case for efficiencies is strongest for new products, complex products, and products whose qualities are difficult to judge before consumption (so-called experience products) or whose qualities are difficult to judge even after consumption (so-called credence products).[1078]

Second, consumers need to receive a fair share of the improvement, in the sense that "the efficiency gains must fully off-set the likely negative impact on prices, output and other relevant factors caused by the agreement."[1079] This condition is very important for the discussion about exclusive territories, since this practice can sometimes harm consumers even if it leads to an increase in total surplus.[1080] As argued above, the American law has adopted a total surplus standard, which would only consider whether an exclusive distribution

[1075] *Id.*, para. 110(d).
[1076] Commission Guidelines on the application of Article [101](3) of the Treaty, OJ [2004] C 101/97.
[1077] EU Vertical Guidelines, para. 124.
[1078] *Id.*, para. 164.
[1079] *Id.*, para. 126.
[1080] *See supra* Part 2.3.2.6.

agreement leads to net gains and would not be concerned with how these gains are distributed.[1081]

This could be seen as an important principal distinction between the American and European approach to exclusive distribution. Nevertheless, it would seem that it has only limited practical significance. On the one hand, in assessing the legality of an exclusive distribution agreement an American court will rarely get to the balancing stage, as the complaint is most likely to be dismissed prior that.[1082] On the other hand, in the EU the use of exclusive territories will most often be either exempted on the basis of the Vertical BER or will be such that an individual exemption will not be probable (e.g., if the agreement contained a hardcore restriction or the parties to the agreement had substantial market power.

Finally, in order to establish that the agreement does not afford the parties the possibility of eliminating competition, an analysis of the agreement's effect on the remaining competitive pressures on the market is needed.[1083] In other words, even if an exclusive distribution agreement leads to significant efficiencies and consumers get a fair share of these efficiencies, the restriction of competition arising out of the agreement must not be such as to completely eliminate competition in the relevant market.

4.4 Exceptions to the prohibition of absolute territorial protection

4.4.1 Active sales

Although the EU's approach towards airtight exclusive territories can be characterized as relatively strict, there are certain situations where even airtight exclusive distribution agreements will not be condemned. For example, if other conditions are satisfied, a manufacturer may legally restrain its distributors from engaging in active sales outside their

[1081] *See supra* Part 3.1.2.
[1082] *See supra* Part 3.4.1.
[1083] EU Vertical Guidelines, para. 127.

assigned territory.[1084] While the prohibition of active sales cannot completely eliminate the free-rider problem, it does seem to be sufficient for tackling some of the most blatant forms of free-riding.[1085] Consequently, some commentators have characterized this approach as adequate for solving the free-rider problem, noting that the prohibition of only passive sales takes into consideration the advantages as well as the risks of territorial protection.[1086]

Although this exception considerably softens the Commission's approach towards exclusive territories, it also entails certain practical problems. These mainly have to do with the fact that it is not always easy to delineate between what constitutes active as opposed to passive sales. In this respect especially ambiguous is the use of the Internet. For this reason in the Vertical Guidelines the Commission explicitly deals with the issue of what practices are regarded as active and passive sales in the Internet context.[1087] Although some of these guidelines may is some respects seem arbitrary, they do offer a certain level of legal certainty, especially taking into the significance of the Commission's views.

4.4.2 Lack of appreciable effect

4.4.2.1 On competition

If parties to an exclusive distribution agreement have an insignificant market share, EU competition law may allow even absolute territorial protection. This is in accordance with the *de minimis*[1088] principle, established by the ECJ in *Franz Völk v S.P.R.L. Ets J. Vervaecke*.[1089] The case involved an airtight exclusive distribution agreement entered into between parties having an extremely small share of the market (both the supplier's and the

[1084] Vertical BER, Art. 4(b)(i).
[1085] *See, e.g., General Motors* (discussed in Part 3.4.2.2 above).
[1086] Monti, *supra* note 630, at 1067.
[1087] *See* EU Vertical Guidelines, paras. 51-54.
[1088] The short of "*de minimis* non curat lex", i.e. "[t]he law does not concern itself with trifles". BLACK'S LAW DICTIONARY, *supra* note 874, at 464.
[1089] Case 5/69 *Franz Völk v S.P.R.L. Ets J. Vervaecke* [1969] ECR 295. A similar doctrine also exists in Amerincan law. *See* Fortner Enterprises, Inc. v. U.S. Steel Corp., 394 U.S. 495, 501 (1969) ("An analysis of market shares might become relevant if it were alleged that an apparently small dollar-volume of business actually represented a substantial part of the sales for which competitors were bidding. But normally the controlling consideration is simply whether a total amount of business, substantial enough in terms of dollar-volume so as not to be merely de minimis, is foreclosed to competitors by the tie.").

distributor's market share was far less than 1 %). Discussing whether such an agreement infringes EU competition law, the Court found that:

> An agreement falls outside the prohibition in Article [101] when it has only an insignificant effect on the markets, taking into account the weak position which the persons concerned have on the market of the product in question. Thus an exclusive [distribution] agreement, even with absolute territorial protection, may, having regard to the weak position of the persons concerned . . . escape the prohibition laid down in Article [101](1).[1090]

Therefore, in the light of *Völk* it seems that an agreement between parties having such a small share falls outside Article 101(1) altogether, regardless of the severity of distribution restrictions.[1091] However, the situation with small but still not negligible market shares is not as clear.

For example, in *Miller International Schallplatten GmbH v Commission*, the Court found that a market share of between 5 % and 6 % is appreciable, especially if the volume of sales is large in absolute terms.[1092] Along the same line, the Court's decision in *SA Musique Diffusion française and others v Commission*[1093] could mean that even a market share of 3 and 4 percent may be appreciable,[1094] especially in the presence of a fragmented market and substantial absolute turnover figures.[1095] Therefore, based on ECJ case-law, the area between 0.1 % and 3 % is some sort of a gray area, where it is not clear whether the share of the market is sufficient for being able to appreciably affect competition.

Apart from ECJ case-law, also of relevance is the Commission's *de minimis* notice.[1096] According to the Notice, agreements between non-competing undertakings that would otherwise fall under 101(1) will not do so if the market share of the parties to the

[1090] *Völk*, paras. 5-7.
[1091] *See also* Case 1-71 *Société anonyme Cadillon v Firma Höss, Maschinenbau KG* [1971] ECR 351, para. 9 (even airtight exclusive distribution agreements may benefit from the *de minimis* exemption).
[1092] The Court noted that such a market share "if not strong, is at any rate important". Case 19/77 *Miller International Schallplatten GmbH v Commission* [1978] ECR 131, para. 10.
[1093] Joined cases 100 to 103/80 *SA Musique Diffusion française and others v Commission* [1983] ECR 1825.
[1094] *Id.,* paras. 82-87.
[1095] *Id.*, para. 86.
[1096] Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (de minimis), OJ [2001] C 368/13.

agreement does not exceed 15 %.[1097] Since a supplier and distributor operate at different market levels, the said exemption also applies to the parties to an exclusive distribution agreement. Therefore, if both the manufacturer and distributor hold less than 15 % of the respective markets, their agreement on exclusive territories will not fall under Article 101(1)[1098] and it will not be even necessary to apply the exemption from the Vertical BER.

However, the Commission's *de minimis* exemption applies only if the agreement does not contain a hardcore restriction. In case an agreement does contain a hardcore restraint, the exemption is not applicable.[1099] One of the situations which the Notice considers as hardcore is airtight exclusive distribution, i.e. distribution which involves a restriction of passive sales.[1100] As shown, the ECJ in *Völk* did not limit the *de minimis* exemption only to a restriction of active sales. Consequently, the Commission's standpoint is contrary to the ECJ's, as it completely excludes the possibility of exemption for agreements containing a prohibition of passive sales.[1101] In any case, perhaps in the future the ECJ will have an opportunity to take a stand on this point and clarify the law.

Finally, the Commission lays down a *de minimis* exemption regarding small and medium enterprises.[1102] This exemption applies even to hardcore restrictions, since such enterprises are considered to be rarely capable of appreciably affecting trade between Member States and restricting competition.[1103] Therefore, if parties to an exclusive distribution agreement qualify as small and medium enterprises, their agreement would

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[1097] *Id.*, para. 7(b).
[1098] In case of cumulative foreclosure effect, this threshold is reduced to 5 %. *Id.*, para. 8.
[1099] *Id.*, para. 11.
[1100] *Id.*, para. 11(b).
[1101] However, there have been suggestions that this does not necessarily have to be the case. For example, some have interpreted the Commission's notice as meaning the Commission will not pursue hardcore restrictions only if the parties' market share is significantly lower than the one prescribed in the notice (i.e. considerably less than 15 %). *See* Jones, *supra* note 1006, at 957-58.
[1102] *De minimis* notice, para. 3 ("[A]greements between small and medium-sized undertakings . . . are rarely capable of appreciably affecting trade between Member States.").
[1103] EU Vertical Guidelines, para. 11. However, the Commission may initiate proceedings against small and medium enterprises if such enterprises have a dominant position in a substantial part of the internal market. *Id.*

generally not be caught by Article 101(1) even with regards to hardcore restraints, unless the parties have a dominant position.

4.4.2.2 On inter-state trade

An agreement may also fall outside Article 101(1) if it does not appreciably affect trade between Member States. In the context of exclusive distribution, of most relevance would be the situation where the agreement involves some non-Member States. This is what for example happened in *Javico International and Javico AG v Yves Saint Laurent Parfums SA,*[1104] a case decided by the ECJ.

The case concerned an exclusive distribution agreement involving the sale of YSL products in Ukraine and Slovenia (at the time Slovenia was not a member of the EU). The agreements contained a clause prohibiting re-export to the EU. In its decision, the ECJ ruled that such export bans are not contrary to Article 101(1) by their very nature,[1105] although they may infringe the said provision if they by effect restrict competition.[1106] Therefore, if an airtight exclusive distribution agreement involves non-EU countries, EU law has a more favorable approach to it, and does not consider it a violation of competition by object.[1107]

4.4.3 New entrant

If imposed by a new entrant into the market, the Commission may not pursue even an exclusive distribution agreement conferring absolute territorial protection. According to the Vertical Guidelines:

> Where substantial investments by the distributor to start up and/or develop the new market are necessary, restrictions of passive sales by other distributors into such a territory . . . which are necessary for the distributor to recoup those investments generally fall outside the scope of Article 101(1) during the first

[1104] Case C-306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA* [1998] ECR I-1983.
[1105] *Id.*, para. 21.
[1106] *Id.*, para. 22.
[1107] A similar approach has been adopted by the Commission in one of its first decisions, *Grosfillex-Fillistorf.* In that case an agreement was exempted since the export ban concerned Switzerland, a non-Member State. *See supra* Part 4.2.2.

two years that the distributor is selling the contract goods or services in that territory.[1108]

Although it is limited to the situation where such restriction is indispensable and although it applies only for the period of up to two years, the exception is important since airtight exclusive territories are especially justified when used by firms entering a market.[1109] However, it should also be taken into account that this exception effectively overrules *Consten-Grundig*[1110] and is yet to be confirmed by the ECJ.

4.4.4 Dealing through a subsidiary

An important exception to the prohibition of airtight exclusive territories is that Article 101 does not apply to conduct inside a firm, i.e. to a situation where a supplier performs distribution in-house.[1111] In this respect, consider the line of cases related to Parker Pen's distribution practices. Parker Pen had a mixed distribution system – in certain Member States it performed distribution through its own subsidiaries, while in others it appointed exclusive distributors. Due to the airtight character of exclusive territories granted, the system came under the Commission's scrutiny. Consequently, Parker Pen was fined for the prohibition of parallel imports contained in distribution agreements with its exclusive distributor for Germany.[1112] On the other hand, the relationship between Parker and its subsidiaries was found to be outside of the scope of Article 101,[1113] although the ECJ did not exclude the possibility that such conduct may nevertheless fall under Article 102.[1114]

Also worth considering in this respect is the line of cases regarding Nintendo's exclusive distribution system. Nintendo also had a mixed system of distribution, distributing its products through its own network and through independent distributors. Both the

[1108] EU Vertical Guidelines, para. 61.
[1109] *See supra* Part 2.3.1.3.
[1110] *See* Monti, *supra* note 630, at 1068.
[1111] *Consten-Grundig* at 340.
[1112] 92/426/EEC *Viho/Parker Pen* OJ [1992] L 233/27. The fine imposed by the Commission was later reduced by the GC. Case T-77/92 *Parker Pen Ltd v Commission* [1994] ECR II-549.
[1113] Case C-73/95 P *Viho Europe BV v Commission* [1996] ECR I-5457, para. 17.
[1114] *Id*. *See also Consten-Grundig* at 340.

subsidiaries and the independent distributors were barred from exporting Nintendo products into other Member States. However, only the arrangements with independent distributors came under the Commission's scrutiny, which imposed a hefty fine upon Nintendo for the restriction of parallel trade.[1115] In addition, it should be emphasized that prior to appointing an exclusive distributor for the market of Great Britain, for which it was so heavily fined, Nintendo used to perform distribution in the market in-house. Therefore, the decision to appoint a distributor turned out to be an expensive decision indeed.[1116]

4.4.5 Specific sectors

Some ECJ decisions suggest that related to certain specific sectors even airtight territorial exclusivity can fall outside Article 101(1). For example, in *SPRL Louis Erauw-Jacquery v La Hesbignonne SC*[1117] the ECJ cleared a clause conferring absolute territorial protection, taking into account significant sunk costs incurred by the holder of plant breeders' rights in developing a plant variety as well as the need for careful handling of basic seed..[1118] Nevertheless, this exception seems to be quite narrow, due to the fragility of plant breeders' rights which expire once the variety ceases to be distinct, uniform, stable and useful.[1119]

In another case the Court found that granting an exclusive right to exhibit a film in the territory of a Member State is not to be regarded as a violation of EU competition law by its object, although it can violate the law as its effect.[1120] In any case, the importance of these two exceptions should not be overestimated – it seems that they were carefully qualified and can hardly be extended beyond their special sectors.[1121]

[1115] 2003/675/EC *Nintendo* OJ [2003] L 255/33 (imposing a fine of almost 150 million euros). Reduced by the GC to 119 million euros. Case T-13/03 *Nintendo Co., Ltd and Nintendo of Europe GmbH v Commission* [2009] ECR II-975.
[1116] *See infra* Part 5.3.2.
[1117] Case 27/87 *SPRL Louis Erauw-Jacquery v La Hesbignonne SC* [1988] ECR 1919.
[1118] *Id.*, paras. 10-11. *See also* 1999/6/EC *Sicasov* OJ [1999] L 4/27, para. 53 ("[a] breeder has the right to restrict the movement of basic seed").
[1119] KORAH & O'SULLIVAN, *supra* note 41, at 82.
[1120] Case 262/81 *Coditel SA, Compagnie générale pour la diffusion de la télévision, and others v Ciné-Vog Films SA and others* [1982] ECR 3381, para. 15.
[1121] J. GOYDER, *supra* note 123, at 72.

4.4.6 Health and safety considerations

Finally, airtight exclusive territories may be exempted where such a restriction is objectively necessary to ensure compliance with a public ban on selling dangerous substances to certain customers due to safety or health reasons.[1122] Regarding this exception, a parallel could be drawn with American law. As shown in the previous chapter, even during the *Schwinn* era, there were certain instances when exclusive territories were not condemned as *per se* illegal – one such instance for precisely where exclusive arrangement was necessary due to health and safety considerations.[1123]

4.5 Horizontal cooperation and exclusive territories

Same as U.S. law, EU competition law has a pronouncedly negative approach towards a horizontal allocation of territories.[1124] On the other hand, a vertical allocation of territories is not treated as harshly – under certain conditions even absolute territorial protection may escape condemnation. Taking this into account, it could be interesting to consider the way in which EU competition law would assess the legality of an arrangement with mixed horizontal and vertical effects. In other words, the question is how EU competition law would judge the legality of an arrangement as the one found in *Topco*.[1125] As such form of cooperation is of mixed nature, it would invoke EU competition rules both regarding horizontal and regarding vertical agreements.

With regards to the horizontal aspects, the first step would be to assess whether the cooperation could be seen as a full-function joint venture. This is important because if it would be found to be a full-function joint venture, i.e. a joint venture performing on a lasting basis all the functions of an autonomous economic entity, the rules on mergers would

[1122] EU Vertical Guidelines, para. 60.
[1123] *See* Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir. 1970).
[1124] *See* TFEU, Art. 101(1)(c).
[1125] *See supra* Part 3.5.

apply.[1126] In order to be a full-function joint venture, a cooperation needs to be autonomous in operation respect.[1127] This means that it has to perform functions that are normally performed by firms operating on the same market and have its own management, staff, and finances.[1128] Based on the facts of *Topco*, Topco would not qualify as a full-function joint venture in this sense. Consequently, the next step would be to assess the arrangement with regards to the rules on horizontal cooperation.

Similarly to the situation with vertical agreements, the Commission has collectively exempted certain types of horizontal agreements with regards to specialization.[1129] In general, a horizontal specialization agreement will be exempted if the combined market share of the parties does not exceed 20 % on any relevant market.[1130] Among the exempted agreements are those where the parties do not independently sell the specialization products but jointly distribute those products.[1131] More broadly, these agreements are what the Commission calls commercialization agreements, i.e. agreements that involve cooperation between competitors in the selling, distribution or promotion of their substitute products.[1132]

Based on this, in order to be exempted, in each of the areas where Topco members were operating the market share would need to be less than 20 %. Taking into account that the market share of participants in the joint venture in *Topco* was between 1.5 % and 16 %, the average share being around 6 %, and that without this cooperation they would not have

[1126] *See* Merger Regulation, Art. 3(4).
[1127] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ [2008] C 95/1 (Jurisdictional Notice), para. 93.
[1128] *Id.*, para. 94.
[1129] Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements, OJ [2010] L 335/43 (Horizontal BER), para. 2(1). The legal basis for this block exemption was established by Regulation (EEC) No 2821/71 of the Council of 20 December 1971 on application of Article 85 (3) of the Treaty to categories of agreements, decisions and concerted practices , OJ [1971] L 285/46.
[1130] Horizontal BER, Art. 3. *See also id.*, recital 8 ("The nature of unilateral and reciprocal specialisation agreements presupposes that the parties are active on the same product market. It is not necessary for the parties to be active on the same geographic market.").
[1131] *Id.*, Art. 2(3)(b).
[1132] Communication from the Commission – Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (Horizontal Guidelines), OJ [2011] C 11/1, para. 225.

been able to compete with the bigger market players,[1133] it is likely that the agreement in *Topco* would satisfy the conditions for horizontal exemption. However, it is important to note that the block exemption would not apply if it would be found that the agreement had as its object the allocation of markets or customers.[1134] Finally, it is worth noting that even if the agreement would not satisfy the conditions for the block exemption, it could still be individually exempted under Article 101(3) TFEU.

If the agreement would satisfy the conditions for the horizontal exemption, it would then need to be assessed with regards to its vertical aspects.[1135] If the annual turnover of the members of Topco would be less than a certain amount, the vertical agreements between Topco and its members as well as between Topco and its suppliers would be exempted by the Vertical BER.[1136] In this respect it is important that absolute territorial protection would most probably not be exempted, as this practice is blacklisted by the Vertical BER.[1137] However, here as well there would be at least a theoretical chance that the agreement would still be exempted individually, based on Article 101(3).

Taking all this into account, it would seem that *Topco*'s outcome in the EU would be the same as in the U.S., i.e. it would be condemned. However, the reasons for this would differ from those put forward by the U.S. Supreme Court. Unlike the U.S., where such an arrangement was condemned for being predominantly horizontal, in the EU it would most probably be struck based on the EU's strict approach to absolute territorial protection.

[1133] *See* Horizontal Guidelines, para. 237 ("A commercialisation agreement is normally not likely to give rise to competition concerns if it is objectively necessary to allow one party to enter a market it could not have entered individually or with a more limited number of parties than are effectively taking part in the co-operation, for example, because of the costs involved.").
[1134] Horizontal BER, Art. 4(c). *See also* Horizontal Guidelines, para. 236.
[1135] *See* EU Vertical Guidelines, para. 30.
[1136] *See* Vertical BER, para. 2(2) ("The exemption . . . shall apply to vertical agreements entered into between an association of undertakings and its members, or between such an association and its suppliers, only if all its members are retailers of goods and if no individual member of the association, together with its connected undertakings, has a total annual turnover exceeding EUR 50 million.").
[1137] Vertical BER, Art. 4(b).

With regards to this, it may be interesting to consider the situation where in a dispute before an American court a party would refer to the EU Horizontal BER in support of the claim that the allocation of exclusive territories through a joint venture should not be treated as illegal *per se*.

At the outset, it has to be taken into account that American judges are not always keen on adopting solutions from the laws of other nations.[1138] Similar sentiments are present in American legal theory. For example, Posner has argued against directly adopting laws of other countries.[1139] However, even he admits that sometimes solutions from other countries can be a good guidance for American judges – he talks of the laws of other countries as laboratories,[1140] making a parallel with the famous statement by Justice Brandeis about states being laboratories of democracy.[1141] Therefore, although American antitrust law started its development earlier and despite the fact that EU competition law has developed under significant influence from the U.S., perhaps there are solutions in EU competition law that the U.S. may consider adopting. In other words, the U.S. may use EU experiences as a "laboratory" referred to by Justice Brandeis.

On the other hand, EU competition law seems to be more prepared to adopt the solutions from the U.S. than it is the case the other way around. In this respect, consider the impact that *Leegin* had on the way in which EU competition law treats minimum RPM, a form of intrabrand restraint with effects largely similar to those of exclusive territories.[1142] Some authors have argued that in *Leegin* the Supreme Court aligned U.S. law with that of the EU, in the sense that American courts now allow arguments that a practice previously seen as

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[1138] *E.g.*, Roper v. Simmons, 543 U.S. 551, 624 (2005) (Scalia, J., dissenting) ("[T]he . . . premise . . . that American law should conform to the laws of the rest of the world . . . ought to be rejected out of hand [since] in many significant respects the laws of most other countries differ from our law.).
[1139] Richard Posner, *No Thanks, We Already Have Our Own Laws*, 2004-AUG LEGAL AFF. 40 (2004).
[1140] *Id.* at 42.
[1141] *See* New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").
[1142] *See supra* Part 2.2.4.

per se illegal is actually procompetitive.[1143] However, this argument seems problematic for at least two reasons.

First, although theoretically EU law does not preclude arguments for Article 101(3) exemption even with regards to the most pernicious restraints, it does not mean that such an exemption will be granted. Even though there have been instances where the Court exempted the use of resale price maintenance,[1144] that will generally not be the case, as EU competition law treats this type of restraint as a hardcore restriction.[1145] Additionally, the rule of reason in American law in large number of cases practically borders with *per se* legality. In other words, if a practice is judged by the rule of reason, chances are that the defendant will prevail. Therefore, the situation where EU competition law considers a certain practice as restricting competition by its object is still very much different from the rule of reason analysis in the U.S.

Secondly, when it comes to the rules concerning minimum RPM, it could rather be argued that EU law is following American developments than the other way around. A good way to assess this is to compare the new Vertical Guidelines with those from 2000. The old guidelines did not devote much attention to minimum RPM, as they considered that the practice is such that can rarely be exempted.[1146] Conversely, the new Vertical Guidelines (adopted after *Leegin*) have a separate section on minimum RPM, including examples of when this practice could be considered as procompetitive.[1147] In addition, the analysis in the Guidelines about the anticompetitive concerns and procompetitive justifications of minimum RPM to a great extent follows the Supreme Court's reasoning in *Leegin.*[1148] This shows that

[1143] WHISH, *supra* note 37, at 118-19.
[1144] *E.g.*, Case 243/83 *SA Binon & Cie v SA Agence et messageries de la presse* [1985] ECR 2015 (exempting RPM with regards to the distribution of newspapers).
[1145] *See* Vertical BER, Art. 4(a).
[1146] *See* Old Vertical Guidelines, para. 111.
[1147] EU Vertical Guidelines, paras. 223-25.
[1148] *Compare* EU Vertical Guidelines, para. 224 *with Leegin*, 551 U.S. at 892-93 (the anticompetitive concerns of minimum RPM); *compare* EU Vertical Guidelines, para. 225 *with Leegin*, 551 U.S. at 890-91 (the procompetitive potential of minimum RPM).

EU law is much more prepared to adopt American solutions than the other way around, although there may be parts of EU competition law which U.S. antitrust law could consider taking over.

4.6 Parallel trade and price discrimination

As shown in the discussion about *Consten-Grundig*, the ECJ considers a clause prohibiting parallel trade between Member States as a restriction of competition by object.[1149] What is more, not only explicit bans are prohibited, but also other practices that effectively amount to prohibition of exports.[1150] The EU's tough stance towards airtight exclusive territories seems to be mostly directed at preventing manufacturers from charging different price in different Member States. As shown, airtight excusive territories are an effective way of preventing the flow of goods from the weaker to the stronger market.[1151] By prohibiting absolute territorial protection, EU law is in effect aiming at impeding manufacturers' ability to prevent arbitrage. However, it is questionable whether such an approach is sound, either from the efficiency, or from the market integration perspective.

[1149] *See Consten-Grundig*. *See also* Case T-66/92 *Herlitz AG v Commission* [1994] ECR 531 (an export ban a violation by its object even if it was not implemented).

[1150] These practices include: excluding export sales from the system of bonuses granted to dealers (Case C-551/03 P *General Motors BV v Commission* [2006] ECR I-3173); the use of trademarks in order to hinder parallel trade (*Consten-Grundig*); curbing sales to buyers in other member states by preventing resale after the repackaging of the product (90/645/EEC *Bayer Dental* OJ [1990] L 351/46); an agreement by which the dealer undertakes to refer to the manufacturer all enquiries with regards to sales outside the contract territory (Case T-176/95 *Accinauto SA v Commission* [1999] ECR II-1635); a manufacturer's practice of buying back his products which had been exported to other member states through parallel channels (Case T-43/92 *Dunlop Slazenger International Ltd v Commission* [1994] ECR II-441); sending circulars to distributors prohibiting export (2002/758/EC *Mercedes-Benz* OJ [2002] L 257/1); charging higher prices when there goods are intended for export (Case 30/78 *Distillers Company Limited v Commission* [1980] ECR 2229); a guarantee scheme where a supplier restricts the guarantee to customers of his exclusive distributor (Case 31/85 *ETA Fabriques d'Ébauches v SA DK Investment and others* [1985] ECR 3933) (i.e., customers should be able to invoke the guarantee in all member states where the manufacturer has his distribution network;); however, a distributor may provide his customers a better guarantee than those offered by the manufacturer (Case 86/82 *Hasselblad (GB) Limited v Commission* [1984] ECR 883).

[1151] *See supra* Part 2.3.2.8. An exhaustive analysis about price discrimination in EU competition law is beyond the scope of this thesis. For this reason it is sufficient to note that in EU law price discrimination could be condemned under Article 101(1)(d) and 102 (c) TFEU. For some of the most important EU cases about geographical price discrimination, see: Case 27/76 *United Brands Company and United Brands Continentaal BV v Commission* [1978] ECR 207; Case C-333/94 P *Tetra Pak International SA v Commission* [1996] ECR I-5951. Both cases were brought under Article 102. In general, price discrimination in EU law is generally an Article 102 problem. Gifford & Kudrle, *supra* note 505, at 1273.

First, even if the price differential between Member States qualifies as price discrimination, in the theoretical chapter it has been shown that this practice does not necessarily have to be welfare-reducing: under certain conditions it could actually bring an increase in total welfare, if charging a uniform price would result in the weaker market not being served at all.[1152] As an example one could take a manufacturer who is marketing his products in two EU Member States, Germany and Bulgaria.[1153] If it were possible to prevent arbitrage by prohibiting parallel trade, the manufacturer would be able to maximize his profits by charging a lower price in Bulgaria and a higher price in Germany.[1154]

On the other hand, if the law prohibited airtight exclusive territories, the manufacturer would have to charge a uniform price for both markets, somewhere in between the two prices charged in the named countries.[1155] As a result, Bulgarian consumers would be worse off as the price they pay would increase, while German consumers would benefit from lower prices.[1156] This situation may enhance total welfare, but only if both markets continue to be served in the absence of price discrimination.[1157] However, if the Bulgarian market would not be able to bear the new price, the result would be that the Bulgarian market would not be served at all.[1158] Such an outcome hardly contributes to market integration, the alleged goal behind the prohibition of parallel imports.

Apart from efficiency, the question of fairness could be raised as well.[1159] Personal income in Germany is significantly higher than in Bulgaria. The prohibition of airtight exclusive territories would mean that the consumers in Bulgaria would be paying a higher price than it would be the case without the prohibition, while the consumers in Germany

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1152 *See supra* Part 2.3.2.8.
1153 *See* MOTTA, *supra* note 190, at 495-96 (using the example of Germany and Portugal).
1154 *See id.* at 495.
1155 *See id.* at 496.
1156 *See id.*
1157 *See id.*
1158 *See id.*
1159 *See* W. Bishop, *Price Discrimination under Article 86: Political Economy in the European Court*, THE MODERN LAW REVIEW, Vol. 44, No. 3 (May, 1981), pp. 282-295, at 282.

would be paying less. In other words, preventing arbitrage by excluding the possibility of having airtight exclusive territories could be seen as transferring income from the poorer consumers to the wealthier ones.[1160]

Due to these and related issues, some commentators have opined that a hard stance towards export bans may have actually brought less competition and less market integration than a more flexible approach would have.[1161] As a result of an outright condemnation of limiting parallel trade, firms may decide not to export at all, if they fear that commercial success will not materialize with an unprotected distributor.[1162] This would be to the detriment of both the competitive process and market integration.[1163] In the alternative, a firm may decide to vertically integrate and thereby avoid the application of 101(1). However, this does not seem as a sound solution, as it could favor vertical integration even if it would not be an optimal solution otherwise.[1164]

Finally, the tough stance towards airtight exclusive territories seems especially problematic with regards to smaller firms. As shown in the theoretical chapter, price discrimination could be profitable only for a manufacturer who possesses certain degree of market power.[1165] In this respect a strict approach towards restrictions of parallel trade seems to make even less economic sense when applied to firms lacking market power.[1166] For example, such an approach could effectively prevent smaller firms from boosting investment.[1167] This is especially the case if the firms do not qualify as SMEs, although the Commission may start proceedings even against such enterprises. In addition, the fact that the

[1160] *See* TIROLE, *supra* note 28, at 139 (by charging a uniform price the supplier effectively "robs Peter to pay Paul").
[1161] MONTI, *supra* note 45, at 41.
[1162] *Id.*
[1163] *Id.*
[1164] *See supra* Part 4.4.4; *infra* Part 5.3.2.
[1165] *See supra* Part 2.3.2.8.
[1166] *See* MOTTA, *supra* note 190, at 497-98.
[1167] *Id.* at 495.

law favors vertical integration could be especially harmful with regards to small firms, as they will generally find it more difficult to integrate than larger firms.[1168]

4.7 Assessment

Compared to the U.S., the EU has had a more stable approach towards the legality of exclusive territories. Right from the start EU competition law has recognized that this type of restraint is not inherently harmful and hence should not be prohibited outright. On the other hand, it also recognized the potential harmful effects of exclusive distribution, especially if the exclusive territories are airtight. Although some elements of this approach have varied over time, it has in the main remained the same. Taking into account the significant oscillations of the American law of vertical territorial restraints, during some periods the U.S. was closer to the desirable rule for exclusive territories while at other times it was the EU's approach that was more optimal.

In the early 1960s, when the law of vertical territorial restraints started developing on both sides of the Atlantic, it can be said that both the American law and that of the EU were neutral with regards to the proposed rule. As shown, the U.S. Supreme Court of that time acknowledged that it did not know much about vertical non-price restraints and fell short of shaping an antitrust policy regarding these restraints. On the other hand, the EU law of the time had a clearer position, as it exempted exclusive distribution agreements in some cases and condemned them in some other instances. However, this approach was not based on economic considerations, but on formal manifestations of an exclusive distribution agreement, including the issue of whether it contains a prohibition of parallel trade. What is more, it did not take into account the importance of interbrand competition, which right from the start makes an economic analysis of exclusive territories practically impossible. Therefore, neither the American nor the European approach of the early years could be

[1168] *See infra* Part 5.3.2.

compared with the proposed rule, as the rule is based on economic considerations and these laws were not.

On the other hand, during the *Schwinn* era it could be said that the European approach was more appropriate. Although both the U.S. Supreme Court and the ECJ of that time had a similar approach towards the significance of intrabrand competition, the consequences of this approach were different in the two jurisdictions. While in the U.S. all vertical territorial restraints were deemed as *per se* illegal, in the EU that was not the case. As shown, even with regards to absolute territorial protection, EU law offered a possibility of exemption, while in the U.S. vertical territorial restraints were condemned across the board. Therefore, although during the *Schwinn* era the European approach did not get much closer to an economic appraisal of the restraint at issue, at least it did not follow the extreme way taken by *Schwinn*. Consequently, it seems that in that period the EU law of exclusive distribution was more appropriate than its American counterpart.

The Supreme Court's decision in *Sylvania* turned things around – while the U.S. took the path of applying economic analysis to the legality of vertical non-price restraints, the EU law of the time remained trapped in its formalistic requirements for exemptions. As shown above, it took the EU more than two decades to reform its approach towards vertical restraints, bringing it closer to *Sylvania* and the desirable rule on exclusive territories. However, it needs to be noted that EU competition law adopted *Sylvania*'s legacy in a particular way. This approach can be said to have both negative and positive sides.

On the one hand, the EU failed to completely incorporate economic analysis into its rules on exclusive territories. The best example for this is the strict approach towards the prohibition of parallel trade: it was shown that EU law may condemn this conduct even when it is arguably efficient. In this respect the *Sylvania* approach seems more appropriate, as it to a greater extent reflects economic considerations expressed in the proposed rule for exclusive territories. Therefore, although the Commission has been creating certain exceptions with regards to situations in which it pursues airtight exclusive territories, it is submitted that its approach towards the restriction of parallel trade should be reexamined and brought more in line with economic considerations.

On the other hand, the approach that the EU has taken since 1999 deserves praise in that it has avoided the pitfalls that the lack of a structured rule of reason analysis brought in the U.S. The Commission's Guidelines on Vertical Restraints are an excellent way of giving structure to what otherwise would be a chaotic situation, where the enforcer would not know which factors to take into account when judging the legality of a restraint. In other words, the EU has succeeded in something that the U.S. has failed to do – it has managed to subject vertical territorial restraints to an economics-driven analysis without going as far as making the conduct virtually *per se* legal, thereby recognizing that the use of exclusive territories also has an anticompetitive potential.

Based on the above, it is submitted that the EU approach towards non-airtight exclusive distribution agreements is appropriate and comes close to the desired rule on exclusive distribution. On the other hand, the way EU law handles the legality of airtight exclusive distribution agreements is not apposite, and deserves to be reconsidered.

