Channel Islands Competition Laws

CICRA Guideline 11 - Vertical Agreements

Issued December 2012

What this guideline is about

This guideline is one in a series of publications designed to inform businesses and consumers about how we, the Channel Islands Competition and Regulatory Authorities (CICRA), apply competition laws in the Channel Islands. Details of how to obtain copies are at the back of this guideline.

The purpose of this guideline is to explain to consumers, businesses and their advisers the provisions in the Jersey and Guernsey competition laws in respect of vertical agreements, such as exclusive purchasing agreements, exclusive distribution agreements and franchise agreements. Specifically, this guideline has been prepared to explain Part 2 of the *Competition (Jersey) Law 2005* and Part II of *The Competition (Guernsey) Ordinance, 2012*.

This guideline should not be relied on as a substitute for the laws themselves. If you have any doubts about your position under the laws, you should seek legal advice.

Contents

1 Introduction

Why is competition important?

Open and vigorous competition is good for consumers because it can result in lower prices, new products of a better quality and more choice. It is also good for fair-dealing businesses, which flourish when markets are competitive.

Competition laws in the Channel Islands

In the Channel Islands, the *Competition (Jersey) Law 2005* and *The Competition (Guernsey) Ordinance, 2012,* prohibit anti-competitive behaviour, including anti-competitive agreements between businesses and the abuse of a dominant position in a market. They also require certain mergers and acquisitions to be notified to CICRA for approval.

What is CICRA?

The Jersey Competition Regulatory Authority (JCRA) and the Guernsey Competition and Regulatory Authority (GCRA) co-ordinate their activities with respect to competition law enforcement in the Channel Islands. For the purpose of this document, the JCRA and the GCRA are together referred to as CICRA, and all references in this document to CICRA should therefore be read as references to each of the JCRA and the GCRA, unless the context otherwise requires.

What powers does CICRA have?

Through the JCRA and GCRA, CICRA has a wide range of powers to investigate businesses suspected of breaching the law. We can order that offending agreements or conduct be stopped and levy financial penalties on businesses and individuals for the breach.

What types of organisation are considered a 'business'?

Throughout this guide, we refer to a 'business'. This term (also referred to as an 'undertaking' in the respective laws) means any entity engaged in economic activity, irrespective of its legal status, including companies, partners, cooperatives, States' departments and individuals operating as sole traders.

A Note on European Union (EU) Competition Law

The competition laws in Guernsey and Jersey are modelled on the competition provisions in the Treaty on the Functioning of the EU. The Channel Islands' legislation places certain obligations on CICRA and the Royal Court in each island when applying the competition laws:

- In Jersey, Article 60 of the *Competition (Jersey) Law 2005* provides that so far as possible questions arising in relation to competition must be dealt with in a manner that is consistent with the treatment of corresponding questions arising under EU competition law; and

- In Guernsey, Section 54 of *The Competition (Guernsey) Ordinance, 2012* provides that CICRA and the Royal Court must take into account the principles laid down by, and any relevant decisions of, the European courts in respect of corresponding questions arising under EU competition law.

As noted above, CICRA must endeavour to ensure that, as far as possible, competition matters arising in the Channel Islands are dealt with in a manner consistent with – or, at least, that takes account of – the treatment of corresponding questions under EU competition law. Relevant sources include judgments of the European Court of Justice or General Court, decisions taken and guidance published by the European Commission, and interpretations of EU competition law by courts and competition authorities in the EU Member States. Article 60 and Section 54, however, do not prevent us from departing from EU precedents where this is appropriate in light of the particular circumstances of the Channel Islands.

2 Vertical Agreements

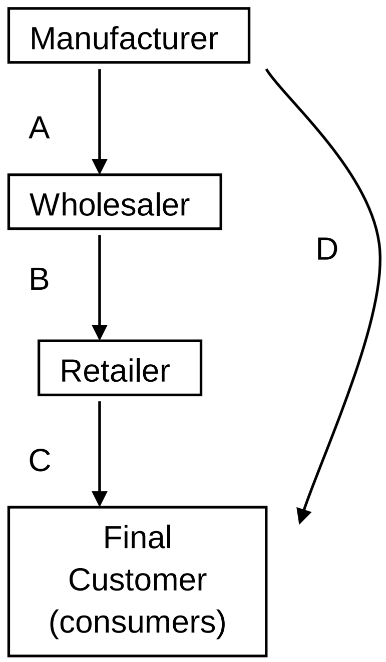
Common forms of vertical agreements include:

- exclusive purchase agreements;
- exclusive distribution agreements;
- exclusive customer allocation agreements;
- selective distribution agreements;
- franchise agreements; and
- exclusive supply agreements.

