INSIGHTS FROM U.S. ANTITRUST LAW ON EXCLUSIVE AND RESTRICTED TERRITORIAL DISTRIBUTION: THE CREATION OF A NEW LEGAL STANDARD FOR EUROPEAN UNION COMPETITION LAW

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1. INTRODUCTION

Is a comparison between European Union (E.U.) and U.S. antitrust law of exclusive and restricted territorial distribution beneficial, and if so, in what ways? The question necessarily turns on the degree of feasibility of the comparison. If its purpose is to compare the antithetical approaches adopted on the two sides of the Atlantic and to suggest remedies designed to cure the alleged flaws of the official positions taken in the European Union by transferring there a series of insights drawn from U.S. law, it certainly may not be pursued independently of the prominent objectives of competition law in the European Union. To many theorists, the “efficiency” and “market power” approaches, largely endorsed in U.S. case law and commentary, are attractive notions, useful for the analysis of exclusive and vertical territorial arrangements in both the United States and in Europe.¹ But the United States


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is a fully integrated market, while the European Union consists of twelve Member States striving to achieve unification. As a result, the Member States are hostile to any private arrangements that artificially perpetuate their segregation. By the same token, proposals derived from U.S. case law or literature may only be feasible if made in light of (1) the basic statutory framework of the Treaty of Rome, and most notably its provisions that are directly applicable in restricted distribution disputes (i.e., the first and third paragraphs of Article 85); (2) the allocation of the antitrust enforcement duties between the European Commission, which is given a central supervisory role on competition matters, and the national judiciaries of the Member States; and (3) the economic realities prevalent in the European market, that often differentiate it from the more flexible and mobile U.S. market.

This Article attempts an application of the neo-classical price theory supported by advocates of the so-called Chicago School in the E.U. law of exclusive distributorships and concomitant territorial arrangements. To establish the background for this transfer of ideas, Section 2 explores whether the pursuit of "efficiency" in the exclusive distribution and vertical territorial restriction context is in conflict with the "market integration" goal of E.U. competition law. In connection with this idea, "parallel imports" are a factor involved in most exclusive and restricted distribution disputes, and they contribute to the creation of a unified European market. Section 3, after briefly referring to the general requirements of Article 85 and commenting on the bifurcated enforcement of its first and third paragraphs, outlines the ways in which intrabrand competition and parallel imports are protected by certain provisions and explanatory interpretations of the Commission's Regulation No. 83/83, including a block exemption of certain categories of exclusive distribution arrangements. In addition, it includes a summary of some of


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the leading decisions of the Commission and of the European Court of Justice on exclusive and restricted territorial distribution. Section 4 discusses the basic economics of exclusive and restricted territorial distribution, identifies the advantages of the "market power" and "efficiency" approaches for both the competitive process and parties to exclusive arrangements, and refers to decisions of U.S. courts, that largely have embraced such approaches. Finally, Section 5 not only makes a proposal properly reconciled with the "market integration" goal and designed for the future resolution of exclusive distribution disputes while following U.S. standards, but also suggests the amendment of the current Regulation 83/83 during a transitional period. Section 5 also demonstrates the effects of the application of the proposal in factual situations already faced by the European Commission and the Court of Justice.

2. EXCLUSIVE DISTRIBUTION AND TWO DIVERGENT ANTITRUST GOALS: EFFICIENCY AND EUROPEAN MARKET INTEGRATION

As a matter of principle, many antitrust theorists both within the European Union and elsewhere embrace the Chicago School neo-classical price theory and consider efficiency the fundamental goal to be achieved in the market, secured by competition and furthered by antitrust laws. An efficient business practice is one that produces more aggregate benefits than aggregate costs, thus resulting on balance in maximized wealth. Efficiency is hence a purely economic principle necessitating the allocation of all available market resources in the best possible way, ultimately leading to an increase in market output.² According to the principles of

² See, e.g., ROBERT H. BORK, THE ANTITRUST PARADOX 90-106 (1978); A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 7 (2d ed. 1989). Polinsky describes efficiency as an increase of aggregate benefits, no matter how the benefits are distributed among members of the society. Bork perceives efficiency in a somewhat different way. He distinguishes between "allocative efficiency" and "productive efficiency." Defining the former as the allocation of productive forces and materials of a market in a way that consumers value most and the latter as the effective use of resources of particular firms, he notes that the central antitrust objective is, or at least should be, the improvement of allocative efficiency without an impairment of productive efficiency. Bork thus introduces a certain "distributional" dimension to the notion of efficiency. See also the
the Chicago School theory, if individuals in business are assumed to be profit-maximizers, they will make only rational decisions, such as adopting vertical restrictions only for efficiency purposes.\(^3\) Further, assuming that the market is self-correcting and punishes individuals who pursue inefficient practices, the long-term survival of vertical or other practices in a market suggests that the latter actually enhance efficiency. Therefore, "second guessing" and expanded intervention by enforcement agencies and courts may only create the risk of destroying efficient practices that are not easily replaced.\(^4\)

Despite the contention of many scholars that efficiency is the emerging goal of E.U. competition law, it is beyond any doubt that E.U. officials view European market integration (i.e., the achievement of a truly unified European market) as its most important objective, if not its \textit{raison d'etre}.\(^5\) The discussion by the Chicago and Harvard schools of thought on the efficient aspects of some of the most commonly attacked antitrust offenses, such as restricted distribution and predatory pricing, in Frank H. Easterbrook, \textit{Workable Antitrust Policy}, 84 Mich. L. Rev. 1696, 1700-01 (1986) and Richard A. Posner, \textit{The Chicago School of Antitrust Analysis}, 127 U. Pa. L. Rev. 925, 938-44 (1979).

\(^3\) See Posner, \textit{supra} note 2, at 928.

\(^4\) See Easterbrook, \textit{supra} note 2, at 1700-01. \textit{But see} Eleanor M. Fox, \textit{The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window}, 61 N.Y.U. L. Rev. 554, 580 (1986). The concept of self-correcting markets is supplemented by some commentators with the utmost rejection of the so-called "barriers to entry." New businesses are likely to enter markets where supracompetitive profits are already being made without any objective barrier making their projects infeasible or unworkable. Economies of scale and advertising do not usually make the entry of firms into industries difficult; rather, they are forms of superior efficiency of the firms already competing. On the other hand, capital requirements and risk premiums are not barriers to entry. Practically any firm may obtain capital, make investments and start competing with firms that are already established. Only in rare circumstances may scarce resources be such a barrier. \textit{See generally} BORK, \textit{supra} note 2, at 310-29; Posner, \textit{supra} note 2, at 934-48.

\(^5\) This is not to say that efficiency considerations are unknown in the Union Competition Law. For example, antitrust scrutiny may be based on efficiency considerations in relation to the third paragraph of Article 85 of the Treaty of Rome, providing for the exemption of schemes violating the first paragraph of the Article, as long as they contribute to the improvement of production or distribution or promote technical or economic progress. Some of the Reports of the European Commission on Competition Policy also refer to efficiency. \textit{See, e.g.}, COMMISSION OF THE EUROPEAN COMMUNITIES, \textit{Twentieth Report on Competition Policy} 11 (1991); \textit{The Community's}
realization of this political aim should not only be protected against any adverse business practices, but actively promoted by the E.U.'s competition policy. Aspects of this market integration-oriented competition policy include: (1) abolition of technical and business barriers partitioning the European market along national lines; (2) prohibition of abuses of dominant positions by powerful firms, which may stimulate disparities among national markets; (3) promotion of trade interpenetration of the markets of different Member States; (4) protection of parallel imports; and (5) encouraging different forms of cooperation between national small- and medium-sized firms.6

Expressions of this ideal may be found in many official documents of the European Union, including the Treaty of Rome (such as Articles 2 and 3), the Reports on Competition Policy of the European Commission, and the decisions of the European Court of Justice.7


7 For example, Article 2 of the Treaty provides that the general goal of the European Union is the establishment of a Common Market and the approximation of economic activities of Member States, as well as the achievement of closer relations between them. Article 3 outlines the means by which the objectives in Article 2 may be achieved. The establishment of a system that ensures that competition in the Common Market is not distorted is one of those means. It is therefore understood that the formulation of a workable competition policy must serve the goal of European market unification. On the other hand, the Commission's Reports on Competition Policy are particularly enlightening. See, e.g., First Report, supra note 1, at 20 (stating that "the Community policy must avoid that restraints and obstacles to trade by the state, which have been cut out, are not replaced by private measures with similar effects. Quota agreements and agreements which aim to carve the common market into regions ... contravene the provisions of the Treaties."). See also NINTH REPORT ON COMPETITION POLICY 9 (1980) (condemning restrictive or abusive practices that result in the partitioning of national markets); Sixteenth Report on Competition Policy 13-18 (1987) (same); Eighteenth Report on Competition Policy 13-17 (1989) (providing that a national market-opening policy prevails in competition matters); Twentieth Report on Competition...
Exclusive distribution controversies fit easily within this context. A manufacturer entering into an exclusive supply agreement with one of its distributors, i.e., agreeing to supply only the latter in a clearly defined geographic area ("the contract territory") and to refrain from selling the same commodity for resale to other traders at the same level of distribution, may want to reinforce the territorial exclusivity of this distributor against incursions of traders operating in adjacent areas. In order to accomplish this goal, the manufacturer might impose on these traders more or less intense vertical territorial restrictions, prohibiting them from engaging in out-of-territory sales and thus curtailing or even eliminating intrabrand competition between them and the exclusive distributor.

In the European Union, exclusive distribution is usually organized along national lines, and the contract territories often coincide with national territories. Intrabrand competition may thus develop among distributors of different Member States. In such cases, cross-sales from one Member State to another may take the form of "parallel imports."

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6 European legislative texts and case law use a variety of terms to refer to these schemes. "Exclusive distributorship," "exclusive supply," and "sole distributorship" are alternatively used in both the block exemption of Regulation No. 83/83 and in decisions of the Commission and the European Court of Justice. By contrast, U.S. judicial authorities occasionally refer to such arrangements as "exclusive dealerships."

7 For an analysis of the types of restrictions based on degree of protection, see 8 PHILLIP E. AREEDA, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1641b (1986), which refers to areas of "primary responsibility" (merely obligating distributors to concentrate their sales activity in a specific area to meet local demands), the "location clause" (obligating dealers to sell from specific locations, but permitting them to serve from there any customer they can reach), "airtight" or "closed territories" (binding distributors not to sell actively outside their prescribed areas or fill any orders from consumers based outside of them), and "pass over payments" and "royalty systems" (commissions paid by distributors for their out-of-territory sales to the "invaded" distributors or to the manufacturer itself).

10 The term "intrabrand competition" designates the rivalry between traders or resellers operating within the distribution network of a single manufacturer's brand, in contrast to "interbrand competition," which occurs between manufacturers producing or resellers distributing different brands.

11 "Imports" refers to the circulation of goods or services from the European country where they are originally produced or intended to be...
which contribute to the equalization of differentiated pricing throughout the E.U. (due to the different tax systems, currency exchange levels, costs of product promotion, consumer tastes, and levels of distributor efficiency in the Member States), and in a sense promote European unification. Any adverse involvement with such parallel imports by means of vertical territorial restraints, which invigorate the exclusivity of national distributors, thus prevent the equalization of prices at a single level and consequently impede European integration.

Significantly, both the provisions of the block exemption included in Regulation No. 83/83 and the decisions of the European Commission and the Court of Justice, discussed in Section 3.2, demonstrate that whenever there is a conflict between the pursuit of efficiency and market integration, E.U. competition law opts for the latter. Because E.U. competition policy is designed primarily to promote the unification of the national markets of Member States, schemes contrary to that goal are not tolerated, regardless of whether they yield output-enhancing results or aim at efficiency. Because European officials display such a strong hostility against exclusive distribution agreements coupled with export or import prohibitions, parallel imports become the essential factor that each trader must take into account before entering into such an agreement if it wishes to enjoy the blessings of the Commission and avoid the prospect of subsequent illegality.

consumed to other Member States. The fact that the circulation of goods must occur across national borders does not mean, however, that the goods must be intended for use in the whole territory of importation. See SIMON HORNER, PARALLEL IMPORTS 1 (1987). "Parallel imports" are made in markets already served by traders supplying identical goods as importers and are thus a form of intrabrand competition. For an analysis of parallel imports as an expression of the free movement of goods within the Union, especially in connection with Articles 12, 13 and 16 of the Treaty of Rome, see id. at 118.

12 For an enumeration of factors contributing to differentiated national price levels, see Waelbroeck, supra note 1, at 50.
3. EXCLUSIVE AND RESTRICTED TERRITORIAL DISTRIBUTION IN THE COMPETITION LAW OF THE EUROPEAN UNION: A BROAD PROTECTION OF INTRABRAND COMPETITION AND PARALLEL IMPORTS


The legal foundations of exclusive and vertical territorial arrangements in the European Union are located primarily in Article 85 of the Treaty of Rome and in a specialized block exemption issued by the European Commission for exclusive distribution practices exhibiting specific characteristics. The structure of Article 85 is divided. Its first paragraph prohibits agreements and concerted practices that restrict competition and affect interstate trade. The second

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In the most common case, exclusive distributorships and vertical territorial restrictions are agreements between two or more undertakings (e.g., a manufacturer and a distributor or subsequent resellers in the vertical chain of distribution). Under an alternative scenario, these arrangements are established following a tacit understanding among those parties. But see WILLY ALEXANDER, THE EEC RULES OF COMPETITION 71 (1973); JAMES P. CUNNINGHAM, THE COMPETITION LAW OF THE E.E.C. 121-23 (1973); D.J. Gijlstra & D.F. Murphy, Distribution Systems and E.E.C. Competition Law: The Law as it Stands, 1976/1 L.I.E.I. 89-92 (making it clear that arrangements between a manufacturer and its agents are not governed by 85(1)).

Moreover, the Commission and the European Court of Justice have consistently taken the position that exclusive distributorships and vertical territorial restrictions prevent, restrict and distort competition within the European Union. Actually, the language of 85(1) does not make any distinction between (1) various types of agreements that may distort competition (e.g., horizontal, vertical, etc.); (2) different parties among which competition may be restricted (e.g., parties to the agreements, third parties, etc.); and (3) different forms of competition that may be suppressed (e.g., interbrand, intrabrand, etc.). See, e.g., Case 32/65, Italy v. Council and Commission, 1966 E.C.R. 389, 407, [1961-1966 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8048 (1966); Joined Cases 56 & 58/64, Etablissements
paragraph declares such agreements or concerted practices void, while the third paragraph provides the Commission with the discretion to make individual exemptions from the prohibitions of the first paragraph, as long as the agreements are beneficial and promote economic progress or otherwise serve the legitimate business purposes of their parties.

3.1.1. Regulatory and Judicial Hints for a "Balanced" Application of Article 85(1)

Although arrangements are traditionally governed by the first paragraph of Article 85 without first being examined in their appropriate legal and economic context, it has been frequently stated that the European Commission and the Court of Justice in several instances have acknowledged that analysis under 85(1) should be more "balanced" and less "automatic." Although Article 85(1), prima facie, seems to establish a per se rule, i.e., a conclusive and non-rebuttable presumption of illegality for agreements or concerted practices falling under its provisions, the Commission and the Court of Justice have allegedly created a set of presumptions that are rebuttable on the basis of specifically required evidence, factual indicia or market data. In addition, they have allocated the burden of proof between plaintiffs and defendants, leaving room for the examination of the pro- and anticompetitive aspects of the challenged schemes.

The most acknowledged hints of such a "rule of reason" inserted in the 85(1) jurisprudence are (1) the Commission's Notice on Minor Agreements,\(^\text{15}\) declaring the inapplicability

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Further, exclusive distributorships and vertical territorial arrangements may have direct, indirect, actual, or probable effects on interstate trade. This is foreseeable with a sufficient degree of probability, as they may be constructed between a manufacturer and its distributors operating in different Member States, to which imports or from which exports are restricted. See, e.g., id. at 341. On the repercussions of purely national vertical schemes on inter-state trade, see the decisions of the Court of Justice, such as Case 63/75, S.A. Fonderies Roubaix-Wattrelos v. Société Nouvelle des Fonderies A. Roux and Société des Fonderies JOT, 1976 E.C.R. 111, 119, Common Mkt. Rep. (CCH) ¶ 8341 (1976); Case 47/76, Alexis De Norre v. NV Brouwerij Concordia, 1977 E.C.R. 65, 93, [1976 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8386 (1977).

\(^{15}\) See Commission Notice on Agreements of Minor Importance, 1986 O.J. (C 231) 2.
of 85(1) to agreements and concerted practices of small- and medium-sized undertakings, which, because of their minor position in the market, will only restrict competition insignificantly; (2) other de minimis considerations in the evaluation of contested vertical practices that are judged outside the scope of 85(1) as adopted by parties with small market shares;\(^\text{16}\) (3) the occasional development of judicial criteria for a "balanced" application of 85(1);\(^\text{17}\) and (4) the adoption, especially in some dicta of the European Court of Justice, of an "ancillary restraint" approach.\(^\text{18}\)

Nonetheless, it is generally true that such "rule of reason" indicators are limited in scope (as exhibited in the Notice on Minor Agreements and in the decisions involving de minimis


\(^\text{18}\) Thus, restrictions considered necessary for a legitimate business purpose, be it the protection of know-how of a franchisor against exploitation by competitors, the preservation of the identity or reputation of a franchise network, the continuity of supplies attributed to clauses of an exclusive purchasing agreement, or the protection of interests of purchasers in avoiding competition from sellers for a minimum period of time (which might be achieved through the insertion of a non-competition clause in a sales agreement), have been found not to violate 85(1). See, e.g., Case 161/84, Pronuptia v. Schillgalis, 1986 E.C.R. 353, 1 C.M.L.R. 414 (1986); Commission Decision Re the Agreements of Verenigde Bedrijven Nutricia NV, 2 C.M.L.R. 165, 174 (1984); Commission Decision Atka A/S v. BP Kemi A/S, 1979 O.J. (L 286) 32, 42, 43, 3 C.M.L.R. 684, 702, 703 (1979).
implementing its prescribed (DG)-IV. paragraph notified will practices fewer indispensable must parties, under effectively restraint" arrangements)\textsuperscript{19} or in subject matter (as in the "ancillary restraint" approach),\textsuperscript{20} or that they are not incorporated effectively in the whole body of E.U. competition case law.

3.1.2. The Third Paragraph of Article 85 and the Exclusive Power of the Commission to Apply It

An exclusive or vertical territorial arrangement falling under 85(1) might be granted an individual exemption under 85(3) if properly notified to the Commission by interested parties,\textsuperscript{21} who must prove that such an arrangement effects an improvement in production or distribution or that it contributes to technical or economic progress. Further, parties must provide evidence that the notified arrangement is indispensable for this improvement in production or distribution or for the technical or economic progress. If these alleged beneficial results may be objectively accomplished with fewer restrictions on competition, exclusive or other vertical practices may not benefit from the advantages of 85(3). Similarly, it must be demonstrated that ultimate consumers will be allowed to enjoy a "fair share" of the benefits of the notified agreements.

Ultimately, however, the power to apply the third paragraph of Article 85 and to grant exemptions for exclusive and vertical territorial arrangements is at the discretion of the Commission, and more specifically its Directorate General (DG)-IV.\textsuperscript{22} This exclusive power initially was given to the Commission to enable it to formulate particular uniform rules

\textsuperscript{19} Thus, agreements even slightly exceeding the market share percentage prescribed by the Notice (5\%) automatically fall under 85(1). Similarly, the "de minimis" considerations are mostly confined to cases where defendant parties occupy only minimal shares (less than 1\% of the relevant market).

\textsuperscript{20} For example, the "ancillary restraint" doctrine has been consistently applied only for those specific categories of arrangements, and only to serve its original purpose as pronounced by the European judicial authorities (e.g., protection of know-how in franchise agreements, etc.), while other practices designed to serve different purposes have been analyzed with much greater skepticism and eventually have been outlawed. See infra notes 45-46 (decisions of the Commission and the European Court of Justice in which vertical territorial schemes have been condemned without regard to their procompetitive justifications).

