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Unilateral Refusal to Supply: an Agreement in Disguise?

Hans Henrik Lidgard

Strategic Planning and Antitrust Concerns

A large company with a subsidiary organisation in Europe can organise its internal affairs and distribute responsibilities between producing units and selling subsidiaries without being regulated by competition law.¹ The rules do not affect inter-company affairs (there is no intra-enterprise conspiracy). It is not until harmful effects occur on the market that the competition rules will apply.

In contrast, small and medium-sized companies (SMEs) do not normally have the advantage of an international organisation and have to distribute their products in co-operation with others. Parties enter agreements that regulate their respective rights and obligations and seek to create a competitive distribution system. This vertical relation is regulated by Article 85 ECT² and a considerable amount of implementing legislation.³ It is also measured by how it affects third parties.

Undoubtedly, from a company perspective it is easier to develop a marketing strategy within a company than to arrange it in collaboration with others. Internal affairs can be controlled but agreements are left to the discretion of authorities. This simple conclusion has promoted concentrative trends over the last decades. European competition policy suffers

from a systems failure,⁴ often discriminating against harmless vertical collaboration between SMEs and in favour of arrangements made by major companies with fully integrated organisations.

Thus, the competition rules control only the unilateral activities of dominant companies and combinations between non-dominant entities. A borderline between dominance and non-dominance must be established. The non-dominant company should in principle be free unilaterally to decide and carry out its business strategy even if it contains anti-competitive elements. The reason is that there are, *ex hypothesi*, alternatives which customers can turn to.

It also becomes important to define a unilateral activity and distinguish it from collaboration. The distinction should be simple to make, but in reality it may not be all that easy. For example, is it a unilateral activity to decide to market products through a system of selective distribution? Does this unilateral strategy become an integral part of a relationship from the moment the producer enters into agreements to execute it? What happens once the strategy is put into practice and the parties act in conflict with it? What obligations occur when third parties require supply in conflict with the strategy? Is a refusal to supply a lawful unilateral activity or a prohibited concertation?

Several of these delicate questions are under review by the Court of First Instance in *Bayer*. The court now has the possibility of clarifying many fundamental competition issues that have not been addressed in a clear and systematic way in the past.

This paper presents the *Bayer* case, analyses prior case law development in the E.U., contrasts the same with the parallel U.S. development to arrive at conclusions regarding a distinction between lawful unilateral activities and controllable combinations and closely related issues.

The Bayer Decision—Yet Another Test Case

In what it considers a test case, the Commission appears to advance a very broad *per se* prohibition on Bayer's attempts to restrict trade between Member States.⁵ The message is that industry—irrespective of form—may not undertake activities

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1 Intra-enterprise conspiracy is not a valid test as established by the Community Courts. See section below, "Unilateral activity and dominance".

2 Case 56/65 *La Société Technique Minière v. Maschinenbau Ulm GmbH (STM-MBU)*, [1966] E.C.R. 235; and Cases 56 and 58/64, *Etablissement Consten S.A. & Grundig Verkaufs GmbH v. Commission* [1966] E.C.R. 299.

3 See, e.g. the Distribution Regulation, Commission Regulation (EEC) No. 1983/83 of June 22, 1983 on the application of Article 85(3) of the Treaty to categories of exclusive distribution agreements, [1983] O.J. L173/5; Purchasing Regulation, Commission Regulation (EEC) No. 1984/83 of June 22, 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements, [1983] O.J. L173/5; Franchise Regulation, Commission Regulation (EEC) No. 4087/88 of November 30, 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, [1988] O.J. L359/46.

4 See B.E. Hawk, "System Failure: Vertical Restraints and E.C. Competition Law", C.M.L. Rev. 1995 p. 973; and H.H.P. Lugard, "Vertical Restraints under E.C. Competition Law: A Horizontal Approach", [1996] 3 E.C.L.R. 166.

5 Commission Decision 96/478/EC, *Bayer AG-Adalat*, January 10, 1996: [1996] O.J. L201/1, [1996] 5 C.M.L.R. 416.

which aim at separating the different national markets. European competition legislation would not only and perhaps not even primarily serve free competition, but rather free movement of goods.⁶

The facts

Bayer's leading product "Adalat" is a calcium antagonist used in the treatment of cardiovascular diseases. Calcium antagonists represent 16.3 per cent of the market in the therapeutical area⁷ and Adalat is a leading brand, ranking ninth in the world's top 40 pharmaceutical products in 1992.