See the Appendix for a brief explanation of each of these types of agreements.

Distribution agreements between manufacturers and wholesalers or retailers are typical examples of vertical agreements. Sales to final customers who do not themselves have market power, and which solely determine the price and quantity of the goods or services provided, generally do not restrict competition and usually fall outside the anti-competitive agreement provisions in the laws.

Therefore, in the following diagram . . .



. . . transactions A and B generally would be potentially subject to the laws and covered by the material in this guideline, while transactions C and D i.e., the final sales to consumers, either by a retailer or direct from a manufacturer, are generally very unlikely to restrict competition in a market, although they may be subject to the laws' application in other circumstances.[1]

It is important to note at the outset that just because an agreement may be subject to the laws <u>does not</u> mean that it necessarily infringes the Law. The laws only apply to vertical agreements that have the object or effect of preventing or hindering competition in Jersey or Guernsey. Furthermore, in some cases, vertical agreements that may be subject to the prohibitions in the laws may still qualify for an exemption.

[1] If, for example, the retailer was a dominant firm and sold the good or service at excessive prices. See generally *CICRA Guideline 5 - Abuse of a Dominant Position*.

3 Basic Parameters

The same basic parameters that govern the applicability of competition law to horizontal agreements also apply to vertical agreements. For more information, see CICRA Guideline 2 - Anti-Competitive Agreements, which explains these parameters in detail.

Particular features in the context of vertical agreements are set out below.

1. Agreement

There must be an arrangement, agreement or understanding, a decision of an association of businesses, or a concerted practice involving businesses[2]. There does not need to be a formal, written agreement, so long as the businesses in question have a "meeting of the minds" as to the actions that each will, or will not, take.

2. At Least Two Businesses

There must be an agreement between <u>two or more businesses</u>. The laws do not apply to agreements between two parts of the same business, i.e. the same economic unit. Thus, in a vertical context, parties to certain forms of agency agreements are not considered to be distinct businesses, meaning that the laws are not applicable to their activities under the agreement in question. This factor is dealt with in more detail in section 4 below.

[2] Article 8 of the *Competition (Jersey) Law 2005* prohibits "***arrangements***" which have the "object or effect of hindering to an appreciable extent" competition. Article 1 of the Law then defines "arrangement" as meaning "any type of arrangement, agreement or understanding". Section 5 of *The Competition (Guernsey) Ordinance, 2012*, prohibits "***agreements between undertakings***" which have the "object or effect of preventing competition". Section 60 then defines "agreements between undertakings" as meaning "any type of agreement, arrangement or understanding..". For the purposes of this guideline, CICRA has referred to the tests as requiring us to consider whether there is an "agreement", recognising that this concept has a wide meaning under both laws.

3. Hindering or preventing competition

The vertical agreement in question must have the object or effect of hindering or preventing competition. This factor is dealt with in more detail in section 5 below.

4. In Jersey or Guernsey

The hindering or prevention of competition must occur in Jersey or Guernsey to be subject to the relevant competition law provisions. This means, as a practical matter, that an agreement entered into in a third country, for example,. the UK or France can still be subject to the laws if it has effects in Channel Islands' markets.

4 Agency agreements and distribution agreements

As noted above, genuine agency agreements are considered to fall outside the scope of the prohibition on anti-competitive agreements where the agent can be regarded in effect as part of the same business as the principal.

Whether a particular agent forms part of the same business as the principal depends on the level of financial or commercial risk the agent assumes in relation to the activities conducted for the principal.

Under competition law as defined in the EU, there are two types of risk:

- risks directly related to the contracts concluded by the agent on the principal's behalf (such as financing inventory or stocks); and
- risks related to investments (investments specifically required for the type of activity for which the agent has been appointed by the principal), which often are irrecoverable or sunk costs.

