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Companies with a strong market position: beware of your commercial policy!

Once again, it is proven that the commercial practices of a company in a dominant position are particularly looked at and kept under strict scrutiny, whereas those same practices implemented by an average company would not arouse any interest from national competition authorities.

This is the lesson to be learned from the commitments undertaken by the companies *Manufacture française des pneumatiques* Michelin and Pneumatiques Kléber (collectively referred to hereinafter as "Michelin", on September 15, 2010[1], after their commercial policy had recently raised "*competition concerns*" from the *Autorité de la concurrence* (French Competition Authority or hereinafter the "FCA").

Even though no emergency interim measures have been ordered following the complaint lodged by *Vulco Développement* and the *GIE*[2] *Pneuman*[3], the FCA nonetheless considered that the implementation of its new commercial policy by the Michelin group could be suspected, in some aspects, of constituting abuses of a dominant position.

As this could raise competition concerns, the FCA considered that an examination on the merits was necessary. The Rapporteur had pointed out, within the framework of his preliminary assessment, six competition concerns.

Michelin being ready to remedy such competition concerns, it has been decided that the commitment procedure, as referred to in Article L.464-2 of the French Commercial Code[1], had to be followed.

I- The contractual background of Michelin's commercial policy

In 2007, the Michelin group was holding 45-50% of the new replacement tires market (against 14.6% for Goodyear Dunlop, 13.1% for Continental, 6.6% for Bridgestone, etc.).

Michelin's commercial policy was mainly structured around three contractual instruments:

- service agreements entered into between Michelin and retailers member of distribution networks (A);
- a partnership agreement entitled "*Michelin performance and responsibility*" (hereinafter "MPRC"») and entered into with specialized dealers (B);
- individual service agreements entered into between Michelin and dealers (C).

In January 2008, Michelin, as part of the reorientation of its commercial policy, decided to change its contractual terms notably to exclude retailers having privileged links with competing manufacturers; these changes logically entailed the exclusion of Vulco Développement (in which Goodyear Dunlop Tires France has a 99.87% stake) and GIE Pneuman (grouping all members of the Vulco Développement network) who consequently filed a complaint with the FCA.

A) The service agreement with the distribution networks

Replacement tires are distributed mainly through the privileged channel of independent specialized dealers grouped in a distribution network under a common brand. Vulco Développement is one of the largest grouping of specialized dealers (with 2,500 points of sale in Europe and 218 in France) among which Euromaster (a subsidiary of Michelin), First stop Métifiot (a subsidiary of Bridgestone), Point S, Eurotyre, but also non-specialized dealers (auto centers, car dealers and garages).

Up to December 31, 2007, the commercial relationships between Michelin and networks like Vulco Développement was governed by two "network" service agreements pursuant to which the services performed by the network retailers (referencing of Michelin's products, advertising and promotion of Michelin's products, etc.) were remunerated on the basis of the effective purchase volume of Michelin's tires by the network retailers; the remuneration being then allocated between the head of network "Vulco Développement" (20%) and the specialized retailers (80%).

In January 2008, Michelin, considering that the quality of the services performed by retailers having links with competing manufacturers was lower, decided to enter into "network" service agreements exclusively with network dealers "in which *competing manufacturers have no shareholding interest and whose affiliated entities are not held by such manufacturers*". As an immediate result, Vulco Développement and GIE Pneuman, that are directly or indirectly held by Goodyear Dunlop, were excluded from these "network" service agreements.

B) The MPRC

Since January 1, 2008, Michelin has been implementing the MPRC, a three-year policy aimed at improving the quality of the dealers' points of sale through the adoption of a quality-label program that requires selected dealers to improve the quality of their points of sale to be granted the "Michelin Quality Center" label for all or part of their points of sale.

To benefit from the MPRC, a dealer must notably be an independent company, having no link with Michelin's manufacturing competitors (which means that a competitor may not have any direct or indirect shareholding interest in the dealer seeking to benefit from the MPRC nor, if applicable, in the network to which such dealer belongs). For Michelin, this independence criterion is fully justified as Michelin does not have to "*subsidize the improvement of the quality of points of sale of dealers belonging – or affiliated – with direct competitors that impose preferential objectives with high purchase targets for their own brands*".

C) Agreements entered into with dealers not benefiting from the MPRC

Dealers benefiting from the MPRC enter into a specific service agreement while those who do not benefit from the MPRC (and, therefore, who do not have to meet the independence criterion) are proposed another type of service agreement.

II- Clauses that raised competition concerns from the FCA and Michelin's commitments to remedy such concerns

A) Competition concerns raised by services agreements

a) Concern n°1 relating to "network" service agreements

(i) The position of the FCA: The FCA considers that the exclusion of network retailers having links with competing manufacturers is disproportionate as the remunerations of the services based on the effective purchase of Michelin's tires would be enough to identify the retailers that "play the game" and indeed promote Michelin's tires and those who do not. In addition, according to the FCA, the effect of the independence criterion is to exclude competing networks since Michelin's tires are deemed "inevitable" as a result of Michelin's dominant position on the replacement tires market.