5 EXCLUSIVE DISTRIBUTION AND ANTITRUST ENFORCEMENT

The main aim of this chapter is to analyze the relevant antitrust enforcement mechanisms and how they have influenced the development of the substantive law of exclusive territories. To this end, the chapter first addresses public antitrust enforcement in the U.S. and the extent to which it has been influenced by politics and ideology. With regards to private enforcement, the chapter explores the significance of the treble damages remedy. The part dealing with the EU has a similar approach, focusing on the relevant aspects of public and private enforcement and the way in which they affect the law of exclusive territories. Finally, the chapter discusses the social cost of antitrust enforcement in the field of exclusive distribution.

5.1 Enforcement in the U.S.

5.1.1 Public enforcement

5.1.1.1 The Department of Justice

The most important body for the public enforcement of federal antitrust law is the Antitrust Division of the U.S. Department of Justice (hereinafter: the DoJ or the Division). The Division is part of the executive branch and is headed by the assistant attorney general for antitrust. The DoJ cannot itself impose penalties upon violators of antitrust laws. Rather, its role is limited to initiating criminal and civil actions in instances where it believes an infringement of antitrust laws has occurred.

Antitrust violations are a criminal offense in the U.S., entailing serious pecuniary penalties as well as incarceration.[1169] When providing for the possibility of criminal liability, the Sherman Act does not distinguish between the types of antitrust violations. This means

[1169] According to the Sherman Act, every person that violates Section 1 or Section 2 of the Act is to be punished "by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court." 15 U.S.C. §§ 1-2. In addition, American criminal law allows the court to assess even a greater fine than the one laid down in the Sherman Act. According to American law, "[i]f any person derives pecuniary gain from the offense, or if the offense results in pecuniary loss to a person other than the defendant, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless imposition of a fine under this subsection would unduly complicate or prolong the sentencing process." Criminal Fine Improvements Act of 1987, 101 Stat 1279, Section 6, 18 U.S.C. § 3571(d).

that in general even the use of exclusive territories could result in the DoJ bringing a criminal action against the alleged offender.[1170] However, this does not happen in practice – the Division criminally pursues only the most blatant cases of horizontal collusion.[1171] What is more, even during the period when it was actively challenging exclusive territories, the Division did not criminally pursue the alleged offenders.[1172]

Such an approach is understandable. First, the DoJ does not have the means to prosecute all types of antitrust violations, and in this light its orientation on the most pernicious practices seems reasonable. In addition, even if the DoJ was technically equipped to criminally pursue all antitrust violations, that would not be in accordance with the goals of enforcement and marginal deterrence.[1173] Basically, this would mean that if the law punished vertically imposed exclusive territories as severely as it punished horizontal collusion, individuals would have no incentive to abstain from entering into the latter, much more pernicious practices.

Apart from a criminal action, the DoJ can also bring a civil claim before a federal court[1174] and ask the court to prevent and restrain an alleged antitrust violation.[1175] For example, in *White Motor* and *Schwinn* the Division asked the competent courts to issue a

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[1170] *See* Nash v. U.S., 229 U.S. 373, 376-78 (1913) (criminal liability under the Sherman Act possible even for offenses assessed under the rule of reason).
[1171] U.S. Department of Justice, Antitrust Division Manual (Fourth Edition, Last Updated December 2008), at III-20 (http://www.justice.gov/atr/public/divisionmanual/atrdivman.pdf, accessed 17 May 2011).
[1172] In *General Motors*, the DoJ pursued the distribution arrangement criminally. However, from the government's point of view that was an instance of *horizontal* collusion among distributors. *See supra* Part 3.4.2.2.
[1173] *See* Herbert Hovenkamp, *Antitrust's protected classes*, 88 MICH. L. REV. 1, 3 (1989) ("Deterrence works because people find punishment unpleasant, and some kinds more unpleasant than others. Society will be better off if it can force violators to minimize the social costs of their violations, and violations are not equally costly. If both mugging and murder are punishable by death, the mugger has little incentive not to kill her victim. The punishment will be no greater, and the risk of apprehension and conviction will in fact be lower because an important witness will have been eliminated. On the other hand, if mugging is punishable by six months in prison and murder by death, the mugger must make a more difficult trade-off of the much higher penalty against the greater risk of apprehension and conviction."). *See also* David Friedman & William Sjostrom, *Hanged for a Sheep: The Economics of Marginal Deterrence*, THE JOURNAL OF LEGAL STUDIES, Vol. 22, No. 2 (Jun., 1993), pp. 345-366.
[1174] *See* Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 379 (1985) (federal antitrust claims within the exclusive jurisdiction of the federal courts).
[1175] Sherman Act Section 4, 15 U.S.C. § 4.

restraining order to the manufacturers imposing exclusive territories in order to prevent them from using such practices. In addition, if it was a purchaser of goods in connection with the antitrust violation, the federal government can sue the infringer for treble damages and the cost of suit.[1176] However, in the light of the direct purchaser rule, government suits for damages are not likely in the context of exclusive territories.[1177]

With regards to civil actions filed by the DoJ, most cases do no reach the trial stage but are settled between the parties.[1178] This is done by consent decrees entered into between the DoJ and the alleged violator of antitrust laws.[1179] Before entering a consent judgment based on the settlement, the court has to determine that the entry of such a judgment is in the public interest.[1180] Upon this determination, the settlement becomes binding. Of relevance for our discussion, there have been a number of consent degrees regarding the use of exclusive territories, especially in the period before *White Motor*.[1181]

In general, defendants are usually very interested in reaching a settlement with the DoJ. This is mainly due to the fact that these decrees are exempted from the rule that a final judgment rendered in a civil or criminal proceeding brought by the DoJ is considered as *prima facie* evidence in any subsequent action brought against the defendant by another party.[1182] In other words, private litigants can use the judgment in order to establish a *prima facie* case against the defendant in a civil damages suit. Taking into account the prospect of having to pay treble damages, the parties against whom the DoJ has started proceedings would be interested in entering a consent decree.

The Division has had an important historical role in shaping the law of exclusive territories, as it has brought some of the most important cases in the field. Most notably, it

[1176] Clayton Act Section 4(a), 15 U.S.C. § 15a.
[1177] *See infra* Part 5.1.2.2.3.
[1178] DOUGLAS BRODER, U.S. ANTITRUST LAW AND ENFORCEMENT 188 (2010).
[1179] Clayton Act Section 5, 15 U.S.C. § 16.
[1180] Clayton Act Section 5(e)(1), 15 U.S.C. § 16(e)(1).
[1181] *See supra* Part 3.2.1.
[1182] Clayton Act Section 5(a), 15 U.S.C. § 16(a).

initiated the actions against manufacturers imposing exclusive territories in *White Motor* and *Schwinn*. However, in the post-*Sylvania* period the Division has not been much active in challenging exclusive territories. This can be to a large part attributed to the views prevalent in the DoJ during the Republican administrations in the 1980s and later on.[1183]

As part of the executive, the DoJ is subject to the views on antitrust enforcement held by the incumbent administration. In this respect a tendency could be noticed that administrations headed by the Democratic Party seem to be for more vigorous enforcement than the Republican ones.[1184] A good example is Reagan's presidency, during which the Division practically stopped challenging vertical restraints. The approach prevalent in the administration of that time is probably best captured by this statement by William Baxter, then head of the Division: "[T]here is no such thing as a vertical 'problem' . . . The only possible adverse competitive consequences of vertical arrangements inhere in their horizontal effects. Only where vertical arrangements facilitate restricted output and raised prices- horizontal impacts - should they be inhibited."[1185]

In this light one should also consider the Vertical Restraints Guidelines that the DoJ issued in 1985.[1186] The guidelines had a lenient approach to what this paper consider as exclusive distribution agreements.[1187] The document regarded non-airtight territorial restrictions as basically *per se* legal,[1188] expressing some degree of concern only regarding

[1183] *See* HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 60 (2005) (the contraction of public antitrust enforcement since 1980 has a lot to do with a string of Republican presidencies).
[1184] *See* Richard A. Posner, *A statistical study of antitrust enforcement,* 13 J.L. & ECON. 365, 411-13 (1970).
[1185] According to: TIROLE, *supra* note 28, at 185.
[1186] 50 FR 6263-03 (1985). The legal significance of the DoJ Vertical Guidelines is twofold. First, they express DoJ views on the legality of a restraint, sending a signal when the DoJ can be expected to take action. Further, the courts treat government guidelines as some sort of source of law. *See* Spencer W. Waller, *Prosecution by regulation: the changing nature of antitrust enforcement*, 77 OR. L. REV. 1383, 1407 (1998).
[1187] *See* DoJ Vertical Guidelines at 6265 ("[V]ertical restraints that only affect intrabrand competition generally represent little anticompetitive threat and involve some form of economic integration between different levels of production or distribution that tend to create efficiencies."); *Id.* at 6269 ("Vertical restraints rarely have a significant anticompetitive effect.").
[1188] *See id.* at 6266 ("[Non-airtight vertical restraints, such as selective distribution, areas of primary responsibility, location clauses and profit passover arrangements] pose negligible anticompetitive risks and have significant potential to enhance efficiency, these Guidelines are not intended to cast doubt on the legality of these forms of vertical restraints and do not apply to them.").

the effect of airtight exclusive territories.[1189] The declared goal of the Guidelines was to state the DoJ's position towards non-price restraints in a simple and clear fashion.[1190] However, it is more likely that their aim was to actually change the law towards a more lenient approach towards vertical restraints.[1191] This is view is especially convincing taking into account that the DoJ had not challenged any form of vertical restraints for five years prior to the issuance of the Guidelines,[1192] nor did it start doing so after the Guidelines were issued.

At the beginning of the Clinton administration, the newly appointed head of the Division withdrew the DoJ Vertical Guidelines as too lenient.[1193] However, this did not result in any noticeable change in the Division's enforcement policy with regards to exclusive territories – even under a Democrat, the DoJ was not very active in pursuing this type of restraint.[1194] Following Clinton, the period between 2000 and 2008 was marked by another period of Republicans in the White House, meaning that vertical restraints were afforded minimal attention by the Division.[1195] Finally, with the election of Barack Obama in 2008 it might be expected that antitrust enforcement would become more vigorous. However, apart from issuing the new set of horizontal merger guidelines in 2010 (together with the FTC),[1196] so far there have been no clear signs that there will be a significant change in DoJ's enforcement practices.

Based on the above, it can be concluded that one's political views considerably influence the person's views regarding antitrust enforcement. In this respect the Chicago

[1189] *See id.*
[1190] *Id.* at 6263-64.
[1191] *See* NAAG Vertical Guidelines, Background Statement.
[1192] *Id.*
[1193] The Guidelines were withdrawn on 10 August 1993 by Anne Bingaman, then head of the Antitrust Division (http://www.justice.gov/atr/public/speeches/0867.htm, accessed 17 May 2011).
[1194] *See* HOVENKAMP, *supra* note 1183, at 60 (although Bill Clinton was a Democrat, he could be characterized as relatively conservative on antitrust matters).
[1195] *See* John D. Harkrider, *Antitrust enforcement during the Bush Administration - an econometric estimation*, 22-SUM ANTITRUST 43, 47 (2008) (showing that the DoJ was less active in challenging transactions during the Bush administration than it was the case during Clinton).
[1196] U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines of 19 August 2010 (http://ftc.gov/os/2010/08/100819hmg.pdf, accessed 17 May 2011).

School approach to vertical restraints can be connected with the Republican ideology: the school can be said to have become influential as pro-Chicago scholars became federal judges (Bork, Posner and Easterbrook) and Supreme Court Justices (Scalia and Thomas).[1197] All of them were appointed by Ronald Reagan, which shows that antitrust doctrine is to a large extent determined by ideology.[1198]

Be that as it may, the lack of DoJ efforts in challenging exclusive territories has had an important impact on the overall level of enforcement regarding this type of restraint. This is mainly connected with the costs arising out of antitrust litigation and the fact that following *Sylvania* exclusive territories are judged according to the rule of reason. Since the rule of reason can be a very expensive way of enforcement,[1199] in the absence of an action by the DoJ private plaintiffs have to be prepared to finance the suits themselves. And taking into account the manner in which the courts have been applying the *Sylvania* rule of reason,[1200] the plaintiff's probability of success in challenging exclusive territories is not that great. What is more, in the absence of DoJ actions private plaintiffs are left without the possibility of relying on judgments rendered in such actions as *prima facie* evidence in their own suits.

5.1.1.2 The Federal Trade Commission

The other main body for the public enforcement of American antitrust law is the Federal Trade Commission (FTC). Unlike the DoJ, which belongs to the executive branch, the FTC is an independent regulatory body created by Congress.[1201] The way in which the

[1197] MONTI, *supra* note 45, at 77.
[1198] *See* W. E. Kovacic, *The Influence of Economics on Antitrust Law*, 30 ECONOMIC INQUIRY 294, 296 (1992) ("[O]wing to the discretion conferred by the antitrust statutes, litigation outcomes in close cases will depend substantially upon the preferences of individual judges. A jurist's receptivity to specific economic arguments will hinge largely upon her tastes, training and experience. Thus, a president can determine how economics and particular economic views affect antitrust litigation by his choice of judicial nominees."). *See also* SANDRA MARCO COLINO, VERTICAL AGREEMENTS AND COMPETITION LAW 35-46 (2010) (discussing the influence of economic and political theory on the law of vertical restraints).
[1199] *See* HOVENKAMP, *supra* note 1183, at 105 (a rule of reason one of the most costly procedures in antitrust).
[1200] *See supra* Part 3.4.1.
[1201] The FTC consists of five commissioners, appointed by the President of the United States, by and with the advice and consent of the Senate. FTC Act Section 1, 15 U.S.C. § 41. Not more than three of the Commissioners

FTC enforces antitrust laws somewhat differs from the enforcement by the DoJ.[1202] Unlike the DoJ, the FTC has the power to issue cease and desist orders[1203] for what it considers as violations of the FTC Act.[1204] It can also seek civil penalties for violations of its orders[1205] as well as file suits for preliminary injunctions.[1206] Finally, it should be noted that FTC orders are subject to judicial review by federal courts.[1207] Therefore, in this case also the court has the final word in assessing the legality of an exclusive territories arrangement.

The FTC's authority over the enforcement of American antitrust law largely overlaps with that of the DoJ. Technically speaking, only the DoJ has authority to enforce the Sherman Act.[1208] However, in practice the FTC has such power as well, since the Supreme Court has interpreted Section 5 of the FTC Act[1209] as encompassing all conduct that could fall under the Sherman Act.[1210] Of most relevance for our discussion, the FTC also has power to challenge the use of exclusive territories.

The FTC started challenging exclusive territories at approximately the same time as the DoJ[1211] and has continued doing so even in the post-*Sylvania* period.[1212] However,

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can come from the same political party. *Id.* Another tool for ensuring the independence of the FTC is the Commissioners' relatively long mandate – they are elected for the term of seven years. *Id.*

[1202] *See* BRODER, *supra* note 1178, at 192-94 (providing an overview of FTC enforcement procedures).

[1203] Cease-and-desist-order is "a court's or agency's order prohibiting a person from continuing a particular course of conduct." BLACK'S LAW DICTIONARY, *supra* note 874, at 237.

[1204] FTC Act Section 5(b), 15 U.S.C § 45(b).

[1205] FTC Act Section 5(l), 15 U.S.C § 45(l).

[1206] FTC Act Section 13(b), 15 U.S.C § 53(b). Preliminary injunction is "a temporary injunction issued before or during trial to prevent an irreparable injury from occurring before the court has a chance to decide the case." BLACK'S LAW DICTIONARY, *supra* note 874, at 800.

[1207] A party seeking review should do so within sixty days from when the order was issued. FTC Act Section 5(c), 15 U.S.C. § 45(c).

[1208] HOVENKAMP, *supra* note 29, at 592.

[1209] 15 USC § 45(a)(1) (declaring unlawful all "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.").

[1210] *See* FTC v. Cement Institute, 333 U.S. 683, 694 (1948) ("[A]ll conduct violative of the Sherman Act may likewise come within the unfair trade practice prohibitions of the Trade Commission Act.").

[1211] *See e.g.*, *In re* Snap-On Tools, 59 F.T.C. 1035 (1961).

[1212] *See, e.g.*, *In re* The Coca-Cola Co., 91 F.T.C. 517 (1978); *In re* Brunswick Corp., 94 F.T.C. 1174 (1979); *In re* Beltone Electronics Corp., 100 F.T.C. 68 (1982); *In re* Lenox, Inc., 1988 WL 1025446 (1988); *In re* Adolph Coors Co., 112 F.T.C. 191 (1989); *In re* the Coca Cola Co., 1990 WL 606319 (1990); *In re* The Coca-Cola Bottling Company of the Southwest, 1991 WL 639922 (1991); *In re* The Coca-Cola Co., 117 F.T.C. 795 (1994); *In re* The Coca-Cola Bottling Company of the Southwest, 118 F.T.C. 452 (1994); *In re* Toys R Us, Inc., 126 F.T.C. 415 (1998).

although the FTC is generally seen as having stricter enforcement policies than the DoJ,[1213] it would seem that today the FTC does not concern itself much with exclusive territories.[1214] Perhaps the main reason for this is the lenient approach that the courts have shown towards exclusive territories – regardless of the FTC's stance, the courts have the last word when it comes to determining the legality of exclusive territories.

5.1.1.3 State Attorneys General

Apart from having authority when it comes to the enforcement of state antitrust laws, state attorneys general also play a role in the enforcement of the federal antitrust laws.[1215] This role is most conspicuous when it comes to *parens patriae* suits. These suits could be described as a specific type of class actions that state attorney generals bring on behalf of the citizens of their state.[1216] If successful, the state can obtain monetary relief threefold the total damage sustained as well as the cost of suit.[1217] Once the court grants monetary relief, it could either distribute the relief in a manner it finds suitable or deposit it with the state's treasury.[1218] On the other hand, a prevailing defendant may obtain a reasonable attorney's fee, if the court finds that the state brought the suit in bad faith.[1219] *Parens patriae* suits are rarely brought, in general and in the context of exclusive territories.[1220] Nevertheless, there have been instances where state attorney generals have used their powers in order to challenge exclusive distribution arrangements.[1221]

[1213] *See* Harkrider, *supra* note 1195, at 47 (a study regarding public enforcement during the Clinton and Bush administrations showing that during both administrations the FTC was more likely to challenge a transaction than the DoJ).
[1214] It seems that the last reported FTC action regarding the imposition of exclusive territories was brought in 1998. *See In re* Toys R Us, Inc., 126 F.T.C. 415 (1998). *See also* Robert Pitofsky, *Past, present, and future of antitrust enforcement at the Federal Trade Commission*, 72 U. CHI. L. REV. 209, 213 (2005) (praising the FTC's modest role in challenging purely vertical arrangements that lack significant horizontal effect).
[1215] *See, e.g.*, California v. American Stores Co., 495 U.S. 271 (1990).
[1216] Clayton Act Section 4c(a)(1), 15 U.S.C. § 15c(a)(1).
[1217] Clayton Act Section 4c(a)(2), 15 U.S.C. § 15c(a)(2).
[1218] Clayton Act Section 4e, 15 U.S.C. § 15e.
[1219] Clayton Act Section 4c (d)(2), 15 U.S.C. § 15c (d)(2).
[1220] ELHAUGE & GERADIN, *supra* note 227, at 9.
[1221] *See, e.g.*, State of N.Y. by Abrams v. Anheuser-Busch, Inc., 811 F.Supp. 848 (1993).

With regards to state attorney generals, it is also important mention the National Association of Attorneys General (NAAG). This body coordinates the work of state attorneys general, *inter alia* in the area of antitrust. Related to our discussion, it is interesting that the NAAG considers exclusive territories and vertical restraints in general as more pernicious than the DoJ does. This conclusion can be made by taking into account the Vertical Restraint Guidelines adopted by the NAAG in 1995.[1222]

Compared to the withdrawn DoJ guidelines, this document is more aggressive towards vertical restraints. For example, the guidelines express certain reservations towards the use of the free-rider argument in the context of vertical restraints, noting that "[t]he free-ride phenomenon is much disputed among theorists, especially with regard to certain products for which servicing or product enhancement is highly unlikely."[1223] Therefore, even though the impact of this document is limited, the views of the NAAG hint a potentially more active approach towards exclusive territories.

5.1.2 Private enforcement

5.1.2.1 Exclusive territories and treble damages

One of the main characteristics of American antitrust is a high level of private enforcement. According to recent statistics, private antitrust suits outnumber those brought by the government by more than 16 to 1.[1224] The most important reason behind so widespread recourse to private antitrust litigation is the prospect of receiving treble damages[1225] and the

[1222] National Association of Attorneys General, Vertical Restraints Guidelines of 1995 (http://www.naag.org/assets/files/pdf/at-vrest_guidelines.pdf, accessed 17 May 2011).
[1223] NAAG Vertical Guidelines, Section 3.2B.
[1224] *See* Princeton Economics Group, Inc. website (http://econgroup.com/peg_news_view.asp?newid=40&latest=true, accessed 17 May 2011) (in 2009 there were 792 private antitrust cases filed in U.S. district courts, as opposed to 49 cases filed by the DoJ).
[1225] In addition to damages, private plaintiffs can also ask for injunctive relief. According to Clayton Act Section 16, "[a]ny person, firm, corporation, or association shall be entitled to sue for and have injunctive relief … against threatened loss or damage by a violation of the antitrust laws." 15 U.S.C. § 26. However, the prospect of treble damages is certainly more tempting that an injunctive relief.

cost of suit.[1226] Although not as significant as the award of treble damages, another provision fueling private antitrust suits is the one according to which prior convictions in government suits could be used as *prima facie* evidence in subsequent private litigation.[1227]

The purpose behind the award of treble damages is to encourage private antitrust enforcement[1228] by creating "private attorneys general".[1229] In other words, the goal is not only to compensate the victims of antitrust violations for their injuries,[1230] but also to deter potential antitrust infringers.[1231] On the one hand, the provision of treble damages could be seen in a positive light, as a way of facilitating detection and suppression of antitrust violations. By giving an incentive for private actions against alleged antitrust offenders, the state is sharing the burden of antitrust enforcement with private parties. However, the existence of treble damages is also connected with certain problems, some of which are especially pronounced in the context of exclusive territories.

The first set of problems has to do with the fact that the existence of treble damages may give private plaintiffs perverse incentives for litigation[1232] and lead to larger-than-

[1226] *See* 15 U.S.C. § 15 (a). In the U.S. the general rule is that each party bears its own costs, regardless of the outcome of the litigation. *See* Charles Price & Yves Stans, *Using Costs as a Case Management Tool in International Arbitration*, ASA Bulletin, Volume 25 Issue 4 (2007), pp. 704-716, at 707. Note, however, that the provision about the recovery of the cost of suit allows only successful plaintiffs to recover; successful defendants could benefit from this provision only if the suit was frivolous. *See* Edward Cavanagh, *Antitrust remedies revisited*, 4 OR. L. REV. 147, 153 (2005).

[1227] *See* Clayton Act Section 5 (a), 15 U.S.C. § 16(a). Although this provision probably contributes to some increase in private antitrust litigation, its impact seems to be limited. This conclusion could be drawn by analyzing the ratio between independent and follow-up suits. For example, between 1978 and 1983 independently initiated cases constituted 94.1 % and follow-up suits only 5.9 % of private antitrust cases. Thomas E. Kauper & Edward A. Snyder, *An Inquiry into the Efficiency of Private Antitrust Enforcement: Follow-on and Independently Initiated Cases Compared,* 74 GEO. L. J. 1163, 1176 (1986). The significance of private suits is even greater with regards to exclusive territories, taking into account the DoJ's lack of interest in pursuing this type of restraint.

[1228] *See* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 130-31 (1969) ("[T]he purpose of giving private parties treble-damage and injunctive remedies was not merely to provide private relief, but was to serve as well the high purpose of enforcing the antitrust laws.").

[1229] *See* Hawaii v. Standard Oil Co. of Cal., 405 U.S. 251, 262 (1972) ("By offering potential litigants the prospect of a recovery in three times the amount of their damages, Congress encouraged these persons to serve as 'private attorneys general.'").

[1230] *See* Pfizer, Inc. v. Government of India, 434 U.S. 308, 314 (1978).

[1231] *See* Texas Industries, Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 639 (1981) ("The very idea of treble damages reveals an intent to punish past, and to deter future, unlawful conduct.").

[1232] This would happen because with the prospect of treble damages a party's incentives to avoid losses arising out of an antitrust injury are reduced. William Breit & Kenneth G. Elzinga, *Antitrust Enforcement and* optimal number of private antitrust suits.[1233] The prospect of treble damages and attorney's fees may encourage litigation in cases where the amount of recovery discounted by the probability of success would otherwise be marginal.[1234] The more enforcement there is, the more likely it is that the enforcement will aim at a conduct the effects of which could not be properly assessed by the court.[1235] In the presence of a damages multiplier and the provision of attorney's fees, the enforcers will attempt to reach increasingly marginal activity whose social costs are more ambiguous.[1236]

Exclusive territories seem to be this kind of marginal conduct. As shown above, this type of restraint has both procompetitive and anticompetitive aspects, and it is not always easy to measure in a particular case which of the two prevails. And even if an exclusive distribution arrangement were to be on balance anticompetitive, it is doubtful that it would deserve to be punished by treble damages. Perhaps this is one of the main reasons why in the wake of *Sylvania* American courts have been so lenient towards exclusive territories – if they would find the arrangement illegal, the award of treble damages would mean that the violator would be punished more severely than the alleged offense deserves. In other words, the American courts may be calibrating their approach to exclusive territories based on the assumption that the threefold amount of damages is overly excessive for this type of restraint.[1237]

Economic Efficiency: The Uneasy Case for Treble Damages, JOURNAL OF LAW AND ECONOMICS, Vol. 17, No. 2 (Oct., 1974), pp. 329-356, at 335. The possibility of receiving more than the actual amount of damages may also give an incentive to an individual to intentionally suffer damages in order to collect the treble amount. *Id.*

[1233] *See, e.g.*, POSNER, *supra* note 80, at 35 (criticizing a surge in private antitrust actions and expressing concern about the overexpansion of antirust laws).

[1234] HOVENKAMP, *supra* note 29, at 603. Consequently, plaintiffs will try to turn every claimed business tort or contract breach into an antitrust violation as well. *Id.* at 604.

[1235] *Id.* at 655.

[1236] *Id.* at 654.

[1237] *See* Stephen Calkins, *Summary judgment, motions to dismiss, and other examples of equilibrating tendencies in the antitrust system*, 74 GEO. L.J. 1065, 1094 (1986) ("The treble damages remedy currently seems to be limiting the breadth of antitrust law's condemnation of certain vertical restraints."). Related to this, some authors have noticed a general tendency in the Roberts Court decisions towards making it more difficult for private claimants to bring antitrust actions. Okeoghene Odudu, *Developing private enforcement in the EU: Lessons from the Roberts Court*, 53 ANTITRUST BULL. 873, 874 (2008). *See, e.g.*, Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 412 (2004) (private antitrust enforcement not desirable

The award of treble damages in cases concerning exclusive territories does not seem justified for another reason. One of the principal justifications for multiple damages is that they are appropriate for situations where the chances that the defendant will be caught are small.[1238] This means that treble damages seem suitable only for secret violations of antitrust law, such as cartels.[1239] However, exclusive distribution agreements do not belong to this group – there the victim i.e. potential plaintiff is usually a party to the agreement in which the offense was contained.[1240] Consequently, single damages seem to be more appropriate for violations arising out of exclusive territories and the aftermath of *Sylvania* should also be viewed from this perspective.

Another set of problems relates not only to treble damages in the context of exclusive territories, but in general. More precisely, a foreign court may refuse to enforce a judgment awarding treble damages on the grounds that these damages are of punitive nature. This invites a discussion about punitive damages, their relationship with treble damages, and the possible implications of this relationship.

Punitive damages are damages awarded in addition to actual damages, with the purpose of punishing and deterring blameworthy conduct.[1241] Apart from the U.S. and some other common law countries, not many jurisdictions recognize punitive damages in civil actions.[1242] According to the English High Court, the only EU Member States recognizing

in regulated industries); Credit Suisse Securities (USA) LLC v. Billing, 551 U.S. 264, 281 (2007) ("antitrust plaintiffs may bring lawsuits throughout the Nation in dozens of different courts with different nonexpert judges and different nonexpert juries. In light of the nuanced nature of the evidentiary evaluations necessary to separate the permissible from the impermissible, it will prove difficult for those many different courts to reach consistent results"); Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007) (toughening the standard which an allegation of an antitrust conspiracy has to satisfy in order to pass the summary stage).

[1238] HOVENKAMP, *supra* note 29, at 667.

[1239] *Id.* at 667. A study has shown that the probability of detection of a price-fixing cartel is between 13 and 17 percent. Peter G. Bryant & E. Woodrow Eckard, *Price Fixing: The Probability of Getting Caught*, THE REVIEW OF ECONOMICS AND STATISTICS, Vol. 73, No. 3 (Aug., 1991), pp. 531-536, at 535.

[1240] *See* HOVENKAMP, *supra* note 29, at 667.

[1241] BLACK'S LAW DICTIONARY, *supra* note 874, at 418-19. *See also* Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 25-27 (1991) (Scalia, J., concurring) (giving an historical overview of the institute of punitive damages).

[1242] *See* John Y. Gotanda, *Punitive damages: a comparative analysis*, 42 COLUM. J. TRANSNAT'L L. 391, 396-98 (2004).

punitive damages are England and Wales, Cyprus, and Ireland.[1243] What is more, some Member States consider such damages contrary to their public policy and refuse to enforce foreign decisions awarding them.[1244] In this respect especially worth considering is the approach taken by Germany.

In a decision from 1992, the highest German court ruled that punitive damages are not in accordance with the German public policy and refused to enforce an American court decision granting such damages.[1245] The court emphasized that German law entitles plaintiffs to compensation for damage arising out of a tort, and that a plaintiff cannot be enriched beyond this compensation.[1246] The role of damages in German law is compensation and not punishment or deterrence – the latter belong to the realm of criminal law.[1247] Taking this into account, it could be debatable whether the arguments against recognizing the award of punitive damages would also apply to treble damages.

In a sense, by awarding more than the single amount of damages, all treble damages are necessarily punitive. However, these two types of damages also differ in at least one important aspect. On the one hand, the damage multiplier in treble damages is by definition set. On the other hand, one of the biggest problems with punitive damages, at least in the U.S.

[1243] [England] Devenish Nutrition Ltd v Sanofi-Aventis SA, 19 October 2007, [2008] E.C.C. 4, para. 33.

[1244] This is also the case with some jurisdictions outside the EU. *See, e.g.*, Nicolas C. Ulmer & Martin Bernet, *Recognition and Enforcement in Switzerland of US Judgments Containing an Award of Punitive Damages*, 22 INTERNATIONAL BUSSINESS LAWYER 272 (1994) (discussing the situation in Switzerland).

[1245] [Germany] Case IX ZR 149/91, Bundesgerichtshof [BGH] [Federal Court of Justice, Civil Division] Jun. 4, 1992, 118 Bundesgerichtshofes in Zivilsachen [BGHZ] 312. English translation available in: Gerhard Wegen & James Sherer, *Germany: Federal Court of Justice Decision Concerning The Recognition and Enforcement of U.S. Judgment Awarding Punitive Damages*, 32 I.L.M. 1320 (1993). According to the German court, "[a] US judgment awarding lump sum punitive damages of a not inconsiderable amount in addition to an award for damages for material and non-material injury cannot, as a rule, be held to be enforceable in Germany." Wegen & Sherer at 1336. For a discussion about this case, see also Peter Hay, *The Recognition and Enforcement of American Money-Judgments in Germany - The 1992 Decision of the German Supreme Court*, 40 AM. J. COMP. L. 729 (1992).

[1246] Wegen & Sherer, *supra* note 1245, at 1322. In Germany, claims for punitive damages could even be seen as violating a defendant's constitutional rights. *See* Wolfgang Wurmnest, *Recognition and enforcement of U.S. money judgments in Germany*, 23 BERKELEY J. INT'L L. 175, 177 (2005).

[1247] Hay, *supra* note 1245, at 746.

system, is precisely the fact they are generally open-ended.[1248] Connected to this, at least one circuit in the U.S. has held that treble damages should not be considered as punitive.[1249] The situation in Germany would seem to be different, at least taking into account the case at hand.

Based on the German court's reasoning, it seems that it would also consider treble damages as being punitive in nature. In the relevant part, the German court noted that if a plaintiff was entitled to an amount exceeding the damage suffered, it would mean that he would be acting as a "private public prosecutor" and infringe the German state's monopoly on punishment.[1250] This reasoning is very interesting from the perspective of treble damages, since the Supreme Court of the United States has praised such damages exactly because they encourage individuals to act as private attorney generals.[1251] Based on this, it would seem that the German court would also refuse to enforce the award of treble damages.[1252]

A hostile approach towards punitive damages is also present in some other EU Member States. With regards to this, the outcome reached in Germany would seem to be the same in countries such as Italy[1253] and France.[1254] On the other hand, some other Member States have exhibited a less antagonistic approach to punitive damages, and thereby arguably also to treble damages In this respect it is important to note that in countries such as

[1248] *But see* BMW of North America, Inc. v. Gore, 517 U.S. 559 (1996)(laying down factors for ascertaining when punitive damages could be regarded as punitive); State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003) (an award that exceeds a single-digit ratio between punitive and compensatory damages may violated due process).
[1249] *See* Investment Partners, L.P. v. Glamour Shots Licensing, Inc., 298 F.3d 314, 317 (5th Cir. 2002) ("the prohibition in the parties' arbitration agreement against awarding "punitive damages" does not extend to statutory treble damages."). *See also* PacifiCare Health Systems, Inc. v. Book, 538 U.S. 401, 406-07 (2003) (leaving to the arbitrators the decision about whether statutory treble damges should be considered as punitive).
[1250] 32 I.L.M. 1320 at 1322.
[1251] *Compare with* Hawaii v. Standard Oil Co. of Cal., 405 U.S. 251, 262 (1972) ("By offering potential litigants the prospect of a recovery in three times the amount of their damages, Congress encouraged these persons to serve as 'private attorneys general.'").
[1252] It seems that the result would be the same in Italy. Komninos mentions a recent Italian decision [Corte di Cassazione, 19 Jan 2007, no 1183, Judy Parrott v Fimez SpA.] that refused to enforce an award of damages considered punitive. ASSIMAKIS P KOMNINOS, EC PRIVATE ANTITRUST ENFORCEMENT 212 n.442 (2008).
[1253] *See* Lucia Ostoni, *Italian rejection of punitive damages in a U.S. judgment*, 24 J.L. & COM. 245, 245 (2005).
[1254] *See* John Y. Gotanda, *Charting developments concerning punitive damages: it the tide changing?*, 45 COLUM. J. TRANSNAT'L L. 507, 517 (2007).

