Brand bidding restraints revisited – What is the appropriate economic and legal framework for the antitrust analysis of vertical online search advertising restraints?

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This paper explores the law and economics of brand bidding restraints. By means of this novel type of restraints, brand owners restrict how their licensed retailers use their brand names and trademarks as keywords in paid search advertising. The paper tests and critically reflects on the restrictive approach European competition watchdogs have recently adopted towards brand bidding restraints. It contends that this harsh antitrust treatment of brand bidding restraints is not sufficiently grounded in the economic analysis of vertical restraints. In proposing a comprehensive framework for the legal and economic analysis of brand bidding restraints, the paper makes three principal contributions. First, it asserts that brand bidding restraints can have a number of procompetitive effects by internalising advertising-related externalities, addressing free-riding on display and traditional advertising and facilitating fixed cost recovery through price discrimination. Second, the paper considers different ways through which brand bidding restraints may harm competition and consumer welfare when they disproportionately affect infra-marginal consumers, prevent meaningful intra- and inter-brand comparisons or result in price discrimination on the basis of search costs rather than brand preferences. Moreover, brand bidding restraints are of particular concern when adopted in the context of dual distribution systems where vertically integrated brand owners have an incentive to raise their retailers' costs to prevent them from cannibalising their own sales channel. Third, the paper explores various legal filters to disentangle and balance the anti- and procompetitive effects of brand bidding restraints. In this respect, the paper makes a number of policy recommendations for the future antitrust analysis of

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This paper explores the law and economics of brand bidding restraints. By means of this novel type of restraints, brand owners restrict how their licensed retailers use their brand names and trademarks as keywords in paid search advertising. The paper tests and critically reflects on the restrictive approach European competition watchdogs have recently adopted towards brand bidding restraints. It contends that this harsh antitrust treatment of brand bidding restraints is not sufficiently grounded in the economic analysis of vertical restraints. In proposing a comprehensive framework for the legal and economic analysis of brand bidding restraints, the paper makes three principal contributions. First, it asserts that brand bidding restraints can have a number of procompetitive effects by internalising advertising-related externalities, addressing free-riding on display and traditional advertising and facilitating fixed cost recovery through price discrimination. Second, the paper considers different ways through which brand bidding restraints may harm competition and consumer welfare when they disproportionately affect infra-marginal consumers, prevent meaningful *intra*- and *inter*-brand comparisons or result in price discrimination on the basis of search costs rather than brand preferences. Moreover, brand bidding restraints are of particular concern when adopted in the context of dual distribution systems where vertically integrated brand owners have an incentive to raise their retailers' costs to prevent them from cannibalising their own sales channel. Third, the paper explores various legal filters to disentangle and balance the anti- and procompetitive effects of brand bidding restraints. In this respect, the paper makes a number of policy recommendations for the future antitrust analysis of brand bidding restraints. These proposals could also inform the ongoing revision of the Vertical Block Exemption Regulation and Vertical Guidelines in the EU and in the UK.

Introduction

With the rise of digital technologies and e-commerce, competition authorities, policy makers and scholars have witnessed the emergence of new forms of vertical online restraints. Through these price and non-price restraints, manufacturers or brand owners contractually constrain retailers' ability to set prices, choose sales channels or advertise when they sell their branded products online. Brand bidding or online advertising restraints whereby a brand owner (trademark proprietor) restricts how its licensed retailers use its brand names and trademarks as keywords in paid search advertising constitute the most novel type of vertical online restraints. The most recurrent use of brand bidding restraints consists of a brand owner, say Adidas, asking its retailers not to reserve or bid on its trademarked brand name 'Adidas' as a keyword when they run a search advertising campaign on Google AdWords.

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Brand bidding restraints have recently attracted the interest of competition authorities[1] and commentators.[2] Though they have been so far only considered in a few cases, there appears to be an emerging consensus among competition authorities in Europe that brand bidding restraints are most of the time anticompetitive. In *Asics*,[3] decided by the German Federal Cartel Office ('FCO') and in *Guess*,[4] decided by the European Commission, brand bidding restraints were held to constitute restrictions of competition by-object in breach of Art. 101 TFEU[5] and so-called 'hardcore restrictions' under Art. 4 (c) of the Vertical Block Exemption Regulation (VBER).[6] In *Adidas*, the FCO also obtained commitments from the brand owner Adidas not to hinder its authorised retailers from using its brand name and trademarks as keywords for search advertising.[7] The Dutch Authority for Consumers & Markets ('ACM') also recently labelled brand bidding restraints as 'hard-core restrictions'.[8] This restrictive approach towards brand bidding restraints is set to be codified as part of the ongoing reform of the EU competition rules on vertical agreements. Indeed, the Commission's recent draft revised Vertical Block Exemption Regulation and draft revised Guidelines on Vertical Restraints also qualify online advertising restraints as hardcore restrictions.[9] Brand bidding restraints are thus currently subjected to a similarly harsh antitrust treatment as resale price maintenance, territorial or customer restraints creating absolute territorial protection and bans on online sales. Their categorisation as restrictions of competition by-object under Art. 101 (1) TFEU implies that

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[1] See for instance, B2-98/11 - Asics, Asics; Case COMP/AT.40428 Guess, Guess. C(2018) 8455 final. Competition and Markets Authority, 'A new pro -competition regime for digital markets - Advice of the Digital Markets Taskforce' . CMA135; S. Haasbeek, J. Sviták and J. Tichem, 'Price effects of non-brand bidding agreements in the Dutch hotel sector' (2019). Working paper.

[2] G. Colangelo, 'Competing Through Keyword Advertising' (2020) 16(3) Journal of Competition Law & Economics 306; N. Jung, 'European Commission Fines Guess over Anti-Competitive Agreements to Block Cross-Border Sales (Case AT.40428 – Guess)' (2019) 20(3) Business Law International 295; T. Kuhn, 'Between Coty, Guess and the new V-BER - where do we stand on e-commerce restrictions?' (2019) 40(8) European Competition Law Review 376; W. Leslie, 'Brand bidding, search advertising and the quest to protect nonprice parameters of competition' (2021) 42(1) European Competition Law Review 9.

[3] Asics (n 1).Upheld by the German Federal Court in Beschluss KVZ 41/17 2017.

[4] Guess (n 1).

[5] Asics (n 1) paras. 259-274, 304-402; (n 3); Guess (n 1).

[6] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101 (3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2010] OJ, L 102/1 2010. O.J. L 102/1.

[7] B3-137/12 - adidas 10.

[8] Guidelines regarding arrangements between suppliers and buyers 2019 7.

[9] Annex to a Communication from the Commission - Approval of the content of a draft for a Commission Regulation on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. C(2021) 5026 final Annex ('Draft Vertical Block Exemption Regulation'), recital 13 Art.1 (1) (n) in conjunction with Art. 4 (b) to (d). Annex to the Communication from the Commission - Approval of the content of a draft for a Communication from the Commission - Commission Notice - Guidelines on vertical restraints, ('Draft Revised Vertical Guidelines'). C(2021) 5038 final Annex paras. 188 and 192 (f). Revision of the Vertical Block Exemption Regulation - Explanatory note 5.

brand biding restraints tend to be in such an overwhelming number of cases anticompetitive that the costs of a more elaborate analysis of their actual effects are not justified.[10]

This paper asks the simple question of whether this 'inhospitable'[11] attitude of EU competition enforcers towards vertical brand bidding restraints is appropriate. The strict legal treatment of brand bidding restraints may, indeed, surprise as the economic impact of this novel category of vertical online restraints is not yet fully understood.[12] Economic evidence supporting the view that brand bidding restraints tend to be inherently anticompetitive remains sparse. The Commission's 2017 E-commerce sector inquiry, for instance, only discussed brand bidding restraints *in passim.* It did not provide any economic or empirical support for the preliminary conclusion that brand bidding restraints, unlike restrictions on the use of certain trademarks or brands as domain names, raise competition issues.[13] A 900 pages-strong support study commissioned by the EU Commission as part of the revision of the VBER discusses brand bidding restraints only in a few instances, without producing or considering economic evidence on their impact on competition.[14] The only existing empirical study by staff members of the Dutch competition authority ACM assesses brand bidding restraints in the Dutch hotel booking market. The study finds that brand bidding restraints consistently result in price increases of roughly 2 % on hotel websites relative to online travel agent websites.[15] Yet, these findings have not yet been tested by other studies and are subject to methodological limitations.[16]

It is hence not an overstatement that there is a considerable discrepancy between the economic and legal analysis of brand bidding restraints: Competition authorities in Europe have pressed ahead with condemning brand bidding restraints, while the economics of these practices are yet to be fully settled. This paper seeks to address this mismatch and knowledge gap, by providing a consistent economic and legal framework to analyse vertical brand bidding

[10] In this sense, Case C-67/13 P *Groupement des cartes bancaires v Commission* ECLI:EU:C:2014:2204 paras. 50-51.

[11]For the 'inhospitability tradition' in antitrust, see F. H. Easterbrook, 'The limits of Antitrust' (1984) 63(1) Tex. L. Rev. 1 4.

[12] The recent consultation on and revision of the Vertical Block Exemption Regulation (VBER) identified the legal status of brand bidding restrictions under Art. 101 TFEU and the VBER as one of the areas where further guidance is needed. Vertical European Commission, 'Evaluation of the Vertical Block Exemption Regulation: Commission Staff Working Document' . SWD (2020) 172 final SWD (2020) 172 final 86, 200-222.

[13] Final report on the E-commerce Sector Inquiry - Staff Working Document. SWD(2017) 154 final paras. 631-632, 997-999.

[14] European Commission, 'Support studies for the evaluation of the VBER Competition: Final report' (2020) 482, 487, see also relatedly, 48-49, 72, 115-116.

[15] Haasbeek, Sviták and Tichem (n 1) 4.

[16] ibid 3.

restraints. The central claim of the paper is that brand bidding restraints may serve brand owners as an essential tool to address vertical and horizontal externalities within their distribution network and/or to recover advertising-related fixed costs through price discrimination. Despite these potentially procompetitive rationales, brand bidding restraints may at the same time produce serious anticompetitive effects. Against this backdrop, the paper explores various channels through which the pro- and anticompetitive effects of brand bidding restraints can be disentangled and netted off. Based on this analysis, the paper formulates policy proposals on how the ongoing revision of the EU Vertical Block Exemption Regulations ('VBER')[17] and Guidelines on Vertical Restraints,[18] as well as the future UK Vertical Agreements Block Exemption Order ('VABEO') and the CMA VABEO Guidance, could enhance the antitrust analysis of brand bidding restraints.[19]

The remainder of the paper is organised as follows. Section 1 sets the scene by providing an overview of the existing competition cases involving brand bidding restraints against the backdrop of the ever-growing importance of online search advertising. Section 2 advances with the 'externality explanation' and 'price discrimination explanation' two complementary procompetitive rationales for brand bidding restraints. Section 3 investigates the anticompetitive effects of brand bidding restraints. Section 4, in turn, explores various filters that may allow competition authorities and courts to isolate and weigh the pro- and anticompetitive effects of brand bidding restraints. Section 5 concludes and provides some policy recommendations.

1 Setting the scene: Online search advertising and brand bidding restraints

The rise of digital markets has revolutionised the way how products are distributed in our economy. Products are no longer only sold and purchased through physical stores. Manufacturers and retailers increasingly use online stores and, in particular, digital platforms as channels to market their products. In 2020, online sales accounted for about 18% of all worldwide retail sales. The Covid-19 pandemic has further accelerated the rise of online sales, which are expected to reach 21.8% of all worldwide retail sales in 2024.[20] Together with the methods of distribution, the way in which products are advertised has changed dramatically. Over the last decade, spending on online advertising increased with an average annual growth

[17] Draft Revised Vertical Block Exemption Regulation (n 9).
[18] Draft Revised Vertical Guidelines (n 9).
[19] The retained Vertical Agreements Block Exemption Regulation - Consultation document, CMA Retained Vertical Agreements Block Exemption Regulation - Consultation document. CMA 145con.
[20] statista, 'E-commerce share of total global retail sales from 2015 to 2024' (2021) <https://www.statista.com/statistics/534123/e-commerce-share-of-retail-sales-worldwide/> accessed 4 June 2021.

rate of 14%.[21] In 2017, the investment in online advertising for the first time eclipsed the expenditure of UK companies for all other advertising.[22] In 2019, online advertising expenditures in the UK totalled about 15.7 bn GBP (up from 13.4 bn GBP in 2018), accounting for 62% of total advertising spending (up from 25% in 2010).[23]

1.1 Display and search advertising as two main forms of online advertising

Businesses today rely on two principal forms of online advertising to reach existing and new audiences. The first is online display advertising. This form of advertising has many features in common with traditional advertising, say through billboards or TV ads. It offers advertisers the possibility to advertise their brands by placing ads on websites of content providers, such as newspapers or streaming services. These ads can take various forms, ranging from banner adverts you can see on newspaper sites, such as FT.com, to audio ads on Spotify or video ads on youtube.com.[24]

The second type of online advertising is online search advertising. When users enter a search query in the search bar of an online search engine, such as Bing! or Google, they will obtain two distinct types of results. The result page will, on the one hand, list a number of links to so-called ‘generic’ search results. The search algorithm of the search engine identifies and positions these generic search results based on their relevance for the keyword(s) the user entered as a search query. On the other hand, the search engine will also display so-called ‘sponsored’ search results which usually appear in a prominent placement on the search results page. Unlike generic search results, sponsored or paid search results are not identified and ranked exclusively on the basis of their relevance to the individual search query entered by the user. Instead, they are displayed and targeted to consumers because advertisers pay for their websites to be prominently linked on the result page when consumers enter a specific keyword as a search query. These links, accompanied by small text elements, will channel consumers clicking on them directly to the website of the advertiser. [25]

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[21] S. Adshead and others, ‘Online advertising in the UK: A report commissioned by the Department for Digital, Culture, Media &Sport’ (2019) 35 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777996/Plum_DCMS_Online_Advertising_in_the_UK.pdf> accessed 30 March 2020.

[22] ibid.

[23] Competition and Markets Authority (CMA), ‘Online platforms and digital advertising: Market study final report’ (2020) para. 2.40.

[24] Adshead and others (n 21) 24 to 30; Competition and Markets Authority (CMA) (n 23) paras- 2.47-2,52; Competition and Markets Authority (CMA) (n 23) 2.44-2.46.

[25] Adshead and others (n 21) 23 to 24; Competition and Markets Authority (CMA) (n 23) paras. 2.44-2.46.

