Competition (Jersey) Law 2005 Guidelines

11. Vertical Arrangements

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EXECUTIVE SUMMARY

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- This Guideline explains the potential application of Part 2 of the Competition (Jersey) Law 2005 (the 'Law') to common vertical arrangements such as exclusive purchasing agreements, exclusive distribution agreements, selective distribution agreements, and franchise agreements.

- Unlike countries within the European Union, no block exemption for vertical arrangements currently exists in Jersey. This means that the JCRA must first assess whether the arrangement in question has the object or effect of appreciably hindering competition in the supply of goods or services in Jersey or any part thereof. For example, exclusive distribution agreements may restrict competition by preventing competition between alternative distributors. Similarly, exclusive purchasing agreements (by preventing the customer from sourcing products from alternative suppliers) may restrict competition between alternative suppliers for sales to a particular customer. Whether these potential restrictions amount to real restrictions for the purpose of the Law, however, depends on whether they restrict competition *in practice* to an appreciable extent. If, for example, from an economic perspective, the size of the Jersey market is such that only a single distributor is viable in any event, then any contractual exclusivity will have no practical effect of restricting competition which might otherwise have taken place, and thus the exclusivity will not be caught by the Law.

- Other the other hand, the JCRA normally will consider certain other restrictions, such as those that fix a re-seller's price or establish a minimum re-sale price, as having the object of appreciably hindering competition and hence void under the Law, without having to establish that they have an anti-competitive effect.

- Vertical arrangements that have the object or effect of appreciably hindering competition in the supply of goods or services in Jersey or any part thereof are void under Jersey law, unless they qualify for an exemption. The JCRA may grant an exemption, upon application for one by a party to the arrangement, if it is satisfied that the arrangement (1) creates efficiencies, (2) that benefit consumers, (3) contains no overbroad restrictions, and (4) otherwise does not substantially eliminate competition.

- In making such assessments, the Law requires the JCRA, so far as possible, to have regard to analogous precedents that have arisen under competition law within the European Union. In this respect, the JCRA will have regard to judgments of the European Court of Justice and Court of First Instance, as well as relevant decisions and guidelines of the European Commission. Such materials provide guidance only, however, to the assessment of vertical arrangements under the Law in Jersey.

Contents **Page**

I. INTRODUCTION 4

II. GENERAL OVERVIEW OF VERTICAL ARRANGEMENTS POTENTIALLY COVERED BY THE LAW 4

III. BASIC PARAMETERS ON THE POTENTIAL APPLICABILITY OF PART 2 6

IV. AGENCY AGREEMENTS COMPARED TO DISTRIBUTION AGREEMENTS 7

V. APPRECIABLE HINDERING OF COMPETITION 8

VI. EXEMPTIONS & GUIDANCE 11

VII. POTENTIAL CONSEQUENCES OF AN INFRINGEMENT 11

VIII. A QUICK NOTE ON ABUSES OF DOMINANCE IN A VERTICAL CONTEXT 12

DEFINITIONS APPENDIX 13

DRAFT

I. INTRODUCTION

Part 2 of the Competition (Jersey) Law 2005 (the 'Law') prohibits arrangements between two or more undertakings which hinder competition in Jersey or part of it. The JCRA's **Guideline on Anti-Competitive Arrangements** explains the general concepts of this prohibition and their potential applicability to so-called 'horizontal arrangements' i.e., agreements between two or more companies in the same relevant market or the same level of distribution.

Part 2 is also applicable to so-called 'vertical arrangements' i.e., agreements between two or more companies at different levels of a distribution chain, such as arrangements between a manufacturer and a wholesaler or a wholesaler and a retailer. This Guideline provides a summary of the Law's potential application in this area.

A Note on European Competition Law

Part 2 is modelled on Article 81 of the Treaty establishing the European Union ('EU'). Throughout this Guideline, we refer to precedents and principles from EU competition law. Under Article 60 of the Law, the JCRA must attempt to ensure that as far as possible, questions arising in Jersey are dealt with in a manner consistent with the treatment of corresponding questions arising under EU competition law. Relevant sources include judgments by the European Court of Justice or Court of First Instance, decisions taken and guidance published by the European Commission, and interpretations of EU competition law by member state courts and competition authorities. Article 60, however, does not prevent the JCRA from departing from European precedents based on particular circumstances in Jersey.

Disclaimer

This Guideline is not a substitute for the Law. Anyone with particular questions concerning the application of this Guideline or the Law to specific facts should seek legal advice. Proof that a person has failed to comply with this Guideline is not proof that a person failed to comply with the law. The JCRA may, however, rely on non-compliance with the Guideline as evidence toward establishing an infringement of the Law. This Guideline remains subject to amendment or revocation by the JCRA.