If the agent bears neither, or an insignificant amount of, these risks in relation to an activity it conducts on behalf of the principal, then the agent will be regarded as part of the same business as the principal, as opposed to a separate business, and hence the agreement between them will fall outside the scope of the laws. The financial risks arising from solely being an agent, for example, an agent's income being dependent on its ability to effectively perform on the principal's behalf, are not relevant in this context.

In addition to the assumption of risk, there are practical indications that often are used to characterise a particular agreement:

Does title to the goods sold pass from one business to the other?	If so, then the agreement in question is likely not to be an agency agreement
Does the business selling the goods pay for the costs of sales, advertising, marketing and transportation?	If so, then the agreement in question is likely not to be an agency agreement. This does not prevent an agent from arranging transport of goods to the Channel Islands, so long as these costs are ultimately paid by the principal.
Does the business selling the goods provide after-sales service that is fully paid for or reimbursed by the other business?	If so, then the agreement in question is likely to be an agency agreement.
Is the agent required to make major market-specific investments in equipment, premises, or training?	If so, then the agreement in question is likely not to be an agency agreement.
Does the business selling a product assume third-party liability for any damage the product may cause?	If so, then the agreement in question is likely not to be an agency agreement.

Finally, although individual agency agreements are excluded from the applicability of the laws, concerns could be raised if multiple principals that otherwise compete against each other all use the same agent in Jersey or Guernsey. This could be seen as leading to concerted action among the principals (arising from information exchanged via the common agent), which could raise independent concerns under the laws.

5 Hindering or preventing competition

Assuming the basic parameters discussed above are satisfied, a vertical agreement will only be subject to the laws if it has the object or effect of hindering or preventing competition in the supply of goods or services within Jersey or Guernsey[3].

The laws require CICRA to act 'with regard to' (Guernsey) or 'as consistently as possible' (Jersey) with the treatment of corresponding questions that have arisen under competition law in the European Union – see section 1 above. Our analysis of vertical agreements will therefore be informed by precedents established by the European Commission and European courts, as well as guidance provided by EU Member States such as the UK. To this end, we will have regard to authorities such as the European Commission's *Guidelines on Vertical Restraints*[4] and the *Guideline on Vertical Agreements* published by the UK Office of Fair Trading. Recourse to such materials, however, only informs our analysis, and does not prevent us from departing from EU precedents if we find that circumstances specific to markets in Jersey or Guernsey warrant such a departure.

Based on sources such as those listed above, set out below are some guiding factors that indicate when a vertical agreement may be seen as having the object or effect of hindering or preventing competition.

[3] Article 8 of the *Competition (Jersey) Law 2005* prohibits arrangements which have the "object or effect of ***hindering*** to an appreciable extent" competition. Article 1 of the Law then defines "hinder" as meaning "prevent, restrict or distort". Section 5 of *The Competition (Guernsey) Ordinance, 2012*, prohibits agreements which have the "object or effect of ***preventing*** competition". For the purposes of this guideline, CICRA has referred to the tests as requiring us to consider whether the relevant agreements or arrangements "hinder or prevent" competition.

[4] O.J. C 130/1, 19 May 2010

Resale Price Maintenance or Vertical Price Fixing

The general prohibition on price fixing agreements under the competition law applies equally in a vertical context, meaning that a manufacturer cannot set a re-seller's prices or enforce its adherence to minimum prices.[5] 'Prices' in this sense would include setting a re-seller's margin; setting the maximum discounts that a re-seller may apply; making payments from a manufacturer (such as rebates) conditional on a re-seller maintaining minimum prices; or the use of intimidation, threats, etc. to pressure a re-seller to maintain a minimum price.

We are likely to conclude that vertical agreements containing any such restrictions have the *object* of hindering or preventing competition.

Furthermore, the inclusion of such restrictions may result in the agreement in question not being capable of satisfying the criteria for an exemption.

Recommended retail prices or the imposition of Maximum Resale Prices

In contrast to vertical price fixing or establishing minimum resale prices, a manufacturer's recommendation of a resale price to a re-seller, or establishing a maximum resale price that a re-seller cannot exceed, are practices that are generally not seen as having the object of hindering or preventing competition. Such practices must be viewed in the context of their effects in the market before determining whether they are anti-competitive. The distinction between a manufacturer merely *recommending* a resale price and *enforcing* a re-seller's adherence to such a price, however, can be fine, and will often depend on the level of economic pressure the manufacturer can impose on the re-seller.

