

CAN ANTITRUST LAW CONTROL E-COMMERCE?
A COMPARATIVE ANALYSIS IN LIGHT OF U.S. AND E.U.
ANTITRUST LAW

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Abstract

*Online Sales Threaten Car Dealer Profitability. With this headline, the E-Commerce Times wrote on January 17, 2000 about the effects of e-commerce on the traditional ways of distribution. The article referred to Amazon.com's leaping into the car business by taking a five percent stake in Greenlight.com.*¹

E-commerce has revolutionized marketing and distribution. Marketing and distribution can now be more direct. Many Internet companies, such as Amazon.com, Inc. and eBay Inc., are fully based on Internet-backed marketing concepts. Traditional companies, such as banks, insurance companies and even automobile manufacturers, such as BMW Group, offer both lines of distribution: the classical channels with intermediaries and e-commerce.² Manufacturers and service providers are attracted to the cost savings associated with e-commerce but they still need intermediaries like independent dealers and distributors. As reselling becomes more centralized by e-commerce, the roles of the dealers might then change from mere resellers to service providers and advisors. Both services and advising are, by their nature, functions the Internet cannot absorb.

In many cases, the classical distribution networks will have to coexist with the direct e-tailing networks. This creates a tension between

¹ Ecommerce Times, <http://www.ecommercetimes.com/story/2321.html>.

² Automotive Intelligence News, <http://www.autointell-news.com/news-2000/May-2000/May-09-00-p9.htm>.

these two competing networks, which is also mirrored by the fact that dealers and distributors may also start selling on the Internet. Therefore, while the manufacturers and dealer/distributors were once in a non-competitive, symbiotic, vertical relationship, the advent and rise of e-commerce may lead those participants to be in direct competition with each other.

As manufacturers begin to compete with their distributors for retail sales, both groups will have to prepare for the future by aligning their distribution agreements accordingly. Can manufacturers reserve for themselves all e-tailing outlets and exclude their distributors from competition in that medium, or must they provide for some coexistence?

In addition to other potential legal constraints, direct sales by manufacturers to consumers via e-commerce will raise antitrust issues, since the reservation of certain markets (e-commerce) between competitors may be deemed a horizontal allocation of markets. Or is the relationship between manufacturers and distributors still a mere vertical one in light of e-commerce? How far might antitrust control extend for e-commerce?

The Internet's lack of geographical territorial boundaries facilitates international e-commerce transactions. This can lead to global legal problems, but due to the absence of any international antitrust regimes, these problems have to be managed by national antitrust regimes. This article will look at the antitrust regulatory regimes of the United States (U.S.) and the European Union (E.U.), whose economies compose a substantial percentage of GDP worldwide.

This article, by analyzing recent statements of the FTC in the U.S. and U.S. antitrust jurisprudence, will conclude that the issue presented here has not been addressed directly. Additionally, Congress has not passed any specific legislation so far on this subject.

On the other side of the Atlantic Ocean, the E.U. has addressed the antitrust aspects of e-commerce in the Block Exemption Regulation on Vertical Restraints 2790/1999 and its commentaries thereon. However, the E.U. also lacks landmark decisions, and both the legislature and European courts have not gone global so far.

So, for the immediate future, the problem is left to scholars and practitioners who have to apply rudimentary statutes and old court rulings. At present it appears that manufacturers/service providers cannot completely exclude their distributors by reserving e-commerce exclusively for their own direct sales efforts. Such an attempt may be deemed a horizontal cartel which will be explained further below. However, limited e-commerce restriction clauses seem to pass muster in what would be mere vertical relationships between manufacturers and their distributors. At the end of the day, both sides have to be prepared

for a fruitful but sometimes contentious coexistence. However, since practitioners rely on guidance from both the legislation and the courts in the U.S. as well as in the E.U., new rulemaking is required. At the end of the day, antitrust laws play an important role in the relationship between manufacturers and distributors, but given the limited guidance available, antitrust laws will hardly control this phenomenon.

I. INTRODUCTION

The reservation of e-commerce by manufacturers may lead to direct rivalry between manufacturers and distributors and may run afoul of distributors' exclusivity. Manufacturers might reserve distribution opportunities on the Internet by e-commerce reservation clauses vis-à-vis their exclusive distributors. However, the question remains as to whether these e-commerce reservation clauses are illegal under U.S. or E.U. antitrust laws. Manufacturers have traditionally sold their wares primarily through complex distribution networks, selling to intermediaries who in turn resell the goods to consumers.³ The medium of the Internet enables manufacturers to more readily sell their wares directly to consumers. If they seek to do this, however, many manufacturers will need to revise the contractual relationships they previously established with their distributors. Hence, in distribution networks in which distributors are granted exclusive sales territories and quite often market a single brand (for example, agricultural machinery dealers in Oregon selling a single brand of machinery in a single appointed territory), the contracting manufacturers might, expressly or impliedly, not be permitted to also sell directly to consumers via e-commerce. When a dealer is contractually granted an exclusive sales territory, the dealer most often assumes exclusive control over all channels of retail distribution in that territory. With this arrangement, the manufacturer is prohibited from competing for retail sales unless the parties' distribution agreement states otherwise. This general exclusivity very often extends to e-commerce sales, even if the distribution contract is silent on the issue. In order to override this default rule, manufacturers who seek to e-tail directly should draft specific e-commerce reservation clauses in their distribution agreements. These clauses vary in their content. The following are three types of e-commerce reservation clauses:

Full Reservation Clause: the manufacturer reserves the exclusive right to sell to consumers via the Internet in all sales territories – a

³ Michael K. Lindsey, *Electronic Sale and Distribution of Goods: Competitive Aspects*, INT'L BUS. LAW., June 1999, at 253.

complete prohibition against the distributors engaging in e-commerce sales. Example: Car manufacturer X reserves for itself the right to pursue any and all e-commerce distribution in the E.U., and accordingly, prohibits its exclusive distributor Y from selling X's cars via the Internet in the E.U.

Limited Reservation Clause: the manufacturer reserves for itself Internet sales of particular accounts or certain products only, while the distributors are allowed to pursue all other Internet sales. Example: Car manufacturer X reserves the right to sell its used cars to consumers via the Internet, whereas exclusive distributor Y is permitted use the Internet to distribute new cars only.

Co-existence Clause: both the manufacturer and the distributor retain the right to sell all products over the Internet within the boundaries of the appointed sales territories. Example: Both car manufacturer X and exclusive distributor Y are entitled to use the Internet as a means of distribution.

Leaving aside the contract law issues, there will be potential antitrust issues when any of the e-commerce reservation clauses described above is enacted, since each of these clauses permits competition between the manufacturer and its existing distributors for retail sales (dual distribution).⁴ This may lead, however, to foreclosing effects on the distribution system as a whole.

Accordingly, the traditional method of selling via independent distributors will have to coexist with the manufacturers' direct distribution channels. This might trigger some well-known antitrust problems such as the hybrid relationships of horizontal and vertical restraints once the manufacturer appears as both a competitor on the wholesale and the retail level (horizontal) or as a mere principal in a distribution contract (vertical).⁵ As an example, the U.S. car manufacturer X might sell via own sales outlets in Washington D.C. where it has appointed independent distributors at the same time. The relationship between manufacturer X and its distributors in Washington D.C. is vertical when it comes to the mere distribution agreement, but the relationship is horizontal as far as X's own outlets compete with the distributors in Washington D.C. The same could apply once X distributes directly on the Internet and via its

⁴ In some U.S. states, laws protect distributors of specific products like cars by allowing them to resell more than one make. Those laws will not be discussed in this article.

⁵ See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled by* *Cont'l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977); *White Motor Co. v. United States*, 372 U.S. 253 (1963); *Graphic Prods. Distribs. v. Itel Corp.*, 717 F.2d 1560 (11th Cir. 1983); *Pitchford v. Pepi, Inc.*, 531 F.2d 92 (3rd Cir. 1975); discussion *infra*.

independent distributors.