Greece[1255] and Spain[1256] there have been instances where the enforcement of a foreign judgment awarding punitive damages was not refused. Consequently, a similar outcome may be possible with regards to statutory treble damages.

Related to the relationship between punitive and treble damages, it is interesting to consider England (i.e. the UK). More precisely, English courts would refuse to enforce a U.S. judgment awarding treble damages, although this country is considered as the place where the American concept of punitive damages originates from. This is due to the fact that England has a statute aimed precisely at preventing the enforcement of foreign judgments granting damages based on damages multipliers,[1257] and treble antitrust damages prescribed by the Clayton Act are exactly of that type. Therefore, the award of treble damages, in the context of exclusive territories and in general, may be coupled with significant enforcement problems.

5.1.2.2 The elements of damages actions

5.1.2.2.1 Causation

In order to prevail in a private antitrust suit, a plaintiff needs to establish the existence of certain elements. The first such element is causation, i.e. plaintiff needs to show that the link between an unlawful conduct and his injury is sufficiently direct. Applied to exclusive distribution, in order to collect damages arising out of the defendant's use of exclusive territories, the plaintiff needs to establish a causal link between the alleged illegal exclusive distribution arrangement and the his injury.[1258] For establishing causation, the plaintiff needs to show that but for the violation the probability or extent of its injury would have been

[1255] *See* KOMNINOS, supra *note* 1252, at 212 n.443.
[1256] Gotanda, *supra* note 1254, at 521.
[1257] *See* [UK] Protection of Trading Interests Act of 1980, section 5(3) (refusing enforcement for "a judgment for multiple damages means a judgment for an amount arrived at by doubling, trebling or otherwise multiplying a sum assessed as compensation for the loss or damage sustained by the person in whose favour the judgment is given.").
[1258] ELHAUGE & GERADIN, *supra* note 227, at 9.

significantly lower.[1259] Related to this it should be noted that the violation does not necessarily have to be more than 50% responsible for the probability or extent of injury.[1260]

5.1.2.2.2 Antitrust injury

Once causation has been established, the plaintiff needs to show that the injury flowed from the *anticompetitive* effects of the violation.[1261] In other words, he needs to establish that the injury suffered was actually an antitrust injury. According to the Supreme Court, antitrust injury is a type of injury the antitrust laws were intended to prevent.[1262] What this actually means is that a plaintiff cannot recover for an injury arising out of a conduct which is actually procompetitive, even if it caused the plaintiff to suffer damages.[1263]

In the context of exclusive territories, this element means that the mere fact that the plaintiff suffered losses due to the defendant's use of exclusive territories is not sufficient for a successful antitrust suit. The use of exclusive territories can enable a manufacturer to improve efficiency and strengthen his market position, which in turn would hurt his competitors. However, this is not sufficient for establishing that an antitrust violation has occurred – what matters is not whether competitors were harmed, but whether there was a harm to the competitive process.

5.1.2.2.3 Standing

The deployment of exclusive territories can potentially inflict damages upon a large number of subjects. On the one hand, through higher than competitive prices it can cause harm to consumers. On the other, it can also harm other parts of the distribution chain, namely wholesalers and retailers. For this reason an important issue is which categories of plaintiffs can have standing in antitrust suits.

1259 *Id.* at 9-10.
1260 *Id.* at 10.
1261 *Id.* at 9.
1262 Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977).
1263 *See* Brown Shoe Co. v. U.S., 370 U.S. 294, 320 (1962) ("[T]he legislative history [of the Clayton Act] illuminates congressional concern with the protection of competition, not competitors.").

The law on the issue can be summarized as follows: a direct purchaser (i.e. generally a distributor who directly dealt with the manufacturer imposing exclusive territories) has standing to sue for the full amount of the overcharge, even if he had passed the overcharge and thus avoided any economic damage;[1264] indirect purchasers (i.e. distributors not dealing directly with the manufacturer, and consumers) do not have standing to sue even if they absorbed the overcharge and actually suffered economic harm;[1265] however, federal antitrust law does not preempt state antitrust laws that allow suits by indirect purchasers.[1266] Therefore, if a manufacturer imposes exclusive territories and as a result consumers and distributors suffer harm in the form of an overcharge, only the distributors could recover damages, and only taken that they directly dealt with the manufacturer. On the other hand, if the injury occurs in a state that allows suits by indirect purchasers, consumers and distributors not dealing directly with the manufacturer may be able to recover as well.

Although there have been cases where the plaintiff has sought damages arising out exclusive territories claiming this type of overcharge,[1267] the bulk of cases involving exclusive territories are suits by disgruntled distributors. A plaintiff will often allege that he was terminated because he did not want to comply with an illegal territorial restraint[1268] and seek the recovery of lost profits arising out of the termination of the distributorship.[1269]

[1264] Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).
[1265] Illinois Brick Co. v. Illinois, 431 U.S. 720, 735 (1977).
[1266] California v. ARC America Corp., 490 U.S. 93, 101 (1989). *See also* Kansas v. UtiliCorp United, Inc., 497 U.S. 199 (1990) (confirming that states can adopt *Illinois Brick* repealer statutes). A number of states have adopted statutes allowing indirect purchasers to sue, which as a result brings the problem of complexity and potential forum shopping. Crane, *supra* note 575, at 14.
[1267] *E.g.*, Package Shop, Inc. v. Anheuser-Busch, Inc., 1984 U.S. Dist. LEXIS 24942 (1984).
[1268] HOVENKAMP, *supra* note 29, at 687.
[1269] See for example *Eiberger*, *Michelin*, *Davis-Watkins*, *JBL Enterprises*, and *Graphic Products*, described in Part 3.4.1.2 above. According to a study that did not concentrate solely on exclusive territories, one third of private plaintiffs in antitrust suits initiated between 1973 and 1983 were defendants' competitors, around 30 percent were dealers or distributors, and less than 20 percent represented what we could characterize as consumers. Lawrence J. White, *The Georgetown Study of Private Antitrust Litigation*, 54 ANTITRUST L.J. 59, 62 (1985). In the context of exclusive territories the most likely plaintiffs are terminated distributors: consumers generally cannot sue due to the indirect purchase rule, while competitors could have difficulties in satisfying other elements of a damages action.

Since exclusive territories could cause harm to a wide range of subjects, those that suffer harm could try to recover through a class action suit. Class actions are actions in which one or more class representatives are formally joined as parties in the case.[1270] Such actions seem to be particularly suitable for antitrust recovery, for the following reasons. First, antitrust violations can potentially have many more victims than an ordinary contract breach or tort.[1271] In addition, antitrust seeks to protect competition in the market as a whole and not individual firms, which means that a number of issues that need to be resolved in antitrust litigation are common to any class of persons in that market.[1272] It seems this is exactly the kind of situation the class action was created for in the first place – to provide an efficient method of litigation where there is a large class of plaintiffs or defendants with similar claims i.e. defenses.[1273] Although class actions are not common in cases involving the use of exclusive territories, there have been instances where they have been brought in this context.[1274]

5.1.2.2.4 The amount of damages

Apart from establishing causation and standing, the plaintiff also needs to ascertain the amount of damages he suffered. The standard of proof with regards to this is not as strict as it is for establishing that the injury has occurred at all.[1275] According to the Supreme Court, "while the damages may not be determined by mere speculation or guess, it will be enough if evidence shows the extent of the damages as a matter of just and reasonable inference,

[1270] RICHARD D. FREER & WENDY COLLINS PERDUE, CIVIL PROCEDURE 808 (2001). Even in cases where private class actions cannot be certified in accordance with Rule 23 of the Federal Rules of Civil Procedure, states can still bring parens patriae actions on behalf of their residents. Clayton Act Section 4c, 15 U.S.C. § 15c. For a discussion about class actions, see generally: FREER & PERDUE at 808-34. *See also* RACHEL MULHERON, THE CLASS ACTION IN COMMON LAW LEGAL SYSTEMS: A COMPARATIVE PERSPECTIVE (2004); DEBORAH R. HENSLER, NICHOLAS M. PACE, BONNIE DOMBEY-MOORE, ELIZABETH GIDDENS, JENNIFER GROSS & ERIK MOLLER, CLASS ACTION DILEMMAS - PURSUING PUBLIC GOALS FOR PRIVATE GAIN (2000).
[1271] HOVENKAMP, *supra* note 1183, at 59.
[1272] ELHAUGE & GERADIN, *supra* note 227, at 23.
[1273] BRODER, *supra* note 1178, at 200.
[1274] *See, e.g.*, Package Shop, Inc. v. Anheuser-Busch, Inc., 1984 U.S. Dist. LEXIS 24942 (1984).
[1275] *See* Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 562 (1931) ("[T]here is a clear distinction between the measure of proof necessary to establish the fact that petitioner had sustained some damage and the measure of proof necessary to enable the jury to fix the amount.").

although the result be only approximate."[1276] The basic principle of awarding antitrust damages is that the plaintiff should be put in a position, notwithstanding trebling, that it would have been in had the anticompetitive conduct not occurred.[1277]

In the post-*Sylvania* period there seem to have been only two reported cases where the court got to the stage of assessing the amount of antitrust damages connected with the use of exclusive territories.[1278] Based on these two cases it would seem that a plaintiff distributor may recover two types of damages. First, he may recover the loss of profits on lost sales arising out of the dealership termination.[1279] In this respect the court compares the profit from actual sales and the anticipated profit from sales which would have occurred without the termination.[1280] In addition, the plaintiff distributor may recover in the amount of reduction in the value of his business as a going concern.[1281] Here the court compares the actual value of the plaintiff's business with the value that the business would have had without the termination.[1282] Once the court establishes these two types of damages, it then trebles the amount.

5.1.2.3 In pari delicto and enforceability

An important issue regarding illegal exclusive distribution agreements is the extent to which such agreements remain enforceable. At common law, contracts in restraint of trade were unenforceable.[1283] This rule was based on the *in pari delicto* (in equal fault) principle, according to which a plaintiff who has participated in a wrongdoing may not recover damages resulting from the wrongdoing.[1284] The *in pari delicto* defense seems to be based on two premises: that courts should not engage in mediating disputes among wrongdoers and

[1276] *Id.* at 563.
[1277] HOVENKAMP, *supra* note 29, at 680.
[1278] *Eiberger* and *Graphic Products*.
[1279] *Eiberger*, 459 F.Supp. at 1285; *Graphic Products*, 717 F.2d at 1579.
[1280] *Eiberger*, 459 F.Supp. at 1286.
[1281] *Eiberger*, 459 F.Supp. at 1288; *Graphic Products*, 717 F.2d at 1579.
[1282] *Eiberger*, 459 F.Supp. at 1288-89; *Graphic Products*, 717 F.2d at 1579-82.
[1283] HOVENKAMP, *supra* note 29, at 623.
[1284] BLACK'S LAW DICTIONARY, *supra* note 874, at 806. *See also* Austin's Adm'x v. Winston's Ex'x, 1 Hen. & M. 33, 12 (1806) ("[H]e who comes here for relief, must draw his justice from pure fountains.").

that denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality.[1285]

Although the *in pari delicto* principle has survived until the present day, in antitrust cases it is not that strictly applied. In this respect, consider the Supreme Court's decision in *Perma Life Mufflers, Inc. v. International Parts Corp*.[1286] The case involved a private antitrust suit by dealers against a manufacturer. The manufacturer imposed several vertical restraints upon his dealers, including exclusive territories.[1287] As for the context, it is important to note that the case was brought in the *Schwinn* era, i.e. during the time when such restraints were deemed as *per se* illegal.

One of the issues before the Supreme Court was whether dealers that are parties to an illegal agreement can claim antitrust damages or whether the *in pari delicto* principle precludes them from this. In addressing the issue, the Court noted that denying recovery to injured parties merely because they participated in an illegal arrangement would undermine the effectiveness of antitrust enforcement.[1288] The Court also emphasized that invoking broad common-law barriers to relief where a private suit serves important public purposes is inappropriate.[1289] Based on this the Court concluded that the *in pari delicto* doctrine should not be recognized in antitrust actions.[1290] Related to our discussion, this would mean that an exclusive distributor would not be precluded from suing for antitrust damages arising out of the exclusive distribution agreement in which the distributor himself participated.

Nevertheless, it has to be noted that the Supreme Court did not completely close the door to the application of the *in pari delicto* principle. According to *Perma Life,* before

[1285] *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985).
[1286] 392 U.S. 134 (1968).
[1287] Plaintiff dealers had to purchase all mufflers and exhaust systems from the defendant and to sell at prices fixed by the defendant. At the same time, each dealer was given territorial protection and obtained other benefits.
[1288] *Perma Life*, 392 U.S. at 139.
[1289] *Id.* at 138.
[1290] *Id.* at 140.

granting relief to a party to an illegal agreement, the court should look at the level of involvement in the illegal contract by the party seeking redress.[1291] Based on this, an exclusive distributor could still be denied relief if his involvement in the illegal agreement was substantial. It would also mean that the supplier will rarely be able to seek recovery, as he is generally the one whose involvement in the deployment of exclusive territories is decisive.

The Supreme Court later further clarified the conditions for the application of the *in pari delicto* principle. In *Bateman*, the Court established two cumulative conditions for barring a private antitrust action based on the plaintiff's own culpability. According to the Court, the action could be barred if first, as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and second, the preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.[1292] Although the case involved federal securities rather than antitrust claims, it has been suggested that the test applies *mutatis mutandis* to antitrust claims.[1293]

In the light of the above, today the court is likely to analyze whether the plaintiff was a full and equal participant in the contract or whether the contract was imposed upon him.[1294] Applied to our discussion about exclusive distribution, it seems that the court would be more likely to grant standing to an exclusive dealer than to a manufacturer. In any case, based on the Declaratory Judgment Act a party could get a judicial declaration that a contract violates

[1291] *Id*.
[1292] *Bateman Eichler*, 472 U.S. at 310-11. *See also* Giorgio Monti, *Anti competitive agreements: the innocent party's right to damages*, E.L. REV. 2002, 27(3), 282-302, at 288 "In most cases only the first limb has been considered with most cases assuming that if the first is satisfied, so is the second.").
[1293] Monti, *supra* note 1292, at 288.
[1294] *See, e.g.,* Sullivan v. National Football League, 34 F.3d 1091 (1st Cir. 1994); General Leaseways, Inc. v. National Truck Leasing Ass'n, 830 F.2d 716 (7th Cir. 1987).

antitrust laws and is therefore unenforceable, regardless of its involvement in implementing the contract.[1295]

5.2 Enforcement in the EU

5.2.1 Public enforcement

5.2.1.1 The European Commission

In contrast with the U.S., in the EU the leading role belongs to public antitrust enforcement. The key body in this respect is the European Commission, although in accordance with Regulation 1/2003 the National Competition Authorities (NCAs) and the courts of the Member States are becoming increasingly important as well.[1296] The Commission has considerable enforcement powers, as it does not need to go to court in order to establish an infringement,[1297] order interim measures,[1298] negotiate commitments,[1299] and impose fines.[1300] However, the Commission is still subject to judicial review by the General Court and the European Court of Justice.[1301]

[1295] *See* Declaratory Judgment Act of 1934, 28 U.S.C. §§ 2201-2202, 2201 ("In a case of actual controversy within its jurisdiction . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.").

[1296] The basic document regulating public enforcement in the EU is Council Regulation 1/2003. This document is often referred to as the Modernization Regulation, as it brought significant changes into the system of enforcement of EU competition law. The regulation replaced Council Regulation 17/62, discussed briefly in the previous chapter. For a discussion about Regulation 1/2003, see for example C.-D. Ehlermann, *The Modernisation of EC Antitrust Policy: A Legal and Cultural Revolution*, 37 COMMON MARKET LAW REVIEW 537 (2000). Perhaps the most notable change compared to the previous system is the direct effect of Article 101(3), which now can be applied not just by the Commission but also by the NCAs and by national courts. *See* Regulation 1/2003, Arts. 5, 6. Another important change is the abolition of notification and exemption procedure that existed under the previous system. Parties are now supposed to make their own assessment of whether the agreement satisfies the conditions for exemption under 101(3), with no prior decision by the competent authority being required. *See* Regulation 1/2003, Art. 1(2). Finally, the regulation brought significant decentralization of EU antitrust enforcement – apart from the Commission, the NCAs and national courts can also directly apply Articles 101 and 102. *See* Regulation 1/2003, Art. 5.

[1297] *See* Regulation 1/2003, Art. 7.

[1298] *Id.*, Art. 8.

[1299] *See id.*, Art. 9.

[1300] *See id.*, Art. 23.

[1301] *See* WHISH, *supra* note 37, at 285-89 (discussing the judicial review of the Commission's acts).

The Commission has had an important role in prosecuting illegal exclusive distribution agreements since the start of what is now the EU.[1302] In addition, the Commission has been very active in condemning what it regards as restrictions of parallel trade between the Member States, imposing fines on such conduct in a number of occasions.[1303] Additionally adding to the importance that the Commission has played in the development of the law of exclusive distribution are its block exemption regulations and guidelines, described in more detail above.

Since the adoption of Regulation 1/2003, a general trend could be noticed that the crux of the EU antitrust enforcement is shifting away from the Commission and towards the NCAs.[1304] For this reason an increase in NCA activity when it comes to exclusive distribution agreements falling under EU competition law may also be expected. Nevertheless, for a variety of reasons the Commission's role is still essential when it comes to enforcing the law in the area of exclusive territories.

First, in order to ensure uniform application of EU competition law throughout the Union, Regulation 1/2003 reserves for the Commission the role of supervising the NCAs.[1305] The cooperation between the Commission and the NCAs is mainly implemented through the

[1302] *See supra* Part 4.2.2.
[1303] *E.g.*, 76/915/EEC *Miller International Schallplatten GmbH* OJ [1976] L 357/40 (a fine of UA 70,000); 78/163/EEC *The Distillers Company Limited, Conditions of Sale and Price Terms* OJ [1978] L 50/16 (no fine imposed); 82/367/EEC *Hasselblad* OJ [1982] L 161/18 (fines of ECU 560,000, ECU 165,000 and ECU 10,000); 87/409/EEC *Sandoz* OJ [1987] L 222/28 (a fine of ECU 800,000); 88/172/EEC *Konica* OJ [1988] L 78/34 (a fine of ECU 75,000); 92/261/EEC *Newitt/Dunlop Slazenger International and Others* OJ [1992] L 131/32 (fines of ECU 5,000,000 and ECU 150,000); 92/426/EEC *Viho/Parker Pen* OJ [1992] L 233/27 (fines of ECU 700,000 and ECU 40,000); 94/987/EC *Tretorn and others* OJ [1994] L 378/45 (fines of ECU 600,000 and ECU 10,000); 95/477/EC *BASF Lacke+Farben AG, and Accinauto SA* OJ [1995] L 272/16 (fines of ECU 2,700,000 and ECU 10,000); 96/478/EC *ADALAT* OJ [1996] L 201/1 (a fine of ECU 3 million); 97/123/EC *Novalliance/Systemform* OJ [1997] 47/11 (a fine of ECU 100,000); 98/273/EC *VW* OJ [1998] L 124/60 (a fine of ECU 102 million); 2001/711/EC *Volkswagen* OJ [2001] L 262/14 (a fine of EUR 30.96 million); 2002/758/EC *Mercedes-Benz* OJ [2002] L 257/1 (a fine of EUR 71.825 million); 2002/190/EC *JCB* OJ [2002] L 69/1 (a fine of EUR 39,614,000); 2003/675/EC *Nintendo* OJ [2003] L 255/33 (a fine of EUR 149.128 million).
[1304] For example, in 2010 there were 169 cases brought inside the ECN, out which 11 by the Commission and 158 by the NCAs. According to: http://ec.europa.eu/competition/ecn/statistics.html (accessed May 17, 2011). Further, exclusive distribution cases brought by the Commission seem to have dropped off due to the block exemption system established in 1999 and modified in 2010. This system to a great extent provides private parties with legal certainty, as they are now aware of the circumstances in which the Commission will challenge the imposition of exclusive territories.
[1305] *See, e.g.*, Regulation 1/2003, Art. 11.

European Competition Network (ECN), consisting of the European Commission and twenty seven NCAs. Additionally, the Commission still tends to get directly involved in exclusive distribution cases for which it is particularly interested. In this respect it has shown that it is prepared to impose hefty fines for the prohibition of parallel imports, sending a clear signal that exclusive territories coupled with this type of restraint will not be tolerated.[1306]

5.2.1.2 National competition authorities

Regulation 1/2003 grants wide powers to the NCAs when it comes to the enforcement of EU competition law. The NCAs may require that an infringement be brought to an end, order interim measures, accept commitments, as well as impose fines.[1307] However, in order for an NCA to be able to exercise some of these powers regarding exclusive distribution agreements, several threshold issues need to be resolved. Before all the agreement has to be capable of affecting trade between Member States.[1308] If this condition is satisfied, it could be disputable which NCA should take action, if more than one Member State is concerned. Based on the Commission's Notice on cooperation within the Network of Competition Authorities, this will generally be the competition authority of the country where the agreement is implemented, i.e. the country of the exclusive distributor.[1309]

In some cases an exclusive distribution agreement could fall both under EU competition law and under competition law of a Member State. If there is a divergence between the two, an important issue would be the relationship between the EU competition law and the national competition law of the Member State. Regulation 1/2003 resolves this potential conflict in favor of the former, proclaiming that the application of national

[1306] *See, e.g.*, 2003/675/EC *Nintendo* OJ [2003] L 255/33 (a fine of EUR 149.128 million for an exclusive distribution system prohibiting parallel trade between Member States).
[1307] Regulation 1/2003, Art. 5.
[1308] *See supra* Part 4.1.1.
[1309] *See* Commission Notice on cooperation within the Network of Competition Authorities, OJ [2004] C 101/43, para. 8 (an authority can be considered to be well placed to deal with a case if the following three cumulative conditions are met: 1) the agreement has substantial direct actual or foreseeable effects on competition within its territory, is implemented within or originates from its territory; 2) the authority is able to effectively bring to an end the entire infringement 3) the authority can gather, possibly with the assistance of other authorities, the evidence required to prove the infringement.).

competition law in general may not lead to the prohibition of a conduct that is legal under EU competition law.[1310] Therefore, if an exclusive distribution agreement invokes the application of both EU law and the law of a Member State, the latter cannot have stricter rules for exclusive distribution than those found at EU level.

5.2.1.3 National courts

Apart from the Commission and the NCAs, the national courts also have the power to apply Articles 101 and 102 TFEU.[1311] When it comes to exclusive distribution agreements, they will generally be in the position to exercise this authority in two contexts. First, this could happen in the light of judicial review of an NCA decision, where a party could challenge the decision condemning the distribution agreement.[1312] In addition, a national court may be in the situation to apply EU competition law in a civil action arising out of a dispute between the parties to the agreement.[1313]

Related to this, an important issue is whether in this situation the national court would have the duty to address EU competition law issues on its own motion. This question is of great significance in the context of exclusive distribution agreements. For example, if a dispute arising out of an exclusive distribution agreement ends up before a Member State court, it is important to consider whether the court could (or even be obliged to) raise EU

[1310] Regulation 1/2003, Art. 3(2).
[1311] *Id.*, Art. 6. *See also* Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC (2004/C 101/04). Regulation 1/2003 contains several provisions the purpose of which is to ensure that EU competition law is applied consistently by Member States' national courts. *Inter alia*, the Regulation provides the following safeguards: 1) national courts must avoid adopting decisions which would conflict with a decision contemplated by the Commission in proceedings it has initiated (Art. 16); 2) national courts have to forward to the Commission a copy of any written judgment deciding on the application of EU competition law (Art. 15(2)); 3) the NCAs and the Commission can, acting on their own initiative, submit written observations to the national courts of Member States related to the application of EU competition law (Art. 15(3)); 4) in proceedings involving EU competition law national courts may ask the Commission to transmit to them information in its possession or its opinion on questions related to the EU competition rules (Regulation 1/2003, Art. 15(1)).
[1312] *See* Francis G. Jacobs & Thomas Deisenhofer, *Procedural Aspects of the Effective Private Enforcement of EC Competition Rules: A Community Perspective*, *in* EFFECTIVE PRIVATE ENFORCEMENT OF EC ANTITRUST LAW 185, 187 (Claus-Dieter Ehlermann & Isabela Atanasiu, eds. 2003).
[1313] *See id.*

competition law issues even if the parties do not do so themselves. ECJ case-law on the topic is somewhat ambiguous.

On the one hand, the Court's wording in *Van Schijndel* could be read as saying that national courts do not have the duty to root out EU law violations on their own motion:

> Community law does not require national courts to raise of their own motion an issue concerning the breach of provisions of Community law where examination of that issue would oblige them to abandon the passive role assigned to them by going beyond the ambit of the dispute defined by the parties themselves and relying on facts and circumstances other than those on which the party with an interest in application of those provisions bases his claim.[1314]

On the other hand, the Court's decision in *Peterbroeck* could be interpreted as saying that the national courts do have such duty:

> Community law precludes application of a domestic procedural rule whose effect, in procedural circumstances such as those in question in the main proceedings, is to prevent the national court, seised of a matter falling within its jurisdiction, from considering of its own motion whether a measure of domestic law is compatible with a provision of Community law when the latter provision has not been invoked by the litigant within a certain period.[1315]

Interestingly enough, both cases were decided on the same day. Based on this, the only conclusion may be that "the combined effect of *Van Schijndel* and *Peterbroeck* is to leave unsettled the circumstances in which a judicial passivity rule can justify the non-application of a Community law rule".[1316]

However, based on some later ECJ decisions, the correct interpretation would seem to be that a national court does have the duty to apply EU competition law *ex officio*, unless the national law of procedure precludes it from acting in that direction.[1317] Therefore, a national court would be obliged to raise EU competition law issues on its own motion in two situations: where the domestic procedural law has such a requirement with regards to binding

[1314] Joined cases C-430/93 and C-431/93 *Jeroen van Schijndel and Johannes Nicolaas Cornelis van Veen v Stichting Pensioenfonds voor Fysiotherapeuten* [1995] ECR I-4705, para. 22.
[1315] Case C-312/93 *Peterbroeck, Van Campenhout & Cie SCS v Belgian State* [1995] ECR I-4599, para. 21.
[1316] PHILLIP LANDOLT, MODERNISED EC COMPETITION LAW IN INTERNATIONAL ARBITRATION 197 (2006).
[1317] *See infra* Part 6.3.2.2 (discussing the ex officio duty from the perspective of arbitration).

domestic rules, or where there is no such requirement but also no prohibition in this respect.[1318]

Regarding the role of national courts, it is also not clear whether the Commission can challenge the legality of an exclusive distribution agreement if the agreement had already been declared lawful by a national court.[1319] Although Regulation 1/2003 is silent on the issue, the Commission does seem to have such power. Firstly, the White Paper on Modernization, which preceded the Regulation, did recognize such a possibility.[1320] More importantly, in the Regulation itself there does not seem to be anything which would prevent the Commission from acting in this direction. However, it needs to be emphasized that the principle does not apply the other way around – a national court faced with an exclusive distribution agreement that has already been decided upon by the Commission has to give way to the Commission's decision.[1321]

5.2.2 Private enforcement

5.2.2.1 Euro-defense and euro-offense

One way of considering the connection between exclusive distribution agreements and private enforcement in the EU is through the prism of euro-defense and euro offense. Euro-defense is a situation where a defendant invokes EU competition law as a shield against a complainant seeking to enforce an allegedly illegal agreement.[1322] The purpose of the defense is to invoke nullity of the agreement and thereby avoid obligations arising out of it. With regards to exclusive distribution agreements, plaintiffs will generally allege a violation

[1318] WHISH, *supra* note 37, at 299. *Contra* ELHAUGE & GERADIN, *supra* note 227, at 50 (national courts cannot act of their own motion against companies infringing EU competition law).
[1319] *See* MONTI, *supra* note 45, at 438.
[1320] White paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, Commission Programme No 99/027, 28 April 1999, para. 102(2) (upon a national court's decision "the Commission can always intervene to prohibit [an] agreement, subject only to the principle of *res judicata* that applies to the dispute between the parties themselves, which has been decided once and for all by the national court.").
[1321] *See* Regulation 1/2003, Art. 16(1). The same applies to the NCAs. *Id.*, Art. 16(2).
[1322] ELHAUGE & GERADIN, *supra* note 227, at 50.

of Article 101(1) TFEU.[1323] However, if the defendant has a dominant position in the market, the plaintiff may also allege that the agreement infringes Article 102.

On the other hand, euro-offense is the situation where a claimant seeks injunctive relief or the award of damages.[1324] Here as well the plaintiff may invoke both Article 101(1) and Article 102. In the context of Article 101(1) the plaintiff will generally allege that the defendant had forced him to enter into an anti-competitive agreement, while with regards to Article 102 the allegation will be that the plaintiff has violated his dominant position.[1325] Euro-offense seems to contribute more to the enforcement efforts than euro-defense, and is therefore more socially desirable.[1326] However, in the context of exclusive distribution agreements euro-offense is not as widespread as euro-defense, in spite of Commission efforts towards facilitating private damages actions.[1327]

Euro-defense is generally connected with the issue of nullity, while euro-offense seems to be most often analyzed with regards to private actions for damages. However, this delineation should not be taken too strictly. There may be situations where invoking voidness could be also considered as a euro-offense. This would for example be the case. if a party would turn to court in order to get a declaratory judgment that the agreement is void.[1328] Be that as it may, both nullity and private damages actions deserve additional attention.

[1323] In this case the defendant can be expected to counter-plead that the agreement satisfies the conditions for exemption laid down in Article 101(3) TFEU. *See* KOMNINOS, supra note 1252, at 2.
[1324] ELHAUGE & GERADIN, s*upra* note 227, at 50. According to Monti, the Euro-offense generally arises in one of the following settings: 1) from customers who pay a higher price for goods; 2) from distributors whose contract is terminated for failing to abide by some anticompetitive restriction; 3) by some would-be distributors who fail to secure a contract with a manufacturer who is distributing goods through a restrictive network. Monti, *supra* note 1292, at 282.
[1325] ELHAUGE & GERADIN, s*upra* note 227, at 50.
[1326] KOMNINOS, *supra* note 1252, at 3.
[1327] *But see, e.g.*, Case T-24/90 *Automec Srl v Commission* [1992] ECR II-2223, para. 13 (a car dealer asking for an injunction which would order a car manufacturer to include the dealer in the manufacturer's distribution system).
[1328] *See* KOMNINOS, *supra* note 1252, at 3.

5.2.2.2 Nullity

Article 101(2) TFEU provides that any agreement or decision infringing Article 101(1) is to be automatically void.[1329] A party wishing to escape from its contractual obligations may rely on this provision, which is how euro-defense is typically used. Although judges do not look favorably at attempts to run away from one's contractual obligations,[1330] private parties nevertheless rely on this type of defense relatively often.[1331] In addition, if *Van Schijndel* stands for the proposition that national courts have to raise the nullity *ex officio* unless this is expressly prohibited by domestic procedural law, the decision can be seen as strengthening the application of Article 101(2).[1332]

The main effect of 101(2) is that it precludes all claims for performance or damages based on the illegal agreement.[1333] However, some other effects of this provision are not as straightforward. As Article 101(2) leaves open many issues related to the consequences of voidness, the ECJ has had several opportunities to clarify the law on the issue.[1334] The Court has also established that issues such as the consequences of the nullity for other parts of the agreement, for any orders and deliveries made on the basis of the agreement, as well the

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[1329] Article 102 provides no sanction of voidness. For this reason it could be disputable whether agreements violating Article 102 are also to be considered void. This issue is not of primary importance for our discussion, as our main focus is on Article 101.
[1330] WHISH, *supra* note 37, at 311.
[1331] Monti, *supra* note 1292, at 282. *See, e.g.*, Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] 353; Case C-234/89 *Stergios Delimitis v Henninger Bräu AG* [1991] ECR I-935; Case C-126/97 Eco Swiss China Time Ltd v Benetton International NV [1999] ECR I-3055; Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* [2001] ECR I-6297.
[1332] *See* Alessandro Di Gio, *Contract and Restitution Law and the Private Enforcement of EC Competition Law*. WORLD COMPETITION 32, no. 2 (2009): 199-220, at 202 (citing *Van Schijndel*).
[1333] KOMNINOS, *supra* note 1252, at 154-55.
[1334] *See Maschinenbau* at 250 (automatic nullity generally applies only to the parts of the agreement violating Article 101(1) and to the agreement as a whole only if the infringing provisions are not severable from the rest of the agreement); Case 10-69 *S.A. Portelange v S.A. Smith Corona Marchant International and others* [1969] ECR 309, para. 10 (Voidness applies only if the agreement does not satisfy the conditions for exemption laid down in Article 101(3)); Case 22-71 *Béguelin Import Co. v S.A.G.L. Import Export* [1971] ECR 949, para. 29 (the nullity referred to in Article 101(2) is absolute, i.e. the null agreement has no effect between the parties and cannot be set up against third parties); Case 48-72 *SA Brasserie de Haecht v Wilkin-Janssen* [1973] ECR 77, paras. 25-27 (the nullity applies to all effects that the null contract can have, i.e. the nullity has retroactive effect).

resulting financial obligations, are to be determined by the national court according to its own law.[1335]

As a result, the consequences of voidness can to a large degree differ across Member States. For example, national laws could differ regarding the way in which they regulate restitution. In some legal systems apart from or in addition to damages parties can also seek restitution, for which no proof of damages, fault, and causal link is required.[1336] The right to restitution arises out of unjust enrichment – a party to a void agreement who has performed its obligations under the agreement may claim restitution corresponding to the other party's enrichment.[1337] Some national laws allow it, while some do not, based on the *in pari delicto* principle.[1338] Going further into the differences in Member States contract laws would be beyond the scope of this dissertation. However, what could be interesting to address is the way in which a national court would decide on the applicable system of contract law.

At EU level, the main instrument for resolving conflict of laws issues in the area of contracts is Regulation 593/2008 (Rome I).[1339] In accordance with the Regulation, parties to an exclusive distribution agreement can choose the law that will govern their contractual relationship.[1340] In the absence of parties' choice, the agreement is to be governed by the law of the country where the distributor has his habitual residence,[1341] i.e. where his central administration is located.[1342] This solution seems reasonable – if the contract parties come from different Member States, a distribution agreement would generally have more effects in

[1335] Case 319/82 *Société de Vente de Ciments et Bétons de l'Est SA v Kerpen & Kerpen GmbH und Co. KG* [1983] ECR 4173, para. 12.
[1336] Di Gio, *supra* note 1332, at 201.
[1337] KOMNINOS, *supra* note 1252, at 155.
[1338] According to Komninos those that do not allow restitution if the *in pari delicto* principle applies include English, German, and Spanish law, while Greek and French law allow restitution if certain conditions are satisfied. *Id.* at 155 n.86.
[1339] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ [2008] L 177/6.
[1340] *See id.*, Art. 3(1).
[1341] *Id.*, Art. 4(1)(f).
[1342] *Id.*, Art. 19(1).

the country where the distributor is located than in the one from which the supplier is coming from.