The product has a strong market presence in the United Kingdom whereas other therapeutic methods prevail in Southern Europe. The U.K. market price is often 25 to 50 per cent higher than in countries like France, Greece and Spain. The price difference is far from the highest in Europe, but is still sufficient to encourage parallel trade in Adalat. Parallel trade is simplified by the transparency of European pharmaceutical prices, the value of the product, the ease of transportation and the fact that pharmaceutical products are identical in different markets.

Bayer produces and markets Adalat in the Member States. Physical distribution is, however, for practical⁸ or legal reasons⁹ left with independent wholesalers.

Normally, pharmaceutical producers and wholesalers collaborate in long-term relations under

which the wholesalers buy the product and sell it on to the retailer (pharmacy). The wholesaler's main function is to provide the product on short notice in the small quantities required. He collects payments and passes returned products back to the producer. Wholesalers are not involved in direct marketing or advertising (where legally permitted) of the product and their proceeds are often calculated as a fixed margin (ranging between 9.7 and 16.5 per cent).

French and Spanish wholesalers ordered excess quantities of Adalat and shipped those to parallel importers in the United Kingdom. Due to existing price differences the wholesalers achieved a far better margin on export transactions than in their home market. Gradually parallel trade in Adalat cannibalised some 50 per cent of the total British market.

Naturally this trade had a detrimental impact on Bayer's U.K. affairs and its overall profitability. Bayer, like all other major pharmaceutical companies, was forced to consider counter-measures. The Commission shows in its Decision that the matter had often been discussed within Bayer and that all kind of measures—some more legal than others—had been contemplated.¹⁰ In the end Bayer confined itself to reducing order quantities from wholesalers to such quantities as Bayer considered were needed locally.

The wholesalers in turn tried their best to obtain excess supplies. To increase the pressure, orders were sent by registered mail. Wholesalers also stopped informing Bayer of the destination of deliveries and tried to obtain additional supplies through co-ordinated actions. Bayer was not able to stop the parallel sales, but was able, in combination with currency fluctuations, to reduce their impact.

The supply agreements between Bayer and its wholesalers did not contain restrictions on onward sale of the product and Bayer did not otherwise impose any sales restrictions. It simply refused to supply or reduced order quantities. Often Bayer did not care to inform the wholesaler of the reason for the supply restriction or reference was simply made to production problems. When a wholesaler proposed to enter into a forecasting system which would allow Bayer to plan its needs, Bayer simply did not respond.

¹⁰ It is probably safe to say that Bayer was not the only pharmaceutical company considering how to combat parallel trade in its products. More likely is that every major R&D-oriented pharmaceutical producer has been encountering similar problems and carefully scrutinised different options.

⁶ H.H. Lidgard, "Territorial Restrictions in Vertical Relations", submitted for publication in *World Competition* during autumn 1997.

⁷ The relevant market is defined by reference to the major therapeutic uses of the product (coronary heart disease and hypertension), which puts Adalat in competition not only with other calcium antagonists but also with ACE inhibitors, beta blockers and diuretics. This definition of the product market is in line with definitions developed by the Commission in merger cases like Decision IV/M.072 *Sanofi and Sterling Drug Inc.*, [1993] 5 C.M.L.R. M1. It seems only natural to group medicines according to their therapeutic properties, *i.e.* intended use. A more narrow definition would in all likelihood have left Adalat with a dominant position and the possible application of Article 86.

⁸ Most products are distributed to the pharmacy organisation and mere numbers support the need to have a specialised distribution organisation. According to the Decision there are 103,500 pharmacies and 14,650 drugstores in the Community of Twelve. Direct sales of pharmaceutical specialities to pharmacies represent 7 per cent of distribution in France, 3 per cent in Spain and 19 per cent in the United Kingdom. Pharmaceutical wholesalers are thus the main intermediaries between laboratories and retailers in the Community of Twelve. European wholesalers thus distribute 90 per cent of medicinal products. There are about 500 wholesalers.

⁹ French law grants distributing wholesalers a monopoly for the distribution of medicinal products to pharmacies. In return for this monopoly, it imposes a number of public service requirements.

The Commission's Decision

Bayer had, according to the Commission, imposed an export ban on sales transactions with wholesalers and the wholesalers had complied with this ban so that it had become an integral part of their commercial relation. The resulting "agreement" fulfilled the requirements of Article 85(1) and ran counter to the competition rules. Bayer was fined 3 million ECU and ordered to inform its wholesalers that export of Adalat be allowed.

CFI decides interim measures

On appeal¹¹ Bayer succeeded in organising its internal affairs so that legal deadlines were met.¹² At the request of Bayer, and as an interim measure, the CFI suspended the information obligation.

