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The Swiss Federal Administrative Court upholds fines imposed by the Competition Commission to a Swiss toothpaste manufacturer and licensor and its Austrian distributor and licensee for prohibiting parallel imports from Austria to Switzerland (Gaba International)

Switzerland, Anticompetitive practices, Agreement, Distribution agreement, Vertical restrictions, Absolute territorial protection, Licensing agreement, Parallel imports, Hardcore restriction, Judicial review, Distribution/Retail, Manufacturing

Federal Administrative Court, Gaba International AG, Gebro Pharma GmbH, B-506/2010, 19 December 2013

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Background and Court decision

Back in 2009, the Swiss Competition Commission (COMCO) hit Gaba International AG – an undertaking part of the Colgate-Palmolive Group and manufacturer of the toothpaste brands Elmex and Meridol – with a CHF 4.8 mio (about EUR 3.9 mio) fine for restricting passive sales of its products to Swiss retailers and consumers by its Austrian licensee Gebro Pharma GmbH. [1] Indeed, until 2006 the license agreement between the two companies provided that Gebro could distribute the licensed products only in Austria and was not to export them to other countries, neither directly, nor indirectly. The contract was then amended in 2006 to allow passive sales while still forbidding active sales. However, Denner, a Swiss food retailers chain, had already filed a complaint with the COMCO in 2005, arguing that it had repeatedly tried without success to import Elmex toothpaste from Austria, where it was available at a cheaper price than in Switzerland.

The decision of the Federal Administrative Court upheld the finding of the COMCO that the limitation of parallel imports, and most specifically passive sales, was to be considered as an unlawful territorial restraint within the meaning of article 5 IV of the Swiss Cartel Act (vertical agreement between manufacturer/licensor and distributor/licensee). [2] The decision of the Federal Administrative Court – which has now been appealed to the Swiss Supreme Court – is to be considered in the broader context of several recent crack-down efforts of the COMCO on vertical restraints (allegedly) leading to the high prices level in Switzerland. [3] It is an important decision

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because it confirms the principles underlying the territorial application of the Swiss Cartel Act. It also sheds some light on the relationship between Swiss law and EU law. Last but not least, it is the first time a court interprets the controversial article 5 IV of the Cartel Act (prohibition of hardcore vertical restraints, namely RPM as well as territorial allocation clauses in distribution agreements). These issues are briefly examined in the present contribution.

Applicability of Swiss law

According to its article 2 II, the Swiss Cartel Act is applicable to facts that trigger effects in Switzerland, even if they occur abroad. In its appeal to the Federal Administrative Court, Gaba argued that (i) the license/distribution agreement concerned only the Austrian market and that (ii) it had no demonstrated effects on competition on the Swiss market anyway. The Court dismissed both arguments. [4] First, it stated that the agreement indirectly prohibited parallel imports – most notably passive sales – to Switzerland by prohibiting exports from Austria, even though Switzerland was not expressly mentioned. Second, the Court held that the "effects principle" set forth in article 2 II of the Cartel Act does not require the proof of a certain level of intensity on the Swiss market. The Court found that the legislator did not mean to introduce such threshold but wanted the scope of application of the law to be as broad as possible. Therefore, the mere likelihood of "some effects" in Switzerland shall be enough to trigger the application of the act, while their intensity is to be assessed at the next stage of the analysis, under the material provisions of the act. While this generally makes sense given the systematic of the law, this might however look more problematic in cases in which the real, quantitative effects of a restraint on the Swiss market would then never be truly assessed at the next stages of the analysis, as the findings of the Court in the present case suggests (see hereafter).

Relationship with EU law

In its appeal, Gaba argued that the restriction of passive sales in the license agreement should have been scrutinized by applying – or at least by referring to – EU law, namely the Technology Transfer Block Exemption Regulation (TTBER), under which it would have allegedly been lawful. [5] The Court dismissed that argument for several reasons : [6] First, to the extent that the appellant called for the application of EU law based on the effects principle, the Court made clear that this principle does not go as far as triggering the application of foreign law in Switzerland. EU law can only be considered in a comparative perspective (given the broad similarities between the two legal systems), the judges reminded. Second, the Court considered that Article 4 II b 1 of the TTBER, stating in substance that the block exemption shall not apply to agreements that have as their object the restriction of the territory into which the licensee may passively sell the contract products, would render the clause at stake illegal. This because the Court was of the opinion that the counter-exception to that provision, stating that restrictions of passive sales into an exclusive territory reserved for the licensor still benefit of the block exemption (Article 4 II b 1 i), would not be applicable in this case : In the opinion of the Court, the parties did not explicitly reserve Switzerland as an exclusive territory for the licensor as alleged by the appellant, but simply restricted exports from Austria, without reference to any particular country. Whether this interpretation of Article 4 II b 1 i TTBER is correct might be questionable given the fact that such licensing would probably not occur without the – at least – implicit reserve of an exclusive territory for the licensor. [7] But as this regulation is not directly applicable in Switzerland, Swiss courts certainly have some margin in interpreting it. [8] The other "twist" here is that the Swiss authorities are trying to apply by analogy