5.2.2.3 Private damages actions

5.2.2.3.1 ECJ case-law

5.2.2.3.1.1 Courage

The only sanction for violating EU competition law expressly mentioned in the TFEU is voidness of the illegal agreement. Consequently, it could be disputable what other consequences flow from the infringement. For example, one issue would be whether a party to an illegal exclusive distribution agreement could claim damages from the other contracting party. The ECJ already in 1974 recognized that individuals have actionable rights on the basis of EU competition law.[1343] However, the case that is usually considered as the watershed when it comes to private damages actions under EU competition law came almost three decades later, with *Courage.*[1344] The facts of the case can be summarized as follows.

Courage was a brewery holding 19 % of the UK market in sales of beer and owning a number of pubs throughout the country. In 1990 Courage and another company also owning a certain number of pubs (Grand Metropolitan) agreed to merge their pubs and transfer them to a new company (Inntrepreneur Estates). Subsequently, Courage and Inntrepreneur Estates entered into an agreement which provided that all Inntrepreneur Estates tenants had to buy their beer exclusively from Courage. In other words, this was an exclusive dealing arrangement. Problems arose in 1993, when Courage brought an action before an English court against Mr. Crehan for failing to pay for the beer delivered by Courage. Mr. Crehan invoked euro-defense, contending that the exclusive arrangement with Courage was contrary

[1343] Case 127-73 *Belgische Radio en Televisie v SV SABAM and NV Fonior* [1974] ECR 51, para. 16 (“As the prohibitions of Articles [101(1)] and [102] tend by their very nature to produce direct effects in relations between individuals, these articles create direct rights in respect of the individuals concerned which the national court must safeguard.”). *See also* Case C-282/95 P *Guérin automobiles v Commission* [1997] ECR 1503, para. 39.

[1344] Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* [2001] ECR I-6297.

to Article 101. In addition, Courage counter-claimed for damages, thereby also using euro-offense.

English law that was applied in the litigation did not allow a party to an illegal agreement to claim damages from the other party. This means that even had the lease in question infringed Article 101 TFEU, the English court would not have been able to allow Mr. Crehan his claim for damages. Consequently, the English court made a reference to the ECJ, inquiring whether a party to a contract infringing Article 101 can rely on the breach of that provision before a national court to obtain relief from the other contracting party. Further, if EU law does allow this possibility, the English court asked what factors must be taken into consideration in assessing the merits of such claim for damages.

In essence, the ECJ found that "any individual can rely on a breach of Article [101(1)] of the Treaty before a national court even where he is a party to a contract that is liable to restrict or distort competition within the meaning of that provision."[1345] The ECJ justified such a broad scope of potential plaintiffs by the interests of deterrence, noting that the full effectiveness of Article 101 would be jeopardized without the right of any individual to claim damages suffered due to a competition law infringement.[1346] The Court further emphasized that the existence of the right to claim damages can significantly strengthen the enforcement of EU competition law.[1347]

Nevertheless, the Court recognized that the Member States can establish limits to this right to claim damages, provided that the principles of equivalence and effectiveness are respected.[1348] Most notably, the national law may deny a party who is found to bear "significant responsibility" for the distortion of competition the right to obtain damages from

[1345] *Id.*, para. 24.
[1346] *Id.*, para. 26.
[1347] *Id.*, para. 27.
[1348] *Id.*, paras. 28-29.

the other contracting party[1349]. Therefore, the next question is what is to be considered as "significant responsibility", which can be related to the discussion about the *in pari delicto* principle.

According to the ECJ, when determining whether a party bears significant responsibility for the violation, the national court should take into account factors such as the economic and legal context in which the parties find themselves, and the respective bargaining power and conduct of the two parties to the contract[1350] In addition, the national court should determine whether the party claiming damages was "in a markedly weaker position than the other party, such as seriously to compromise or even eliminate his freedom to negotiate the terms of the contract and his capacity to avoid the loss or reduce its extent".[1351] Based on this, compared to *Perma Life* it would seem that the ECJ adopted a less restrictive approach than the Supreme Court.[1352]

5.2.2.3.1.2 Manfredi

In *Manfredi*,[1353] the ECJ further clarified certain aspects of damages claims under EU competition law. The case involved damages actions brought against three Italian insurance companies. The basis for the claim was an illegal agreement between the insurance companies the result of which were increased premiums for compulsory civil liability insurance relating to accidents caused by motor vehicles. The illegality of this agreement was established by the Italian competition authority. Plaintiffs were individuals who sought damages before an Italian court, seeking to obtain from the insurance companies damages in

[1349] *Id.*, para. 31.
[1350] *Id.*, para. 32.
[1351] *Id.*, para. 33.
[1352] *See* MONTI, *supra* note 45, at 288 ("An immediate difference [between *Perma Life* and *Courage*] is that [in *Perma Life*] the right to damages is denied when responsibility between the two contracting parties is 'substantially equal' whereas the Court of Justice would deny damages only when the plaintiff's degree of responsibility is 'substantial.'").
[1353] Joined cases C-295/04 to C-298/04 *Vincenzo Manfredi v Lloyd Adriatico Assicurazioni SpA (C-295/04), Antonio Cannito v Fondiaria Sai SpA (C-296/04) and Nicolò Tricarico (C-297/04) and Pasqualina Murgolo (C-298/04) v Assitalia SpA* [2006] ECR I-6619.

the amount of the increase in the cost of premiums they paid. During the course of the proceedings, the Italian court referred several question to the ECJ.

In its decision, the ECJ first addressed the issue of causality. According to the Court, "**any individual** can claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under Article [101 TFEU]."[1354] The Court further noted that it is for domestic legal systems to lay down the details about how this right to compensation will be exercised, including the way in which causal relationship is to be determined.[1355]

The Court further found that it is for domestic legal systems to set the criteria for determining the extent of damages, provided that the principles of equivalence and effectiveness are observed.[1356] The principle of equivalence would require that if it was possible to award exemplary or punitive damages in domestic actions similar to actions founded on EU competition rules, it should also be possible to award such damages in actions founded on EU rules.[1357] As for the principle of effectiveness, the injured individual must be able to seek compensation not only for actual loss (*damnum emergens*) but also for the loss of profit (*lucrum cessans*) plus interest.[1358] Therefore, the Court seems to have set the floor when it comes to the amount of damages, but it did not place any ceiling – it left this determination to national laws.

In the wake of *Courage* and *Manfredi,* EU competition law recognizes a wide scope of potential plaintiffs in private damages actions. If *Courage* allows co-contractors to sue for damages, *Manfredi* extends this right to third parties. Applied to exclusive distribution, this would mean that both the supplier and the exclusive distributor could potentially seek antitrust damages from the other contracting party. In addition, the Court's ruling in *Manfredi*

[1354] *Id.*, para. 61 (emphasis added).
[1355] *Id.*, para. 64.
[1356] *Id.*, para. 92.
[1357] *Id.*, para. 99.
[1358] *Id.*, para. 100.

could mean that competitors and consumers can also seek damages for the injury they sustained due to an illegal exclusive distribution agreement, although proving causation and the amount of damages suffered could be a substantial obstacle in this respect.[1359] Be that as it may, the Court's ruling in *Courag*e started a trend of increased interest at EU level with regards to private damages actions. Especially active in this respect has been the European Commission.

5.2.2.3.2 The Commission's standpoint

Compared to the U.S., private damages actions in Europe seem to be quite rare.[1360] This could mainly be explained by the following reasons. First, the European systems of civil procedure do not have discovery in the way it exists in the U.S., making it more difficult for potential plaintiffs to collect information about the infringement.[1361] Further, although *Manfredi* does not preclude national laws from awarding multiple damages for infringements of EU competition law, in most cases national courts do not have the power to grant multiple damages.[1362] And as shown above, one of the main drivers of private enforcement in the U.S. is exactly the existence of treble damages.[1363]

Another reason behind the low level of private enforcement could be the system of cost allocation between the parties in litigation.[1364] The most common rule in the EU is costs follow the event.[1365] Applied strictly, this principle would mean that the party that finally

[1359] *See* Daniel Beard & Alison Jones, *Co-contractors, damages and Article 81: the ECJ finally speaks*, E.C.L.R. 2002, 23(5), 246-256, at 255 ("It seems unlikely, however, that even the most hardened drinkers would contemplate their losses being sufficient to make proceedings against the brewers worthwhile. In the US the treble damages rule might reduce the likelihood that the wrongdoer will retain the fruits of his unlawful behaviour and increase the incentives for litigation (although the rule in *Illinois Brick* generally precludes claims by indirect purchasers there.").

[1360] *See* Study on the conditions of claims for damages in case of infringement of EC competition rules (2004) (the Ashurst Study), at 1 (http://ec.europa.eu/competition/antitrust/actionsdamages/comparative_report_clean_en.pdf, accessed 17 May 2011) (estimating the number of private damages actions based on EU competition law at only around 60 in all Member States combined).

[1361] *See* ELHAUGE & GERADIN, *supra* note 227, at 43.

[1362] *See id.*

[1363] *See supra* Part 5.1.2.1.

[1364] ELHAUGE & GERADIN, *supra* note 227, at 43.

[1365] *See* Price & Stans, *supra* note 1226, at 706.

wins its case is entitled to recover all the costs arising out of the litigation, including the costs of legal representation.[1366] Different variations of this rule exist. For example, if a party only partially wins its case, then some systems allow for the costs to be apportioned between the parties.[1367] Consequently, if a party faces the possibility of having to pay for the other party's costs, it may be discouraged from filing a suit in the first place.

The Commission has perceived this situation as an obstacle towards a more efficient system of antitrust enforcement, and following *Courage* has undertaken several steps in the direction of facilitating private damages actions. For example, in 2005 the Commission presented the Green Paper on Damages Actions for Breach of EU Antitrust Rules.[1368] *Inter alia*, the Green Paper emphasized that facilitating damages claims will make it easier for the injured parties to get compensation for their injury, as well as have a deterrent effect, thereby strengthening antitrust enforcement.[1369] In the Green Paper the Commission also introduced some bold proposals for reform, including the possibility of double damages in some cases of horizontal collusion.[1370]

Following the comments on the Green Paper, in 2008 the Commission drafted the White Paper on Damages Actions for Breach of the EU antitrust rules.[1371] The proposal to introduce double damages did not find its way into the White Paper, but some other interesting suggestions did. For example, the White Paper laid down certain proposals regarding the introduction of some sort of class actions (more precisely, representative actions and opt-in collective actions),[1372] disclosure of evidence (in a sense comparable to discovery from the American system),[1373] and the rules on cost allocation.[1374]

[1366] *Id.*
[1367] *Id.* This seems to be the case in Germany and Austria. *Id.* at 707.
[1368] Green Paper – Damages actions for breach of the EC antitrust rules, COM (2005) 672, 19.12.2005.
[1369] *Id.* at 3.
[1370] *See* Green Paper on Damages Actions at 7.
[1371] White Paper on Damages Actions for Breach of the EC antitrust rules, COM (2008) 165, 2.4.2008.
[1372] *Id.* at 4.
[1373] *Id.*
[1374] *Id.* at 9.

The White Paper also proposed the rule that decisions by the NCAs within the ECN have a *res judicata* effect with regards to national courts.[1375] Courts in some EU Member States are already bound by the findings of a competition authority,[1376] but this applies only to the decisions by the competition authority from the court's Member State. The proposal seems to be aimed at encouraging follow-on actions, as this would significantly facilitate the antitrust plaintiff's position. As mentioned, Regulation 1/2003 provides that national courts are bound by the Commission's decisions,[1377] but there is no corresponding guarantee when it comes to decisions by the NCAs. Consequently, the proposal is aimed at filling in the gaps with regards to some important enforcement issues.

As stated on the website of the Directorate General for Competition, during 2011 the Commission plans to adopt a Communication on private enforcement of the EU competition rules, laying down principles that will guide any possible future initiative in this area.[1378] However, before the adoption of the Communication, the Commission decided to first hear the opinion of the interested parties. In this respect, in February 2011 it launched a public consultation on collective redress.[1379] This was preceded by a joint statement made by the EU Commissioners for Justice, Competition and Consumer Policy, in which they emphasized the necessity of providing the possibility of collective redress with regards to violations of EU competition law.[1380] The public consultation was open until the end of April, which means that the Commission should now be in the process of drafting the Communication mentioned above.

[1375] *Id.* at 6.
[1376] According to Monti, this is the case with the UK and Germany. MONTI, *supra* note 45, at 435.
[1377] Regulation 1/2003, Art. 16(1).
[1378] *See* http://ec.europa.eu/competition/antitrust/actionsdamages/index.html (accessed 17 May 2011)
[1379] *See* http://ec.europa.eu/competition/consultations/2011_collective_redress/index_en.html (accessed 17 May 2011).
[1380] *See* http://ec.europa.eu/transparency/regdoc/rep/2/2010/EN/2-2010-1192-EN-1-0.Pdf (accessed 17 May 2011).

5.2.2.3.3 Distributors' and suppliers' right to damages

The right to seek damages can be justified on two separate grounds. First, the person seeking damages may have a subjective right which falls under the protective ambit of Article 101.[1381] In addition, allowing private damages actions could lead to deterring unlawful agreements.[1382] Although the ECJ in *Courage* focused on deterrence,[1383] it also touched upon the issue of subjective rights.[1384] Consequently, the question could be which parties have a subjective right to claim damages under EU competition law; especially, whether such a right belongs to parties to an illegal exclusive distribution agreement.

On the one hand, it could be argued that a party to an exclusive distribution agreement should not have the right to claim this type of damages. Apart from questioning the extent to which distributor suits contribute to deterrence,[1385] several reasons have been proposed against granting distributors the right to sue. First, in a competitive market a person will not enter an exclusive distribution agreement unless this is in accordance with its interests.[1386] A party will normally want to make an antitrust claim when it suffers a loss because it did not carefully calculate the benefits they would receive; consequently, the party could be using EU competition law in order to escape a bad bargain.[1387] Second, a person that enters an exclusive distribution agreement will seek damages only if it suffers losses; this is unlikely to happen, as the purpose of exclusive territories is to enhance the distributor's profit margin.[1388] Further, a distributor who wishes to turn to court when contractual relations deteriorate

[1381] *Id.* at 426.
[1382] *Id.*
[1383] *Courage*, paras. 26-27.
[1384] *See Courage,* para. 23 (Articles 101(1) and 102 "create rights for the individuals concerned which the national courts must safeguard").
[1385] *See* MONTI, *supra* note 45, at 429 (distribution agreements are generally not concealed in the way cartels are, and for this reason it is not clear to what extent does giving distributors a right to damages contribute to bringing to light illegal conduct). *See also supra* Part 5.1.2.1 (discussing the appropriatness of treble damages for the use of exclusive territories).
[1386] *See* Monti, *supra* note 1292, at 287-88.
[1387] *Id.* at 301.
[1388] *See id.* at 287-88.

already has a sufficient incentive in the possibility of declaring the contract void and giving him also the right to claim damages is unnecessary.[1389]

The argument concludes that the main potential harm arising out of distribution agreements is market foreclosure and distributors do not seem to be affected by it.[1390] On the opposite, the distributor is rather likely to benefit from the manufacturer's foreclosure efforts, as this could drive out of business the distributor's competitors.[1391] Therefore, the crux of these arguments is that distributors should not be allowed to claim damages because they generally will not suffer any damage anyway.

However, the fact that distributors do not normally suffer any damage does not justify that the law bars them from seeking damages altogether. If a distributor did not suffer any injury his claim would fail anyway, since one of the elements of every damages action is proof of damages. Consequently, there do seem to be cases where distributor actions could be helpful for antitrust enforcement.

In this respect, consider an airtight exclusive distribution agreement in contravention of EU competition law: the prospect of being awarded antitrust damages could encourage the distributor to bring to light the illegal agreement.[1392] In this situation the prospect of damages could encourage the distributor to violate the export ban hoping that he will not be caught, and if he is subsequently terminated he can seek damages as well as a mandatory injunction to resume supplies.[1393] Taking into account the attention that the EU affords to the internal market considerations, the possibility that a rule will assist in establishing a functional internal market could be sufficient to justify the rule.

The right to seek damages against the other contracting party could also be questionable in connection with the Commission's policy on fines. In this respect it has been

1389 *See id*. *See also* Part 5.1.2.3 (discussing the *in pari delicto* principle).
1390 MONTI, *supra* note 45, at 428.
1391 *Id.* at 429-30.
1392 Monti, *supra* note 1292, at 287.
1393 *Id.*

argued that undertakings who can seek damages against the other contracting party should also be entitled to avoid a fine from the Commission for having entered into that agreement.[1394] Otherwise, an odd situation would arise; competition law would on the one hand allow a person to claim damages and on the other impose a fine on it. This opens up a broader issue of the relationship between the award of damages and fines imposed by the Commission or NCAs.

The Commission's insistence on encouraging private damages actions also means that the current system of fines in EU competition law should be reconsidered. In the American context, the widespread private enforcement of antitrust laws seems appropriate, since enforcement agencies generally do not have the power to impose fines. However, a system which would allow both the possibility of (hefty) fines and of extensive private damages actions could lead to over-deterrence. This could especially be problematic with regards to exclusive distribution agreements. As shown, exclusive distribution agreements are not necessarily anticompetitive and often bring significant efficiencies. For this reason the situation where a supplier that establishes an exclusive distribution system potentially faces both severe fines and private damages suits could lead him to abstain from entering into exclusive distribution agreement in the first place.

Finally, it could be interesting to address the issue of whether a supplier may recover antitrust damages from a distributor. Following *Manfredi*, there is no formal obstacle that even a supplier asks for damages, as with regards the right to claim damages it refers to "any individual".[1395] However, if situations where a distributor would have a justifiable claim are rare, situations where it would be justifiable to grant damages to a supplier seem even rarer. In an exclusive distribution agreement, a supplier is generally the side with more bargaining power, i.e. the one bearing "significant responsibility" for the distortion of competition.

[1394] *See id.* at 292-93.
[1395] *Manfredi*, para. 24.

Consequently, he generally will not have the right to claim damages in accordance with *Courage.*[1396] Nevertheless, the supplier's right to sue should not be disregarded completely, especially taking into account the possibility that the distributor may possess buyer power, potentially making him the side that bears "significant responsibility" in accordance with *Courage*.

5.2.2.3.4 Conflict of laws issues

5.2.2.3.4.1 Jurisdiction

Another important question is which court would be competent to hear a claim for antitrust damages arising out of an exclusive distribution agreement. At EU level the issue of competency for deciding such actions is regulated by Council Regulation 44/2001[1397] (Brussels I). The Regulation respects party autonomy, as it allows the parties to choose on their own the venue for solving their dispute[1398]. Therefore, parties to an exclusive distribution agreement may choose decide which court will be competent for the resolution of disputes potentially arising out of the agreement.

In the absence of party choice, the pertinent rules of the Regulation apply. According to the Regulation, in matters relating to tort a person domiciled in a Member State may be sued in another Member State where the harmful event occurred or may occur.[1399] Related to damages arising out an illegal exclusive distribution agreement, this would be the place where the anticompetitive effects of the territorial restraint occurred. For example, in case of a suit by an exclusive distributor against a supplier, the competent court would probably be the distributor's Member State. On the other hand, if an action would be brought by a supplier's competitor who was foreclosed by the imposition of exclusive territory, it would

[1396] *Courage,* para*.* 31.
[1397] Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ [2001] L 12/1 (Brussels I).
[1398] *Id.*, Art. 23. This autonomy is limited by instances of exclusive jurisdiction laid down in Art. 22 of the Regulation (none of which are relevant for our discussion).
[1399] *Id.*, Art. 5(3).

seem that the action could be brought before the courts of the competitor's Member State. Finally, since according to *Manfredi* anyone can seek damages,[1400] it could be imaginable that consumers could also seek damages arising out of the exclusive distribution agreement; in that case the competent court would be of the place where the consumers suffered anticompetitive harm.

5.2.2.3.4.2 Applicable law

Once the proper jurisdiction has been established, an additional problem is which national law would be applicable to the damages action between parties to an exclusive distribution agreement. When it comes to determining applicable law in the area of torts, the relevant instrument at EU level is Regulation 864/2007 (Rome II).[1401] The regulation gives the parties certain autonomy. In other words, it recognizes that parties to an agreement generally can submit non-contractual obligations to the law of their choice.[1402]

In the absence of parties' choice, the law applicable to non-contractual obligations arising out of restrictions of competition is the law of the country where the market is or is likely to be affected.[1403] If the restriction of competition arising out of an exclusive distribution agreement affects the market in more than one Member State, the plaintiff could have a choice regarding the law under which to bring his suit for damages. If in such a situation the plaintiff sues in the court of the domicile of the defendant, he could also establish jurisdiction in that Member State, as long as the market in that Member State is amongst those directly and substantially affected by the restriction of competition.[1404]

[1400] *See supra* Part 5.2.2.3.1.2.
[1401] Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II) ,OJ [2007] L 199/40.
[1402] *Id.*, Art. 14(1). However, this autonomy may be limited in certain circumstances. First, if all the elements relevant to the event giving rise to damages are located in a country other than the country whose law has been chosen, the choice of the parties may be overridden by imperative norms of that other country. Id., Art. 14(2). In addition, under certain conditions the will of the parties may be overridden by provisions of EU law. *Id.*, Art. 14(3).
[1403] *Id.*, Art. 6(3)(a).
[1404] *Id.*, Art. 6(3)(b); for the purposes of the Regulation, a company is domiciled at the place where it has its statutory seat, central administration, or principal place of business [Art. 60(1)].

Therefore, there are three possibilities for bringing a private suit with regards to antitrust damages arising out of an illegal exclusive distribution agreement. First, in case the agreement contains a choice of law with regards to non-contractual obligations, applicable law will generally be that law. In the absence of such a provision, the plaintiff may have a choice. On the one hand, he could bring the suit in accordance with the law of the country where the market is or is likely to be affected by the imposition of exclusive territories. In the alternative, he could base his claim on the law of the country where the defendant is domiciled, if other conditions were satisfied.

5.2.2.3.4.3 Multiple damages

The issue of multiple damages in the EU could be of relevance for exclusive distribution agreements in several respects. The first aspect is the extent to which Member States are prepared to enforce foreign judgments or arbitral awards granting multiple damages. This is basically the problem of enforcing awards of treble damages based on the Sherman Act, and was addressed above.[1405] The second issue is whether the national laws of the Member States may grant multiple damages for violations of EU competition law. Following *Manfredi* it clear that Member States can award such damages.[1406] Finally, the third issue, addressed in this section, is whether a Member State may refuse to enforce a judgment from another Member State granting multiple damages.

The situation where some Member States allow the award of multiple damages and some do not can lead to certain problems related to private damages actions. In this respect one should particularly take into account the relevant rules of Rome II and Brussels I. Rome II specifically provides that the law applicable to non-contractual obligations governs the existence, the nature and the assessment of damage or the remedy claimed.[1407] According to Brussels I, a judgment given in a Member State is to be recognized in the other Member

[1405] *See supra* Part 5.1.2.1.
[1406] *See supra* Part 5.2.2.3.1.2.
[1407] Rome II, Art. 15(c).

States without the requirement of any special procedure;[1408] under no circumstances may the judgment be reviewed as to its substance.[1409] By reading these provisions one may conclude that if the applicable law allows a possibility of awarding punitive damages then such law is to be applied by the court seized of the action. However, this does not have to be the case.

According to Brussels I, a national court may refuse to recognize a judgment if the recognition would be manifestly contrary to the public policy of the Member State in which recognition is sought.[1410] A recital in Rome II[1411] also refers to this possibility, noting that the courts of the Member States can in exceptional circumstances refuse to apply the applicable law, if the application would be contrary to the court's public policy and mandatory law.[1412] The recital further specifically provides that this also applies to the possibility of awarding non-compensatory exemplary or punitive damages.[1413]

As a result, based on Brussels I a Member State court may refuse to recognize a judgment awarding punitive damages. This does not mean that the court would be reviewing the judgment on the merits; that would directly contravene the Brussels I provision which mandates that a judgment cannot be reviewed as to its substance.[1414] Rather, in cases concerning punitive damages the court would simply refuse to recognize the part of the judgment contrary to its public policy.[1415] However, the outcome would be the same – the judgment awarding punitive damages would not be enforced.

As can be seen, the possibility of awarding multiple damages for violations of EU competition law is coupled with a number of enforcement problems. However, in the context of exclusive distribution the award of punitive damages would be even more problematic.

[1408] Brussels I, Art. 33(1).
[1409] *Id.*, Art. 36.
[1410] *Id.*, Art. 34(1).
[1411] Rome II, recital 32.
[1412] *Id.*
[1413] *Id.*
[1414] *See* Brussels I, Art. 36.
[1415] M. Danov, *Awarding exemplary (or punitive) antitrust damages in EC competition cases with an international element - the Rome II Regulation and the Commission's White Paper on Damages*, E.C.L.R. 2008, 29(7), 430-436, at 434.

Taking into account the procompetitive potential that exclusive territories possess, the award of punitive damages for their deployment would not be appropriate. This would be the case even when it comes to airtight exclusive territories impeding trade between Member States. If anything, in such a situation the Commission could fine the undertakings, and the prospect of having to pay multiple damages on top of the fine could be regarded as overly excessive. Therefore, in the presence of Commission and NCA fines, the impact of private damages actions in the EU could be seen as having the same effect as the award of treble damages have in the U.S.,[1416] even if the damages were not multiple in nature. This is because in the presence of fines by public enforcement agencies even single damages could be an inappropriately harsh sanction for a practice such as exclusive territories.

5.3 Social cost of enforcement

5.3.1 Enforcement errors

Studying procedure is of essence even if one's focus is on substantive law – it is not possible to properly understand the substantive rules without considering the relevant enforcement mechanisms.[1417] Without taking into account the procedural rules one could come to incorrect conclusions about the differences in the substantive laws. One of the issues related to this interplay between substantive and procedural law is the problem of enforcement mistakes.

There are two main types of enforcement errors. The first type occurs when a conduct with negative welfare effects is wrongly allowed and is usually referred to as a "false positive".[1418] On the other hand, an enforcement mistake where a behavior that would have increased welfare is condemned is called a "false negative".[1419] Ideally, an enforcement system would not make mistakes of either of the two types. However, as this does not seem

[1416] *See supra* Part 5.1.2.1.
[1417] Crane, *supra* note 575, at 1. *See also* William F. Baxter, *Separation of Powers, Prosecutorial Discretion, and the 'Common Law' Nature of Antitrust Law*, 60 TEX. L. REV. 661 (1982).
[1418] *See* Christiansen & Kerber, *supra* note 634, at 225.
[1419] *See id.*

to be possible in practice, an interesting issue would be which of the two mistakes should be considered as less harmful.

A tendency towards one type of error in substantive rules could be counterbalanced by a tendency in the opposite direction in procedural rules.[1420] For example, if a system of remedies is too aggressive, judges could respond by defining substantive violations too narrowly.[1421] It seems this is what has happened with the way in which American law treats exclusive territories. Due to the fact that the law prescribes the award of treble damages for all antitrust violations, judges may be reluctant to condemn a practice the anticompetitive effects of which are ambiguous. This would also seem to be the case with the use of exclusive territories – although there are situations in which the condemnation of exclusive territories is justified, the imposition of treble damages would seem excessive. In other words, the courts in the post-*Sylvania* period may be reasoning that the costs of over-enforcement in the area of exclusive territories would exceed the costs of under-enforcement, effectively opting for the latter as the lesser of two evils.

Conversely, the EU approach towards exclusive distribution could be more characterized as over-enforcement. Although EU competition law now seems to be more flexible in its treatment of exclusive territories than it used to be the case earlier, the ordoliberal influence and the single market imperative still play an important role in this respect. As discussed in the theoretical chapter, affording even airtight exclusive territories a quasi-*per se* illegality treatment does not seem to be justified from the viewpoint of economic theory, especially if the firm deploying the restraint lacks market power. Another sign of over-enforcement is the trend towards encouraging private antitrust enforcement. If the strengthening of private enforcement is not followed by a reconsideration of somewhat strict

[1420] Crane, *supra* note 575, at 3.
[1421] HOVENKAMP, *supra* note 1183, at 76.

substantive rules governing exclusive distribution, over-enforcement could become even more pronounced.

With regards to the reasons behind different tendencies in the two jurisdictions, there are views that one of the reasons why U.S. enforcement leans more towards false negatives than EU law does is the doctrine of *stare decisis*. According to Easterbrook, in a precedent-based system a court makes a mistake by condemning an efficient practice, the benefits may be lost definitely.[1422] Based on *stare decisis* other firms may rely on the condemnation, which aggravates the cost of the initial mistake.[1423] On the other hand, in such a situation a false negative would be less harmful – monopolies are generally self-destructive.[1424] Consequently, false negatives are self-correcting while false positives are not.[1425]

Some authors oppose this to the situation in the EU, arguing that the absence of *stare decisis* in EU law is one of the reasons that tilt EU enforcement in the direction of false positives.[1426] However, it is arguable whether such explanation is correct. First, the principle of *stare decisis* in the U.S. is quite flexible and does not seem to be as binding on the courts as it might be perceived at first glance.[1427] On the other hand, the ECJ has strived towards consistency in its decisions, even in the absence of the *stare decisis* doctrine.[1428] Therefore, in the area of exclusive distribution the U.S. tendency towards false negatives and EU the tendency towards false positives seem to be grounded on other considerations.

5.3.2 Inefficient vertical integration

Perhaps the most significant cost of antitrust enforcement in the area of exclusive distribution agreements is if a manufacturer decides to vertically integrate in order to avoid the condemnation of antitrust laws. This situation seems to have been a recurring incidence

1422 Frank Easterbrook, *The limits of antitrust*, 63 TEX. L. REV. 1, 2 (1984).
1423 *Id.*
1424 *Id. See also* Cooper, Froeb, O'Brien & Vita, *supra* note 498, at 661.
1425 Easterbrook, *supra* note 1422, at 2-3.
1426 *See* Cooper, Froeb, O'Brien & Vita, *supra* note 498, at 661.
1427 *See supra* Part 3.6.
1428 *See supra* Part 4.2.3.2.

on both sides of the Atlantic. For example, as a result of the Supreme Court's decision in *Schwinn*, the bicycle manufacturer decided to vertically integrate into distribution: in some areas it acquired some of its existing distributors, while in other it opened new distribution centers.[1429] This way Schwinn replaced a business practice which was obviously more profitable to it[1430] with complete vertical integration, merely in order to satisfy the formal requirement promulgated by the Court.[1431] It is difficult to see who benefited from such an outcome. Former Schwinn distributors certainly did not – those that were not acquired by Schwinn either went out of business or started dealing with other brands.[1432]

It is also doubtful that the Court's decision in any way benefited consumers – a situation where intrabrand competition was limited was replaced by a situation where this type of competition was completely eliminated. Additionally, even if Schwinn's practices could be somehow seen as harming consumers by raising the price of its bicycles, the prohibition of exclusive territories certainly did not make this harm go away. Once it vertically integrated into distribution, Schwinn was able to establish even tighter control over its distribution process than it was able to do by using exclusive territories. What is more, the fact that the integration was forced by legal considerations and not made due to economic reasons, it could be reasonable to presume that as a result of the integration the price charged by Schwinn would even higher than without the integration.

There have also been similar cases in the EU. For example, following the ECJ's ruling in *Consten-Grundig*, Grundig acquired Consten and thereby vertically integrated into distribution.[1433] As a result of the acquisition, Grundig was able to completely seal off the

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[1429] Grimes, *supra* note 701, at 160.
[1430] Otherwise he would not have employed the practice in the first place.
[1431] Related to this, consider also *Aspen Skiing*, discussed in Part 3.1.2 above. The Court's decision in this case basically prevented a stronger firm from driving out of business its smaller and less efficient competitor. However, this salvation was only short-lived, as in the end the stronger firm acquired the smaller rival. *See* George L. Priest & Jonathan Lewinsohn, *Aspen Skiing: Product Differentiation and Thwarting Free Riding as Monopolization*, in ANTITRUST STORIES 229, 255 (Eleanor M. Fox & Daniel A. Crane eds., 2007).
[1432] Grimes, *supra* note 701, at 160.
[1433] KORAH & O'SULLIVAN, *supra* note 41, at 62.

French market without infringing EU competition law. The case of Grundig does not seem to be the only one – following the Commission's finding, Parker Pen also decided to vertically integrate into distribution.[1434] Unlike the U.S., where the effect of *Sylvania* basically minimized the cost of inefficient vertical integration, in the EU the reasons behind the occurrence of this phenomenon are still present.

A system in which vertical integration is the way of avoiding antitrust rules could be characterized as flawed.[1435] According to some studies, vertical integration into distribution is less profitable than having distribution performed by outside representatives.[1436] In addition, integration is not equally advantageous to all firms – it is more profitable for companies with large market shares.[1437] In other words, strict rules on exclusive distribution may not only lead to inefficient vertical integration, but may in addition favor larger firms over smaller ones. This is even more problematic if one of the goals of antitrust enforcement is to protect small firms, as arguably is the case in the EU.

Related to this, it could be argued that whatever is allowed to an integrated manufacturer should also be allowed to a manufacturer imposing distributions restraints.[1438] Otherwise, the latter would have an incentive to vertically integrate even if the integration would not make economic sense. From a manufacturer's point of view, a situation where the law prohibits certain types of vertical restraints can be considered as a transaction cost related to dealing with independent contractors.[1439] In turn, this can create a situation that actually happened in *Schwinn* – in order to exercise control over the distribution process the

[1434] MONTI, *supra* note 45, at 41. *See also supra* Part 4.4.4.
[1435] *See Leegin,* 551 U.S. at 903-04 ("In sum, it is a flawed antitrust doctrine that serves the interests of lawyers-by creating legal distinctions that operate as traps for the unwary-more than the interests of consumers-by requiring manufacturers to choose second-best options to achieve sound business objectives.").
[1436] *See* Cady, *supra* note 136, at 37.
[1437] *See id*. at 36-37.
[1438] *See supra* Part 2.4.2.
[1439] *See supra* Part 2.1.2.1.1.

manufacturer had to vertically integrate, which is an outcome that can hardly be in the interest of competition.

On the other hand, one should also take into account that the interests of an individual can diverge from that of society;[1440] consequently, a manufacturer's rationality cannot be the only guarantee that the imposition of exclusive territories will not have anticompetitive effects. There are certain situations where the imposition of exclusive territories could harm the interest of society, even if the arrangement is beneficial for the parties that enter into it;[1441] this is especially the case if the parties possess market power.

Another consideration is the difference in the cost needed for vertical integration as opposed to the cost of entering an exclusive distribution agreement. As it can be presumed that the latter is lower, an exclusive distribution agreement enables a manufacturer to achieve procompetitive sides of integration with less cost. However, the other side of the coin is that through this type of integration a manufacturer may also more effectively achieve some anticompetitive goals. Consequently, from the perspective of enforcement costs, a *per se* legality approach towards exclusive distribution does not seem justified either.