Search engines operate their paid advertising services through an auction mechanism, for instance, Google AdWords. Advertisers bid for certain keywords for which they wish to have a search ad placed on the result page of the search engine. If a user enters this reserved keyword or a phrase containing the keyword as a search query, the search engine will display and rank search ads taking into account two factors: the highest bidder and the relevance of the search ad for the user's search query. While advertisers usually pay for display ads depending on how many times consumers have viewed the ad (cost by thousand impressions ('CPM')), the costs of search advertising are typically calculated based on the number of users clicking on the link ('cost per click' ('CPC')). [26]

1.2 Online search advertising at the core of recent brand bidding restraint cases

The way retailers harness online search advertising to attract consumers to their online stores is at the heart of the *Asics* and *Guess* cases which lay the foundations of the strict antitrust treatment of brand bidding restraints in Europe. Both cases involved with Asics – a Japanese manufacturer of running shoes – and Guess – a US producer of fashionable apparel and accessories – two well-known brands. Both brands had in common that they used a dual distribution model to commercialise their products.[27] On the one hand, they were vertically integrated into the distribution level by selling their products through their own physical stores in various Member States of the EU[28] and by operating their own online shops.[29] On the other, Guess and Asics also operated selective distribution networks with independent mono-brand and multi-brand retailers. Under these selective distribution agreements, Asics and Guess entrusted wholesalers and retailers as sublicensees to distribute, promote, and, in the case of retailers, sell their product lines in their assigned territory through licensed stores. The authorised wholesalers and retailers were selected on the basis of qualitative criteria, for instance, pertaining to the store design and quality standards for pre-sale services and advertising. These quality criteria were geared towards the promotion of their brand image.[30]

As part of these selective distribution agreements, Asics and Guess imposed a set of vertical restraints on their authorised retailers which restricted how the latter could distribute the licensed products. The most novel amongst those restraints was a clause that *de facto*

[26] Competition and Markets Authority (CMA) (n 23) paras. 2.46 and 2.52.
[27] Guess (n 1) para. 20.
[28] ibid paras. 20-21.
[29] ibid paras. 20-22. Asics (n 1) paras. 49, 231.
[30] Guess (n 1) para. 23, 25-28, 31. Asics (n 1) paras. 50-56.

prohibited authorised retailers from using or bidding for Asics and Guess trademarks and brand names as keywords for online search advertising via Google AdWords. [31]

In both cases, the FCO and the Commission concluded that these brand bidding restraints violate Art. 101 (1) TFEU. Both competition authorities asserted that the brand bidding restraints could not be explained by an attempt on the part of Asics or Guess to preserve their trademark rights or brand image.[32] Instead, they found that the brand owners pursued a two-fold strategy by forcing brand bidding restraints on their authorised dealers. The first reason why the brand owners had recourse to these brand bidding restraints was to minimise their advertising costs. As Google AdWords selects advertisers displayed in Google's sponsored search results on the basis of an auction process, brand owners' advertising costs increase, the more players are bidding for the same keywords.[33] By prohibiting their dealers from using and bidding for their trademarks and brand names in Google AdWords, Asics and Guess thus sought to prevent them from driving up their search advertising costs.[34]

The second reason why brand owners imposed brand bidding restraints was to reduce the 'findability' of retailers' online presence, while reserving as much traffic as possible to the brand owners' own shop.[35] As a consequence, these restraints considerably dampened *intra*-brand competition in online distribution and restricted, in particular, the authorised retailers' ability to use the internet in order to sell their product outside their contractual territory or area of commercial activity.[36] In stressing their adverse impact on retailers' ability to engage in cross-border sales, both competition watchdogs likened brand bidding restraints with restraints on passive sales, preventing parallel trade. Brand bidding restraints were thus classified as a clear-cut by-object restriction of competition in breach of Art. 101 (1) TFEU.[37]

Asics and *Guess* moreover clarified that brand bidding restraints could not benefit from a general exemption under the VBER or an individual exception under Art. 101 (3) TFEU. Rather, the competition authorities took the view that such restrictions amount to hard-core restrictions within the meaning of Art. 4 (c) of the VBER as they 'limited the ability of the authorised retailers' (sic!) to sell the contract products actively or passively (depending on the

[31] Asics (n 1) paras. 28-32, 243-245; Guess (n 1) para. 40-52.
[32] Asics (n 1) paras. 371-379; Guess (n 1) paras. 116-119, 122-133.
[33] Guess (n 1) para. 44; Asics (n 1) para. 312.
[34] Guess (n 1) para. 50.
[35] ibid paras. 120-121.
[36] Asics (n 1) para. 323. Guess (n 1) paras. 120-121.
[37] Asics (n 1) para. 268-272. Guess (n 1) para. 114, 124-125; Case 86/82 *Hasselblad v Commission* ECLI:EU:C:1984:65 paras. 49, 52; Case C-439/09 *Pierre Fabre Dermo-Cosmétique* ECLI:EU:C:2011:649 para. 47.

targeted audience or territory).'[38] In addition, the competition authorities concluded that the restrictions could not benefit from an individual exemption under Art. 101 (3) either. For there were 'no indications […] that the conduct was indispensable, for example to address free-riding, or protect [the defendant's] brand image.'[39]

The *Asics* and *Guess* decisions thus lay the foundations for a hostile competition law approach towards brand bidding restraints that treats restraints on retailers' search advertising as by-object restrictions of Art. 101 (1) TFEU,[40] which are unlikely to qualify for an exemption under the VBER or Art. 101 (3) TFEU. This strict approach is driven by the concern that brand bidding restraints foreclose retailers from online sales channels and thereby effectively ban them from using the internet to sell outside their assigned sales territory.[41] This strict treatment of brand bidding restraints is just the latest reminder that the goal of promoting the internet as a tool to enhance market integration constitutes a central rationale of the application of EU competition rules to vertical restraints.[42]

2 Potential procompetitive effects of brand bidding restraints

From an economic point of view, though, the strict antitrust treatment of brand bidding restraints in *Asics* and *Guess* remains puzzling. In both cases, the competition authorities provided very little economic reasoning in support of the strict prohibition of brand bidding restraints as by-object restrictions which presupposes that they have very rarely, if at all, procompetitive effects. The current antitrust approach towards brand bidding restraints in Europe, indeed, fails to ask and answer a simple, yet fundamental, question: 'Why should manufacturers ever want to restrict their retailers' advertising?'[43] The answer to this question is all but obvious. This section proposes two complementary accounts that may help shed light on why brand owners may have a procompetitive motive to regulate the amount of online search advertising provided by their retailers.

[38] Guess (n 1) para. 157.
[39] ibid para. 164. Asics (n 1) paras. 391-392.
[40] Case 86/82 *Hasselblad v Commission* (n 37) para. 49-52.
[41] See for a recent reaffirmation of this view (n 8) 7. European Commission (n 12) 128, 218.
[42] Guidelines on Vertical Restraints, Guidelines on Vertical Restraints. OJ [2010] C 130/01 para. 52, in particular. Case C-439/09 *Pierre Fabre Dermo-Cosmétique* (n 37) para. 47.G. Monti, 'Restraints on Selective Distribution Agreements' (2013) 36(489-512) World Competition 509–510.
[43] See for a similar puzzle, L. G. Telser, 'Why Should Manufacturers Want Fair Trade' (1960) 3 Journal of Law and Economics 86.

2.1 The externality explanation

The standard economic explanation for vertical restraints is that they primarily serve manufacturers as a tool to overcome coordination problems within their vertical supply chains. Vertical restraints allow non-integrated manufacturers or brand owners to address two types of externalities that would not materialise had they vertically integrated into the distribution of their products.

2.1.1 Vertical restraints as tools to internalise vertical and horizontal externalities

The first externality vertical restraints may tackle is vertical in nature. It flows from the fact that retailers do not appropriate the additional increment in profits that upstream manufacturers earn through the wholesale profit margin ($P_{wholesale}$ - C) on each additional unit that retailers sell by lowering their retail price or expanding demand, for instance through promotional efforts such as advertising.[44] Retailers, for instance, do not feel the adverse impact that increases in their retail price have on the manufacturer's profits. They, therefore, have an incentive to maximise their profits by setting excessively high retail prices. This double-marginalisation problem is one way in which the vertical externality manifests itself.[45] The vertical externality between retailers and manufacturers may also stem from the fact that retailers do not account for the positive externality that demand expanding activities have on the manufacturer's profit margin and, therefore, under-invest in advertising.[46]

This vertical externality is further compounded by horizontal externalities that may arise between retailers. Competing retailers impose on each other a negative pecuniary externality as price increases will prompt consumers to switch to other retailers. While this horizontal externality may attenuate the vertical externality of double-marginalisation, fierce competition may compel retailers to set their prices at too low a level and to underinvest in advertising. Moreover, when there are informational spill-overs, retailers' advertising efforts create gains for other retail outlets that they cannot appropriate. This fear that other retail outlets would be able to ride on the coattails of their advertising efforts may further dampen retailers' advertising efforts.[47]

Manufacturers can use various vertical restraints, ranging from resale price maintenance (RPM), over two-part (franchise) fees, quantity forcing to closed distribution territories (CDT)

[44] G. F. Mathewson and R. A. Winter, 'An Economic Theory of Vertical Restraints' (1984) 15(1) The RAND Journal of Economics 27 32.
[45] J. J. Spengler, 'Vertical Integration and Antitrust Policy' (1950) 58(4) Journal of Political Economy 347.
[46] Mathewson and Winter (n 44), 32.
[47] Mathewson and Winter (n 44), 32; Telser (n 43), 89–96.

as tools to internalise these vertical and horizontal externalities arising from double-marginalisation, under-investment in advertising, and free-riding.[48] Franchise fees, quantity forcing, or recommended retail prices allow manufacturers, for instance, to control the level of retail prices or to appropriate retail margins and, thereby, to internalise the vertical double-marginalisation externality. RPM and CDT, in turn, enable manufacturers to eliminate the horizontal externalities retailers impose on each other through 'excessive competition' or free riding that lead to under-investment in advertising. This, in turn, also neutralises the vertical externality that retailers' under-investment in advertising inflicts on the manufacturer's profit margin.

2.1.2 Brand bidding restraints and vertical externalities

Against this backdrop, brand bidding restraints that restrict retailer advertising may, at first glance, appear to run counter to the standard economic rationale underpinning vertical restraints. Indeed, standard economic theory would suggest that brand owners have an interest in promoting rather than restricting retailer advertising.[49] The reason why a brand owner, such as Guess or Asics, may nonetheless have a procompetitive motive to regulate the amount of retailer online search advertising lies with the specific issues that online search advertising raises in the context of a dual distribution system.

Unlike in the standard economic models of vertical restraints, in the context of dual distribution retailers' investment in search advertising imposes a negative vertical externality on the brand owner. When retailers start to use search advertising, brand owners are compelled to follow suit to prevent them from siphoning off traffic from their online outlets. The 'traffic stealing effect' of retailer online search advertising pushes the brand owner to adopt a defensive bidding strategy even though it inflates its advertising and, ultimately, its distribution costs.[50] As the costs (i.e., cost-per-click) of online search advertising are determined by an auction system, greater search advertising efforts drive up the advertising costs of the retailers and brand owners alike. In the context of dual distribution, retailer search advertising thus drags the brand owner and retailers into a prisoner's dilemma: they are forced to spend more on search

[48] Mathewson and Winter (n 44), 33–37.
[49] This may also explain why the Commission and the FCO rejected the free-rider explanation Guess (n 1) para. 164. Asics (n 1) paras. 260, 378, 394. 394.
[50] P. S. Desai, W. Shin and R. Staelin, 'The Company That You Keep: When to Buy a Competitor's Keyword' (2014) 33(4) Marketing Science 485 488; A. Sayedi, K. Jerath and K. Srinivasan, 'Competitive Poaching in Sponsored Search Advertising and Its Strategic Impact on Traditional Advertising' (2014) 33(4) Marketing Science 586 595; A. Simonov, C. Nosko and J. M. Rao, 'Competition and Crowd-Out for Brand Keywords in Sponsored Search' (2018) 37(2) Marketing Science 200 202.

advertising, although it might be more profitable for them to coordinate their advertising efforts or not to advertise at all.[51]

In contrast to the normal setting where retail advertising creates a positive externality for brand owners, in the presence of dual distribution, retailers' investment in search advertising imposes a negative externality on brand owners' margins by driving up the advertising and distribution costs of its retailers and its own retail presence. The size of this adverse effect of the competitive use of keywords by retailers on the brand owner's advertising cost and margins largely depends on the number of authorised retailers bidding for the same trademark as keywords in Google AdWords.[52]

2.1.3 Brand bidding restraints and horizontal externalities

Along with creating a vertical externality, retailer advertising also involves important horizontal externalities. Brand owners, like Guess and Asics, must carefully coordinate with the members of their distribution networks how they attribute advertising expenditure across various advertising channels: in particular, online search, online display (e.g., banners, images or videos) and traditional offline advertising (e.g., TV, radio and print media).[53] This is a tricky exercise because each form of advertising performs a different role in promoting brand recognition and triggering purchasing decisions on the part of the consumers. Marketing studies show that various forms of advertising interact with consumers at different stages of the so-called 'conversion funnel' (Figure 1) that traces consumers' journey from becoming aware of a brand to making the final purchasing decision.[54] Online search advertising interacts with consumers closer to their actual purchasing decision than do online display and traditional forms of advertising. It also engages the consumers as it primarily relies on customer-initiated features and directly routes customers who click on the sponsored link to the advertisers' online

[51] Desai, Shin and Staelin (n 50), 494–495.
[52] In the *Asics* and *Guess*, this number was particularly high. Asics had about 2000 authorised dealers in Germany Asics (n 1) para. 52. In the European Economic Area (EEA), Guess' products were distributed by about 113 authorised mono-brand stores operated by 30 companies and by up to 3000-5500 independent multi-brand dealers Guess (n 1) para. 21.
[53] For a similar observation regarding the allocation of advertising expenses by a single firm I. M. Dinner, H. J. van Heerde and S. A. Neslin, 'Driving Online and Offline Sales: The Cross-Channel Effects of Traditional, Online Display, and Paid Search Advertising' (2013) 51(5) Journal of Marketing Research 527 527–528; E. Bayer and others, 'The impact of online display advertising and paid search advertising relative to offline advertising on firm performance and firm value' [2020] International Journal of Research in Marketing, 3, 14.
[54] P. Kireyev, K. Pauwels and S. Gupta, 'Do display ads influence search?: Attribution and dynamics in online advertising' (2016) 33(3) International Journal of Research in Marketing 475 476; Competition and Markets Authority, 'Online platforms and digital advertising: Market study interim report' (2019) 153–155 <https://assets.publishing.service.gov.uk/media/5dfa0580ed915d0933009761/Interim_report.pdf> accessed 30 March 2020.

store. As a result, the effectiveness of search advertising in eliciting customer behaviour and generating sales outperforms that of display and offline advertising.[55]

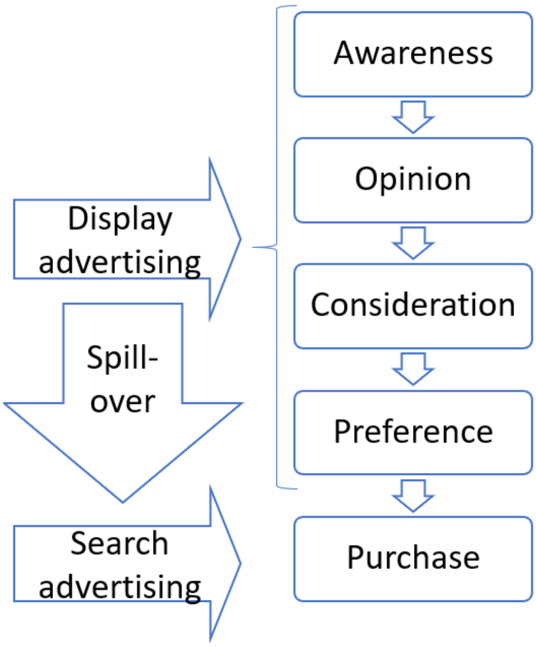

Figure 1 - The role of display and search advertising in the conversion funnel (Source: CMA[56])

Online display and traditional offline advertising, by contrast, interact with consumers primarily in the early stages of their purchasing decision-making process.[57] While eliciting only to a limited extent direct purchasing decisions, display and traditional advertising are particularly effective in raising awareness for a brand, attracting new audiences and differentiating the brand from competitors.[58] Most importantly, display advertising may also have significant positive spill-over effects on search advertising. They create general consumer awareness for a brand or a specific need. In so doing, they indirectly prompt clicks and purchasing decisions.[59] In essence, without display and traditional advertising, consumers might simply not enter the brand name as a search term in Google's search bar in the first place.