II. GENERAL OVERVIEW OF VERTICAL ARRANGEMENTS POTENTIALLY COVERED BY THE LAW

A goal of Part 2 is to facilitate the supply of goods and services into Jersey's domestic markets. It thus tries to facilitate a range of goods and services offered to consumers in Jersey.

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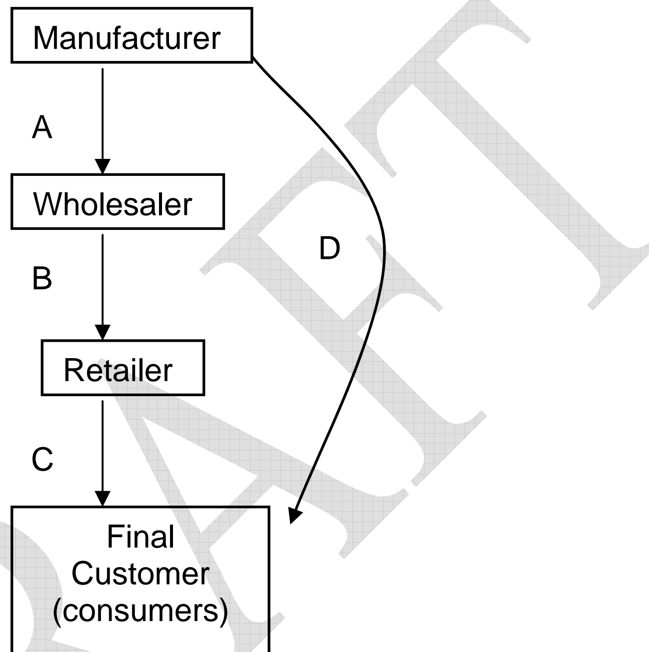
Common forms of vertical arrangements include: exclusive purchase agreements, exclusive distribution agreements, exclusive customer allocation agreements, selective distribution agreements, franchise agreements, and exclusive supply agreements (see Appendix 1 for a brief explanation of these agreements). Distribution agreements between manufacturers and wholesalers or retailers are typical examples of vertical agreements. Sales to final customers that themselves do not have market power, however, which solely determine the price and quantity of the goods or services provided, generally do not restrict competition and fall outside of Part 2. Therefore, in the following diagram . . .



. . . transactions A and B generally would be potentially subject to this Guideline and Part 2, while transactions C and D (i.e., the final sales to consumers, either by a retailer or direct from a manufacturer) are generally not seen as restricting competition and thus fall outside of Part 2, although they may be subject to the Law's applicability in other circumstances.[1]

It is important to note at the outset that just because an arrangement may be subject to Part 2 does not mean that it necessarily infringes the Law. The Law only applies to vertical arrangements that have an object or effect of appreciably hindering competition in Jersey or any part thereof. Furthermore, vertical arrangements that may be subject to this prohibition still may qualify for an exemption from the JCRA.

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

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III. BASIC PARAMETERS ON THE POTENTIAL APPLICABILITY OF PART 2

The same basic parameters that govern the applicability of Part 2 to horizontal arrangements also apply to vertical arrangements. The JCRA's **Guideline on Anti-Competitive Arrangements** explains these parameters in detail, but particular features in the context of vertical agreements are set forth below.

1. Arrangement

For Part 2 to apply there must be an 'arrangement', which the Law defines as 'any type of arrangement, agreement, and understanding, and in respect of an arrangement made by undertakings includes a decision by an association of undertakings and a concerted practice involving undertakings.'[2] For Part 2 to apply, the arrangement in question does not have to be a formal, written agreement, so long as the undertakings in question have a meeting of the minds as to the actions that each will, or will not, take.

2. At Least Two Undertakings

For Part 2 to apply there must be an arrangement between two or more undertakings. An 'undertaking' includes any natural person, or group of persons, capable of carrying on commercial or economic activities relating to goods or services, whatever its legal status. It includes companies, firms, businesses, and partnerships, individuals operating as sole traders, agricultural co-operatives, trade associations and non profit-making organisations. It also includes the States, a body created by Act of the States and any States Authority, to the extent that they are carrying on an economic activity. An economic activity includes any activity consisting of offering goods or services in a market.

Part 2 of the Law does not apply to arrangements between persons that form part of the same undertaking; i.e. the same economic unit. Thus, in a vertical context, parties to certain forms of agency agreements are not considered to be distinct undertakings, meaning that Part 2 is not applicable to their activities under the agreement in question. This factor is dealt with in more detail in the following section.

3. Appreciably Hinder Competition

For Part 2 to apply, the vertical arrangement in question must have the object or effect of appreciably hindering competition. This requirement is discussed in more detail, below.

4. In Jersey or Any Part of Jersey

[2] Art. 1, Competition (Jersey) Law 2005.