Bayer's main argument¹³ is that the analysis made by the Commission removes a central element from the concept of agreement within the meaning of Article 85, namely the existence of a joint intention. On the other hand, the Commission maintains that the conduct had not been unilateral. In the Commission's argument, "an agreement within the meaning of Article 85(1) requires an interest of the two parties in concluding that agreement, without the interest necessarily being held in common. Here, the applicant's interest was to prevent, or at least reduce, parallel exports. The wholesalers' interest was to avoid a reduction in supplies of Adalat."¹⁴

According to the CFI an agreement requires joint intent, but not necessarily a formal consent. Such consent may also arise implicitly from the conduct of undertakings in continuing commercial relations. The CFI relied on prior case law in the European Community. No element could be overlooked and the court was at least in this preliminary phase sceptical of the efforts of the Commission to create new

law by applying Article 85(1) to a unilateral refusal to supply.

Unilateral Activity in European Case Law Development

Bayer is not the first case where the Community courts have addressed the question of effects of unilateral activity on competition. Such discussion frequently occurs. The matter is less complicated in relation to Article 86, but has also been considered in relation to Article 85.

Unilateral activity and dominance

In *Parker Pen*,¹⁵ the company divided the European market between its different subsidiaries and cross-border transactions were referred to the subsidiary in the country where the order was to be executed. The practice was held to be an abuse of a dominant position and the ECJ in its 1996 judgment did not accept that Parker Pen and its subsidiaries should be treated as independent companies under Article 85. They were held to form a single economic unit within which the subsidiaries did not enjoy real autonomy in determining their course of action. They were merely carrying out the instructions of the parent company. Parker Pen's practice of dividing markets was an abuse of a dominant position. Such unilateral conduct could fall under Article 86 of the Treaty if the other conditions for its application were fulfilled.

This 1996 judgment is a follow up of earlier cases¹⁶ and reflects the scheme of the Treaty, where Article 86 is applied to groups of companies forming an economic unit with a dominant position. It was an abuse by Parker Pen to refer requests for delivery rather than to supply according to the order. Does the position mean that the dominant company has a general obligation to supply whenever a buyer requests delivery and has it lost its ability unilaterally to design and carry out a strategy for its own products?

No doubt special reasons are required if a dominant company is breaking an existing commercial relation and by that causing harm to a former buyer. It is equally doubtful if a dominant company which

11 CFI (order by the President) T-41/96R, *Bayer AG v. Commission*, [1996] 5 C.M.L.R. 290.

12 See the fairly hard treatment of Bayer for its failure to meet the two months deadline prescribed by Article 173 ECT in Case C-195/91P, *Bayer AG v. Commission* ("Bayo-n-ox") [1994] E.C.R. I-5619, [1996] 4 C.M.L.R. 32.

13 There appears to be three principle issues in the case: a) can a unilateral refusal to supply always be construed as an "agreement"; b) do conditions in the pharmaceutical industry merit special rules; and finally c) can a producer require that its partners do not engage in passive sales outside their allotted territories? Bayer appears to be focusing on the first issue and is shying away from the last. It is probably good tactics, but the questions are interrelated and a broader approach is possible for the CFI, if it so wishes.

14 T-41/96R, *Bayer AG v. Commission*, n. 11 above, para. [39].

15 ECJ, Case C-73/95-P, *VIHO Europe BV v. Commission* ("Parker Pen"), October 24, 1996: Proceedings 28/96 p. 26.

16 See, e.g. ECJ, Case 22/71, *Beguelin Import Co. v. G.L. Import Export SA* [1971] E.C.R. 949, and Case 15/74, *Centrafarm BV v. Sterling Drug* [1974] E.C.R. 1147.

has full control over a raw material can refuse supplies—even if there has been no prior relation.¹⁷

Companies are not considered as dominant solely because of the monopoly conferred by industrial property rights and can, at least in principle, freely design their strategy regarding such property.¹⁸ In certain situations—especially when the property rights allow control over secondary, unsatisfied markets—the situation may change based on the theory of essential facilities.¹⁹

However, when the company has decided from the beginning to pursue a strategy of providing the market not only with the patented substance itself, but also the end product, it is not likely that it will have to create competition in its own core business.²⁰

In summary, the legislation and the case law in relation to Article 86 are designed to cover unilateral activities. The dominant company has a special responsibility²¹ when it unilaterally decides to refuse supplies. If there are specific circumstances related to the buyer, the company may have a lawful argument for its refusal. Otherwise, it is only when the dominant company has a strategy of exploiting its own intellectual property rights or when it from the start has decided to produce the end product itself, that a refusal can be accepted.