Owing to these positive spill-overs or positive externalities, the benefits of the investment in display advertising are more difficult to appropriate because they may often benefit other members of the distribution network. This explains why online display advertising and traditional advertising are widely perceived as less effective advertising methods than paid

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[55] Dinner, van Heerde and Neslin (n 53), 528-530, 541-543. Bayer and others (n 53), 3,13. Kireyev, Pauwels and Gupta (n 54), 487–489.
[56] Competition and Markets Authority (CMA) (n 23) 216.
[57] Dinner, van Heerde and Neslin (n 53), 530.
[58] Bayer and others (n 53), 2–3; Dinner, van Heerde and Neslin (n 53), 542; Competition and Markets Authority, 'Online platforms and digital advertising: Market study interim report' (n 54) 49, 157.
[59] Dinner, van Heerde and Neslin (n 53), 530, 539-540; Kireyev, Pauwels and Gupta (n 54), 475-476, 487-489.

search advertising.[60] Investments in search advertising, by contrast, can be easily appropriated because it generates high click-through and conversion rates, while producing less positive spill-overs that benefit other members of the distribution network. Therefore, retailers tend to consider search advertising as the least risky alternative: the return on investment is higher and less uncertain than for other forms of advertising.

Retailer investment in search advertising thus generates two horizontal externalities. First, retailers are likely to over-invest in search advertising and to intensify *intra*-brand competition between the sellers of the same branded product. This imposes a negative horizontal pecuniary externality on other retailers and the brand owner's own sales channel. At the same time, owing to the informational spill-overs of display advertising, retailers are likely to underinvest in display advertising or traditional advertising because they fear that other retailers will benefit from their investments. This, in turn, leads to a situation where retailers have an incentive to free-ride on the brand owners' expenses for online display and traditional advertising that are crucial for promoting the brand image and stimulate *inter*-brand competition.[61]

By restricting or entirely banning online search advertising on the part of retailers, brand bidding restraints allow the brand owner to internalise these negative pecuniary (intensified *intra*-brand competition) and positive (information spill-overs) horizontal externalities and coordinate the different advertising channels of their distribution system. From this perspective, brand bidding restraints constitute nothing more (or less) than the attempt of the manufacturer to contractually integrate and control the advertising function of its distribution network online. While brand bidding restraints reduce the amount of online search advertising provided by retailers and dent *intra*-brand competition, this reduction may be outweighed by the positive impact of greater investment in display advertising that intensifies *inter*-brand competition.

In sum, like other vertical restraints, brand bidding restraints constitute contractual tools that allow brand owners to address three types of vertical and horizontal externalities that beset the provision of promotional services in the form of search advertising in (dual) distribution systems. Brand bidding restraints thus enable brand owners to coordinate their advertising across various channels and to implement an integrated outcome by internalising the:

[60] Kireyev, Pauwels and Gupta (n 54), 475.
[61] Bayer and others (n 53), 2.

- vertical externality that retailer search advertising exerts on the brand owner's advertising costs and margins through the competitive auction system of Google AdWords;
- horizontal pecuniary externality that retailer search advertising imposes on the brand owner's and other retailers' sales channels;
- horizontal informational externality/spill-overs of display advertising that results in retailers' free-riding on the brand owner's investment in display advertising and over-investment in search advertising.

2.2 The price discrimination explanation

Antitrust literature mostly focuses on the role of vertical restraints in internalising vertical and horizontal externalities within distribution networks and, thereby, addressing free-riding issues.[62] This free-rider rationale often overshadows the longstanding economic insight that vertical restraints also allow brand owners to engage in price discrimination.[63] Vertical restraints enable brand owners to vertically segment their customer groups by offering high- and low-quality versions of their product in accordance with consumers' willingness to pay (i.e., so-called 'quality differentiation' or 'vertical differentiation'). Such vertical differentiation allows brand owners to price discriminate and extract a maximum amount of consumer surplus.[64]

2.2.1 Vertical restraints as tools to orchestrate intra-brand price discrimination

Vertical information restraints, such as restrictions on online search advertising, play a crucial role in facilitating or sustaining such a price discrimination strategy. Alongside the internalisation of externalities and free-riding issues discussed in the previous subsection, this price discrimination strategy offers a complementary explanation for the use of brand bidding restraints.

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[62] Spengler (n 45); Telser (n 43); Mathewson and Winter (n 44); H. Marvel and McCafferty, 'Resale Price Maintenance and Quality Certification' (1984) 15(3) RAND Journal of Economics 349; B. Klein and K. M. Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms' (1988) 31(2) The Journal of Law and Economics 265.

[63] W. S. Bowman, 'The Prerequisites and Effects of Resale Price Maintenance' (1955) 22(4) The University of Chicago Law Review 825.

[64] ibid 833, 839-840. P. Bolton and G. Bonanno, 'Vertical Restraints in a Model of Vertical Differentiation' (1988) 103(3) The Quarterly Journal of Economics 555 555–556. See for further discussion of the relevant literature M. L. Katz, 'Chapter 11 Vertical contractual relations' in R. Schmalensee and R. D. Willig (eds), *Handbook of industrial organization* (Handbooks in economics vol 10, 1. ed. [10.] reprint. Elsevier 2008) 679–683. The analysis that follows differs from the one by Professor Chen who shows that RPM can be used to address distortions of the manufacturer's margin caused by price discrimination Y. Chen, 'Oligopoly Price Discrimination and Resale Price Maintenance' (1999) 30(3) The RAND Journal of Economics 441.

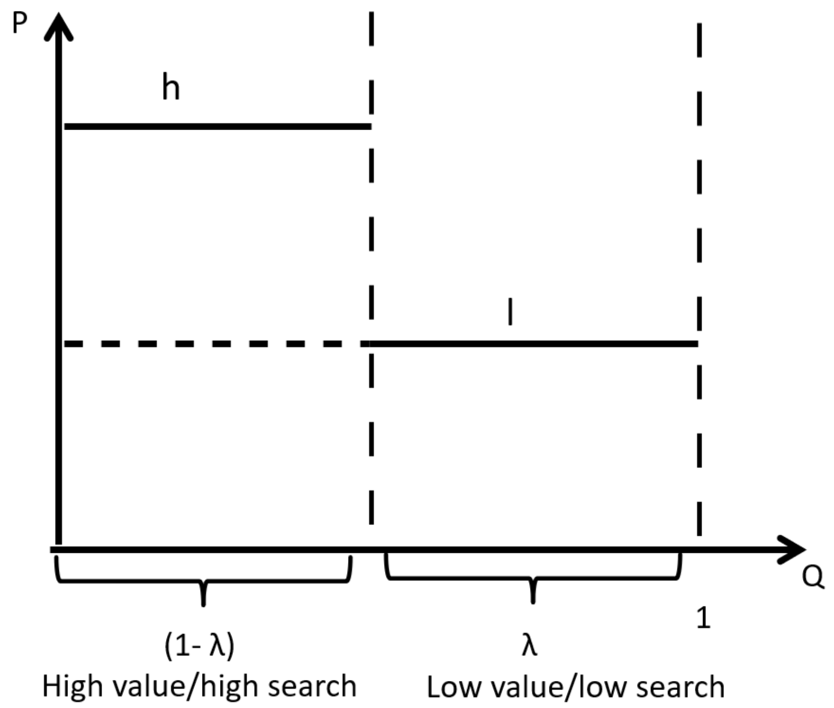

Figure 2 – Vertical differentiation

To illustrate this argument, suppose that manufacturer M relies on only two retailers, R_H and R_L, to distribute its products.[65] Suppose further that consumers differ in their valuation of the product or additional promotional services. One fraction (1-λ) of consumers have a high willingness to pay for additional pre- and after-sales services. The remainder (λ) have a low valuation for the product and additional services (Figure 2). [66]

M can maximise its profits by asking its retailers to provide diverging service levels at different prices (Figure 2). R_H will adopt a 'high-end' business model that involves the provision of a high level of promotional services, for instance in the form of product-specific advertising or advice through well-trained sales staff. R_H would sell the product together with a high level of customer services at a high price $P_{high.}$ By contrast, R_L will revert to a 'no frills' business model selling the product with no or only a low level of additional sales services at a low price P_{low}. R_H would be serving those consumers with a high valuation for the product (1-λ), while R_L would sell to consumers with a low willingness to pay (λ). This combination of 'high-end' and 'no frills' distribution models would allow M to orchestrate *intra*-brand price discrimination at the retail level. Any additional profits R_H generates by charging P_H can be

[65] I draw here on the model by J. Asker and H. Bar-Isaac, *Vertical Information Restraints: Pro- and Anti-Competitive Impacts of Minimum Advertised Price Restrictions* (National Bureau of Economic Research 2016).
[66] For a similar approach see Bolton and Bonanno (n 64), 557–558. Y. Spiegel and Y. Yehezkel, 'Price and non-price restraints when retailers are vertically differentiated' (2003) 21(7) International Journal of Industrial Organization 923 924, 928-929; Asker and Bar-Isaac (n 65) 11.

either used to recoup the investment in a higher service level or be absorbed by M by charging a commensurate fixed fee.[67]

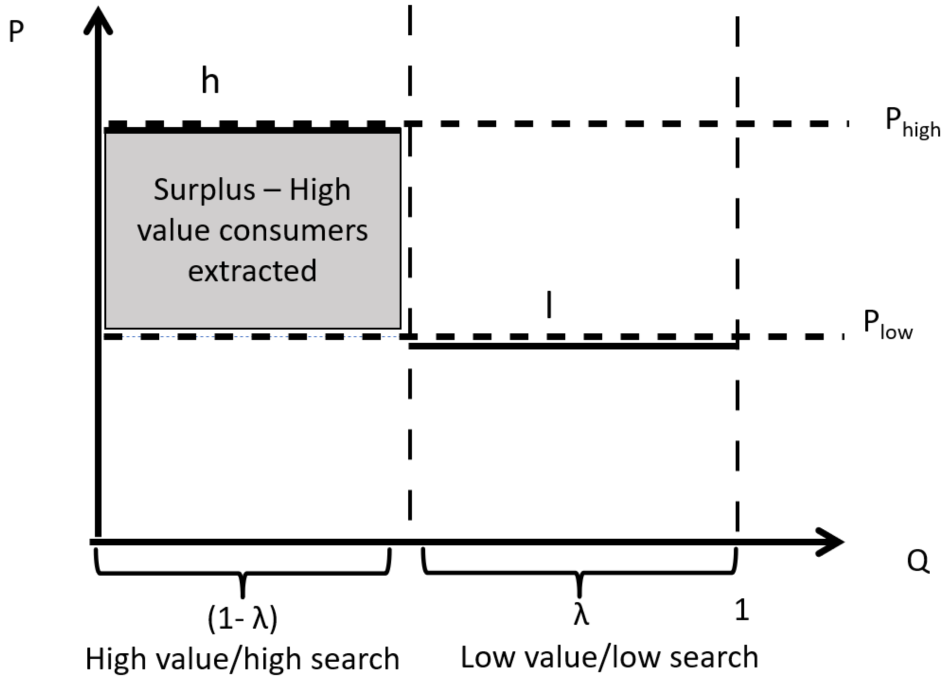

Figure 3 - Price discrimination strategy

Offering various levels of product/service quality through its retailers will allow M to segment its consumers in accordance with their willingness to pay. This brand-wide price discrimination enables M to extract additional surplus that high-value consumers would retain if the retailers were to set a uniform price at P_{low} (see the shaded area in Figure 3). At the same time, consumers in the aggregate are better off relative to a situation where retailers set a uniform price at P_{high} because low-value consumers continue to be served and are not priced out of the market. Brand-wide price discrimination thus allows for surplus extraction without leading to quantity restriction. [68] A similar outcome could be expected when M is vertically integrated, provides both service levels and reverts to price discrimination.[69]

2.2.2 Brand bidding restraints as informational restraints sorting high- and low-value consumers

Appealing as it is, such a price discrimination strategy through the vertical segmentation of consumers is difficult to put in place. This is because the willingness of consumers to pay

[67] Bolton and Bonanno (n 64), 562–563.Spiegel and Yehezkel (n 66), 936.Asker and Bar-Isaac (n 65) 12–13.
[68] ibid.
[69] Bolton and Bonanno (n 64), 558–559. Spiegel and Yehezkel (n 66), 931.

for additional services is not easily observable. Moreover, the price-discrimination strategy is difficult to police and only sustainable as long as high-value consumers cannot purchase from R_L.[70] In other words, M would have to minimise the proportion of high-value consumers churning to R_L.[71]

If we assume that high-value and low-value consumers have different information costs, M can use contractual information or advertising restrictions, such as brand bidding restraints, to segregate customer groups and engage in price discrimination. [72] Suppose, for instance, that it is more costly for high-value consumers to search for cheaper products than for low-value consumers who have lower search costs. Information or advertising restraints, which prevent R_L from using certain forms of advertising that reduce search cost, allow M and its retailers to identify and segment high- and low-value customers. By limiting the retailers' use of its trademarks as keywords and leaving them just with the opportunity to bid on a long tail of less effective search terms with lower click-through rates,[73] brand bidding restraints increase search costs and search friction for consumers. This, in turn, allows the manufacturer to maintain price dispersion across its distribution system if consumers have different valuations for its products and different search costs. [74] Brand bidding restraints thus might constitute an essential mechanism to insulate high-value customers and facilitate brand-wide price discrimination. Again, this price discrimination may be welfare-enhancing because it allows surplus extraction without resulting in output restriction. While high-value consumers' surplus may be reduced, low-value consumers benefit because they are not priced out of the market.[75]