[5] Throughout these bullet points, we use the terms 'manufacturer' and 're-seller.' The use of these terms is for ease of reference, and the principles discussed herein apply equally to other vertical relationships.

Exclusive agreements are always more potentially problematic than non-exclusive ones

As a general rule, exclusive agreements in a vertical context, such as exclusive purchase or distribution agreements, raise more serious concerns than non-exclusive agreements.[6] This is because effective competition may be compromised if suppliers are 'tied' to certain re-sellers through exclusive obligations, or if re-sellers agree to sell only one manufacturer's product. This general rule does not mean that exclusive agreements will always be anti-competitive or that they may not otherwise qualify for an exemption. Exclusive distribution agreements can be important to ensure the supply of goods or services into the market, or to prevent one re-seller from 'free-riding' off the investments made by another re-seller, and the laws permit us to take such matters into account when analysing a specific agreement. Furthermore, just because an agreement is non-exclusive in form does not mean that it automatically falls outside of the restrictions in the laws when in fact it has an exclusive effect in Jersey or Guernsey.[7]

[6] An exclusive agreement includes agreements where a customer agrees to purchase all, or a substantial part (generally, 80% or more) of its total requirements of a given good or service from a single seller. It also includes agreements where a manufacturer agrees to provide a good or service through a single re-seller in Jersey or Guernsey.

[7] Such a situation could arise, for example, if a manufacturer sells a product into either Jersey or Guernsey through an agreement that is expressly non-exclusive, but the extent of the product's demand in Jersey or Guernsey means that the manufacturer is highly unlikely to appoint more than one re-seller for it in Jersey or Guernsey.

The longer the duration of an exclusive agreement, the potentially more problematic, and vice-versa

Exclusive supply obligations generally are viewed as more restrictive for dominant suppliers than non-dominant suppliers

The effect on competition arising from the duration of an exclusive supply agreement may be affected by the market power of the supplier. For suppliers holding a position of dominance in a given market, even a modestly tied market share, or exclusive contracts of limited duration, may hinder or prevent competition. On the other hand, exclusive agreements entered into by suppliers with a market share of 30% or less usually will not be seen as hindering or preventing competition, so long as they do not contain hard-core restrictions such as vertical price fixing.

Such an analysis requires us to define relevant markets and assess the levels of concentration in these markets. For more information, see *CICRA Guideline 7 – Market Definition*.

Restrictions on Inter-Brand competition are usually more potentially problematic then those on Intra-Brand competition

A general goal competition law is to provide consumers with a choice of the goods or services on offer. Thus, for example, vertical agreements that restrict the distribution of a particular brand of a product may not hinder or prevent competition if there are many competing brands for that product.

Generally, a manufacturer should not require a re-seller to purchase additional products or services from it as a condition for the re-seller purchasing the desired product or service from the manufacturer

For example, a re-seller wanting to sell a particular manufacturer's photocopiers should not be required to also purchase paper from the manufacturer as a condition for purchasing the photocopiers.

Generally, a manufacturer cannot force a re-seller to purchase the given good or service that is subject to a supply agreement solely from the manufacturer, even if the agreement is exclusive

The re-seller should remain free to purchase the good or service in question from other sources, such as wholesalers or other re-sellers.

Non-compete agreements after the expiration of a supply contract

Non-compete agreements must be necessary to protect commercially sensitive information transferred from the manufacturer to the re-seller. They must also be limited in scope and duration.[8]

[8] For more discussion on the analysis of ancillary restraints such as non-compete covenants, see JCRA Decision M072/06, *Neville Keith Moore, Glenda Faith Moore-Wilson & Island Estates LLP/A de Gruchy Co. & Ltd*, paragraphs 14-16 (8 November 2006).

Communications between re-seller and supplier under a supply agreement

In general, a re-seller is allowed to help a manufacturer protect and enforce its intellectual property rights by reporting potential infringement of such rights to the manufacturer. A manufacturer is also generally allowed to gain market intelligence through its re-sellers. However, concerns may arise in this area if several competing manufacturers contract with the same re-seller. In this scenario, the re-seller may need to have adequate internal safeguards in place to ensure that commercially sensitive information about one manufacturer is not passed to other manufacturers.