Hence, in such cases, manufacturers might encounter horizontal antitrust problems where they have previously faced only vertical antitrust issues. This problem might be intensified, once dual distribution via e-commerce has been established. This is due to the fact that e-commerce leads to cost efficiencies and increased price transparency. For example, e-commerce may lead to fierce price competition between the manufacturer/e-commerce distributor and the regular distributors. As a consequence, lower margins of the regular distributors might be achieved, thereby triggering the problem of resale price maintenance,⁶ and foreclosing effects on the whole distribution system. In that regard, e-commerce might be a catalyst for already existing antitrust problems and might further require a realignment of antitrust rules. The areas outlined above (e-commerce and dual distribution in general) will be the subject of this analysis. All areas that are dealt with herein have in common that e-commerce sheds light into the ambiguous areas between horizontal and vertical aspects in dual distribution and the foreclosing effects on vertically integrated distribution systems. The different e-commerce reservation clauses above will be viewed in that light.

Furthermore, since both the Internet and e-commerce by their very nature do not know any geographical boundaries, one should look at how the second largest antitrust regime in the world, the European Union Competition Law, deals with the issues illustrated above. The following is, therefore, a comparative analysis.

The following Part II outlines briefly the legal background in both the U.S. and E.U., whereas an in-depth analysis will be carried out in Part III. Part III will take a closer look at how different e-commerce clauses are viewed in light of statutory and case law. A conclusion in Part IV will complete the analysis.

II. LEGAL BACKGROUND

To better understand the issues presented herein, the following is a brief description of how the U.S. and E.U. antitrust law regimes function and what rationales drive these regimes.

⁶ See Navid Soleymani, *Legislature Takes Aim at California's Higher Gas Prices*, 74 S. CAL. L. REV. 1395 (2001).

A. The U.S. Antitrust System

1. Statutes and Case Law

The applicable statutes to the question presented here are the Sherman Antitrust Act of 1890⁷ and the Clayton Act of 1914.⁸ The Sherman Act §1, a key provision in the U.S. antitrust law regime, states in relevant part: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal...”⁹ The Clayton Act §3 declares tying and exclusive dealing contracts in certain circumstances illegal.¹⁰

These provisions only apply to illegal collective actions, activities engaged in by two or more parties.¹¹ Due to the statutory language of these provisions and the judicial opinions that have interpreted them since their adoption, the Sherman Act §1 and the Clayton Act §3 overlap each other to a certain extent. For instance, with regard to several of the issues presented by this article (e.g. horizontal cartels and resale price maintenance), there is overlap. While both statutes declare the conduct they describe illegal, only the Sherman Act criminalizes certain behavior.¹²

U.S. antitrust law is largely influenced by federal case law. Two U.S. Supreme Court decisions reveal the development of U.S. antitrust law as it pertains to dual distribution. Dual distribution is a situation where a manufacturer engages in retail sales in direct competition with its independent resellers.

In *United States v. Arnold, Schwinn & Company*, 388 U.S. 365 (1967) (hereinafter, “*Schwinn*”), the Supreme Court held territory restrictions were illegal “per se” based on a formalistic approach of determining whether title of the merchandise had passed from the manufacturer to the distributor.¹³ This was crucial as to determine whether the dealer sold on behalf of Schwinn or in its own name and for its own account. In the former case this would have been a mere intra-company relationship (“manufacturer-agent”) whereas in the

⁷ Sherman Antitrust Act, 15 U.S.C. § 1 (2000).

⁸ Clayton Act, 15 U.S.C. §§ 2-3 (2000).

⁹ Sherman Antitrust Act, 15 U.S.C. § 1 (2000).

¹⁰ Clayton Act, 15 U.S.C. §§ 2-3 (2000).

¹¹ ERNEST GELLHORN & WILLIAM E. KOVACIC, *ANTITRUST LAW AND ECONOMICS IN A NUTSHELL* 23 (4th ed. 1994).

¹² *Id.* at 29.

¹³ *See Arnold, Schwinn & Co.*, 388 U.S. 365.

latter case, a pure third party relationship “manufacturer-dealer” existed. Only the latter is subject to the full scope of antitrust scrutiny.

The Supreme Court overruled itself a decade later in *Continental T.V. v. GTE Sylvania, Inc.* (hereinafter “*Sylvania*”).¹⁴ In *Sylvania*, the Court criticized the formalistic approach the majority had adopted in *Schwinn*. The *Sylvania* Court discarded the *Schwinn* bright line approach in favor of a case-by-case factual determination method. As a result, vertical territory allocation schemes were no longer “per se” illegal, but rather judged under the “rule of reason” – an approach the Court had adopted for several other agreement types. The only type of vertical restraint that remains per se illegal today is minimum vertical price fixing, or Resale Price Maintenance, (hereinafter “RPM”), where the manufacturer sets the minimum retail price that a distributor may charge. The *Sylvania* decision has had a substantial effect on the level of scrutiny courts apply when reviewing vertical agreements. This has led one scholar to call it the “modern Everest” of U.S. antitrust jurisprudence.¹⁵

2. The Rationale of Antitrust Law

The conflict outlined above is representative of the public policy debate concerning the objectives of U.S. antitrust law. There has been a long lasting battle between scholars preferring the so-called Efficiency Model fostered by the “Chicago School” and the Interventionist Model represented by scholars from the Harvard Business School.¹⁶ According to the Efficiency Model, antitrust law’s sole objective is to foster efficiency. Thus, according to Chicago School scholars, if vertical restraints may lead to pro-competitive efficiencies, they should be permitted. This is the case for many intra-brand restraints, such as the establishment of exclusive territories, customer allocation, etcetera.¹⁷ The Efficiency Theory was dominant during the Reagan Administration, and, as a rule, is favored by Republican Governments.¹⁸

In contrast, Harvard School Interventionists want antitrust law to promote goals such as guaranteeing free access to markets, providing

¹⁴ *Cont’l T.V., Inc.*, 433 U.S. at 36.

¹⁵ GELLHORN & KOVACIC, *supra* note 11, at IV.

¹⁶ THOMAS A. PIRAINO JR., *Sharp Dealing: The Horizontal/Vertical Dichotomy in Distributor Termination Cases*, 38 EMORY L.J.311, 315 (1989), *see* GELLHORN & KOVACIC, *supra* note 11, at 31.

¹⁷ *See Cont’l T.V.*, 433 U.S. 36; PIRAINO, *supra* note 16, at 312.

¹⁸ PIRAINO, *supra* note 16, at 312; *see also* PETER HAY, LAW OF THE UNITED STATES 249 (1st ed.2002).

customers with the widest choice of suppliers and the preventing abuse of economic power.¹⁹ The Interventionists also favor the stern “per se” approach over the flexible “rule of reason” approach, whereas the Efficiency Model operates, in general, the opposite way.²⁰

E-commerce reservation clauses in dual distribution cover both horizontal and vertical aspects. Therefore, problems centering around the designation as horizontal or vertical are also associated with the dispute about whether to apply the “per se” or “rule of reason” test, Interventionist v. Efficiency and horizontal v. vertical.

B. *The E.U. Antitrust System*

1. The EC Treaty and the Statutes.

As of the appointment of 10 new member states on May 1, 2004, the E.U. consists of 25 countries and covers an integrated economic area of over 450 million inhabitants. The E.U. has substantially reformed its body of antitrust law over the past few years, and some of those revisions coincided with the E.U.’s accession of its newest member states on May 1, 2004. These revisions include the Council Regulation 1/2003, including the procedural part of E.U. Competition Law.²¹ Even considering the numerous reforms undertaken, E.U. Competition Law is still dominated by art. 81, 82 of the EC Treaty. This treaty represents the core part of E.U. Competition Law. When it comes to collective action and the classical horizontal and vertical cartels, art. 81 of the EC Treaty is of primary importance and could be considered the transatlantic brother of section 1 of the Sherman Act.

Art. 81 EC Treaty, *inter alia*, states the following:²²

“(1) The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations and concerted practices which may affect trade between Member States and which have as their object the prevention, restriction or distortion of competition with the internal market, and in particular those which:

¹⁹ HAY, *supra* note 18, at 249; PIRAINO, *supra* note 16, at 312.

²⁰ PIRAINO, *supra* note 16, at 312.

²¹ See Council Regulation 1/2003, art. 45, O.J. (L 001) 1 [hereinafter EC 1/2003].

²² Treaty Establishing the European Community, Nov. 10, 1997, 1997 O. J. (C 340) 3 [hereinafter EC Treaty].

directly or indirectly fix purchase or selling prices or any other trading conditions;

(b)....

share markets or sources of supply;

(d)...and (e)...

(2) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

(3) Paragraph 1 may, however, be declared inapplicable in the case of:

any agreement or category or agreements between undertakings;

any decision or category of decisions by associations of undertakings;

any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to improving technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a)...