\textsuperscript{21} See Council Regulation 17/62, 1959 O.J. (L 62) 87 (the first Regulation implementing Articles 85 and 86 of the Treaty of Rome).

\textsuperscript{22} Id. art. 9(1).
and approaches in E.U. competition law, thereby giving guidance to businesses as to which of their practices are legal and which violate the legal order of the E.U..\textsuperscript{23} It soon became evident, however, that its limited staff was consistently unable tocope effectively and within reasonable time limits with all the notifications that reached its Brussels headquarters. In the absence of any kind of interlocutory relief or provisional validity until a formal exemption is granted,\textsuperscript{24} businesses wishing to draft their arrangements in a manner different from that provided in the block exemption on exclusive distribution face considerable delays and uncertainty. As a result, they frequently included clauses of dubious legality in their agreements, some of which were annulled by the Commission. This deterred some businesses from using such clauses, despite the fact that the clauses may have been procompetitive and beneficial.\textsuperscript{25}

3.2. The Block Exemption of Regulation No. 83/83 and its Safeguards Against National Market Isolation

Regulation No. 83/83, which is currently in effect and provides for the block exemption of exclusive distribution


\textsuperscript{25} Many European scholars have heavily criticized the exclusive power of the Commission to grant exemptions, and have proposed solutions ranging from favoring a rule of reason under 85(1) to suggesting that national courts be able to grant exemptions under 85(3). See Forrester \& Norall, supra note 23, at 38-45; JOLIET, supra note 1, at 115; Stephen Kon, Article 85, Para. 3: A Case For Application By National Courts, 19 COMMON MKT. L. REV. 541, 554-61 (1982); Korah, supra note 24, at 350-55; Mark Clifford Schechter, The Rule of Reason in European Competition Law, 1982/2 L.I.E.I. 1, 2, 13-15; Ernst Steindorff, Article 85 and the Rule of Reason, 21 COMMON MKT. L. REV. 639, 646 (1984); Helmuth R.B. Schröter, Antitrust Analysis Under Article 85(1) and (3), 1987 FORDHAM CORP. L. INST. 645, 690-92; Venit, supra note 23, at 33-51; see also unpublished notes from a lecture by Professor Korah on exclusive distribution, given at the University of Pennsylvania Law School on February 21, 1994, at 18 (on file with author).
arrangements with specifically defined characteristics, is an amendment of Regulation No. 67/67, which was issued after an era during which cases of exclusivity in distribution were only exempted individually under 85(3) following notifications by interested parties to the Commission. Although Regulation No. 83/83 maintains most of the provisions of Regulation No. 67/67, it also includes some additions designed to circumvent the risk that the exempted arrangements would serve purposes of national market sharing.

3.2.1. Raison d’être and the Limits of Exclusive Distribution

The block exemption of Regulation No. 83/83 covers "bilateral" agreements between a manufacturer and a single

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27 See, e.g., Commission Regulation 83/83, art. 3(c) (including a provision to ensure that end users in every Member State have an alternative intrabrand source of supply outside the Member State); Commission Regulation 83/83, art. 6 (providing for the discretion of the Commission to withdraw the benefit of the block exemption if parallel imports are made impossible for reasons other than those included in Article 3). Useful comments and analyses on the provisions of this Regulation can be found mainly in Valentine Korah, Exclusive Dealing Agreements in the E.E.C.: Regulation 67/67 Replaced (1st ed. 1984); Valentine Korah & Warwick A. Rothnie, Exclusive Distribution and the EEC Competition Rules: Regulations 1983/83 & 1984/83 (2d ed. 1992); Helmuth Lutz & Terry R. Broderick, EEC Agreements for Exclusive Distribution and Purchasing, 14 INT’L BUS. L. 162 (1986); William T. McGrath, Group Exemptions for Exclusive Distribution Agreements in the Common Market, 9 N.C. J. INT’L L. & COMM. REG. 231 (1984); Utz Toepke, EEC Law of Competition: Distribution Agreements and Their Notification, 19 INT’L LAW 117 (1985); Floris O.W. Vogelaar, The Overall Policy of the Commission Concerning Distribution in the Light of Recent Developments, 1986 FORDHAM CORP. L. INST. 185.

28 The first condition refers to the number of undertakings which are parties to the agreement. It is intended to discourage the use of exclusive distribution schemes as a means of establishing or maintaining cartels among competing distributors. A manufacturer appointing multiple exclusive distributors with a single contract might apply identical terms of sale to all of them, and thus indirectly facilitate their collusion. See Helmuth R. B. Schröter, The Application of Article 85 of the EEC Treaty to Distribution Agreements—Principles and Recent Developments, 1984 FORDHAM CORP. L. INST. 375, 398.
distributor, granting the distributor exclusive "resale" rights to the manufacturer's "goods." The Preamble to the Regulation recognizes that exclusive supply agreements help improve and rationalize distribution networks and are often the only way for small- or medium-sized undertakings to enter new markets. These agreements facilitate the promotion and intensive marketing of products within specific areas. If the agreements are used to eliminate intrabranded competition between exclusive distributors or exclusive supply or parallel imports from one national market to another, consumers may be deprived of their "fair share" of the improvements in distribution through lower resale prices, and, as a result, the block exemption will become inapplicable or will be withdrawn. Exclusive arrangements reinforced with intense vertical territorial restraints that shield distributors from such extraterritorial competition do not meet the specifications set forth in Regulation No. 83/83. According to its underlying philosophy, the regulation seeks to avoid the evil of compartmentalized national markets at the intrabranded level.

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29 By contrast, transformation or further processing of the manufacturer's product is not covered by the Regulation. The exclusive distributor may, however, repackage those goods according to packaging specifications prevalent in other countries in order to export them there eventually. See Commission's Explanatory Memorandum (commonly referred to as "the Guidelines"): "The economic identity of the goods is not affected if the reseller merely breaks up and packs the goods into other packages before resale." 1983 O.J. (C 355) 7, 8.

30 But see Guideline 11, which states: "Exclusive agreements for the supply of services rather than the resale of goods are not covered by the Regulations." Id. at 8. See also BARRY E. HAWK, UNITED STATES, COMMON MARKET AND INTERNATIONAL ANTITRUST 444, 445 (1990).

31 See Recital 6 to Regulation 83/83, 1983 O.J. (L 173) at 1. The Recital provides:

[E]xclusive distribution agreements facilitate the promotion of sales of a product and lead to intensive marketing and to continuity of supplies while at the same time rationalizing distribution; ... they [also] stimulate competition between the products of different manufacturers. ... [T]he appointment of an exclusive distributor who will take over sales promotion, customer services and carrying of stocks is often the most effective way, and sometimes indeed the only way, for the manufacturer to enter a market and compete with other manufacturers already present .... [T]his is particularly so in the case of small and medium-sized undertakings.

Id.

32 See id. at 2 (providing that "[c]onsumers will be assured of a fair share

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3.2.2. Protection of Intrabrand Competition and Parallel Imports Under Regulation 83/83

Many of Regulation 83/83's provisions emphasize its most prominent characteristic: the condemnation of intense vertical restrictions amounting to the absolute territorial protection of national exclusive distributors, which leads to the compartmentalization of national markets. Parallel imports must remain viable and intrabrand competition among traders from different Member States must flourish to make possible the development of interstate trade and the achievement of a unified Europe. The following is a summary of those provisions of Regulation 83/83 and of the Commission's Explanatory Memorandum which directly or indirectly safeguard the unification of European markets and protect the so-called “fair share” interests of European consumers:

1) Point 27 of the Guidelines, interpreting Article 1 of the Regulation, defines the limits of “exclusive supply.” It provides that the supplier remains free to sell the contract good to resellers outside the territory who later intend to sell within it, thus creating an alternative source of supply for consumers. It also fosters rivalry at the intrabrand level and, frequently, among parallel imports, where exclusivity is granted along national lines. As a result, the exclusive distributor might occasionally be undercut by resellers from outside the territory.

Guideline 27 provides that “[t]he exclusive supply obligation does not prevent the supplier from providing the contract goods to other resellers who afterwards sell them in the exclusive distributor's territory.” 1983 O.J. (C 355) 7, 10. Guideline 27 contradicts Guideline 28, which states that...
2) Guideline 30 gives the manufacturer, as intrabrand competitor of the exclusive distributor, discretion to supply to certain final consumers or end users who buy its goods outside the contract territory but are permanently based in it. Thus, the exclusive distributor is truly exclusive only as long as its supplier has decided not to compete with it for the patronage of the same customers.

3) Article 2(1) of the Regulation indicates that the supplier may not bear any obligations toward the exclusive distributor other than those referred to in Article 1. It thus implies that the supplier may not prohibit other distributors in its network from engaging in parallel imports or from invading the exclusive distributor’s territory when this territory coincides with a Member State.

4) Guideline 28 qualifies the limited territorial protection granted to the distributor in Article 2(2)(c), by stating that although the exclusive distributor may not engage in active sales outside its contract area, it may still accept and fill orders from customers residing in other territories. Again, the provision seeks to preserve parallel trade and intrabrand competition among exclusive distributors, who have the opportunity to sell in other areas.

5) Both Guideline 17 and Recital 8 of the Preamble to the regulation state that exclusive distributors may not accept any further restrictive obligations that would limit their

“resale” by the exclusive distributor has to take place within the contract territory. Id. If the manufacturer supplies one of its exclusive distributors wishing to resell in another distributor’s territory, its practice conforms with Guideline 27, but not with Guideline 28. See KORAH, supra note 27, at 14, 15.

34 1983 O.J. (C 355) 7, 11. Guideline 30 provides that “[t]he supplier remains free to supply the contract goods outside the contract territory to final users based in the territory.” Id.; see also KORAH, supra note 27, at 14; KORAH & ROTHNIE, supra note 27, at 101.

35 See KORAH, supra note 27, at 15; KORAH & ROTHNIE, supra note 27, at 101.

36 Guideline 28 provides that “[u]nder Article 2(2)(c), the supplier can prohibit him [the exclusive distributor] only from seeking customers in other areas, but not from supplying them.” 1983 O.J. (C 355) 7, 10. See also KORAH & ROTHNIE, supra note 27, at 105; Valentine Korah, Group Exemptions For Exclusive Distribution and Purchasing in the E.E.C., 21 COMMON MKT. L. REV. 53, 78 (1984).
freedom to determine prices, other conditions of sale, or customers. For example, distributors may not agree with their suppliers to respect resale price maintenance schemes or customer restrictions. Such schemes are occasionally used to protect the territory of distributors, either by making uneconomical sales or parallel imports or by banning sales to customers outside the contract area. By forbidding manufacturers to impose such restrictions on their exclusive distributors, Guideline 17 and Recital 8 deprive manufacturers of a possible method of controlling cross-trade between contract territories and contribute to the preservation of intrabrand competition among these exclusive distributors.37

6) Guideline 9 broadly defines the term "resale" to include the repackaging of contract goods by the exclusive distributor. The exclusive distributor is free to purchase the contract good and to alter its package so that it conforms to the requirements of territories or Member States where other distributors are appointed and to sell or export it to those territories. Fostering intrabrand competition thus helps foil attempts of distributors to retain among themselves the markets of the different Member States.38

7) Article 3(c) condemns the block exemption and declares it inapplicable to exclusive distribution agreements where

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37 1983 O.J. (C 355) 7, 9 (Guideline 17); 1983 O.J. (L 173) 1, 2 (Recital 8). "[I]f further restrictive obligations and in particular those which limit the exclusive distributor's choice of customers or his freedom to determine his prices and conditions of sale cannot be exempted under this Regulation." 1983 O.J. (L 173) 1, 2. "Apart from the exclusive supply obligation . . . , obligations defined in Article 1 . . . must be present if the block exemption is to apply, the only other restrictions on competition that may be agreed by the parties are those set out in Article 2(1) and (2)." 1983 O.J. (C 355) 7, 9; see also KORAH & ROTHNIE, supra note 27, at 116, 117.

38 See Guideline 9, 1983 O.J. (C 355) at 7, 8; see also Case 102/27, Hoffman-LaRoche & Co. v. Centrafarm, 1978 E.C.R. 1139, 3 C.M.L.R. 217, 249 (1978) (third party may repackage goods, but proprietor of the trademark right of the goods may prevent their marketing in another Member State). But see C.W.F. Baden Fuller, Economic Issues Relating to Property Rights in Trademarks: Export Bans, Differential Pricing, Restrictions on Resale and Repackaging, 1981 EUR. L. REV. 162, 176-78 (criticizing this decision and arguing that the curtailment of intrabrand competition achieved by the imposition of post-sale restrictions on repackaging or relabelling may serve the lawful purpose of promoting interbrand rivalry between different manufacturers of comparable goods).
end users can obtain contract goods only from the exclusive distributor, with no recourse to any alternative suppliers outside the contract territory or outside their Member State in the form of parallel imports. As explained in the preamble to the regulation, customers must be able to obtain a fair share of the benefits achieved through the exclusive distribution scheme, such as better service, effective marketing of products, rationalization of distribution, and advance planning of production, at lower prices. The Commission was concerned that without alternative suppliers, exclusive distributors would charge supracompetitive prices and impose unfavorable conditions of sale on their customers. As most of the consumers would be price-motivated, the exclusive scheme would be to their detriment.39 Intrabrand competition, on the other hand, will lead to lower prices. Article 3(c) also provides a safeguard for parallel imports in cases in which the contract territory consists of a whole Member State and the alternative sources of supply originate outside the state in the form of imports.40

8) Article 3(d) also condemns obstructions of parallel imports through the institution of exclusive schemes, but it pertains to exclusive distributorships in which contract goods can circulate to the ultimate consumers through intermediaries, and where the lack of alternative suppliers is due to either the unilateral or bilateral41 actions of the

40 See art. 3(c), 1983 O.J. (L 173) at 3 (providing that Article 1 shall not apply where users can obtain the contract goods in the contract territory only from the exclusive distributor and have no alternative supplier outside the contract territory).

This paragraph of Article 3 apparently refers to situations in which the exclusive distributor sells the contract goods directly to final consumers or users and the lack of alternative suppliers is due to external factors and not to unilateral or concerted practices of the parties to the exclusive agreement. See Schröter, supra note 28, at 405.

41 See art. 3(d), 1983 O.J. (L 173) at 3. Art. 3(d) provides that:
Article 1 shall not apply where:
d) one or both parties make it difficult for intermediaries or users to obtain the contract goods from other dealers inside the common market, or, in so far as no alternative source of supply is available there, from outside the common market, in particular where one or both of them:
1. exercises industrial property rights so as to prevent dealers or users from obtaining outside, or from selling in, the contract territory properly
parties to the exclusive agreement.

9) Finally, Article 6(c) provides that the Commission can withdraw the block exemption for an exclusive distributorship where intrabrand competition or parallel imports (or both) are not possible at terms customary in the contract territory or for reasons not covered by Article 3(c) and (d). 42

What is remarkable in those provisions and explanatory guidelines, however, is the total absence of market analysis and an overemphasis on the Commission’s interest in unifying national markets through parallel imports and intrabrand competition, even when the competition originates from the manufacturer or from other distributors. What matters is that they all contribute to the equalization of prices between different distributor contract territories and, eventually, in the whole European Union. The Commission is content to outlaw any exclusive scheme not conforming to those conditions. Unfortunately, it fails to consider a number of factors that place intrabrand restrictions and the limitation of parallel imports in their correct market context.

First, the aforementioned provisions of the Regulation and the interpretative comments of the Guidelines make the legality of exclusive distributorships depend on the existence marked or otherwise properly marketed contract goods;

2. exercises other rights or take other measures so as to prevent dealers or users from obtaining outside, or from selling in, the contract territory contract goods.

Id.

The fact that the application of Article 3(d) is triggered not only in situations where intrabrand competition or parallel imports are impeded as a result of concerted actions by the manufacturer and the exclusive distributor, but also because of unilateral actions by one of the parties, has been criticized.

42 See art. 6(c), 1983 O.J. (L 173) at 4 (providing that “[t]he Commission may withdraw the benefit of this Regulation,... in particular where . . . for reasons other than those referred to in Article 3(c) and (d) it is not possible for intermediaries or users to obtain supplies of the contract goods from dealers outside the contract territory on terms there customary”).

The Commission will apply 6(c) and withdraw the block exemption only in cases in which external factors, such as independent action of third parties in other territories or local market conditions (not caused by the behavior of the parties to the exclusive agreement), do not completely impede intrabrand competition or parallel imports, but simply dictate prices and terms of sale unfavorable to customers in the contract territory.
of alternative sources of supply and on the absence of absolute territorial protection of the distributors. No reference is made to more general market conditions, such as market structure, the number of competing manufacturers in the contract territory, or the vigor of interbrand competition. Considering that consumers will obtain a fair share of the improvements in distribution only if rivalry at the intrabrand level remains unfettered, the provisions fail to give proper weight to interbrand competition as a balancing factor for any intrabrand restriction.

Second, the Commission does not distinguish between situations in which the absolute territorial protection of the exclusive distributors reflects the will of the manufacturer, and those merely resulting from an express or implied agreement of exclusive distributors who aim to share territories or national markets among themselves and discourage competition.

Third, because the Commission makes no such distinction, the provisions allow this protection to be independently granted by the manufacturer in order to enhance the competitiveness of its product. Such a manufacturer may, for example, improve the competitive status of its product by restricting its channels of distribution.

Given the strictness of the provisions regarding absolute territorial protection of distributors and the absence of any mitigating grounds for lifting it, “exclusivity” takes on a new meaning. On the one hand, a trader appointed by a manufacturer as its sole distributor within a territory bears all the risks and expenses related to product promotion and customer satisfaction. On the other hand, the block exemption provided by Regulation No. 83/83 will not apply without the existence of alternative sources of supply—such as other distributors, resellers, or even the manufacturer—in the territory.

3.3. **Exclusive Distribution and Vertical Territorial Restrictions in E.U. Case Law**

3.3.1. *The Typical Scenario: Infringement of Article 85(1) and Refusal to Grant Exemption Under Article 85(3)*

Parties to an exclusive distribution arrangement not
covered by Regulation 83/83 may only obtain an individual exemption under Article 85(3). In most cases, parties seek exemption from the absolute territorial protection of exclusive distributors. Through a variety of practices, manufacturers wishing to control their distribution networks may explicitly or tacitly agree with their distributors to protect them from territorial incursions by intrabrand competitors. Apart from direct import and export bans, parties may ban horizontal supplies, use trademark rights, control the price mechanism, use dual pricing, establish a selective distribution system, or selectively grant guarantee rights to consumers, either to discourage parallel imports or to make them uneconomical.43

Both the Commission and the Court of Justice unanimously condemn each of these practices using the following reasoning. Initially, they find that Article 85(1) applies because these practices restrict competition and negatively affect trade between Member States. In most situations, contested practices or agreements are automatically caught by 85(1), without first being examined in their appropriate economic and legal market context and without regard to the market position of the manufacturer adopting them. As long as the manufacturer's share in the relevant market is greater than five percent, competition is considered to be "appreciably" restricted.44

The Commission and the Court of Justice then refuse to apply 85(3) because most of its criteria are not met; absolute territorial protection schemes run contrary to the goal of European market integration. Even if there is an improvement in distribution, they hold that the direct or indirect impediment to parallel imports denies European consumers a fair share of these improvements in the form of lower prices. Moreover, they hold that the "indispensability" test is not met, and no improvement in distribution is considered important enough to justify the prevention of parallel imports. In the view of the Commission and the Court

43 A more detailed discussion of each of these practices appears later in this section. See infra sections 3.3.3-3.3.8.

44 See Commission Notice on Agreements of Minor Importance, 1986 O.J. (C 231) 2, 2-3. Even market shares that slightly exceed the levels specified by the Notice are caught by 85(1). See supra notes 15, 18, and 19, and accompanying text.
of Justice, there are always less restrictive methods to achieve the same result.

3.3.2. Direct Export Bans in the Miller Decision

Export bans, although the most effective means of controlling both intrabrand competition within distribution networks and parallel imports from one Member State to another, are seldom used because of the marked hostility that both the Commission and the Court of Justice show to them. The Miller case, decided by the Court of Justice on appeal of a Commission decision that condemned an agreement because it provided for direct export bans, exemplifies the way in which Article 85(1) is applied in practice.