6 Exemptions and Guidance

There are circumstances under which a vertical agreement in either Guernsey or Jersey may qualify for an exemption from the prohibitions on preventing or hindering competition set out in the laws. However, a vertical agreement that hinders or prevents competition is prohibited by the laws unless it qualifies for an exemption. Applications for individual exemptions must be made to CICRA. To grant such an exemption, we must be satisfied under the laws that the agreement:

a) is likely to improve the production or distribution of goods or services, or to promote technical or economic progress in the production or distribution of goods or services;

b) will allow consumers of those goods or services a fair share of any resulting benefit;

c) does not impose on the businesses concerned terms that are not indispensable to attainment of the objectives mentioned in (a) and (b); and

d) does not afford the businesses concerned the ability to eliminate competition in respect of a substantial part of the goods or services in question.

For more information, see CICRA Guideline 2 – Anti-Competitive Agreements and CICRA Guideline 9 – Applications for Guidance and Exemptions.

It is important to note that the Vertical Agreements Block Exemption Regulation (BER)[9] that is applicable within the European Union does not apply in Jersey or Guernsey. Like other EU precedents, the BER is a source that we may use to inform our analysis of individual exemption applications in Jersey or Guernsey.

[9] Commission Regulation (EU) No 330/2010

7 Potential consequences of an infringement

The consequences for ignoring the laws' application to vertical agreements are potentially severe. An agreement that prevents or hinders competition and is not otherwise subject to an exemption is void as a matter of law. This concept of voidness applies not only to the agreement in question, but to all other agreements 'tainted' by the anti-competitive agreement. In a vertical context, this potentially means that not only would a re-seller's contract with a manufacturer be void and unenforceable if it is found to infringe the competition law, but the re-seller's contracts with its own customers for the goods or services in question also could be void and unenforceable.

If CICRA decides that an agreement infringes the laws, we may issue directions that we deem appropriate to the parties to bring the infringement to an end. We may also impose financial penalties, limited to 10% of the turnover of the business during the infringement, up to a maximum period of 3 years. Our decisions in this regard are subject to appeal by the parties to the Islands' Royal Courts.

Under the laws, third parties that have been harmed as a result of infringements of the laws may bring their own action for damages, including punitive damages, in the Royal Courts.

8 Abuse of dominance in a vertical context

This guideline has focussed on applicability of the Channel Islands' competition laws to common vertical agreements between businesses. It should be noted, however, that the laws' prohibition on abuses of dominance may also be applicable to certain forms of conduct in relation to vertical agreements. For example, a business that supplies a critical input to downstream markets may abuse a dominant position by refusing to supply the input, or offering to supply it only on discriminatory or excessive terms. Furthermore, an abuse of dominance may arise if a business that controls an essential facility denies access to that facility to others. The business in question must hold a dominant position in the market or markets in question.

For more information, see CICRA Guideline 5 – Abuse of a Dominant Position.

9 How can I find out more?

Please contact us if you have a question about the competition law in either island, or if you suspect that a business is breaching the law and wish to complain or discuss your concerns.

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Publications

All our publications, including the detailed guidelines we publish covering specific areas of the laws, can be downloaded from our website: www.cicra.je and www.cicra.gg. You can order copies of our publications by telephone from the numbers above.

Appendix - Common forms of vertical agreements

Exclusive Customer Allocation Agreements – a supplier agrees to sell its products to one distributor for resale to a particular class of customers.

Exclusive Distribution Agreements – a supplier agrees to sell its products only to one distributor for resale into a particular territory.

Exclusive Purchase Agreements – also called ‘single branding’ agreements, where the buyer is induced or obliged to concentrate 80% or more of its purchases of a particular type of product on the brand of one supplier.

Exclusive Supply Agreements –a supplier is obliged or induced to sell a particular good or service to only one buyer.

Franchise Agreements – a privilege given by a franchisor to a franchisee to sell its goods or services in a given area, with or without exclusivity. In addition to the supply of goods or services from the franchisor to the franchisee, such agreements often also include the licensing of the franchisor’s intellectual property rights, trade marks and know-how, and various forms of assistance provided by the franchisor to the franchisee.

Selective Distribution Agreements – a restriction imposed by a supplier on the number of distributors that may resell a particular product, based on selection criteria established by the supplier, for example, authorized distributors.