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.”

Art. 81 EC Treaty §1 sets out a scope of the prohibition similar to section 1 of the Sherman Act, which makes collective horizontal and vertical restraints illegal. Section 2 prescribes the nullity of any such collective conduct. In comparison to the Sherman Act §1, Art. 81 of the EC Treaty § 3 uses a different approach, as it allows the exemption from the prohibition in art. 81 § 1 in certain circumstances. Thus, the E.U. operates with a general rule v. exemption scheme rather than the per se/rule of reason approach of the U.S.

In the first few years following the E.U.'s inception, exemptions under art. 81 § 3 were determined on a case-by-case basis and based on

administrative decisions of the EC Commission (now known as the European Commission). Over the years, the EC Commission formed categories of contracts and concerted practices that enjoyed exemption. These contracts and practices were the so-called Block Exemption Regulations (hereinafter "BER").

The several BERs deal with different subjects like research & development, technology transfer, and the insurance industry. However, the most important one with regard to e-commerce and dual distribution is the "Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices" (hereinafter "EC 2790/1999), nicknamed "Umbrella Regulation." This is the most important BER because it covers all types of vertical restraints regardless of the industry at issue.²³

The BERs are not the only concrete application of art. 81, or more precisely, art. 81 § 3 EC Treaty. The aforementioned Council Regulation (EC) No 1/2003 of Dec 16th, 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (hereinafter "EC 1/2003") also sets out the general rules of EC antitrust law. It provides, inter alia, the complete abstention of the European Commission from the principle of individual filings under art. 81 § 3 EC Treaty and the full responsibilities of the companies abiding by art. 81 and the BER, (e.g. in a system of self-assessment rather than notification).²⁴

Another particularity of the E.U. legal system is the increasing tendency of the European Commission to issue commentary on its own legislation. This commentary provides guidance on its interpretation of the law, but is not itself binding. It is worthwhile to mention the "Guidelines on Vertical Restraints" of the European Commission (hereinafter "Vertical Guidelines").²⁵ In the Vertical Guidelines, the European Commission covers antitrust aspects of e-commerce and the Internet which will be dealt with in detail *infra*.²⁶

In addition to the Treaty, the statutes (called Regulations according to the E.U. terminology) and the Guidelines, the case law has formed European antitrust law. Such law has been issued by the EC/European Commission as part of the administrative body of the E.U., as well as by the European Court of First Instance and the European High Court of Justice as the judicial branch of the E.U.

²³ Commission Regulation 2790/1999, 1999 O.J. (L 336), 21-25.

²⁴ See Council Regulation 1/2003, art. 1, § 1, 2003 O.J. (L 1/7).

²⁵ Commission Notice, Guidelines on Vertical Restraints, 2000 (C 292/1).

²⁶ *Id.* at § 51.

However, as of today, neither the European Commission nor the European courts have ruled on internet or on e-commerce aspects in connection with antitrust law specifically.

Furthermore, contrary to U.S. law, most European court rulings stem from administrative proceedings (by the European Commission) against which one of the parties (in most cases the companies against whom the proceedings were directed) appealed. In comparison to the U.S., civil antitrust lawsuits are uncommon in the E.U. Only a handful have been brought before the courts of the member states to date. The paucity of cases might be due to the fact that U.S. concepts of class actions and treble damages, which entice potential plaintiffs to bring private antitrust claims, do not exist in the continental European jurisdictions. However, following the recent reform of EC 1/2003, national courts shall play a more important role in applying European antitrust law.²⁷

2. The Rationale of E.U. Antitrust Law

The key objectives of European antitrust law have been to foster competition within the internal market, the free trade between the E.U. member states and consumer protection.²⁸ Efficiencies have also played a role, since the European Commission has considered the benefits of vertical integration and accepts the reduction of intra-brand competition in certain circumstances.²⁹ Furthermore, both the European Commission and the European Courts have developed a more market-orientated approach over the last few years, taking into account the individual economic circumstances.³⁰ This is mirrored by the fact that the recent BERs all have included market share thresholds, e.g. they take market figures into consideration.³¹

A radical Efficiency Model has not been applied in the E.U., and generally E.U. antitrust law is more interventionist than U.S. antitrust law. Hence, the mere existence of vertical antitrust law has never been disputed in the E.U. as it has in the U.S. by the Efficiency Theory. Vertical restraints play a big role in E.U. antitrust law. This is easier to

²⁷ See Council Regulation 1/2003, § 7, 2003 O.J. (L 1/7), 1.

²⁸ See EC Treaty, *supra* note 20, art. 81.

²⁹ See Commission Notice, Guidelines on Vertical Restraints, § 155, 2000 (C 292/1); Alex Nourry & Maddi Lawrence, *B2Bs: Overcoming the Antitrust Concerns*, GLOBAL COUNSEL, October 2000, at 33.

³⁰ See Alex Nourry & Tony Reeves, *Vertical Restraints, The Commission's Hearing on its Green Paper*, EUROPEAN COUNSEL, Dec. 1997-Jan. 1998, at 41; Jeffrey I. Zuckerman, *Decision: French Case Note*, 86 AM. J. INT'L L. 561 (1992).

³¹ See Council Regulation 2790/1999, *supra* note 21, art. 3, § 1.

understand when one takes into account the important notion of the single market within the E.U. According to the single market principle, the market barriers within the E.U. due to different languages, currencies and national legal requirements need to be overcome. Therefore, European legislation and administration have always been stern toward exclusive dealing practices that hamper parallel imports within the E.U. E-commerce, as a boundary-less means for distribution, tends to weaken or even break up exclusive and foreclosing distribution systems. Due to this effect, it is viewed pro-competitive by the European Commission. It has, therefore, enjoyed the utmost protection by the European Commission from its advent.

III. ANALYSIS

As outlined above in section I, the following analysis covers e-commerce reservation clauses in exclusive distributorship agreements, with a focus on how both horizontal and vertical aspects play together in that connection. The analysis starts with U.S. law and concludes with E.U. law.

An illustrating example: a automobile manufacturer in the U.S. or E.U. might sell directly on the Internet to specific accounts like car rental agencies due to a limited reservation clause, while the exclusive distributors in their territories of responsibility resell to all other customers. Direct sales by the manufacturer leads to competition between the manufacturer and its exclusive distributors. The relationship has, therefore, some horizontal aspects, even though it is mainly vertical, as far as the mere distribution agreement between the manufacturer and the distributors is concerned.

A. *U.S. Law*

Are e-commerce reservation clauses, like those mentioned in the Introduction, vertical restraints, thus to be reviewed under the “rule of reason”? Or are they horizontal and thus subject to a “per se” prohibition under the Sherman Act §1?³² It is still to be established how to analyze such clauses once they are subject to the rule of reason. This may largely depend on the factual circumstances of the individual case at issue.

Once the manufacturer provides for a limited reservation clause, like serving particular groups of customers, the horizontal impact may be less than in cases where the manufacturer foresees a full reservation

³² Sherman Antitrust Act, 15 U.S.C. § 1 (2000).

clause for e-commerce sales. However, pricing issues (e.g. RPM) might come into the play as well. A co-existence clause might be more pro-competitive than the other two options of e-commerce reservation clauses. This is due to the fact that the manufacturer does not interfere so much in cases of co-existence. The relationship between manufacturer and distributor is then less horizontal.

In the field of horizontal/vertical restraints together with dual distribution, the landmark decisions *White Motor Co. v. United States* (hereinafter "*White Motor*"),³³ *Schwinn* and *Sylvania* will be viewed together with other rulings.

Scrutiny of *White Motor*,³⁴ *Schwinn* and *Sylvania* reveals that distinctions should be made between the cases. For example, there are differences regarding customer restrictions, which are the key in e-commerce reservation clauses.

1. *White Motor*

A vertical territorial allocation scheme was at issue in *White Motor*, where a truck manufacturer granted franchisees exclusive sales territories while reserving for itself the right to sell directly to governmental organizations.³⁵ The parties to the distribution agreements assumed that the manufacturer could also own retail outlets and compete with its distributors.³⁶ This situation is similar to what would exist under an e-commerce reservation clause.