This price discrimination rationale may explain the use of brand bidding restraints in cases such as *Guess* and *Asics*. The only difference to the stylised example above is that Asics and Guess were partially vertically integrated into the retail level as they relied on a dual distribution system. This difference, however, does not undermine the price discrimination

[70] Bolton and Bonanno (n 64), 562.
[71] ibid 563–565.Spiegel and Yehezkel discuss the possibility of imposing a minimum RPM on R_H as one way of maintaining the price discrimination and preventing R_H from aligning its strategy with that of R_L. Spiegel and Yehezkel (n 66), 935–937; Asker and Bar-Isaac (n 65) 13.
[72] This argument draws upon the analysis of price-related information restraints by Asker and Bar-Isaac (n 65) 2, 11-17; J. Asker and H. Bar-Isaac, 'Advertising and Related Restraints' [2018] Competition Policy International Antitrust Chronicle 1.
[73] Dinner, van Heerde and Neslin (n 53), 543. O. J. Rutz, M. Trusov and R. E. Bucklin, 'Modeling Indirect Effects of Paid Search Advertising: Which Keywords Lead to More Future Visits?' (2011) 30(4) Marketing Science 646 648.
[74] S. Salop, 'The Noisy Monopolist: Imperfect Information, Price Dispersion and Price Discrimination' (1977) 44(3) The Review of Economic Studies 393 393-394, 402-403; Asker and Bar-Isaac (n 65) 2, 11-17; Asker and Bar-Isaac (n 72).s
[75] Salop (n 74), 402.

explanation.[76] On the contrary, if we assume that Asics' or Guess' own online (retail) shop is identical with R_H in the example above the price discrimination explanation becomes even more plausible, as Guess and Asics do not have to rely on a two-part tariff to absorb the higher profits generated through price discrimination at the retail level. Rather, it is their own retail outlet that would take the place of R_H and could skim off the additional surplus and profits by adopting a 'high end' business model. As they enable the brand-owner to price discriminate, brand bidding restrictions offer a handy tool to recover the fixed cost it incurs by investing in its online shop or in display advertising.[77]

2.3 Two complementary pro-competitive rationales for brand bidding restraints

Along with the internalisation of externalities (discussed in sub-section 2.1.), the price discrimination account thus may offer a second potentially procompetitive explanation for the use of brand bidding restraints in distribution systems. If the FCO and Commission were right and the brand bidding restraints ensured Asics' and Guess' own online stores higher visibility on Google, high-value/high-search costs consumers who are not inclined to shop around to find cheaper alternatives will end up buying their sneakers or jeans on Asics' or Guess' online outlets. Low-value consumers with low search costs, by contrast, will still have the possibility to purchase their jeans from cheaper retailers after having invested some more time in searching on the internet. Restricting online search advertising by its retailers thus enables brand owners such as Asics and Guess to create search frictions to segment their consumers and orchestrate brand-wide price discrimination.

This price discrimination explanation importantly adds to the analysis of brand bidding restraints because it suggests that brand bidding restrictions may have a welfare-enhancing effect irrespective of whether they are used to address free-riding problems or internalise other externalities.[78] Even in the absence of any externality or free-rider issues, the potentially procompetitive welfare effects of brand bidding restraints thus do not support their outright condemnation as by-object restrictions. The price discrimination explanation also shows that the finding of the Commission and the FCO that brand bidding restraints in *Guess* and *Asics*

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[76] Spiegel and Yehezkel (n 66), 941. See also Y. Yehezkel, 'Downstream competition between an upstreamsupplier and an independent downstream firm: Working Paper' (2003) 12.
[77] For the importance of price discrimination for fixed cost recovery see D. Ridyard, 'Exclusionary pricing and price discrimination abuses under Article 82 - an economic analysis' (2002) 23(2) European Competition Law Review 286 287–289.
[78] Spiegel and Yehezkel (n 66), 925.

could not be explained by free-riding issues should not have precluded their analysis under Art. 101 (3) TFEU. [79]

That being said, it bears noting that the externality and price discrimination stories may often constitute complementary explanations for the use of brand bidding restraints. By enabling brand owners to engage in brand-wide price discrimination and to regulate the amount of search advertising, brand bidding restraints may play an important role in coordinating and financing a brand's advertising strategy. In facilitating *intra*-brand price discrimination, brand bidding restraints offer brand owners a handy tool to recover the fixed cost they incur by investing in more expensive and risky forms of display and additional advertising.[80] At the same time, they allow the brand owners to mute vertical and horizontal externalities arising from over-investment in retailer online search advertising. While reducing *intra*-brand competition, online search advertising restraints may stimulate *inter*-brand competition and preserve the short- and long-term incentives of brand owners to invest in brand recognition and the creation of new brands.

3 Anticompetitive effects of brand bidding restraints

The 'externality' and 'price discrimination' explanations discussed in the previous section provide two complementary accounts of procompetitive rationales why manufactures may want to impose brand bidding restraints on their authorised retailers. They thus enrich the existing antitrust analysis of brand bidding restraints in Europe which currently calls for strict antitrust liability without delving into their economic rationale and effects. This, however, should not suggest that brand bidding restraints are invariably welfare-enhancing or innocuous.

3.1 Post-Chicago qualifications of the welfare analysis of vertical restraints

The previous discussion has focused on different ways in which brand bidding restraints may allow brand owners to internalise vertical and horizontal externalities that arise from the over-investment of retailers in online search and under-investment in display or traditional advertising. Brand bidding restraints may increase consumer welfare if they ensure the brand owners' and retailers' incentives to invest in promotional efforts, such as display or traditional

[79] This may also explain why the Commission and the FCO rejected the free-rider explanation Guess (n 1) para. 164. Asics (n 1) paras. 260, 378, 394. 394.
[80] For the importance of price discrimination for fixed cost recovery see Ridyard (n 77), 287–289.

advertising, that expand demand and intensify quality competition between different brands (*inter*-brand competition).

Even so, post-Chicago analysis of vertical restraints shows that greater investment in promotional efforts does not necessarily make consumers better off. The aggregate welfare implications of brand bidding restraints, like that of other vertical restraints, depend on how much different consumer groups value the increase in quality competition made possible by the restraints.[81] Brand owners will have an incentive to impose brand bidding restraints to increase the level of service quality or promotional efforts (e.g., display advertising) whenever the value marginal consumers attribute to a slight increase in product/service quality or promotional efforts exceeds the accompanying price increase.[82] Brand bidding restraints may, in this case, constitute a profit-maximising strategy that increases the surplus of marginal consumers.

By contrast, the welfare of infra-marginal consumers whose initial valuation of the product exceeds the original market price by far may be harmed. They will continue to buy the product after a price increase, even if, in their view, the increase in promotional efforts or product/service quality is not worth the additional price increase.[83] The price increase ensuing from brand bidding restraints will harm infra-marginal consumers, who would prefer to purchase the branded product at a lower price without additional advertising or investment in the brand image, for instance because they already know the product fairly well.[84] In case the harm inflicted by vertical brand bidding restraints on these infra-marginal consumers outweighs the benefit that marginal consumers draw from the additional advertising or intensified quality competition, brand bidding restraints will harm consumers in the aggregate. Consequently, even if they were to enable greater investment in promotional services, brand bidding restraints do not necessarily have welfare-enhancing effects. This would notably be the case if a majority of consumers who are purchasing the product online are infra-marginal consumers who are using the internet to shop around and find the best deal, without attributing any particular importance to the brand image or promotional services.

Brand bidding restraints may also harm consumer welfare by increasing information and search costs and, thereby, diminishing *intra*- and *inter*-brand competition.[85] Restrictions on

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[81] For a summary of this post-Chicago analysis F. M. Scherer and D. Ross, *Industrial market structure and economic performance* (Houghton Mifflin 1990) 541–547.
[82] W. S. Commanor, 'Vertical Price-Fixing, Vertical Market Restrictions and the New Antitrust Policy' (1985) 98 Harvard Law Review 98 991.
[83] ibid.
[84] F. M. Scherer, 'The Economics of Vertical Restraints' (1983) 52 Antitrust L.J. 687 699–704; Commanor (n 82), 990–999.
[85] R. L. Steiner, 'The Nature of Vertical Restraints' (1985) 30 Antitrust Bulletin 143 146, 190.

online search advertising introduce significant search frictions and reduce the ability of consumers to carry out informed *intra*-brand price comparisons between different online shops selling the same brand. If brand bidding restraints constrain how authorised multi-brand dealers advertise their products on Google, the ability of consumers to carry out meaningful *inter*-brand price and quality comparisons may suffer, too.[86]

Aside from reducing consumer welfare, brand bidding restraints may also raise distributional concerns. The distributional effects of brand bidding restraints are particularly acute if the infra-marginal consumers are less willing to pay for additional advertising or quality certification exactly because they are less affluent and, hence, face greater budgetary constraints than the less price-sensitive marginal consumers who value additional sales services or quality certification. Vertical restraints may have even greater distributive effects if the search frictions they create prevent vulnerable consumers, who are subject to cognitive biases and find it more challenging to engage with markets, from finding a lower-priced product.[87] Brand bidding restraints may thus disproportionately affect low-income or vulnerable consumers.

3.2 Adverse welfare effects of brand bidding restraints inducing search-cost based price discrimination

Brand bidding restraints may also lead to consumer harm if they are used by brand owners to orchestrate *intra*-brand price discrimination. Traditionally, economic literature has primarily focused on the welfare effects of price discrimination by a monopolist.[88] It suggests that the net welfare effects of price discrimination practised by a monopolist are ambiguous.[89] More recent economic literature on price discrimination in a competitive or oligopolistic setting[90] indicates that the impact of price discrimination on competition importantly depends

[86] ibid 183.
[87] See in this respect Competition and Markets Authority, 'Tackling the loyalty penalty' (2018) <https://www.gov.uk/government/publications/tackling-the-loyalty-penalty/tackling-the-loyalty-penalty>.
[88] J. Robinson, *The Economics of Imperfect Competition* (Macmillan 1933); R. Schmalensee, 'Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination' (1981) 71(1) The American Economic Review 242; H. R. Varian, 'Price Discrimination and Social Welfare' (1985) 75(4) The American Economic Review 870.
[89] I. Aguirre, S. Cowan and J. Vickers, 'Monopoly Price Discrimination and Demand Curvature' (2010) 100(4) American Economic Review 1601; D. Bergemann, B. Brooks and S. Morris, 'The Limits of Price Discrimination' (2015) 105(3) American Economic Review 921; C. Townley, E. Morrison and K. Yeung, 'Big Data and Personalized Price Discrimination in EU Competition Law' (2017) 36 Yearbook of European Law 683 690.
[90] M. L. Katz, 'Price Discrimination and Monopolistic Competition' (1984) 52(6) Econometrica 1453; S. Borenstein, 'Price Discrimination in Free-Entry Markets' (1985) 16(3) The RAND Journal of Economics 380. T. J. Holmes, 'The Effects of Third-Degree Price Discrimination in Oligopoly' (1989) 79(1) The American Economic Review 244; M. Armstrong and J. Vickers, 'Competitive Price Discrimination' (2001) 32(4) The RAND Journal of Economics 579.

on the type of consumer information that allows the discriminating firm to identify and sort price-inelastic consumers.[91]

Price discrimination by brand owners may have an unambiguously positive impact on competition and consumer welfare if it is conditioned on information about the brand preferences of consumers.[92] In the case of brand-preference-based discrimination, competing brands will charge high prices to their group of 'strong'[93] customers who have a strong preference for and loyalty to their branded product. At the same time, they will charge a low price to win over 'weak' customers who prefer the product of a rival brand. If price discrimination is based on differences in brand preferences, there is some form of best-response asymmetry between rival branded sellers.[94] The strong consumers of brand A are weak consumers for the other brand B, and *vice versa*. In this setting, each rival brand A and B has an incentive to charge high prices to their strong consumers while heavily discounting to their weak consumers. As a consequence, price discrimination may intensify price competition and increase consumer welfare in the aggregate relative to uniform pricing.[95]

This finding that price discrimination in a competitive setting may have unambiguously welfare-enhancing effects and reduce prices for all consumers hinges on the assumption of best-response asymmetry. This assumption only holds as long as various producers rank different customer groups as 'strong customers', as it is the case for preference-based discrimination.[96] The outcome is different, though, when competing firms perceive the same customer group as their 'strong consumers'. This occurs where price discrimination is not informed by the strength of consumers' brand preferences but is conditioned on information about their search and switching costs.[97] In this case, brand owners will charge high prices to 'strong' consumers who face high search costs and are not searching around to find the cheapest deal, while imposing low prices to 'weak' consumers who have low search costs and shop around. In this setting,

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[91] Townley, Morrison and Yeung (n 89), 692–693. K. S. Corts, 'Third-Degree Price Discrimination in Oligopoly: All-Out Competition and Strategic Commitment' (1998) 29(2) The RAND Journal of Economics 306 307; M. Armstrong, 'Recent Developments in the Economics of Price Discrimination' in R. Blundell, T. Persson and W. K. Newey (eds), *Advances in economics and econometrics: Theory and applications, Ninth World Congress : Volume 2* (Econometric Society monographs vol 42. Cambridge University Press 2006) 110–113.
[92] Armstrong (n 91) 113–115. J.-F. Thisse and X. Vives, 'On The Strategic Choice of Spatial Price Policy' (1988) 78(1) The American Economic Review 122 134. Townley, Morrison and Yeung (n 89), 692–693.
[93] For this traditional terminology of strong and weak markets Robinson (n 88); Holmes (n 90), 245.
[94] The concepts of best-response symmetry and asymmetry have been coined by Corts (n 91), 311–315.
[95] Townley, Morrison and Yeung (n 89), 692–693.Thisse and Vives (n 92), 134; Corts (n 91), 307-308, 311-316; Armstrong (n 91) 111–115; Armstrong and Vickers (n 90), 594.
[96] Corts (n 91), 311.
[97] Y. Chen, 'Paying Customers to Switch' (1997) 6(4) J Economics Management Strategy 877 893; Armstrong (n 91) 111; Chen (n 64), 442.

strong and weak consumer groups are no longer different across sellers. Rather, all sellers face the same group of strong customers to whom they can charge high prices because search costs prevent them from shopping around. As these consumers are relatively price-insensitive, the rival brands have little incentive to compete for their respective strong customers by lowering prices. As a consequence, price discrimination based on search costs entails a best-response symmetry rather than best-response *a*symmetry between all sellers.[98] Price discrimination practised under best response symmetry between competing brands may hence dampen price competition between brands and make consumers worse off compared to uniform pricing. [99]

Economic analysis of competitive price discrimination thus suggests that the impact of brand bidding restraints depends on whether they are driven by preference-based or search-cost-based price discrimination. Our previous discussion of brand bidding restraints as tools to implement price discrimination (in section 2.2) assumed that brand preference and search costs coincide. In this setting, search costs are just a proxy for brand preferences. Brand bidding restraints, by increasing search frictions, thus serve as pointers from which competing brands can infer privately held information about consumers' brand preferences to orchestrate preference-based (third-degree) price discrimination. 'Strong consumers' of one brand remain weak customers of the other. If high-value and high-search costs consumers are identical, best response asymmetry prevails and brand bidding restraints, while restricting *intra*-brand competition, may intensify *inter*-brand competition. The opposite situation applies if we relax the assumption that high-value customers are also high-search cost customers and, instead, suppose that search costs are not correlated with brand preferences. In this situation of best-response symmetry, brand bidding restraints restrict not only *intra*-brand competition but also dampen *inter*-brand price competition between brands who face the same category of strong consumers. If brand bidding restraints are used to implement search-cost-based price discrimination, they may have an adverse effect on competition and consumer welfare relative to uniform pricing.