(ii) Commitments made by Michelin and accepted by the FCA: Michelin waives the independence criterion and commits, for all service agreements to be proposed, to "*apply the same conditions for access and the same remuneration system for the to-be-performed services to all distribution networks, irrespective of any shareholding by a competing manufacturer, insofar as the services are properly performed*".

(iii) General comment: Assuming that Michelin holds a dominant market position, the FCA may appear quite strict in its approach. Whereas it is acknowledged in Decision 09-D-12 that the exclusion sought by Michelin

respond to "*legitimate considerations*" (§53 of the Decision), the FCA sanctions this practice because there exists a risk of market exclusion for network dealers having links with competing manufacturers, such network dealers being likely to find themselves unable to supply Michelin's tires. This does not however correspond to the reality: the network dealers can still purchase Michelin's tires pursuant to general terms applicable to suppliers (as opposed to the terms applicable under the "network" service agreement). The argument according to which this competition disadvantage results in an exclusion from the market is exaggerated. This is, at most, a risk of discrimination[5].

Yet, the FCA considers that Michelin legitimately reserves the possibility not to propose services to dealers of the networks that would have link with competing manufacturers. In addition, the FCA considers that Michelin is entitled to expect from dealers, even those having links with competing manufacturers, "*an active and loyal participation in these services*", which implies that such dealers should renounce if they have a conflict of interest.

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b) Concern n°2 relating to "dealer" service agreements

(i) Position of the FCA: The mere fact that there exist two types of "dealer" service agreements – depending on whether the relevant dealer has signed the MPRC or not – justifies, according the FCA, the existence of competition concern: "*this distinction implies that dealers are treated differently based on whether they have links with competing manufacturers or not*".

(ii) Commitment made by Michelin and accepted by the FCA: *"For all service agreements proposed to specialized dealers that are not capitalistically integrated to a competing manufacturer, Michelin commits to apply the same conditions of access and the same remuneration system, irrespective of whether such dealers have signed the MPRC".*

(iii) General comment: Michelin's will to apply such a distinction could be seen as legitimate[6]. The FCA, without further assessing the potential anti-competitive effects of such distinction, decided to hold it illegal on the basis of a limited analysis of the situation (so-called *prima facie* analysis inherent to the commitment procedure). The FCA considers that the remedy proposed by Michelin lifts this concern but it enables Michelin not to propose certain qualitative services to integrated dealers (considering that in case of conflict of interest these highly strategic services might be poorly performed and consequently damage Michelin's reputation).

B) The competition concerns raised by the new MPRC

a) Concern n°3 relating to the partners' obligation to "do their best efforts to promote Michelin's products and to satisfy market demand"

(i) Position of the FCA: The FCA considers that Article 4.1 of the MPRC is "*likely to encourage the partner to prioritize Michelin's products and, therefore, to strengthen Michelin's position on the relevant market".*

(ii) Commitment made by Michelin and accepted by the FCA: Michelin proposed to delete the reference to the promotion of its products and to amend Article 4.1 as follows: "*the partner shall do its best efforts to satisfy market demand".*

(iii) General comment: This is typically a clause that would be considered as normal in any commercial relationship but that appears as suspect because of Michelin's position on the relevant market. At this stage, the FCA's position seems very excessive: stimulating commercial partners is part of a pro-competitive policy, isn't it? (This is all the more true since in the MPRC the partner has no obligation to guarantee a certain level of sales of Michelin's products).

b) Concern n°4 relating to the "professionalization fund"

The MPRC provides for the creation of a so-called "professionalization fund" that held partners finance efforts to improve the quality of their points of sale and meet the "Michelin Quality Center" label requirements. The sums paid under this professionalization fund are calculated on the amount of Michelin's tires purchased by the relevant partners.

(i) Position of the FCA: the FCA considers that "*insofar as the amount of the sums paid under the fund are proportional to the number of Michelin's tires sold by the dealers and that the scheme does not currently clearly guarantee the reimbursement of the expenses actually incurred, the partners' interest is to favor the brand. As such, this arrangement, even if it is likely to improve the partners' professionalization and thereby to benefit other brands, is however likely to strengthening Michelin's position on the relevant markets".*

(ii) Commitment made by Michelin and accepted by the FCA: Michelin commits (i) to pay the sums accrued under the professionalization funds only upon presentation of appropriate documentary evidence of the investments made and expenses incurred by the dealer, (ii) to cap the sums paid annually to the dealer under the professionalization fund at 4% of the price of a Michelin's tire (after deduction of rebates, discounts and reductions) and (iii) to apply this cap per line of products.