Miller International Schallplatten GmbH (Miller), a German manufacturer of music records and tapes, appointed two exclusive distributors, one for the French province of Alsace-Lorraine, and one for the Netherlands. It then imposed

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on these distributors—as well as on all of its wholesalers and retailers in Germany—the obligation to refrain from exporting to other countries. After determining that Miller’s market share was between 4.91% and 6.07% (not a negligible percentage) the Court concluded that through its export bans, Miller could negatively influence intrabrand competition, parallel imports, and interstate trade to an appreciable degree. Applying Article 85(1), the Court fined Miller and ordered an end to its alleged infringement.47

3.3.3. Prohibitions on Horizontal Supplies and the GEROfabriek Decision

Bans on horizontal supplies involve a prohibition of cross-supplies among distributors operating at the same level of a manufacturer’s network, rather than a prohibition on distributors’ sales to end-consumers or to traders of subsequent levels. In GEROfabriek,48 a Dutch cutlery manufacturer prohibited its retailers from selling to other retailers within the Netherlands and from selling at all outside the country. GEROfabriek had also appointed an exclusive distributor in Belgium, which in turn sold to several retailers. The combination of these two arrangements effectively prevented Belgian dealers from supplementing their stocks if they became depleted.

Without taking into account GEROfabriek’s market position or the strength of competition among cutlery producers in the Belgian market, the Commission stated that Article 85(1) was applicable. The Commission reasoned that by preventing Dutch retailers from supplying Belgian dealers, the GEROfabriek arrangement denied Belgian consumers potentially lower prices and their fair share of any improvement in distribution. The Commission also considered

47 On the other hand, because the Miller agreement had not been notified to the Commission for an individual exemption, there was no discussion in the decision as to the applicability of 85(3). Relevant precedents, however, indicate that direct export bans are seldom exemptible. See Newitt, 1992 O.J. (L 131) at 44 (finding Article 85(3) ground inapplicable), Vīho, 1992 O.J. (L 233) at 31 (same); see also Moēt et Chandon, 1982 O.J. (L 94) at 9-10, 2 C.M.L.R. at 171 (rejecting argument that export prohibitions could be justified by the tightness of supplies in each of the involved national markets).

that it was far from certain that these restrictions were
needed to improve distribution. For those reasons, it refused
to grant an exemption to the contested agreement under
Article 85(3).

3.3.4. The Use of Industrial Property Rights to Achieve
Absolute Territorial Protection and the Grundig-Consten
Case

The use of trademark rights by their owners to prevent
parallel imports from one Member State to another has been
the subject of considerable debate. National trademark laws
were initially enacted to indicate the origin of a
manufacturer's goods and to differentiate them from
comparable products of other manufacturers. From the
inception of the European Union, many commentators
predicted that national industrial property legislation would
be useful as a means of perpetuating national market
compartmentalization, since any attempt to engage in
interstate trade or parallel imports could become tainted by an
infringement of the respective rights. To discourage such
use of national trademark legislation, Article 36 of the Treaty
of Rome creates an exception to the general validity of national
property systems of different Member States found in Article
222. Article 36 introduces a limitation on the unfettered
eexercise of national industrial property rights, stating that it
must not "constitute a means of arbitrary discrimination or a
disguised restriction on trade between Member States."

The Grundig-Consten case involved two trademarks

49 See, e.g., COMMON MARKET AND AMERICAN ANTITRUST 246 (James A.
Rahl ed., 1970); Rex Brown, The Effect of the European Common Market
on Trademarks, 49 TRADEMARK REP. 515, 522 (1959); Remo Franceschelli,
Trademark Problems in the Common Market, 50 TRADEMARK REP. 306, 308
(1960); Michel Waelbroeck, Trademark Problems in the European Common

50 Treaty on European Union, Together with the Complete Text of the

51 Commission Decision 64/566, Grundig-Consten, 1964 J.O. 2545, on
E.C.R. 299, Common Mkt. Rep. (CCH) ¶ 8,046 (1966). Much has been
written about this decision. See Leon J. DeKeyser, Territorial Restrictions
and Export Prohibitions Under the United States and the Common Market
Antitrust Laws, 2 COMMON MKT. L. REV. 271, 288 (1964-65); Arved

https://scholarship.law.upenn.edu/jil/vol15/iss4/2
registered in two European countries, owned not by a single person but by two separate traders: a manufacturer and its national exclusive distributor. Therefore, the principle of "exhaustion," which mandates that trademark protection ceases to exist, or is "exhausted," once a manufacturer affixes the trademark on its goods and releases them into the market, did not apply.

The facts of the case are well-known: Grundig, a German manufacturer of electrical appliances, appointed Consten as its exclusive distributor in France. To protect Consten from parallel imports from other Member States, Grundig prohibited its exclusive distributors in other countries from selling in France. To make sure that this prohibition would be respected, and although all products already bore a GRUNDIG trademark, Consten registered an additional trademark, GINT, in France under its own name. Consten planned to transfer the trademark to Grundig or to cancel its registration at the end of its relationship with Grundig. Both the Commission and the Court held that the combination of export bans and the use of the GINT trademark obstructed parallel imports and violated Article 85(1). In addition, Article 222 was deemed inapplicable because the GRUNDIG trademark was held sufficient to indicate to consumers the source of every electrical appliance.

Both the Commission and the Court also rejected the applicability of Article 85(3) and refused to grant an exemption to the exclusive agreement because it eliminated intrabrand competition and prevented French consumers from obtaining

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a fair share of benefits in the form of lower prices. In addition, parallel importers could not buy goods from Germany at discount and resell them in France. Finally, the "indispensability" test was not met. Arguments in favor of providing absolute territorial protection to Consten, which would have allowed it to engage in and rely upon advance planning and to provide adequate warranties or after-sales services, were all rejected.⁵²

3.3.5. Controlling Price Mechanisms to Impede Parallel Imports in the Hennessy-Henkell Decision

The difference in price levels at which a manufacturer's goods are sold throughout the European Union is the essential factor creating incentives for parallel imports from one Member State to another. Parallel importers normally buy from low-priced countries and sell in the high-priced ones, undercutting local exclusive distributors. The control of resale prices by a manufacturer is thus an effective means of monitoring its distributors' operations within the manufacturer's network. Although, in principle, any tampering with the price mechanism is unanimously condemned in Europe (as in the United States), control of resale prices acquires a different dimension when used to enforce territorial restraints or to shield exclusive distributors from undesirable invasions by others in their territories. The Commission and the Court of Justice have confronted several situations in which the manipulation of resale prices of goods was used for this purpose.

In Hennessy-Henkell,⁵³ for example, a producer of alcoholic beverages (Hennessy) agreed to a sale price low enough to permit its exclusive distributor (Henkell) to charge a correspondingly low resale price in order to ensure protection from "the point of view of prices against infiltration" under Article 5(4) of the agreement.⁵⁴ They further stipulated in Article 6 of the agreement that the distributor would fix its

⁵⁴ See id at 12.

https://scholarship.law.upenn.edu/jil/vol15/iss4/2
resale price at a specified low level so that parallel importers would find it unprofitable to compete. The Commission used strict language to make clear that Article 85(1) was applicable because Hennessy's intervention in the determination of prices both deprived Henkell of the freedom to fix its own prices and held margins at such a low level that traders from other Member States were kept out of the German market. Article 85(3), by contrast, was found inapplicable. The curtailment of the exclusive distributor's freedom to set resale prices at a lower level than the one agreed upon deprived German consumers of a fair share of any improvements in distribution. Additionally, the resale restrictions failed the "indispensability" test because the Commission found that distribution could be improved without them.

3.3.6. Dual Pricing to Combat Parallel Imports and the Distillers Case

A variation of the price mechanism control is dual pricing. This occurs when a manufacturer charges different prices based on whether its customer plans to resell within its own Member State or to export to other states. Dual pricing frustrates parallel trading, distorts competition among traders of various Member States, and creates a counter-incentive for exports. Both the antitrust enforcement authorities and the judiciary in the European Union view dual pricing as plainly anticompetitive and antithetical to the ideal of European integration.

In Distillers, a group of distillery companies that produced a wide variety of alcoholic beverages in the United Kingdom applied different conditions of sale and price terms to trade customers that resold locally and to those that resold

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55 See id.
56 See id. at 14-15.
57 See id. at 15-17.
on the Continent, where Distillers had recently appointed national exclusive distributors to promote its products. While the former group received substantial discounts on the purchase price (i.e., certain allowances, rebates and discounts), the latter group was charged the gross price without any discount. Without taking into account the market position of Distillers in the countries of Continental Europe, the Commission held that Distillers’ dual pricing policy discouraged parallel imports and prevented the lower prices of Scotch whisky from existing in Continental Europe. Dual pricing thus amounted to an indirect export ban and resulted in the absolute territorial protection of European exclusive distributors in violation of Article 85(1).

The Commission also refused to grant an individual exemption under 85(3) with respect to Distillers’ conditions of sale. It argued that no improvement in distribution had come about and that European consumers were deprived of the benefit of lower prices. All the justifications proffered by Distillers concerning the higher promotion and advertising costs of the sole distributors in Europe who needed to be protected from price competition by resellers exporting from the United Kingdom were similarly rejected.59

3.3.7. Selective Distribution Systems Obstructing Parallel Imports and the Hasselblad Decision

Selective distribution systems are defined as systems established by manufacturers of certain technically complex or high quality goods who appoint specialized wholesalers or retailers with the necessary knowledge or technical expertise required to preserve the quality of those products or to provide specialist services to resellers and consumers.60 Manufacturers often use these systems to exclude from their networks those retailers that would buy their goods from parallel importers or engage in parallel importing themselves. In Hasselblad,61 a manufacturer of specialized professional

59 See Distillers, 1978 O.J. (L 50) at 26, 28, 29.
60 For an extended analysis on selective distribution systems in the European Union, see Gijlstra & Murphy, supra note 14, at 81, and HAWK, supra note 30, at 483.
cameras appointed sole distributors in the various Member States of the European Union. In the United Kingdom, where the exclusive distribution had been entrusted to Hasselblad (GB), retailers were appointed according to a selective system which, on its face, was based on such criteria as their technical qualifications and the suitability of their premises. The criteria were meant to ensure that the retailers could successfully promote and service such highly complex goods as professional cameras. The Commission found, however, that Hasselblad was using largely arbitrary criteria to select its retailers (e.g., whether the retailer would be willing to buy its goods from parallel importers at lower prices). As a result, many retailers were excluded from the system even though they met the stated qualitative criteria. Camera Care, once Hasselblad's dealer in the United Kingdom, was terminated after selling goods there which were purchased abroad at discount prices. Since price advertisements were overseen in the United Kingdom, Camera Care suggested that it was terminated because it did not respect an alleged system of fixed retail prices.62

Both the Commission and the Court of Justice found that this selective system had as its purpose the exclusion of all dealers. By not allowing Camera Care to compete in price with other appointed dealers within the system, the system restricted competition and interstate trade and violated Article 85(1). No exemption was granted under 85(3) because the prevention of parallel imports and of price competition at the retail level would deprive English consumers of a fair share of the benefits of Hasselblad's distribution system and would isolate the United Kingdom from the markets of other Member States.

3.3.8. The Limitation of Guarantee Rights and the ETA Decision

Absolute territorial protection of exclusive distributors may also be achieved by limiting the guarantee rights of consumers to only those goods that have been purchased by the local exclusive distributor. In ETA,63 a manufacturer of

63 See Case 31/85, ETA Fabriques d'Ebauches S.A. v. DK Investment
inexpensive watches distributed its products in the E.U. through a network of national exclusive distributors. It also restricted recognition of warranties covering physical defects in watches to those consumers who had bought them from the official network of the national exclusive distributors. By contrast, the manufacturer refused to honor warranties for watches purchased from parallel importers. In its decision, the Court again omitted any analysis of the relevant market structure in which cross-trade had been restricted. The Court rejected ETA's argument that parallel importers could not be made to comply with its specifications concerning the maximum storage period for the watches and might therefore sell watches in a deteriorated condition. The Court reasoned that since ETA watches were not technically complex goods requiring extra care, the limitation on warranties was abusive. It concluded that the existence of guarantee rights is an essential factor in the decision-making process of consumers when buying a product, and that consequently ETA blocked parallel imports and violated 85(1).

4. THE ECONOMIC APPROACH AS INCORPORATED IN THE U.S. LAW OF EXCLUSIVE AND RESTRICTED TERRITORIAL DISTRIBUTION: AN ALTERNATIVE VIEW

4.1. The Procompetitive Character of Exclusive Distribution and Vertical Territorial Restraints

Economic theory and experience teach that not only exclusive distribution agreements but also vertical restraints that protect exclusive distributors from territorial incursions by their competitors may have procompetitive effects. They may therefore be an expression of a rationalized distribution policy, with the aim of enhancing economic efficiency.

The procompetitive character of those practices is inextricably linked to unity of interests of manufacturers and consumers. In general, as several antitrust scholars following the Chicago School of thought suggest, it is in a manufacturer's interest to maintain its distributors' markups as low as possible. The lower the distributors' profits, the
lower the manufacturer's distribution costs, which results in lower retail prices charged to the ultimate consumers. Higher prices, caused by larger profits of distributors insulated from competition, may result in lost sales and diminished profits for the manufacturer. Since, as a matter of principle, manufacturers in a competitive market are price takers, only those that keep their distribution costs low will avoid losing customers to competitors. Therefore, if manufacturers grant exclusivity to their distributors, they might do so to attract capable and aggressive traders in their distribution networks who are willing to: (1) make the investments necessary for the successful dissemination of the manufactured goods; (2) provide pre-sale or post-sale services, especially if expensive goods are involved; or (3) commit themselves to promoting new products aggressively. Additionally, manufacturers might appoint a small number of exclusive distributors in order to decrease their own sales costs, minimize credit risks, facilitate production planning, or permit

the development of scale economies at the downstream level.

Alternatively, a manufacturer might further establish vertical territorial restrictions, thereby impeding cross-sales among the contract territories of its exclusive distributors in order to avoid inter-organizational problems in its network. Sometimes, however, mere exclusivity is inadequate to protect the distributors' investments against those competitors who reap the fruits of their own efforts and expenses. This is especially true in situations in which transportation costs within the contract territory and general cross-selling barriers are low. If the exclusive distributor is required to provide services for expensive goods or to market new products aggressively while out-of-territory distributors or resellers are left to sell freely the same products at a discount, then the resulting free rider problem may force the exclusive distributor to stop providing services, engage in promotional activities, or go out of business. Consumers desiring these services or promotional activities, which inform them about the marketed goods, may become dissatisfied. The superior goodwill of the manufacturer's products may be harmed. 65 Although some consumers may welcome free riders offering lower-priced goods, free riding harms the "invaded" distributor, by making its efforts to provide upgraded distribution facilities or to make purchasers familiar with its suppliers' products unsuccessful.66 On the other hand, vertical integration is too

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66 Such activities are often referred to by some commentators as "opportunistic." "Opportunism" is any post-contractual manipulative activity that results in an unexpected transfer of wealth to any of the contracting parties, against which, however, the injured parties may not take any retaliatory measures. In our case, "free riders" enrich themselves at the expense of the incumbent exclusive distributors, who may not retaliate against them. See Henry N. Butler & Barry D. Baysinger, Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory,
extreme a measure by which to control such inter-organizational distribution problems. Vertical integration is very costly and, hence, unattainable for those small manufacturers unable to raise the necessary funds or lacking the expertise to set up their own distribution systems. In addition, vertical integration transforms distributors into mere employees of the manufacturers, depriving them of freedom and discretion. Therefore, vertical territorial restraints are the most suitable means to remedy those problems, while still maintaining the advantages of market distribution of products (e.g., hiring independent distributors). Manufacturers appointing independent traders to distribute their products may benefit from economies of scale and scope as well as from the core competencies developed by the latter.

Furthermore, the institution of vertical territorial restrictions may preserve the quality of manufacturers' goods, thus maximizing consumer satisfaction. For example, exclusive distributors not burdened by free riders may willingly spend the money needed for product quality and safety. Alternatively, in the absence of cross-selling among distributors' territories, the source of defective products may


On the contrary, other "less restrictive" methods of protecting distributors against free riders might not be as effective. For example, even if manufacturers directly pay distributors' expenses to avoid free riding in their networks, manufacturers might still need to institute a system of control to detect whether such payments are used for improvements in their distribution network, or to fill the pockets of the distributors themselves. Detecting cross-selling and violations of vertical territorial restrictions is much easier than meticulously monitoring distributor performance. Alternatively, if a manufacturer, in order to deter opportunistic activities, provides services or other marketing activities distinct from its product and consumers are correspondingly charged for the services they desire, then distributors must also bear the costs of instituting a marginal cost pricing system adjusted to individual consumer needs. See Telser, supra note 64, at 92-94. Additionally, some services (e.g., advertising) may not be sold to consumers separately from the products.

be more easily traced, thereby motivating each exclusive distributor to maintain the quality standards of its supplier.

4.2. Inherent Anticompetitive Effects of Exclusive Distribution and Vertical Territorial Restraints: Market Structure as a Response

Although exclusive distributorships and vertical territorial restrictions are means used by manufacturers to organize rationalized distribution networks, such devices negatively affect intrabrand competition—at best curtailing it and at worst eliminating it. Exclusive distributorships and vertical territorial restrictions also tend to stabilize distributor prices within each exclusive territory, thus jeopardizing the welfare of certain consumers. As intrabrand competition is restricted, customers of exclusive distributors are compelled to accept high resale prices even though such prices might reflect a number of non-price efficiencies offered by distributors in connection with the product (e.g., services, advertising and promotion).

One may distinguish three categories of consumers based on effects of exclusive distribution and vertical territorial schemes. The first consumer category values most non-price efficiencies and responds favorably when the manufacturer or distributors offer them. A second consumer category simply does not need the efficiencies, and instead, buys a smaller quantity of the product. Finally, a third category, the so-called "inframarginal consumers," are insensitive to any increase in the price of the product. No matter how high the price is, these "inframarginal consumers" buy the same quantity of the particular product. It follows that as a result of non-price efficiencies, only the first category of consumers is better off. In contrast, the welfare of the second and third categories of

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69 Intrabrand competition is perceived by many antitrust theorists as a significant source of rivalry in the market because it induces distributors to lower prices, enhance efficiency, and improve performance by discovering innovations, introducing new methods of distribution, and generally keeping consumer satisfaction at a maximum level. See Thomas A. Piraino, Jr., A Reformed Antitrust Approach to Distributor Terminations, 68 NOTRE DAME L. REV. 271, 297-99 (1992); Intrabrand Competition, supra note 64, at 159, 183, 187; Sylvania Economics, supra note 64, at 44, 54.
consumers is impaired.\textsuperscript{70}

The effects of non-price efficiencies may not, however, be viewed only in the abstract, independently of the structure of the relevant market in which the exclusive and vertical territorial schemes are instituted or of the market position of the instituting manufacturer. For example, the structure of the relevant market and other market characteristics indicate the degree to which other forms of competition are available to fill the vacuum created by the elimination of intrabrand competition at the distributor level. Additionally, the market structure indicates the extent to which inframarginal and other consumers, allegedly harmed by the exclusive and vertical schemes, maintain the freedom to select desired brands. Finally, weak manufacturers facing strong interbrand competition may be unwilling to adopt exclusive and vertical territorial practices for anticompetitive purposes because high distribution margins may push consumers to buy competitive brands or comparable goods.