The economic analysis of price discrimination in imperfectly competitive/oligopolistic markets thus provides important insights for the assessment of brand bidding restraints. It suggests that the adverse effect of brand bidding restraints does not depend on the market power

[98] Corts (n 91), 315; Armstrong (n 91) 112. Townley, Morrison and Yeung (n 89), 693–694; Chen (n 97), 893–894.
[99] Corts (n 91), 315; Holmes (n 90), 249–250; Chen (n 97).

of the discriminating brand owner. Rather, the competitive impact of brand bidding restraints turns on whether they are drivers of best response symmetry or asymmetry.[100]

3.3 Raising retailers' cost strategies in dual distribution settings

A third reason why brand bidding restraints may raise competition concerns is that they are often adopted in the context of dual distribution models. The specific features of dual distribution models may, at least in part, explain the strict treatment of brand bidding restraints as by-object restrictions in *Asics* and *Guess*. In the context of dual distribution, the hybrid role of brand owners acting both as manufacturers and retailers injects an important horizontal element into the analysis of vertical restraints.[101] As they are vertically integrated into the retail level, brand owners directly compete with their authorised dealers. In the context of dual distribution models, the seminal distinction between vertical and horizontal relationships that importantly guides the legal analysis of agreements under Art. 101 TFEU becomes increasingly blurred.[102]

This blurring of vertical and horizontal relationships in dual distribution systems may be the source of important conflicts of interest. On the one hand, brand owners have an interest in stimulating their retailers' investment in promotional efforts to build up and secure their brand reputation. On the other hand, they may have a significant interest in restricting retailers' access to online sales channels lest they cannibalise the profitability of the brand-owned online outlet. This conflict of interest arising from the horizontal element brought about by dual distribution models calls into question the basic assumption that vertical restraints are less restrictive than horizontal agreements which is usually advanced in support of a more lenient treatment of vertical restraints.[103] Most importantly, the assumption that the manufacturers' interests are largely aligned with that of consumers because both benefit from fierce retail competition and lower retail prices does not necessarily hold in a dual distribution setting.[104] In the context of dual distribution systems, the brand owner's interest in maintaining retail competition is considerably attenuated. The manufacturer benefits from higher retail prices and

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[100] M. E. Levine, 'Price Discrimination Without Market Power' (2002) 19(1) Yale Journal on Regulation 1.Townley, Morrison and Yeung (n 89), 698–699. Chen (n 97), 893–894. In the case of best response asymmetry, market power may even increase consumer surplus Thisse and Vives (n 92).

[101] Kuhn (n 2), 379.

[102] I. Lianos, 'The Vertical Horizontal Dichotomy in Competition Law: Some Reflections with Regard to Dual Distribution and Private Labels' in A. Ezrachi and U. Bernitz (eds), *Private labels, brands, and competition policy: The changing landscape of retail competition* (Oxford Univ. Press 2009).

[103] *Case C-32/11 Allianz Hungária Biztosító and Others* ECLI:EU:C:2013:160 para. 43.

[104] Telser (n 43); Mathewson and Winter (n 44); D. Gilo, 'Private Labels, Dual Distribution and Vertical Restraints: An Analysis of the Competitive Effects' in A. Ezrachi and U. Bernitz (eds), *Private labels, brands, and competition policy: The changing landscape of retail competition* (Oxford Univ. Press 2009) 19.

from a weakening of the competitive pressure of its retail competitors as it can maximise the profits of its own outlet.[105] Dual distribution importantly changes the brand owner's incentive structure because the sales efforts of its distributors impose a direct horizontal negative externality on its sales. Brand owners may hence have an incentive to dampen retail price competition and hinder retailers from cannibalizing their own retail sales by rising rivals' costs[106] or reserving the most profitable sales channels to themselves.[107]

Moreover, the presence of dual distribution systems may weaken or even reverse the logic of the free-rider explanation for vertical restraints. In the context of dual distribution models, vertical restraints may even result in some form of a 'reverse free-riding problem'. Such opportunistic behaviour arises when vertical restraints, such as brand bidding restraints, allow the brand owner to take a free-ride on the investments of its retailers in their offline sales channel and promotional services. This may be the case when the brand owner uses vertical restraints to reserve the most profitable online sales channel to its own outlet, without offering comparable offline or online sales services.[108]

While dual distribution models attenuate or even mute some of the potentially procompetitive effects of vertical restraints that underpin their more lenient legal treatment, commentators advise against automatically equalising vertical restraints in the context of dual distribution with horizontal agreements. Instead, they point out that the competitive effect of vertical restraints applied in the context of a dual distribution system depends on context-specific factors.[109] The economic literature on franchising, for instance, documents a number of procompetitive reasons why suppliers may want to blend elements of vertical integration and vertical separation in their distribution network.[110] Although the existence of dual distribution systems weakens some of the procompetitive rationales of vertical restraints, it may also provide legitimate reasons for brand owners to adopt vertical restraints to internalise the externalities that potentially competing sales channels impose on each other and to avoid multichannel conflict.[111]

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[105] Gilo (n 104) 19–20. G. T. Gundlach and A. G. Loff, 'Dual Distribution Restraints: Insights from Business Research and Practice' (2013) 58(1) The Antitrust Bulletin 69 86–96.
[106] Gilo (n 104) 23; ; Yehezkel (n 76).
[107] Gilo (n 104) 20–26.
[108] (n 7) 6.Asics (n 1) paras. 42, 84.cs (n 1) paras. 42, 84.
[109] Gilo (n 104) 19-20, 22.
[110] F. Lafontaine and P. J. Kaufmann, 'The evolution of ownersip patterns in franchise systems' (1994) 70(2) Journal of Retailing 97 101–102.F. Lafontaine, 'Franchising versus corporate ownership' (1999) 14(1) Journal of Business Venturing 17 18–22. See also J. A. Brickley and F. H. Dark, 'The choice of organizational form The case of franchising' (1987) 18(2) Journal of Financial Economics 401.
[111] Lafontaine (n 110), 20–21.Gundlach and Loff (n 105), 96–98.

4 Various filters to ‘balance’ pro- and anticompetitive effects

The preceding sections of this article provide a detailed analysis of the potential pro- and anticompetitive effects of brand bidding restraints. They show that their impact on competition and consumer welfare is more complex than what the current legal characterisation of brand bidding restraints as by-object or hardcore restrictions would suggest. Given their potentially ambiguous effects on competition, a categorical treatment of all types of brand bidding restraints as hardcore or by-object restrictions, envisaged by the Commission’s revised VBER and Guidelines on Vertical Restraints,[112] appears to be unwarranted. At the same time, the observation that the effects of brand bidding restraints may pull in two directions raises the question of how competition law analysis can account for, disentangle, and balance the potential market power and efficiency effects of brand bidding restraints.

The existing framework for the application of Art 101 TFEU to vertical restraints provides for a number of safety valves that are supposed to allow procompetitive vertical restraints to escape the prohibition of Art. 101 (1) TFEU. Only a few of these filters require an explicit balancing of pro- and anticompetitive effects of vertical restraints, whilst others carry out this welfare balancing implicitly. This section explores how these existing filters may inform the legal and economic analysis of brand bidding restraints. This analysis is at the same time backward- and forward-looking. On the one hand, it critically reflects on past analysis of brand bidding restraints in *Asics* and *Guess*. On the other, it also investigates the extent to which the existing framework should be reformed as part of the ongoing reform process of the VBER and Vertical Guidelines at the EU and UK level to enhance legal certainty about the status of brand bidding restraints under Art. 101 (1) TFEU and the Chapter 1 prohibition of the Competition Act 1998.

4.1 *The* Metro *doctrine and the ‘scope of the trademark’ test*

The so-called *Metro* doctrine constitutes a first filter that screens out on balance procompetitive vertical restraints which form part of a selective distribution agreement from the prohibitive scope of Art. 101 (1) TFEU. In *Metro*, the Court of Justice of the European Union (CJEU) for the first time explicitly acknowledged that certain types of vertical restraints, while restricting *intra*-brand competition, may strengthen *inter*-brand competition, as they

[112] Draft Revised Vertical Block Exemption Regulation (n 9) Art. 1 (n) in conjunction with Art. 4 (b) to (d); Draft Revised Vertical Guidelines (n 9) paras. 188 and 192 (f).

secure the incentives of brand owners and authorised dealers to invest in service quality and promotional efforts.[113] On this account, the Court held in *Metro* and subsequent case law[114] that contractual restraints forming part of a selective distribution agreement are not caught by Art. 101 (1) TFEU, provided that

(i) the nature of the product at issue justifies the manufacturer's interest in restricting the type of outlets through which the product is sold in order to promote quality competition;

(ii) the distributors are chosen based on objective criteria of qualitative nature;

(iii) the criteria are laid down uniformly for all potential distributors

(iv) the criteria apply in a non-discriminatory way. [115]

The *Metro* doctrine thus provides a scaffolding that implicitly balances reductions in *intra*-brand price competition with procompetitive effects in the form of intensified *inter*-brand quality competition.[116] The safe harbour carved out in *Metro* turns on the assumption that the positive impact on quality competition of selective distribution agreements that comply with these four cumulative criteria and do not completely eliminate price competition is likely to outweigh their adverse impact on price competition.[117] It bears noting that the safe harbour carved out in *Metro* applies only to qualitative selective distribution agreements. Accordingly, the same type of vertical restraint exempted under the *Metro* doctrine may run afoul of Art. 101 TFEU if it is contained in other types of distribution agreements, such as quantitative selective distribution or exclusive distribution agreements.

The brand bidding restraints in *Asics* and *Guess* both formed part of selective distribution agreements. In both cases, the competition authorities, therefore, employed the *Metro* doctrine as a filter to ascertain whether brand bidding restraints fell outside the scope of Art. 101 TFEU because they pursued a legitimate objective in relation to Asics' and Guess' selective distribution networks, such as the protection of their trademarks and brand image.[118] In applying the *Metro* doctrine, the two authorities ventured into hitherto uncharted territory.

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[113] Case 26/76 *Metro v Commission* ECLI:EU:C:1977:167 para. 21.

[114] Case 26/76 *Metro v Commission* (n 113) paras. 20-22; Case 31/80 *L'Oréal v De Nieuwe AMCK* ECLI:EU:C:1980:289 paras. 15-18; Case C-439/09 *Pierre Fabre Dermo-Cosmétique* (n 37) para. 41; Case 107/82 *AEG v Commission* ECLI:EU:C:1983:293 paras. 33-36; Case C-230/16 *Coty Germany* ECLI:EU:C:2017:941 para. 24.

[115] Case 26/76 *Metro v Commission* (n 113) paras. 20-22; Case 31/80 *L'Oréal v De Nieuwe AMCK* (n 114) paras. 15-18; Case C-439/09 *Pierre Fabre Dermo-Cosmétique* (n 37) para. 41; Case 107/82 *AEG v Commission* (n 114) paras. 33-36; Case C-230/16 *Coty Germany* (n 114) para. 24.

[116] Case 26/76 *Metro v Commission* (n 113) paras. 20-22.

[117] ibid para. 21.

[118] Guess (n 1) para. 115; Asics (n 1) paras. 247-262, 371-379.

Instead of assessing whether the restrictive effect of brand bidding restraints on competition went beyond what is necessary to ensure the quality or brand image of Asics' or Guess' distribution networks, the FCO and the Commission considered whether existing trademark case law – notably the leading cases on the competing use of trademarks as keywords *Google France*[119] and *Interflora*[120] – provides for legitimate reasons for a trademark proprietor to restrict the way in which their distributors use their trademarks in online search advertising.[121]

The FCO and the Commission concluded that brand bidding restraints adopted in a selective distribution agreement could not be explained by the legitimate objective of ensuring the indication-of-origin[122] function of Asics' and Guess' trademarks. They contended that the protection of the essential origin function of Ascis' and Guess' trademarks was not at stake because the use of trademarks and brand names by authorised Asics and Guess dealers was not capable of entailing any risk of consumer confusion over the origin of the trademark-bearing product. [123] The FCO and Commission also took the view that retailers' competing use of trademarks in keyword advertising does not undermine the advertising function of the trademark even if it resulted in an increase of the advertising cost of the trademark proprietor who has to intensify its advertising in order to maintain or enhance its profile with consumers.[124] Taking the view that neither the origin nor the advertising function protected by trademark law could justify a restriction of online search advertising by *intra*-brand competitors, the FCO and Commission concluded that the brand bidding restraints could not be explained by the legitimate objective of ensuring the quality of Asics' or Guess' selective distribution agreement.[125] The restriction, therefore, clearly fell within the scope of Art. 101 (1) TFEU without there being the need to inquire any further as to whether the prohibition on online search advertising was appropriate, proportionate and necessary to pursue such a legitimate objective.[126]

This reliance on trademark law to determine the legality of vertical restraints under Art. 101 (1) TFEU is unprecedented and innovative. In essence, both authorities adopted a 'scope of the trademark' approach to decide when brand bidding restraints are breaching competition

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119 Case C-238/08 *Google France* ECLI:EU:C:2008:389.
120 Case C-323/09 *Interflora* ECLI:EU:C:2011:604.
121 Asics (n 1) paras. 342, 366-379; Guess (n 1) paras. 115-123.
122 Asics (n 1) paras. 372-374.Guess (n 1) para. 116; Case C-238/08 *Google France* (n 119) para. 99.
123 Guess (n 1) para. 117. See for a similar reasoning with regard to the origin function of the trademark Asics (n 1) paras. 262-267, 372-374; Asics (n 1) para- 376.
124 Asics (n 1) paras- 375-377. Case C-323/09 *Interflora* (n 120) para. 56. Guess (n 1) paras. 122, 125.
125 Guess (n 1) para. 119; Asics (n 1) para. 384.
126 Guess (n 1) para. 123.

rules. Under this approach, the antitrust legality of brand bidding restraints depends on whether they are necessary to protect the 'origin function' of the trademark and to reduce the likelihood of confusion. Brand bidding agreements that fall within the scope of the trademark because they are securing its origin function by avoiding consumer confusion are presumed to qualify for the *Metro* doctrine and therefore to fall outside the remit of Article 101 (1) TFEU. However, if a brand bidding restraint is not necessary to ensure the origin function of the trademark, it is automatically considered not to qualify for the *Metro* doctrine and to fall within the remit of Art. 101 (1) TFEU.