5.4 Assessment

By explaining the relevant enforcement mechanisms, this chapter has shed more light on the development of the law of exclusive territories and its current state. As for the U.S., the analysis shows the significance of politics and ideology with regards to the approach to exclusive territories and vertical restraints in general. The influence of the Chicago School has been sweeping, to a large extent thanks to the political support from President Reagan and his followers. As the current Supreme Court could also be characterized as ideologically leaning in that direction, there do not seem to be any signs that the tide will turn towards a stricter approach towards vertical territorial restraints.

[1440] *See supra* Part 2.3.2.1.
[1441] *See id.*

Another important implication with regards to the antitrust enforcement in the U.S. is the influence that the existence of treble damages has had on the development of the law of exclusive territories. Taking into account that this type of restraint has a limited potential for causing antitrust harm, the award of treble damages for antitrust violations arising out of the use of exclusive territories would not seem appropriate. Viewed in this light, the lenient approach that post-*Sylvania* courts have taken with regards to vertical non-price restraints would be easier to justify. Faced with the choice between excessively deterring the deployment of exclusive territories or overly exonerating them, the courts seem to have opted for the latter. Related to this, it would seem that a possible change in the way American courts treat exclusive territories could come only if the system of remedies is reconsidered and the award of treble damages limited to some more pernicious antitrust violations. Finally, based on the analysis presented in this chapter, the approach taken by the American courts can be said to have at least one obvious advantage compared to the law of the EU: it minimizes the social cost in the form of inefficient vertical integration.

By comparing it with the U.S., the chapter has also shown the different nature of antitrust enforcement in the EU. As the enforcement in the EU is predominantly public, the vigor of enforcement in the area of exclusive distribution can be explained by a relatively stable approach that the Commission has had towards this type of restraint. With regards to this, the influence that ideology played in the development of the U.S. approach to exclusive territories can be compared with the stance that the EU has had towards the restrictions of parallel trade since the start of the European Communities. Consequently, the more pronounced fluctuations exhibited in the American law can be connected with ideological shifts in the Supreme Court and society as a whole, while the EU's relatively stable approach has to do with the constancy of the Commission's tough stance towards airtight exclusive territories.

Another inference of the analysis of the relevant enforcement mechanisms is that solutions from one system cannot be transplanted into another without serious implications with regards to the system as a whole. In the context of exclusive territories, most conspicuous with regards to this is the process of facilitating private damages actions in the EU, mostly fueled by the Commission. If private damages actions are encouraged but at the same time the system of imposing fines remains in tact, a situation may arise where the firms using exclusive territories could face not only significant fines from the Commission and the NCAs but also suits from the other contracting party, competitors, and even consumers. As a result, this could give an additional incentive to firms to vertically integrate, aggravating the problem of inefficient integration. Therefore, certain trends in the area of enforcement could offset some positive sides of the EU law of exclusive territories (such as a well-structured rule of reason and recognition that exclusive territories have both pro- and anticompetitive aspects) and aggravate some of its shortcomings (most notably, an overly interventionist stance with regards to airtight exclusive territories).

6 EXCLUSIVE DISTRIBUTION AND ARBITRATION

6.1 Identifying the main problems

The relationship between exclusive distribution agreements and arbitration is important in several aspects, especially considering the rising significance of arbitral dispute settlement. Since arbitration can be seen as the preferred method of resolving international commercial disputes,[1442] it is not rare that disputes arising out of an exclusive distribution agreement end up before an arbitral tribunal.[1443] Taking into account the specific nature of arbitration as well as that of exclusive distribution agreements, this situation opens up several legal issues.

As shown, exclusive distribution agreements may invoke the application of antitrust laws. Related to this, it may be arguable whether an arbitral tribunal would have authority to decide on these antitrust issues arising out of the agreement. Arbitration is a creature of the parties to the arbitration agreement, and generally they are the ones deciding about the disputes that are to be resolved by the arbitral tribunal. This is in accordance with the contractual nature of arbitration and the principle of party autonomy. However, this autonomy is not absolute – certain types of disputes that are intertwined with public interest cannot be referred to arbitration. This is also sometimes the case with antitrust-related disputes. Consequently, the first set of issues arising out of the relationship between exclusive distribution agreements and arbitration is whether antitrust issues arising out of these agreements may be decided by an arbitral tribunal.

[1442] Michael F. Hoellering, *Managing international commercial arbitration: the institution's role*, 49-JUN DISP. RESOL. J. 12, 12 (1994).
[1443] *See, e.g.*, Agent (Spain) v. Principal (Denmark), Final award in case no. 8817 of 1997, 25 YEARBK. COMM. ARB'N 11 (2000); Distributor (Japan) v. Manufacturer (Sweden), Interim Award in Case No. 7337 of 1996, 24a YEARBK. COMM. ARB'N 149 (1999); Distributor (UK) v. Manufacturer (US), Final Award of 1995 in Case No. 8362, 22 YEARBK. COMM. ARB'N 164 (1997); Manufacturer (France) v. Distributor (Ireland), Partial Award in Case No. 7319 of 1992, 24a YEARBK. COMM. ARB'N 141 (1999); Seller (France) v. Buyer (US), Final Award of 1990 in Case No. 5946, 16 YEARBK. COMM. ARB'N 97 (1991); Claimant (Germany) v. Respondent (Yugoslavia), Award of 1967 in Case No. 1455, 3 YEARBK. COMM. ARB'N 215 (1978).

Further, even if arbitrators do have authority to decide on these issues, the story does not end there. Although most states have a pro-arbitration attitude and encourage this type of dispute settlement, they also reserve some rights with regards to the control of the arbitrators' decision. The supervision is commonly exercised through the procedure of recognition and enforcement as well as the setting aside of arbitral awards. Therefore, to a greater or lesser extent courts can review the decision of the arbitrators'. As will be shown in this chapter, due to the importance that some jurisdictions afford to their antitrust laws, this control may be more intrusive with regards to antitrust-related issues than it is commonly.

Related to this is the question of whether in certain cases arbitrators should take into account antitrust laws even of those jurisdictions that are outside the *lex causae*. This is the question of the application of mandatory law and the extent to which antitrust legislation can be seen as constituting part of this law. Consequently, if antitrust rules are part of mandatory law, arbitrators deciding a dispute involving an exclusive distribution agreement may consider applying even the law applicable to vertical territorial restraints that is outside the law chosen by the parties.

Based on this, the purpose of this chapter is threefold. First, it addresses the issue of whether arbitrators could decide on antitrust issues arising out of an exclusive distribution agreement. If the answer is in the positive, the next problem is the extent to which the courts can review the arbitrators' decision with regards to its antitrust aspects. Finally, the chapter reflects on the issue of mandatory law and the extent to which arbitrators are supposed to take into account antitrust laws even of those jurisdictions not selected by the parties to the arbitral agreement. In answering these questions the analysis will inevitably deal with some general aspects of the connection between antitrust issues and arbitration. Nevertheless, this examination is of direct relevance for our discussion about exclusive distribution, as the conclusions it reaches generally apply to the issues arising out of an exclusive distribution agreement.

6.2 Arbitrability of antitrust issues

6.2.1 General considerations

6.2.1.1 The concept of arbitrability

The concept of arbitrability establishes the point at which party autonomy ends and public adjudication begins.[1444] Antitrust law, along securities law, intellectual property, and bankruptcy, is one of the areas where public interest has been traditionally strong.[1445] It is also an area where potentially a conflict between public and general interest could occur – the enforcement of competition rules is in public interest, while the arbitrators' decision binds only parties to the arbitration agreement. Consequently, in some legal systems antitrust claims cannot be decided by the arbitral tribunal. In other words, antitrust issues arising out of exclusive distribution agreements may not always be arbitrable.

There is no uniform definition about what the term "arbitrability" exactly means. For example, in the United States the term "arbitrability" has a broader meaning. On the one hand, it is used to delineate between disputes that are referable to arbitration and those that are not (substantive arbitrability).[1446] In addition, the term is also used in order to describe whether a dispute falls under the scope of the arbitration agreement (contractual arbitrability).[1447]

The European concept is a bit different. For example, French law distinguishes between subjective and objective arbitrability.[1448] Subjective arbitrability (or arbitrability *ratione personae*) relates to deficiencies in contractual capacity of the parties, such as where

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[1444] Thomas Carbonneau, *Cartesian Logic and Frontier Politics: French and American Concepts of Arbitrability*, 2 TUL. J. INT'L & COMP. L. 193, 194 (1994).
[1445] TIBOR VÁRADY, JOHN J. BARCELO III & ARTHUR T. VON MEHREN, INTERNATIONAL COMMERCIAL ARBITRATION – A TRANSNATIONAL PERSPECTIVE 233 (2009).
[1446] Carbonneau, *supra* note 1444, at 194.
[1447] *Id.*
[1448] *Id.* at 210.

one of the parties is a public entity.[1449] Conversely, objective arbitrability (or arbitrability *ratione materiae*) may prohibit arbitration by the reason of the subject matter of the dispute.[1450] Despite these differences, the distinction between subjective and objective arbitrability is roughly comparable to the one between substantive and contractual arbitrability.[1451] In this chapter the term "arbitrability" is used in its ordinary meaning – to delineate whether a certain type of disputes can be settled by arbitration.[1452]

6.2.1.2 Arbitrability in international instruments

Determining whether antitrust disputes can be referred to arbitration is not a straightforward task. The most important international instruments in the field of arbitration are silent on the issue, regulating arbitrability only in general terms. For example, the New York Convention[1453] mentions disputes "concerning a subject matter capable of settlement by arbitration."[1454] The UNCITRAL Model Law is along the same line, also referring to disputes "capable of settlement by arbitration".[1455] The arbitration rules of the main arbitral institutions also avoid determining with more precision what kinds of dispute are arbitrable.[1456] As a result, the determination about the types of disputes that can be decided by the arbitral tribunal is left to national legal systems.

[1449] Bernard Hanotiau, *The Law Applicable to Arbitrability*, *in* IMPROVING THE EFFICIENCY OF ARBITRATION AND AWARDS: 40 YEARS OF APPLICATION OF THE NEW YORK CONVENTION 146, 147 (Albert Jan van den Berg ed., 1999).
[1450] Carbonneau, *supra* note 1444, at 210
[1451] *Id.*
[1452] This generally corresponds to the American concept of substantive arbitrability and the French concept of objective arbitrability.
[1453] Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, 330 U.N.T.S. 38 (New York Convention or NYC).
[1454] *See* NYC, Art. II(1) ("Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them . . . concerning a subject matter **capable of settlement by arbitration**.") (emphasis added); *id.,* Art. V(2) ("Recognition and enforcement of an arbitral award may . . . be refused if the competent authority in the country where recognition and enforcement is sought finds that . . .[t]he subject matter of the difference is not **capable of settlement by arbitration** under the law of that country.") (emphasis added).
[1455] *See* UNCITRAL Model Law on International Commercial Arbitration of 1985 (as amended in 2006), Arts. 34(2)(b)(i), 36(1)(b)(i).
[1456] *See, e.g.*, International Chamber of Commerce Rules of Arbitration of 1998 (ICC Rules), Art. 1; International Arbitration Rules of the American Arbitration Association of 2009 (AAA Rules), Art. 1.

The approach taken by the NYC seems sensible. Each country has its own understanding of what constitutes a public interest, and consequently of which disputes can be referred to arbitration. An attempt to formulate a uniform rule in this respect may be considered as over-reaching and discourage some countries from acceding to the Convention in the first place. Additionally, even if a uniform solution were to be found, it is questionable what its quality would be. Each time when negotiations involve such a large number of participants the outcome is necessarily a compromise, which often leads not to the best solution but to the one that represents the lowest common denominator.[1457]

6.2.1.3 Arbitrability in national legislation

Another relevant source of law are national arbitration statutes. Although they generally provide more guidance than the NYC, they also regulate arbitrability in broad terms. For example, the U.S. Federal Arbitration Act [1458] does not use the term "arbitrability", instead mentioning issues "referable to arbitration".[1459] As can be seen, the FAA does not say with more precision than the NYC whether antitrust disputes can be settled by arbitration. The term "issues referable to arbitration" is equally vague as "subject matter capable of settlement by arbitration".

The European statutes also regulate arbitrability in general terms, but have a slightly different approach. There the distinction is usually made between claims that are within the free disposition of the parties and those that are not.[1460] However, these systems also tend not to specify the group to which antitrust issues would belong. For example, under French law a

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[1457] *But see* J. Patrick Ovington, *Arbitration and U.S. Antitrust Law: A Conflict of Policies*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 2 No. 2 (1985), pp. 53-60, at 59 (arguing that the Convention should have regulated arbitrability more specifically).

[1458] Federal Arbitration Act of 1925, 9 USC §§ 1-14 (FAA).

[1459] *See* FAA Section 3, 9 U.S.C. § 3 ("If any suit or proceeding be brought in any of the courts of the United States upon any issue **referable to arbitration** under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is **referable to arbitration** under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.") (emphasis added).

[1460] VÁRADY, BARCELO & VON MEHREN, *supra* note 1445, at 233.

person can refer to arbitration all rights of which it can dispose freely.[1461] Similarly, Italian law declares as inarbitrable disputes that cannot be the subject of a compromise.[1462]

German law, following the Swiss approach,[1463] seems to go a bit further, declaring that "[a]ny claim involving an economic interest can be the subject of an arbitration agreement".[1464] At first glance this approach might seem to encompass almost all conceivable claims, since basically all claims can be construed as being related to an economic interest. However, this formulation should not be read too broadly, since it does not exclude the possibility of precluding arbitrability of certain claims based on public interest considerations.

An important exception to these indeterminate clauses about arbitrability of antitrust disputes is Sweden. The Swedish Arbitration Act is somewhat more concrete on the issue, explicitly providing that "arbitrators may rule on the civil law effects of competition laws as between the parties."[1465] The Act therefore sets two limitations to arbitrability of competition law disputes. The first one is that arbitrators can decide only on civil law aspects of antitrust infringement, such as the issue of damages. If an antitrust violation would also bear public law responsibility, such as penalties imposed by competition authorities, the arbitral tribunal would clearly not have jurisdiction to decide on it. Secondly, the Swedish act is unequivocal that the arbitrators' decision will be binding only between the parties to the arbitration agreement. This is in accordance with the principle that an award binds only parties to the arbitration agreement, and for this reason the formulation seems appropriate.

As can be seen, by taking into account the NYC, the rules of the main arbitral institutions, and national statutes, it generally cannot be determined whether antitrust issues

[1461] [French] Code Civil of 1804, Art. 2059.
[1462] [Italian] Code of Civil Procedure of 1990, Art. 806.
[1463] [Swiss] Private International Law Act of 1987, Art. 177.
[1464] [German] Arbitration Law of 1998, Sect. 1030(1).
[1465] [Swedish] Arbitration Act of 1999, Sect. 1, para. 3 (according to: Klaus Peter Berger, *The Arbitration Agreement under the Swedish 1999 Arbitration Act and the German 1998 Arbitration Act*, ARBITRATION INTERNATIONAL, Vol. 17 No. 4 (2001), pp. 389-400).

arising out of an exclusive distribution agreement may be settled by arbitration. For this reason, in order to make this determination the relevant U.S. and EU case-law on the issue needs to be addressed. However, before that it is also useful to reflect on the issue of the law according to which arbitrability is determined.

6.2.1.4 Law applicable to arbitrability

An antitrust dispute may be arbitrable according to the law of one country and not arbitrable according to the law of another. For this reason the determination about which law applies to the issue of arbitrability could be crucial as to whether a dispute will be resolved by arbitration or the tribunal will refer the dispute to a court.

There is no single answer to the question about which law to apply to arbitrability.[1466] However, this does not mean that general principles on the matter cannot be discerned. Most importantly, determination on the law applicable to arbitrability would seem to depend on the stage of arbitration proceeding at which the issue of arbitrability arises. In general, arbitral proceedings can be divided into three stages: 1) litigation over whether the court should hear the dispute or send the parties to arbitration; 2) determination by arbitrators whether to hear the dispute or decline jurisdiction; and 3) court review of an award in setting aside or recognition and enforcement procedures.[1467]

As for Stage 1, it is important to note that the NYC does not regulate the issue of which law the court is to apply to arbitrability when seized of an action despite the existence of an arbitration agreement. According to the Convention, when seized of such an action, the court should refer the parties to arbitration, unless it finds that the agreement is null and void,

[1466] *See* Karl-Heinz Bockstiegel, *Public Policy and Arbitrability*, *in* 3 ICCA CONGRESS SERIES 177, 184 (1986) ("Agreement on the conclusion that there is disagreement seems to be the only common denominator that one can find between arbitrators, courts and publicists regarding the question which is the applicable law on arbitrability."). *See also* Hanotiau, *supra* note 1449, at 153 ("[T]he issue of which law governs arbitrability is not an easy one and . . . the answer to it may depend upon the tribunal or court before which it is raised.").
[1467] John J. Barceló III, *Who decides the arbitrators' jurisdiction? Separability and competence-competence in transnational perspective*, 36 VAND. J. TRANSNAT'L L. 1115, 1118 (2003).

inoperative or incapable of being performed.[1468] Although this provision is silent regarding the law that is to be applied to the validity of the arbitration agreement, the court will generally apply the *lex fori*. And following the view that arbitrability should be assessed in accordance with the law governing the validity of the arbitration agreement, courts at Stage 1 can be expected to assess arbitrability in accordance with the *lex fori*.[1469]

The situation with Stage 2 is more complex. There are numerous solutions as to the law according to which arbitral tribunals are supposed to assess arbitrability of disputes before them. According to one approach, arbitrators should always resolve this issue according to the *lex arbitri.*[1470] This approach seems to be in accordance with the Model Law. Although the Model Law does not expressly provide which law should be applied to arbitrability, it does so impliedly. According to the Model Law, one of the grounds for setting an award aside is if "the court finds that: the subject-matter of the dispute is not capable of settlement by arbitration under the law [of the country where the award was made]".[1471] Therefore, if they assess arbitrability according to a law other than the *lex arbitri*, arbitrators may run the risk of seeing their award being set aside.

In the light of the NYC, it seems that arbitrators should also take into account the law of the country where their award is most likely to be enforced. True, Article V(2)(a) is addressed to courts, and does not bind arbitrators directly. Nevertheless, taking into account

[1468] NYC, Art. II(3).
[1469] Piero Bernardini, *Arbitration Clauses: Achieving Effectiveness in the Law Applicable to the Arbitration Clause*, 9 ICCA CONGRESS SERIES 197, 200 (1999). *See also* Herman Verbist, *Arbitrability of Exclusive Distributorship Agreements in Belgium: Lex Fori (and Lex Contractus)?*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 22 No. 5 (2005), pp. 427-434, at 430 (discussing a Belgian Supreme Court case *Colvi v. Interdica* (October 15, 2004), where the court overturned a lower court's decision which interpreted Article II(3) of the NYC as meaning that the court should apply lex contractus to the validity of the arbitration agreement.).
[1470] *See* ALAN REDFERN, MARTIN HUNTER, NIGEL BLACKABY & CONSTANTINE PARTASIDES, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 81 (2004) ("[L]ex arbitri is likely to extend to … [w]hether a dispute is capable of being referred to arbitration"). *But see* Hanotiau, *supra* note 1449, at 157 ("As a matter of principle, the arbitrability of a dispute should not be decided by direct application of the law of the seat of the arbitration.").
[1471] UNCITRAL Model Law, Art. 34(2)(b).

their general duty to render an enforceable award,[1472] arbitrators cannot disregard the provisions of the Convention. The problem with this approach is that it is not clear how arbitrators can know in advance in which country their award is going to be enforced. Additionally, an award can be enforced in more than one country, which would imply that arbitrability would have to be assessed in accordance with all of those laws. And if those laws would have a different approach to arbitrability, the arbitral tribunal would have to choose to which law to give primacy.

Regarding Stage 2, another approach suggests that arbitrators should assess arbitrability in accordance with the law applicable to the validity of the arbitration agreement.[1473] Although it is far from clear which law would that be,[1474] some general remarks can be made. Most notably, the arbitration agreement does not necessarily have to be regulated by the same law that applies to the contract as a whole (*lex causae*). Separability of the arbitration clause from other provisions of the agreement seems to be now commonly recognized. According to the Model Law, "an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract".[1475] This implies that the law applicable to the arbitration agreement and the law applicable to the contract do not have to be the same.[1476]

[1472] *See, e.g.*, ICC Rules, Art. 35; London Court of International Arbitration Rules of 1998 (LCIA Rules), Art. 32.2.
[1473] *See* VARADY, BARCELO & VON MEHREN, *supra* note 1445, at 277-81.
[1474] *See* Marc Blessing, *The Law Applicable to the Arbitration Clause*, 9 ICCA Congress series 168, 168-69 (1999) (identifying nine possible solutions: (1) the law of the place where the arbitration agreement has been concluded; (2) the law of the seat of the arbitral tribunal (*lex arbitri*); (3) the proper law of the arbitration agreement; (4) the proper law of the substantive contract in which the arbitration clause is embedded (*lex causae*); (5) the law of the parties, or of one of them; (6) the law of the country whose courts would have jurisdiction absent an arbitration clause; (7) the law of the country where the arbitral award is most likely to be enforced; (8) a combination of laws which may be contemplated under any one of the foregoing seven solutions; (9) an a-national or denationalized approach, according to which the arbitration clause should be governed by common and fundamental principles of law.).
[1475] UNCITRAL Model Law, Art. 16(1).
[1476] *See* JULIAN D.M. LEW, LOUKAS A. MISTELIS & STEFAN M. KRÖLL, COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION 107-08 (2003); Antonias Dimolitsa, *Separability and Kompetenz-Kompetenz* (*in* IMPROVING THE EFFICIENCY OF ARBITRATION AND AWARDS: 40 YEARS OF APPLICATION OF THE NEW YORK CONVENTION 217, 219 (Albert Jan van den Berg ed., 1999).

However, in certain cases these two laws can coincide. If the arbitration agreement is contained in an arbitration clause in a contract, the law applicable to the contract as a whole should also govern the validity of the arbitration clause.[1477] It seems this would generally be the situation with exclusive distribution agreements, since with regards to this type of agreement the arbitration agreement will generally be contained in an arbitral clause in the distributorship contract. On the other hand, if the arbitration agreement is in the form of a *compromis* and the parties are silent on the issue, the validity of the arbitration agreement should be determined in accordance with *lex arbitri*.[1478]

Finally, the situation with regards to assessing arbitrability at Stage 3 (court review) seems more straightforward. According to the NYC, the court dealing with enforcement of the award will apply the *lex fori* to the issue of arbitrability.[1479] The Model Law offers the same solution, both regarding refusing enforcement[1480] and setting aside[1481] of an award. Therefore, it seems widely accepted that at the enforcement and setting aside phase arbitrability will be assessed in accordance with the *lex fori* of the enforcement i.e. setting aside court.

6.2.2 Arbitrability of antitrust issues in the U.S.

6.2.2.1 The American Safety doctrine

The American approach towards the arbitrability of antitrust disputes has not been constant. Initially, the American courts did not allow Sherman Act claims to be referred to arbitration. The rationale was that antitrust enforcement is too intertwined with public interest to be left for deciding to a private tribunal and should hence be limited to the state judicial system. The most well known case representing this view was *American Safety Equipment*

[1477] REDFERN, HUNTER, BLACKABY & PARTASIDES, *supra* note 1470, at 129-30.
[1478] *Id.* at 130.
[1479] NYC, Art. V(2)(a) ("Recognition and enforcement of an arbitral award may also be refused if . . .[t]he subject matter of the difference is not capable of settlement by arbitration under the law of [the country where recognition and enforcement is being sought].").
[1480] Art. 36(1)(b)(i).
[1481] Art. 34 (2)(b)(i).

Corp. v. J. P. Maguire & Co.;[1482] consequently, the standpoint that antitrust disputes cannot be decided upon by arbitrators is usually referred to as the "*American Safety* doctrine".

The doctrine expressed distrust in arbitration and its fitness to deal with an issue of general interest such as antitrust. This was mainly justified by four arguments. First, agreements out of which antitrust disputes arise are usually contracts of adhesion, and the arbitral clause they contain does not reflect the free will of the parties.[1483] Second, private actions for treble damages play an important role in the American antitrust system, and leaving them out of the judiciary might weaken antitrust enforcement as a whole.[1484] Third, antitrust laws are very complex, and their application requires skills which arbitrators usually lack.[1485] And fourth, arbitrators usually come from the business community and hence it cannot be expected that they would be fit enough to decide on issues of great public interest.[1486]

However, over time the courts' sentiment gradually started to change. One of the signs of this trend was the Supreme Court decision in *M/S Bremen v. Zapata Off-Shore Co.*[1487] Although the case did not directly concern the arbitrability of antitrust claims, it is significant because it emphasized the importance of arbitration for international trade.[1488] The pro-arbitration tendency continued with the Court's decision in *Scherk v. Alberto-Culver Co.*,[1489] which allowed the arbitrability of disputes arising out of securities regulations in the international context. Securities regulations are similar to antitrust laws in that both serve not

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[1482] 391 F.2d 821 (2d Cir. 1968). Although this was not a Supreme Court case, it seems to have been unanimously followed by all circuits.
[1483] *Id.* at 828.
[1484] *Id.* at 827.
[1485] *Id.* at 828.
[1486] *Id*.
[1487] 407 U.S. 1 (1972).
[1488] *Id.* at 14. *See also id.* at 9 ("The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts" and consequently "[w]e cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.").
[1489] 417 U.S. 506 (1974).

only to protect individual parties, but also the general interest. For this reason the ruling in *Scherk* announced a possible change in the area of the arbitrability of antitrust disputes.

6.2.2.2 Mitsubishi

The new era with regards to the arbitrability of antitrust disputes came with the well known case of *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*[1490] The case concerned a dispute between the Japanese car manufacturer Mitsubishi and the car dealer form Puerto Rico called Soler. The facts of the case are somewhat complex, but can be summarized as follows.

In 1979 Mitsubishi and Soler entered into a distribution agreement according to which Soler was supposed to distribute Mitsubishi cars in Puerto Rico. The agreement provided for a minimum sales volume Soler was supposed to achieve; initially, Soler had no problems in fulfilling this obligation. Nevertheless, in 1981 the demand for new cars slackened, and Soler was not able to meet the minimum sales requirement. As a result of weak demand in Puerto Rico, Soler attempted to transship surplus vehicles into Latin America and continental U.S. However, Mitsubishi opposed this, and consequently withheld a shipment of new vehicles.

Since the agreement contained an arbitration clause, in 1982 Mitsubishi filed for an order to compel arbitration in the U.S. District Court in Puerto Rico. Mitsubishi also submitted a request for arbitration before the Japan Commercial Arbitration Association. Soler counterclaimed, alleging among other things that the exclusive character of the distribution agreement was in violation of the Sherman Act. The District Court referred practically all claims to arbitration, including the ones about alleged antitrust violations. Invoking the *American Safety* doctrine, the Court of Appeals reversed. The dispute eventually reached the Supreme Court, the main question being “whether an American court should

[1490] 473 U.S. 614 (1985).

enforce an agreement to resolve antitrust claims by arbitration when that agreement arises from an international transaction."[1491]

The Court seemingly answered in the positive, with certain qualifications. In reaching this decision the Court rebutted the reasons for inarbitrability of antitrust issues put forward by *American Safety*. First, the Court refuted the argument that antitrust disputes should not be arbitrable because of possible unfairness in the drafting of arbitral clauses. The Court stated that it should not be presumed that the forum selection in favor of arbitration is unfair – if the arbitral clause has in any way been tainted, the party alleging this can challenge the validity of the clause.[1492]

The Court then turned to the argument that private enforcement is of such importance for antitrust that it cannot be left to arbitrators to decide on it. In this respect it emphasized that the treble damage remedy is before all a private remedy,[1493] implying that as such it can be sought outside American courts.[1494] Noting that by applying American law arbitral tribunals will also apply the Sherman Act, the Court concluded that by allowing the arbitrability of antitrust claims the Act will preserve both its remedial and deterrent function.[1495] Consequently, the Court found no reason to assume *a priori* that international arbitration is an inadequate mechanism for resolving antitrust disputes.[1496]

The Court's reasoning seems sound. By allowing arbitrability of disputes arising out of the Sherman Act, the effectiveness of antitrust enforcement does not appear to suffer. Even

[1491] *Id.* at 624.
[1492] *Id.* at 632.
[1493] *Id.* at 635-36 ("Section 4 [of the Clayton Act] . . . is in essence a remedial provision. It provides treble damages to '[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws....' Of course, treble damages also play an important role in penalizing wrongdoers and deterring wrongdoing, as we also have frequently observed . . . It nevertheless is true that the treble-damages provision, which makes awards available only to injured parties, and measures the awards by a multiple of the injury actually proved, is designed primarily as a remedy.").
[1494] In a later decision, the Supreme Court confirmed that treble damages are not an exclusive prerogative of the courts, and hence arbitral tribunals are not precluded from awarding them. *See* PacifiCare Health Systems, Inc. v. Book, 538 U.S. 401, 405 (2003).
[1495] *Mitsubishi,* 473 U.S. at 637 ("[S]o long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function.").
[1496] *Id.* at 636.

if it would be presumed that an arbitral tribunal might fail to sanction an anticompetitive conduct, the award is conclusive only between the parties to the arbitration agreement. Therefore, nothing prevents other subjects not bound by the arbitration agreement, that is other damaged private parties or government agencies, to start their own proceedings against the infringer of the Sherman Act.[1497] Additionally, the same applies to the other contracting party, with regards to issues falling outside the scope of the arbitration agreement.

However, the dissent was more concerned about a different scenario – that an arbitral tribunal could condemn a business practice that is actually not anti-competitive.[1498] This concern does not seem to be justified for at least two reasons. First, it is difficult to see why an arbitral tribunal would intentionally condemn a business practice which it considers as efficient. Although theoretically possible, this fear does not seem to have much basis in reality. In addition, even if arbitrators condemned an efficient conduct by mistake, it is not clear why arbitrators would be more prone to errors than judges.

Connected to this is the third premise of *American Safety*, namely that antitrust issues are too complex to be left for arbitrators to decide. The Court rebutted this presumption, holding that complexity alone is not enough for a determination that arbitral tribunals cannot properly handle antitrust matters.[1499] This reasoning seems sound. On a general level, it is not clear why antitrust should be considered as more difficult than other areas of law.[1500]. In addition, arbitrators are generally experienced lawyers, who can be expected to know enough

[1497] *See* Brief of the American Arbitration Association as *amicus curiae* (Note, *Mitsubishi v. Soler Chrysler-Plymouth, US Supreme Court, 2 July 1985*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 2 No. 3 (1985), pp. 82-96, at 93-94) ("The antitrust enforcement authorities of the United States Government are free at all times to initiate proceedings to enforce the antitrust laws . . . Moreover, a transnational arbitration agreement has no effect on the rights of injured third parties to enforce, the antitrust laws through actions for treble damages, injunctive relief or both. Where an antitrust violation has occurred or is threatened in the course of a contractual relationship, the standing requirements may be satisfied by parties outside the contract, such as competitors … customers . . . or suppliers.").
[1498] *Mitsubishi,* 473 U.S. at 657 n.32 (Stevens, J., dissenting).
[1499] *Id.* at 633-34.
[1500] *See* Andreas F. Lowenfeld, *The Mitsubishi case: another view*, ARBITRATION INTERNATIONAL, Vol. 2 No. 3 (1986), pp. 178-190, at 182.

about antitrust in order to solve antitrust issues arising out of the dispute.[1501] Arbitrators are generally recruited among distinguished legal experts, and it does not seem that they are in any way less knowledgeable than judges to deal with antitrust claims. If anything, the opposite could be argued.

The Supreme Court also rejected the fourth *American Safety* argument, i.e. that allowing arbitrators to decide on antitrust disputes would be in some way dangerous for the public interest. The fact that arbitrators often come from the business community does not automatically make them ineligible to decide on issues intertwined with general interests.[1502] In this respect the Court expressed trust in arbitrators that they will foster the public interest even if in a particular situation it would be in conflict with the interest of the business community.

Based on this, the Court found the arbitration agreement enforceable with regards to antitrust issues.[1503] By allowing the arbitration to go forward, *Mitsubishi* can be seen as recognizing that arbitrators do have authority to decide on antitrust issues, at least in the international context.[1504] In other words, *Mitsubishi* can be seen as acknowledging that these disputes are arbitrable. However, it will be shown that the Court did not give arbitrators complete freedom in this respect. In addition, *Mitsubishi* left open a number of issues related to the issue of arbitrability in a wider sense.

[1501] *See id.*
[1502] *See Mitsubishi,* 473 U.S. at 634 (the Court declining "to indulge the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent, conscientious, and impartial arbitrators").
[1503] *Id.* at 640.
[1504] *But see* Hans Smit, *Mitsubishi: It is Not What it Seems To Be*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 4 No. 3 (1987), pp. 7-24, at 8 (arguing that everything that *Mitsubishi* said about arbitrability of antitrust issues was only *dictum*).

6.2.2.3 Some limitations of Mitsubishi

6.2.2.3.1 Domestic v. international context

One of the issues that *Mitsubishi* left unclear is whether antitrust issues can also be arbitrable outside the international context. In other words, the Court did not explicitly decide if domestic antitrust disputes can be referred to arbitration. Rather, it limited its decision to disputes in the international context, finding it unnecessary to decide on the legitimacy of the *American Safety* doctrine with regards to domestic arbitration.[1505]

However, this does not mean that domestic antitrust disputes cannot be referred to arbitration. Following *Mitsubishi*, several lower courts have implicitly or explicitly extended the arbitrability of antitrust disputes to the domestic context,[1506] as long as the interests of the third parties are not affected.[1507] It is also considered that the Supreme Court did the same in *Gilmer v Interstate/Johnson Lane Corp.*[1508] There the Court noted that claims under the Sherman Act are appropriate for arbitration,[1509] leaving out the qualification "in the international context". This can be read as the Court's recognition that all disputes arising out of the Sherman Act are arbitrable, including those in the domestic context.

[1505] *Id.* at 629.

[1506] *E.g.*, GKG Caribe, Inc. v. Nokia-Mobira, Inc., 725 F.Supp. 109 (1st Cir. 1989); Gemco Latinoamerica, Inc. v. Seiko Time Corp., 671 F.Supp. 972 (1st Cir. 1987); Kowalski v. Chicago Tribune Co., 854 F.2d 168 (7th Cir. 1988); Hough v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 757 F.Supp. 283 (2d Cir. 1991); Prestige Ford v. Ford Dealer Computer Services, Inc., 324 F.3d 391 (5th Cir. 2003); Seacoast Motors of Salisbury, Inc. v. DaimlerChrysler Motors Corp., 271 F.3d 6 (1st Cir. 2001); Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); HCI Technologies, Inc. v. Avaya, Inc., 446 F.Supp.2d 518 (4th Cir. 2006); Empire State Ethanol and Energy, LLC v. BBI Intern., 2009 WL 790962 (2d Cir. 2009); Xerox Corp. v. Media Sciences, Inc., 609 F.Supp.2d 319 (2d Cir. 2009).

