European Commission adopts revised block exemption for vertical restraints

Introduction

On 20 April 2010, the European Commission ("Commission") adopted a new vertical agreements block exemption regulation[1] ("Regulation") and revised vertical restraints guidelines[2] ("Guidelines"). The Regulation replaced the existing regime from 1 June 2010 and applies to any distribution, supply or purchasing arrangement with effect in Europe. The Regulation exempts from the application of Article 101 TFEU – which prohibits agreements that restrict or distort competition within Europe – agreements between parties operating at different levels of the supply chain and which contain "vertical restraints" on competition.

This paper explores the Commission's approach to vertical agreements and the exemption provided for by the Regulation and Guidelines, going on to examine, in particular, the more detailed guidance as to retail price maintenance and arrangements for online distribution now provided for.

Background

Article 101 of the Treaty on the Functioning of the European Union applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition ("vertical restraints"). Whilst Article 101(1) prohibits agreements which appreciably restrict or distort competition, Article 101(3), subject to the satisfaction of certain criteria, exempts those agreements whose benefits sufficiently outweigh their anti-competitive effects.

In its Guidelines, the Commission recognises that, in general, vertical restraints are less harmful to competition than horizontal restraints and may provide substantial scope for efficiencies in the distribution chain. Competition concerns can generally only arise for vertical restraints if there is insufficient competition at one or more levels of trade i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels.

Certain agreements will, in any event, fall outside the application of Article 101. Agreements that are not capable of *appreciably* restricting competition by object or effect are not caught by Article 101(1). Subject to the conditions set out in the Commission's *de minimis* notice relating to a number of specified hardcore restrictions and to cumulative effect concerns, vertical agreements entered into by non-competing undertakings whose individual market share on the relevant market does not exceed 15 per cent are generally considered to fall

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[1] 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 OJ L 102/1 23.04.2010.

[2] Commission Notice – Guidelines on Vertical Restraints SEC(2010) 411.

outside the scope of Article 101(1).[3] In addition, the Commission considers that, subject again to cumulative effect and the inclusion of hardcore restrictions, vertical agreements between small and medium-sized undertakings, as defined by the Commission, are rarely capable of appreciably affecting trade between Member States or of appreciably restricting competition within the meaning of Article 101(1) and generally fall outside the prohibition.[4]

In the case of agency agreements, as defined in the Guidelines,[5] the selling or purchasing function of the agent forms part of the principal's activities. Since the principal bears the commercial and financial risks related to the selling and purchasing of the contract goods or services, all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 101(1). The agreement between the agent and its principal may, however, fall within Article 101(1), since the agent is a separate undertaking from the principal. Whilst exclusive agency provisions are unlikely to lead to anti-competitive effects, single branding and post-term non-compete provisions, which concern inter-brand competition, may lead to foreclosure effects on the market. In addition, where an agency agreement facilitates collusion, e.g. where a number of principals use the same agents whilst collectively excluding others from using these agents or where they use the agents to collude on marketing strategy or to exchange sensitive information between principals, this may also fall foul of Article 101.

Application of the Block Exemption

Provided that they do not contain certain “hardcore” restrictions of competition, which are viewed as having the restriction of competition as their object, the Regulation creates a presumption of legality (pursuant to Article 101(3)) for vertical agreements, depending on the market share of the supplier and the buyer. In order for the exemption to apply, the supplier's market share must not exceed 30 per cent of the market on which it sells the contract goods or services and the buyer's market share on the market where it purchases the contract goods or services must not exceed 30 per cent. The Regulation introduces a 30 per cent market share threshold for buyers to take into account the fact that some buyers may also have market power with potentially negative effects on competition. It is hoped that this will also benefit small and medium-sized enterprises which could otherwise be excluded from the distribution market.[6] Above the market share thresholds there is, however, no presumption that vertical agreements are caught by Article 101(1) nor that they fail to satisfy the criteria set out in Article 101(3). Rather, such agreements will fall to be assessed on an individual basis.

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[3] *See* Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*"de minimis"*) OJ C 368 22.12.2001. For agreements between competing undertakings, the *de minimis* market share threshold is 10 per cent for their collective market share on each affected relevant market.

[4] *See* Annex to Commission Recommendation 2003/361/EC OJ L 124/36 20.05.2003.

[5] *See* the Guidelines at paras 12 to 17.

The exemption contained in the Regulation applies to both agreements and concerted practices between two or more undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain. It does not apply to unilateral conduct which will continue to be assessed under the provisions of Article 102. Nor does it apply to reciprocal vertical agreements between actual or potential competitors, with such agreements being assessed under the Commission's Guidance on the applicability of Article 101 to horizontal co-operation agreements.[7]

A number of "hardcore" restrictions are set out in the Regulation, the inclusion of which will lead to the exclusion of the entirety of the agreement from the application of the exemption. Including such a restriction in an agreement gives rise to a presumption that the agreement falls within Article 101(1) and will not satisfy the criteria set out in Article 101(3). The Commission does point out, however, that undertakings will have the possibility to demonstrate pro-competitive effects of any such provision under Article 101(3) on an individual basis.

The hardcore restrictions set out in Article 4 of the Regulation concern resale price maintenance ("RPM"), resale restrictions (with certain exceptions) imposed on buyers or their end customers, restrictions of active and passive sales to end users, restrictions of cross-supplies between appointed distributors in a selective distribution system and restrictions which prevent or restrict end users, independent repairers and service providers from obtaining spare parts directly from the manufacturer of those spare parts.

Where vertical agreements contain such hardcore restraints, the Guidelines provide further detail as to the individual assessment of these arrangements under Article 101(3).