Some authors have welcomed the adoption of this 'scope of the trademark' test as it draws an elegant and clear balance between trademark or intellectual property ('IP') law and competition law. While guaranteeing the ability of trademark owners to preserve the essence of their IP rights and thereby securing dynamic efficiencies, the scope of the trademark test is also said to ensure that the protection of the interests of trademark owners does not result in a complete elimination of competition.[127]

Despite its apparent simplicity, the choice of the scope of the trademark test to determine the legality of brand bidding agreements under Art. 101 TFEU is fraught with a number of difficulties. The first flaw of this approach is that it is unduly formulaic in transposing trademark principles into competition analysis. The scope of the trademark approach thus loses sight of important differences between trademark case law that is concerned with the competitive use of trademarks in online search advertising by competing brands (*inter*-brand competition) and vertical brand bidding restrictions that involve the use of trademarks by *intra*-brand competitors.

With respect to the origin function, the scope of the trademark test applied in *Asics* and *Guess* suggests that any brand bidding restraint that forms part of selective distribution and, arguably, also other distribution agreements contravenes Art. 101 (1) TFEU as there is no genuine risk of confusion when the branded products are advertised and sold by authorised retailers. This leaves very little, if any room, to balance the adverse impact of brand bidding restraints on *intra*-brand competition with their positive impact on *inter*-brand competition. With respect to the advertising function,[128] the 'scope of the trademark test' obfuscates that the adverse effect of competitive bidding by *intra*-brand competitors in Google AdWords on the advertising costs of a trademark proprietor is likely to exceed that of competitive bidding by

[127] Colangelo (n 2), 342–345.
[128] Case C-323/09 *Interflora* (n 120) paras. 56-58. Guess (n 1) paras. 122, 125; Asics (n 1) para. 375.

competing brands (i.e., *inter*-brand competitors) – the scenario envisaged by trademark law. This can be explained by the simple fact that the number of authorised retailers and, hence, *intra*-brand competitors of the trademark proprietor often exceeds by far the number of its horizontal *inter*-brand competitors. While Asics and Guess competed with only a few other fashion brands, their products were distributed by 2000 and 3000-5500 independent dealers, respectively.[129] Unrestricted competitive bidding for Asics' or Guess' brands and trademarks in AdWords by these authorised dealers may drive up the brand owners' advertising cost to a much greater extent than if the trademark was used in keyword advertising by their closest *inter*-brand competitors. By simply shoehorning trademark principles into the competition law analysis of restrictions of *intra*-brand competition, the 'scope of the trade mark' analysis ignores that the effects of restrictions on *inter*-brand and *intra*-brand competition pull not necessarily in the same direction.

As it fails to account for the different dynamics of *intra*- and *inter*-brand competition, the 'scope of the trade mark' test runs the risk of being at the same time too over- and under-inclusive. Consequently, the scope of the trademark test may lead to the prohibition of brand bidding restraints that are not essential to secure the core function of a trademark, although these restraints may have a procompetitive rationale in the vertical setting of selective or exclusive distribution agreements. At the same time, however, the scope of the trademark test may also become underinclusive. This would be, in particular, the case if the Court of Justice of the European Union were to further expand the protected trademark functions or raise the standard of protection of trademarks, for instance by adopting a broader definition of the investment or advertising function of trademarks. In this case, the scope of the trademark approach may shield brand bidding restraints from the scope of Art. 101 (1) TFEU even though they have anticompetitive effects.

Though it has been advocated by distinguished scholars,[130] *Asics* and *Guess* show that the use of intellectual property (IP) rights as an external normative source or benchmark is an inappropriate tool to determine the legality of vertical or horizontal restraints under competition law. This also explains why the EU Commission and Courts have consistently resisted the notion of a 'scope of IP right' test that would shield any anticompetitive conduct falling within

[129] Guess (n 1) para. 21.
[130] P. I. Colomo, 'Pay-For-Delay and the Structure of Article 101(1) TFEU: Points of Law Raised in Lundbeck and Paroxetine' [2020] Journal of European Competition Law & Practice, 9–12; Colangelo (n 2), 342.

the formal scope of an IP right from competition law scrutiny.[131] On the contrary, the Court of Justice's seminal distinction between the existence and exercise of the IP right suggests that although EU competition law does not call into question the existence of an IP right, certain ways of using this IP right may violate competition rules even if this exercise falls formally within the exclusionary scope of the IP right.[132] The flipside of this distinction between the existence and exercise of the IP right is that certain restrictions imposed by an IP proprietor on its licensees are not necessarily caught by competition law, even though they do not fall within the formal scope of the IP right.

Against this backdrop, the recourse by the FCO and the Commission to trademark law as an external benchmark to determine the legality of brand bidding restraints appears to be difficult to square with existing case law. Moreover, it remains unclear whether the 'scope of the trademark' test, as applied by the FCO and the Commission in *Asics* and *Guess*, is only relevant for the assessment of brand bidding restraints that form part of qualitative selective distribution agreements (under the *Metro* doctrine) or whether it applies to all types of brand bidding restraints irrespective of the form of the vertical agreement they are part of.[133] If the former is the case, the same type of brand bidding restraint, which would fall outside the scope of Art. 101 (1) TFEU when included in a qualitative selective distribution agreement, would be prohibited if it is contained in other forms of distribution agreements, such as quantitative selective distribution or exclusive distribution agreements. For these reasons, the 'scope of the trademark test' appears to be an unsuitable filter for the competitive assessment of brand bidding restraints. The Commission and the CMA should therefore refrain from using the 'scope of the trademark' test to determine the legality of brand bidding restraints in future cases or from codifying it in the revised EU and UK Vertical Guidelines.

4.2 The active/passive sales distinction

A second filter that plays a crucial role in the assessment of vertical non-price restraints under Art. 101 (1) TFEU is the distinction between active and passive sales. Since the 1960s, EU competition law distinguishes between vertical restraints that restrict the ability of retailers

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[131] For trademark case law, see for instance Case 56/64 *Consten and Grundig v Commission of the EEC* ECLI:EU:C:1966:41 pp. 345-346. Case IV/27.879 Sirdar-Phildar. OJ [1975] L 125/27 p. 25, II, 5. Case IV/30.128 Toltecs/Dorcet. OJ [1982] L 379/19 pp. 24–25, II (3) (A)(c)-(f); Joined cases 142 and 156/84 *BAT and Reynolds v Commission* ECLI:EU:C:1987:490 paras. 33-38. For patent cases see for instance Case C-307/18 *Generics (UK) and Others* ECLI:EU:C:2020:52 paras. 97, 99; Case C-588/16 P *Generics (UK) v Commission* ECLI:EU:C:2021:242 paras. 76-77.
[132] Case 56/64 *Consten and Grundig v Commission of the EEC* (n 131) pp. 345-346.
[133] This has also been recently raised during the consultation process for the VBER revision European Commission (n 12) 129.

to actively approach individual customers outside their assigned sales territory or assigned customer groups (‘active sales’) and restraints that prohibit retailers from ‘responding to unsolicited requests from individual customers outside their territory or customer groups’ (‘passive sales’).[134] While restrictions on both active and passive sales as part of a selective distribution agreement are considered hard-core restrictions of competition under Art. 4 (c) VBER, Art. 4 (b) (i) VBER[135] provides for an exception for exclusive distribution agreements that restrict active sales.[136]

This dichotomy between active and passive sales draws an implicit balance between the pro-and anticompetitive effects of vertical restraints. It acknowledges that vertical territorial or customer restrictions may be necessary to secure the incentives of retailers to enter new markets, invest in sales promotion, ensure the integrity of exclusive distribution networks and, thereby, stimulate *inter*-brand competition. By largely exempting restraints on active sales from Art 101 (1) TFEU, this distinction allows members of exclusive distribution networks to restrict a considerable amount of *intra*-brand competition so as to enable them to appropriate their investments in sales efforts. At the same time, the treatment of restrictions on passive sales as hard-core restrictions under Art. 4 (b) (i) seeks to guarantee a minimum amount of residual *intra*-brand competition and parallel trade. The active/passive sales dichotomy thus encodes the second and fourth conditions of Art. 101 (3) TFEU, which require that consumers obtain a fair share of the benefits of the exempted agreement and that the agreement does not afford the parties the possibility of eliminating competition in respect of a substantial part of the products.[137] It thus strikes an implicit balance between procompetitive efficiencies and more intense quality competition, on the one hand, and the protection of price competition, economic liberty and market integration on the other.

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[134] Commission Regulation No 67/67/EEC on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements, Regulation No 67/67/EEC recitals 9–10, Art. 2 (1) (b); Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution agreements. OJ [1983] L 173/1 recital 11-12, Art. 2 (1) and (2) (c).Commission notice - Guidelines on Vertical Restraints. OJ [2000] C 291/1 paras. 50-51; Guidelines on Vertical Restraints (n 42) para. 51. J. Shaw, ‘Group Exemptions for Exclusive Distribution and Purchasing Agreements in the EEC’ (1985) 34(1) The International and Comparative Law Quarterly 190 195. Until the 2000 VBER, the exception for restrictions on active sales was limited to territorial restrictions and did not cover customer group restrictions. R. Whish, ‘Regulation 2790/99: The Commission's ``new style'' Block Exemption for Vertical Agreements’ (2000) 37(4) Common Market Law Review 887 914.

[135] Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. OJ [1999] L336/21, Art. 4 (b) (i).Commission Regulation No 330/2010 of April 20, 2010 on the application of Article 101 (3) TFEU (n 6) Art. 4 (b) (i).

[136] Leslie (n 2), 13.

[137] Regulation No 67/67/EEC (n 134) rectials 9-10.

As *Asics* and *Guess* involved selective distribution agreements, both decisions left open whether brand bidding restraints constitute restrictions of active or passive sales. This point is of crucial importance because if brand bidding restraints are considered restrictions of active sales, they may qualify for the exemption under Art. 4 (b) (i) VBER as long as they are adopted as part of an exclusive distribution (rather than a selective distribution) agreement.

In the aftermath of *Guess*, some commentators have advanced the view that brand bidding restraints constitute restraints on active sales.[138] Unless they are part of selective distribution agreements, brand bidding restraints should, accordingly, be exempted under Art. 4 (b) (i) VBER and fall outside the scope of Art. 101 (1) TFEU, provided that the parties comply with the other conditions of the VBER, notably the market share thresholds.[139] In support of this reading, commentators point to the Commission's 2010 Vertical Guidelines that define active sales as

> *actively approaching individual customers by for instance direct mail, including the sending of unsolicited e-mails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory.*[140]

More specifically, with respect to online advertisement, the Guidelines consider

> *online advertisement specifically addressed to certain customers as a form of active selling to those customers. For instance, territory-based banners on third party websites are a form of active sales into the territory where these banners are shown. In general, efforts to be found specifically in a certain territory or by a certain customer group is active selling into that territory or to that customer group. For instance, paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory is active selling into that territory.*[141]

Some commentators read these passages as compelling an interpretation of brand bidding restraints as restrictions on 'active sales'.[142] On this account, they assert that, by equating brand bidding restraints with restrictions on passive cross-border sales and broadly condemning them as by-object restrictions, the FCO and the Commission unduly circumvented their analysis under the VBER.[143] This characterisation of brand bidding as restrictions of

[138] Leslie (n 2), 10, 12.
[139] ibid.
[140] Guidelines on Vertical Restraints (n 42) para. 51.
[141] ibid para. 534.
[142] Leslie (n 2), 10, 12.
[143] Leslie (n 2), 13–14; Kuhn (n 2), 381.

passive sales would run counter to the Commission's own 2010 Guidelines and depart from the basic rationale of the VBER that 'If it is not forbidden, it is permitted'.[144] From this perspective, *Asics* and *Guess* appear to undermine the use of the distinction between active and passive sales as a filter to shield procompetitive brand bidding agreements from Art. 101 (1) TFEU.

While this criticism rightly pinpoints a lack of clarity in the existing VBER, Vertical Guidelines and the Commission's decisional practice, the sweeping characterisation of all online search advertising as restrictions of 'active sales' does not stand scrutiny. Instead of classifying all forms of online advertising or online search advertising as 'active sales', the Guidelines use a number of qualifiers, such as 'approaching a specific customer group or customers in a specific territory', [145] 'specifically targeted at that customer group or targeted at customers in that territory'[146] and 'paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory is active selling into that territory'[147] to designate when online (search) advertising constitutes active sales. This seems to suggest that the Guidelines regard only search advertising that is specifically targeted at customers located within a specific territory (and outside the advertiser's assigned territory) as active sales. Accordingly, not all search advertising but only search advertising targeted at a certain location outside the retailer's territory would qualify as active sales.[148] By contrast, search advertising that is limited to the assigned sales area or that is not at all targeted geographically does not amount to 'active sales' within the meaning of paragraphs 51 and 53 of the Vertical Guidelines and should therefore be considered as passive sales.

This nuanced interpretation of the notion of active sales in relation to search advertising is not only supported by the letter and the spirit of the existing Vertical Guidelines but also more in line with the technological and economic features of online advertising. Google AdWords indeed offers specific geotargeting and local pay-per-click (PPC) services that allow advertisers to target their advertising to consumers located in a specific geographic region.[149] By contrast, a broad definition of active sales that would encompass all types of online search advertising disregards that search advertising (unlike other forms of advertising such as display

[144] Whish (n 134), 898.
[145] Guidelines on Vertical Restraints (n 42) para. 51.
[146] ibid.
[147] ibid para. 53.
[148] This also appears to be the view adopted by the Commission in Guess. The Commission observed that brand bidding restraints 'limited the ability of the authorised retailers' to sell the contract products actively or passively (depending on the targeted audience or territory).' Guess (n 1) para. 157. See also for the proposition that the qualification of brand bidding restraints as restriction of active or passive sales depends on the specific context (n 8) 7.
[149] Google Inc. 'Location targeting' (26 May 2021) <https://support.google.com/google-ads/answer/6317?hl=en>.

advertising or the good old spam emails) has important customer-initiated features.[150] So long as search advertising is not geographically directed at them, it is the consumers alone who solicit the advertising by entering a specific search query in the Google search bar. It is hence perfectly conceivable that online retailers will receive unsolicited clicks from consumers outside their sales territory without having geotargeted their online search advertising at them. Such a situation would squarely fall within the definition of passive sales of the Guidelines. The Guidelines, in fact, clarify that

> *General advertising or promotion that reaches customers in other distributors' (exclusive) territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in one's own territory, are considered passive selling. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' (exclusive) territories or customer groups.*[151]

An indiscriminate characterisation of all online search advertising as active sales, as it is advocated in some quarters,[152] would condone brand bidding restraints that ban online search advertising across the board, including online search advertising that is directed at customers located within the assigned sales territory of the retailer. Such a broad reading of the notion of active sales would allow brand owners to deprive their retailers of the most effective means of advertising even within their exclusive sales territories.