[1507] In order for an antitrust dispute to be arbitrable, it has to fall under the scope of the arbitration agreement. Clearly, when there is no arbitration agreement between the parties, an arbitral tribunal is not competent to deal with an antitrust claim. In this respect Baker and Stabile emphasize that in general there may be a basis for arbitrability of antitrust disputes in case there is privity between the parties (i.e. between commercial partners), while in case of disputes with regards to conspiracies with strangers or disputes between competitors the basis for arbitrability will generally not exist. Donald I. Baker & Mark R. Stabile, *Arbitration of antitrust claims: opportunities and hazards for a corporate counsel*, 48 BUS. LAW. 395, 398-400 (1993). In this respect see Coors Brewing Co. v. Molson Breweries, 51 F.3d 1511, 1517-18 (10th Cir. 1995) (antitrust claims arising out of a vertical licensing agreement between the parties are arbitrable, while claims that allege a horizontal market division involving a firm which is not a party to the arbitration agreement are not).

[1508] 500 U.S. 20 (1991).

[1509] *Id.* at 28.

6.2.2.3.2 Choice of law

One of the most important qualifications set out by *Mitsubishi* is contained not in the main text but in a footnote of the decision. In the footnote the Court noted that "in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy".[1510] In other words, parties are limited in their choice of law – whatever law they choose as *lex causae*, when the dispute is substantially related to the U.S. the arbitral tribunal should always apply American antitrust legislation. Otherwise, American courts may refuse enforcement of the award on the grounds that it is against public policy. Some commentators have described the footnote as the most important part of the decision.[1511] Consequently, the issue deserves to be addressed more fully below.[1512]

6.2.2.3.3 Waiver of remedies

6.2.2.3.3.1 Treble damages

Although *Mitsubishi* held that statutory claims can be referred to arbitration,[1513] it also noted that by agreeing to arbitrate a statutory claim a party does not relinquish the rights provided to it by the Sherman Act.[1514] Consequently, it is not clear whether parties to an arbitration agreement can modify the remedies provided by the Act. One such remedy is the award of treble damages. According to the Court of Appeals for the First Circuit's decision in *Kristian v. Comcast Corp.*,[1515] the award of treble damages cannot be waived, and

[1510] *Mitsubishi,* 473 U.S. at 637 n.19.
[1511] Jacques Werner, *A Swiss Comment on Mitsubishi*, JOURNAL OF INTERNATIONAL ARBITRATION, Volume 3 Issue 4 (1986), pp. 81-84, at 82.
[1512] *See infra* Part 6.4.1.
[1513] *See Mitsubishi,* 473 U.S. at 625 ("[W]e find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims.").
[1514] *See id.* at 628.
[1515] 446 F.3d 25 (1st Cir. 2006).

consequently an arbitration clause prohibiting the award of treble damages is unenforceable.[1516]

In *Comcast* the arbitral agreement provided an explicit waiver with regards to the award of treble damages.[1517] A related question is whether an arbitral clause that precludes the award of punitive damages also encompasses the award of treble damages.[1518] The Supreme Court addressed this issue in *PacifiCare Health Systems, Inc. v. Book*.[1519] In this decision the Court did not give a straightforward answer, leaving the assessment about this issue to the arbitral tribunal interpreting the arbitration agreement.[1520] Therefore, punitive damages may or may not encompass treble damages, depending on the arbitrators' judgment in a particular case.[1521] According to at least one lower court decision before *PacifiCare*, the prohibition in an arbitral agreement against awarding punitive damages does not extend to the award of treble damages.[1522]

The issue of treble damages is also related to the enforcement of arbitral awards outside the United States. This is due to the fact that the institute of treble damages is an American peculiarity and other legal systems generally do not recognize this type of damages. What is more, treble damages can be seen as a type of punitive damages. As discussed above, the situation becomes even more complex if we take into account that certain countries see punitive damages as against their public policy, hence refusing to enforce arbitral awards awarding such damages.[1523]

[1516] *Id.* at 48.
[1517] *See id.* at 44 ("In no event shall we or our employees or agents have liability for punitive, treble, exemplary, special indirect, incidental or consequential damages.").
[1518] *See supra* Part 5.1.2.1.
[1519] 538 U.S. 401 (2003).
[1520] *PacifiCare*, 538 U.S. at 407.
[1521] *See supra* Part 5.1.2.1.
[1522] *See* Investment Partners, L.P. v. Glamour Shots Licensing, Inc., 298 F.3d 314, 317 (5th Cir. 2002).
[1523] *See supra* Parts 5.1.2.1, 5.2.2.3.4.3.

6.2.2.3.3.2 Litigation costs

Antitrust litigation can be very complex and expensive. The rule that a successful antitrust plaintiff can recover litigation costs is an incentive for private parties to go after antitrust infringers, aimed at making antitrust enforcement more effective.[1524] Consequently, the rule regarding the attorney's fees is at least partly aimed at protecting the public interest. Due to the involvement of the public interest, it is not clear whether parties to an arbitration agreement can waive this provision or not.

This issue arose in the already mentioned *Comcast* case.[1525] The First Circuit Court of Appeals found this waiver unenforceable, holding that the prohibition on the recovery of litigation costs directly conflicts with the Sherman Act provision providing such costs.[1526] Based on this decision, it would seem that the provision regarding attorney's fees in antitrust litigation is an imperative one and hence beyond the reach of parties' autonomy. In this respect it should be noted that with regards to international arbitration the rule is generally that costs follow the event, meaning that the prevailing party is entitled to recover all its costs arising out of the litigation.[1527] This is unlike the general American rule on cost allocation, according to which each party bears its own costs, regardless of the outcome of the litigation.[1528] Consequently, the Sherman Act rule on costs is more in line with the trend in international arbitration than the general rule in American civil procedure is.

6.2.2.3.3.3 Equitable reliefs

A related issue is whether parties can waive the right to seek an injunctive relief. This issue came up in the Court of Appeals for the Seventh Circuit decision in *Kowalski v.*

[1524] *See supra* Part 5.1.2.1.
[1525] The arbitration agreement in question contained the following provision: "The Company will pay for all reasonable arbitration filing fees and arbitrator's costs and expenses except that YOU ARE RESPONSIBLE FOR ALL COSTS THAT YOU INCUR IN THE ARBITRATION, INCLUDING, BUT NOT LIMITED TO, YOUR EXPERT WITNESSES OR ATTORNEYS." *Comcast,* 446 F.3d at 50.
[1526] *Id.* at 50.
[1527] *See* Price & Stans, *supra* note 1226, at 706.
[1528] *See id.* at 708.

Chicago Tribune Co.[1529] There the arbitral agreement provided that in the case of a dispute monetary relief will be the exclusive remedy. Despite this, one of the parties turned to the court requesting an injunctive relief with regards to the alleged antitrust violation. The Court (Judge Posner) found that the applicant was not entitled to equitable relief, since the arbitration agreement explicitly limited remedies to monetary relief.[1530]

Based on this it could be concluded that the outcome in *Kowalski* seems to be in conflict with *Comcast*. Both the provision on treble damages and attorneys fees and the one on injunctive relief use the term "shall".[1531] However, while *Comcast* ruled that this wording implies an imperative norm that cannot be changed by the parties' agreement, *Kowalski* went the other way, finding that the will of the parties to an arbitration agreement can subrogate the solution in the law. Therefore, in order to resolve this conflict between different circuits, the Supreme Court may be expected to address the issue of waiving remedies at some point in the future.

6.2.2.4 The impact of Mitsubishi

At the time when it was rendered, *Mitsubishi* received a lot of attention among legal commentators. Although the American Arbitral Association and the ICC submitted amicus briefs in the case arguing that parties should be able to refer antitrust disputes to arbitration, it does not mean that everyone in the arbitral community was satisfied with the Court's ruling. Attacks came from several sides, with some using quite strong words to condemn the decision.

[1529] 854 F.2d 168 (7th Cir. 1988).
[1530] *Id.* at 170. ("The plaintiffs could have negotiated for some form of equitable relief in the event of termination but they evidently decided that monetary relief would be adequate and expressly waived any other form of remedy. They argue now that they never surrendered their right to seek equitable relief *from a court* in the event of an unjust termination, but we cannot understand how this jibes with the provision in the agreements that makes arbitration the parties' "exclusive remedy to resolve *any* dispute concerning the termination of a Distributor".).
[1531] *Compare* Clayton Act Section 4, 15 U.S.C. § 15 *with* Clayton Act Section 16, 15 U.S.C. § 26.

For example, Professor Carbonneau argued that the Court in *Mitsubishi* did not properly take into account public policy considerations, asking whether there are any limits to arbitrability if such fundamental issues as antitrust matters can be submitted to arbitration.[1532] He went on to make a bold forecast - that *Mitsubishi* will bring arbitration into a state of "'a-national' lawlessness".[1533] On the other hand, Jacques Werner addressed the bulk of his criticism at footnote 19 of the decision. He called it "a magnificent example of an attempt to export U.S. substantive laws where they had no place up to now: in international arbitration proceedings held outside the United States under an arbitration agreement providing for a non-U.S. law as law governing the dispute."[1534] He concluded that "[i]f the price for *Mitsubishi* is this dilution of parties' freedom and extension of U.S. substantive laws operated in tandem, I doubt that the users of international arbitration can afford to pay it."[1535]

Another line of criticism was that the Court in *Mitsubishi* unnecessarily went too far, since international comity and the NYC did not make it in any way necessary for the Court to declare antitrust disputes arbitrable. The argument was that Article V of the NYC itself recognizes that arbitration is not capable of dealing with certain disputes which are connected to the fundamental interest of nations.[1536] Consequently, had the U.S. insisted on non-arbitrability of antitrust disputes, this would not have in any way violated its international obligations.[1537] Following this line of argument, another commentator noted that "[i]f all antitrust claims arising from international contracts were found to be arbitrable, the

[1532] Thomas E. Carbonneau, *Mitsubishi: the Folly of Quixotic Internationalism*, ARBITRATION INTERNATIONAL, Volume 2 Issue 2 (1986), pp. 116-139, at 135. Some other commentators followed this line, noting that "[t]he presence of international business concerns in the arbitration do not outweigh the importance of this fundamental domestic policy." Lisa Sopata, *Mitsubishi Motors Corp. v. Soler Chrysler- Plymouth, Inc.: International Arbitration and Antitrust Claims*, 7 NW. J. INT'L L. & BUS. 595, 616 (1986).
[1533] *See* Carbonneau, *supra* note 1532, at 136 ("The court's failure to acknowledge logical, sensible, and necessary restraints countermands the basic consensus of the New York Arbitration Convention and moves closer to placing international dispute resolution through arbitration in a realm of 'a-national' lawlessness.").
[1534] Werner, *supra* note 1511, at 83.
[1535] *Id.*
[1536] *See Mitsubishi,* 473 U.S. at 665.
[1537] Jill A. Pietrowski, *Enforcing international commercial arbitration agreements - post-Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 36 AM. U. L. REV. 57, 89 (1986).

Convention's language, 'nor capable of settlement by arbitration,' would have little or no meaning."[1538]

Nevertheless, there have also been a number of commentators who defended the ruling.[1539] Some have added optimistic notes, predicting that the *Mitsubishi* decision "will open the door to increased international trade with American parties due to the certainty of enforcement of their arbitration agreements."[1540] It has also been forecasted that the outcome of *Mitsubishi* "will strengthen and encourage the use of arbitration in international commercial disputes."[1541] Perhaps the most interesting justification of *Mitsubishi* comes from Eric Posner.[1542] According to him, *Mitsubishi*'s vagueness about the court review of awards dealing with antitrust issues is probably the best part of the decision. In order to show this, he created a model analyzing the interaction between the courts and arbitral tribunals.

The model envisages three possible equilibriums. First, if the courts care more about efficiency than about the Sherman Act, they will always enforce awards, and as a result arbitrators might start ignoring the Act.[1543] Second, if the courts care enough about the Sherman Act application, then they can adopt a randomizing strategy of sometimes enforcing and sometimes reviewing arbitral awards. This way they would induce arbitrators to also engage in a randomizing strategy of sometimes respecting and sometimes ignoring antirust rules.[1544] And third, if the courts do care about the application of antitrust rules but are not able to adopt a randomizing strategy, they will always review arbitral awards, thereby driving parties away from arbitration.[1545]

[1538] Sopata, *supra* note 1532, at 611.
[1539] *See, e.g.*, Lowenfeld, *supra* note 1500.
[1540] Lisa M. Ferri, *Note on Mitsubishi Motors Corp. v. Soler Chrysler-Plymout, Inc.*, 17 SETON HALL L. REV. 448, 472-73 (1987).
[1541] Lauri Newton, *Arbitration and antitrust: a leg up for international arbitration*, 25 WASHBURN L.J. 536, 551 (1986).
[1542] Eric A. Posner, *Arbitration and the harmonization of international commercial law: a defense of Mitsubishi*, 39 VA. J. INT'L L. 647 (1999).
[1543] *Id.* at 653.
[1544] *Id.* at 653-54.
[1545] *Id.* at 654.

Eric Posner argues that the second equilibrium is the superior one and opines that *Mitsubishi*'s ambiguity about the level of review actually provided such an equilibrium.[1546] Of course, this does not have to mean that the Justices made a law and economics analysis before writing a vague opinion. However, it seems that the outcome is what matters. And according to Eric Posner, the result is that in fourteen years following *Mitsubishi* there were no cases where a party would before American courts try to set aside an award dealing with antitrust issues.[1547] This means that arbitrators were in general properly applying the Sherman Act[1548], justifying the trust in arbitration expressed by the Supreme Court.

6.2.3 Arbitrability of EU competition law

In the EU, the situation regarding the arbitrability of antitrust (or competition law) matters seems to be more vague than in the U.S. First, at EU level there is no ruling which would directly deal with the issue of whether competition law disputes can be referred to arbitration. Further, the case where the ECJ came closest to the point - *Eco Swiss*[1549] - is in many ways vague and ambiguous. As a result, the national courts of EU Member States have interpreted this ECJ decision in different ways.

The facts of *Eco Swiss* can be summarized as follows. Benetton and Eco Swiss entered a licensing agreement according to which Benetton granted Eco Swiss the right to market watches under the name "Benetton by Bulova". However, Benetton terminated the license before the licensing period expired. In accordance with the arbitral clause in the licensing agreement, Eco Swiss invoked arbitration in the Netherlands. The arbitral tribunal

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1546 *Id.* at 667.
1547 *Id.*
1548 *See id.* at 668 ("If arbitrators fear the possibility of de novo review, they might respect mandatory rules. If they respect mandatory rules, the losing party knows that it cannot win in a U.S. court, even if the court grants a de novo trial. To avoid litigation costs, the party declines to sue.").
1549 Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055. Some argue that the ECJ implicitly recognized arbitrability of antitrust disputes even earlier, in Case 102/81 *Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG* [1982] ECR 1095. Edward Kling, *Court Review of Antitrust International-Arbitral Awards*, NEW YORK LAW JOURNAL, Vol. 238, No. 26 (2007).

found that Benetton did in fact breach the licensing agreement, and consequently awarded damages to Eco Swiss.

During arbitration the parties did not raise any antitrust claims, and the arbitrators did not address such issues *ex officio*. Nevertheless, Benetton challenged the award before a Dutch court, arguing that the licensing agreement based on which the damages were awarded was not in accordance with EU competition law and was therefore in violation of public policy. The case eventually reached the Dutch Supreme Court, which found that competition law is not part of Dutch public policy. The court then made an Article 267 TFEU reference to the ECJ, asking *inter alia* whether EU competition rules are part of public policy at EU level.

The ECJ found that they are, stating that Article 101 TFEU should be regarded as a matter of public policy within the meaning of the NYC.[1550] The court went on to say that:

> a national court to which application is made for annulment of an arbitration award must grant that application if it considers that the award in question is in fact contrary to Article [101] of the Treaty, where its domestic rules of procedure require it to grant an application for annulment founded on failure to observe national rules of public policy.[1551]

Therefore, *Eco Swiss* does not expressly provide that antitrust disputes are arbitrable. However, it seems to have done so impliedly, by holding that the reviewing court will annul arbitration awards that are not in compliance with EU competition law.[1552] If an arbitral award has to be in compliance with EU competition rules, it means that arbitral tribunals can and should apply such rules. Consequently, if arbitral tribunals can decide on competition law issues, then such issues are deemed to be arbitrable. This is the position that seems to be accepted both by the commentators[1553] and courts.[1554]

[1550] *Eco Swiss*, para. 39.
[1551] *Id.*, para. 49.
[1552] The Court noted that an award should be annulled if it does not comply with the prohibition laid down in Article 101(1) TFEU. *Id.*, para. 37.
[1553] *See, e.g.*, LANDOLT, *supra* note 1316, at xiii ("no one doubts that [EU] competition law is arbitrable").
[1554] *See, e.g.*, [England] ET Plus SA v Welters, [2005] EWHC 2115 (Comm) of 7 November 2005 ("The Arts. [101] and [102] claims: There is no realistic doubt that such 'competition' or 'antitrust' claims are arbitrable; the issue is whether they come within the scope of the arbitration clause, as a matter of its true construction.").

With regards to the arbitrability of EU competition law, it should be noted that despite the fact that based on *Eco Swiss* arbitrators have the power (and arguably even the duty) to apply EU competition rules, this does not lessen the Commission's powers in the enforcement of these rules. The Commission may launch proceedings against an exclusive distribution agreement even where there is a pending arbitral proceeding regarding the agreement.[1555] What is more, the Commission could do so even if the arbitral tribunal has already rendered its decision.[1556] However, this does not apply the other way around. Although the Commission is not bound by arbitral awards, arbitral tribunals do have to take into account the Commission's decisions.[1557] Otherwise they run a danger of having their award set aside by a national court.[1558]

Even if it is beyond doubt that EU competition law is arbitrable, there are many other aspects of the problem that are still far from uncontested. This mainly refers to the level of review that national courts are supposed to apply with regards to the arbitral awards involving EU competition law. Also, an important issue is whether arbitrators have the duty to apply EU competition law ex officio. These issues will be afforded due attention, right after a corresponding discussion about the level of court review in the U.S.

6.3 Court review of awards dealing with antitrust issues

6.3.1 U.S.

6.3.1.1 Mitsubishi second look

Even if an arbitral tribunal can decide on issues arising out of the Sherman Act, its decision might not be final. According to *Mitsubishi*, "[h]aving permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-

[1555] *See* Carl Nisser & Gordon Blanke, *Reflections on the role of the European Commission as amicus curiae in international arbitration proceedings*, E.C.L.R. 2006, 27(4), 174-183, at 178.
[1556] *Ibid*.
[1557] Renato Nazzini, *International Arbitration and Public Enforcement of Competition Law*, E.C.L.R. 2004, 25(3), 153-162, at 161.
[1558] Epameinondas Stylopoulos, *Powers and duties of arbitrators in the application of competition law: an EC approach in the light of recent developments*, E.C.L.R. 2009, 30(3), 118-124, at 123.

enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed."[1559] In other words, the courts may have a second look at the award during the enforcement procedure. Consequently, the court review of arbitral awards dealing with antitrust claims is often referred to as the "second look doctrine". However, based only on *Mitsubishi* it is not clear how far reaching this review should be.

According to *Mitsubishi*, "[w]hile the efficacy of the arbitral process requires that substantive review at the award-enforcement stage remain minimal, it would not require intrusive inquiry to ascertain that the tribunal took cognizance of the antitrust claims and actually decided them."[1560] Although the Court did not specify in more detail the way in which the review is supposed to be performed, from the quoted wording it seems that the review should be rather limited. Therefore, an arbitral tribunal has two duties with regards to antitrust issues.

First, the arbitral tribunal needs to "[take] cognizance of the antitrust claims". The wording that the tribunal needs to acknowledge antitrust *claims* rather than antirust *issues* seems to imply that the tribunal does not have the duty to address antirust issues *ex officio*, but only if one of the parties puts forward a claim that antitrust laws have been violated. Second, the wording that the court examining an award needs to inquire whether the tribunal "actually decided" antitrust claims can be read as saying that the court will limit itself to the inquiry only whether the arbitral tribunal addressed the claims raised by the parties and not the way in which it addressed them.

The breadth of the *Mitsubishi* second look was revisited by the Court of Appeals for the Seventh Circuit in *Baxter Intern., Inc. v. Abbott Laboratories*.[1561] This case held that parties cannot reargue before the court antitrust issues decided by the arbitral tribunal.[1562] The

[1559] *Mitsubishi,* 473 U.S. at 638.
[1560] *Id*.
[1561] 315 F.3d 829 (7th Cir. 2003).
[1562] *Id.* at 831.

court noted that *"Mitsubishi* did not contemplate that, once arbitration was over, the federal courts would throw the result in the waste basket and litigate the antitrust issues anew. That would just be another way of saying that antitrust matters are not arbitrable."[1563] In other words, if parties were allowed to reargue antitrust issues before a court although they had already been decided by an arbitral tribunal, then the law could as well prohibit antitrust issues from being referred to arbitration in the first place. The outcome would be the same – the courts would be the ones deciding on antitrust claims.

The last sentence of *Baxter* deserves additional attention. The decision ends with the words that "[a]ll that matters today is that the arbitrators have concluded that the antitrust laws . . . do not diminish [a party's] contractual rights-and that decision is **conclusive between [the] parties**."[1564] This can be read as containing two important messages. First, a decision of an arbitral court is conclusive, i.e. final. In other words, once the arbitral tribunal makes the decision, it cannot be reargued before a court. Second, this finality applies **only between the parties** to the arbitration agreement. Therefore, other subjects, such as government agencies or private parties not bound the arbitration agreement, can still refer to the court to decide on antitrust issues, as has been noted above.

Baxter's interpretation of the Mitsubishi second look seems to be correct. At the outset, the grounds for refusing the enforcement of an award envisaged by the NYC are limited,[1565] and American courts cannot refuse enforcement on other basis.[1566] In addition, one of the main advantages of arbitration compared to litigation before the state judiciary is that arbitral proceedings are supposed to be faster, with in general no possibility for appeal. If the courts would submit arbitral awards to more extensive scrutiny than the one envisaged in

[1563] *Id.* at 832.
[1564] *Id.* at 833 (emphasis added).
[1565] *See* NYC, Art. 5.
[1566] This of course applies only with regards to the awards that fall under the auspices of the NYC.

Baxter, they might be acting as a *de facto* appeal instance, thereby eliminating one of the advantages of arbitral dispute settlement.

Finally, it should be noted that the American courts will not always have the chance to review arbitral awards dealing with antitrust issues. The "second look" could be missing due to some practical reasons arising out of the case at hand. In general, the prevailing party will turn to a court for the enforcement of an award in order to be compensated against the assets of the losing party. If the losing party does not have any assets in the U.S., the party that prevailed in arbitration will not have a reason to turn to an American court to seek enforcement of the award. Consequently, in such a situation the second look envisioned by *Mitsubishi* and *Baxter* will not be possible, even if the award concerns the application of the Sherman Act.

6.3.1.2 Manifest disregard of the law

It is possible that the second look laid down by *Mitsubishi* is not the only way in which the courts can exercise supervision over awards dealing with antitrust issues. Another potential avenue for such a review could be the doctrine of manifest disregard of the law. This doctrine originates from court practice and does not have any basis in the FAA.[1567] More precisely, it comes from the dicta in *Wilko v. Swan*[1568] according to which "the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation."[1569] This could be read as saying that although courts cannot review the way arbitrators interpreted the law, such a review is possible if arbitrators acted in manifest disregard of the law.

[1567] Stephan Wilske & Nigel Mackay, *The Myth of the 'Manifest Disregard of the Law' Doctrine: Is this Challenge to the Finality of Arbitral Awards Confined to U.S. Domestic Arbitrations or Should International Arbitration Practitioners be Concerned?*, ASA Bulletin, Vol. 24 No. 2 (2006), pp. 216-228, at 217.
[1568] 346 U.S. 427 (1953).
[1569] *Id.* at 436-37.

The exact reach of the doctrine is not easy to determine. On the one hand, it is because the concept itself is vague.[1570] It is far from clear whether the Court in *Wilko* was actually referring to a new ground for court review of awards or not. In addition, cases involving manifest disregard of the law are few and it is hence difficult to discern any general principles about the doctrine.[1571] In any case, it is important to emphasize that the manifest disregard doctrine does not apply to the enforcement of awards covered by the NYC. Article V of the Convention lists the grounds for refusing the enforcement of arbitral awards, and the manifest disregard of the law is not one of them.[1572] A related issue is whether the manifest disregard of the law can be invoked under Article V(2)(b) of the Convention, that is on grounds that the award is against public policy of the country where enforcement is being sought. At least one court has found that this is not possible.[1573]

However, the doctrine has been successfully invoked regarding the setting aside of arbitral awards rendered in the U.S.[1574] This is because the NYC does not apply to such

[1570] Steven C. Bennett, *The developing American approach to arbitrability*, 58-APR DISP. RESOL. J. 8, 13 (2003). *See also* Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 706 (Posner, J., 7th Cir. 1994) ("Created ex nihilo to be a nonstatutory ground for setting aside arbitral awards, the Wilko formula reflects precisely that mistrust of arbitration for which the Court in its two Shearson/American opinions criticized Wilko. We can understand neither the need for the formula nor the role that it plays in judicial review of arbitration (we suspect none-that it is just words). If it is meant to smuggle review for clear error in by the back door, it is inconsistent with the entire modern law of arbitration. If it is intended to be synonymous with the statutory formula that it most nearly resembles-whether the arbitrators "exceeded their powers"-it is superfluous and confusing. There is enough confusion in the law. The grounds for setting aside arbitration awards are exhaustively stated in the statute. Now that Wilko is history, there is no reason to continue to echo its gratuitous attempt at nonstatutory supplementation.").

[1571] Wilske & Mackay, *supra* note 1567, at 221.

[1572] *See, e.g.*, Shanghai Foodstuffs Import & Export Corp. v. International Chemical, Inc., 2004 U.S. Dist. LEXIS 1423 (2d Cir. 2004) (manifest disregard of the law cannot be invoked in light of Article V of the NYC); International Trading and Indus. Inv. Co. v. DynCorp Aerospace Technology, 2011 WL 192517, at 12 (D.C. Cir. 2011) ("there is simply no support in either the text of the New York Convention or case law for DynCorp's position that an arbitrator's 'manifest disregard of the law' is a valid basis upon which the Court can deny confirmation of an arbitral award").

[1573] *See* M & C Corp. v. Erwin Behr GmbH & Co., KG, 87 F.3d 844, 851 n.2 (6th Cir. 1996) ("Whatever may be meant by the manifest disregard doctrine applicable in domestic arbitration cases, it is clear that such a doctrine does not rise to the level of a violation of public policy that is necessary to deny confirmation of a foreign arbitral award.").

[1574] *See, e.g.*, Montes v. Shearson Lehman Bros., Inc., 128 F.3d 1456 (11th Cir. 1997); Halligan v. Piper Jaffray, Inc., 148 F.3d 197 (2d Cir. 1998); New York Telephone Company v. Communications Workers of America Local 1100, 256 F.3d 89 (2d Cir. 2001).

proceedings, since its application is limited to the enforcement[1575] of foreign[1576] arbitral awards. Since antitrust disputes in the domestic context are now also considered as arbitrable,[1577] the manifest disregard of the law may be used as a tool for the court review of domestic arbitral awards dealing with antitrust issues.

In this respect, consider *American Cent. Eastern Texas Gas Co. v. Union Pacific Resources Inc,*[1578] a case that involved the setting aside of an arbitral award rendered in the U.S. Among other issues, the award dealt with claims arising out of the Sherman Act. The party that lost in arbitration challenged the award before a federal district court in Texas, arguing that in reaching its decision the arbitral tribunal acted in manifest disregard of the law. The district court refused to set aside the award, and following an appeal the award was examined by the Fifth Circuit Court of Appeals. The Court of Appeals affirmed, in a manner which is of significance for our discussion.

In reaching its decision, the Court of Appeals went very much into the substance of antitrust claims. For example, the court was analyzing whether the arbitrator correctly found that the company in question had monopoly power in the relevant market[1579] and whether it was engaged in exclusionary conduct.[1580] Although this might not amount to reexamination on the merits, it certainly approaches it. *Texas Gas* shows that the court review of arbitral awards dealing with antitrust issues can potentially be much more extensive than what one might infer from *Mitsubishi* and *Baxter*. From this it would follow that arbitral tribunals sitting in the U.S. should pay additional attention when applying the Sherman Act, since their reasoning might come under close court scrutiny by American courts applying the manifest

[1575] Rather than setting aside.
[1576] Rather than domestic.
[1577] *Gilmer*, 500 U.S. 20.
[1578] 93 Fed.Appx. 1 (5th Cir. 2004) (*Texas Gas*).
[1579] *Id.* at 7-8.
[1580] *Id.* at 9.

disregard of the law doctrine. However, two recent Supreme Court decisions seem to limit the importance of *Texas Gas*.

First, in *Hall Street Associates, L.L.C. v. Mattel, Inc.*[1581] the main issue was whether parties to an arbitration agreement can contractually add grounds for setting aside an arbitration award, apart from those provided by the FAA.[1582] In deciding this issue, the Court also considered the manifest disregard of the law. In essence, Hall Street was arguing that if courts can expand the scope of award review (by adding the manifest disregard of the law as one of the grounds for setting aside an award), then so can the parties to an arbitration agreement.[1583] However, the Court rejected such a contention.[1584] In doing so, the Court limited itself to holding that parties cannot expand the statutory grounds for setting aside, remaining silent on whether courts could do so.

The Court's decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*[1585] casts further shadow on the manifest disregard doctrine. In this case the Court even declined to confirm that the doctrine exists in the first place.[1586] Based on this, the future of the manifest disregard doctrine does not seem to be bright, and the Court may even explicitly abandon it at some point in the future. Consequently, the type of review exercised by *Texas Gas* seems to be an exception when it comes to examining the way in which arbitral tribunals decide antitrust claims.

[1581] 552 U.S. 576 (2008).
[1582] The arbitration agreement in question contained a provision which read: "The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous." *Hall Street*, 552 U.S. at 1400-01.
[1583] *Id.* at 1403.
[1584] *See id.* at 1403-04.
[1585] 130 S.Ct. 1758 (2010).
[1586] *See id.* at 1768 n.3 ("We do not decide whether 'manifest disregard' survives our decision in [*Hall Street*] as an independent ground for review.").

6.3.2 EU

6.3.2.1 Eco Swiss second look

The issue of the level of scrutiny that the courts are to afford to arbitral awards dealing with antitrust issues is also very important for the EU. Even if *Eco Swiss* does allow arbitrability of antitrust issues, it does not mean that the ECJ gave arbitrators a blank check in dealing with EU competition law. On the opposite, the Court wanted to make sure that arbitrators will diligently apply EU antitrust legislation. The Court can be seen as doing this in two respects. First, it envisaged that the courts will be able to review the award in order to make sure that it was rendered in compliance with EU law. And second, the ECJ arguably imposed on arbitrators the duty to deal with competition law issues even of their own motion, thereby making sure that EU competition law issues will be properly addressed even absent parties' claims in that direction.

Using language similar to the one in *Mitsubishi*, *Eco Swiss* envisaged that, in order to make sure compliance with EU competition law, the national courts will have an opportunity to give arbitral awards a second look.[1587] Same as in the U.S., the issue is how broad the second look should be. According to *Eco Swiss*, the review should be "more or less extensive depending on the circumstances."[1588] In addition, the ECJ noted that the "annulment of or refusal to recognize an award should be possible only in exceptional circumstances."[1589] However, in the next paragraph the Court went on to stress the importance of EU competition

[1587] *Compare Eco Swiss,* para. 32 ("[W]here questions of Community law are raised in an arbitration resorted to by agreement, the ordinary courts may have to examine those questions, in particular during review of the arbitration award, which may be more or less extensive depending on the circumstances and which they are obliged to carry out in the event of an appeal, for setting aside, for leave to enforce an award or upon any other form of action or review available under the relevant national legislation.") *with Mitsubishi,* 473 U.S. at 638 ("Having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed.").
[1588] *Eco Swiss,* para. 32.
[1589] *Id.,* para. 35.

rules, stating that "Article [101] of the Treaty constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community."[1590]

Based on this, the Court's standpoint on the scope of court review of arbitral awards seems somewhat ambiguous. On the one hand, the ECJ found that the review should be limited in scope and performed only in exceptional circumstances. On the other hand, by stressing the importance of competition law the court implied that awards dealing with antitrust issues are exactly one of those exceptional circumstances. Therefore, the standard of review of arbitral awards in the light of *Eco Swiss* is not clear and the issue is left to national legal systems for clarification.[1591] Before analyzing the way in which Member States courts have interpreted *Eco Swiss*, the issue of the arbitrator's duty to apply EU competition law of its own motion is addressed.

6.3.2.2 Arbitrators' duty to apply EU competition law ex officio

With regards to the court review in the light of *Eco Swiss*, one of the questions that the ECJ left open is whether arbitrators have the duty to address antitrust issues even if the parties themselves did not raise such issues during arbitral proceedings. In other words, it is not clear whether arbitrators have the duty to apply EU competition law *ex officio*. This is of great importance for the arbitral proceeding as a whole, as it could affect the future of an arbitral award. If arbitrators do have this duty and fail to fulfill it, the national courts could set aside such an award, in accordance with the *Eco Swiss* second look.

The *ex officio* problem revolves around the question of how far the reviewing courts can go in scrutinizing the award. On the one hand, the arbitrator's duty to act *ex officio* is not easy to reconcile with the contractual nature of arbitration. In general, arbitrators can decide only on claims raised by the parties. Otherwise, they would run a danger of their award (or

[1590] *Id.*, para. 36.
[1591] Renato Nazzini, *A Principled Approach to Arbitration of Competition Law Disputes: Competition Authorities as Amici Curiae and the Status of Their Decisions in Arbitral Proceedings*, *in* EUROPEAN BUSINESS LAW REVIEW SPECIAL EDITION - ARBITRATING COMPETITION LAW ISSUES 89, 103 (Gordon Blanke ed., 2008).

part of the award) being set aside. This is the case even in pro-enforcement jurisdictions such as France.[1592] On the other hand, it can be argued that a typical arbitration clause gives the arbitrator sufficient jurisdiction to decide antitrust issues *ex officio* and that no special authorization by the parties is needed in that respect.[1593]

Related to this, it is important to emphasize the distinction between deciding antitrust claims *ex officio* as opposed to deciding antitrust issues in the same manner. Arbitrators do not have the power to raise claims not raised by the parties, but they do have the power to address issues related to the parties' claims.[1594] For example, if with regards to an exclusive distribution agreement a party raised a claim related to contract performance, the arbitral tribunal would have power to address issues related to such a claim, such as whether the agreement is void under Article 101(2) TFEU.[1595] In addition, the existence of the *ex officio* duty could be justified by some general arbitrators' obligations, such as to render an enforceable award[1596] and to meet the legitimate expectations of the parties.[1597]

Be that as it may, *Eco Swiss* is not specific on whether arbitrators have the above mentioned duty. However, its existence could be inferred from the part of the decision which

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[1592] *See* Alan Redfern, *The Jurisdiction of an International Commercial Arbitrator*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 3 No. 1 (1986), pp. 19-34, at 26 ("[O]ne of the few grounds on which it is possible to challenge an international award in the French courts is where . . . [t]he arbitrator's decision does not conform to the terms of his reference."). *See also* [French] Code of Civil Procedure (as amended), Art. 1502(3) (the recognition/enforcement may be refused "[w]here the arbitrator ruled without complying with the mission conferred upon him").