Because intrabrand competition is eliminated as a result of exclusive and territorial schemes, even distributors representing a weak manufacturer who faces numerous interbrand rivals will charge higher prices than if intrabrand competition existed without restraint. Such prices or other terms of sale must, however, be adjusted to meet equivalent conditions under which the distributors of interbrand rivals offer comparable products. With vigorous interbrand competition among manufacturers (and their distributors) in the relevant market, distribution mark-ups will not rise to excessive levels, as would happen if interbrand competition were weak (due to the manufacturer's large market share or the differentiation of its product) or if manufacturer concentration rates were high.\textsuperscript{71} Interbrand competitive forces balance and alleviate the inherent anticompetitive effects of intrabrand restrictions, no matter how intense these

\textsuperscript{70} See Comanor, supra note 64, at 983 (suggesting that vertical non-price restraints should be illegal because of the harm they inflict on inframarginal consumers). But see Don Boudreaux & Robert B. Ekelund, Jr., \textit{Inframarginal Consumers and the \textit{Per Se} Legality of Vertical Restraints}, 17 HOFSTRA L. REV. 137, 148-56 (1988).

anticompetitive effects may be. On the contrary, weak interbrand competition or a high concentration level among competing manufacturers requires the preservation of intrabrand competition as the primary source of rivalry in the relevant market.\(^7\)

Interbrand competition may provide a better alternative for the two categories of consumers who endure a partial loss of surplus due to the existence of exclusive and vertical territorial schemes, thereby enabling these consumers to choose manufacturers offering more favorable “product-service” mixes. Such consumers also have viable alternatives in markets not excessively covered by exclusive and vertical territorial restraints because other forms of distribution (e.g., providing low-priced products without non-price efficiencies) remain available.

4.3. The Distributors’ Cartel and the “Cartel Ringmaster” Hypothesis: An Exception to the Rule

Exclusive distributorships and vertical territorial restrictions sometimes serve as catalysts or implementing vehicles by which to establish an unlawful distributor cartel.\(^\)\(^\)\(^7\) As a result, the monopolist-distributor or the

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\(^7\) Concentration at the manufacturer level might be especially dangerous in causing oligopolistic interdependence. Should all manufacturers of an industry decide to follow the example of one competitor and incorporate similar vertical schemes in their networks, the relevant market could be flooded by such restrictive schemes, excluding other forms of distribution. See Scherer, *supra* note 64, at 704.

\(^7\) “Catalyst” refers to situations in which these practices facilitate the organization of a cartel, while “implementing vehicle” refers to the practices used to enforce the cartel and punish cheaters (e.g., by excluding discounter from the colluding group). Opponents of the collusive character of exclusive and vertical territorial restrictions argue that cartels “hidden” under such practices may be dealt with and condemned under the conventional rules applying to horizontal agreements and that there is therefore no real case against them on such grounds. See, e.g., Posner, *supra* note 71, at 22. See also Wesley J. Liebeler, *Intrabrand “Cartels” Under GTE Sylvania*, 30 UCLA L. Rev. 1, 20-23 (1982). In the vast majority of cases, the anticompetitive use of exclusive and territorial schemes will be invoked either when one or more distributors pressure a common supplier to grant them exclusivity or airtight territorial protection, or when a distributor complains to the manufacturer that a competitor is a discounter and requests immediate termination. The problem of how to distinguish acceptable and procompetitive exclusive and territorial practices, which enhance the competitiveness of a manufacturer’s distribution network, from
distributors-cartelists restrict output to consumers, raising the prices of the particular product. The distributors’ supplier may act as a “cartel ringmaster,” that is, as an instrumentality yielding to the distributors’ pressures and responsible for coordinating the cartel and terminating its cheaters.\(^{74}\) Why, however, would the supplier agree to go along with such a plan? One explanation is that the supplier needs some or all of the pressuring distributors because they are either powerful\(^{76}\) or are the only ones that may keep the distribution of its product functioning at a minimum efficient scale. Additionally, there might be a general lack of available distributors in the market because, for example, other distributors are tied up by competing suppliers bound by exclusive purchasing obligations and are therefore unable to carry the supplier’s products. A second explanation might be that the manufacturer has agreed to favor the anticompetitive plans formulated by its distributors because the manufacturer will share some of their profits in exchange for its coordinating and supervisory role. Of those two arguments, the first seems more compelling. The second, although not unrealistic, sometimes runs afoul of the basic premise that a manufacturer wants to minimize its distribution costs to reduce distribution mark-ups. Sharing some of the distributors’ profits might not

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74 The term “ringmaster” is used in Thomas G. Krattenmaker & Steven C. Salop, Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price, 96 YALE L.J. 209, 238 (1986).

76 A distributor will usually be considered “powerful” when it carries a significantly large volume of the manufacturer’s goods, so that its absence might leave a significant percentage of purchasers unsatisfied or create substantial transaction costs for replacement of the distributor. See Piraino, supra note 69, at 303.
adequately compensate a manufacturer who has lost sales due to high distributor prices. In some cases, however, sharing of distributor profits might be adequate, and the "ringmaster" might be sufficiently compensated for its contribution to the organization and implementation of the distributors' cartel.

Such "horizontal" practices, which further the anticompetitive purposes of distributors, must be distinguished from those "vertical" schemes utilized by manufacturers whose only motivation is to improve their competitive status. When they grant exclusivity to their distributors or protect distributor territories, manufacturers induce distributors to invest in the successful promotion of their products without the negative impact of opportunistic activities, while preventing distributors from enjoying supracompetitive profits.

The distinction is not easy, but it is facilitated by the following considerations:

1) The purpose of an exclusive or territorial practice. The purpose of enhancing manufacturer competitiveness may indicate a vertical character, while the purpose of enhancing the distributors' desire to share supracompetitive profits among themselves or with the manufacturer may indicate a horizontal character.

2) The form of the scheme. The fact that, on its face, a practice might seem horizontal or vertical may not necessarily determine its procompetitive or anticompetitive function. For example, an exclusive and territorial practice within a dual distribution network that is horizontal in form may in fact be an expression of the independent business purposes of the manufacturer.

3) The involvement of one or more distributors in the institution or enforcement of the exclusive or territorial schemes. Such involvement should be irrelevant because distributors usually communicate useful market information to their suppliers, who are thus assisted in the more effective organization of their distribution network. The fact that one or more distributors convey to their supplier(s) information about competitive pricing behavior

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76 See Comment I, supra note 73, at 631.
does not indicate that a distributor necessarily harbors anticompetitive purposes. It may simply be explained by their common concern of circumventing free rider problems.\textsuperscript{78}


For almost two decades, economic theories favoring the "efficiency" and "market structure" approaches have been an integral part of U.S. law regarding exclusive distribution and vertical territorial arrangements. The endorsement of such theories in U.S. antitrust considerations is primarily due to the absence of regulatory interventions and the consequent flexibility in the analysis of restricted distribution issues. E.U. competition law gives both the antitrust enforcer and judge statutory guidelines (located primarily in Regulation 83/83) to determine (1) which provisions in an exclusive distribution arrangement are lawful and which are not; and (2) which factors prevail in a rule-of-reason analysis under Article 85(3). By contrast, U.S. law on those issues has been overwhelmingly judge-made. The U.S. judiciary is given almost complete discretion to apply Section 1 of the Sherman Act, which prohibits any contract, combination, or conspiracy in restraint of trade.\textsuperscript{79} Additionally, U.S. courts scrutinize cases of exclusive and restricted distribution at will to determine if such schemes dangerously impede competition, and to specify whether and how their evaluation is connected to the structure of the relevant markets in which such schemes exist.

4.4.1. GTE Sylvania and the Market Structure Approach

Issued in reaction to the Schwinn decision which held vertical post-sale non-price restrictions \textit{per se} illegal on the

\textsuperscript{78} See Baker, \textit{supra} note 77, at 1505-06. Rather, the content and the type of the possible communications may be a strong indication of the purpose hidden under the adoption of exclusive distributorships and territorial restraints. For example, ultimatum-type communications from one or more distributors to their supplier should more or less be considered dangerous. \textit{See} Piraino I, \textit{supra} note 73, at 334.

rather arbitrary ground that manufacturers parting with title, domion and control over their products could not control their subsequent distribution, the Supreme Court's Sylvania decision introduced the Rule of Reason standard to this area of antitrust. The application of the Rule of Reason to all vertical non-price restrictions without distinction based on degree or form is important because all such arrangements currently are evaluated under the same standard, regardless of the arrangement's effects on intrabrand competition. Instead, their general effect on competition weighs most heavily in judging their reasonableness.

Indeed, one significant aspect of Sylvania relates to the purported need to examine the effect of the challenged practices only "in light of the competitive situation 'in the product market as a whole.'" Such an examination is not complete, however, merely by concluding that a vertical restriction has reduced or even eliminated intrabrand competition. This reduction or elimination of intrabrand competition should be subsequently balanced against any interbrand effects created by the restraints in question. Interbrand competition, the Court said, creates an important source of rivalry within a market by providing a check on the lack of intrabrand competition that results from the institution of the restraints, because consumers can "substitute a different brand of the same product." The Sylvania Court also acknowledged that it is likely that vertical non-price restrictions have a procompetitive function. Based on economic evidence, the Court observed that "manufacturers have an economic interest in maintaining as much intrabrand

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81 Continental T.V. v. GTE Sylvania, 433 U.S. 36, 58-59 (1977). See generally Michael L. Denger, Vertical Restrictions: The Impact of Sylvania, 46 ANTITRUST L.J. 908 (1977-78) (arguing that Sylvania will be heralded as a landmark decision with significant implications beyond its holding); Robert H. Bork, Vertical Restraints: Schwinn Overruled, 1977 SUP. CT. REV. 171, 171-72 (discussing whether Sylvania is a promising antitrust decision or merely the latest inconclusive statement by the Court in the area of vertical restraint law).
82 Sylvania, 433 U.S. at 45 (quoting Schwinn, 388 U.S. at 382).
83 Id. at 57 n.27.
84 Id. at 52 n.19.
competition as is consistent with the efficient distribution of their products.\textsuperscript{85} Therefore, no business would institute territorial or customer restrictions merely to enrich its distributors or to increase their mark-ups.

This does not mean that \textit{Sylvania} excludes the possibility that some of the restrictions at issue will be condemned as \textit{per se} violations. After \textit{Sylvania}, however, the application of the \textit{per se} rule "must be based upon demonstrable economic effect rather than—as in \textit{Schwinn}—upon formalistic line drawing."\textsuperscript{86} For example, horizontal restrictions among distributors deserve \textit{per se} treatment.

\textit{Sylvania} is now the law governing vertical arrangements. Although it cured the inconsistencies and corrected the weaknesses of \textit{Schwinn} by requiring an analysis of the overall competitive impact of vertical non-price arrangements and by acknowledging their efficiency-enhancing nature, the \textit{Sylvania} decision provided only general directions concerning the application of the Rule of Reason to vertical territorial restrictions, leaving lower courts free to refine the application. As a result, classifying vertical non-price restraints as "not \textit{per se} illegal" began a debate as to how a Rule of Reason could be applied in this context and which factors would be considered prominently in the analysis. Supplying a general statement as to the applicability of a general method of analysis is one thing. Inventing a specialized formula that creates appropriate rebuttable presumptions based on specific amounts of evidence,\textsuperscript{87} allocates the burden of proof among plaintiffs and defendants, and balances the pro- and anticompetitive aspects of the contested vertical schemes in each individual case, while allowing businesses to organize their networks efficiently without unduly jeopardizing competition in the relevant market, is quite a different proposition.

Since \textit{Sylvania}, lower courts have sought to refine the Rule

\textsuperscript{85} Id. at 56.
\textsuperscript{86} Id. at 59. \textit{See also id.} at 58 n.28 (recognizing occasional problems in distinguishing between vertical and horizontal restrictions).
\textsuperscript{87} But see, e.g., \textit{AREEDA}, supra note 9, ¶ 1649c, at 550-51 (referring to examples where the presumption of illegality in the vertical non-price restraint context should not be rebuttable, but rather conclusive, as it is unlikely that parties would be able to produce evidence supporting opposite contentions).
of Reason enunciated by the Supreme Court. All courts, using a ubiquitous market power filter, have characterized vertical territorial and other non-price restrictions as presumptively legal, leaving plaintiffs to challenge their validity. The majority of decisions imply that with a proper market analysis and a plaintiff’s failure to demonstrate that the defendant manufacturer possesses market power, a defendant can prove that a territorial scheme does not have anticompetitive effects. Courts refer to business justifications not as a part of the Rule of Reason analysis, but rather to clarify the benefits of the challenged practice. Small manufacturers supposedly use

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88 Some courts, however, have required a showing of a pro-competitive justification for the restrictions in addition to the failure of the plaintiff to demonstrate a large market share controlled by the instituting manufacturer before immunizing challenged vertical non-price restrictions. See Graphic Prods. Distrib. v. Itek Corp., 717 F.2d 1560, 1573 (11th Cir. 1983) (stating that the rule of reason involves a two-step analysis: (1) examining the effects of the restraints on competition, mainly on the basis of the manufacturer’s market power; and (2) offering an adequate rationale for the restraints, which might include interpreting the intent of the manufacturer); Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1202 (6th Cir. 1982) (holding that the basic inquiry to determine the reasonableness of the attacked vertical non-price restrictions is: (1) whether the defendant manufacturer has market power, thus inflicting a substantial harm on competition; and (2) whether there are any justifications for the adoption of the restrictions), cert. denied, 466 U.S. 931 (1984). Other courts have upheld such contested schemes only when no less restrictive means were available to achieve the same business purposes. See, e.g., Cowley v. Braden Indus., 613 F.2d 751, 755 (9th Cir.) (“[T]here was no showing . . . of any effective, alternate means to maintain an efficient distributor system.”), cert. denied, 446 U.S. 965 (1980).

89 See Murrow Furniture Galleries v. Thomasville Furniture Indus., 889 F.2d 524, 529 (4th Cir. 1989) (“[A] finding of no market power precludes any need to further balance the competitive effects of the challenged restraint.” (quoting Assam Drug Co. v. Miller Brewing Co., 798 F.2d 311, 316 (8th Cir. 1986))); Murphy v. Business Cards Tomorrow, Inc., 854 F.2d 1202, 1205 (9th Cir. 1988) (affirming grant of summary judgment because plaintiffs failed to raise a material issue of fact regarding anticompetitive effect); Pennsylvania v. Pepsico, 836 F.2d 173 (3d Cir. 1988) (stating that effective interbrand competition justifies the immunization of territorial restraints); Three Movies of Tarzana v. Pacific Theaters, Inc., 828 F.2d 1395, 1399 (9th Cir. 1987) (noting vertical restraints are reasonable if likely to increase interbrand competition without unduly restricting intrabrand competition); Ryko Mfg. v. Eden Servs., 823 F.2d 1215, 1231-32 (8th Cir. 1987) (manufacturer's market power will only be required in order to effectively challenge a vertical non-price restraint, which will otherwise be upheld), cert. denied, 484 U.S. 1026 (1988); Assam, 798 F.2d at 319 (“The market power approach is a proper method of evaluating vertical non-price restraints under the rule of reason . . . .”); O.S.C. Corp. v. Apple Computer,
such schemes for efficiency-enhancing purposes. Most courts define market power as the market share of a manufacturer or, stated otherwise, the volume of a manufacturer's sales compared to the sales of its competitors. Consequently, courts limit the entire territorial restriction analysis to those manufacturers possessing market power. To this end, courts first must define the relevant product and geographic market in which the particular manufacturer competes. The relevant product market delineates the number of brands and goods reasonably interchangeable with the manufacturer's brand. The geographic market delineates the outer territorial boundaries of the area within which these competitors seek the patronage of the same consumers.\(^9\) Many decisions imply

792 F.2d 1464, 1469 (9th Cir. 1986) (failing to show an adverse effect on interbrand competition will lead a court to dispose of antitrust claim against resale non-price restriction); Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 702 (7th Cir. 1984) (stating that manufacturer's market power must be primarily shown under the rule of reason standard, for without it there may be no adverse effect on competition), cert. denied, 469 U.S. 1018 (1984); Dart Indus. v. Plunkett Co., 704 F.2d 496 (10th Cir. 1983) (denying relief in a situation in which plaintiff-appellee was unable to show injury from an allegedly rigid and per se illegal vertical restraint); Golden Gate Acceptance Corp. v. General Motors Corp., 597 F.2d 676, 678 (9th Cir. 1979) (acknowledging no antitrust violation results when defendant manufacturer conspires with others to simply switch distributors at one exclusive franchise and to cease doing business with former dealer); JBL Enters. v. Jhirmack Enters., 698 F.2d 1011, 1017 (9th Cir. 1983), cert. denied, 464 U.S. 829 (1983); Mendelovitz v. Adolph Coors Co., 693 F.2d 570, 575 (5th Cir. 1982) (stating that, under rule of reason analysis, it must be proved that the vertical non-price restrictions have a general anticompetitive effect); see also Copy-Data Sys. v. Toshiba America, 663 F.2d 405, 411 (2d Cir. 1981) (reversing trial court's award of treble damages to plaintiff-appellee because restriction imposed by defendant had sufficient potential for enhancing interbrand competition under a rule of reason analysis); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981) (noting that although market power and effect on interbrand competition are the main components of the Rule of Reason, there are also secondary references to the business purposes served by the restraints); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1006 (5th Cir. 1981) (observing that restrictions alleged to harm interbrand competition actually may have improved interbrand competition), cert. denied, 454 U.S. 827 (1981).

\(^9\) For an enlightening scholarly analysis, based on substantial court precedents, of the factors to be taken into account when defining the relevant product and geographic market, see William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 944-51, 960-67 (1981). According to the authors, the product market is not composed solely of brands competing with each other, but it also includes
that if the relevant market is not accurately defined, taking into account several factors including entry of new producers and potential expansion of output by existing manufacturers, then using the manufacturer's market share as a factor of analysis would be misleading for the outcome of the case.\footnote{See Murrow Furniture, 889 F.2d at 528-29 (concluding plaintiffs "have not defined a relevant product market, let alone established that [defendants] had market power"); Murphy, 854 F.2d at 1205 (observing that the competitiveness of the relevant market, "the wholesale thermography market for business cards, letterheads and envelopes," is unaffected by the restraints in question); Ryko, 823 F.2d at 1231-32 (implying that the existence of barriers to the entry of new firms or to increased output of already operating firms may alter the definition of the relevant market); Assam, 798 F.2d at 318 (making useful observations as to the area covered by the geographic market); Graphic Prods., 717 F.2d at 1569-70 (explaining that ample evidence demonstrated that the relevant geographic market was national in scope while the relevant product market was merely one of several products manufactured by defendant); JBL, 698 F.2d at 1016 (defining the market not only in terms of product and geographic factors but also according to distribution level); Muenster Butane, 651 F.2d at 295-96 (stating the proper scope of the relevant product market was not Zenith television sets, but rather all television sets).}

After determining which markets are relevant, courts generally are unanimous in deciding the threshold level of market share necessary for the condemnation of restraints. Certainly, a \textit{de minimis} share less than 5\% of the relevant market always leads to immunity.\footnote{See, e.g., JBL, 698 F.2d at 1017 (stating that a market share of between 1\% and 2\% does not have a substantially adverse effect on competition); Sandura Co. v. FTC, 339 F.2d 847, 849, 852 (6th Cir. 1964) (noting in a pre-\textit{Sylvania} decision that where the manufacturer's share is 1\%, closed distribution territories are upheld).} The manufacturer involved in such cases is either a small or a failing firm that depends on the institution of those restraints for its establishment or survival. Territorial restraint practices of manufacturers with shares amounting to 20\% of the market or less are also generally upheld.\footnote{See, e.g., Ryko, 823 F.2d at 1232 (relevant market power between 8\% and 20\% is not sufficient evidence of relevant market power).} Beyond this level of market

“substitutes in consumption,” “substitutes in production,” the “output of fringe firms” and the “entry of new competitors.” Similarly, the geographic market includes not only the competing manufacturers of a given geographic area, but also other suppliers making substantial imports into this area who, because of the absence of significant transportation costs, potentially may divert all their production to this area. \textit{See also} Kevin J. Arquit, \textit{Market Power in Vertical Cases}, 60 \textit{ANTITRUST L.J.} 921 (1991-92) (focusing particularly on market power and its role in the analysis of non-price vertical territorial restraints and customer restraints).
share, there is a certain ambiguity, although percentages of 50% or more prompt courts to question seriously the validity of the challenged schemes.  

94 See, e.g., Graphic Prods., 717 F.2d at 1569-70 (noting the existence of a market share of 70-75%, enhanced by strong product differentiation will satisfy the threshold burden). 

But see Cowley v. Braden Indus., 613 F.2d 751, 753, 756 (7th Cir. 1980) (choosing not to infer market power from a share of over 70%).