With regard to the territorial limitations, it was assumed that such a vertical territory restriction was to be further scrutinized at trial, e.g. with a more in-depth factual analysis under the "rule of reason."³⁷ The Supreme Court did not establish a general standard for the application of the "rule of reason" in vertical relationships; rather, it rejected an approach where it would rule on an alleged violation of Section 1 of the Sherman Act in a summary judgment action based on little factual analysis.³⁸ The Court took economic arguments into account as a justification of vertical restraints and adhered (more or less) to a "rule of reason" approach.³⁹ Again, the Court drew a distinction between territorial and customer restraints in exclusive distribution contracts.

³³ *White Motor Co.*, 372 U.S. at 253.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 256.

³⁷ *Id.* at 266.

³⁸ See GELLHORN & KOVACIC, *supra* note 11, at 310.

³⁹ *White Motor Co.*, 372 U.S. at 267.

Regarding territorial restraints, the reduction of intra-brand competition was considered a fostering of inter-brand competition between competing makes. This was due to its strengthening the distributor's sales efforts by his concentrating on just one make in his exclusive territory.⁴⁰

Another justification for territory restraints is protecting distributors from "free-riders." Many distributors invest substantially in their facilities, sales staff, marketing and the like in order to retain and upsell customers via after-market service. In comparison, free-rider distributors are those that do not make those expenditures themselves, but rather "free-ride" off the promotion efforts of other distributors. Exclusive distributors may be protected from free-riders by territory restraints and the proscription of sales between distributors and resellers outside the distribution network.⁴¹ The latter is the only effective means of keeping free-riders from getting access to the goods sold in the exclusive distribution. This applies even more once hazardous or risky products are brought into a market. Therefore, in these cases, a distributor is to be insulated from competing distributors, be it within the distribution network (intra-/inter-brand argument) or outside the distribution network (free-rider problem).⁴²

The Supreme Court considered vertical territory restrictions resembling horizontal geographic divisions of markets among competitors.⁴³ Both are territorial divisions. The issues covered under the term "territory protection" deal with the relationships between the distributors and their competing re-sellers. They do not, however, directly affect the relationship between the distributors and the manufacturer, which more concerns the issue of customer restrictions, e.g. e-commerce reservation clauses in this connection.

In concurrence, Justice Brennan distinguished between territorial and customer restrictions. He was more critical of the latter than the former, since they did not provide the benefits of fostering inter-brand competition.⁴⁴ This is true, for instance, for the prevention of free-riding and the fostering of *inter*-brand competition. Both do not arise

⁴⁰ *White Motor Co.*, 372 U.S. at 270; *aff'd* United States v. McKesson & Robbins, Inc., 351 U.S. 305, 312 (1956); United States v. Klearflax Linen Looms, Inc., 63 F. Supp. 32 (Minn. 1945).

⁴¹ *White Motor Co.*, 372 U.S. at 270.

⁴² *Id.* at 269.

⁴³ *Id.* at 270.

⁴⁴ *Id.* at 272.

out of customer restrictions by the manufacturer.⁴⁵ Customer restrictions are rationalized on different grounds than territory restrictions. A manufacturer may argue, as in *White Motor*, that he has the sole expertise to handle big accounts like government institutions.⁴⁶ Customer restrictions are more harmful to competition in a situation where distributors compete with manufacturers for government procurement accounts. Distributors are at a competitive disadvantage to a manufacturer-distributor, due to the manufacturer's direct distribution chain, which provides an inherent cost advantage as compared to pure distributors.⁴⁷ Although Justice Brennan differentiated between territory and customer restrictions, he did not further classify the problem of the latter, e.g. as lacking underpinning arguments under the "rule of reason" approach or even as triggering the "per se" standard. Since Justice Brennan concurred (and did not dissent) it is likely that he thought the "rule of reason" was the proper standard of review, but found other arguments against competition for customer restrictions in light of the "rule of reason." This interpretation is reinforced by the fact that he took the economic arguments into consideration even in this respect.

However, since this argument concerns competition between the manufacturer and its distributors for end user customers, it focuses on the horizontal aspects of their relationship. Their relationship is nearing the point of being judged horizontal and "per se" illegal. This becomes even more clear when this argument is compared to the arguments raised in connection with territorial restraints, where free-riding and inter-brand competition play a role, e.g. the competition between the distributors themselves regardless of their selling the same make (intra-brand competition) or competing makes (inter-brand competition).

Thus, it can be concluded that customer restrictions have more horizontal aspects than territorial restrictions. This is important for e-commerce reservation clauses (both full and limited e-commerce reservation clauses) that are normally customer restriction clauses. This holds true to a limited extent for co-existence clauses where neither the manufacturer nor the distributors are limited by legal terms. Limitations might only arise out of factual circumstances, like the distributor facing competition by its manufacturer.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.* at 275, see also PHILPP E. AREEDA, ANTITRUST LAW, AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION, § 1616(d) and 1642(a) (2d ed. 2001).

Two decisions from the U.S. Courts of Appeal lend support to this thesis. In *Pitchford v. Pepi, Inc.*, 531 F.2d 92 (3rd Cir. 1975) (hereinafter “Pitchford”), Pepi, a manufacturer of scientific instruments, granted its distributors exclusive sales territories but then established its own competing sales outlets.⁴⁸ Pepi had reserved for itself the exclusive right to sell to government accounts.⁴⁹ The Third Circuit determined this dual distribution network was a per se illegal horizontal restraint, even though the horizontal restraint was mainly seen in the dividing of territories.⁵⁰

The Fifth Circuit reached a similar result in *Hobart Brothers Co. v. Malcolm T. Gilliland, Inc.*, 471 F.2d. 894 (5th Cir. 1973) (hereinafter “Hobart”), where Hobart, a welding equipment manufacturer, set up a dual distribution system. Here, as in *Pitchford*, the manufacturer directly competed with its distributors (who were granted exclusive territories) through its own sales outlets and reserved for itself certain accounts.⁵¹ The court struck down this arrangement as per se illegal after determining it was a horizontal territory allocation scheme.⁵² It is important to note that all the decisions cited above are pre-*Sylvania*, and may have been decided differently if heard today. Ultimately, dual distribution, such as in the case of customer restrictions, might be treated differently in light of the distinction between horizontal and vertical, and rule of reason and per se. This is an important intermediary result for the evaluation of e-commerce clauses. However, this goes primarily for full and limited e-commerce reservation clauses, since co-existence clauses do not provide for legal restraints of competition.

2. *Schwinn* and *Sylvania*

The intermediary result accomplished herein has to be reviewed in light of *Schwinn* and *Sylvania*, which overruled *Schwinn*. In *Schwinn*, a bicycle manufacturer, distributed its products via a two-channel distribution network. Schwinn sold its products both to (1) wholesale distributors who in turn sold to franchised retail distributors, and (2)

⁴⁸ See *Pepi, Inc.*, 531 F.2d. 92.

⁴⁹ *Pepi, Inc.*, 531 F.2d. at 101; see Herbert Hovenkamp, *Vertical Restraints and Monopoly Power*, 64 B.U. L. REV. 521 note 124 (1984) (regarding the nexus of this decision to e-commerce).

⁵⁰ *Pepi, Inc.*, 531 F.2d. at 104.

⁵¹ *Hobart Bros. Co. v. Malcolm T. Gilliland, Inc.*, 471 F.2d. 894 (5th Cir. 1973) ; see Hovenkamp, *supra* note 49 (regarding the nexus of this decision to e-commerce).

⁵² *Hobart Bros. Co.*, 471 F. 2d. at 900.

directly to franchised retailers on a commission basis.⁵³ Thus, Schwinn competed directly with its wholesale distributors. Schwinn's distributorship contracts (between Schwinn and its distributors) included territorial restrictions clauses (e.g. the prohibition to set up additional outlets within the appointed sales area) and prohibited the distributors from reselling to non-franchised retailers.⁵⁴ The Supreme Court determined these clauses were per se illegal vertical restraints under the Sherman Act §1.⁵⁵ The Court created a bright line standard for determining whether there was a per se violation, the threshold being whether or not dominion in the merchandise passed from the manufacturer to the distributor. If answered in the affirmative, there was a per se violation; if not, there was no violation. For example, territorial restraints in mere agency relationships were acceptable.⁵⁶ *Schwinn* led to several decisions in which courts invalidated vertical agreements by invoking the per se rule, provoking criticism that the Supreme Court's approach was too formalistic.⁵⁷

The Supreme Court overruled *Schwinn* ten years later in *Sylvania*.⁵⁸ In *Sylvania*, a manufacturer of television sets maintained a dual distribution system, including one channel with independent wholesale and retail distributors and another consisting only of franchised retailers to which Sylvania sold directly on a commission basis.⁵⁹ *Sylvania's* factual background was similar to *Schwinn*, except that it addressed a location clause (e.g. the distributor's undertaking to establish its sales outlet at a designated location) instead of fixed territories. Sylvania argued the plaintiff, San Francisco distributor Continental T.V., violated Sylvania's location clause when it tried to expand to Sacramento. Accordingly, Sylvania gave Continental T.V. notice of termination, and Continental T.V. brought suit claiming the termination was invalid.⁶⁰ The Court held the termination to be valid, since Continental T.V. violated the location clause which was in line with Section 1 of the Sherman Act and, therefore, effective.⁶¹

In reversing *Schwinn*, the Supreme Court ended its formalistic approach in which the application of the per se standard just depended

⁵³ See *Arnold, Schwinn & Co.*, 388 U.S. 365.

