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CASE CARD | 9 February 2022

Character merchandise (Sanrio) (AT.40432)

Limitation of out-of-territory sales by licensees

1. CASE SUMMARY

A. Summary of facts

Sanrio, a Japanese company designing, licensing, producing and selling products focusing on Japanese 'kawaii' artistic and cultural style, employs merchandising agreements which govern both the non-exclusive licensing of intellectual property rights and the distribution of the merchandise products.

These merchandise products are of a varied nature such as toys, clothing, shoes or bags, onto which a certain image or text is applied during the manufacturing process. The products incorporate Sanrio's proprietary characters, including Hello Kitty, My Melody, Little Twin Stars, Keroppi, Chococat, Mr. Men and Little Miss.

Sanrio grants direct and indirect licenses over the intellectual property rights of its proprietary characters for the manufacture and distribution of products incorporating these characters. The licensee either both manufactures and distributes the products or sub-contracts the manufacture further. The licenses are generally granted for one or more specific countries in the EEA on a non-exclusive basis. Moreover, the products are only sold offline throughout the EEA or online within the assigned territory.

Through its merchandising business, Sanrio implemented several practices restricting active and passive cross-border sales of licensed merchandise both offline and online throughout the EEA. The practices were implemented through direct measures as well as through indirect measures.

1. *Direct* measures restricting out-of-territory sales by licensees, such as

- passive sales restrictions in the form of so-called gentleman's agreements between Sanrio and its licensees aimed at preventing cross-border sales of the merchandise products (§38);
- passive sales restrictions through direct communication by Sanrio asking licensees to avoid making cross-border sales, and specifically passive sales and this at its own initiative, or following complaints of other licensees or requests of other licensees to authorise specific passive sales (§39-40);
- active sales restrictions explicitly included in clauses within specific licensing agreements and within the draft standard contract (§41-42);
- active sales restrictions through enforcement of the contractual obligations by Sanrio so as to block active

sales (§43);

- clauses either outright prohibiting online sales or only allowing in-territory online sales (§45-47);
- obligations to refer orders for out-of-territory sales to Sanrio (§49-50); and
- clauses imposing language requirements to restrict out-of-territory sales (§51-52).

2. *Indirect* measures restricting out-of-territory sales by licensees, such as

- conduct of audits into the business dealings of licensees to ensure compliance with the out-of-territory sales restrictions (§56-57); and
- threats of non-renewal and actual non-renewal of licensing agreements due to the licensee having made out-of-territory sales (§58).

B. Legal analysis

B.1 - Framework of analysis – licensing agreements

Prior to analysing Sanrio's conduct under Article 101 TFEU, the Commission recalls the legal framework for licensing agreements:

- First, the Commission finds that the practices investigated in this case, including the clauses restricting sales in agreements for the licensing and distribution of merchandise products, amount to restrictions prohibiting or limiting the cross-border supply of goods. Irrespective of whether intellectual property rights are exhausted, such restrictions fall under EU competition law. (§62) In particular, EU courts have acknowledged their competence to assess the legality of such clauses under EU competition law and have found that a misuse of intellectual property rights may amount to an infringement of competition rules. (§63)
- Second, the Commission refers to case law finding that a misuse of intellectual property rights may amount to an infringement of the competition rules. (§63)

B.2 - Article 101(1) TFEU – object restrictions

The conduct presents all the characteristics of agreements and/or concerted practices entered into between Sanrio, on the one hand, and licensees, on the other. Sanrio enforced the out-of-territory restrictions by means of contractual agreements spanning the whole duration of the infringement. Moreover, even in the absence of explicit contractual clauses, Sanrio and its licensees agreed to behave, and/or engaged in concerted practices, in such a manner as to restrict out-of-territory sales. (§73)