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an EU regulation applicable to restraints between Member States to a third party country that is not part of the single market. [9]

Quasi *per se* illegality of territorial restraints in distribution agreements

In substance, article 5 IV of the Cartel Act, introduced in 2004, sets forth that vertical agreements such as between suppliers / manufacturers and distributors / retailers, are presumed to suppress competition when they impose a minimum or fixed resale price (resale price maintenance – RPM), as well as when they allocate exclusive territories in a distribution contract while forbidding passive sales from one territory to another. [10] This presumption can however be rebutted by showing that competition is not completely suppressed on the relevant market(s) thanks to the existence of some intra- and/or inter-brand competition. In such case, the authority has then to check whether competition may nevertheless be significantly restrained, in a both qualitative and quantitative perspective. [11] The Communication of the COMCO on the appreciation of vertical agreements (ComVert) specifies in substance that territory allocations including a prohibition of passive sales are considered as qualitatively significant restraints. [12] Finally, even a significant restraint on competition can in theory be lawful if it is counter-balanced by cognizable efficiencies.

Here, the COMCO had already accepted the rebuttal of the presumption based on the existence of sufficient inter-brand competition. But the appellant challenged its finding that competition was nevertheless qualitatively and quantitatively significantly restrained. In backing the COMCO the Court took the surprising stand that, because the prohibition of passive sales in the licensing agreement was a *qualitatively* significant restraint (based on the ComVert), and because the Cartel Act presumes that such clause suppress competition (based on article 5 IV), it was not necessary to assess whether it was also a *quantitatively* significant restraint. [13] This reasoning is particularly questionable because it has so far been a well established principle of Swiss competition law that only agreements which trigger at least both a qualitatively *and* quantitatively significant restraint on competition could be unlawful. [14] Even the ComVert explains that the fact that a prohibition of passive sales is considered to be “qualitatively serious” simply means that it can substantially affect competition even if it has only a limited quantitative effect. [15] This does not mean, however, that the analysis of the quantitative effects can simply be left out. Especially a more thorough analysis of inter-brand competition and potential competition / entry than the one generally conducted when checking whether the presumption of illegality can be rebutted. [16] In fact, the reasoning of the Court amounts to already applying the so-called “quasi per se illegality” of RPM and territorial allocations prohibiting passive sales proposed by the Federal Council in the pending revision of the Cartel Act. [17] This is especially surprising as this part of the revision package is currently heavily debated in Parliament. [18]

Hardcore restraints sanctionable also when the presumption of suppression of competition is rebutted

According to article 49a I of the Cartel Act, an undertaking involved in an unlawful agreement within the meaning of articles 5 III and 5 IV can be sanctioned with a fine of up to 10% of its Swiss turnover during the three previous years. It was however not clear whether an agreement for which the presumption of suppression of competition set forth in articles 5 III or 5 IV could be successfully rebutted could nevertheless be fined if it significantly affected competition within the meaning of article 5 I of the Cartel Act. In other words, the Court had to figure out whether a financial sanction

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shall be the consequence of the suppression of competition or of certain type of hardcore agreements (whatever the exact extent of their effects). Gaba notably argued that a literal interpretation of article 49a, which mentions only "illegal agreements under articles 5 III and 5 IV", clearly spoke for the limitation of financial sanctions to hardcore agreements completely shutting down competition on a market. But the judges held that such a limitation would deprive article 49a of its meaning and effects as cases where competition is completely suppressed are very rare. [19] Consequently, the Court found that this could not have been the intent of the lawmakers and ruled that a hardcore restraint presumed to suppress competition can nevertheless be sanctioned with a fine if it "only" significantly affects competition and is not justified by efficiencies.