(iii) General comment: Same comment as for the preceding competition concern. While the FCA acknowledges that this professionalization fund is likely to benefit other manufacturers (through the general improvement of the quality of the dealers' points of sales), it considers such fund as suspect whereas it is nothing more than an "incentive" mechanism aimed at dynamizing and stimulating dealers. Not doubt that the FCA's strict and radical approach has been influenced by Michelin's strong market position.

c) Concern n°5 relating to the training and assistance provided by Michelin in commercial and financial management

As part of the commercial training and assistance provided by Michelin to dealers, the latter benefits from specific training modules called "*organization and optimization of sales forces*" "*financial diagnosis, I identify the levers of improving the economic performance of my business*" and "*financial consulting, I improve the economic management of my business*".

(i) Position of the FCA: While the FCA believes it is legitimate that "*Michelin wishes to assist its partners in their professionalization process (…) these provisions, combined with Article 1.1.4 of the MPRC, can result in Michelin exercising a significant influence on dealers' management and present a risk of interference of the same nature as that previously identified by the European Commission*"[7].

(ii) Commitment made by Michelin and accepted by the FCA: Michelin commits that "*the training and assistance provided in the framework of the aforementioned MPRC and service agreements will not, by any means whatsoever, lead to any binding, direct or indirect instructions, directives or recommendations concerning the partner's commercial/financial strategy or policy*".

(iii) General comment: This competition concern seems quite legitimate. The risk of interference by Michelin in the partner's commercial and financial policy is likely to restrain the latter's autonomy, which may, if a directive behavior is established, falls within the scope of Article L.420-1 of the French Commercial Code. The FCA's assessment of the risk is modeled on the decision rendered by the European Commission.

C) The competition concerns raised both by the MPRC and the other service agreements

a) Concern n°6 relating to information held by partners and made available to Michelin

In return for the commercial training and assistance that Michelin provides to the dealers, the latter are requested to communicate "*for example*" information about all brands marketed by the dealers (with detailed

information for each brand of the Michelin group) concerning revenues, sold quantities, balance sheets and profit and loss accounts (Article 1.1.14 of the MPRC).

(i) Position of the FCA: The FCA considers that *"while Michelin may legitimately access certain information to check the partners' professionalization efforts (…) the provisions of the MPRC and other service agreements, as drafted, allow Michelin to access sensitive information concerning its competitors and dealers"*.

(ii) Commitment made by Michelin and accepted by the FCA: Michelin commits notably to (i) exhaustively list the information that partners must provide under the MPRC and (ii) prepare a limitative list of information that are mandatory.

(iii) General comment: by requesting its partners to communicate sales figures for all brands, Michelin could benefit from confidential information on its competitors' market positioning, which is indeed likely to constitute a questionable sharing of information under antitrust laws (Article L.420-1 of the French Labor Code) and to enable Michelin to strengthen its position (by giving it an in-depth knowledge of its competitors' position). This competition concern was justified.

In conclusion, Decision n°10-D-27 is a perfect example of how the "negotiated right" principle born from the commitment procedure can result in the creation of contractual provisions highly sophisticated in a sensitive context (dominant position) aimed at finding an optimal compromise between the resolution of competition concerns identified by the FCA and a company's legitimate commercial concerns to expand and promote its products on a specific market.

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[1] Decision n°10-D-27 of September 15, 2010 regarding the practices implemented by the companies *Manufacture française des pneumatiques* Michelin and *Pneumatiques* Kléber.

[2] "GIE" means Economic Interest Group.

[3] Decision n°09-D-12 of March 18, 2009 regarding emergency interim measures request by *Vulco Développement* and the GIE *Pneuman* against practices implemented by the companies *Manufacture française des pneumatiques* Michelin and *Pneumatiques* Kléber.

[4] Article L.464-2 I of the French Commercial Code states: *"the Competition Authority may order companies or bodies concerned to cease their non-competitive practices within a specified period or may impose special conditions. It may also accept commitments from them in order to put an end to competition issues likely to represent prohibited practices pursuant to Articles L.420-1, L.420-2 and L.420-5".*

[5] It is interesting to note that "price differentiation" may be treated differently, depending on whether it is analyzed through the prism of anti-competitive practices or restrictive business practices. While discriminatory

price conditions are likely to constitute an abuse of dominant position under Article L.420-2 of the French Commercial Code, they are no longer punishable as such under restrictive business practices pursuant to the LME 2008-776 of August 4, 2008 (Article L.441-6 of the French Commercial Code).

[6] This is all the more true since the FCA considers that the independence criterion – which lies at the foundation of the MPRC – is legitimate "because, on the one hand, competitors have already implemented similar arrangements and because, on the other hand, as many dealers remain free to market any brands they wish, the other manufacturers can already benefit from the efforts made by Michelin in the framework of the MPRC".

[7] The FCA makes a direct reference to Decision 2002/405/CE of June 20, 2001 rendered by the European Commission who, having found that Michelin held a dominant position in the replacement tires for heavy vehicles market, established notably that the obligation imposed on dealers to provide to Michelin their statistical sales data and forecasts per category of products and for all brands resulted in "*the dealer being closely bound to the manufacturer in terms of finance, organization and marketing, in a manner that clearly constitutes abuse within the meaning of Article 82 of the Treaty.*"