The uncertainties surrounding the status of online search advertising as a form of active or passive selling highlight the urgent need for further clarification of this distinction in the revised EU VBER and Guidelines on Vertical restraints, as well as the retained framework for vertical restraints in the UK. [153] The revised EU and UK rules should clarify when online search advertising qualifies as active and passive sales. The discriminating factor should be whether the online search advertising is (geo-)targeted to specific customers outside the retailers' assigned sales area or customer group. By contrast, general search advertising campaigns or search advertising limited to the assigned sales territory should be considered passive sales. Any generalised ban on brand bidding, such as the ones adopted in *Asics* and *Guess*, should therefore be treated as restrictions on passive (and active) sales.

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[150] Bayer and others (n 53), 2,13.
[151] Guidelines on Vertical Restraints (n 42) para. 51.
[152] Leslie (n 2).
[153] This lack of clarity of the active/passive sales dichotomy with regard to online sales and promotional efforts has been also flagged during the ongoing revision process of the VBER and Vertical Guidelines European Commission (n 12) 215–217.

The CMA's consultation document on the retained Vertical Block Exemption remains silent on the status of online search advertising as active or passive sales.[154] By contrast, the European Commission's draft of the revised Guidelines on Vertical Restraints provides some welcome clarification in this respect. While paragraph 200 of the draft Guidelines classifies targeted online advertising as a form of active selling, it clarifies that

> *online advertising or promotion which is meant to reach customers in a distributor's own territory or customer group but which cannot be limited to that territory or customer group, is considered a form of passive selling, to the extent that it is not designed to target customers across specific territories or customer groups.*[155]

This explanation that search advertising which is not targeted at customers outside the retailers' assigned territory or customer group constitutes a form of passive sales is a step in the right direction as it is consistent with the technological features of this mode of advertising and the economic rationale underpinning the active/passive sales dichotomy. This clarification should, therefore, also be adopted by the retained framework for vertical restraints in the UK, provided that CMA envisages maintaining the active/passive sales distinction in the future VABEO.[156]

4.3 An effects-based analysis

A third filter to discriminate between pro- and anticompetitive effects of vertical restraints consists of a case-by-case analysis of their effects. A more thorough analysis of the effects of brand bidding restraints would become particularly relevant once they do not benefit from an automatic exemption under the VBER. This effects-based analysis would ascertain the competitive impact of brand bidding restraints by assessing the types and quantity of products covered by the restraints, the market shares of the parties to the agreements, their isolated or cumulative effect, the severity of their clauses, and the likelihood of entry.[157] The rationale underpinning these factors is that the adverse impact of vertical restraints on competition depends on the market share of the parties, the foreclosure rate of the restraints and the intensity of this contractual foreclosure. If the parties do not hold any market power, the foreclosure rate of sales channels is not substantial, or the foreclosure can be easily circumvented, vertical

[154] CMA Retained Vertical Agreements Block Exemption Regulation - Consultation document (n 19) paras. 4.12 - 4.42.
[155] Draft Revised Vertical Guidelines (n 9) para. 200; see also para. 327; Draft Revised Vertical Block Exemption Regulation (n 9) Art. 1 (1) (l) and (m).
[156] CMA Retained Vertical Agreements Block Exemption Regulation - Consultation document (n 19) para. 4.30.
[157] Case 56/65 *Société Technique Minière v Maschinenbau Ulm* ECLI:EU:C:1966:38 pp. 249-250; Case C-234/89 *Delimitis v Henninger Bräu* ECLI:EU:C:1991:91 paras. 13-26; Case C-345/14 *Maxima Latvija* ECLI:EU:C:2015:784 paras. 26-31.

restraints are unlikely to result in substantial restrictions of *intra*- or *inter*-brand competition and to cause prices to rise.[158] In this case, the procompetitive effects of vertical restraints can be presumed to outweigh their potential anticompetitive effects.

In *Asics* and *Guess,* the competition authorities omitted to carry out an in-depth analysis of the effects of brand bidding restraints on *intra*- and *inter*-brand competition and consumers.[159] The authorities thereby gave little attention to the fact that brand bidding restraints can, at best, only lead to the partial foreclosure of retailers. While they limit or entirely restrict retailers' ability to place online search advertising, retailers nonetheless continue to appear in the generic search results and remain free to bid for non-branded keywords such as 'jeans' or 'running shoes'.[160] Moreover, the overall impact of brand bidding restraints on the ability of retailers to sell online is contingent on the importance of online search advertising as a distribution channel. Instead of ascertaining the extent to which the brand bidding restraints hindered retailers' online advertising and affected consumers' search behaviour, the FCO and the Commission simply presumed that brand bidding restraints substantially inhibit retailers' ability to reach consumers by reducing their visibility or findability.[161]

This absence of any serious consideration of the competitive effects of brand bidding restraints also characterises the ongoing revision of the EU and UK rules on vertical restraints. In their current state, neither the CMA's proposed recommendation on the VABEO and VABEO Guidance,[162] nor the Commission's draft of the revised Guidelines on Vertical Restraints lay down a consistent framework for an effects-based analysis of brand bidding restraints. This is all the more surprising as the draft Guidelines provide detailed guidance on the analysis of other vertical online sales restraints, such as restraints on the use of online market places,[163] parity obligations ('MFN clauses')[164] and restrictions on price comparison websites,[165] which the Commission labels as a specific form of online advertising

[158] B. E. Hawk, 'System failure: Vertical Restraints and EC Competition Law' (1995) 32 Common Market Law Review 973 975–977; J. M. Jacobson, 'Exclusive Dealing, Foreclosure and "Consumer Harm"' (2002) 75 Antitrust Law Journal 311 348.360, 365-68.
[159] The FCO explicitly stated that it was not required to show concrete effects to conclude that the brand bidding restraints was in breach of Art. 4 VBER Asics (n 1) para. 329-333.
[160] Leslie (n 2), 13–14.
[161] Guess (n 1) paras. 120-121.
[162] CMA Retained Vertical Agreements Block Exemption Regulation - Consultation document (n 19).
[163] Draft Revised Vertical Guidelines (n 9) paras. 313-322.
[164] ibid paras. 333-353.
[165] ibid paras. 323-332.

restrictions.[166] Such disparate treatment of online and, notably, online advertising restraints sits uneasily with an effects-based approach and should, therefore, be reconsidered.

Instead of considering the competitive effects of brand bidding restraints, the draft Guidelines seemingly codify the sweeping presumption – initially coined in *Asics* and *Guess* – that online advertising restrictions have the same effect on online sales as online sales bans. Admittedly, this presumption appears to be limited to online advertising restrictions that 'have as their object to prevent the buyers or their customers from effectively using the internet'.[167] It remains, however, unclear how much case-specific evidence would be required to activate this presumption. Nor do the draft Guidelines explain whether and under which circumstances this presumption can be rebutted by parties to a non-brand bidding agreement. The draft Guidelines thus omit to clarify whether brand bidding restraints must entail a substantial foreclosure effect to qualify as hardcore restrictions and, conversely, whether such a characterisation can be rebutted by case-specific evidence demonstrating that a specific brand bidding restraint is unlikely to result in a material foreclosure of online sales channels. The missing guidance on the effects-based analysis of brand bidding restraints in the draft Guidelines on Vertical Restraints and the CMA's proposed recommendation on the VABEO and VABEO Guidance is a major omission that should be addressed in later versions.

The apparent reluctance of European competition watchdogs to engage in a serious analysis of the competitive impact of brand bidding restraints raises the question of how a more effects-based analysis of brand bidding restraints could look like. The CMA's 2017 Digital Comparisons Tools Market Study Paper E provides a number of helpful factors around which a more effects-based analysis of brand bidding restraints could be structured. As a starting point, a more effects-based analysis should account for the market power of brand owners and retailers. This market power analysis would provide a first proxy for the significance of any consumer harm and foreclosure effect resulting from brand bidding restraints. The larger the market share of the brand owner, the higher the number of consumer searches affected by brand bidding restraints. Moreover, the larger the market shares of the retailers to which the restraints apply ('restricted advertiser'), the larger is the impact on competitive advertising that consumers would have seen in the absence of the agreement.[168]

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[166] ibid paras. 324, 327.
[167] ibid paras. 188 and 192 (f). Draft Revised Vertical Block Exemption Regulation (n 9) recital 13, Art. 1 (1) (n).
[168] Competition and Markets Authority, 'Digital comparison tools market study - Final Report: Paper E: Competitive landscape and effectiveness of competition' (2017) 4.63.

The restrictive scope or degree of foreclosure brought about by brand bidding restraints is a second relevant factor for the assessment of their competitive impact. The specific design of brand bidding restraints is essential in this respect. Brand bidding restraints can take three different forms. First, brand owners can impose narrow brand bidding restraints whereby the retailers ('restricted advertisers') commit not to bid on the brand owner's brand name when a search term entered by consumers only includes that brand name (and not other words).[169] The foreclosure effect and consumer harm caused by narrow brand bidding agreements tend to be limited as they are likely to affect a relatively small number of search queries. This is because narrow brand bidding restraints merely restrict search advertising by retailers in instances where consumers only use the brand name as a keyword. Moreover, narrow brand bidding restraints are likely to affect search queries of consumers who were actually looking for the brand owner's website rather than consumers who are shopping around.[170]

Brand bidding restraints can also take the form of wide brand bidding restraints. Such wide brand bidding restraints prevent the restricted advertisers not only from bidding on the brand owner's brand name when the search query only contains the brand name alone but also affect search queries which include the brand name and some additional generic non-brand related words (such as 'compare Brand X with Y').[171] Broad brand bidding restraints are, hence, likely to affect a greater number of search queries and are more likely to lead to foreclosure of retailers and consumer harm than narrow brand bidding restraints. Whereas under narrow brand bidding restraints, retailers remain free to bid for search terms that include the brand name together with generic terms, this is not the case for broad brand bidding restraints. Also, broad brand bidding restraints are more likely to affect customers that are shopping around and comparing various sellers rather than merely looking for the brand owner's online store.

Negative matching agreements are arguably the most restrictive type of brand bidding restraints. They go even one step further than broad brand bidding restraints, in so far as the restricted advertisers agree to add the brand owner's name to their list of negative keywords. This automatically prevents their ads from appearing when a consumer search term includes the brand name alone or with other generic terms.[172] Negative matching agreements eliminate any possibility for the restricted advertisers' add to appear when consumers use the brand owner's name as a standalone search term or together with other search terms. Whereas broad

[169] ibid 4.47.
[170] ibid para. 4,63.
[171] ibid 4.47.
[172] ibid.

brand bidding restraints leave some possibility that the restricted advertiser's ad appears when consumers enter search terms that contain the brand name and other generic words that are not covered by the broad brand bidding agreement, negative matching agreements preclude that possibility as the restricted advertisers' adds are automatically removed from the auction.[173] Negative matching agreements thus make brand bidding restraints "waterproof" and are likely to have the most important impact on search queries. Negative matching agreements are, therefore, most likely to entail material foreclosure effects and consumer harm.

A third factor for the determination of the competitive harm likely to arise from brand bidding restraints is how they affect traffic, as well as the clicking and search behaviour of consumers. The harm to competition increases with the number of search queries affected by the restraints and the degree to which consumers would have otherwise shopped around and purchased from competing retailers in the absence of the brand bidding restraints.[174] That, in turn, depends on the likelihood of consumers to click on a competing retailer's link (click-through rate) and the probability of consumers clicking on the link to purchase on the website of the retailer (conversion rate). The higher the click-through and conversion rate on retailers' links in the absence of the bidding restraint, the larger the anticompetitive harm. The impact of the brand bidding restraints on the click-through and conversion rates on the brand owner's website is also relevant for the analysis of potential anticompetitive effects.[175] As part of a counterfactual analysis, competition authorities should also assess consumers' search and clicking behaviour with respect to sponsored and generic search. The analysis should, in this respect, not only focus on the quantity but also consider the quality of clicks. A high return rate showing that consumers swiftly return in 30 seconds or less to the search results after having clicked on sponsored links (so-called 'quick back rate') would suggest that brand bidding restraints have little impact on search behaviour as a high ranking in generic search results tends to compensate for sponsored search.[176]

A fourth factor for the assessment of the anticompetitive effects of brand bidding restraints is their overall market impact. This market impact is likely to be greater if they affect not only *intra*- but also *inter*-brand competition. This would occur when the restraints are not only constraining the search advertising of mono-brand retailers but also cover multi-brand

[173] ibid 4.52–4.53, 4.62-4.63 and Figure 4.1.
[174] ibid paras. 4.60–4.61; 4.79.
[175] ibid paras. 4.61.
[176] A. Simonov and S. Hill, 'Competitive Advertising on Brand Search: Traffic Stealing, Adverse Selection and Customer Confusion' [2018] Columbia Business School Research Paper No. 18-59, 4.

retailers or price comparison websites.[177] In this case, brand bidding restraints may prevent consumers from accessing competing brands on multi-brand retailer or price comparison sites altogether. The impact of online brand bidding restraints is likely to be greatest when other firms also impose similar restraints. Moreover, the foreclosure effect and harm to consumers depends on the importance of online search advertising as a distribution channel relative to brick-and-mortar sales or direct sales via retailer websites. In this respect, it is also relevant to assess whether the brand bidding restraints are part of a broader set of vertical restraints imposed by a brand owner or whether they are standalone restraints.[178] The cumulative effects of multiple restraints imposed by a single brand owner or the use of brand bidding restraints by multiple brand owners may reinforce their anticompetitive impact on *intra*- and *inter*-brand competition.

