Territorial Supply Constraints in the Spotlight

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Ever wondered why consumers pay different prices for the same goods in different EU member states? The European Commission (*EC*) thinks territorial supply constraints (*TSCs*) bear much of the blame. Although they have long been a regular topic of antitrust debate, investigations into TSCs have been rare. This is unlikely to stay the case: a recent study into TSCs commissioned by the EC, recent enforcement action, and the pending revision of the regulatory framework show that TSCs have become a policy focus of the EC, and national competition authorities may follow. A just-announced EC investigation into Mondelēz International, one of the world's largest snacks companies, for alleged breaches of the competition rules through TSCs may be a sign of things to come. We outline why TSCs are in the antitrust spotlight and what companies should expect from competition enforcers in the future.

Territorial supply constraints – the competition concerns

TSCs are restrictions that manufacturers or other suppliers impose on retailers or wholesalers that prevent them from freely choosing where to source products and services. They limit the ability of retailers or wholesalers to source or distribute goods in other EU countries than the one they are based in, generally referred to as parallel trade. While this can affect trade within the internal market, EU competition law recognises that restrictions of sales into other territories may be legitimate in certain situations. For instance, they may enable manufacturers to enter new markets in the first place. They may also prevent distributors from 'free riding' on the promotional efforts of other distributors. Under specific conditions, EU competition law also permits exclusive distribution systems. However, suppliers must not restrict passive sales (i.e. sales in response to unsolicited orders) in any way. Such conduct would constitute a "hardcore restriction" under Article 101 (1) TFEU and carry the risk of potentially significant fines.

DG GROW study on territorial supply constraints

In November 2020, the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) released an in-depth study on TSCs. It found that half of the surveyed EU fast moving consumer goods resellers had experienced supply constraints based on their location, in particular in the form of refusals to supply, differentiation of product packaging and content, and destination obligations. These practices may have led to higher prices for specific goods in some member states. According to the DG Grow study, a significant price difference between member states remained even after accounting for other explanatory factors such as company structures, taxation regimes,

regulatory framework, costs of labour, raw materials, production and logistics. It concluded that this was likely due to TSCs.

The study further emphasized the need to distinguish TSCs from related practices such as product differentiation, e.g. changes in packaging and labelling. It noted that such related practices are not TSCs per se forbidden and may occur for perfectly legitimate reasons. For instance, companies may change the labelling or packaging of their products purely for marketing reasons; changes may also occur to reflect regulatory requirements, such as different national language requirements. However, the study noted that such actions may also be TSCs-related. They could enable TSCs in the first place, increase their effectiveness or have a similar effect.

Finally, the study concluded that the difficult distinction between legitimate business practices and potentially critical TSCs (or related practices) would have to be made on a case-by-case basis. It noted that attention to TSCs had recently increased, giving the EC an incentive to act in order to allow retailers and wholesalers to purchase products from whom and where they want. Specifically, the study highlighted the EC's May 2019 decision to impose a EUR 200 million fine on AB InBev for breaching EU competition rules by using TSCs.

The EC's AB InBev decision

In its 2019 AB InBev decision, the EC imposed a fine of EUR 200 million on the world's largest brewer. The EC found that AB InBev had abused a dominant position on the Belgian beer market by hindering cheaper imports of one of its brands from the Netherlands into Belgium in order to maintain higher prices in Belgium. The EC specifically considered the following actions as TSCs and related practices:

- Changing of product packaging in the Netherlands to make products harder to sell in Belgium;
- Limitation of beer supply to a wholesaler in the Netherlands in order to restrict imports into Belgium;
- Refusal to sell other key products to a specific retailer unless that retailer agreed to limited imports of the beer in question from the Netherlands to Belgium;
- Granting promotions and incentives for beer sales to Dutch retailers only if they agreed not to offer the same promotions to their Belgian customers.

The AB InBev case shows the fine line between perfectly legitimate product differentiation and TSCs. While the EC concluded that the company had violated EU competition rules, the case highlights the limitations for enforcement where TSCs are imposed unilaterally by the supplier: the adverse finding was based on the rules of dominance (Article 102 TFEU). If the EC had not considered AB InBev a dominant supplier, it would not

have been able to address some of its practices under EU competition rules (specifically under Article 101(1) TFEU). Article 101(1) TFEU does not cover purely unilateral measures – where there is no agreement between supplier and distributor – by non-dominant suppliers such as unilateral volume limitations. Also, competition rules do not apply to "internal" measures taken by vertically integrated suppliers vis-à-vis their national distributors. This may explain why none of the 17 European National Competition Agencies (NCAs) surveyed in the TSC study was currently dealing with cases related to supply restraints falling under EU competition law.

The Mondelēz investigation – a sign of things to come?

However, there are clear signs that competition authorities will increasingly target TSCs in the future: on 28 January, the EC announced it had opened an investigation into Mondelēz International for possible restrictions of competition in national markets for chocolate, biscuits and coffee – large markets worth billions of Euros annually. Mondelēz is one of the largest producers of these products in the EU. The EC is concerned that Mondelēz may have restricted cross-border trade between member states through unilateral practices and agreements with distributors. In particular, the EC is investigating whether Mondelēz has restricted passive sales or potential sales territories. The EC will also assess whether Mondelēz has penalised customers for trading products across borders through price increases or volume reductions, or whether it has directly imposed TSCs by contractually prohibiting customers from importing or exporting from other member states. As in the AB InBev case, the EC will assess possible restrictions on the languages used on packaging and review whether Mondelēz has refused to supply certain traders with a view to restricting imports into certain markets. The EC is currently investigating these practices under both the rules for anticompetitive agreements (Article 101) and those for abuse of dominance (Article 102 TFEU).

What to expect in the future

The patterns described in the DG Grow study are very similar to what has been sanctioned by the EC in the AB InBev case and the practices targeted in the Mondelēz investigation. It is likely that the EC will investigate similar behaviour in other areas of FMCG products and beyond.

Additional impetus may follow the EC's pending review of the Vertical Block Exemption Regulation (VBER), which provides for a "safe harbour" exemption from the prohibition of Article 101(1) TFEU for certain types of vertical agreements, and the parallel revision of the guidelines on vertical agreements. On the one hand, the EC is assessing whether it should allow further exceptions in order to give suppliers more flexibility. In particular, it is considering allowing suppliers to prevent unauthorized distributors from selling products from other regions in selective distribution territories. On the other hand, over the course of both reviews, the EC has also received complaints from stakeholders arguing that TSCs prevent them from benefiting from the single market – particularly from

distributors in the area of fast-moving consumer goods. While overall, as a result of the market feedback it seems that the pendulum has swung towards greater flexibility, it is yet unclear how this play out in the revised VBER and guidelines. In any event, there can be little doubt that the EC will continue to vigorously pursue cases of (suspected) restrictions on passive sales and safe harbours for TSCs will, if anything, remain limited to specific situations.

Suppliers are well advised to keep an eye on these changes to the regulatory framework and recent enforcement trends and – if necessary – adjust their supply relationships and compliance efforts accordingly. BLOMSTEIN is closely monitoring the EC's ongoing evaluation process and current developments in antitrust enforcement. If you have any questions concerning TSCs, Max Klasse, Philipp Trube and our entire competition law team will be pleased to assist you.