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For Part 2 to apply, the appreciable hindering of competition must occur in Jersey or any part thereof. This means, as a practical matter, that an agreement entered into in a third country (e.g., the UK, Guernsey, France) can still be subject to Part 2, if it has effects in Jersey's markets.

IV. AGENCY AGREEMENTS COMPARED TO DISTRIBUTION AGREEMENTS

As noted above, genuine **Agency Arrangements** are considered to fall outside the scope of Part 2 where the agent can be regarded in effect as part of the same undertaking as the principal.

Whether a particular agent forms part of the same undertaking 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 undertaking as the principal, as opposed to a separate undertaking, and hence the agreement between them will fall outside the scope of Part 2. 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 characterize a particular arrangement:

Does title to the goods sold pass from one undertaking to the other?	If so, then the arrangement in question is likely not an agency arrangement
Does the undertaking selling the goods pay for the costs of sales, advertising, marketing, and transportation?	If so, then the arrangement in question is likely not an agency arrangement. This does not prevent an agent from arranging transport of goods to Jersey, so long as it is ultimately paid for by the principal.
Does the undertaking selling the goods provide after-sales service that is fully paid	If so, then the arrangement in question

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for or reimbursed by the other undertaking?	likely is an agency arrangement.
Is the agent required to make major market specific investments in equipment, premises, or training?	If so, then the arrangement in question is likely not an agency arrangement.
Does the undertaking selling a product assume third-party liability for any damage the product may cause?	If so, then the arrangement in question is likely not an agency arrangement.

Finally, although individual agency arrangements are excluded from the applicability of Part 2, concerns could be raised under Part 2 if multiple principals that otherwise compete against each other all use the same agent in Jersey. 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 Law.

V. APPRECIABLE HINDERING OF COMPETITION

Assuming the basic parameters discussed above are satisfied, a vertical arrangement will only be subject to Part 2 if it has the object or effect of hindering to an appreciable extent competition in the supply of goods or services within Jersey or any part of Jersey.

Because Article 60 requires the JCRA to interpret Part 2's application to vertical arrangements in Jersey as consistently as possible with the treatment of corresponding questions that have arisen under competition law in the European Union, the JCRA's analysis of vertical arrangements before it will be informed by precedents established by the European Commission, 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, O.J. C 291/1 (13 Oct. 2000), the Commission's document entitled *Competition policy in Europe: The competition rules for supply and distribution agreements* (2002), and the Guideline on Vertical Agreements published in December 2004 by the UK's Office of Fair Trading. Recourse to such materials, however, only informs the JCRA's analysis, and Article 60 does not prevent the JCRA from departing from EU precedents if it finds that circumstances specific to markets in Jersey warrant such a departure.

Based on sources such as those listed above, set forth below are some general guiding principles of the factors that indicate when a vertical arrangement may be seen as having the object or effect of appreciably hindering competition in Jersey or any part of Jersey.

- **Resale Price Maintenance or Vertical Price Fixing** – Part 2's general prohibition on price fixing agreements applies equally in a vertical context, meaning that a manufacturer cannot set a re-seller's prices or enforce its

adherence to minimum prices.[3] 'Prices' in this sense would include setting a re-seller's margin; setting maximum discounts 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. The JCRA is likely to conclude that vertical arrangements containing any such restrictions are likely to have the object to appreciably restricting competition in Jersey. Furthermore, the inclusion of such restrictions may result in the arrangement in question not being capable of satisfying the Law's necessary 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 appreciably hindering competition. Such practices must be viewed in the context of their effects in the market before determining whether Part 2 applies. 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.

- **Exclusive agreements are always more potentially problematic than non-exclusive** – As a general matter, exclusive agreements in a vertical context, such as exclusive purchase or distribution agreements, raise more serious questions under Part 2 than non-exclusive agreements.[4] This is because the general goal identified above – providing suppliers with a means of offering their goods and services into Jersey – may be compromised if suppliers are 'tied' to certain customers only through exclusive obligations, or if re-sellers in Jersey agree to sell only one manufacturer's product. This general rule does not mean that exclusive agreements always will infringe Part 2, 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 Jersey, or to prevent one re-seller from 'free-riding' off the investments made by another re-seller, and the Law permits the JCRA to take such matters into account when analyzing a specific arrangement. Furthermore, just because an arrangement is non-exclusive in form does not mean that it automatically falls outside of Part 2, when in fact it has an exclusive effect in Jersey.[5]

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[3] Throughout these bullet points, we use the terms 'manufacturer' and 're-seller.' The use of these terms is solely for ease of reference, and the principles discussed herein apply equally to other vertical relationships.
[4] 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 only provide a good or service through a single re-seller in Jersey.
[5] Such a situation could arise, for example, if a manufacturer sells a product into Jersey through an agreement that is expressly non-exclusive, but the extent of the product's demand in Jersey means that the manufacturer is highly unlikely to appoint more than one re-seller for it in Jersey.