Through the set of practices restricting out-of-territory sales, Sanrio restricted the ability of its licensees to sell

licensed merchandise cross-border, thereby restoring the divisions between national markets. Sanrio engaged in that restrictive behaviour by different direct means, including putting into practice different measures prohibiting or preventing licensees of its licensed merchandise products from concluding active and passive out-of-territory sales, both online and offline. Such practices, by their very nature, have as their object the restriction of competition within the meaning of Article 101(1) TFEU. Through those direct measures, Sanrio aimed at ensuring a compartmentalization of its licensing network so as to prevent cross-border sales between territories and customers within the EEA. All these practices are liable to frustrate the Treaty's objective of achieving the integration of national markets through the establishment of a single market. (§80-82)

In addition to direct measures restricting out-of-territory sales, Sanrio at times used indirect measures to support the out-of-territory restrictions. Sanrio's use of these indirect measures constitutes conduct that, by its very nature, has as its object the restriction of competition within the meaning of Article 101(1) TFEU. (§83)

The Commission considered that the infringement by Sanrio was a single and continuous infringement. The restrictions implemented by Sanrio were all adopted in pursuit of an overall anti-competitive objective, namely a compartmentalization of its licensing network in order to prevent cross-border sales to territories and customers within the EEA. The evidence demonstrates that those practices formed part of an overall business strategy by Sanrio aimed at controlling the territories in which the licensees could sell the products, to the detriment of competition. Those practices led to a reduction in the choice available to consumers and, potentially, increased prices for certain products as a direct result from the lower level of competition. Sanrio's conduct followed a similar pattern throughout the whole infringement and throughout the territories of the EEA. (§87-90)

B.3 - Article 101(3) TFEU – no block or individual exemption

Given that the agreements governing Sanrio's licensed merchandise products govern both the licensing of intellectual property rights and the distribution of the products incorporating those rights, the Vertical Block Exemption Regulation ('VBER') and the Technology Transfer Block Exemption Regulation ('TTBER') could provide guidance on the assessment of the restrictions in this case. However, the hardcore nature of these restrictions means that the exemptions in the VBER and in the TTBER would not apply in this case. The Commission also concludes that Sanrio's conduct does not meet the conditions for exemption set out in Article 101(3) TFEU. (§99-100)

This case illustrates that, despite hardcore restrictions in an agreement, an undertaking's conduct can in theory still meet the conditions for Article 101(3) TFEU. The Commission deemed that in this case such individual exemption was not available. The main reasons were that there are no indications that Sanrio's conduct was indispensable to induce retailer investment in certain territories or to alleviate repercussions of free-riding between

licensees. Moreover, the restrictions implemented by Sanrio throughout its network of licensees resulted in reduced competition between licensees and distributors of the products bearing Sanrio characters, reducing the possibility of wider choice and lower prices for consumers. (§101)

B.4 - Fines – vertical restraints less harmful

When determining the level of the fine, the Commission noted that vertical agreements are generally less harmful than horizontal ones and therefore the percentage of value of sales to be used in this case was set at 8%. (§128)

Given the nature of the merchandising business, the value of sales should be based on the royalties received by Sanrio from its licensees for sales of licensed merchandise products in the EEA. These royalties represent Sanrio's revenues from its licensed merchandise business and are paid to Sanrio in exchange for the use of the intellectual property rights licensed. (§125)

Sanrio was fined EUR 6,222,000 for the implementation and the enforcement of a series of agreements and/or concerted practices contrary to Article 101(1) TFEU with a purpose of restricting cross-border sales of licensed merchandise, both offline and online.