⁵⁴ *Id.*

⁵⁵ *Id.* at 378.

⁵⁶ *Id.*

⁵⁷ GELLHORN & KOVACIC, *supra* note 11, at 312.

⁵⁸ See *Cont'l. T.V.*, 433 U.S. 36.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

on the formalistic criterion of whether or not title had passed between the manufacturer and the reseller. The Court also reiterated the rule of reason approach for all forms of vertical restraints (except RPM).⁶² In reaching its decision, the Court relied on economic theory, allowed for pro-competitive arguments to temper its decision. For example, the Court considered promotion of inter-brand competition and the avoidance of free rider effects,⁶³ and the Court referred to the Chicago Business School's Efficiency theory for the first time.⁶⁴

It is important to determine what *Sylvania* might contribute in the context of e-commerce and what is eventually out of *Sylvania*'s reach. The pro-competitive arguments raised in *Sylvania* to legitimize vertical territorial restrictions (specifically, to foster inter-brand competition and avoid free riding) are beyond any doubt, as far as territorial restrictions or its relatives, location clauses, are at stake. As Justice Brennan outlined in his *White Motor* concurrence, however, these arguments are insufficient to justify customer restrictions that are at the core of e-commerce reservation clauses.⁶⁵ Thus, *Sylvania*'s holding appears not to apply to e-commerce reservation clauses. Contrary to *White Motor*, *Sylvania* is only about territory restrictions, and not about customer restrictions.⁶⁶ Comparing *White Motor* to *Sylvania*, it becomes clear again that vertical customer restrictions involve more horizontal aspects than vertical territory restrictions.

3. Post-*Sylvania*

In *Graphic Prods. Distribs., Inc., v. Itek Corp.*, 717 F.2d 1560, (11th Cir. 1983); (hereinafter "*Itek*") it was suggested by the court that the rule that vertical territorial and customers restrictions are per se legal is inapplicable to cases involving dual distribution systems.⁶⁷ One scholar has considered a non-application of the "rule of reason" standard in dual distribution cases, as he assumed dual distribution cases could always be horizontal and, therefore, subject to the "per se" standard.⁶⁸ *Itek* is the only decision approaching an application of the "per se" rule to vertical restraints after *Sylvania*.

In contrast to *Itek*, the Sixth Circuit held in *Clairol Inc. v. Boston*

⁶² GELLHORN & KOVACIC, *supra* note 11, at 315 (a starting point for the rule of reason approach was *Standard Oil Co. v. United States*, 221 U.S. 1, 31 (1911).)

⁶³ *See Cont'l. T.V.*, 433 U.S. 36.

⁶⁴ *Id.*

⁶⁵ *White Motor Co.*, 372 U.S. at 265, *see AREEDA, supra* note 47, at § 1642(a).

⁶⁶ *See AREEDA, supra* note 47, at § 1642(a).

⁶⁷ *Graphic Prods. Distribs., Inc.*, 717 F.2d at 1568; Hovenkamp, *supra* note 49.

⁶⁸ Hovenkamp, *supra* note 49.

Discount Center of Berkley, Inc., 608 F.2d 1114 (6th Cir. 1979) (hereinafter “*Clairol*”) that customer restriction clauses in a dual distribution scheme are vertical restrictions and must be analyzed under the “rule of reason.” In *Clairol*, a cosmetics manufacturer of the same name selected its distributors by putting candidates through an approval process based on certain selection criteria. For example, only specialized distributors and its own outlets were allowed to resell certain cosmetics. The court decided that this limited reservation clause was legal under the “rule of reason.”⁶⁹

The FTC has also determined that customer restriction clauses are vertical restrictions and subject to the rule of reason. See *National Fire Hose Corp.*, F.T.C. LEXIS 56 (1986); *Beltone Electronics Corp.*, 100 F.T.C. 68 (1982)).⁷⁰ Carstensen argues the growth of e-commerce may significantly alter the market conditions that justify customer restrictions.⁷¹ The FTC recognized this problem, noting in its 2002 Statement, anti-competitive developments due to anti-competitive protectionist state legislation meant to protect “brick-and-mortar-dealers.”⁷² The FTC also assumed in the 2002 Statement that manufacturers try to prevent their distributors from selling via e-commerce.⁷³ The two examples above illustrate that vertical restraints occur in the e-commerce arena, but the authorities and the courts have not given guidance as to how e-commerce reservation clauses are to be viewed under the Sherman Act. The antitrust problems set out above associated with e-commerce reservation clauses are even more severe when pricing aspects are considered.

4. E-commerce and RPM

The Internet, as a medium for conducting commerce, makes retail prices and conditions (such as discounts, rebates, bonuses) more transparent. For the online customer, choosing another vendor is as

⁶⁹ *Clairol Inc. v. Boston Discount Center of Berkley Inc.*, 608 F.2d 1114, 1130 (6th Cir. 1979).

⁷⁰ *Nat'l. Fire Hose Corp.*, 1986 F.T.C. 56 (1986); *Beltone Electronics Corp.*, 100 F.T.C. 68 (1982), see also Kevin J. Arquit, *The Cutting Edge of Antitrust: Market Power: Market Power in Vertical Cases*, 60 ANTITRUST L. J. 921 (1991).

⁷¹ Peter C. Carstensen, *The Competitive Dynamics of Distribution Restraints, The Efficiency Hypothesis versus the Rent-Seeking, Strategic Alternatives*, 69 ANTITRUST L.J. 569 (2001).

⁷² Prepared Statement of the Federal Trade Commission Before the Committee on the Judiciary Subcommittee on Antitrust, Competition, and Business and Consumer Rights United States Senate, Concerning an Overview of Federal Trade Commission Antitrust Activities, 2002 F.T.C. 53, 44 (2002) [hereinafter Statement].

⁷³ *Id.*

easy as clicking away from one e-tailer's website to another's. E-commerce, especially as assisted by so-called "shopping bots," leads to a greater visibility, transparency and flexibility.⁷⁴ Thus, competition between the manufacturer/e-tailer and its other distributors becomes more direct and horizontal in nature. For example, imagine a scenario where a manufacturer sells its goods to consumers at prices which are barely above the wholesale prices that the manufacturer charges its distributors for the same goods. In this context, the pricing pressure that results from internet distribution is so fierce that the ordinary distributors are forced to sell at almost no margin and are essentially bound to engage in maximum resale price maintenance (factual price binding), since they do not have any room to choose their own price points.⁷⁵ In these cases, the manufacturer and its dealers compete directly, meaning they have a horizontal relationship in which the *per se* standard applies anyhow. The harm is even greater when the parties enact a Full Reservation Clause, as the manufacturer is empowered to sell in every territory with lower costs relative to its distributors. Its exclusive distributors, in comparison, are only permitted to sell in a single territory, with higher costs and only by the traditional means of distribution. In this scenario, the margins of the exclusive distributors are at a high risk.

5. Result

Neither the legislature, courts, nor FTC have addressed e-commerce reservation clauses in exclusive distribution agreements in detail. The FTC and U.S. courts subject limited customer restrictions to "rule of reason" scrutiny. This might also be true for limited e-commerce customer restrictions as well, even though it is unclear how the additional impacts like RPM influence this outcome. There is insufficient guidance from the courts and the legislature to be certain of this result. Therefore, there is only a certain likelihood that limited e-commerce reservation clauses are subject to the "rule of reason."

However, full customer restrictions have never been the subject of U.S. court and FTC rulings. Since Full Reservation Clauses are more restrictive, they might be considered horizontal restraints and be adjudged *per se* illegal. Contracting parties should do their best to avoid them.