Conclusions

The decision of the Federal Administrative Court in the Gaba case sparked a lot of criticisms, especially because the court relied on a quasi per se illegality principle that has not yet been enacted into law and is heavily debated. It will therefore be very interesting to see if this ruling is upheld or not by the Swiss Supreme Court and why. This will also have a decisive impact on other appeals pending in vertical restraints cases, namely the *BMW* and *Nikon* cases. Meanwhile, licensors and companies setting up and managing a distribution network including Switzerland will have to be extremely cautious and, beyond the applicable EU rules, carefully review the legality of their contracts under Swiss law.

[1] Decision of the COMCO (first instance), RPW 2010/1 p. 65, available at http://www.weko.admin.ch/dokumentat... (p. 65). Gebro was actually also sanctioned, but with a much smaller fine of CHF 10'000 (EUR 8'200).

[2] Decision of the Federal Administrative Court from December 19, 2013 (hereafter "Decision"), available at http://www.bvger.ch/index.html?lang... (decision concerning Gaba ; the decision concerning Gebro is available at http://www.bvger.ch/index.html?lang...).

[3] Notably *BMW* case in 2012, see **Pierre Kobel**, The Swiss Competition Commission fines car manufacturer for preventing parallel imports by prohibiting its authorised dealers within the EEA from selling new cars to customers located in Switzerland (BMW), 7 May 2012, e-Competitions Bulletin May 2012, Art. N° 49633, and *Nikon* case in 2011, see **Patrick Krauskopf, Fabio Babey**, The Swiss Competition Commission fines leading camera manufacturer a total of 12.5 million CHF because of the restrictions on parallel imports of the company's imaging products (Nikon), 28 August 2011, e-Competitions Bulletin August 2011, Art. N° 45012, for both of which appeals to the Federal Administrative Court are pending. See also the pending revision of the Cartel Act, which includes a proposal to introduce the "quasi per se illegality" of certain vertical agreements (RPM and territorial allocations). See http://www.seco.admin.ch/aktuell/00... and hereafter.

[4] Decision, pp. 25-33.

[5] Commission Regulation (EC) n° 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, available at http://eur-lex.europa.eu/LexUriServ....

[6] Decision, pp. 84-86.

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[7] Moreover, the reserve of an exclusive territory or customer group for the licensor is presumed – up to the market share threshold – to encourage the pro-competitive dissemination of technology and its integration into the production assets of the licensee. See Guidelines on the application of Article 82 of the EC Treaty to technology transfer agreements, n. 100, available at http://eur-lex.europa.eu/LexUriServ...):EN:NOT.

[8] Further, it shall be added that the judges were also of the opinion that Article 6 II TTBER would have called anyway for the withdrawal of the exemption by a Member State, given that the effects of such prohibition of passive sales would have allegedly been absolutely incompatible with Article 101(3) of the Treaty (walling off a national market).

[9] From an EU point of view, the restraint of exports to Switzerland was certainly not problematic as it did not affect trade between Member States.

[10] Swiss Cartel Act, available at http://www.admin.ch/opc/fr/classifi....

[11] Article 5 I of the Cartel Act.

[12] Communication on the appreciation of vertical agreements of 28 June 2010 (ComVert), n. 12 (2) b) and 12 (2) b) i (stating the same principle as the 2002 version of the Communication applicable to the facts of the case), available at http://www.weko.admin.ch/dokumentat....

[13] Decision, pp. 102-103.

[14] Even for hardcore cartels when the presumption of suppression of competition is rebutted, which is (was ?) an important difference with the treatment of restrictions by object under article 101(1) TFUE.

[15] ComVert, n. IX.

[16] Here, it is interesting to point out that in its 2009 decision the COMCO did assess the quantitative criterion and held that there was a quantitatively significant restraint, mainly because Gaba's products had a quite strong market position, a 30% to 50% market share, and because there was a substantial price difference between Austria and Switzerland that could/should have provided for an interesting arbitrage opportunity (see Decision of the COMCO, p. 104).

[17] It is only a "quasi" per se rule because the presumption could in theory still be rebutted by the showing of cognizable efficiencies – which was not the case here. On the pending revision of the Cartel Act, see http://www.seco.admin.ch/aktuell/00....

[18] In fact, the Commission for economic affairs of the National Council (lower chamber) recently refused to submit the proposed revision package to the plenum notably because of dissensions over the introduction of this quasi per se illegality. See for example the article in the Neue Zürcher Zeitung from January 29, 2014, available at http://www.nzz.ch/aktuell/schweiz/a....

[19] Decision, pp. 130-133.

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