[1593] *See* Robert B. von Mehren, *The Eco-Swiss Case and International Arbitration*, ARBITRATION INTERNATIONAL, Vol. 19 No. 4 (2003), pp. 465-469, at 468-69 ([A]rbitrators should . . . raise sua sponte questions of competitive law that are present in the matter before them . . . I am not too concerned about the problem of such matters falling outside of the arbitrators' jurisdiction. A typical arbitration clause reads: 'Any dispute arising out of or relating to this contract, including the breach, termination or validity thereof, shall be finally resolved by arbitration'. This formulation seems to me to encompass issues arising under any applicable law, including anticompetitive and antitrust laws.").

[1594] Yves Derains, *Panel discussion on arbitration courts*, *in* EFFECTIVE PRIVATE ENFORCEMENT OF EC ANTITRUST LAW 283, 290 (Claus-Dieter Ehlermann & Isabela Atanasiu eds., 2003).

[1595] *See id*.

[1596] *See, e.g.*, ICC Rules, Art. 35; LCIA Rules, Art. 32.2.

[1597] *See* Sotiris I. Dempegiotis, *EC Competition Law and International Arbitration in the Light of EC Regulation 1/2003 - Conceptual Conflicts, Common Ground, and Corresponding Legal Issues*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 25 No. 3 (2008), pp. 365-395, at 384 ("The disregard by arbitrators of transnational mandatory rules objectively applicable to the dispute in hand falls definitely outside the legitimate expectations of the parties and impairs the quality of their award, thereby rendering it susceptible to national courts' scrutiny.").

proclaims that an arbitral award has to be in compliance with EU competition law, or else a national court can set it aside as contrary to the public policy.[1598] One of the ways in which an arbitral award could be in nonconformity with EU competition law is if the dealings between parties were in violation of competition rules but neither of the parties raised any claims on that basis, and the arbitral tribunal did not address those issues on its own motion. Therefore, if parties fail to raise competition law claims and the arbitral tribunal does not address them of its own motion, the award might be considered as not being in accordance with EU competition law. Consequently, national courts could set aside such award on the basis that it violates public policy.

Since *Eco Swiss* alone does not tell us much about the scope (and even the existence) of the *ex officio* duty, taking into account some other ECJ cases might be helpful for our analysis. One of the relevant cases is *Van Schijndel*, discussed above in the context of the duty of the national courts to address EU competition law issues of their own motion.[1599] If the impact of *Van Schijndel* on the duty of national courts to raise antitrust issues of their own motion is ambiguous, this is even more so if the decision were to be by analogy applied to arbitrators. This is because EU law does not afford arbitrators the same rights it affords to the national courts, and for this reason it could be argued that as a result their duties differ as well.

Especially relevant in this respect is ECJ judgment in *Nordsee.*[1600] There the Court found that arbitral tribunals are not tribunals for the purposes of EU law, and hence do not have the right to make an Article 267 TFEU reference to the ECJ.[1601] In the light of *Eco Swiss, Nordsee* could be interpreted in the following way. Since arbitrators do not have the same rights as judges, they also do not have the same obligations. For this reason, even if *Van*

[1598] *Eco Swiss*, para. 37.
[1599] *See supra* Part 5.2.1.3.
[1600] Case 102/81 *Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG* [1982] ECR 1095.
[1601] *Id.*, para. 13.

Schijndel holds that courts do not have the duty to root out infringements of EU law of their own motion, this applies to judges only. Consequently, the fact that judges do not have the duty to address competition law issues *ex officio* does not mean that arbitrators do not have it. However, one could turn the situation around and apply *Nordsee* to *Peterbroeck*, in the sense that even if *Peterbroeck* holds that judges should root out infringements on their own motion, such a duty does not apply to arbitrators.

Regarding the duty of arbitral tribunals to address EU competition law *ex officio*, also worth considering is the triad of ECJ cases about this duty in the light of the consumer protection directive: *Mostaza Claro*,[1602] *Pannon*[1603] and *Asturcom*.[1604] All three cases involved arbitral disputes between telecom operators and customers and the power of the enforcing court to address consumer protection issues even if none of the parties raised them in the arbitral proceedings.[1605] Taken together with *Van Schijndel* and *Eco Swiss,* these three cases shed more light on the arbitrator's duty to address EU competition law issues of its own motion.

In *Mostaza Claro*, Ms Claro concluded a mobile telephone contract with the telecom operator Movil; the contract contained an arbitration clause. A dispute arose about the subscription period, and Movil initiated arbitral proceedings against Ms Claro. The arbitral tribunal found in favor of Movil. Subsequently, Ms Claro moved before a Spanish court to set aside the award, arguing that the arbitration agreement is void since it represents an unfair contractual term. However, Ms Claro did not raise such a claim before arbitration, and consequently the question that the Spanish court referred to the ECJ was as follows:

> May the protection of consumers under [a consumer protection directive] … require the court hearing an action for annulment of an arbitration award to

[1602] Case C-168/05 *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421.
[1603] Case C-243/08 *Pannon GSM Zrt. v Erzsébet Sustikné Győrfi* [2009] ECR I-4713.
[1604] Case C-40/08 *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira* [2009] ECR I-9579.
[1605] For a discussion about these cases, see Jules Stuyck, *Case C-243/08, Pannon GSM Zrt v Erzsebet Sustikne Gyorfi and Case C-40/08, Asturcom Telecomunicaciones SL v Maria Cristiba Rodriguez Nogueira*, C.M.L. REV. 2010, 47(3), pp. 879-898.

> determine whether the arbitration agreement is void and to annul the award if it finds that that arbitration agreement contains an unfair term to the consumer's detriment, when that issue is raised in the action for annulment but was not raised by the consumer in the arbitration proceedings?[1606]

The ECJ answered affirmatively,[1607] twice citing *Eco Swiss* in order to support its finding.

First, the Court referred to *Eco Swiss* in the sense that if an award fails to comply with some fundamental Community rules, it can be set aside by national courts as against public policy.[1608] In addition, the Court emphasized the importance of consumer protection for the Community legal system, making a parallel with the importance that *Eco Swiss* gave to competition law rules.[1609] Consequently, *Mostaza Claro* held that, in actions for setting aside, the national court dealing with the action has to assess whether the arbitration agreement contained an unfair term, even though the consumer had not pleaded that invalidity in the course of the arbitration proceedings, but only in that of the action for annulment.[1610]

Applied to our discussion, *Mostaza Claro* could mean that even if parties do not raise an objection during arbitration that a contract is against EU competition law, they can do so later, in the setting aside procedure. This is because it would seem that both consumer protection and competition law are of fundamental importance to the EU, and hence the rights conferred by such legislation cannot be waived. This reading of *Mostaza Claro* would imply that arbitrators do have the duty to apply EU competition law *ex officio*, or else face the possibility that their award could be set aside as being against public policy.

Pannon seem to have gone a bit further than *Mostaza Claro*. In light of EU consumer protection legislation, the Court in this case found that the role of the national court is not limited to a mere power to rule on the possible unfairness of a contractual term. Rather, where it has available to it the legal and factual elements necessary for that task, the national

[1606] *Mostaza Claro*, para. 20.
[1607] *Id.*, para. 39.
[1608] *Id.*, para. 35.
[1609] *Id.*, para. 37.
[1610] *Id.*, paras. 38-39.

court also has the obligation to examine that issue of its own motion.[1611] If a parallel with competition law could be made, then *Pannon* would stand for the proposition that a national court not only has the power to examine EU competition law issues when faced with an issue related to EU competition law, but also has the duty to do so.

Finally, by recognizing the *res judicata* principle,[1612] *Asturcom* could be seen as mitigating *Pannon*.[1613] *Asturcom* is also interesting because it refers to both *Eco Swiss* and *Van Schijndel*. With regards to *Eco Swiss*, the Court noted that this case stands for the proposition that "Community law does not require a national court to disapply domestic rules of procedure conferring finality on a decision, even if to do so would make it possible to remedy an infringement of a provision of Community law."[1614] As for *Van Schijndel*, *Asturcom* first mentioned it in the context of the principle of equivalence, in the sense that under domestic law the conditions under which the courts may apply EU law of their own motion must not be less favorable than the conditions pertaining to such application of domestic law.[1615] The Court added that:

> The national court or tribunal is . . . under . . . an obligation [to assess consumer protection issues ex officio when seized of enforcement of an award] where, under the domestic legal system, it has a discretion whether to consider of its own motion whether such a clause is in conflict with national rules of public policy.[1616]

Based on this, it would now seem with more certainty that *Van Schijndel* does stand for the proposition that national courts do have the duty to address EU competition law issues *ex officio*, unless this would be in violation of domestic procedural rules. However, the effect of *Van Schijndel* on the corresponding duty by the arbitrators is still not completely clear.

[1611] *Pannon*, para. 32.
[1612] *See Asturcom*, para. 38.
[1613] Stuyck, *supra* note 1605, at 890.
[1614] *Asturcom*, para. 37.
[1615] *Id.*, para. 49
[1616] *Van Schijndel*, para. 54.

The Court in *Eco Swiss* in effect avoided deciding on this issue, although that question was part of the Dutch Supreme Court's referral to the ECJ.[1617] As a result of this ambiguity, commentators have interpreted *Eco Swiss* in different ways. Consequently, the legal theory is split between those who argue that arbitrators have the duty to apply EU competition law *ex officio,*[1618] and those who think that such a duty does not exist.[1619] In light

[1617] *See Eco Swiss*, para. 42 (noting that there is no need to answer the question).
[1618] *See* Hanotiau, *supra* note 1449, at 154 ("[I]f the arbitral tribunal discovers that a provision regarding arbitrability and pertaining to international public policy might be applicable to the particular case, it must raise the issue ex officio."); REDFERN, HUNTER, BLACKABY & PARTASIDES, *supra* note 1470, at 141 ("Although the ECJ did not explicitly rule on whether arbitrators have a duty to apply Art. [101] ex officio if the parties themselves made no reference to it, this decision is generally seen - at the very least - as implying that arbitrators should do so or risk the annulment of their award on grounds of a violation of public policy."); LANDOLT, *supra* note 1316, at 230 ("In the result, although the ECJ does not say that arbitrators are under a duty to raise EC competition law matters of their own motion, the strong suggestion in *Eco Swiss* is that they are."); Dempegiotis, *supra* note 1597, at 385 ("International arbitrators have a de facto duty to apply EC competition law *ex officio* when it is relevant to the dispute before them."); Yves Brulard & Yves Quintin, *European Community Law and Arbitration – National Versus Community Public Policy*, JOURNAL OF INTERNATIONAL ARBITRATION 18(5), 533-547 (2001), at 536 ("The Eco Swiss judgment establishes the arbitrators' duty to apply community public policy, which includes Article [101], ex officio."); Robert B. von Mehren, *supra* note 1593, at 468, 469 ("*Eco Swiss* extends *Mitsubishi*, which held that claims arising out of competition laws *may* be arbitrated, by holding that they *must* be arbitrated…") ("Arbitrators should . . . raise *sua sponte* questions of competitive law that are present in the matter before them."); Georgios I. Zekos, *Eco Swiss China Time Ltd v Benetton International NV - Courts' Involvement in Arbitration*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 17 No. 2 (2000), pp. 91 – 94, at 93. ("It could be argued that if the award is to be enforced within the territory of the EU, then the arbitrator may take into consideration matters in Article [101], regardless of the absence of the parties' agreement and in excess of his powers…"); Frank-Bernd Weigand, *Evading EC Competition Law by Resorting to Arbitration?*, ARBITRATION INTERNATIONAL, Vol. 9 No. 3 (1993), pp. 249-258, at 251 ("Even in an adversarial jurisdiction as in the United Kingdom, where a judge deals only with those issues placed before him, EC law should be applied *ex officio* where it declares a contract null and void."); Gordon Blanke, *ICC Draft Best Practice Note on the European Commission Acting as Amicus Curiae in International Arbitration Proceedings – The Text*, *in* EUROPEAN BUSINESS LAW REVIEW SPECIAL EDITION - ARBITRATING COMPETITION LAW ISSUES 198, 202 (Gordon Blanke ed., 2008) ("Coupled with the international arbitrator's **potentially implied ex officio duty to raise EC competition law issues** in the making of arbitral awards, this raises the question of the desirability of the Commission's involvement as amicus curiae in Ordinary EC Antitrust Arbitrations.") (Emphasis added.). *See also* Claimant v. Respondents, Final Award of 1992 in Case No. 7181, 21 YEARBK. COMM. ARB'N 99, 105 (1996) ("In view of the public policy character of Art. [101](1) the Arbitral Tribunal does have to examine *ex officio* whether Art. X of the Agreement is not caught by the prohibition of restrictive agreements."); Supplier (Italy) v. Buyer (South Korea), Preliminary Award of 22 September 1983 in Case No. 4132, 10 YEARBK. COMM. ARB'N 49, 51 (1985) ("[T]he Tribunal must . . . on its own initiative investigate whether the Agreement comes under the prohibition of Art. [101(1) TFEU].").
[1619] *See* Alexis Mourre, *Dissenting Opinion on a Dangerous Project*, *in* EUROPEAN BUSINESS LAW REVIEW SPECIAL EDITION - ARBITRATING COMPETITION LAW ISSUES 219, 221 (Gordon Blanke ed., 2008) ("[T]he European Court of Justice case law does not support the existence of such duty . . . as it did not rule on the question in its Eco Swiss judgment."); WHISH, *supra* note 37, at 318 ("[T]he ECJ's judgment in Van Schijndel established that there is no obligation upon a national court **(nor therefore upon an arbitration panel)** pro-actively to root out infringements of the competition rules.") (emphasis added); Opinion of Mr Advocate General Saggio in *Eco Swiss*, delivered on 25 February 1999, para. 26 ("Community law does not require arbitrators, when they have been asked to rule on the performance of an agreement, to raise of their own motion questions about the compatibility of that agreement with Community competition law if consideration of those questions would oblige them to abandon the passive role assigned to them, going beyond the ambit of the dispute defined by the parties and relying on facts and circumstances other than those on which the party with an interest in application of those provisions relied in order to substantiate his claim.").

of all this, it would seem useful to examine how the matter has been dealt with by the national courts.

6.3.2.3 Review before national courts

6.3.2.3.1 France

France was one of the first countries to recognize arbitrability of issues arising out EU competition law. It happened as early as 1993, with the decision in *Labinal v. Mos & Westland Aerospace*.[1620] The facts of the case can be briefly summarized as follows.[1621]

Mors and Westland created a joint venture in order to make an offer for the supply of aircraft parts to British Aerospace. Eventually, the two companies started to consider a joint submission with Labinal, which was also doing business in the same field. At some point Mors learned of secret negotiations between Westland and Labinal, the aim of which was to exclude Mors from the whole transaction. As a result, despite the existence of an arbitration agreement, Mors started an action before the Paris Commercial Court, alleging *inter alia* that the joint venture between Westland and Labinal violated EU competition law. The Commercial Court refused to stay the proceedings, on the basis that the rules of competition law cannot be referred to arbitration and an appeal followed.

The Paris Court of Appeal reversed, finding antitrust disputes arbitrable. This French ruling seems to have been to a large extent influenced by *Mitsubishi*. Carbonneau has drawn a parallel between the two decisions noting that "the United States Supreme Court's decisional law on substantive inarbitrability has made considerable inroads into French legal thinking, nearly acquiring the force of precedent among French lower courts."[1622] The same way he was against the outcome *Mitsubishi*, Carbonneau also lashed out at *Labinal*.[1623]

[1620] Cour d'appel [CA] [regional court of appeal] Paris, 1e ch., May 19, 1993.
[1621] The facts are summarized based on: Antoine Kirry, *Arbitrability: Current Trends in Europe*, ARBITRATION INTERNATIONAL, Vol. 12 No. 4 (1996), pp. 373-390, at 376.
[1622] Carbonneau, *supra* note 1444, at 209.
[1623] *See id.* at 221 ("Although the tempo and logic differ, 'a-legality' informs the arbitral decisional law of the United States Supreme Court and the French courts alike. Each madness has its own method.").

Some later cases seem to show that the French courts have maintained this pro-arbitrability attitude expressed by *Labinal*. The first relevant French case following *Eco Swiss* is *SA Thales, Air Défense v. Euromissile*.[1624] There a disagreement arose between Thales and Euromissile, two companies involved in production of missiles. In accordance with the arbitral clause, Thales referred the dispute to arbitration. The tribunal found against Thales and awarded Euromissile damages. Neither party raised antitrust issues during the proceedings, nor did the tribunal assess them on its own motion.

Thales subsequently challenged the award before the Paris Court of Appeals, arguing that the award violated public policy because it was not in accordance with Article 101 TFEU. The court noted that in accordance with the French law the award can be set aside only if the violation was manifest, actual and specific. Consequently, the court found that the award in question did not satisfy such a strict standard, and hence refused to set it aside. From this it can be concluded that in France the court review of awards dealing with EU competition law is not far reaching – the court will be satisfied to determine that there was no manifest, actual and specific violation of competition law.

Based on this, some commentators have drawn the conclusion that in France the failure of an arbitral tribunal to address competition law issues does not on its own represent a violation of public policy and is therefore not a ground for annulment of the award.[1625] On the one hand, this could also mean that in France arbitrators do not have the duty to address EU competition law of their own motion. However, *Thales* could also be read as saying that the non-application of EU competition rules does not have to lead to annulment of an award,

[1624] Cour d'appel [CA] [regional court of appeal] Paris, Nov. 18, 2004. The summary of the facts is based on Emmanuel Gaillard, *Extent of Court Review of Public Policy*, NEW YORK LAW JOURNAL, Vol. 237 – no. 65 (2007).
[1625] *See* Denis Bensaude, *Thalès Air Defence BV v. GIE Euromissile: Defining the Limits of Scrutiny of Awards Based on Alleged Violations of European Competition Law*, JOURNAL OF INTERNATIONAL ARBITRATION, Volume 22 Issue 3 (2005), pp. 239-244, at 240 (*Thales* "makes clear that an arbitral tribunal's failure to raise issues of European competition law sua sponte does not, in and of itself, provide a basis for annulling an award on public policy grounds.").

but that it might – if as a result of non-application a violation of French public policy occurred. Finally, some commentators have read *Thales* arguing that the Paris Court of Appeals actually confirmed that arbitrators do have such a duty.[1626] Therefore, if arbitrators fail to properly address competition law issues, this may or may not endanger the enforcement of the award in France. Be that is at may, not long after *Thales* French courts had another chance to consider the *Eco Swiss* second look.

The case in question was *SNF v. Cytec*,[1627] the facts of which can be summarized as follows.[1628] French company SNF and Dutch company Cytec entered into a long-term agreement for the purchase of a certain chemical. SNF terminated the contract before expiration and Cytec initiated arbitration. According to the arbitration agreement, the seat of the tribunal was in Belgium, with French law applicable. In 2002 the tribunal rendered a partial award, which found that the purchase agreement violated Article 101 TFEU and was therefore null and void. The final award was rendered in 2004, and it granted damages exclusively to Cytec. Cytec then sought to enforce the award in France. SNF challenged the enforcement and also started the setting aside procedure in Belgium.

SNF was arguing before the Paris Court of Appeal[1629] that the award should not be enforced since the arbitrators did not correctly apply EU competition law. According to SNF, the arbitrators found all elements of abuse of dominant position by Cytec, but failed to draw the consequences of such a finding, concluding that only SNF was liable for distorting

[1626] *See* Gordon Blanke, *A Réplique to Denis Bensaude's "Thalès Air Defence BV v. GIE Euromissile"*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 23 No. 3 (2006), pp. 249-257, at 250 ("A careful reading of the decision reveals that the Paris Court of Appeal does not question the general existence of an implied ex officio duty to raise EC competition law issues as flowing from the European Court of Justice's (ECJ) Eco Swiss case law. On the contrary, it actually confirms the existence of such a duty and proceeds to define the parameters to be applied by a French court in order to decide whether an award is unenforceable at the national level due to the arbitrator's breach of that duty.").
[1627] Cour d'appel [CA] [regional court of appeal] Paris, Mar. 23, 2006; Cour de Cassation, Jun. 4, 2008.
[1628] The facts are based on Dirk De Meulemeester & Maud Piers, *Brussels Court, Judgment R.G. 2005/7721/A of 8 March 2007, SNF SAS (F) v. Cytec Industrie (NL) - Merits revisited? Arbitral Award, Public Policy and Annulment - The Belgian Experience*, ASA BULLETIN, Vol. 25 No. 3 (2007), pp. 630-642.
[1629] SNF v. Cytec, Cour d'appel [CA] [regional court of appeal] Paris, Mar. 23, 2006.

competition.[1630] However, the Paris court refused to examine the way in which the arbitrators applied the law, stating that "the court, which is the judge of the award rather than of the [arbitration] proceeding, only carries out an extrinsic review, because it only examines whether [the award's] recognition or enforcement is compatible with international public policy when [the award] is submitted to the court."[1631] Consequently, the court limited itself to determining whether the award's enforcement would violate public policy, and found that it would not.[1632]

SNF appealed and the Cour de cassation affirmed.[1633] According to the highest French court, "[the court of appeal], which – within the limits of its powers, that is, without reviewing the merits of the arbitral award – reviewed the awards in light of the application of the community rules on competition, correctly held that their recognition and enforcement were not contrary to international public policy."[1634] The French highest court can here be read as saying that, even if an award deals with EU competition law, the reviewing court can reexamine the award on the merits only in the spectrum of public policy. In other words, the reviewing court should limit itself to finding that the arbitral tribunal applied EU competition law and that in the process there was no flagrant, effective and concrete violation of public policy.

6.3.2.3.2 Belgium

The dispute between SNF and Cytec had its continuation in Belgium: parallel with fighting enforcement in France, SNF also challenged the award in Belgium. The Brussels Court of First Instance, which was deciding on SNF's application, seems to have given the award a much closer scrutiny than it was the case in France.[1635] In analyzing the award the

[1630] *Id.*, para. 7.
[1631] *Id.*, para. 9.
[1632] *Id.*, para. 14.
[1633] SNF v. Cytec, Cour de Cassation, Jun. 4, 2008.
[1634] *Id.*, para. 7.
[1635] SNF SAS v. Cytec Industrie, Brussels Court, Judgment R.G. 2005/7721/A of 8 March 2007.

court found that the tribunal's reasoning connected to the award of damages was contradictory in its essence.[1636] Consequently, the court found that that the award violated EU competition law, and based on *Eco Swiss* set the award aside.

In reaching it decision the Belgian court went significantly into the substance of the dispute, and “seems to have substituted or at least compared the arbitrator's opinion with its own”.[1637] This shows that the court review envisaged by *Eco Swiss* does not have to be of the lip service type exercised by French courts. Rather, it could be of intensity that comes close to reexamining the award on the merits. As will be shown, Belgium does not seem to be alone at this approach.

6.3.2.3.3 The Netherlands

It seems that in the Netherlands the situation is similar to the one in Belgium, at least taking into account *Marketing Displays International v. VR Van Raalte Reclame*.[1638] The case involved a dispute between the American company Marketing Displays International (MDI) and the Dutch company VR Van Raalte Reclame. In 1990 the two companies entered into a license agreement for the marketing of billboard frames in Benelux countries. The agreement contained an arbitral clause, providing for arbitration in the U.S., with Michigan law applicable. In 1998 a dispute arose, and MDI resorted to arbitration. The arbitral tribunal found that Van Raalte breached the license agreement and consequently awarded MDI damages.

[1636] Dirk De Meulemeester & Maud Piers, *Brussels Court, Judgment R.G. 2005/7721/A of 8 March 2007, SNF SAS (F) v. Cytec Industrie (NL) - Merits revisited? Arbitral Award, Public Policy and Annulment - The Belgian Experience*, ASA BULLETIN, Vol. 25 No. 3 (2007), pp. 630-642, at 635.
[1637] *Id.*
[1638] Cases nos. KG/RK 2002-979 and 2003-1617, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Rechtbank [Rb.] [Court of First Instance], The Hague, May 27, 2004; Cases nos. 04/694 and 04/695, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Gerechtshof [Hof] [Court of Appeal], The Hague, Mar. 24, 2005.

MDI sought to enforce the award in the Netherlands. However, the Hague Court of First Instance refused enforcement.[1639] The court found that the license agreement was not in accordance with Article 101 TFEU and that consequently the award violated the Dutch public policy. In its analysis the court seemingly touched upon the substance of the dispute, similar like the Belgian court in *SNF v. Cytec*[1640]. Following MDI's appeal the Court of Appeal affirmed,[1641] confirming the level of scrutiny afforded to the award by the Hague Court of First Instance.

An interesting part of the Court of Appeal's decision is that the situation where competition law issues were not raised before the arbitral tribunal did not validate the license agreement contrary to Article 101 [TFEU]. Rather, the court allowed the possibility that a party invokes invalidity of an agreement at the enforcement stage. This seems to be in line with the ECJ's ruling in *Movil*, and tends to show that arbitrators should raise competition law issues on their own motion, or risk their award being refused enforcement – at least in the Netherlands.[1642]

6.3.2.3.4 Switzerland

Although Switzerland is not an EU Member State, an examination of how Swiss courts look at arbitrability of competition law disputes is of relevance for our discussion. Parties from the EU often choose Switzerland as the place of arbitration, and it is not uncommon that among other things the arbitral dispute also involves issues connected to

[1639] Cases nos. KG/RK 2002-979 and 2003-1617, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Rechtbank [Rb.] [Court of First Instance], The Hague, May 27, 2004.
[1640] *See supra* Part 6.3.2.3.2.
[1641] Cases nos. 04/694 and 04/695, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Gerechtshof [Hof] [Court of Appeal], The Hague, Mar. 24, 2005.
[1642] *See id.*, paras. 27-28 ([27] "The question of the validity of the license agreement in light of European competition law was not dealt with at all in the arbitration, nor was it apparently raised by Van Raalte in that proceeding. The arbitral awards assumed that the license agreement was valid, held that Van Raalte breached that agreement, inter alia, by offering products protected by MDI patents for sale outside Benelux, and inflicted on Van Raalte [certain] obligations and prohibitions. [28] "Under these circumstances, this court too holds that recognition and enforcement of the three arbitral awards would be contrary to public policy within the meaning of Art. V(2)(b) of the New York Convention.").

Articles 101 and 102 TFEU. For this reason it is interesting to consider the standpoint of the Swiss courts when it comes to arbitrating EU competition law disputes.

Switzerland has recognized arbitrability of EU competition law claims as early as 1992, in *V SpA v G Sa.*[1643] The facts of the case can be summarized as follows. In 1986, G (a Belgian company) and V (an Italian company) entered a cooperation agreement that contained an arbitral clause. Eventually certain disagreements arose, and in 1989 the parties submitted the dispute to arbitration. The award was rendered in 1990 and was subsequently challenged before a Swiss court. One of the grounds for the challenge was that the arbitral tribunal violated the Swiss law by holding that it did not have jurisdiction to apply Article 101 TFEU. The Swiss Federal Court granted the challenge, holding that the arbitral tribunal did have jurisdiction to apply Article 101. This can be interpreted in a way that if the tribunal had jurisdiction to apply EU competition law rules, it means those rules are arbitrable.

The Swiss approach to the issue of the arbitrability of EU competition law was recently revisited in *X. S.p.A. v. Y. S.r.l.*[1644] The case concerned X and Y, two Italian firms involved in the construction business. In 1998 the two companies entered a cooperation agreement, the purpose of which was their joint application for a tender regarding the construction of a high speed railroad between Milan and Naples. The agreement was of exclusive character, in that each company was to abstain from any separate agreements with other companies and also from bidding individually. An arbitral clause in the agreement proclaimed Italian law as applicable and Switzerland as the place of arbitration.

After consulting each other about the price, the two companies submitted joint offers regarding the above mentioned railroad construction. The construction works were awarded to X and to certain consortiums X created with some other companies. Alleging that X's actions violated the cooperation agreement, in 2002 Y started arbitral proceedings asking for

[1643] Arrêts du Tribunal Fédéral Suisse [ATF] [Federal Court] Apr. 28, 1992, 118 II pp. 193-198.
[1644] Swiss Federal Court, Case 4P.278/2005 of 8 March 2006.

damages. X's defense during arbitration was that the cooperation agreement violated Italian and European competition laws and was thus void. However, the arbitrators did not find any competition law infringement and ordered X to pay damages to Y for the breach of contract. Dissatisfied with such an outcome, X turned to a Swiss court. X challenged the award as being against public policy since the arbitrators disregarded fundamental provisions of European and Italian competition laws.

The Swiss Federal Court refused to set the award aside, on the grounds that EU competition law cannot be considered as being part of Swiss public policy. The court stressed that "the differences between the various laws on competition are too acute – specially between Switzerland and the European Union – to allow a finding that a transnational or international rule public policy would have to be found there."[1645] After an extensive analysis of the notion of public policy, the court concluded that "there is no more room for doubt: the provisions of competition laws, whatever they may be, do not belong to the essential and broadly recognized values which, according to the concepts prevailing in Switzerland, would have to be found in any legal order."[1646]

This Swiss decision does not seem to correspond to the ECJ's finding in *Eco Swiss* that EU competition law is part of public policy. However, as a non-EU country Switzerland is not bound by ECJ decisions and its own courts are the ones who are supposed to assess what represents a violation of Swiss public policy. This decision is also important because it shows that the courts in Switzerland are not prepared to reexamine in depth awards dealing with competition law issues. In other words, on this point Switzerland is in line with some pro-arbitration EU Member States, such as France.

[1645] *Id.* at 557.
[1646] Id. at 558.

6.3.2.3.5 Italy

However, the decision of the Swiss Supreme Court in *X. S.p.A. v. Y. S.r.l.*[1647] was not the last word in the dispute between the two Italian companies. After successfully defending the award from the challenge in Switzerland, the claimant (referred to as company Y) initiated proceedings in Italy in order to enforce the award.[1648] Eventually, the court that had the final word about the enforcement was the Milan Court of Appeal.[1649]

The judgment revealed a lot of previously unknown facts about the parties and the dispute itself. It turned out that company X was actually called Tensacciai, while company Y's name was Terra Armata. Same as in Switzerland, Tensacciai also argued that the award should not be enforced because it violates public policy, since the arbitrators did not properly apply EU and Italian competition law. The result was identical to the one reached by the Swiss court, since the Milan court decided to enforce the award. However, it is important to note that the review exercised by the Italian court was much more extensive than the one performed by its Swiss counterpart.

For example, the Court reviewed (and agreed with) the arbitral tribunal's definition of the relevant market. The process of defining the relevant market, involving both legal and economic examination, could be considered as being part of substantive antitrust analysis. The fact that the Court was prepared to evaluate the tribunal's reasoning on such substantive issues tends to show that the Italian interpretation of *Eco Swiss* is much closer to the one adopted by the Belgian and Dutch courts than to the deferential approach embraced by France.

[1647] *See supra* Part 6.3.2.3.4.

[1648] Italian courts have a relatively long history of dealing with the arbitrability of EU competition law claims. Actually, Italy was among the first countries to recognize the arbitrability of EU competition law. *See* SpA Coveme v. CFI - Compagnie Française des Isolants SA, Corte di Appello [Court of Appeal], Dec. 21, 1991, Bologna no. 1786.

[1649] Terra Armata v. Tensacciai S.p.A., La Cour d'Appel de Milan, Première Section Civile [Milan Court of Appeals, First Civil Section], Jul. 5, 2006. For a discussion about this case, see Phillip Landolt, *Note - 8 March 2006 - Swiss Supreme Court*, *in* EUROPEAN BUSINESS LAW REVIEW SPECIAL EDITION - ARBITRATING COMPETITION LAW ISSUES 129 (Gordon Blanke ed., 2008).

6.3.2.4 The impact of Eco Swiss

Eco Swiss did not give arbitrators a blank check with regards to the application of EU competition law. Rather, the ECJ pronounced that national courts will have an opportunity to review arbitral awards dealing with antitrust issues, in order to make sure that the awards complied with EU competition rules. As shown, such a review can be only superficial, as exercised by the French courts. On the other hand, the examples of Belgium, the Netherlands, and Italy show that the review could also be much more intrusive, scrutinizing the substance of the arbitrators' antitrust analysis.

Another important implication of the way in which the national courts have interpreted *Eco Swiss* has to do with the arbitrator's duty to apply EU competition law *ex officio*. In this respect the national courts do not have a uniform approach. Rather, it seems that the existence of such a duty depends on how far the court is willing to go in reviewing arbitral awards. Consequently, this duty does not seem to exist in France, since *Thales* showed that the fact that arbitrators did not resolve antitrust claims on their own motion will not be sufficient for the court to set aside the award.

On the other hand, the Hague Court of Appeal in *Marketing Displays* allowed the party opposing the enforcement to argue that the award was not in accordance with EU competition law, even though such a claim was not raised during arbitral proceedings. By this the Dutch court implied that even absent parties' claims arbitrators should address antitrust issues of their own motion, or the enforcing court might find that the award violated public policy. Considering the intensity that the Belgian and Italian have shown in scrutinizing awards dealing with competition law issues, it would seem that the *ex officio* duty also exists in these two jurisdictions.

Taking into account the levels of scrutiny exercised by the courts in the EU when examining arbitral awards dealing with antitrust issues, it is interesting to compare the impact of *Eco Swiss* with that of *Mitsubishi*. The deferential approach taken by the Paris Court of Appeals in *Thales* seems to be in line with the level of review set out by the Seventh Circuit Court of Appeals in *Baxter*. In both cases the reviewing courts were reluctant to go into the merits of the dispute, being satisfied with an extrinsic examination of the award. The French "manifest, actual and specific" standard would seem to have the same effect as *Baxter*'s "took cognizance of antitrust claims and actually decided them" approach – the reviewing court will interfere with the award only in exceptional circumstances. In this respect it is interesting to note that *Thales* was decided one year after *Baxter*. This means that the French court actually might have been influenced by the *Baxter* decision when interpreting *Eco Swiss*. If this was the case, it would confirm the tendency noticed by Carbonneau that American decisions on arbitrability have significant influence on French courts.[1650]

The more stringent type of review exercised by Belgium, the Netherlands and Italy could be roughly compared with the approach taken by the Fifth Circuit Court of Appeals in *Texas Gas*. In all of these instances the reviewing courts were willing to get involved in substantive antitrust analysis, such as defining the relevant market or assessing the adequacy of damages awarded by the arbitral tribunal. However, despite these similarities, major differences also have to be pointed out.