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- **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 competition. On the other hand, exclusive agreements entered into by suppliers with a market share of 25% or less usually will not be seen as appreciably hindering competition, so long as they do not contain hard-core restrictions such as vertical price fixing. Such an analysis requires the JCRA to define relevant markets and assess the levels of concentration in these markets, as set forth in the JCRA's **Guideline on Market Definition.**

- **Restrictions on <u>Inter-Brand</u> competition are usually more potentially problematic then those on <u>Intra-Brand</u> competition** – As stated above, a general goal of Part 2 is to provide consumers in Jersey 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 in Jersey may not appreciably hinder competition, if there exists many competing brands for that product in Jersey.

- **A manufacturer generally 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 may not be required to also purchase paper from the manufacturer as a condition required to purchase the photocopiers.

- **A manufacturer generally 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 sources, such as wholesalers or other re-sellers.

- **Non-compete agreements after the expiration of a supply contract –** 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.[6]

- **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

[6] For more discussion on the JCRA's analysis of ancillary restraints such as agreement to not compete, see JCRA Decision M072/06, Neville Keith Moore, Glenda Faith Moore-Wilson & Island Estates LLP/A de Gruchy Co. & Ltd, ¶¶ 14-16 (8 Nov. 2006).

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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 Jersey. In this scenario, the re-seller may need to have adequate internal safeguards in place to ensure that commercially sensitive information from one manufacturer is not passed to other manufacturers.

VI. EXEMPTIONS & GUIDANCE

A vertical arrangement that appreciably hinders competition is prohibited by the Law if it qualifies for an exemption under Part 2. Applications for **individual exemptions** may be made to the JCRA. To grant such an exemption, the JCRA must be satisfied under the Law that the arrangement in question satisfies the following four criteria:

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 undertakings concerned terms that are not indispensable to attainment of the objectives mentioned in sub-paragraphs (a) and (b); and

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

Further guidance concerning these criteria and the exemption process is provided in the JCRA's Guidelines on **Anti-Competitive Arrangements** and **Applications for Guidance & Exemption**.

It is important to note that the Block Exemption Regulation ('BER')[7] that is applicable within the European Union does not apply in Jersey. Like other EU precedents, the BER is a source the JCRA may use to inform its analysis of individual exemption applications in Jersey.

The JCRA remains available to provide both **formal and informal guidance** to parties of whether or not their vertical arrangements appreciably hinder competition and whether an individual exemption is necessary.

VII. POTENTIAL CONSEQUENCES OF AN INFRINGEMENT

The consequences for ignoring the Law's application to vertical arrangements are potentially severe. An arrangement that appreciably hinders competition under Part 2

[7] Regulation (EC) No 2790/1999.

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and is not otherwise subject to an exemption is void as a matter of Law. This concept of voidness applies not only to the arrangement in question, but to all other arrangements 'tainted' by the anti-competitive arrangement. 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 Part 2, but the re-seller's contracts with its own customers for the goods or services in question also could be void and unenforceable.

The JCRA also may impose financial penalties, limited to 10% of an undertaking's turnover in Jersey for a maximum period of 3 years, for Law infringements that are committed intentionally, negligently, or recklessly. In addition, the JCRA may issue directions it deems appropriate to bring the infringement to an end. The JCRA's decisions in this regard are subject to appeal by the parties to Jersey's Royal Court.

Finally, under the Law third parties that have been harmed as a result of infringements of the Law may bring their own action for damages, including punitive damages, in Jersey's Royal Court.

VIII. A QUICK NOTE ON ABUSES OF DOMINANCE IN A VERTICAL CONTEXT

This Guideline has focussed on the Law's potential applicability to common vertical arrangements between undertakings under Part 2. It should be noted, however, that the Law's prohibition on abuses of dominance contained in Part 3 may also be applicable to certain forms of vertical conduct. For example, an undertaking 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 an undertaking that controls an essential facility denies access to that facility to others. To infringe Part 3, the undertaking in question must hold a dominant position in the market or markets in question. The Law's potential applicability to these types of actions is explained further in the JCRA's **Guideline on Abuse of a Dominant Position**.

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DEFINITIONS APPENDIX

Common forms of vertical arrangements:

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 – obliged or induced a supplier to sell a particular good or service to only one buyer.

Franchise Agreements – a privilege given by a franchiser 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 franchiser to the franchisee, such agreements often also include the licensing of the franchiser's intellectual property rights, trade marks and know-how, and various forms of assistance provided by the franchiser 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 (e.g., 'authorized distributors').

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