Unilateral activities and non-dominance

Does the same restrictive interpretation apply to the unilateral activities of non-dominant companies? Do

17 ECJ, Cases 6 and 7/73, *Istituto Chemioterapico Italiano and Commercial Solvents Corp. v. Commission* [1974] E.C.R. 223.

18 See ECJ, Case 237/87, *Volvo AB v. Erik Veng (U.K.) Limited* [1988] E.C.R. 6211; and Case 53/87, *Consortio Italiano Della Componentistica Di Ricambio Autoveicoli and Maxicar v. Regie Nationale des Usines Renault, (Renault)* [1988] E.C.R. 6039.

19 See ECJ, Cases C-241/91 and C-242/91, *Radio Telefis Eireann and Independent Television Publication Limited v. Commission (Magill TV Guide)* [1995] E.C.R. I-743.

20 Commission information, *Lederle-Praxis Biologicals*, 1994 Competition Report at 353. Lederle tried to get access to vaccine products developed and produced by the Pasteur Merieux/Merck JV for itself. The Commission stated that "... it is highly doubtful whether one could impose an obligation upon a dominant firm . . . to share its intellectual property rights with third parties, to allow them to develop, produce and market the same products which the alleged dominant firm was also seeking to develop, produce and market . . . Even a simple refusal to supply could not be considered as an abuse as Lederle was not an existing customer that had found itself in a situation of factual dependence for supply of Hep B. The companies did not break off an ongoing relationship with Lederle."

21 R. Subioto, "The special responsibility of dominant undertakings not to impair genuine undistorted competition", *World Competition*, March 1995, Vol. 18 No. 3, pp. 5-30.

they also have an obligation to supply in most instances or may they freely decide when they will and when they will not contract?

The normal answer under Article 85 would be that as long as companies do not have a dominant position and they are not co-ordinating with others, they should come outside the E.C. competition rules and be allowed to work freely under their strategy. A review of the case law development, however, does not confirm such a simple answer.

First, the company has to consider the narrow interpretation of the notion "relevant market" made by the Commission and the Community courts. It makes companies who were not aware of it dominant in narrowly defined market segments.²²

Secondly, even in situations where the question of dominance would not arise, the E.C. authorities have a wide definition of what is to be understood by an agreement under Article 85. The Treaty already includes "concerted practices" and this is taken to cover co-ordination between undertakings that, without going as far as to amount to an agreement, knowingly substitutes a practical co-operation between them for the risks of competition.²³ This wide notion catches many activities that could also be said to be unilateral decisions and by that makes Article 85 fully applicable. There is no requirement as to form,²⁴ which reinforces the wide and sometimes arbitrary interpretation.

Agreement stipulations inserted at the insistence of one party

In almost every relation between two companies the terms of the collaboration are inserted at the wish

22 ECJ, Case 22/78, *Hugin Kassaregister AB v. Commission* [1979] E.C.R. 1869 is demonstrating the narrow interpretation sometimes made by the authorities.

23 ECJ, Case 48/69, *Imperial Chemical Industries Ltd v. Commission (ICI)* [1972] E.C.R. 619, para. [118]: "While it is permissible for each manufacturer to change his prices freely and to take into account for this purpose the behaviour, present and foreseeable, of his competitors, it is, on the other hand, contrary to the competition rules of the Treaty for a manufacturer to cooperate with his competitors, in whatever manner, to determine a coordinated course of action relating to an increase in prices, and to ensure its success by the prior elimination of all uncertainty as to mutual behaviour relating to the essential elements of this action, such as rates, subject matter, date and place of the increases."

24 In *Sandoz*, n. 42 below, summary 2, the ECJ held that "In order to constitute an agreement within the meaning of Article 85 of the Treaty it is sufficient that a provision is the expression of the intention of the parties without it being necessary for it to constitute a valid and binding contract under national law." In Case 28/77, *Tepea BV v. Commission* [1978] E.C.R. 1391 and Case T-43/92 *Dunlop*, n. 26 below, the Community courts disregarded requirements that the agreement be in writing.

of one partner. This is done because it is a part of its corporate strategy or it suits its wishes in other respects. The fact that the provision is agreed upon does not necessarily suggest that the opponent would have suggested a similar stipulation himself. On balance it can be tolerated.