Coexistence clauses, on the other hand, do not restrict either a

⁷⁴ Fiona Carlin, *Vertical Restraints and the Internet*, EUROPEAN COUNSEL, August 2000, at 29, 31.

⁷⁵ See Soleymani, *supra* note 6, at 8, *see also* Carlin, *supra* note 74.

manufacturer or its distributors' sales ability. Thus, they are generally not anti-competitive and are potentially pro-competitive. They do not raise any antitrust concerns.

B. E.U. Law

As e-commerce is global, the legal view of it should be as global as possible. Therefore, a look will be taken at how E.U. Competition Law addresses the antitrust concerns regarding e-commerce. The example at the beginning of Part III refers to a case where a car manufacturer has appointed exclusive distributors in the E.U. and tries to reserve e-commerce for itself. This case represents the former distribution strategy of car makers in the E.U. It has become outdated to most car manufacturers in the E.U., as the new regulation on distribution in the motor vehicle sector has made exclusive distribution very difficult.⁷⁶ However, exclusive motor vehicle distribution systems are still legal under E.U. Competition Law. They have just become less popular due to legal changes not at stake herein.

While the legal framework used to analyze a distribution agreement is significantly different under E.U. law as compared to U.S. law, the legal conclusions reached are similar, but vary in detail. However, E.U. determines in a far more formalistic way whether a relationship is vertical or horizontal. In light of the above mentioned hybrid nature of e-commerce, this means the following:

1. Art. 2 EC 2790/1999

According to article 2, paragraph 1 of EC 2790/1999, a vertical agreement receives a block exemption under the "Umbrella Regulation."⁷⁷ A vertical agreement is defined there as

....agreements or concerted practices entered into between two or more undertakings each of which operates at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services.⁷⁸

Since distribution agreements are entered into by companies on different levels of the production chain, even agreements including an e-commerce reservation clause between a manufacturer and a

⁷⁶ Commission Regulation 1400/2002, 2002 O.J. (C 67/2).

⁷⁷ Commission Regulation 2790/1999, art. 2, § 1, 1999 O.J. (L 336), 21-25.

⁷⁸ *Id.*

distributor are considered vertical agreements.⁷⁹ This is true in Example 3 as described above.

Article 2, paragraph 4 of EC 2790/1999 excludes agreements between competitors from the block exemption of the “Umbrella Regulation.” For example, a supply agreement for car engines between two competing car manufacturers would be excluded.⁸⁰ Agreements between competitors are governed by art. 81 EC and the “Guidelines on the applicability of art. 81 of the EC Treaty to horizontal cooperation agreements” (hereinafter “Horizontal Guidelines”).⁸¹ With the latter, the European Commission has given guidance on the treatment of horizontal agreements under art. 81 EC.

Unlike U.S. law, under E.U. law, a distribution relationship will be deemed horizontal only if entered into by competitors.⁸² Pursuant to the definition of art. 1 lit. a of EC 2790/1999, the term “competing undertakings” comprises “actual or potential suppliers in the same product market.”⁸³ Furthermore, article 2, paragraph 4, generally excludes vertical agreements between competitors from the scope of the Umbrella Regulation. For example, a provision for an art. 81 EC regime, such as the engine supply agreement described above, would be excluded.⁸⁴

Under E.U. law, distributors competing on the same distribution tier may be deemed competitors, as they are arguably “suppliers” under the rubric of art. 1 lit a. of EC 2790/1999.⁸⁵ However, when it comes to dual distribution, art. 2 para. 4 of EC 2790/1999 provides an exemption from the rule of art. 2 para. 4 by which vertical agreements between competitors receive a block exemption if the following conditions are met:

“...it (EC 2790/1999) shall apply where competing undertakings enter into a non-reciprocal vertical agreement and:...

(b) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract

⁷⁹ *Id.*

⁸⁰ *Id.* at § 4, 21-25.

⁸¹ Commission Notice, Guidelines on the applicability of art. 81 of the EC Treaty to horizontal cooperation agreements, O.J. C 3, 2 (2001) [hereinafter Horizontal Guidelines].

⁸² Commission Regulation 2790/1999, art. 2, § 4, 1999 O.J. (L 336), 21-25.

⁸³ Commission Regulation 2790/1999, art. 1, § 4, 1999 O.J. (L 336), 21-25.

⁸⁴ *Id.*

⁸⁵ *Id.*

goods...” (e.g. dual distribution).”⁸⁶

A parallel set up of e-commerce distribution and classical distribution by a manufacturer stipulated in a distribution agreement would fall under that definition.⁸⁷ E-commerce reservation clauses in exclusive distribution agreements are vertical agreements according to E.U. Competition Law.⁸⁸ In the above example, the distribution agreement between the car manufacturer and its distributors providing for an e-commerce reservation clause would be considered vertical and subject to EC 2790/1999.⁸⁹

2. Art. 4 lit. b. EC 2790/1999

However, problems arise in another context. As discussed supra, e-commerce reservation clauses in exclusive distribution agreements might be construed as customer restrictions. Customer restrictions are dealt with in art. 4 lit. b. that states:

The exemption (e.g. block exemption) provided for in art. 2 shall not apply to vertical agreements which, directly or indirectly...have as their object:...

(b) the reservation of the territory into which, or of the **customers to whom**, the buyer may sell the contract goods or services, except:

the restriction of active sales into the exclusive territory or to an exclusive **customer group** reserved to the supplier or allocated by the supplier to another buyer....⁹⁰

Two issues arise in connection with art. 4 lit. b.:

- Restriction of certain customers/groups of customers is illegal and will void the block exemption, and
- Restriction of active sales to customer groups reserved by the supplier that are permitted.

⁸⁶ Commission Regulation 2790/1999, art. 2, § 4, 1999 O.J. (L 336), 21-25; Commission Notice, Guidelines on Vertical Restraints, § 27, 2000 (C 292/1); see also JÖRG-MARTIN SCHULTZE, STEPHANIE PAUTKE, DOMINIQUE S. WAGENER, DIE GRUPPENFREISTELLUNGSVERORDNUNG FÜR VERTIKALE VEREINBARUNGEN, § 330 (2001) [The Block Exemption Regulation on Vertical Agreements].

⁸⁷ Commission Regulation 2790/1999, art. 2, § 4, 1999 O.J. (L 336), 21-25; Commission Notice, Guidelines on Vertical Restraints, § 27, 2000 (C 292/1).

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ See Commission Regulation 2790/1999, art. 2, § 4, 1999 O.J. (L 336).

Therefore, this article evaluates whether and when e-commerce reservation clause are customer or customer groups restrictions.

3. Full Reservation Clause as a Customer Restriction

The European Commission provides some guidance on how it treats e-commerce in Vertical Guidelines Cipher 51. Its guidelines state, *inter alia*:

“In any case the supplier cannot reserve to itself sales and/or advertising on the Internet⁹¹.”

This general statement follows a set of more specific statements by the European Commission made in the same context that are dealt with below. This statement should be viewed in the context of general customer restrictions pursuant to art. 4 para. 4 b. of EC 2790/1999.⁹² In general, a Full Reservation Clause would be a customer restriction under art. para. 4 lit b. of EC 2790/1999 and would nullify the entire distribution agreement (hardcore restriction). However, in some cases it might be justified to exclude internet distribution as a whole, for instance when products are dangerous or very complex, like complex machinery or pharmaceuticals.⁹³ The complexity or hazards of products was also considered an aspect that might justify customer restrictions under U.S. law (see *supra* Part III A).⁹⁴

This statement overrides three old rulings of the European Commission – the two “*Grundig*” decisions and the “*Yves Saint Laurent*” decision, in which the Commission held that the manufacturer’s total ban on mail order sales was not an illegal vertical restraint.⁹⁵ Mail order sales and online trading may be to some extent comparable, but given the opportunities e-commerce provides to the distributors, the flexibility to act everywhere and swiftly outweighs the importance of mail order sales. Removing the right to engage in e-commerce sales has a more substantial effect on a distributor’s bottom line than removal of mail order sales, as it may represent a much bigger portion of the distributor’s business.⁹⁶ In addition, given that e-

⁹¹ Commission Notice, Guidelines on Vertical Restraints, § 51, 2000 (C 292/1); Carlin, *supra* note 74, at 30.

⁹² SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 539-40.

⁹³ Carlin, *supra* note 74, at 31.