95 See, e.g., Ryko, 823 F.2d at 1232.

96 See Illinois Corporate Travel v. American Airlines, 806 F.2d 722, 729 (7th Cir. 1986). A few courts, however, have followed a justification-oriented (rather than market structure-oriented) rule of reason, wherein vertical territorial schemes lacking procompetitive justification are condemned without regard to market factors. See, e.g., General Leaseways v. National Truck Leasing Ass'n, 744 F.2d 588, 592, 595 (7th Cir. 1984); Eiberger v. Sony Corp. of Am., 622 F.2d 1068, 1079 (2d Cir. 1980).


98 See Rutman Wine Co., 829 F.2d at 735; Valley Liquors, Inc. v. Renfield Importers, Ltd., 822 F.2d 656, 666 (7th Cir. 1987); Westman Comm'n Co.,
4.4.2. Exclusive Distributorships, Vertical Territorial Restraints and Horizontal Action Claims

Instead of challenging exclusive distributorships and vertical territorial restraints as unreasonable, some plaintiffs attack them as per se illegal, charging that they have such pernicious effects that they should be condemned without further inquiry. If such "vertical" practices disguise a concealed horizontal agreement among distributors, then courts find for the plaintiffs on that basis alone. Lower courts after Sylvania have frequently found such "horizontal-vertical" arrangements and applied the per se rule based on the purpose of the practices. If the practices were designed to further a manufacturer’s business strategy for rationalized distribution, they are considered purely vertical; if the practices were adopted as a result of anticompetitive distributor coercions, however, they are found to cover collusive activities among distributors.

Before applying the per se rule, some courts apply the Supreme Court standards established in the group boycott context, which require the existence of a wide combination of distributors collectively furthering their anticompetitive purposes.98 Thus, an agreement among two or more distributors, who subsequently seek and obtain from their supplier a contractual or other commitment for exclusivity or protection from intrabrand competition, and who occasionally force the supplier to refuse to do business with or terminate some of the distributors’ competitors, clearly meets this group boycott “plurality” requirement.100

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100 See Big Apple BMW v. BMW of N. Am., 974 F.2d 1358, 1372 (3d Cir. 1992); ES Dev., Inc. v. RWM Enters., 939 F.2d 547, 556-57 (8th Cir. 1991), cert. denied, 112 S. Ct. 1176 (1992). In other cases, courts found that the "plurality" requirement was not satisfied. See Key Fin. Planning Corp. v. ITT Life Ins. Corp., 828 F.2d 635, 641-42 (10th Cir. 1987); Lomar Wholesale

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Alternatively, some courts hold that arrangements involving distributors who have a veto power over the appointment of prospective applicants are horizontal and thus \textit{per se} illegal. In those decisions, the fact that distributors may exclude intrabrand competition at will is considered particularly dangerous.\footnote{See Central Telecommunications v. TCI Cablevision, 800 F.2d 711, 726-27 (8th Cir. 1986); Affiliated Capital Corp. v. City of Houston, 700 F.2d 226, 236 (5th Cir. 1983); Quality Mercury Inc. v. Ford Motor Co., 542 F.2d 466, 471 (8th Cir. 1976) (stating that exclusive franchise "in perpetuity" is suspect under the Sherman Act), \textit{cert. denied sub nom.}, Prestige Lincoln-Mercury, Inc. v. Quality Mercury, Inc., 433 U.S. 914 (1977); American Motor Inns v. Holiday Inns, 521 F.2d 1230, 1242 (3d Cir. 1975).}

Finally, a group of decisions holds that restrictions which are vertical in form might in reality be horizontal in nature when their source is a distributor whose interests clearly are being served (rather than that of the instituting manufacturer).\footnote{See Murphy v. Business Cards Tomorrow, Inc., 854 F.2d 1202, 1205 (9th Cir. 1988); General Leaseways v. National Truck Leasing Ass'n, 744 F.2d 588, 595 (7th Cir. 1984); Davis-Watkins Co. v. Service Merchandise,}


\textit{But see} Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 168-70 (3d Cir. 1979). Cernuto, a distributor, had been terminated, and one of its competitors had been granted an exclusive distributorship. \textit{Cernuto} set a dual standard to determine when horizontal action exists in distributor terminations or similar situations: (1) the manufacturer should have received complaints from a distributor, and, acting in concert with it, should have refused to deal with one of its competitors or have granted it exclusive rights; and (2) the purpose and effect of the challenged conduct should be to restrain price competition between the complaining distributor and its terminated competitors. The \textit{Cernuto} standard therefore covered situations where only one distributor was pressuring a supplier for anticompetitive purposes, i.e., where \textit{Klor's} did not apply. Other lower court decisions refined the \textit{Cernuto} standard by conditioning horizontal action upon a finding of causality between the complaints and the termination and upon evidence that the manufacturer had acted "but for" the complaints. \textit{See}, \textit{e.g.}, Tunis Bros. Co. v. Ford Motor Co., 763 F.2d 1482, 1499-1501 (3d Cir. 1985); Zidell Explorations, Inc. v. Conval Int'l, 719 F.2d 1465, 1469 (9th Cir. 1983).

This holding and other precedents following \textit{Cernuto}, were overruled by the Supreme Court in \textit{Business Electronics Corp. v. Sharp Electronics Corp.}, 485 U.S. 717, 723-31 (1988). In \textit{Business Electronics}, the Court held that the characterization of distributor violations as \textit{per se} illegal antitrust offenses may eventually penalize perfectly legitimate manufacturer behavior. \textit{Id.} at 728.
from distributors may have preceded the adoption or enforcement of a vertical scheme does not, however, suffice to characterize the arrangement as horizontal, unless it is proven that the distributor has coerced the manufacturer to act against its will. As noted in Sylvania, the per se rule can be applied only upon demonstrable economic effect and not upon the basis of formalistic line drawing.

4.5. Conclusion: The Market Power and Interbrand Competition Approach Versus the Intrabrand Competition and Parallel Import Approach

4.5.1. The Strength of the Market Power Approach

Assuming that manufacturers are profit maximizers and that the market is a self-correcting mechanism that effectively penalizes businesses which further non-efficiency goals, U.S. theorists belonging to the Chicago School of thought view exclusive distributorships and concomitant vertical territorial restrictions on distributors as efficiency-enhancing schemes, which rarely raise antitrust concerns. Particularly in industries that are not concentrated and where interbrand competition is vigorous, a producer lacking market power may not risk insulating its distributors from intrabrand competition and thus risk giving distributors supracompetitive profits without providing an objectively justifiable reason. Higher distributor prices may deter consumers from buying the producer's goods and force consumers toward alternative commodities. Accepting the truth of this hypothesis, it is possible that such a producer is seeking to further its legitimate interests in improved distribution. The market power and interbrand competition approach thus furnishes a simple and time-saving standard, which can be easily applied by judges unfamiliar with complex economic theories. Furthermore, this approach does not require an elaborate analysis of the confusing points presented by controversial exclusive and territorial agreements. While acknowledging that exclusive and vertical territorial schemes may be


103 See supra notes 3-4 and accompanying text.

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anticompetitive in situations in which a high percentage of manufacturer power and industry concentration exist, this approach suggests that such schemes deserve protection when they benefit manufacturers, distributors and consumers.

4.5.2. Weakness of the Intrabrand Competition and Parallel Import Approach

In contrast to these U.S. approaches, E.U. officials show marked hostility toward practices which completely eliminate intrabrand competition within a single distribution network. While generally protecting pure exclusive distributorships, as demonstrated by the provisions of Regulation 83/83, these officials generally outlaw territorial schemes which further shield exclusive distributors from trade activities originating outside their territories. Similarly, although the Regulation permits the inclusion of some mild territorial restrictions in the exclusive contract, it outlaws more intense intrabrand restrictions. Such restrictions are driven by valid but excessive concerns, namely, that the obstruction of parallel imports among traders from different Member States, which is one specific form of intrabrand rivalry, will prevent the equalization of differentiated national prices and hinder the unification of the E.U. market. These restrictive policies neglect, however, the proper appraisal of the competitive conditions within the relevant market in which the contested territorial schemes are instituted. Instead, the Commission and the European Court of Justice confine themselves to a short-sighted assessment of the impact of the airtight territorial restrictions. As a result, both the Commission and the Court of Justice penalize conduct that might otherwise be perfectly legitimate. These penalties deter businesses from exercising the necessary control over their distribution channels, from creating or maintaining a superior image for their brand, and from enhancing their competitive status. Viewing the specific forms of intrabrand restrictions as non-exempted violations of E.U. competition law may decrease—rather than increase—competition in the interbrand market in the long run.104 The manufacturer market power and

104 The idea that scrutiny of intense intrabrand restrictions in the European Union is conducted narrowly and without the required market
interbrand competition test, therefore, provides a more accurate and balanced standard by which to evaluate restricted distribution practices.

4.5.3. Similarities Between Exclusive Distributorships and the Absolute Territorial Protection of Distributors

The condemnation of the absolute territorial protection of distributors alone, and not of other milder forms of intrabrand restrictions or exclusive distributorships, demonstrates that E.U. authorities distinguish between exemptible and non-exemptible schemes based on the intensity of each intrabrand restriction, irrespective of their similar nature and analogous use by manufacturers. If, as the Chicago School theory mandates, the underlying rationale for upholding exclusive and mild territorial restrictions is to organize effective and competitive distribution networks, then the same holds true for the absolute territorial protection of distributors. Once substance is selected over form as the basis for antitrust evaluations, and given that "manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products," it follows that any distinction between exclusive distributorships or "qualified" territorial restraints is unwarranted, absent significant manufacturer market power or substantial industry concentration. On the other hand, as will be shown, concerns about absolute territorial protection as a symptom indicative of a segregated E.U. market may be ill-founded. Such concerns focus more on the immediate effects of territorial protection, such as the preservation of differentiated pricing throughout the European Union, rather than on the potential role of protection as a tool by which to promote more effective competition and expansion of national manufacturers

analysis is supported by various commentators. See KORAH & ROTHNIE, supra note 27, at 26, 31-33; Chard, supra note 1, at 435-36; Gyselen, supra note 1, at 658-62.; Hawk, supra note 1, at 72; Van Bael, supra note 1, at 43, 48, 56. As noted by these commentators, restrictions on intrabrand competition should be appraised in connection with the surrounding economic realities (e.g., in support of vigorous interbrand competition).

See supra note 79 and accompanying text. The rule of reason standard was established in the Sylvania decision without any distinction being drawn between variations of the basic vertical non-price model.

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from Member State to Member State.


This section explores the feasibility of applying the economic "efficiency" and "market structure" theories, widely endorsed by U.S. courts, to the E.U. exclusive and vertical territorial controversies. As already discussed, these theories seek to protect the manufacturers' desire for improved distribution, without jeopardizing the welfare of ultimate consumers.\(^{106}\) Whether the application of the "efficiency" and "market structure" theories in practice does not impede the realization of the E.U.'s principal goals for competition law, such as the unification of the European market, is a somewhat more complex issue.\(^{107}\) It will be demonstrated, however, that the "efficiency" and "market structure" approaches protect exclusive and vertical territorial practices only when they foster this goal. Thus, what has been advocated in the United States, a slightly different environment in which the market is already integrated and not composed of distinct countries with distribution networks organized along national lines, may fertilize European thought and therefore deserves more than immediate dismissal by E.U. officials.

The proposal made in this section, inspired by U.S. theories and precedents, can be successfully reconciled with the dual substance of Article 85, which includes the bifurcated allocation of duties between the Commission and the national judiciary of Member States,\(^{108}\) as well as the differing economic realities of the European Union (e.g., national monopolies, frequent collusive phenomena, and barriers to entry and exit) and U.S. markets.\(^{109}\) Because E.U. officials might, at first, be reluctant to accept the usefulness of this

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\(^{106}\) See supra Sections 4.1-4.2.

\(^{107}\) See supra Section 2.

\(^{108}\) See supra Section 3.1.

\(^{109}\) See infra Section 5.1. See, e.g., KORAH & ROTHNIE, supra note 27, at 23-24; Waelbroeck, supra note 1, at 49.
proposal, an amendment to Regulation 83/83 would be worthwhile in order to accommodate the immediate needs of private parties.\textsuperscript{110} Once established as feasible, the ideas suggested in this proposal will lead the Commission and the Court of Justice to analyze exclusive and restricted territorial distribution controversies under a revised set of standards, as demonstrated by a concrete application of U.S. precedents in factual circumstances already prevalent in Europe.\textsuperscript{111}

5.1. The Proposal Modeled on U.S. Theories and Precedents

5.1.1. The Proposal: The Market Power Filter and the Different Interpretation of Article 85. The Rule of Reason Under 85(1)

As already demonstrated, adoption of the U.S. "market structure" approach may improve the short-sighted evaluation of intense vertical territorial schemes by E.U. authorities. This subsection will explore suggestions for the successful adaptation of the "market structure" approach within the European Union, while the next subsection will examine the approach with respect to its compatibility with the market integration objective.

This incorporation of U.S. ideas within the European Union would mean a radical change for E.U. competition law. Furthermore, it would mandate the assessment of intrabrand territorial restrictions under Article 85 within the correct market context, irrespective of the intensity of the restrictions. To this end, Europeans should utilize a Rule of Reason analysis under Article 85(1), thereby recognizing that not every scheme which protects distributor territories from intrusions mechanically falls within its scope.\textsuperscript{112} Along with agreements adopted due to concerted distributor pressures,

\begin{itemize}
\item\textsuperscript{110} See infra Section 5.2.
\item\textsuperscript{111} See infra Section 5.3.
\item\textsuperscript{112} Viewing the rule of reason through a comparative perspective, Professor Joliet was the first to support the idea of such a rule. See Joliet supra note 1; see also KORAH & ROTHNIE, supra note 27, at 48-50 (arguing that such a policy may grant to exclusive distributors the amount of protection required for the recoupment of their investments); Hawk, supra note 1, at 72 (noting the need for insertion of a U.S.-type Rule of Reason in this paragraph of Article 85).
\end{itemize}
which should be treated under a strict per se rule,\textsuperscript{113} intrabrand restrictions adopted by powerful manufacturers facing limited interbrand competition and operating in concentrated industries would be considered potentially dangerous. In such cases, the Commission and the Court of Justice would intervene to examine whether, on balance, the overall anticompetitive effect is outweighed by any procompetitive justifications or efficiencies. Under this new interpretation of Article 85(1), the requirements of Article 85(3) would be met, although in a more "relaxed" version. According to economic theory and experience, a manufacturer who lacks market power does not risk giving supracompetitive profits to its distributors when the manufacturer includes in its distribution contract clauses "not indispensable," with the hope of attaining an improvement in distribution or another efficiency objective. Furthermore, one cannot argue that consumers themselves would be harmed as a result of such restrictions. The somewhat higher distributor prices may deprive consumers of a "fair share" in terms of price, but consumers may gain an advantage from the non-price efficiencies that result from the restrictions (e.g., service and preservation of high product quality) which do not currently factor into official E.U. fair share antitrust analyses. Higher prices may reflect the costs necessary to achieve those distribution efficiencies rather than supracompetitive distribution margins, which may be unlikely because of existing interbrand competition.\textsuperscript{114}

With the introduction of such new standards, a plaintiff, upon proof of an agreement or other concerted practice between a manufacturer and any of its direct or indirect purchasers, would have to produce further evidence concerning the degree of manufacturer market power. For this purpose,

\textsuperscript{113} See supra Section 4.2.

\textsuperscript{114} For a generous interpretation of the requirements under Article 85(3), see DeKeyser, supra note 51, at 290-93; Deringer, supra note 51, at 613-20.

Mere relaxation of the conditions, however, would not remedy the current defects of the European policy. If Article 85(1) were continually applied under a mechanical approach, almost all vertical territorial arrangements would be in violation of it. As a result, the arrangements would be saved only by a formal individual exemption granted by the Commission. Parties would thus experience the same problems of delay and uncertainty that they currently face. See supra Section 3.1.2.
the relevant product and geographic market must be defined. Although frequently perceived as subject to manipulation by litigants advocating a specific outcome, the relevant product and geographic markets may be verified through a series of pervasive tests, such as purchasing patterns, price levels, transportation costs, etc. After defining the relevant markets, the manufacturer's market share or the differentiation level characterizing the manufacturer's product should be calculated.\textsuperscript{116} These factors should be supplemented by considerations including the level of concentration in the relevant market and the degree to which that market is covered by such intense territorial practices. Manufacturer market shares below 20\% (the level largely followed in U.S. cases concerning vertical non-price restrictions), low concentration levels (denoted by an HHI below 1,000), and limited coverage of the relevant market by analogous practices should all lead to the rejection of the plaintiff's claims.\textsuperscript{116}

\textsuperscript{116} See 2 Phillip E. Areeda & Donald F. Turner, Antitrust Law: An Analysis of Antitrust Principles and Their Application 351-66 (1978). The definition of the relevant market may include substitutes in consumption and production and fringe firms, according to the Landes/Posner definition. See Landes & Posner, supra note 90, at 944-51, 960-67. The geographic market may include output by foreign manufacturers of substitute goods which respond to any price increase and attempt to import into the contract territory of distributors in a Member State. See George Hay, et al., Geographic Market Definition in an International Context, 1990 Fordham Corp. L. Inst. 67-73 (1991); see also Merger Guidelines of the United States Department of Justice, 4 Trade Reg. Rep. 20,573 (1992) [hereinafter Merger Guidelines] (referring to the "small but significant and non-transitory" increase in price as a tool for defining relevant markets).

\textsuperscript{116} See supra Section 4.4; see also Merger Guidelines, supra note 115, at 20,573-5 to 20,573-6. The Herfindahl-Hirschman Index (HHI) is calculated by summing the squares of the shares of all competitors in the market, and thus demonstrates the levels of concentration among the top four firms, in comparison to the shares of the smaller firms in it. A market with an HHI below 1,000 is usually considered as unconcentrated, with an HHI between 1,000 and 1,800 as moderately concentrated, and with an HHI above 1,800 as highly concentrated. In situations of absolute monopoly, when a single firm holds a 100\% market share, the HHI is equal to 10,000. The "degree of market coverage by analogous agreements" is also discussed in a few decisions of the European Court of Justice, but reference to it is coincidental and fragmentary. See Case 75/84, Metro SB-Grossmärkte GmbH v. Comm'n, 1986 E.C.R. 3021, 3085, 1 C.M.L.R. 118 (1987); Case 23/67, S.A. Brasserie de Haecht v. Wilkin, 1967 E.C.R. 407, 414-15, Common Mkt. Rep. (CCH) ¶ 8,053 (1971); Case 56/65, Société Technique Minière v. Maschinebau Ulm GmbH, 1966 E.C.R. 235, 260, Common Mkt. Rep. (CCH) ¶ 8,047 (1966); Notice on Agreements of Minor Importance, art. 16, 1986 O.J. (C 231).
Since this whole analysis would be conducted under Article 85(1), national judges would, according to the third paragraph of Article 9 of Council Regulation 17/62, be empowered to apply the Rule of Reason in practice, thereby protecting most of the vertical territorial arrangements brought before the court. Thus, in the event that U.S. approaches are adopted by the European Union, restricted distribution disputes would be quickly resolved, and parties would be relieved of the burden of notifying the Commission of their arrangements and waiting for extended periods of time for the Commission's response. The Commission, on the other hand, would not only be relieved of many currently excessive duties, but it also would need to scrutinize only the small number of truly dangerous restricted distribution arrangements either found in violation of Article 85(1) by national judges or notified to the Commission for individual exemptions under Article 85(3). In such cases, the burden of proof rests with the defendant private parties. Such defendants would be required to demonstrate that insertion of such clauses in distribution arrangements is necessary for valid and legitimate business purposes.\(^{117}\)

This shift of responsibilities to national courts would not jeopardize the uniform application or interpretation of competition law throughout the European Union. Although it is possible that national judges might make contradictory evaluations—especially in marginal cases that approach the minimum power market percentage—the Commission could exercise some control over the courts, at least in the initial stages of applying the proposed approach. Furthermore, the Commission could cooperate with the courts evaluating contested legal or economic data.\(^{118}\) On the other hand, if doubts arise as to the interpretation of Article 85(1), national judges would be able to exercise the discretion granted by Article 177 of the Treaty of Rome and turn to the Court of

\(^{117}\) See supra Section 4.4 (describing the allocation of the burden of proof in U.S. lower court cases).