Most importantly, the European courts reviewed the awards based on the premise that they might be against public policy, while the American court analyzed the award in order to determine whether it was in manifest disregard of the law. This difference has an important practical implication in that the public policy exception also applies to international arbitral awards, while the manifest disregard of the law doctrine is reserved for awards rendered in the U.S. Further, public policy can be the basis both for refusing the enforcement and for setting aside of arbitral awards, while the manifest disregard of the law can be used only for

[1650] Carbonneau, *supra* note 1444, at 209.

vacatur (i.e. setting aside). Nevertheless, the resemblance between the two approaches remains, which is rather remarkable taking into account the different settings in which they have emerged.

6.4 Mandatory character of the law of exclusive territories

6.4.1 Antitrust legislation as mandatory law

With regards to the arbitral resolution of disputes arising out of an exclusive distribution agreement, an important issue is whether the rules comprising the law of exclusive territories have mandatory character. Once the arbitral tribunal has assessed the arbitrability of issues before it and found that they are arbitrable, it then proceeds by determining the law applicable to the dispute (*lex causae*). In accordance with the contractual nature of arbitration, parties are generally free to choose the *lex causae* themselves. However, this party autonomy is sometimes limited by the concept of mandatory rules.

Mandatory rules are rules for the application of which a state is extremely interested whenever a dispute has a strong connection with it.[1651] If arbitrators disregard a mandatory rule, the courts of the country which enacted it might refuse to enforce the award on the grounds that it violates public policy.[1652] Consequently, arbitrators may sometimes override the parties' choice of law, if such a choice would be against the relevant mandatory law. The arbitrators might do so for at least two reasons.

First, there is a general duty for arbitrators to render an award that would be enforceable.[1653] If an arbitral tribunal rendered an award that courts would refuse to enforce, then the whole arbitral procedure would turn out to be a waste of time and resources. Such an outcome is certainly neither in the parties' nor in the arbitrators' interest. In addition, arbitral tribunals should respect mandatory rules in order to preserve the good will that countries have

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[1651] *See* Sigvard Jarvin, *Mitsubishi- ICC comment*, JOURNAL OF INTERNATIONAL ARBITRATION, Vol. 4 No. 1 (1987), pp. 87-90.
[1652] NYC, Art. V.
[1653] *See, e.g.*, ICC Rules, Art. 35; LCIA Rules, Art. 32.2.

shown towards arbitration. The power to decide disputes that would otherwise be resolved by courts is accompanied by the responsibility to take into account the public policy of countries connected with the dispute. If arbitrators do not live up to this responsibility, the country whose mandatory law was ignored may react by refusing to enforce the award.[1654]

It is not always easy to precisely determine which laws are considered as mandatory.[1655] Public policy does not have the same contents in all countries, and what is mandatory law in one country might not be so in another. However, certain generalizations can be made. Mandatory rules usually include restrictions on trade, political measures relating to currency, acts of state, and – competition (or antitrust) law.[1656] In order to determine whether a norm is to be treated as mandatory, one should look at whether the courts of the jurisdiction that promulgated it have pronounced it so.[1657] From this perspective, today it seems beyond dispute that antitrust rules are to be considered as mandatory law both in the U.S. and in the EU.

The U.S. Supreme Court has repeatedly emphasized the importance of antitrust rules for the American economy as a whole.[1658] Additionally, in the relevant part *Mitsubishi* could be read as confirming that the Sherman Act is part of mandatory law. This is despite the fact that in *Mitsubishi* itself the problem of mandatory law did not come up, since the defendant conceded that the Sherman Act applies to the dispute. According to the Court, "in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little

[1654] Hanotiau, *supra* note 1449, at 161.
[1655] *See, e.g.*, Rome I, Art. 9(1) ("Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organization.").
[1656] *See* LANDOLT, *supra* note 1316, at 114.
[1657] *Id.* at 184.
[1658] *E.g.*, U.S. v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) ("Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise.").

hesitation in condemning the agreement as against public policy."[1659]. In other words, private parties are effectively limited in their choice of law in antitrust-related disputes. This approach has been both praised[1660] and criticized.[1661] Be that as it may, arbitrators should always have in mind the Sherman Act if the dispute before them is substantially related to the U.S.; otherwise, an American court may refuse to enforce the award. Of course, if enforcement is sought outside the U.S., this pronouncement does not have much effect.

As for the EU, the mandatory character of EU competition law can be implied from *Eco Swiss*. The ECJ there held that the enforcement of an award will be refused if it is not in accordance with Article 101 TFEU.[1662] This implies that arbitrators should apply EU competition law regardless of the law applicable to the dispute or their award might not be enforceable in the EU. In other words, the ECJ effectively proclaimed that the provisions of EU competition rules are mandatory.[1663] Therefore, if a dispute has sufficient connections with the EU, arbitrators should apply (or at least take into account)[1664] EU competition law rules. Otherwise, the award might not be enforceable within the EU.

6.4.2 Circumstances that trigger mandatory rules

An important question is which jurisdiction should be considered as having sufficiently strong relationship with the dispute in order for the arbitral tribunal to be obliged to consider its mandatory rules. Although there is no clear rule, it seems that the jurisdiction where the contract is to be performed qualifies in this respect. Accordingly,

[1659] *See Mitsubishi*, 473 U.S. at 637 n.19 ("[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.).
[1660] *See, e.g.*, Lowenfeld, *supra* note 1500, at 186 (emphasizing the need of deciding antitrust claims based on U.S. law whenever the performance of the contract significantly involves the U.S.).
[1661] *See, e.g.*, Werner, *supra* note 1511, at 83 (attacking the idea that parties cannot freely determine applicable law).
[1662] *See Eco Swiss*, para. 37.
[1663] *See* Dempegiotis, *supra* note 1597, at 381 ("[A]rbitrators should apply EC competition law, when relevant, as a set of transnational mandatory rules and irrespective of it being part of the applicable law.").
[1664] *See* LANDOLT, *supra* note 1316, at 227 (suggesting that even if the arbitrator does not apply EU competition law fully, he is obliged to at least take it into account).

> if he wishes to avoid abuse of office, the international arbitrator has to guarantee as a minimum the respect of the mandatory rules of the place of performance of the contract, which the arbitrators consider to apply as a matter of course when the parties have not chosen a *lex contractus*.[1665]

Therefore, if the contract is to be performed in the U.S., the arbitrator should take into account the provisions of the Sherman Act. *Mutatis mutandis*, the same applies for Articles 101 and 102 TFEU, if the contract is performed in the EU. In this respect it is also necessary to reflect on the territorial scope of application of U.S. and EU antitrust rules.

As for the U.S., The Sherman Act has a very broad range of application. As noted by the Supreme Court, "the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States."[1666] Related to our discussion, an exclusive distribution agreement could fall under the Sherman Act whenever it produces substantial effect in the U.S. This will generally be the case if the exclusive territory is in the U.S., but from the quoted Supreme Court wording this does not necessarily have to be the case. However, based on the analysis from the previous chapters, even if the Sherman Act would apply it is unlikely that it would condemn the use of exclusive territories.

On the other hand, identifying the situations in which EU competition law applies seems to be of more practical significance. In this respect an arbitral tribunal may be required to apply EU competition law whenever trade between Member States is affected, even if the *lex causae* is of a non-Member State.[1667] As shown above, with regards to exclusive distribution agreements EU competition law will generally apply if the exclusive territory is located in a Member State.[1668] However, based on *Javico* EU competition law may apply even if the prohibition of parallel trade applies for a non-Member State.[1669] Therefore, whenever an exclusive distribution agreement is likely to affect trade between Member

[1665] Yves Derains, *Public Policy and the Law Applicable to the Dispute in International Arbitration*, 3 ICCA CONGRESS SERIES (1986), pp. 227 – 256, at 251-52.
[1666] Hartford Fire Ins. Co. v. California, 509 U.S. 764, 796 (1993).
[1667] *See* Stylopoulos, *supra* note 1558, at 120.
[1668] *See supra* Part 4.1.1.
[1669] *See supra* Parts 4.1.1, 4.4.2.2.

States, there is a possibility that EU competition law will apply. Taking into account that the EU's approach to exclusive territories is somewhat stricter than that of the U.S., identifying the situations in which EU competition may assert its application is of great practical significance for an arbitrator wishing to avoid the risk of his award being set aside in the EU.

6.4.3 Rome I

Despite uncertainties, the application of mandatory rules outside of *lex causae* seems to be a reality in today's world. Especially worth noting in this respect is Rome I Regulation, which in pertinent part reads:

> Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.[1670]

This provision seems to give the judge the possibility of invoking relevant mandatory rules regardless of the parties' choice of law. However, it would be interesting to consider if arbitrators may also rely on this provision as grounds for the application of a law outside *lex cauasae*.

At the outset it should be noted that the Regulation is addressed to judges and not to arbitrators. In addition, the Regulation explicitly excludes arbitration agreements from its scope.[1671] What is more, the Regulation does not make the application of mandatory rules compulsory, noting that effect "may be given" to mandatory rules outside of *lex causae*. Consequently, the Regulation leaves it to the discretion of judges (and, arguably, arbitrators) whether they will apply the mandatory rules or not.

However, arbitrators may still find a way to invoke the Regulation, especially having in mind the significant freedom they possess when it comes to determining the applicable law.

[1670] Rome I, Art. 9(3).
[1671] *Id.*, Art. 1(2)(d).

The process could be as follows. First, the arbitrator should find a way to invoke the Regulation. He should then conclude that antitrust rules are part of mandatory law and that there is a close connection between the dispute and the country that enacted those antitrust rules. Finally, the arbitrator should apply these antitrust rules, relying on the provision from the Regulation with regards to mandatory rules.

Invoking the Regulation might also be a solution for the *ex officio* problem. By relying on the pertinent part of Rome I, arbitrators would have an additional basis for addressing antitrust issues of their own motion. This way they may be able to make the award less prone to attacks that the arbitrators went beyond their competence, in accordance with the duty to render an enforceable award.

6.5 Assessment

This chapter has shown that some tendencies identified in the context of the substantive and procedural law of exclusive territories also have their expression in the field of arbitration. More precisely, the analysis about the connection between exclusive distribution agreements and arbitration has shown that the European approach towards the review of arbitral awards dealing with antitrust issues is somewhat stricter than the American one. With regards to arbitrability, the two systems seem to be along the same line – in both jurisdictions antitrust issues are arbitrable. However, regarding the level of scrutiny that courts afford to awards dealing with antitrust issues, in certain aspects there are considerable differences.

In the U.S., this scrutiny is relatively non-intrusive. Even if some parts of *Mitsubishi* could be read as giving the courts an opportunity for a more invasive supervision of arbitral awards dealing with antitrust issues, this has not happened in practice. Based on this, perhaps the effect of *Mitsubishi* could be compared with that of *Sylvania*. As described above, although *Sylvania* established the rule of reason as the standard according to which the legality of exclusive territories is to be assessed, in practice the way in which lower courts interpreted it actually meant *de facto per se legality* for this type of restraint. Similarly, although *Mitsubishi* itself has the potential for a stricter type of scrutiny, this has not realized in practice.

The effect of *Mitsubishi* could be compared with that of *Sylvania* in another way. Both cases represented a significant departure from what had been the law before the cases were rendered. In the case of *Sylvania*, this was the rigid *per se* illegality rule laid down by *Schwinn*. On the other hand, with regards to *Mitsubishi* it was the *American Safety* doctrine and its hostile approach towards arbitration. In this respect, both *Sylvania* and *Mitsubishi* started new trends in the respective fields of law – one with regards to the law of vertical restraints, and the other with regards to arbitration. Additionally, both cases effectively brought less intrusion by the state in private contractual relationships – concerning the deployment of exclusive territories i.e. the use of arbitration.

As for the EU, this chapter has shown that arbitrators deciding a dispute involving an exclusive distribution agreement should take EU competition law seriously. It has been shown above that there are still a number of circumstances which could make the use of exclusive territories illegal under EU law. This is especially the case if the exclusive distribution is airtight, as it can be perceived as impeding parallel trade between Member States. Taking also into account that the national courts of certain Member States apply a relatively high level of scrutiny to awards dealing with EU competition law issues, when examining an exclusive distribution agreement arbitrators are advised to take into account this law. Otherwise, there is not insignificant probability that their award will not be enforced.

Finally, this chapter has also shown the EU's (and that of its Member States) readiness to adopt solutions from U.S. law. One example is arbitrability – first the U.S. Supreme Court allowed the arbitrability of antitrust issues and then some European countries and the ECJ followed suit. However, what can also be noticed with regards to this issue is that the EU is not adopting American solutions uncritically. If it is considered that *Sylvania* inclined the Commission towards adopting a more economics-based approach to vertical restraints, it has been shown that the sort of rule of reason for (non-airtight) exclusive territories adopted by the Comission is somewhat more structured than that of *Sylvania*. The same could be noticed about arbitrability and the level of scrutiny that courts exercise in reviewing arbitral awards dealing with antitrust. As shown, some Member States have not followed the lenient approach that seem to be dominant in the U.S., rather giving the awards more scrutiny. Consequently, although there does seem to be a trend that in many respects the EU is following the developments in U.S. law, the EU is not doing so without adapting the solutions to its own system. In this respect, it will be interesting to see how the EU will manage to achieve the same with regards to the facilitation of private damages actions, taking into account the different contexts in which the actions arise in these two jurisdictions.

7 CONCLUSION

When deciding about the way in which he will market his goods, a manufacturer before all takes into account which solution would be most cost-effective. In addition, he also needs to consider some other factors, such as the legal treatment of certain modes of distribution. On the one side of the spectrum, a manufacturer may decide to sell his products directly to the final customer, using his own employees for this purpose. On the other hand, he may decide to entrust distribution to an outside representative, be that an agent or a distributor. In the latter case, a manufacturer relinquishes much of the control over the distribution process, which sometimes he is not willing to do. If vertical integration into distribution would not be cost-effective, a manufacturer may opt for the middle ground in the form of a restrictive distribution agreement. Most importantly for our discussion, he could market his products based on exclusive distribution agreements. Exclusive distribution enables the manufacturer to retain a certain degree of control over distribution without the need to vertically integrate. Such an arrangement is also beneficial for the exclusive distributor, since he is assured that all of the benefits arising out of his promotion efforts will accrue to him.

The effects of an exclusive distribution agreement are ambiguous. On the one hand, it brings certain benefits to the parties that enter into it; if this would not be the case, they would not enter such an arrangement in the first place. However, it can also have some harmful effects with regards to the general interest. For example, it could facilitate collusion, either among manufacturers or among distributors; facilitate price discrimination; and in other ways cause harm to consumers. As a result, the legal approach towards the imposition of exclusive territories cannot be straightforward – neither *per se* legality nor outright prohibition is a suitable treatment for this type of arrangement. Rather, it should be afforded a type of analysis that takes into account both beneficial and harmful effects of the arrangement; this analysis could be referred to as a rule of reason.

However, the approach that a legal system adopts towards exclusive distribution agreements does not depend solely on economic considerations. This could be seen on the example of both jurisdictions analyzed in this dissertation – the U.S. and the EU. In the U.S., the legal approach towards exclusive territories is to a large extent predisposed by the Chicago School ideology. Although there are differences between scholars belonging to the school, the general view by the school's followers is that antitrust should rarely (if ever) be concerned about vertical restraints. Such an approach could also be connected with American politics and ideology. Scholars arguing for less intrusive antitrust policies can in the main be linked with the Republican philosophy; at its core are a non-interventionist approach and a belief that the best thing that a government could do is to leave the market to regulate itself. The connection between the Chicago School scholarship and law-making was mainly established during the Reagan administration. By appointing Chicago scholars to the federal courts, President Reagan enabled the infiltration of the Chicago ideas into the judicial system. And taking into account the precedent-based system present existing in the U.S., this in turn has had a great influence on the shaping of the substantive law of exclusive territories and vertical restraints in general.

American antitrust scholars, especially the Chicago School followers, emphasize the importance of economics in the shaping of antitrust rules. However, with regards to exclusive territories, the current state of the law in the U.S. does not seem to be in accordance with economic theory. Based on the discussion presented in the theoretical chapter, it seems beyond doubt that under certain conditions the use of exclusive territories can be anticompetitive. Consequently, the current American approach towards this practice (bordering with *per se* legality) does not seem to be appropriate. The present situation could be mainly explained by two factors: first, the influence of the Chicago School and its lenient approach towards vertical restraints and vertical integration in general; in addition, one should also consider the peculiarities of American antitrust enforcement. The trait that is of most relevance for our discussion is the existence of treble damages. Even if exclusive distribution agreements under certain conditions do deserve condemnation, it is doubtful that imposing a penalty in the form of treble damages is appropriate. In this light, a soft approach towards exclusive territories taken by American courts could be seen as an attempt to save antitrust defendants from excessive penalties.

The European approach towards exclusive territories has developed in a different setting. First, EU competition law provisions are not stand-alone in the way this is the case in the U.S. Rather, they are part of a larger document, more precisely the Treaty on the Functioning of the European Union. As a result, EU competition law provisions are necessarily influenced by the other parts of the Treaty and have to be interpreted by taking into account the Treaty as a whole. Most importantly, the EU approach towards exclusive distribution is affected by the single market imperative.

This means that apart from promoting economic efficiency as such, EU competition law also takes into account whether an agreement hinders the achievement of an integrated European market. In this respect airtight exclusive distribution agreements could be seen as conflicting with market integration and are hence afforded a treatment which could be characterized as quasi *per se* illegality. Such an approach does not seem justified, for several reasons. First, exclusive distribution agreements, even the airtight ones, have significant redeeming virtues. Consequently, condemning them across the board may prevent the realization of certain efficiencies and thereby hurt the economy as a whole. A strict approach towards the imposition of exclusive territories is especially problematic in case the restraint is used by a small firm. As shown in the theoretical chapter, exclusive distribution agreements can rarely if ever be harmful if the parties do not have significant market power. In addition, by to a large extent exempting vertically integrated firms from the application of EU competition law, the law is giving firms an incentive to perform distribution in-house; by vertically integrating into distribution, a firm can achieve all the goals it aims to achieve through the use of exclusive territories, only with more cost. Finally, as shown in the chapter about the EU law of exclusive territories, it is doubtful whether a strict approach towards airtight exclusive territories actually contributes to market integration.

Therefore, the EU approach towards exclusive distribution could generally be characterized as over-enforcement. This is especially so if one takes into account the enforcement mechanisms available in EU competition law and the active role that the Commission has in rooting out restrictions on parallel trade between Member States. The Commission has shown its readiness to impose heavy fines on firms deploying such restrictions, in the context of exclusive distribution or otherwise.

In the light of the efforts to increase the level of private enforcement in the EU, the over-reaching character of the EU law of exclusive distribution agreements could be extended even further. First, if a firm using exclusive territories could potentially face both a heavy fine from the Commission or a national competition authority and be required to pay damages to the injured person(s), the firm could be discouraged from using the restraint in the first place. As a result, the procompetitive potential of exclusive distribution agreements could go unrealized. Additionally, if an optimal level of enforcement is to be achieved, changes in the enforcement mechanism have to be followed by adequate changes in the substantive law. Consequently, if efforts to facilitate private enforcement are not followed by a reconsideration of the substantive law of exclusive distribution, the consequence could be an even greater level of over-enforcement.

The results reached in the chapter about the relationship between exclusive distribution and arbitration are in line with the findings in the rest of the paper. First, the present state of the arbitrability of antitrust disputes shows that the American hands-off approach in antitrust matters extends also to the field of arbitration. Perhaps this could also be connected with the neoliberal ideology and the Chicago School, i.e. with the trust in the market and private initiative (in this case, trust in arbitration as a contractual way of solving disputes). Similarly, the European approach towards the level of scrutiny of awards dealing with antitrust issues seems to be in line with a higher degree of attention that the EU is affording to the public role in antitrust intervention, especially in the field of exclusive distribution.

Finally, the discussion about arbitration is also important as it shows the way in which EU law adopts solutions from the U.S. In general, the American courts can be seen as setting a trend, which the EU later adopts. However, as the discussion has also shown, EU law does not adopt American solutions uncritically – it adapts the solution to the European legal framework. In practice, this would mean that it gives the American solution more teeth. However, one could also notice that the EU has not in all cases followed the American developments; for example, even during the *Schwinn* era the EU had a relatively balanced approach towards vertical non-price restraints. In addition, there are areas in which the EU approach could be characterized as less strict, such as with regards to horizontal specialization agreements. Consequently, the exchange of ideas and solutions in the sphere of antitrust between the U.S. and the EU does not necessarily have to be a one-way street – both jurisdictions by considering some solutions from the other side of the Atlantic.

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2. *In re* Beltone Electronics Corp., 100 F.T.C. 68 (1982)
3. *In re* Brunswick Corp., 94 F.T.C. 1174 (1979)
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2. Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR 3359
3. Case C-40/08 *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira* [2009] ECR I-9579
4. Case T-24/90 *Automec Srl v Commission* [1992] ECR II-2223
5. Case 22/71 *Béguelin Import Co. v S.A.G.L. Import Export* [1971] ECR 949
6. Case 127-73 *Belgische Radio en Televisie v SV SABAM and NV Fonior* [1974] ECR 51
7. Case T-219/99 *British Airways plc v Commission* [2003] ECR 5917

8. Case 15/74 *Centrafarm BV and Adriaan de Peijper v Sterling Drug Inc.* [1974] ECR 1147
9. Case 262/81 *Coditel SA, Compagnie générale pour la diffusion de la télévision, and others v Ciné-Vog Films SA and others* [1982] ECR 3381
10. Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* [2001] ECR I-6297
11. Case T-325/01 *DaimlerChrysler AG v Commission of the European Communities* [2005] ECR II-3319
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13. Case T-43/92 *Dunlop Slazenger International Ltd v Commission* [1994] ECR II-441
14. Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055
15. Case C-168/05 *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421
16. Case 31/85 *ETA Fabriques d'Ébauches v SA DK Investment and others* [1985] ECR 3933
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18. Joined cases T-374/94, T-375/94, T-384/94 and T-388/94 *European Night Services Ltd (ENS), Eurostar (UK) Ltd, formerly European Passenger Services Ltd (EPS), Union internationale des chemins de fer (UIC), NV Nederlandse Spoorwegen (NS) and Société nationale des chemins de fer français (SNCF) v Commission* [1998] ECR II-3141
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20. Case 5/69 *Franz Völk v S.P.R.L. Ets J. Vervaecke* [1969] ECR 295
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22. Joined cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P, *GlaxoSmithKline Services Unlimited v Commission of the European Communities* (C-501/06 P) *and Commission of the European Communities v GlaxoSmithKline Services Unlimited* (C-513/06 P) *and European Association of Euro Pharmaceutical Companies (EAEPC) v Commission of the European Communities* (C-515/06 P) *and Asociación de exportadores españoles de productos farmacéuticos (Aseprofar) v Commission of the European Communities* (C-519/06 P) [2009] ECR I-09291
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29. Case T-17/93 *Matra Hachette SA v Commission* [1994] ECR II-595
30. Case 26/76 *Metro SB-Großmärkte GmbH & Co. KG v Commission* [1977] ECR 1875
31. Case T-112/99 *Métropole télévision (M6), Suez-Lyonnaise des eaux, France Télécom and Télévision française 1 SA (TF1)* v Commission [2001] ECR II-2459
32. Case 19/77 *Miller International Schallplatten GmbH v Commission* [1978] ECR 131
33. Case T-13/03 *Nintendo Co., Ltd and Nintendo of Europe GmbH v Commission* [2009] ECR II-975

34. Case 102/81 *Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG* [1982] ECR 1095
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36. Case T-77/92 *Parker Pen Ltd v Commission* [1994] ECR II-549
37. Case C-312/93 *Peterbroeck, Van Campenhout & Cie SCS v Belgian State* [1995] ECR I-4599
38. Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] 353
39. Case 42/84 *Remia BV and others v Commission* [1985] ECR 2545
40. Case 10/69 *S.A. Portelange v S.A. Smith Corona Marchant International and others* [1969] ECR 309
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42. Case 48/72 *SA Brasserie de Haecht v Wilkin-Janssen* [1973] ECR 77
43. Case 63/75 *SA Fonderies Roubaix Wattrelos v Société nouvelle des Fonderies A. Roux and Société des Fonderies JOT* [1976] ECR 111
44. Joined cases 100 to 103/80 *SA Musique Diffusion française and others v Commission* [1983] ECR 1825
45. Case 1-71 *Société anonyme Cadillon v Firma Höss, Maschinenbau KG* [1971] ECR 351
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51. Case 27/76 *United Brands Company and United Brands Continentaal BV v Commission* [1978] ECR 207

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3. 2000/475/EC *CECED* OJ [2000] L 187/47
4. 65/366/EEC *D.R.U.-Blondel* OJ [1065] 131/2194
5. 94/322/EC *Exxon/Shell* OJ [1994] L 144/20
6. 93/49/EEC *Ford Volkswagen* OJ [1993] L 20/14
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8. 64/566/EEC *Grundig-Consten* OJ [1964] 161/2545
9. 82/367/EEC *Hasselblad* OJ [1982] L 161/18
10. 65/426/EEC *Hummel-Isbecque* OJ [1965] 156/2581
11. 2002/190/EC *JCB* OJ [2002] L 69/1
12. 88/172/EEC *Konica* OJ [1988] L 78/34
13. 95/477/EC *BASF Lacke+Farben AG, and Accinauto SA* OJ [1995] L 272/16
14. 66/5/EEC *Maison Jallatte S.A.* OJ [1966] 3/37

15. 2002/758/EC *Mercedes-Benz* OJ [2002] L 257/1

16. 76/915/EEC *Miller International Schallplatten GmbH* OJ [1976] L 357/40

17. 92/261/EEC *Newitt/Dunlop Slazenger International and Others* OJ [1992] L 131/32

18. 2003/675/EC *Nintendo* OJ [2003] L 255/33

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22. 1999/6/EC *Sicasov* OJ [1999] L 4/27

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24. 78/163/EEC *The Distillers Company Limited, Conditions of Sale and Price Terms* OJ [1978] L 50/16

25. 94/987/EC *Tretorn and others* OJ [1994] L 378/45

26. 92/426/EEC *Viho/Parker Pen* OJ [1992] L 233/27

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28. 98/273/EC *VW* OJ [1998] L 124/60

8.3.3 Other

8.3.3.1 National courts (listed alphabetically according to the country)

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2. [England] Devenish Nutrition Ltd v Sanofi-Aventis SA, 19 October 2007, [2008] E.C.C. 4

3. [England] ET Plus SA v Welters, [2005] EWHC 2115 (Comm) of 7 November 2005

4. [France] Labinal v. Mos & Westland Aerospace, Cour d'appel [CA] [regional court of appeal] Paris, 1e ch., May 19, 1993

5. [France] SA Thales, Air Défense v. Euromissile, Cour d'appel [CA] [regional court of appeal] Paris, Nov. 18, 2004
6. [France] SNF v. Cytec, Cour d'appel [CA] [regional court of appeal] Paris, Mar. 23, 2006
7. [France] SNF v. Cytec, Cour de Cassation, Jun. 4, 2008
8. [Germany] Case IX ZR 149/91, Bundesgerichtshof [BGH] [Federal Court of Justice, Civil Division] Jun. 4, 1992, 118 Bundesgerichtshofes in Zivilsachen [BGHZ] 312
9. [Italy] Judy Parrott v Fimez SpA, Corte di Cassazione decision no 1183 of 19 Jan 2007
10. [Italy] SpA Coveme v. CFI - Compagnie Française des Isolants SA, Corte di Appello [Court of Appeal], Dec. 21, 1991, Bologna no. 1786
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12. [Switzerland] V SpA v. G SA, Arrêts du Tribunal Fédéral Suisse [ATF] [Federal Court] Apr. 28, 1992, 118 II pp. 193-198
13. [Switzerland] X. S.p.A. v. Y. S.r.l., Swiss Federal Court, Case 4P.278/2005 of 8 March 2006
14. [The Netherlands] Cases nos. 04/694 and 04/695, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Gerechtshof [Hof] [Court of Appeal], The Hague, Mar. 24, 2005.
15. [The Netherlands] Cases nos. KG/RK 2002-979 and 2003-1617, Marketing Displays International Inc./VR Van Raalte Reclame B.V., Rechtbank [Rb.] [Court of First Instance], The Hague, May 27, 2004

8.3.3.2 Arbitral awards (listed chronologically)

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2. Supplier (Italy) v. Buyer (South Korea), Preliminary Award of 22 September 1983 in Case No. 4132, 10 YEARBK. COMM. ARB'N 49 (1985)
3. Seller (France) v. Buyer (US), Final Award of 1990 in Case No. 5946, 16 YEARBK. COMM. ARB'N 97 (1991)
4. Claimant v. Respondents, Final Award of 1992 in Case No. 7181, 21 YEARBK. COMM. ARB'N 99 (1996)
5. Manufacturer (France) v. Distributor (Ireland), Partial Award in Case No. 7319 of 1992, 24a YEARBK. COMM. ARB'N 141 (1999)
6. Distributor (UK) v. Manufacturer (US), Final Award of 1995 in Case No. 8362, 22 YEARBK. COMM. ARB'N 164 (1997)
7. Distributor (Japan) v. Manufacturer (Sweden), Interim Award in Case No. 7337 of 1996, 24a YEARBK. COMM. ARB'N 149 (1999)
8. Agent (Spain) v. Principal (Denmark), Final award in case no. 8817 of 1997, 25 YEARBK. COMM. ARB'N 11 (2000)

8.4 *Table of legislative and related materials*

8.4.1 US

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1. American Recovery and Reinvestment Act of 2009 (Stimulus Bill), 123 Stat 115
2. Automobile Dealers' Day in Court Act of 1956, 15 U.S.C. §§ 1221-1225
3. Clayton Antitrust Act of 1914, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53
4. Criminal Fine Improvements Act of 1987, 101 Stat 1279
5. Declaratory Judgment Act of 1934, 28 U.S.C. §§ 2201-2202
6. Federal Arbitration Act of 1925, 9 USC §§ 1-14
7. Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41-58
8. Sherman Antitrust Act of 1890, 15 U.S.C. §§ 1–7

8.4.1.2 Related materials (listed alphabetically)

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2. RESTATEMENT (THIRD) OF AGENCY (2006)
3. U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines of 19 August 2010 (http://ftc.gov/os/2010/08/100819hmg.pdf, accessed 17 May 2011)
4. U.S. Department of Justice Vertical Restraints Guidelines of 23 January 1985, 50 FR 6263-03
5. U.S. Department of Justice, Antitrust Division Manual (Fourth Edition, Last Updated December 2008) (http://www.justice.gov/atr/public/divisionmanual/atrdivman.pdf, accessed 17 May 2011)

8.4.2 EU

8.4.2.1 Legislation (listed chronologically)

1. EEC Council: Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, OJ [1962] 13/204
2. Regulation No 19/65/EEC of 2 March of the Council on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices, OJ [1965] 36/533
3. Regulation No 67/67/EEC of the Commission of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements, OJ [1967] 57/849
4. Regulation (EEC) No 2821/71 of the Council of 20 December 1971 on application of Article 85 (3) of the Treaty to categories of agreements, decisions and concerted practices , OJ [1971] L 285/46
5. Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article [101](3) of the Treaty to categories of exclusive distribution agreements, OJ [1983] L 173/1
6. Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article [101](3) of the Treaty to categories of exclusive purchasing agreements, OJ [1983] L 173/5
7. Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, OJ [1986] L 382/17
8. Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85 (3) of the Treaty to categories of franchise agreements, OJ [1988] L 359/46

9. Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ [1999] L 336/21
10. Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ [2001] L 12/1
11. Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles [101] and [102] of the Treaty, OJ [2003] L 1/1
12. Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ [2004] L 24/1
13. Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II) ,OJ [2007] L 199/40
14. Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ [2008] L 177/6
15. Commission Regulation 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, OJ [2010] L 102/1
16. Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements, OJ [2010] L 335/43

8.4.2.2 Related materials (listed chronologically)

1. Commission Notice on Exclusive Dealing Contracts with Commercial Agents, OJ [1962] 139/2921
2. Commission notice concerning Commission Regulations (EEC) No 1983/83 and (EEC) No 1984/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution and exclusive purchasing agreements, OJ [1984] C 101/2
3. Commission notice on the definition of the relevant market for the purposes of Community competition law, OJ [1997] C 372/5
4. White paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, Commission Programme No 99/027, 28 April 1999
5. Commission Notice - Guidelines on Vertical Restraints, OJ [2000] C 291/1
6. Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article [101](1) of the [TFEU] (de minimis), OJ [2001] C 368/13
7. Commission Guidelines on the application of Article [101](3) of the Treaty, OJ [2004] C 101/97
8. Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2004] C 31/5
9. Commission Notice - Guidelines on the effect on trade concept contained in Articles [101] and [102] of the Treaty, OJ [2004] C 101/81
10. Commission Notice on cooperation within the Network of Competition Authorities, OJ [2004] C 101/43
11. Green Paper – Damages actions for breach of the EC antitrust rules, COM (2005) 672, 19.12.2005.

12. Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ [2008] C 95/1
13. Commission Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2008] C 265/6
14. White Paper on Damages Actions for Breach of the EC antitrust rules, COM (2008) 165, 2.4.2008.
15. Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article [102] of the [TFEU] to abusive exclusionary conduct by dominant undertakings, OJ [2009] C 45/7
16. Commission Guidelines on Vertical Restraints, OJ [2010] C 130/1
17. Communication from the Commission – Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ [2011] C 11/1

8.4.3 Other

8.4.3.1 Treaties (listed chronologically)

1. Treaty Establishing the European Coal and Steel Community of 1951 (Paris Treaty), 261 U.N.T.S. 140
2. Treaty Establishing the European Economic Community of 1957 (Rome Treaty), 298 U.N.T.S. 11
3. Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention), 330 U.N.T.S. 38

8.4.3.2 National statutes (listed alphabetically according to the country)

1. [Belgian] Law on the unilateral termination of exclusive distribution agreements of indefinite duration of 1961
2. [French] Code Civil of 1804
3. [French] Code of Civil Procedure (as amended)
4. [German] Arbitration Law of 1998
5. [Italian] Code of Civil Procedure of 1990
6. [Serbian] Law on Obligations of 1978 (as amended)
7. [Swedish] Arbitration Act of 1999
8. [Swiss] Private International Law Act of 1987
9. [UK] Protection of Trading Interests Act of 1980

8.4.3.3 Arbitration rules and model laws (listed alphabetically)

1. International Arbitration Rules of the American Arbitration Association of 2009
2. International Chamber of Commerce Rules of Arbitration of 1998
3. London Court of International Arbitration Rules of 1998
4. UNCITRAL Model Law on International Commercial Arbitration of 1985 (as amended in 2006)