Such one-sided, but agreed, stipulations are not to be considered a unilateral activity and the defence is rarely invoked. In *Distillers*,²⁵ the U.K. group of spirits producers had originally required an export prohibition in its standard distribution contracts. The clause was needed to counterbalance the large price differences which existed on the European market. Later Distillers eliminated the export prohibition and applied different pricing terms depending on the destination of the product. The strategy was undoubtedly designed by the British group. Yet there was little doubt that it had become part of the agreed relations with the distributors and therefore Article 85 applied. Unilateral conduct was not an issue.

In 1994 in *Dunlop*,²⁶ the sports equipment producer sold its products through subsidiary companies in most Member States. In Holland it operated through an independent exclusive distributor. To remove incentives for parallel trade in the products, the parties were striving for a price equilibrium for their products. The CFI found this practice to be a particularly serious infringement.²⁷ Dunlop had suggested that the export prohibition was the result of a unilateral activity rather than made in agreement with the distributor. The court disagreed. The general prohibition on re-exporting could not be attributed to unilateral action by Dunlop that as such would escape Article 85(1). A contractual provision which is contrary to Article 85(1) does not have to

be recorded in writing, but may form a tacit part of the contractual relation between an undertaking and its commercial partners. The court added that

Moreover, assuming that it were established that Newitt did not explicitly consent to the ban which the applicant imposed on it, that fact would not in itself affect the existence of the ban in question. For an agreement between a supplier and a reseller to fall within the prohibition in Article 85(1) of the Treaty, it is sufficient that the reseller accepts, at least tacitly, the anti-competitive prohibition which the supplier imposes upon him.²⁸

Concerted practices prompt refusal to supply

In *Pioneer*,²⁹ a British subsidiary of the Japanese group was responsible for European marketing activities. Pioneer Europe had created a net of local distributors where each was responsible for a defined national territory. The distribution agreements did not contain an export prohibition. When the German distributor refused to supply parallel traders, it was regarded as a result of a concertation between Pioneer and its distributors and not the consequence of a unilateral decision by that distributor.

The distributor in France, which was the target market for the parallel importation, claimed as far as it was affected by the decision, that it had acted in self-defence and accordingly should not carry any responsibility under Article 85. The ECJ did not agree as parallel importation could not be regarded as an unfair commercial practice, which could cause a situation of legitimate self-protection.³⁰

Selective distribution requires refusal to deal with third parties

It was not until 1983 that the ECJ in *AEG-Telefunken*³¹ had to deal with unilateral activity as a defence. AEG had received individual exemption for a selective distribution system that it then applied in conflict with notified terms. It restricted admission to the system suggesting it was a unilateral activity not prohibited by Article 85.

²⁸ *ibid.*, at para. [60].

²⁹ ECJ, Case 100-103/80, *SA Musique Diffusion Française and Others v. Commission* ("Pioneer") [1983] E.C.R. 1825.

³⁰ *ibid.*, at para [89].

³¹ ECJ, Case 107/82, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v. Commission* ("AEG") [1983] E.C.R. 3151.

²⁵ ECJ, Case 30/78, *Distillers Company Limited v. Commission* [1980] E.C.R. 2229.

²⁶ CFI, Case T-43/92, *Dunlop Slazenger International Ltd v. Commission* [1994] E.C.R. II-441.

²⁷ Case T-43/92, *Dunlop*, n. 26 above, at para. [117]: "It is clear from the body of serious, specific and convergent evidence . . . that the applicant in concert with AWS sought to put an end to the competitive advantage which price differences on two separate national markets, the United Kingdom and the Netherlands, gave a trader who was not a party to the distribution agreement in question, such as Newitt. . . . Those findings are not invalidated, as claimed by the applicant, by the motivation or the trading arrangements of the parallel importers targeted by those measures, since, even if such considerations were proved, they would concern the conduct of a third party and are not in any event such as to have any bearing on the existence, the scope or the effects of a concertation which has objectively been established. . . . The plea that the applicant did not adversely affect trade between Member States, and in particular parallel trade, must therefore be rejected."

Based on *Metro*,³² AEG also maintained that it was lawful to grant its distributors a minimum margin.

In a well-reasoned judgment the ECJ laid out a model for testing the limits of selective distribution. According to the court, such a system necessarily affects competition. Selective distribution has, however, clear advantages, such as the maintenance of a specialist trade capable of providing specific services regarding high-quality and high-technology products, which justifies a reduction of price competition in favour of other factors. The court held that

A restriction of price competition must, however, be regarded as being inherent in any selective distribution system in view of the fact that prices charged by the specialist traders necessarily remain within a much narrower span than that which might be envisaged in the case of competition between specialists and non-specialists. The restriction is counterbalanced by competition as regards the quality of the services supplied to customers . . .³³

Such systems can therefore escape the prohibition in Article 85(1).