\(^{118}\) See Delimitis v. Henninger Bräu, 1991 E.C.R. 935, 5 C.M.L.R. 2101 (1992). Although discussion in this decision mainly refers to cases in which the Commission is notified of such agreements, it may also apply even in the absence of notification. See also KORAH & ROTHNIE, supra note 27, at 44-46 (discussing the breakdown of the notification procedure). The cooperation of the Commission and courts may plausibly take the form of a short commentary offering advice.
Justice for advice.

5.1.2. The Institutional Goal of Market Integration and the Proposal Reconciled

The principal objection an E.U. official would most likely assert against this proposal concerns the focus upon the market integration objective. If parallel importers, the "heroes" who effect highly desirable price equalization of goods in the twelve Member States, were eventually cut off from the official distributor networks of several manufacturers, thereby denying suppliers to these parallel importers following the proposed exemption of many intense territorial restraints, European markets would allegedly remain segregated. Each appointed national exclusive distributor and other purchasers in the vertical chain of distribution for various products would then be able to charge differentiated prices without being subject to intrabrand competition from other Member States in which identical goods of the same manufacturers are cheaper. Rather than negatively interfering with market integration, it will be demonstrated that the adoption of the proposal would instead generate opportunities for fostering market integration. The only difference between the hypothesis described by E.U. authorities and the one suggested in the proposed approach is that of the distribution level at which the integration takes place. European officials may wish that integration is achieved due to the existence of parallel imports, which equalize the resale prices of national distributors of manufacturers, i.e., at an intrabrand level. Nonetheless, integration may eventually be prevented at the interbrand level as more entrepreneurs think carefully before expanding operations into different Member States or selectively operating in only a few other states in order to

119 See KORAH & ROTHNIE, supra note 27, at 23; Gyselen, supra note 1, at 649; Hawk, supra note 1, at 75; Van Bael, supra note 1, at 39. See also Commission Regulation 1983/83, 1983 O.J. (L 173) at 1-2 (Recitals 7 and 11).

120 See, e.g., KORAH & ROTHNIE, supra note 27, at 15-16 (advocating the ex ante/ex post distinction in the context of exclusive distribution). The fact that the Commission and the Court of Justice scrutinize and outlaw vertical practices after the distributors' investments have been made (ex post) leads them to overlook the fact that such investments would not have been made without vertical restrictions protecting the distributors' territories (ex ante).
avoid opportunistic activities within their distribution networks.

The major flaw in the decisions of European agencies on individual restricted distribution cases and of the "blacklisted" provisions of Regulation 83/83 is that they all focus on the phenomenon of differential pricing throughout the Union without any reference to the underlying reasons for such variations. This policy may give an advantage only to parallel importers while harming both manufacturers and official distributors. Unless the different conditions causing the price variations are assimilated and other differences in economic conditions in the various Member States cease to exist, the equalization of prices in the abstract may have no rational basis. This is especially true with regard to external conditions, which manufacturers and their distributors are unable to control. In addition, different promotional costs, required levels of investment for successful operation in national markets, national government measures, rates of inflation and national currency fluctuations are all outside their control. Other factors that are closely related to the manufacturer's own behavior and deliberate tactics and account for variations in national pricing (e.g., price discrimination following different levels of demand and other competitive situations throughout the Union, the institution of predatory pricing in specific Member States, varying degrees of efficiency in distribution of a manufacturer's goods from Member State to Member State) are generally incompatible with the proposed market power filter. 121

Assume, first, that the exclusive distributor of a business in country A has to incur higher distribution costs than exclusive distributors in other Member States. 122 The difference may be explained by a need for heavy advertising in one country in order to inform local consumers, who currently demonstrate strong loyalty to other competitive goods, about the products. The difference can also be explained by the existence of high minimum wages or salaries controlled by collective bargaining agreements, which generate higher costs for hiring employees and workers during the time needed to

121 See Waelbroeck, supra note 1, at 51.
122 See Chard, supra note 1, at 435.
organize and oversee a viable distribution network. Finally, the difference can be explained by the need to purchase or lease various commodities or real property for the successful organization of such a network.

Suppose next that an exclusive distributor or another trader from country B, where minimal advertising is required and where wages or other costs of distribution are lower, decides to sell in country A at correspondingly low prices, without paying for any advertising, by hiring the smallest possible number of employees and operating from a rented warehouse in a low-income area. This is a classic case in which the difference in prices is justified by external factors and an objective discrepancy between operation costs in different Member States easily creates free rider problems. If parallel trade is left free, some distributors may be reluctant to carry a supplier's line in those countries where distribution expenses are substantially higher than in others. The supplier may then decide not to enter that specific high-priced market at all, or it may decide to withdraw completely from the low-priced market.

Alternatively, the tax structure and relevant statutory provisions of a Member State may make it compulsory for distributors operating therein to pay high taxes that are not required in other Member States. Distributors or resellers in those other Member States may occasionally import there, incurring only a portion of the total costs that the local distributor has incurred and thus undercutting it. Monetary exchange fluctuations and inflation rates are also significant in this regard. Parallel imports into a country in which the national currency has been recently devalued or in which inflation rates have skyrocketed are extremely profitable. This is especially true for imports from countries with very strong currencies and low inflation in which identical goods are sold at lower prices. As a result, the local distributor in a high-priced market may eventually stop selling the manufacturer's product, and the manufacturer may accordingly plan to withdraw from that market. National tax laws, currency, and inflation matters are examples of other conditions beyond the control of manufacturers and distributors. These factors also objectively differentiate the status of distributors in different Member States and enable parallel importers to make easy profits by taking advantage of the expenses incurred by the
less-favored national distributors.

Manufacturers operating in more than one Member State may decide to charge their distributors—and, hence, their ultimate consumers—varying prices. They may be responding either to the different levels of national competition or to different elasticities of demand. Alternatively, they may choose to lower their prices considerably in one Member State in order to exclude their competitors from that market unlawfully in an attempt to create a monopoly. Under those circumstances, the variation in prices is not due to conditions beyond the control of the manufacturer or its distributors, but it is in fact the result of the manufacturer's own policy. The same is true in a third case in which a single manufacturer deliberately appoints distributors of various efficiency levels in different Member States. Would free trade be beneficial in those situations? Should restricted distribution schemes therefore be prohibited? As will be made clear, if the manufacturer has little market power and other favorable market conditions in the proposed model exist, it is unlikely that the price differentials will be preserved. In the first case, the manufacturer charges higher prices, which are passed on by the distributors and other resellers to the ultimate consumers in a specific Member State because competition is not as vigorous there as it is in other countries in which price levels are lower. Thus, local consumers have no choice but to buy the manufacturer's goods at relatively unfavorable terms. The manufacturer is thus discriminating in pricing by charging consumers according to their elasticities, without regard to any cost discrepancies from one Member State to the other. Such manufacturers tend to prevent arbitrage from one country to the other by protecting the high-priced distributor territories through vertical practices. In the meantime, cross-trade may assimilate prices from territory to territory and diminish the manufacturer's own profits as a result.

The successful implementation of such a scheme, however, is based on the hypothesis that the manufacturer faces a relatively inelastic market demand in the protected, high-priced territory, making it incompatible with the proposed market power model. By contrast, an elastic state of demand would imply that the manufacturer lacked the ability to charge
such high prices.\textsuperscript{123} Below the market structure levels suggested in the proposal (20% market share, 1,000 HHI), the divergence of discriminatory national prices that are not cost-justifiable may not generate profitable cross-trade, especially in view of the transportation costs from one country to another. Only small national price differences may occur, as is also true in fully integrated markets such as that of the United States.

In the second case, the manufacturer will try either to enter a new national market or to reinforce an existing powerful market position in a Member State and thus exclude its other competitors from that state by charging substantially lower prices through its distributors, occasionally below average variable cost.\textsuperscript{124} This strategy is usually followed by manufacturers trying to recoup their losses by charging supracompetitive prices in the specific market in which the exclusion is likely to occur or in other markets in which they are already powerful enough to extract high profits. In the latter case, these markets (which might coincide with two Member States) must be artificially isolated with absolute territorial protection schemes. If cross-trading occurs, not only will the predator be unable to fund the below-cost prices in the low-priced country, but its distributors in the high-priced country will also be required to sell at a loss. This situation is also incompatible with the proposed model. Losses incurred through predatory behavior may only be recouped in markets in which the predator enjoys a quasi-monopoly or in which the barriers to entry are extremely high. The proposed model, however, suggests that the absolute territorial protection of distributors is immunized only when relatively small manufacturers operate in markets where interbrand

\textsuperscript{123} For the correlations among demand elasticity of the market, demand elasticity of the firm, and market power, see Landes & Posner, supra note 90, at 939-52.


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competition is strong. Unfortunately, attacking the symptom of differential pricing—and not the conditions that brought it about—is harmful to the predator's distributors. Rather than attacking vertical territorial restrictions that preserve price differences, predatory pricing itself should be attacked as a potentially anticompetitive practice.

Finally, the prices of the manufacturer's goods throughout the European Union may be different, depending upon the efficiency level of its various national distributors, the level of technological development and organizational experience, and the suitability of its methodology. Less efficient distributors have higher costs and charge local consumers more. Furthermore, the thrust of parallel imports may make their survival improbable. The protection of these distributors against parallel imports is not, however, in the manufacturer's best interest. In the presence of strong interbrand competition, manufacturers may either leave intrabrand competition free to put pressure on the distributors and force them to increase their efficiency or terminate those distributors in favor of better-equipped competitors with lower operating costs. Restricted distribution schemes that perpetuate national price differences are thus unlikely to be explained by different degrees of distribution efficiency.

Adopting a U.S.-type standard for evaluating intense vertical territorial restrictions in the European Union, however, would neither create artificial barriers for European markets nor perpetuate the existing European markets. First, these vertical schemes would not be adopted to make price discrimination or predatory pricing more effective or to shield inefficient national distributors from intrabrand competition. Second, integration would be fostered in all other cases in which distribution protection is justified on grounds of differentiated distribution costs or other variable conditions. Leaving parallel trade free in this instance may only support parasitic activities which harm established local distributors and operate as a counter-incentive for businesses to expand in the territories of Member States. These activities force businesses either to withdraw from low-priced markets or to

125 Note that this assumes that there are no differentiated levels of efficiency in production among the Member States of the European Union.
establish uniform increased prices throughout the European Union in an effort to discourage interstate trade.\(^{126}\)

5.1.3. Vertical Integration as a Threat to European Unification

A European business instructed by the Commission that it must abandon all measures designed to protect one or more of its distributors against parallel imports may create its own subsidiaries responsible for the promotion of its products in the national markets of various Member States (i.e., by expanding internally). In order to avoid future violations of Article 85(1), the business will undoubtedly integrate vertically with one of the distributors already operating at the downstream level. Indeed, the provisions of this article are only applicable to "agreements between undertakings." Any decisions made by units operating within the internal structure of a single enterprise are necessarily outside its ambit.\(^{127}\) A manufacturer expanding internally or externally is thus able either to limit the territorial scope within which each of its vertical branches is allowed to operate or to police its strategies without risking antitrust liability.\(^{128}\) The manufacturer may also benefit from other advantages usually attributed to vertical integration, such as optimal internal firm organization, effective flow of information between different

\(^{126}\) On the other hand, the opposite stance may not only assist European integration, but also may enable European businesses to enhance their competitive position in the international markets. See Douglas E. Rosenthal, *Competition Policy, in Europe 1992: An American Perspective* 293, 329-30 (Gary C. Hufbauer ed., 1990); see also Daniel Oliver, *Antitrust as a 1992 Fortress* WALL ST. J., Apr. 24, 1989, at A14 (noting that the EEC antitrust policy has as its primary goals the unification of the European economy and the protection and promotion of competition).

\(^{127}\) Commercial agency is an alternative measure that serves purposes similar to vertical integration. Since commercial agents are traders who negotiate and conclude transactions on behalf of their principals without assuming any personal financial risks, contracts concluded between the two are not covered by 85(1). See Commission’s Notice on Agency, J.O. 2961/62. The criteria used by the Commission and the Court to determine whether there is an agency agreement vary from case to case. In addition, the parties sometimes may remain uncertain whether their arrangements are governed by 85(1). See, e.g., Decision de la Commission IV 26876, 1972 J.O. (L 272) 35, 38; Commission Regulation 476/88, 1988 O.J. (L 49) 1, 19, 20.

\(^{128}\) See KORAH & ROTHNIE, supra note 27, at 5; WHISH, supra note 14, at 538.
divisions, and prompt control and decision-making on distribution matters.\textsuperscript{129}

If vertical integration patterns are the only legitimate means of protecting distributors' investments, however, they may adversely affect not only efficiency but also the successful implementation of European unification. First, vertical integration is, by definition, a very costly means of distributional organization. Consequently, many enterprises find vertical integration of limited success, especially those companies that lack the necessary experience to organize their internal expansion in an appropriate manner. Thus, the condemnation of absolute territorial protection schemes may not only preclude expansion of the European market, but it may also prevent the vertical growth of individual Member State enterprises. These protection schemes will, in turn, deter both competition and European integration.

Second, the diseconomy that may occasionally result from vertical integration may make it more difficult for European firms to penetrate national markets. Vertical internal expansion, which requires the establishment of a new subsidiary, deprives entrepreneurs of the benefit of core competencies and other economies of scale and scope already developed by existing independent firms involved in the local distribution business. Local distributors, which either use tested and successful methods designed to meet the needs of consumers in their own Member State or invent ways to operate at a substantially lower cost, have a competitive advantage over less industrial distributors. A manufacturer who decides to establish a subsidiary in a specific Member State which is ill-equipped to understand the local market or which functions at a higher cost than the distributors of other interbrand competitors will lose its competitive advantage.\textsuperscript{130}

Vertical integration may therefore be an ineffective means of

\textsuperscript{129} See MILGROM & ROBERTS, \textit{supra} note 68, at 544; Williamson, \textit{supra} note 68, at 969-72.

\textsuperscript{130} See KORAH & ROTHNIE, \textit{supra} note 27, at 4 (stating that vertical integration within a firm is not always efficient). Since the staff of the subsidiary distribution firm is composed of manufacturer employees, they are protected by national labor laws and thus may be dismissed only under certain limited circumstances. This holds true even if they are responsible for substantial inefficiencies in the functioning of the subsidiary vis-à-vis other competitors in the local market.
penetrating the European market and thus for the general development of interstate trade.\textsuperscript{131}

Unfortunately, once vertical integration has commenced, it will automatically end all intrabrand competition within the manufacturer's own distributional network. Vertical branches of a single firm will no longer compete among themselves. By attacking vertical integration, European officials may have as their main goal the elimination of national price differences resulting from intrabrand trade. Businesses which choose internal growth as an alternative solution to serve their needs without exposing themselves to liabilities may, however, be surprised at the results. Such growth will likely perpetuate individual differences and ultimately thwart the attainment of the goal of European market integration.

5.1.4. The Distributors' Cartel Hypothesis in the E.U. Vertical Context

The proposal for a new model of evaluation for restricted distribution in the European Union would be incomplete if it did not exempt from its general formula those cases involving market-dividing aspirations of distributors, restricted output, and impaired consumer welfare. In such cases, intense vertical territorial restrictions are not instituted to serve the interests of European business. These interests include increased efficiency, preservation of brand image and characteristics, and elimination of free-rider and other parasitic activities.\textsuperscript{132} It is true, however, that abundant evidence is required to support the condemnation of a supposed vertical scheme as horizontal. In the absence of such proof, otherwise legitimate activity may be penalized.\textsuperscript{133}

\textsuperscript{131} The same is true when manufacturers have bought most of the successful distribution firms. The remaining enterprises may subsequently be unable to use the facilities of those firms, and they will probably be hampered from entering specific national markets on an efficient scale. See generally Margaret E. Guerin-Calvert, Vertical Integration As a Threat to Competition: Airline Computer Reservation Systems, in The Antitrust Revolution 338, 349-51 (John E. Kwoka, Jr. & Lawrence J. White eds., 1989) (noting that the exclusive use of computer reservation systems on two airline companies was an impediment to competition in the long run).

\textsuperscript{132} But see Waelbroeck, supra note 1, at 48 (contending that the distinction is unworkable).

\textsuperscript{133} See supra Section 4 (discussing the "plurality" and the "source of the
Neither Regulation 83/83 nor the individual decisions of the Commission and the Court of Justice, however, seem to be particularly concerned with such horizontal practices. In fact, Article 1 of the Regulation requires that only two parties may enter into an exclusive distribution agreement free from exemption. The Commission presumably fears that if more than two firms or undertakings (i.e., a manufacturer and numerous distributors) sign an exclusive contract, all distributors who are party to the agreement may then purchase from the manufacturer on equal terms, thereby enabling them to resell without competing among themselves. Differentiated pricing would allegedly make it more difficult for these distributors to coordinate their anticompetitive activities. Article 1, however, remains inadequate because it catches true “vertical-horizontal” restrictions only incidentally. The proof of horizontal action is not inextricably related to the equal treatment of distributors in a single contract. Identical purchase terms may indeed facilitate the implementation of a distributors cartel. Nevertheless, even in their absence, cartel members may coordinate and collude. Furthermore, despite the equal purchase terms, such a joint exclusive distribution agreement may be completely legitimate.

Similarly, the Commission’s decision falls short because it fails to examine whether the challenged absolute territorial protection schemes are horizontally initiated. This trend may be partly explained by the fact that antitrust complaints in those cases are submitted by “outsiders” or third parties. This latter group includes prospective parallel importers, which officially appointed resellers in the manufacturing network have refused to supply, and which therefore have no access to inside information concerning potential anticompetitive

restraint” requirements). On the other hand, the importance of the “horizontal/vertical” distinction is not disturbed by the fact that the successful implementation of any horizontal action depends on manufacturer market power. In the absence of the latter, combinations of distributors or cartels will not be able to extract supracompetitive profits from consumers. The anticompetitive results of the horizontal division of markets among distributors are such that relevant instances occasionally must be examined on their own merits.

See Korah & Rothnie, supra note 27, at 73-75; Schröter, supra note 28, at 398 (stating that “[t]he block exemption covers only agreements to which not more than two undertakings are party”) (citation omitted).
schemes secretly implemented among those resellers. Alternatively, this lack of information may stem from the fact that the scrutiny of specific cases follows official notification of agreements by the manufacturers themselves. These manufacturers then intentionally fail to inform the Commission of such matters due to their understandable concern that the illegal clauses will void the whole distribution agreement.  

The introduction of the "vertical-horizontal" distinction in the proposed model is indispensable. It may not only lead to the per se condemnation of those cases in which the manufacturer is manipulated and consumers are harmed, but it may also penalize abuses against European market integration itself. "Vertical-horizontal" schemes do not aim to promote business efficiency, and they do not serve as a tool for entrepreneurs expanding their operations across national territories to further European unification. Instead, they are designed to perpetuate the fragmentation of the Common Market among exclusive distributors.

5.2. The Proposed Amendment of Regulation No. 83/83

The prospective admission of the rule of reason standard under 85(1) in European restricted distribution controversies raises an additional issue: the future applicability of Regulation 83/83. Although the Regulation will expire at the end of 1997, it is now valid and fully enforced by the Commission and national judicial authorities. Assuming that the proposed approach would be incorporated in European competition law, national courts would dispose of all agreements now covered by the Regulation as legitimate, rendering the Regulation obsolete. The question remains,

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185 See Viho, 1992 O.J. (L 233) at 29; Tipp-Ex, 1987 O.J. (L 222) at 2; Johnson & Johnson, 1980 O.J. (L 377) at 23 (discussing an export prohibition clause in a contract undertaken within the meaning of Article 85(1)); see also Hennessy-Henkell, 1980 O.J. (L 383) at 13 (noting that Hennessy informed the Commission that amendments had been made to a previous agreement only after the Commission requested such information).