This list of factors may constitute the basis for an effects-oriented analysis of online search advertising restrictions under the reformed EU Guidelines on Vertical Restraints and the CMA VABEO Guidance. Such framework would comprise the analysis of market power of brand owners and retailers, the design of brand bidding restraints (narrow or broad restraints, or negative matching agreements), their coverage, duration and their cumulative effect in combination with other restraints imposed by the brand owner or similar brand bidding restraints adopted by competing suppliers. Alternatively, these factors may also form the basis for the design of (optimally) differentiated,[179] better-tailored rules that might create a rebuttable presumption of illegality against the most egregious forms of brand bidding restraints, while other types may be exempted or subjected to a case-by-case analysis. If competition authorities envisage relying on a presumption that certain brand bidding agreements lead to substantial foreclosure effects,[180] the revised Guidelines should clarify by which circumstances this presumption is triggered and how it can be rebutted.

4.4 The exception of Article 101 (3) TFEU/s. 9 of the Competition Act 1998

The exception under Art. 101 (3) TFEU/s. 9 of the Competition Act 1998 provides for the last channel through which the anticompetitive and procompetitive effects of vertical restraints can be balanced, in case they do not qualify for the automatic safe harbour of the

[177] Haasbeek, Sviták and Tichem (n 1) 2, 22.
[178] Kuhn (n 2), 380.
[179] A. Christiansen and W. Kerber, 'Competition Policy with Optimally Differentiated Rules Instead of per se Rules vs. Rule of Reason' (2006) 2(2) Journal of Competition Law and Economics 215.
[180] There seems to be at least some empirical support for a presumption that brand bidding restraints have a substantial impact on click-through rates. Simonov, Nosko and Rao (n 50), 209.Sayedi, Jerath and Srinivasan (n 50), 587; Simonov and Hill (n 175); Haasbeek, Sviták and Tichem (n 1) 5–6; Decision in Case No COMP/AT.39740 Google Search (Shopping). C(2017) 4444 final paras. 454-488.

VBER and an individual analysis under Art. 101 (1) TFEU/the Chapter I prohibition of the Competition Act 1998 indicates their *prima facie* anticompetitive nature. To be exempted under Art. 101 (3) TFEU/s. 9 of the Competition Act 1998, agreements must meet four cumulative conditions[181]: namely, they must (i) generate some form of cost or non-cost/qualitative efficiencies;[182] (ii) compensate consumers for any anticompetitive harm suffered by providing them a fair share of the economic gains they generate;[183] (iii) not go beyond what is necessary to achieve these efficiencies;[184] and (iv) not eliminate all remaining competition in the market.[185] Unlike the other filters, the four cumulative conditions of Art. 101 (3) TFEU/s. 9 of the Competition Act 1998 provide the framework for some explicit balancing of pro- and anticompetitive effects of vertical agreements.[186]

Our analysis in the previous sections suggests that brand bidding restraints can be employed to address various externalities within a distribution network and attenuate potential conflicts between different distribution channels. In particular, they can be used to internalise free-riding on display advertising, coordinate different types of advertising and reduce advertising costs.[187] Moreover, brand owners can resort to brand bidding restraints to orchestrate *intra*-brand price discrimination that may benefit consumers and enable the brand owner to recover fixed costs, for instance in terms of advertising expenditure.

While these types of cost and qualitative efficiencies are, in principle, cognisable under Art. 101 (3) TFEU,[188] the FCO and Commission outright rejected potential efficiency claims in *Asics* and *Guess*. They found no indication that brand bidding restraints were necessary to address free-riding or to promote the brand image of Asics or Guess.[189] This can, at least in part, be explained by the fact that the defendants did not advance any convincing procompetitive explanation for their adoption of brand bidding restraints.[190] Existing studies

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[181] Guidelines on the application of Article 81(3) of the Treaty, Guidelines on the application of Article 81(3). OJ [2004] C 101/97 paras.32-47.
[182] ibid paras. 48-72.
[183] ibid paras. 83-104.
[184] ibid paras. 73-82.
[185] ibid paras. 105-116.
[186] ibid para. 11.
[187] This has also been recently recognised by some competition authorities Competition and Markets Authority (n 167) paras. 4.64-4.73; Haasbeek, Sviták and Tichem (n 1) 2–3.
[188] Guidelines on the application of Article 81(3) (n 180) para. 72.
[189] Guess (n 1) para. 164; Asics (n 1) paras. 391-399.
[190] T. Kuhn and M. Rust, 'Between Coty, Guess and the new V-BER - where do we stand on e-commerce restrictions?' (2019) 40(8) European Constitutional Law Review 376 380.

also observe that while it is plausible that brand bidding restraints may generate efficiencies, firms have so far omitted to substantiate them by proffering convincing evidence.[191]

To ensure the effectiveness of Art. 101 (3) TFEU/s. 9 of the Competition Act 1998 as a filter of last resort to balance the competitive effects of brand bidding restraints, the revised Commission Guidelines on Vertical Restraints and the new CMA VABEO Guidance should clarify when online advertising-related efficiencies are cognisable under Art. 101 (3)/s. 9 of the Competition Act 1998 and which evidentiary requirements have to be met for them to be exempted.

The Commission's draft of the revised Guidelines on Vertical Restraints only envisages a few situations in which online advertising restraints could generate procompetitive effects. It appears to limit the application of Art. 101 (3) TFEU to instances where brand bidding restraints are necessary to protect the brand image, to ensure that advertising complies with certain quality standards, or to reduce the sale of counterfeiting.[192] This narrow focus on purely quality-related justifications omits to consider when the elimination of advertising-related free-riding and the reduction of advertising costs through brand bidding restraints would produce procompetitive efficiencies that meet the conditions of Art. 101 (3) TFEU.[193] A burning question in this respect is whether the reductions in advertising costs have to be shown to be passed on to consumers in the form of reduced prices for this to be the case.[194] Relatedly, it remains unclear the extent to which qualitative (non-cost) efficiencies and consumer benefits due to the elimination of free-riding and greater sales efforts ought to be substantiated and quantified.[195]

The revised Commission Guidelines and CMA Guidance should also clarify the extent to which efficiencies (for instance in the form of fixed cost recovery) stemming from the use of brand bidding restraints as tools to coordinate *intra*-brand price discrimination can be accounted for under Art. 101 (3) TFEU/s. 9 of the Competition Act 1998. The existing EU case law and Guidelines treat price discrimination primarily as a source of potential anticompetitive harm while remaining silent on the possibility of efficiency-enhancing or competitive price discrimination.[196] In particular, the question of whether the gains for low-value and harm to

[191] Competition and Markets Authority (n 1) paras. 4.69, 4.73.
[192] Draft Revised Vertical Guidelines (n 9) paras. 193-194, 196, 323, 323.
[193] There are some indications that this might be the case. Guidelines on Vertical Restraints (n 42) para. 166.
[194] See in this sense Haasbeek, Sviták and Tichem (n 1) 3. Competition and Markets Authority (n 1) 4.72.
[195] Guidelines on the application of Article 81(3) (n 180) paras. 56-57, 102-104.
[196] Case C-403/08 *Football Association Premier League and Others* ECLI:EU:C:2011:631 para. 115. Guidelines on Vertical Restraints (n 42) paras. 151, 167-168, 217. See also to this effect Draft Revised Vertical Guidelines (n 9) paras. 103, 12.

high-value consumers can be weighed off against each other merits further consideration.[197] Lastly, the revised Guidelines should also provide guidance on what alternative solutions are considered to be less restrictive means to address search-advertising related externalities or implement procompetitive price discrimination.

5 Conclusion

This paper explores the law and economics of brand bidding restraints which constitute the most novel type of vertical restraints imposed by brand owners on their distributors in digital markets. The paper tests and critically reflects on the restrictive approach towards brand bidding restraints European competition watchdogs have adopted in recent cases and soft-law. So far, brand bidding restraints have been broadly condemned as by-object or hard-core restrictions of competition in breach of Art. 101 (1) TFEU which are unlikely to lead to procompetitive efficiencies cognisable under Art. 103 (3) TFEU.

The paper shows that this strict antitrust treatment of brand bidding restraints is not sufficiently grounded in the economic analysis of vertical restraints. In proposing a comprehensive framework to assess the economic impact of brand bidding restraints, the paper makes three principal contributions. First, it asserts that brand bidding restraints can have a number of procompetitive rationales. They can be used to internalise free-riding on display and traditional advertising, coordinate different types of advertising and reduce advertising costs.[198] The paper also demonstrates that brand bidding restraints constitute a handy tool to orchestrate *intra*-brand price discrimination that may benefit consumers and enable the brand owner to recover fixed costs, for instance, in the form of advertising expenditure. Second, the paper considers different ways through which brand bidding restraints may harm competition and consumer welfare when they disproportionately affect infra-marginal consumers, prevent meaningful *intra*- and *inter*-brand comparisons or result in price discrimination on the basis of search costs rather than brand preferences. Moreover, brand bidding restraints are of particular concern when adopted in the context of dual distribution systems where vertically integrated brand owners have an incentive to raise their retailers' (rivals') costs to prevent them from cannibalising their own sales channel. Third, the paper also explores various legal filters to disentangle and balance the anti- and procompetitive effects of brand bidding restraints. In this respect, the paper makes a number of policy recommendations for the future antitrust analysis

[197] Guidelines on the application of Article 81(3) (n 180) paras. 43, 95, 99.
[198] This has also been recently recognised by some competition authorities Competition and Markets Authority (n 167) paras. 4.64-4.73; Haasbeek, Sviták and Tichem (n 1) 2–3.

of brand bidding restraints. These proposals could also inform the ongoing revision of the VBER and Vertical Guidelines in the EU and the VABEO and CMA VABEO Guidance in the UK.

Proposal 1: The paper shows that a formalistic 'scope of the trade mark' test which conditions the legality of brand bidding restraints under competition law on whether they fall within the scope of the trademark rights bestowed on the brand owner should be discarded as it does not sufficiently account for the difference between *intra*- and *inter*-brand competition. Depending on the case at hand, the scope of the trademark test may be at the same time over- and under-inclusive when used to determine the legality of brand bidding on restraints under competition law. Instead of mechanically transposing trademark principles into competition analysis, competition authorities should carry out a standalone analysis of whether brand bidding restraints are necessary to secure potentially procompetitive efficiencies and to enhance the brand image of a distribution system.

Proposal 2: The paper shows that the status of online search advertising as active or passive sales within the meaning of Art. 4 (b) (i) and paragraphs 51 to 53 of the Vertical Guidelines requires further clarification. The distinguishing factor to decide whether search advertising qualifies as active or passive sales should be whether it is (geographically) targeted to customers outside the retailers' assigned sales area or customer group. Absolute and indiscriminate bans of brand bidding should, therefore, be regarded as restrictions on passive (and active) sales.

Proposal 3: Further understanding of the competitive impact of brand bidding restraints on competition and consumers is needed. An effects-based analysis should account for the market share of the parties to a non-brand bidding agreement, the specific design of the brand bidding restriction (narrow, broad brand bidding restriction, or negative matching agreements), as well as their impact on clicking behaviour, traffic and online sales channels. Gaining a better understanding of the actual effects of brand bidding restraints does not necessarily mean that all brand bidding must be subject to a case-by-case analysis. On the contrary, these factors may also form the basis for the design of (optimally) differentiated rules that might create a rebuttable presumption of illegality against the most egregious forms of brand bidding restraints, while other types may be exempted or subjected to a case-by-case analysis.

Proposal 4: The revised Vertical Guidelines should clarify the extent to which online advertising-related efficiencies or efficiencies obtained through price discrimination are cognisable under Art. 101 (3) TFEU/s.9 of the Competition Act 1998 and clearly set out the evidentiary requirements that the parties to brand bidding restraints have to meet to substantiate their procompetitive effects.

Yet, even if the revised EU and UK VBER and Guidelines were to address these points, brand bidding restraints raise some broader questions about the current approach of EU (and UK) competition law towards vertical restraints. First, brand bidding restraints in the context of dual online distribution add an interesting twist to the ongoing policy debate on how the rise of digital platforms has created new forms of conflicts of interest for vertically integrated gatekeeper platforms.[199] The recent brand bidding restraint cases show that these conflicts of interest stemming from the dual role that vertically integrated upstream firms play as vertical input-providers and horizontal competitors are not limited to large online platforms but also affect interactions between smaller players within vertical value chains. One might wonder how a sufficient degree of consistency between the application of competition law and the proposed new platform regulations to these instances of conflicts of interest can be ensured. Relatedly, the brand bidding cases raise questions about when such conflicts of interest stemming from the hybrid role of brand owners in dual distribution systems create a sufficient risk of anticompetitive harm to warrant antitrust intervention in the form of *ex ante* prohibitions (e.g., the treatment of brand bidding restraints as by-object restrictions).

Second, while this paper approaches brand bidding restraints from the perspective of welfare economics, one may wonder whether the current restrictive approach towards brand bidding restraints is at all grounded in concerns about consumer welfare. A central concern that permeates *Asics* and *Guess* is that brand bidding restraints undermine the economic liberty and opportunities of smaller retailers to harness the internet as a sales channel.[200] The restrictive approach towards brand bidding restraints thus stands in continuation of the existing EU policy towards vertical restraints which seeks to ensure that retailers remain free to sell their products via the internet and to choose the advertising tools they would like to use for this purpose. The restrictive policy towards brand bidding restraints is hence less concerned about consumer welfare than about the question of how the surplus created by the rise of digital markets is

[199] J. Furman and others, 'Unlocking digital competition: Report of the Digital Competition Expert Panel' (2019) 41, 47; J. Crémer, A.-Y. de Montjoye and H. Schweitzer, 'Competition policy for the digital era' (2019) 54, 60-63; Proposal for a Regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act). COM/2020/842 final, recitals 2-6; Art. 3; Competition and Markets Authority (n 1) paras. 2.4, 4.17-4.22.
[200] Asics (n 1) paras. 29-30, 41,87, 253-254, 272-273, 307, 312-219, 327-328. Guess (n 1) paras. 120-121, 124-125, 157.

distributed amongst online platforms, large, international brand-owners and their local, small or medium-sized retailers. The critical impact these political economy considerations have on the current policy towards vertical restraints is not a problem in itself, but it should be more clearly articulated in the revised Guidelines and legislation.

Third, even if it is rather informed by political economy than welfare considerations, the strict antitrust treatment of brand bidding restrictions may have some important counterintuitive implications. The use of Art. 101 TFEU to protect retailers' ability to harness the new opportunities of online search advertising and thus to intensify *intra*-brand competition does not only help small and medium-size online dealers. After all, more competition on AdWords means more advertising revenue for Google. Strict antitrust treatment of brand bidding restraints aimed at helping the 'little guy' (here small and medium-size retailers) may also have the unintended consequence of supporting the 'big guy' (here Google). Greater attention should be paid to these unintended consequences and spill-overs in the ongoing policy debate about the reform of the competition law approach towards vertical online restraints and the regulation of digital platforms.[201]

[201] Cf. for the proposition that consistency is ensured between the revised rules on vertical agreements and the Digital Markets Act Revision of the Vertical Block Exemption Regulation - Explanatory note (n 9) 6.

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