Competition Competence Report

Applicability of Article 101 (1): Economic Analyses of Vertical Restraints

Agreements below market power are not harmful for competition. That is why a market share threshold of 30% for vertical agreements was introduced by the Block Exemption Regulation (BER). Vertical agreements above the market share cap of 30% require an individual examination under Article 101 TFEU. First, an assessment has to take place whether Article 101 (1) applies at all. An agreement restricting competition under Article 101 (1) still might be legal if the party can show that it fulfills the conditions set out in Article 101 (3). Companies can invoke Article 101 (3) directly before a national court or national competition authority.[1]

Thus companies are required to do a self-assessment of the possible consequences of their vertical agreements under Article 101 as a whole. While the former CCR describes the economic aspects of vertical restraints in general, this CCR intends to illustrate the concrete applicability of Article 101 (1) in detail.

Assessment of Vertical Restraints

The assessment of a vertical restraint involves in general four steps:

1) First, the undertakings involved need to define the relevant product and geographic markets in order to establish the market share of the supplier or the buyer, depending on the vertical restraint involved;

[1] Regulation 1/2003 has removed the centralised notification and authorisation system for the application of Article 101(3).

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2) If the relevant market share does not exceed the 30 % threshold, the vertical agreement is covered by the Block Exemption Regulation, subject to the hardcore restrictions and conditions set out in that regulation;
3) If the relevant market share is above the 30 % threshold, it is necessary to assess whether the vertical agreement falls within Article 101(1);
4) If the vertical agreement falls within Article 101 (1), it is necessary to examine whether it fulfills the conditions for exemption under Article 101 (3).

In the following, the economic assessment under Article 101 (1) is elaborated in detail.

Applicability of Article 101 (1)

For the purpose of assessing whether an agreement or its individual parts may restrict inter-brand competition and/or intra-brand competition it needs to be considered how and to what extent the agreement affects or is likely to affect competition on the market. For the purpose of the assessment of the competitive effects of vertical restraints, a well-founded economic expert analysis is suitable. Thus, in assessing cases above the market share threshold of 30 %, a full competition analysis is required. The following factors are considered by the EC Commission as the most important ones to establish whether a vertical agreement restricts competition within the meaning of Article 101 (1).

First, it has to be assessed if the agreement restricts actual or potential competition that would have existed without the agreement. If the answer is a positive one, the agreement might be caught by Article 101 (1). In making this assessment it is necessary to take into account competition between the parties and competition from third parties. For instance, where two undertakings established in different Member States agreed not to sell products in each other's home markets, (potential) competition that existed prior to the agreement is restricted. By evaluating whether the parties to an agreement are actual or potential competitors, the economic and legal context must be taken into account. For instance, if due to the financial risks involved and the technical capabilities of the parties it is unlikely that each party would be able to carry out its own activities covered by the agreement, the parties are deemed to be non-competitors in respect of that activity. It is for the parties to bring forward evidence.

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Second, it is essential to analyze if the agreement restricts actual or potential competition that would have existed in the absence of the contractual restraints. If so, the agreement may be caught by Article 101

(1). For example, where a supplier restricts its distributors from competing with each other, (potential) competition that could have existed between the distributors absent the restraints is restricted.

However, certain restraints are under certain circumstances not caught by Article 101 (1) when the restraint is objectively necessary for the existence of an agreement of that type or that nature. The question is whether - given the nature of the agreement and the characteristics of the market - a less restrictive agreement would not have been concluded by undertakings in a similar setting. A prohibition imposed on all distributors not to sell to certain categories of end users may not be restrictive of competition if such restraint is objectively necessary for reasons of safety or health related to the dangerous nature of the product in question. If the agreement restricts competition in one of the aforementioned manner, it might be caught by Article 101 (1). Then, in the first case the companies have to prove that each party of its own would not be able to carry out the activities covered by the agreement. In the second case, the restraints are not caught under Article 101 (1) when the restraint is objectively necessary for the existence of an agreement of that type or nature (e.g. for reasons for safety or health). The importance of individual factors may vary from case to case and depends on all other factors. It is therefore not possible to provide strict rules on the importance of the individual factors. In the following, the methodology to perform a full competition analysis is described in brief.

- *Market share analysis*

In the assessment of the market position of the supplier, market shares on the relevant product and geographic market provide first indications. Market shares are a vital indicator to estimate the economic impact of vertical agreements. Before assessing market shares, the relevant markets have to be defined accordingly.

- *Assessment of market position*

Negative effects on competition within the relevant market are likely to occur when the parties individually or jointly have or obtain some degree of market power and the agreement contributes to the creation, mainten-

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ance or strengthening of that market power or allows the parties to exploit such market power.[2]

- *Countervailing market power*

A high level of concentration of firms on the buyer side of the market is not in itself sufficient evidence to disprove market power of a supplier, since any buying power initially affects all suppliers to an equal extent. This is particularly the case when the level of concentration on the supply side is equal or even superior to the level of concentration on the demand side. Instead of this, a prerequisite for buyer power is that a powerful buyer awards its contracts according to market-strategic considerations, so as not to become dependent on suppliers with market power.

- *Resources*

Superior financial strength may provide a firm with a scope of action, in particular as regards the use of parameters of competition such as price, investment, research and advertising.

- *Access to supply and sales markets and competition from (imperfect) substitutes*

A firm's easier access to the supply or sales markets in relation to its competitors may give it a paramount market position. This is the case in particular if a powerful firm (in terms of its market share) can make access to such markets difficult or even impossible for its rivals on account of its own very good access to the supply or sales markets (raising the barriers to entry/ risk of foreclosure).

- *Barriers to market entry/ potential competition*

Barriers to entry and potential competition are important indications of a market position. Even a firm with a high market share cannot apply excessive prices since in the case of low barriers to entry, it is very likely that potential competitors would be able to enter the market quickly and limit the scope of anti-competitive action of the company.

- *Market phase, level of trade and nature of the product*

The market phase refers to the development stage of a market and hence to the stability of its competitive conditions. It is thus not an independent factor, but provides important information for evaluating market shares and their developments. Level of trade and nature of the product are

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[2] Market power is defined as the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time.

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examined too. Level of trade is linked to the distinction between intermediate and final goods and services. Negative effects are in general less likely at the level of intermediate goods and services. The nature of the product plays a role in particular for final products: when the product is more heterogeneous and resembles more a one-off purchase, vertical restraints are more likely to have negative effects.

Applicability of Article 101 (3)

A vertical agreement that infringes Article 101 (1) may be exempted if the four conditions of Article 101 (3) are met:

- *First condition of Article 101 (3): Efficiency gains*
- *Second condition of Article 101 (3): Fair share for consumers*
- *Third condition of Article 101 (3): Indispensability of the restrictions*
- *Forth condition of Article 101 (3): No elimination of competition*

Practical Application and Conclusion

Due to the self-assessment required by the new more economics based approach, companies might need assistance in the assessment of the competitive effects of their vertical restraints. The EE&MC approach to assess Article 101 (1) consists of a broad economic analysis that is adapted to each particular case. This assessment contains - following the definition of the relevant market and the calculation of the particular market share - an analysis of all aforementioned important economic factors: market position, buyer power, resources, access to supply and sales markets as well as competition from (imperfect) substitutes, barriers to entry/ potential competition, market phase, level of trade and nature of the product. Such a broad and well-founded economic expert opinion facilitates the self-assessment of companies as required by EU competition law.

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