The introduction of a selective distribution strategy was, however, not a unilateral decision.

On the contrary, it forms part of the contractual relations between the undertaking and resellers. Indeed, in the case of admission of a distributor, approval is based on the acceptance, tacit or express, by the contracting parties of the policy pursued by AEG which requires *inter alia* the exclusion from the network of all distributors, who are qualified for admission but are not prepared to adhere to that policy.³⁴

AEG-*Telefunken* concerned a refusal to supply due to a selective distribution strategy, which is a typical situation where the question of a unilateral activity may be raised. To some extent the situation was similar in *Hasselblad*,³⁵ but there the unilateral activity was not a separate issue.

In *Ford*,³⁶ the argument reappeared. Ford decided to withdraw right-hand driven vehicles from distribution in Germany. Such cars had earlier been provided in an export sales programme, probably designed for tax reasons as in many other parts of Europe. Due to existing price differences, the programme had led to damaging parallel purchases

between Germany and the United Kingdom. Ford wanted to end the trade by simply ending supply of the product for which there was no specific demand in Germany itself. The company claimed that this decision was made unilaterally and that it was unconnected with the ordinary distribution agreements. The ECJ did not accept this position:

Such a decision on the part of the manufacturer does not constitute, on the part of the undertaking, a unilateral act which, as the applicant claim, would be exempt from the prohibition contained in Article 85(1) of the Treaty. On the contrary, it forms part of the contractual relations between the undertaking and its dealers. Indeed, admission to the Ford AG dealer network implies acceptance by the contracting parties of the policy pursued by Ford with regard to the models to be delivered to the German market.³⁷

Therefore, the court rejected Ford's argument based on the unilateral nature of the withdrawal of right-hand-drive cars from Ford's model range.

*Bayerische Motorenwerke ALD Auto-Leasing*³⁸ is another instance of a refusal to supply an external party—here a leasing company purchasing vehicles from the ordinary distributors and leasing them to customers. The reason for the refusal was the selective distribution scheme introduced by BMW and the wish of the distributors that the leasing company should not cross borders fixed for different selective representatives: BMW prohibited its authorised dealers from selling to an independent leasing company unless the lessee of that company was established on the territory of the dealer. This practice, according to the court, amounted to an absolute territorial protection of the individual dealers.

The case turned on the interpretation of the former block exemption for motor vehicles,³⁹ and as in other instances the ECJ held that any exemptions contained in a regulation should be interpreted narrowly.⁴⁰

37 *ibid.*, at para [21].

38 ECJ, Case C-70/93, *Bayerische Motorenwerke AG v. ALD Auto-Leasing D GmbH* [1995] E.C.R. I-3439.

39 "Motor Vehicle Distribution", Commission Regulation (EEC) No. 123/85 of 12 December 1984 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements [1985] O.J. L15/16. Regulation 123/85 is now replaced by Regulation 1475/95 [1995] O.J. L145/25.

40 Case C-70/93, *BMW*, n. 38 above, at para [28] "... having regard to the general principle prohibiting anti-competitive agreements laid down in Article 85(1) of the Treaty, provisions in a block exemption which derogate from that principle cannot be interpreted widely and cannot be construed in such a way as to extend the effects of the regulation beyond what is necessary to protect the interests which they are intended to safeguard."

32 ECJ, Case 26/76, *Metro v. Commission* [1977] E.C.R. 1875.

33 Case 107/82, *AEG-Telefunken*, n. 31 above, at para [42].

34 *ibid.*, at para [38].

35 ECJ, Case 86/82, *Hasselblad (GB) Ltd v. Commission* [1984] E.C.R. 883.

36 ECJ, Cases 25 and 26/84, *Ford-Werke AG & Ford of Europe Inc. v. Commission* [1985] E.C.R. 2725.

Refusal to supply as a means to prevent parallel trade

In *Sandoz*⁴¹ the Commission in 1987 extended the reasoning of *Ford* and advanced the argument that a refusal to supply to control parallel trade was not a unilateral activity, but an agreement covered by Article 85(1). The Commission took objection to the Sandoz practice of reducing quantities ordered by its customers to what it considered their "normal" demand. According to the Commission, this could be an element of an agreement, when it was a systematically applied commercial policy on a market characterised by active parallel trade. The limitations could be taken as evidence of an effort to prevent parallel trade when there were no different explanations.