186 There may be a few exceptions (i.e., exclusive agreements in the networks of dominant manufacturers, now covered by the Regulation, may potentially violate 85(1)). Nevertheless, this will be the case for only a limited number of dangerous agreements which rise above the threshold established in the proposal and thereby warrant the Commission’s scrutiny.
however, whether and to what extent the Commission and the Court of Justice will shift from existing precedent and accept the new standard. Some commentators still insist that the Regulation is of limited value. They go on to note that E.U. authorities allegedly display a certain willingness to apply Article 85(1) narrowly, thereby protecting several challenged schemes which would have violated 85(1) under the "mechanical" rule. Yet, the rule of reason has not yet crystallized as a valid standard by which to analyze agreements in the European Union.

A brief discussion of case law will better illustrate this point regarding Regulation 83/83. On June 30, 1966, the Court of Justice issued Société Technique Minière, ruling on a pure exclusive distribution case the same way it decided the Delimitis case only three years ago. Although the factual scenarios were slightly different, both decisions required a full analysis of the particular economic and legal issues that had been raised. Nonetheless, in the meantime, Article 85(1) has seldom been applied to the rule of reason. Société Technique Minière and Delimitis may indeed be important decisions, but under no circumstances do they signal a change in the interpretation of Article 85. Until both the Commission and the Court adopt a new position, intermediate measures will be required to cover the practices of parties now outside the Regulation. This is especially true for enterprises which are instituting intense territorial restraints. Amending some of the provisions of the Regulation, as well as certain Recitals and Guidelines, may fulfill this purpose effectively and without further unnecessary delay. Once the interpretation of 85(1) matches the proposed model, however, the Regulation should cease to apply.

If the U.S. "market structure" approach for evaluating vertical territorial schemes is utilized, all proposed amendments should necessarily refer to an explanatory

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137 See, e.g., KORAH & ROTHNIE, supra note 27, at 249-50 (noting that the sophisticated economic analysis allegedly established in 85(1) makes the Regulation useful only rarely).

138 Case 56/65, Société Technique Minière, 1966 E.C.R. 235, 250 (stating that "Article 85(2) provides that 'Any agreements or decisions prohibited pursuant to this Article shall be automatically void.'").

provision added in the proposed text of the new regulation. Furthermore, the amendments should define terms such as “market structure,” “market power,” “powerful supplier,” and “high concentration among suppliers.” The language of such a provision might read as follows:

For purposes of the present Regulation, consideration of market structure cumulatively includes assessing: (1) the power of the supplier instituting the scrutinized restricted distribution schemes; (2) the concentration levels among suppliers in the relevant market; and (3) the degree of market coverage by similar schemes excluding other forms of distribution. Market power might be alternatively demonstrated either by the large share of the supplier in the relevant product and geographic market or by the highly differentiated character of its product; above a threshold of 20% market share, the supplier will be presumed powerful. High concentration among suppliers is demonstrated by an HHI of above 1,000.

The proposed amendments are thus divided into three categories. The first relates to provisions regulating the scope of permissible obligations assumed by and discretion given to a manufacturer supplying an exclusive distributor. The second covers provisions delineating the obligations of the exclusive distributors or resellers at subsequent trade levels. Finally, the third amendment covers “blacklisted” provisions, which control the behavior of parties irrespective of trade level operations.

An amended regulation is thus necessary to curb manufacturing practices. For instance, under the current status quo, intrabrand activities which undermine the exclusive distributors’ investments and relate to the manufacturers’ scope of operation are encouraged under Guideline 27. This allows the manufacturer to sell not only to traders outside the exclusive distributor’s territory but also to those wishing to resell within the area. Guideline 30 acknowledges the manufacturer’s discretion to supply products outside the contract territory and to users based within the region. Furthermore, Article 2 mandates that the supplier assume no other obligations than those already listed in

https://scholarship.law.upenn.edu/jil/vol15/iss4/2
Article 1. This provision includes a few exceptions, such as the prohibition of cross-sales among the contract territories of the supplier's exclusive distributors. Finally, an amended version of the regulation and guidelines should provide for the possibility of contractual curtailment of such activities, subject, of course, to the conditions prevalent in the relevant market. It will only be necessary to preserve intrabrand competition in concentrated industries, in which only a few manufacturers enjoy large market shares. Guidelines 27 and 30, respectively, should be modified to read as follows:

The supplier may, however, assume the obligation not to supply such resellers outside the contract territory, if it is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000), and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

The supplier may, however, assume the obligation not to supply such final users outside the contract territory, if it is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000), and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

Article 2(1) should be slightly altered so that weak manufacturers can protect their exclusive distributors against cross-trade, free-rider activities. Following the current language, "[a]part from the obligation referred to in Article 1 no restriction on competition shall be imposed on the supplier," an additional phrase similar to the following should be included: "Unless such a supplier is not powerful (holds a market share below 20%), the supplier concentration

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141 See supra Section 4.2.
142 See Guidelines, supra note 29, at 7.
143 Id.
levels in the relevant market are low (HHI below 1,000), and the market is not covered by restricted distribution schemes that exclude alternative forms of distribution." Nevertheless, since this exception will refer to restrictions on intrabrand competition that stem not from the supplier itself but rather from other exclusive distributors, the original wording of Article 2 should be changed. The phrase "restriction on competition"\(^\text{145}\) (by the supplier) should be replaced by the more general term "obligations" (of the supplier), which also include the obligation of the supplier to impose territorial restrictions on various exclusive distributors in its network. Finally, the word (obligation) "imposed"\(^\text{146}\) (on the supplier) should be replaced by "assumed" (by the supplier), as the former tends to designate situations in which a supplier unwillingly accepts an obligation following pressures from the members of a distributors cartel.

At the same time, the current version of the Regulation encourages free rider activity. It gives free rein to exclusive distributors or subsequent resellers to engage in extraterritorial passive sales,\(^\text{147}\) thus permitting both the repackaging of contract goods by the exclusive distributor and their resale in other Member States with higher prices.\(^\text{148}\) Furthermore, the current regulation indirectly reduces the scope of maximum permissible obligations of distributors and resellers by disallowing the imposition of post-sale territorial or price restrictions, which are designed to curtail parallel imports.

This topic merits further discussion. First, the structure of Article 2(2) should be slightly altered. The current text should be preceded by the following phrase: "Unless the supplier of an exclusive distributor is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000) and this market is not covered by restricted distribution schemes that exclude alternative forms of distribution . . . ." This amendment to Article 2 would allow a manufacturer to include in its

\(^{145}\) *Id.* at 2.

\(^{146}\) *Id.*

\(^{147}\) See Guidelines, *supra* note 29, no. 28, at 10 (construing art. 2(2)(c)).

\(^{148}\) See *id.*, no. 9, at 8.
exclusive agreement the clauses needed to enhance its competitive status. This only holds true, however, as long as the assessment of the market structure of the specific territories sought to be protected from intrabrand competition demonstrates that interbrand competition and viable alternatives exist for consumers and there is no potential for anticompetitive abuses. Second, Recital 8\textsuperscript{149} and Guideline 17\textsuperscript{150} should be adapted accordingly to include in their text the following language:

Restrictive obligations not mentioned in Article 2 may be agreed upon, however, if the supplier is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000), and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

Guideline 28 should similarly provide:

Bans on passive sales are exemptible clauses if the supplier is not powerful, the supplier concentration levels in the relevant market are low, and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

By the same token, a manufacturer should have discretion to restrict the exclusive distributor or other third parties from repackaging its goods both for quality control reasons and to help foster the elimination of free riders. Guideline 9 should therefore provide:

Repackaging prohibitions imposed on the exclusive distributors or other resellers might be included in the exclusive contract, however, if their supplier is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000), and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

\textsuperscript{149} See Recital 8, supra note 37 at 1, 2.
\textsuperscript{150} See Guidelines, supra note 29, no. 17, at 9.
Finally, the "blacklisted" clauses\textsuperscript{151} regarding withdrawal of the benefit of the block exemption by the Commission and Recitals 11\textsuperscript{162} and Guideline 32\textsuperscript{153} should be conditioned on consideration of the market structure. Parallel imports may confer a "fair share" to consumers, but consumers may also receive non-price benefits as a result of restricted distribution schemes instituted by weak manufacturers in non-concentrated industries. The current text of the "blacklisted" provisions should also be amended to include the following sentence:

The block exemption shall continue to apply (in cases c and d), however, even if parallel imports are impeded, as long as the supplier is not powerful (holds a market share below 20%), the supplier concentration levels in the relevant market are low (HHI below 1,000), and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

An identical sentence should also be included at the end of Guideline 33.\textsuperscript{154} In addition, Recital 11\textsuperscript{155} should be supplemented with the following language:

Clauses included in the agreement that discourage parallel imports may be exemptible to the extent that the supplier is not powerful, the supplier concentration levels in the relevant market are low, and this market is not covered by restricted distribution schemes to an extent excluding alternative forms of distribution.

Similarly, Article 6(c)\textsuperscript{156} should provide:

The withdrawal will not be possible only if the supplier is not powerful, the supplier concentration levels in the relevant market are low, and this market is not covered by restricted distribution schemes to an extent

\textsuperscript{151} See Commission Regulation 1983/83, art. 3(c) & 3(d), 1983 O.J. (L 173) at 3.
\textsuperscript{152} See id. at 2.
\textsuperscript{153} See Guidelines, supra note 29, at 11.
\textsuperscript{154} See id.
\textsuperscript{155} See Recital 11, supra, note 39 at 2.
\textsuperscript{156} See Commission Regulation 1893/83, art. 6(c), 1983 O.J. (L 173) at 4.
excluding alternative forms of distribution.

Finally, the Regulation should include an additional article condemning "horizontal/vertical" exclusive and territorial arrangements. Since the distributor cartel hypothesis is also applicable in the European context, consumers should be protected against any manipulative practices that are disguised by schemes presumed to be efficient and which promote output restrictions. Furthermore, E.U. officials should condemn practices which artificially thwart the unification and growth of the European market. A future form of the Regulation should therefore provide that:

Agreements described in Article 1 are not covered by the present Regulation, as long as they are unwillingly adopted by the supplier following pressures from the exclusive distributor. Evidence supporting a causal nexus between the pressures and the adoption of the arrangements is necessary to establish that the supplier has acted but for the pressures.

5.3. An Illustration of the Proposed Solutions: European Exclusive and Restricted Distribution Under U.S. Standards

Perhaps nothing better demonstrates the function and application of a model conceived and developed in the abstract than its application to a specific set of facts. The decisions of the Commission and the Court of Justice on restricted distribution plans may provide the necessary background for this purpose. Assuming that a U.S. judge must resolve a dispute involved in one of the European decisions, how would s/he draft an opinion? It is possible to predict with relative certainty which arguments would be proffered and which evaluative methodology would be followed because both E.U. and U.S. precedents have occasionally governed analogous territorial restrictions or other indirect devices used to make them effective, including: curtailment of the territorial

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157 See supra notes 128-30 and accompanying text.
158 Both European and U.S. cases frequently cover the so-called "indirect export bans," which, although they do not explicitly limit cross-sales among Member States, may make them unprofitable or even unworkable in
scope of a manufacturer's distributors;\textsuperscript{159} a manufacturer's refusal to do business with distributors or subsequent resellers not abiding to the challenged territorial restrictions;\textsuperscript{160} a second manufacturer's refusal to supply out-of-territory resellers wishing to import the contract goods in their own areas;\textsuperscript{161} or the obligation of importers to obtain such supplies from their "assigned" distributors in those areas.\textsuperscript{162}

\textsuperscript{158} See Miller, 2 C.M.L.R. at 336; cf. Newitt/Dunlop, 1992 O.J. (L 131) at 33; Three Movies of Tarzana, 828 F.2d at 1398 (holding that theaters in one area can be prevented from showing same movies at the same time); Dart, 704 F.2d at 499 (allowing manufacturers to refuse to ship goods to distributors for resale outside their territories).

\textsuperscript{159} See, e.g., Tipp-Ex, 1987 O.J. (L 222) at 5; Cf. Graphic Prods., 717 F.2d at 1578 (discussing whether corporation's distributor system was unreasonably anticompetitive and a restraint on trade); Mendelovitz, 693 F.2d at 577 (noting that distributor's refusal to sell Coors beer to a wholesaler had no anticompetitive effect); Muenster Butane, 651 F.2d at 298 (holding that the restrictions a distributorship imposed on its dealer had no anticompetitive effect).

\textsuperscript{160} See, e.g., Sperry New Holland, 1985 O.J. (L 376) at 22; Johnson & Johnson, 1980 O.J. (L 377) at 21-25; cf. Ron Tonkin, 637 F.2d at 1388 (noting distributor's decision not to appoint an additional dealer was not plainly anticompetitive); Quality Mercury, 542 F.2d at 471 (holding that a franchisee with perpetual veto power over all applications for new franchises in the area stated a cause of action under the Sherman Act).

\textsuperscript{161} See, e.g., Moët et Chandon Ltd., 1982 O.J. (L 94) at 7-9; cf. Assam, 798 F.2d at 318-19 (holding exclusive territories did not violate state antitrust law after brewery established that it lacked market power); Davis-Watkins, 686 F.2d at 1202-03 (noting there was insufficient evidence that a conspiracy or concerted action existed among microwave oven manufacturers' distributors or dealers to violate the Sherman Act).
5.3.1. The Miller Case Analyzed With U.S. Insights

The Miller court ruled against the defendant manufacturer of German records who had imposed export bans on its distributors in the Netherlands, Alsace-Lorraine and Germany, but a U.S. judge would have held that those contested practices were reasonable. Even assuming that intrabrand competition from Germany to the French province of Alsace-Lorraine would have flourished in the absence of the export prohibitions, the relevant clauses of the exclusive agreement would have been evaluated with regard to the competitive situation of the relevant market as a whole. Such non-price intrabrand restrictions alone would never have been considered per se illegal in a U.S. court. Moreover, although the product market would include only records of light music, which are not interchangeable with records purchased by different categories of consumers, the relevant geographic market would not coincide with Germany’s territory. Instead, the market would, at a minimum, comprise the area where Miller distributors were protected and, hence, where the effects of the export bans were to be appraised. The fact that Alsace-Lorraine, with its German-speaking population, is in a French territory would imply that local consumers rarely turn to German producers or resellers and that it is a separate geographic market.

Second, a U.S. judge would examine Miller’s power in the French province. Because Miller’s market share in Germany, where the light music record market is comparatively flooded by records in German, varied only from 4.91% to 6.07%, it was

163 See Miller, 2 C.M.L.R. at 350-54 (1978). Although no Miller products were to be exported from Alsace-Lorraine to other countries, a theoretical possibility for this development infringed Article 85. Miller distributors in Germany had been active in exporting goods, accounting for 3.25% of the total German exports in a single year. Id. at 343.

164 Cf. Rutman Wine, 829 F.2d at 735 (noting that the agreement between a manufacturer and a distributor to establish an exclusive distributorship is not a per se violation of antitrust laws); Westman, 796 F.2d at 1229 (noting that “the evil to be avoided is the reduction of interbrand competition ... not the reduction of intrabrand competition”).

165 See Miller, [1978] 2 C.M.L.R. at 343. Cf. Ryko, 823 F.2d at 1231-32 (noting the importance of the prospective entry of new firms in the definition of the relevant market). See also Sylvania, 433 U.S. at 59.

166 See, e.g., Assam, 798 F.2d at 318.
probably even smaller in Alsace-Lorraine, where a large number of French records were also sold. A U.S. court would consider such a market share negligible and therefore hold that Miller's export bans were reasonable restrictions not in violation of Article 85(1).\footnote{Cf. JBL, 698 F.2d at 1017 (holding that minimal manufacturer shares have little adverse effect on intraband competition); Sandura, 339 F.2d at 852 (holding that closed distribution territories are reasonable when a manufacturer's market share is 1%). See also Rutman Wine, 829 F.2d at 735 (noting that exclusive distribution arrangements are not per se violations of antitrust laws); Westman, 796 F.2d at 1225-26 (same); A.H. Cox, 658 F.2d at 1306 (same).} In light of this method of analysis, there would be no further need to examine whether export bans were "indispensable" to attain some legitimate business purpose. Furthermore, assuming the truth of the Chicago School economic theories, a record producer of a size similar to Miller would only impose export bans on his German wholesalers to protect his exclusive distributors in other territories for good reason. This would also undoubtedly hold true for distributors in Alsace-Lorraine. Additionally, distribution costs might be higher in France than in Germany. Therefore, German resellers not incurring these large costs could find it profitable to export to Alsace-Lorraine, thereby free-riding on the investments of the local exclusive distributor.\footnote{Other European cases would have an outcome analogous to the one suggested for Miller. This would probably hold true for Polistil/Arbois, 2 C.M.L.R. at 599, in which the relevant market was highly fragmented, and the position of the involved manufacturer was weak. On the contrary, no conclusions may be drawn for decisions whose reasoning includes no substantial market data. See, e.g., Sperry New Holland, 1985 O.J. (L 376). Finally, the market situation in some other cases may support the unreasonableness of the challenged export bans. See Viho, 1992 O.J. (L 233) at 28 (data redacted to preserve confidentiality); Newitt, 1992 O.J. (L 131) at 33 (noting the relevant market was oligopolistic, with the top five manufacturers accounting for almost 90% of all tennis ball sales in the Community); Tipp-Ex, 1987 O.J. (L 222) at 2 (data redacted to preserve confidential information).} Consumers in Alsace-Lorraine would also not be deprived of the "fair share" of benefits attributed to Miller's exclusive distribution efforts. Despite the fact that prices for its products were somehow higher there than in Germany,
these consumers were actually receiving their "fair share" in the form of non-price efficiencies.

Finally, a U.S. judge scrutinizing the Miller case would also examine whether the circumstances under which the export bans were adopted by Miller would support any inferences of horizontal action among its distributors. Although the current decision states that Article 85(1) is applicable no matter when the export bans are adopted, this ruling would be different under U.S. precedent. Pressures from distributors forcefully demanding that Miller insulate them from intrabrand competition and parallel imports would probably lead a U.S. judge to conclude that the export bans were horizontally imposed and therefore illegal per se. There is, however, no such evidence in Miller. The institution of the bans appears to be purely vertical, forming part of the manufacturer's independent distribution strategy.

Such an analysis of the challenged arrangements under Article 85(1) would benefit Miller, its local distributors, the ultimate consumers in Alsace-Lorraine and the development of interstate trade. Promoting Miller's records in a Member State outside Germany would contribute to the integration of the European market.

5.3.2. A U.S. Evaluation of the GERO-fabriek Decision

The strong similarities between the prohibition on horizontal supplies challenged in the GERO-fabriek decision and the export bans involved in Miller may imply that

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169 Miller, 2 C.M.L.R. at 350-51.
170 See Big Apple, 974 F.2d at 1379; Red Diamond Supply, 637 F.2d at 1004; American Motor Inns, 521 F.2d at 1242. The vertical/horizontal standard might have been applied in Newitt, 1992 O.J. (L 131) at 37-38, where all direct and indirect measures aimed at the prevention of parallel imports were taken at the behest of a powerful distributor of the involved sport goods manufacturer, who was afraid that the former would cease carrying his products if not protected against intrabrand competition. Taking into account that the relevant market was also concentrated, and interbrand competition rather weak, one may assume that implementing the anticompetitive purposes of the pressuring distributor could be successful.
171 Both practices amount to cross-trade restrictions, although the usual export bans restrict supplies from traders operating at a given level of distribution to resellers at the immediately subsequent level or to ultimate consumers, while horizontal bans restrict supplies between traders at the same level of distribution. See GERO-fabriek, 1977 O.J. (L 16) at 8-12.
GERO-fabriek and Miller would have similar outcomes in a U.S. court. Given that the mere existence of restrictions on intrabrand competition from one Member State to another would not be determinative, the analysis would focus on the effect of the horizontal supplier bans on the competitive conditions of the relevant market as a whole. Following an appropriate definition of the relevant market, which would include the sale of cutlery in Belgium, a U.S. assessment of the case would refer to the economic context surrounding the scrutinized practices. GERO-fabriek, the manufacturer which prohibited horizontal sales among its dealers, enjoyed only a 15% share of the local Belgian market, where interbrand competition among the various producers of cutlery was flourishing. As a result, the imposition of those restrictions would not be considered to threaten competition or consumer welfare, and it would not be caught by Article 85(1). Such a manufacturer would only include "indispensable" clauses in its dealership agreements. Such clauses would prevent dealers from countries such as the Netherlands, where distribution costs and other monetary burdens resulting from different national conditions (e.g., inflation rates, tax provisions, and equivalence of national currency) are lower than in other Member States and where substantially higher-investment rates are necessary, from horizontally reselling in those high-priced markets. It could thus take a free ride from the efforts and expenses of local dealers. Absent evidence that dealer pressures or threats forced GERO-fabriek to adopt the ban on horizontal supplies, no per se claims against the ban would be sustained. A U.S. court could therefore consider the bans purely vertical and, therefore, reasonable restraints of trade by focusing on the enhanced performance of Belgian distributors and of GERO-fabriek in the local Belgian market. The resulting expansion of the Belgian market would also benefit the development of a unified European market in which

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172 See supra notes 147-48 and accompanying text.
173 Cf. Assam, 798 F.2d at 318 (holding that the vertical territorial practices of a manufacturer with a share of 19.1% were reasonable).
174 See supra note 152. The analysis would be similar in Deutsche Philips, C.M.L.R. at D243, involving not only bans on horizontal supplies, but also prohibitions on direct sales from wholesalers to consumers in other member states. This could have prevented recoupment of the investments made by local retailers.
numerous producers operate and compete in all the Member States.