2. QUOTES

"*The doctrine of regional exhaustion establishes that once products or services bearing a certain intellectual property right have been placed in the EEA by or with the consent of the rightholder, rightholders can no longer use their intellectual property rights to prevent a further distribution of those goods within the Area. EU Courts have a long standing tradition of recognising the exhaustion of trade mark rights. See in this respect Judgment of the Court of 16 July 1998, C-355-96, Silhouette International Schmied v Hartlauer Handelsgesellschaft, EU:C:1998:374. EU Courts have also acknowledged that the distribution right enjoyed by the copyright holder is also exhausted with the first sale in the EEA of the original of a work or copies thereof by the rightholder or with his consent. See in this respect, Judgment of the Court of 3 July 2012, UsedSoft GmbH v Oracle International Corp, C-128/11, EU:C:2012:407.*" (footnote 49 at §62)

"*Sanrio engaged in that restrictive behaviour by different direct means, including putting into practice different measures prohibiting or preventing licensees of its licensed merchandise products from concluding active and passive out-of-territory sales, both online and offline. Such practices, by their very nature, have as their object the restriction of competition within the meaning of Article 101(1) of the Treaty.*" (§81)

"*In addition to those direct measures restricting out-of-territory sales, Sanrio at times used a series of indirect measures to support the out-of-territory restrictions, as described in Section 5.2.2. Sanrio's use of these measures*

as an indirect means to support and reinforce the direct measures restricting out-of-territory sales constitutes conduct that, by its very nature, in the context of the underlying territorial restrictions, has as its object the restriction of competition within the meaning of Article 101(1) of the Treaty." (§83)

"*The evidence described in Section 5.2 demonstrates that Sanrio's practices formed part of an overall business strategy by Sanrio aimed at controlling the territories in which the licensees could sell the products, to the detriment of competition. Those practices led to a reduction in the choice available to consumers and, potentially, increased prices for certain products as a direct result from the lower level of competition.*" (§89)

"*Given that the agreements governing Sanrio's licensed merchandise products govern both the licensing of intellectual property rights and the distribution of the products incorporating those rights, the Vertical Block Exemption Regulation and the Technology Transfer Block Exemption Regulation could provide guidance on the assessment of the restrictions in this case. However, the hardcore nature of these restrictions means that the exemptions in the Vertical Block Exemption Regulation and in the Technology Transfer Block Exemption Regulation would not apply in this case*." (§99)

"*Out-of-territory restrictions by their very nature, restrict competition within the meaning of Article 101(1) of the Treaty. However, vertical restraints are generally less harmful than horizontal ones. Taking into account these factors and the EEA-wide impact of the restrictions on out-of-territory sales, the percentage of the value of sales to be used for calculating the fine in this case should therefore be set at 8%.*" (§128)

"*[…] In view of the effective and timely cooperation provided by the addressees in this case, the basic amount of the fine should be reduced by 40% pursuant to point 37 of the Guidelines on Fines.*" (§136)

3. RELEVANT LEGISLATION

- Article 101 TFEU
- Regulation 330/2010
- Regulation 316/2014
- Fining Guidelines, §37

4. RELEVANT LITERATURE

On the role of intellectual property rights in the context of vertical agreements, see F. WIJCKMANS and F. TUYTSCHAEVER, *Vertical Agreements in EU Competition Law*, Oxford University Press, 2018, §4.13 – 4.37.

5. PRACTICAL SIGNIFICANCE

This is a follow-on decision to the 2017 Commission's e-commerce sector inquiry. This case is relevant for practitioners because it illustrates that:

- restrictions on out-of-territory (passive or active) sales are object restrictions;
- contractual clauses restricting active out-of-territory sales and the enforcement of these clauses, clauses outright prohibiting online sales or only allowing in-territory online sales, gentleman's agreements restricting passive out-of-territory sales, obligations to refer orders for out-of-territory sales to the licensor and clauses imposing language requirements to restrict out-of-territory sales were all considered direct restrictions;
- perfectly legitimate practices and clauses such as the right to carry out audits or to not renew agreements for cause become problematic if they are used in practice to monitor and sanction out-of-territory sales;
- license agreements are subject to competition law and it is irrelevant for the analysis whether the exhaustion doctrine applies;
- when the VBER and TTBER do not apply due to the inclusion of hardcore restrictions, it is in theory possible to obtain an individual exemption;
- fines for vertical restraints are lower because vertical restraints are considered less harmful than horizontal restraints which is reflected in the fact that the percentage of the value of sales relied upon in this case is 8%.