The ECJ⁴² escaped this extended test on unlawful unilateral activity by establishing that the systematic dispatching of invoices bearing the words "Export prohibited" was an unlawful agreement. It is not unilateral conduct, when it forms part of a set of continuous business relations governed by a standard agreement. Customers consented through tacit acceptance, which was confirmed by new orders placed on the same conditions.⁴³

In summary, a non-dominant company, in contrast to the dominant company, should have a larger latitude to refuse to supply without falling foul of the E.C. competition rules. However, when the purpose is to restrict parallel trade, the Commission and the Community courts tend to take a restrictive attitude that borders on a *per se* prohibition. Even when the refusal could be said to be a unilateral activity, the courts will look for its impact on the parties and claim either that it is a concerted practice or that the refusal is a part of a contractual relation. By that Article 85 becomes applicable. Form does not matter—accordingly no attention is paid to whether the agreement is legally binding or made in writing as long as it has an impact on the behaviour of the parties. An obsolete specific provision could be sufficient, even if it does not affect their activities.

Unilateral Activity in U.S. Case Law Development

Unilateral activities and their impact on competition have also been dealt with in distribution relations

under the U.S. legal system—but here the triggering factor has been price rather than market isolation and territorial restrictions. Already in 1919 in *United States v. Colgate & Co.*,⁴⁴ the U.S. Supreme Court recognised the right of a manufacturer to decide freely with whom he would deal. He was free to announce in advance the circumstances under which he would refuse to sell.

In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognised right of trader or manufacturer engaged in entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.

The liberal position taken by the Court in *Colgate* has been narrowed down in subsequent cases.⁴⁵

In brief, the Supreme Court could sum up this development in 1960 in *United States v. Parke, Davis & Co.*⁴⁶ Unilaterally Parke Davis had decided to impose a resale price for its products. It stopped supplying wholesalers and retailers who did not follow the policy. However, after having undertaken these measures, the company entered into discussions with its former partners and secured commitments from them before it resumed deliveries.

An unlawful combination did not arise just from an agreement—express or implied. It would, according to the Supreme Court, also follow if the producer secured adherence to his suggested policy by means that went beyond a mere refusal to deliver to those customers who did not follow his policy. A judicial inquiry should not stop with the search for evidence of purely contractual arrangements. When the manufacturer's action goes beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which lead to adherence to his resale prices, he has put together a combination in violation of the Sherman Act.⁴⁷

If this manufacturer seeks to achieve uniform adherence by inducing each customer to adhere, the customers' acquiescence is not then a matter of individual free choice. The manufacturer is the organiser of a price-maintenance combination or conspiracy in violation of the Sherman Act. Under the Act "competition not combination, should be

41 Commission Decision 87/409/EEC, *Sandoz Prodotti Farmaceutici SpA* [1987] O.J. L222/28.

42 C-277/87, *Sandoz Prodotti Farmaceutici SpA v. Commission* [1990] E.C.R. I-45 (Summary publication).

43 Compare Commission Decision 90/645/EEC, *Bayer AG (Dental)* [1990] O.J. L351/46.

44 *United States v. Colgate & Co.*, 250 U.S. 300 at 307.

45 *Federal Trade Commission v. Beech-Nut Packing Co.*, 257 U.S. 441; *United States v. Schrader's Son, Inc.*, 252 U.S. 85; *Frey & Son, Inc. v. Cudaby Packing Co.*, 256 U.S. 208; *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707.

46 *United States v. Parke, Davis & Co.*, 362 U.S. 29.

47 *ibid.*, at 44 and 46-47.

the law of the trade." Collaboration entered for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilising the price of a commodity in interstate and foreign commerce was held illegal *per se*.

In conclusion, the U.S. development leaves the actors on the market freedom to decide with whom they will deal. The moment the policy is the result of any concertation it becomes the subject of scrutiny under the antitrust legislation.

Conclusions

An argument in *Bayer* could be made that conditions in the pharmaceutical industry require specific solutions,⁴⁸ and it also ties in to the upcoming discussion on the Green Paper.⁴⁹

The most likely issue upon which the case could be focused is whether a non-dominant company is entitled unilaterally to refuse to supply. Prior case law has not addressed this point.⁵⁰ It only shows that unilateral activities are often disguised restrictions caught by either Article 86 or Article 85 of the Treaty.

Article 86 is designed to cover such activities by dominant companies and they carry a special responsibility for ensuring that their activities do not create harm in the market. Even if a dominant company should in principle be allowed to design and set up its own business strategy, the case law explains that it can often be an abuse to refuse supplies.