⁹⁴ *White Motor Co.*, 372 U.S. at 269.

⁹⁵ Case 85/404/EC, *Comm’n v. Grundig*, 1985 O.J. (L 223, 1), Case 94/29/EC *Comm’n v. Grundig*, 1994 O.J. (L 20, 15); Case 92/2/EC *Comm’n v. Yves Saint Laurent*, 1992 O.J. (L 12), 24.

⁹⁶ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§539-40.

commerce has a much broader and quicker application, and is therefore economically more important than the classical mail order services, it is sensible that the European Commission now puts a bigger emphasis thereupon.⁹⁷ Furthermore, a lot of time has passed between the old court rulings and the European Commission's commentaries which also explain the different treatment given to e-commerce and mail order services.⁹⁸ This illustrates why the European Commission treats e-commerce differently from mail order sales. The prior case law is thus not applicable.

Following the above, it is quite likely that Full Reservation Clauses would be considered illegal under art. 4 lit. b. EC 2790/1999.

4. Limited Reservation Clauses as Customer or Customer Group Restrictions

In practical terms, Limited Reservation Clauses are more often used in Distribution Contracts and have thus played a larger role than Full Reservation Clauses. The legal adjudication of these kinds of restrictions is, however, much more difficult. The following are examples of the types of limited reservations:

- Prohibitions against a manufacturer's distributors to sell to customer groups;
- Qualitative requirements in selective distribution systems (e.g. requirements for sales outlets, skills of sales personnel, etc.);
- Minimum sales requirements schemes offering bonuses for agreeing not to sell over the Internet.

It is questionable whether Limited Reservation Clauses fall within the scope of the term "customer" in art. 2 para. 4 lit b. of EC 2790/1999 or whether they match the term "customer group" in the same article allowing for the restriction of active sales.⁹⁹ The problem is that internet customers are not a distinct group and it may be difficult to make that sharp distinction in distribution agreements.¹⁰⁰ The Vertical Guidelines, as outlined below, do not give further guidance on this issue.¹⁰¹

A further analysis as to whether Limited Reservation Clauses are to be considered customer restrictions should examine what limitations

⁹⁷ Commission Notice, Guidelines on Vertical Restraints, § 51, 2000 (C 292/1).

⁹⁸ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 539-40.

⁹⁹ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 543.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

are set forth quite often in practice. Those examples help us understand the notion of customer restrictions. They help draw the line between legal and illegal reservation clauses.

(a) *Prohibitions to sell actively to reserved groups of customers/territory restrictions*

Quite often, distributors are prohibited from selling actively to certain customers (like municipalities) and/or outside their appointed territories.¹⁰² This may come with an additional e-commerce clause stating that the distributor's sales via e-commerce are deemed active sales unless the distributor can prove the contrary.¹⁰³ This would be an example of a Limited Reservation Clause.

The notion of active and passive sales. In this situation, it is worthwhile to mention that under E.U. Competition Law, the differentiation between active and passive sales plays a big role in connection with exclusive distributor territories. See, for example, art. 4 para. 2 EC 2790/1999.¹⁰⁴ Both E.U. and U.S. law hold that an undertaking that establishes exclusive sales territories is a vertical restraint. However, contrary to U.S. antitrust law, absolute export bans within the E.U. (e.g. total restriction to distribute outside the appointed sales territory) are illegal under E.U. Competition Law.¹⁰⁵ This is due to the notion of the single market, according to which trade between the Member States would be hampered if absolute territory restrictions were allowed. Therefore, E.U. Competition Law only allows for relative territory protection including the rationale that exclusive territories might only be protected via the prohibition of active sales into other territories. For example, Dealer A with a territory in Italy might be obstructed from selling on his initiative to France, which is assigned to Dealer B. Whereas mere passive sales into other sales territories might not be hindered at all. For example, once a French customer approaches A in Italy, A may sell to this customer in France. Accordingly, in the example at beginning of Part III, the car manufacturer might only provide that its exclusive distributors are not allowed to pursue active sales in a territory

¹⁰² See Carlin, *supra* note 74, at 31.

¹⁰³ *Id.*

¹⁰⁴ Commission Regulation 2790/1999, art. 4, §. 2, 1999 O.J. (L 336).

¹⁰⁵ See Case T-67/01, JCB Service v. Comm'n of the European Communities, 2004 O.J. (C 85/23); on the contrary, absolute export bans from the E.U. to outside the EU are legal *see inter alia* Case (C-306/96), Javico v. Yves Saint Laurent, 1998 O.J. (C-306/96); Case 78/253/EEC Comm'n v. Campari, 1977 IV/171; Case 85/79/EEC; Comm'n v. John Deere, 1984 IV/30.809.

appointed to another distributor, whereas passive sales may not be hampered.

(b) *E-commerce as active or passive sales*

With regard to e-commerce, the European Commission reiterates the distinction between active and passive sales when it states:

In general the use of the Internet is not considered a form of active sales into such territories or customer groups, since it is a reasonable way to reach the customer. The fact that it may have effects outside one's territory or customer group results from the technology, i.e. the easy access from everywhere.... Insofar as a web site is not specifically targeted at reaching customers primarily inside the territory or customer group exclusively allocated to another distributor, for instance with the use of banners and links in pages of providers specifically available to these exclusively allocated customers, the web site is not considered a form of active selling...¹⁰⁶

Following the Vertical Guidelines above, the following ways of advertising on the Internet should be deemed passive marketing

- general use of the Internet outside the appointed territory
- use of any language reaching customers outside the territory.¹⁰⁷

Active marketing is limited to the following activities:

- links and banners exclusively available to allocated customers
- soliciting e-mails to specific customers.¹⁰⁸

In detail, the above means the following: the European Commission states that when a distributor creates and runs a web site, it is not active marketing.¹⁰⁹ The same is true for meta tags, even though they are affirmative actions taken to direct customers via search engines to specific web sites. They are considered by the European Commission to be a general establishment of a web site, even though they allow distributors to direct and solicit customers

¹⁰⁶ Commission Notice, Guidelines on Vertical Restraints, § 51, 2000 (C 292/1); Carlin, *supra* note 74, at 30.

¹⁰⁷ *Id.*

¹⁰⁸ Commission Notice, Guidelines on Vertical Restraints, § 51, 2000 (C 292/1).

¹⁰⁹ *Id.*

directly.¹¹⁰

It is not easy to understand why links to websites, such as those created not by the distributor but rather by a third party, are treated as active marketing. A meta tag when established in a particular language, is a much more active form of soliciting customers, since it is targeted and based on the distributor's initiative, while links merely refer customers to third parties.¹¹¹

The European Commission seems to hold that even the establishment of a web site in a foreign language is not to be treated as active marketing, since it is not targeted at specific customers (outside the allocated territory).¹¹² This may be true as long as, for instance, a web site has been set up in English, since English is a language widely used throughout the world.¹¹³ Therefore, advertising on an English web site might not be specifically targeted and not considered active marketing. However, this might not be true for advertisements in languages spoken by minorities like Basque, Catalan or Sorbic, or even languages which are spoken only in one or a few countries like German or Italian.¹¹⁴ It is hard to believe that a dealer with an appointed territory – for instance, Languedoc-Roussillon in Southern France – does not pursue active marketing when it has a web site in the Basque language, which is only spoken outside his territory. The same example might even go for a Provençal dealer having an Italian web site, to attract customers from Italy, outside the allocated territory. Therefore, the language criterion is not enough to sharply draw the line between active and passive sales in e-commerce.¹¹⁵

This means there will be a wide interpretation of the term passive sales and a general assumption that dealers' sales on the Internet are, in general, passive unless proved otherwise by the manufacturer. This burden of proof-like provision would be exactly contrary to the e-commerce contract clause above, and one reason why the clause would not be considered legal.¹¹⁶

However, since the distributors are in control of their dealings and the manufacturer can hardly trace whether a distributor transaction is based on the outside customer's initiative (passive) or the distributor's

¹¹⁰ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 576-82.

¹¹¹ *Id.* at § 578.

¹¹² SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 574-75.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ Carlin, *supra* note 74, at 30; SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§574-75.

¹¹⁶ Commission Notice, Guidelines on Vertical Restraints, § 51, 2000 (C 292/1); *see* Carlin, *supra* note 74, at 30.

one (active), this shift of the burden of proof would not be unfair.