5.3.3. A U.S. Evaluation of the Grundig-Consten Decision

To suggest that Grundig-Consten, perhaps the most significant European antitrust case ever, should have been decided differently is a delicate matter. The following alternative assessment of the Grundig agreement, however, is well-founded. A U.S. court would have analyzed this agreement under the rule of reason customarily applied to vertical restrictions after Sylvania. Instead of holding that such an agreement restricts intrabrand competition and automatically violates Article 85(1), even if it promotes interbrand competition (and without regard to the intensity of intrabrand competition in the relevant market), the court would first have defined this market, computed Grundig's market share, and then taken into consideration other economic realities. This redefined product market might include recorders, dictaphones, and television sets, commodities normally not regarded as interchangeable by consumers. Furthermore, the market would be geographically tailored to coincide with the territory of France, i.e., the area shielded against intrabrand competition from Grundig's foreign resellers. Although there is no reference in the decisions of the Commission or the Court concerning Grundig's turnover or total sales in comparison with its interbrand competitors, the parties' arguments (when the Commission's decision was appealed) imply that interbrand competition was vigorous enough to counterbalance the presumed negative impact of eliminating parallel imports from Germany to France.

In addition, the conclusion that Grundig lacked power in France when it instituted its export bans would make obsolete any further consideration of the availability of less restrictive

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175 This approach was explicitly rejected in the Court's decision in Consten, 1966 E.C.R. at 327, since the balancing considerations usually made under a rule of reason were believed to be within the exclusive power of the Commission when applying the third paragraph of Article 85.

176 See id. at 342. See also Grundig-Consten, 1964 J.O. at 2546 (noting the importance of intrabrand competition and the need to preserve it).

alternatives serving the same purposes. Facing competition from other producers of recorders, dictaphones, and television sets, Grundig would adopt only the most appropriate, indispensable means to achieve its business goals. Grundig could have integrated vertically, setting up a French subsidiary, as it did in Germany. Vertical integration was not, however, suitable for a country like France, whose consumers were highly distrustful of Germans and wished to see Grundig acquire a French persona before buying its products.\textsuperscript{178} On the other hand, Grundig likely decided not to expand internally in France because it lacked the necessary capital and the experience to understand the local French market and to plan accordingly. Once Grundig appointed Consten, an independent distributor, in France, it had to protect the latter’s territory from German intrusions, in light of the difference in overhead distribution costs in France and Germany. The Commission and the Court ignored Grundig’s argument that the difference in pricing was caused by the difference in expenses incurred by Consten and German wholesalers.\textsuperscript{179} In organizing the Grundig network in France, Consten bore more expenses than the average German wholesaler, especially during the start-up phase. Consten had to finance extensive advertising programs,\textsuperscript{180} purchase and store large and carefully selected inventories, and pay the large costs necessary for recruiting an efficient transportation group that would efficiently distribute Grundig products throughout the thinly-populated French territory. Of course, Grundig could have alleviated Consten’s expenses by bearing at least part of the costs itself, but it was financially incapable of doing so, and it probably wished to avoid the continuous and costly monitoring of Consten for the successful performance of

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\textsuperscript{178} See Grundig-Consten, 1964 J.O. at 2550; Consten, 1966 E.C.R. at 329. On the necessity of the institution of export bans versus vertical integration, see Korah, \textit{supra} note 24, at 344-45.
\textsuperscript{179} See Consten, 1966 E.C.R. at 323.
\textsuperscript{180} Advertising in Germany was limited, financed by Grundig itself, and then charged in the form of higher ex-factory prices to German wholesalers. In addition, it did not reach the proportions necessary for the French market. \textit{See} Consten, 1966 E.C.R. at 331. The guarantee and post-sale services were also paid by Grundig in France, and thus no free-rider situations could develop as far as these services were concerned. \textit{Id.} at 336, 349. \textit{See also} Grundig-Consten, 1964 J.O. at 2551.
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all the activities it financed. Finally, the assignment to Consten of the entire French market, excluding the sales of parallel importers, enabled Consten to plan ahead with precision, observe the reactions and preferences of French consumers more closely, and to inform Grundig so that it could adapt its production accordingly. Parallel importers would, to a large extent, disturb such monitoring of the French market and would lead both Consten and Grundig to incorrect conclusions as to French trends.\textsuperscript{181} It is also reasonable to infer that if Grundig's strategy had been protected by the E.U. authorities, French consumers would actually receive their "fair share" from the benefits derived from the export bans. They would be able to buy Grundig products from a well-organized network that provided them with information and services tailored to their needs.\textsuperscript{182}

As for the second practice challenged in the decision, the use of the additional trademark GINT to impede parallel imports and thus to enforce the agreed export bans in an efficient manner, a U.S. court would probably have rejected the European approach and held that parallel imports in France actually infringed the GINT trademark. A U.S. judge would probably have upheld this use of GINT on two grounds: (1) as an indirect means of enforcing territorial restrictions otherwise subject to a rule of reason evaluation and found to be reasonable in this case because of the strong interbrand competition that Grundig faced in the relevant market;\textsuperscript{183} and (2) as an independent measure to preserve brand quality, which must be kept uniform for all products originating from a single producer. Contrary to what the Commission stated,\textsuperscript{184} the use of only one trademark might have been insufficient to guarantee that products would be imported to France and sold to consumers with the same care in handling

\textsuperscript{181} See Grundig-Consten, 1964 J.O. at 2551; Consten, 1966 E.C.R. at 334, 336, 348; see also DeKeyser, supra note 51, at 292-93; Deringer, supra note 51, at 617.

\textsuperscript{182} See Grundig-Consten, 1964 J.O. at 2550; Consten, 1966 E.C.R. at 332; DeKeyser, supra note 51, at 290; Deringer, supra note 51, at 615-16.

\textsuperscript{183} See, e.g., Eastern Scientific, 572 F.2d at 885 (holding that a resale price maintenance scheme designed to make vertical territorial practices enforceable is no more restrictive than the latter and should be examined under the rule of reason).

\textsuperscript{184} See Grundig-Consten, 1964 J.O. at 2547.
and high standards set by Grundig by parallel importers as they would receive from official distributors.\footnote{See, e.g., K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 293-94 (1988) (holding in a slightly different context than Grundig that the importation of foreign-made goods in the United States, where the United States trademark owner had authorized the use of the mark in the foreign country, should be prohibited). Of course, the K Mart case involved goods manufactured abroad, even if with the consent of the trademark owner, which perhaps varied in quality from their U.S. counterparts. See id. at 292-94. It is possible, however, that Grundig was aiming to preserve quality as well.}

This hypothetical holding would not contradict Article 36 of the Treaty of Rome, which condemns uses of industrial property rights that disguise trade restrictions among Member States.\footnote{Treaty of Rome, art. 36.} Such trade might in fact have been prevented through the challenged export bans and related practices, but it would have flourished at the manufacturer level such that Grundig would have the opportunity to expand to France by selecting the most appropriate measures to achieve this purpose.

5.3.4. A U.S. Evaluation of the Hennessy-Henkell Decision

One may also predict with relative certainty that a U.S. court would have held in favor of Hennessy in the Hennessy-Henkell decision involving control of prices that discouraged parallel imports into Germany, where Henkell had exclusively undertaken the distribution of Hennessy's products. Despite the \textit{per se} illegality of resale price maintenance, which is generally accepted by both the United States and the European Union, the Hennessy price-regulating scheme would only have been considered a means of furthering vertical territorial restrictions.\footnote{See Eastern Scientific, 572 F.2d at 885.} Hennessy was an alcoholic beverage producer that accounted for only 16\% of the French cognac market, the site of its principal operations, and presumably for an even smaller percentage of other relevant markets such as Germany, where Henkell had absolute territorial protection.\footnote{See Hennessy-Henkell, 1980 O.J. (L 383) at 11.} The fact that Henkell enjoyed only a small market share and faced competition from German spirits would not allow it to protect Hennessy's territory for
plainly anticompetitive purposes. Clauses 5.4 and 6 of the exclusive agreement with Henkell could only protect Henkell's investments against parallel importers and allow it to reap the fruits of its efforts. At the same time, it is not evident from the facts of the case that Hennessy unwillingly controlled prices at Henkell's request to enable it to extract supracompetitive profits. If the case had been decided according to U.S. standards, the outcome would reflect that the arrangement was advantageous for German consumers and recognize the output-enhancing effects of the contested scheme.

5.3.5. Distillers Reconsidered

Although the Commission's decision in Distillers verified the marked hostility of E.U. officials to direct or indirect practices preventing parallel imports, its repercussions demonstrated that export bans and other indirect devices curtailing parallel trade may actually benefit manufacturers, distributors, consumers and European market integration in the long run. Distillers, a group of companies producing alcoholic spirits and charging higher prices to English wholesalers wishing to export to the continent rather than to resell locally, reacted when the Commission refused to exempt its practices under Article 85(3) by totally withdrawing its products from the continental European countries, thus cutting off much of the European Union from the advantages of interstate trade.

A U.S. court would have viewed the situation from a different perspective. Distillers' products were generally unknown on the continent but were well established in England, where they enjoyed the favor of a substantial number of local consumers. Their minimal share in the relevant

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189 See Korah & Rothnie, supra note 27; Schröter, supra note 28; text accompanying note 134.

190 See also Deutsche Philips, 1973 O.J. (L 293) at 40; Du Pont de Nemours, 1973 O.J. (L 194) at 27. In both cases, the hypothetical outcome under the rule of reason would be analogous to the outcome in Hennessy-Henkell.

191 See Korah, supra note 58, at 68-69.

192 See Chard, supra note 1, at 430. The market shares of Distillers in continental Europe were similar to those of some manufacturers challenged
markets of the Member States on the continent would preclude any inferences of manipulating dual pricing for anticompetitive purposes. Distillers' scheme was nothing but "indispensable." Sole distributors on the continent had to bear high promotion costs while their equivalents in the United Kingdom had no comparable expenses. The continental consumers were loyal to national brands in their countries, and as a result, only intense advertising would make them shift to the Distillers' products, particularly because discriminatory taxes favoring local spirits imposed by some national governments on Scotch whiskey made Distillers' price even higher in those states.\(^{193}\)

The different prices charged by Distillers according to product destination were therefore not set arbitrarily, and they did not amount to price discrimination responding to the difference in elasticities of demand between continental Europe and the United Kingdom. The price differences were simply due to the higher costs of promotion incurred by the sole distributors on the continent. These distributors would have faced serious free-rider problems in their territories but for the adoption of the dual pricing scheme.\(^{194}\) On the other hand, the need for dual pricing may have also been supported by the lack of alternatives open to Distillers to achieve the same goal. Vertical integration would have been far too costly and would have prevented Distillers from taking advantage of the sole distributors' core competencies and their knowledge of the local markets. Likewise, Distillers' assumption of the promotion costs might have resulted in their selling at a loss on the continent. Similarly, the standardization of all prices at a higher level for the entire European Union would have forced consumers in the United Kingdom to shift to lower-

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\(^{193}\) See, e.g., Distillers, 1978 O.J. (L 50) at 23.

\(^{194}\) See id. at 23. See also Van Bael, supra note 1, at 46-47, and Borden Co. v. Fed. Trade Comm'n, 381 F.2d 175 (5th Cir. 1967), on the distinction between mere price differentials and price discrimination. The manufacturer in Borden was selling a premium brand at higher prices than its non-premium brand, but this differential reflected the heavy advertising costs that it incurred for the promotion of the premium brand. Id., 381 F.2d at 180 n.17.
priced brands. Thus, there were no viable alternatives.\textsuperscript{195} Using a U.S. standard to analyze the circumstances would mean taking into consideration that ultimate consumers on the continent would receive a "fair share" of benefit because the contested dual pricing scheme enabled them to have access to a well-advertised good, thus considerably broadening their freedom of selection among competing spirit brands.\textsuperscript{196}

5.3.6. Hasselblad Revisited

If the E.U. officials in Miller, GEROFabrik, Grundig-Consten, Hennessy-Henkell and Distillers were dealing with manufacturers enjoying small market shares who protected their exclusive distributors from free-riders because they had no other effective means to implement the successful distribution of their products, it is far less clear that this was the case in Hasselblad. Camera Care, a price-active dealer who carried Hasselblad’s goods imported from Member States, where they were sold at lower prices, was excluded through the use of a selective distribution system. At first glance, this act might be interpreted as a device designed to enforce a vertical territorial scheme. Hasselblad could have sought to protect its full-price sole distributors and dealers from competition, as only they would be willing to provide an adequate level of service for its complex product, professional single lens reflex cameras. This control of the price mechanism has often been used to prevent intrabrand competition from country to country.\textsuperscript{197} Alternatively, this policy may also be characterized as wholly unilateral, originating from the manufacturer itself, which, after being notified that parallel imports are occurring, recommends that its national sole distributors take the necessary measures to monitor sales by Hasselblad dealers operating in their

\textsuperscript{195} On the existence of less restrictive alternatives than dual pricing, see Distillers, 1978 O.J. (L 50) at 28-29, and Van Bael, supra note 1, at 49.

\textsuperscript{196} But see Sharpe, supra note 58, at 458 (focusing on the need to preserve price competition between European distributors and parallel importers).

\textsuperscript{197} See Eastern Scientific, 572 F.2d at 884-85. The territorial restrictions may have been necessary because national currency fluctuations made cross-sales profitable to parallel importers. See Hasselblad, 1982 O.J. (L 161) at 20, on appeal, 1984 E.C.R. at 887.
respective territories.

A U.S. court, however, would have ruled differently. Defining the product market to include only the type of professional cameras sold by Hasselblad, as the European Court did, and limiting the geographic market to the United Kingdom, a U.S. court would have found that the sales of Hasselblad cameras accounted for an overwhelming percentage of the local market. Such market power may give a manufacturer the opportunity not only to use territorial restrictions to insulate markets and discriminate in prices but also to further several anticompetitive purposes. In the Hasselblad context, a U.S. judge could also apply the multiple horizontal conspiracy standards. Several sole distributors whose territories had been "invaded" by parallel importers communicated among themselves and complained to their common supplier, which instituted a new policy in response. Dealers buying at low prices from parallel importers would be cut off from the distribution network, and distributors could exchange price lists to fix their prices and avoid intrabrand competition. By themselves, complaints by distributors would be considered immaterial by a U.S. court, as those complaints are often useful only in conveying information to a manufacturer concerned about the organization of its distribution network. Combined with the communication among distributors and the exchange of price lists, however, they would be considered suspicious. If distributors can adjust their prices at any time to combat parallel imports, their original high prices are due not to increased promotion costs or other monetary burdens but

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188 Hasselblad estimated its share in England at 25%, based on a far broader product market definition. The delineation of a narrower product market, distinguishing between Hasselblad medium format reflex cameras and other professional cameras on the basis of format, quality of reproduction, handling and range of accessories, would have led a court to conclude that Hasselblad enjoyed a much larger market share than estimated. In analogous cases, vertical territorial arrangements blocking cross-sales have been held unreasonable by U.S. courts. See, e.g., Graphic, 717 F.2d at 1569-70.

189 See supra note 100 and accompanying text.


191 See Hasselblad, 1982 O.J. (L 161) at 20.

192 Id. at 23, 33.

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rather to supracompetitive profits. An exchange of lists may also lead to increased fixed distributor prices in the long run.

5.3.7. The Limitation of Guarantees in ETA Under the U.S. Lens

Finally, in ETA\textsuperscript{203} the absolute territorial protection of the national sole distributors of a brand of inexpensive watches was achieved through the supplier's denial of watches to honor the guarantee rights of consumers who had purchased such watches from parallel importers. This practice would be assessed by a U.S. court under the rule of reason, which is applicable to all vertical territorial schemes. After appropriately defining the relevant market, ETA's market share, and other market conditions, a U.S. court would have ruled based on the reasonableness of the restrictions. Absent market power or other adverse market conditions, claims against the contested practice would be dismissed. A limitation of guarantees may therefore only further the competitiveness-enhancing purposes of a manufacturer. If watches were not sold under guarantee to parallel importers and were not given guarantee service, it was probably because ETA could not monitor whether the watches had reached the ultimate consumers in perfect condition without observing their maximum storage period.\textsuperscript{204}

6. CONCLUSION

The proposal made in this Article, although inspired by U.S. antitrust theory and practice, which focuses on the need to consider legitimate all efficiency-enhancing vertical territorial schemes that do not result in consumer welfare impairments, is also in conformity with the basic goals and characteristics of E.U. competition law. First, it is designed to foster, not prevent, the unification of the European market. At the same time, the evaluation of intense vertical territorial intrabrand restrictions according to a market structure analysis guarantees that the latter will not serve predatory


\textsuperscript{204} See id., 2 C.M.L.R. at 677.
behavior, price-discrimination or other manufacturer practices, which artificially preserve trade barriers among national territories. The *per se* condemnation of distributor cartels and other similarly manipulative activities disguised as innocent vertical schemes also ensures that the European market will not remain segregated due to colluding distributors. Second, the traditional central enforcement role of the Commission would not be disturbed by assigning new duties to national courts, which will follow the application of the proposed model. By retaining the discretion to consult with courts during the first steps of the implementation of the proposal, the Commission could then dedicate its resources to the scrutiny of truly dangerous schemes of absolute territorial protection and other collusive activities. Third, the proposal respects the current bifurcated structure of Article 85. Although it introduces a rather narrow scope for its first paragraph, which would require use of a rule of reason and market power considerations, it suggests reforms only to the extent necessary to avoid inefficient results. Fourth, using a market structure filter approach, the proposal recognizes the economic realities prevalent in the European market. Since the market is already characterized by concentration, entry and exit barriers, and limited mobility, only vertical territorial restrictions that raise minimal or absolutely no anticompetitive concerns would be protected.

On the other hand, as is apparent from the application of the proposed approaches in specific situations already faced by the E.U. antitrust authorities, the intervention of the Commission under the third paragraph of Article 85 would rarely be required. In most cases, national courts could apply the U.S. rule of reason, disposing of antitrust claims against vertical territorial restraints under 85(1). It seems, however, that it will take some time before such practices earn the sympathy of E.U. officials. In spite of a limited number of European decisions, mainly originating from the Court of Justice, and considering them exemptible under 85(3), an

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205 See, e.g., Pronuptia, 1986 E.C.R. at 353. In Pronuptia, absolute territorial protection was held exemptible only under Article 85(3) and only during the start-up phase of a trader's operation. On the other hand, the Court of First Instance has taken a negative stance against any impediment of parallel imports, thus perpetuating the already demonstrated hostility of
avalanche of precedents point to the opposite result. Until the voices of commentators are heard and a sufficient degree of economic realism is displayed in the reasoning of European decisions, only amendment of the existing regulation on exclusive distribution can remedy the weaknesses of the current case law.