Article 85, on the other hand, allows a non-dominant company to freely design its strategy and unilaterally implement it without being affected by competition provisions. If competitors, customers or consumers are disturbed by the policy of an undertaking they could simply turn to alternatives.

A "non-dominant company" must, however, consider the fine line between dominance and non-dominance. Even if not a major actor, it could find itself dominant on a narrowly defined market segment. The experience is that Community authorities

look for a more narrow definition of the relevant market than industry does.

Furthermore, the notion of unilateral activity is not clear. Article 85 covers agreements and concerted practices; these notions are interpreted in an extensive way covering all types of combinations between companies. Form does not matter, nor whether the agreement has the purpose or effect of affecting behaviour of the opponent party. A concerted practice extends the agreement to cover any combination where parties wilfully co-ordinate their activities. As a consequence, activities that may have the appearance of unilateral acts will often be regarded as disguised agreements and are accordingly covered by Article 85. Parties have a freedom to contract, but when they decide not to, the reasons for their "unilateral decision" will be carefully evaluated and could often hide an agreement or concertation with other parties. Such disguised agreements activate Article 85(1) ECT. The European and American approach is similar in this respect.

Bayer raises the question if unilateral activities by non-dominant companies can be caught by Article 85 even if no disguised agreement and no joint intent can be inferred. The Commission focuses its argumentation on the fact that Bayer imposed an export ban and the distributors' reaction reflected an "implicit acquiescence". The combination of these factors amounted to an agreement.⁵¹ However, the facts of the case as presented suggest that this interpretation may not be correct. Far from being passive and accepting Bayer's strategy, the distributors tried every conceivable way of obtaining products without Bayer's permission or support. On that ground the Commission should fail.

This is, however, not the point of the case. It would mean that where distributors did nothing when exposed to threats of refusals, "implicit acquiescence" would amount to an unlawful agreement. If on the other hand the distributor took action, the relation would be characterised as legal unilateral conduct outside the scope of the competition rules. Such a solution would hardly make good law.

The real significance of the case is if Community law can be said to contain a *per se* prohibition on restrictions on parallel trade applicable both to dominant and non-dominant companies. This case

48 See, e.g. C. Fernández Vicién "Why Parallel Import of Pharmaceutical Products Should be Forbidden", [1996] 4 E.C.L.R. 219. The ECJ declined this solution in Cases C-267/95 and C-268/95, *Merck & Co. Inc. v. Primecrown Ltd and Beecham Group plc v. Europharm of Worthing Ltd.* [1997] 1 C.M.L.R. 83. The problem remains and *Bayer* raises a new opportunity to find a better balance to protect the R&D-based pharmaceutical industry.

49 See Lidgard, n. 6 above.

50 As earlier discussed, the Commission did address the matter in *Sandoz*, but the ECJ did not follow up in its judgment.

51 The Commission on its side insisted that the conduct was not purely unilateral, but resulted from the joint intentions of the parties. The interest did not necessarily have to be held in common. Bayer's interest was to prevent, or at least reduce, parallel exports. The wholesalers' interest was to avoid a reduction in supplies of Adalat.

confirms the endeavours of the Commission, but such an interpretation is not in conformity with the Treaty, nor with a sound industry policy.

For Article 85 to apply, the different elements of an agreement must be fulfilled. Where a non-dominant company is unilaterally carrying out a strategy without seeking the assistance of others, there is simply no legal base for condemning the activity.

From a general industry perspective it appears important to allow non-dominant companies to design their strategy to take products to the European market. Refusals to supply do not endanger the competitive climate. If Bayer is operating through wholesalers rather than integrating forwards, it should be entitled to require that these wholesalers perform their task, which is to provide

Adalat on optimal terms to the French/Spanish market. If the wholesaler is more interested in performing a parallel trade function—in conflict with Bayer's interests—it should purchase freely available Adalat and sell it to the United Kingdom. Bayer is under this theory not only fully entitled to reduce requested quantities, but also to refuse supplies entirely. It should even be able to make the non-exportation of Adalat a condition for any supply to wholesalers in the local markets.⁵²

⁵² As is clear from the recent Commission Decision in *Systemform*, Press release IP(96)1124, [1997].4 C.M.L.R. 7 this is clearly not the way the Commission sees things, and in the "Green Paper on Vertical Restrictions", COM(96) 721 Final, January 22, 1997, the Commission repeatedly recalls the objective of unifying the European market. See Lidgard, n. 6 above.