However, the European Commission holds a different view on that and favors distributors over manufacturers in general, and in particular when it comes to e-commerce.¹¹⁷

Furthermore, e-commerce customers cannot be sharply distinguished as a customer group under art. 4 lit b. EC 2790/1999.¹¹⁸ Limited restrictions just addressing e-commerce customers are likely to be considered a customer restriction illegal under art. 4 lit. b EC 2790/1999.¹¹⁹ The customer group restrictions (government, municipalities, army etc.) are the ones that have been existing anyway under many distribution agreements, regardless of e-commerce. The options for e-commerce reservation clauses are, therefore, very limited under E.U. law. In the end, the current e-commerce framework is likely to distort manufacturers' exclusive distribution networks.

Regardless of e-commerce, the European Commission has been widely criticized for its creating and allowing loopholes in the legal framework of exclusive distribution systems. This criticism was renewed when the E.U. set up the regulation EC 1400/2002 for the Distribution in the Motor Vehicle sector. This regulation provides specific rules on vertical restraints, applicable only to car makers and their distributors, but largely comparable to EC 2790/1999.¹²⁰ When issuing EC 1400/2002 on Car Distribution, the European Commission went even further in restricting exclusivity schemes.

An analysis of the examples provided in the Vertical Guidelines reveals that the European Commission generally favors dealers over manufacturers and in particular, the pursuit of e-commerce by dealers. This, however, has severe effects on exclusive distribution networks as a whole. The Commission is not manufacturer-friendly in that regard. This is further illustrated below.

(c) *The failure of the Vertical Guidelines*

The Vertical Guidelines are not a viable legal framework in helping companies establish e-commerce together with exclusive distribution networks. It is hard to align the Vertical Guidelines with the statutory text of art. 4 lit b. EC 2790/1999. Art. 4 lit b. EC 2790/1999 prohibits the general restrictions to sell to particular customers, but allows the restrictions to sell actively to certain

¹¹⁷ *Id.*

¹¹⁸ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 543.

¹¹⁹ *Id.*

¹²⁰ Commission Regulation 1400/2002, 2002 O.J. (C 67/2); *see also* Carlin, *supra* note 74, at 30.

customer groups.¹²¹ This might be put together as long as Full Reservation Clauses are considered illegal customer restrictions and Limited Reservation Clauses meet the distinctions between active and passive sales. For example, when customers are reserved to the manufacturers, the dealer may only be proscribed to pursue active sales to these accounts, and passive sales are to be permitted.¹²²

Since the differentiation in art. 4 lit. b. EC 2790/1999 between customer restrictions and customer group restrictions is difficult to make for internet sales, and since the Vertical Guidelines do not seem to fit internet distribution, it might be questionable whether this current framework is able to meet the e-commerce challenge. Given the difficulties illustrated above, it may be wise to abandon old fashioned criteria like the distinction between active and passive sales and cover internet distribution with a regulatory framework of its own. At least the European Commission should provide companies with further guidance on internet distribution. For example, it should provide further examples on the distinction between active and passive sales.¹²³

(d) Result

As a result of the above, Full Reservation Clauses are likely to be deemed illegal under art. 4 lit. b. EC 2790/1999 (customer restriction), whereas Limited Reservation Clauses should stay within the guidelines set out in the Vertical Guidelines (e.g. respect of the distinction between active and passive sales) which is in practice very difficult to accomplish. Co-existence clauses do not fall within the scope of both art. 81 EC and art. 4 lit. b. EC 2790/1999 and are to be considered *per se* legal due to their pro-competitive effect.

5. Qualitative Requirements in Selective Distribution Systems

According to art. 4 lit b 3rd alt. EC 2790/1999, restrictions of sales to unauthorized distributors may be exempt from the general prohibition to restrict sales to customers as a whole.¹²⁴ The question is whether certain qualitative criteria, for instance for shops and skills of sales personnel, fit together with the European Commission's general

¹²¹ Commission Regulation 2790/1999, art. 4, 1999 O.J. (L 336).

¹²² SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 581.

¹²³ Carlin, *supra* note 74, at 30; SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 581.

¹²⁴ Commission Regulation 2790/1999, art. 4, 1999 O.J. (L 336).

assumption of freedom of internet distribution.¹²⁵ In the example above, where the car manufacturer might request its distributors to sell cars only from showrooms that meet certain corporate identity criteria, internet sales would not meet this criterion, since they can, by their very nature, only be made by electronic means. In general, a selective distribution system does not justify a Full Reservation Clause due to the European Commission's notion of liberty of internet distribution.¹²⁶ However, certain quality criteria do not necessarily contradict advertising on the Internet.¹²⁷ For example, a car manufacturer might provide rules on how its distributors set up their showrooms and what skills the sales personnel should have, but may allow advertising on the Internet at the same time.¹²⁸ On the contrary, some requirements can, by their very nature, not be met by an e-commerce distributor, like operating a showroom and having a permanent exhibition of cars.¹²⁹ However, it is still unclear how selective distribution systems and e-commerce distribution interact in light of E.U. Competition Law requirements.¹³⁰

6. Result

As a result, the challenge of e-commerce to E.C. Competition Law does not lie at the border line between horizontal and vertical restraints. The issue is more whether e-commerce reservation clauses are customer or customer group restrictions under art. 4 lit b. EC 2790/1999 and how they fit into the framework of the Vertical Guidelines. It appears that this challenge is still available. The E.U. should provide another statement or statute to provide further guidance.

IV. CONCLUSION

Both the U.S. and E.U. legal regimes do not specifically address distribution over the Internet, leaving ambiguity and concern in the following areas:

1. Internet distribution leads to a high degree of visibility and

¹²⁵ SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 583-92.

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ Carlin, *supra* note 74, at 30; SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at §§ 583-92.

¹³⁰ Carlin, *supra* note 74, at 30; SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 585.

transparency of prices that narrow distributors' room for setting their own prices.¹³¹ In dual distribution systems based on an e-commerce scheme, this easily triggers RPM (see above Part III) to a much larger extent than in dual distribution systems that are not internet-based.

2. Both U.S. and E.U. antitrust law differentiate between territorial and customer restrictions; both consider the latter more harmful to competition than the former. Classical arguments like avoiding free-riding, efficiencies via reduction of intra-brand competition in order to foster inter-brand competition, are not applicable when it comes to customer restrictions.¹³²

3. Under U.S. antitrust law, there is the danger that once RPM is at stake and the *White Motor* ruling applies, e-commerce reservation clauses could quite easily run into being treated as per se violations. Under E.U. law, the horizontal aspects of e-commerce in dual distribution have not been recognized, but e-commerce reservation clauses might be considered customer reservations according to art. 4 EC 2790/1999.

4. Companies are advised not to use full reservation clauses, since they might be per se illegal under U.S. law or run afoul of art. 4 EC 2790/1999.

5. It is questionable how much legal comfort Limited Reservation clauses can actually give. Pragmatically, it is hard to distinguish Full and Limited e-commerce reservation clauses. Most cases involved limited reservation clauses, like the reservation by manufacturers of specific accounts, but they did not involve e-commerce. Since the practice of e-commerce is hard to limit, a reservation from the manufacturer leads quite often to full exclusion of the distributor from e-commerce by the mere size and market penetration of the manufacturer. Given the example above, how may the manufacturer reserve e-commerce to its specific account only? Once e-commerce is available to these accounts, it is hard to limit this form of distribution only to the car rental agencies. They themselves might act as resellers from there on and the like. Given the other issues above like price transparency and RPM, any reservation of e-commerce by manufacturers is hard to limit. Therefore, e-commerce reservation by itself may lead to a full reservation and much more severe antitrust considerations.

6. It is unclear how courts would resolve cases focused on e-commerce limitation clauses, and thus companies are left with a high degree of uncertainty. This analysis has revealed that the European

¹³¹ See SOLEYMANI, *supra* note 6, at 8, *see also* Carlin, *supra* note 74, at 31.

¹³² *White Motor Co.*, 372 U.S. at 272.

Commission has not developed a framework to analyze e-commerce reservation clauses in light of art. 4 EC 2790/1999.¹³³

7. This article illustrates that the e-commerce medium is much more than just a catalyst for existing antitrust problems. It not only reveals existing problems but facilitates a new form of marketing which requires new rule making in both the U.S. and the E.U.

¹³³ Carlin, *supra* note 74, at 30; SCHULTZE, PAUTKE & WAGENER, *supra* note 86, at § 581.