The Regulation also excludes certain vertical restraints from the exemption. Although the excluded restraints will themselves fall outside the Regulation, the inclusion of such provisions will not affect the application of the exemption to the rest of the agreement, if the excluded provision is severable from the remaining obligations. Such excluded provisions include non-compete obligations lasting for more than 5 years (or tacitly renewable beyond a period of 5 years), post-term non-compete obligations and limitations on the sale of competing goods in a selective distribution system.

As stated above, where agreements or the provisions which they contain fall outside the Regulation, this does not imply that they are *per se* illegal. It means only that any such arrangements must be assessed on an individual basis to determine whether any efficiencies derived directly from such provisions outweigh their anti-competitive effects. The Commission's guidance to accompany the Regulation provides further details on the way in which the Commission will carry out any such analysis.

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[6] *See* Commission's press release 20 April 2010 (IP/10/445).

[7] OJ C 3 06.01.2001. *See also* the Draft Communication from the Commission – Guidelines of the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements SEC(2010) 528/2.

Guidelines on Vertical Restraints

As discussed above, the Commission's Guidelines provide an explanation of the Commission's enforcement policy in individual cases for those vertical agreements which fall outside the exemption provided for in the Regulation. The most significant changes to the Guidelines from the Commission's previous guidance relate to pricing arrangements and provisions restricting the use of the internet in exclusive and selective distribution systems.

(a) Pricing Provisions

Under the previous regime, the imposition upon distributors and retailers of minimum or fixed resale prices would amount to price fixing, infringing Article 101(1) as having the restriction of competition as their object.[8] As such, this practice amounted to a hardcore restraint contrary to Article 4(a) of the block exemption. To date, however, it has not been clear whether resale price maintenance ("RPM") could ever satisfy the criteria of Article 101(3). In a past investigation, the Commission appeared to be sympathetic to the idea that a newspaper publisher should be allowed to impose a cover price on newspapers, although the Commission's final decision on the matter was not made public[9] and in *Matra Hachette v Commission*, the General Court ruled that the parties to *any* kind of agreement are entitled to defend it under Article 101(3).[10]

The Guidelines now make it clear that whilst RPM still falls within Article 101(1) and thus outside the Regulation (i.e. RPM remains an express hardcore restriction), there may be circumstances where such arrangements may result in efficiencies.[11]

It is incumbent on the parties to substantiate that likely efficiencies result from the inclusion of RPM in their agreement and to demonstrate that all the conditions of Article 101(3) are satisfied.[12] It then falls to the Commission to assess the likely negative effects on competition and consumers before deciding whether these conditions are met.

The Commission explains that RPM may restrict competition in a number of ways. RPM may facilitate collusion between suppliers by enhancing price transparency in the market and thereby making it easier to detect whether a supplier deviates from the collusive arrangement by cutting its price. By eliminating intra-brand price competition, RPM may also facilitate collusion between buyers. RPM may reduce competition between suppliers and may even allow a manufacturer with market power to foreclose smaller rivals as the increased margin that RPM may offer distributors may lead them to favour one brand over another when advising customers. The Commission also remains concerned that RPM may reduce

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[8] *See* Article 101(1)(a) TFEU *and* Commission Notice – Guidelines on Vertical Restraints 2000/C 291/01 at para 47.

[9] Commission's Notice in *Agence et Messageries de la Presse* OJ [1987] C 164/2.

[10] Case T-17/93 *Matra Hachette v Commission* [1994] ECR II-595.

[11] *See* the Guidelines at para 225.

[12] *See* the Guidelines at para 223.

dynamism and innovation at the distribution level by restricting competition between distributors and preventing more efficient retailers from entering the market.

However, as mentioned above, the Commission also recognises that RPM may not only restrict competition but may also lead to efficiencies. The Commission suggests that where a manufacturer introduces a new product, RPM may be helpful during the introductory period to induce distributors to promote the new product. RPM may also provide distributors with the means to increase sales efforts and induce them to expand overall demand for the product. In addition, RPM may allow retailers to provide (additional) pre-sales services. If enough customers take advantage of these services to make their choice and then purchase at a lower price with retailers who do not provide such services, high-service retailers may reduce or eliminate these services to match the lower prices charged by other distributors, reducing demand for the supplier's product. In that situation, RPM may help to prevent such free-riding at the distribution level. The parties will then need to demonstrate that the RPM arrangement can be expected not only to provide the means but also the incentive to overcome this issue and that the pre-sales services offered benefit consumers.[13]

The practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price remains within the exemption provided for in the Regulation where the relevant market share requirements are met and where this does not amount to a minimum or fixed resale price as a result of pressure from, or incentives offered by, any of the parties.[14] Where market share thresholds are exceeded, these arrangements will continue to be assessed under the provisions of Article 101(3) for efficiencies.

(b) Online Restrictions

One of the primary aims of the new Guidelines is to clarify the position of vertical restraints relating to the use of the internet. The Commission acknowledges the internet as a powerful tool to reach more and different customers and advocates that, in principle, every distributor must be allowed to use the internet to sell products.[15] At the same time, the Commission does recognise that running a website may have effects outside an appointed territory or customer group and therefore considers websites as a form of passive selling.

The Commission sets out a number of provisions which it regards as hardcore restrictions on such passive selling for the purposes of the Regulation.

Arrangements which provide that an exclusive distributor shall prevent customers located in another (exclusive) territory from viewing its website or automatically re-routes customers to another distributor's website will prevent the agreement benefitting from the exemption. Agreeing that a member of an exclusive distribution system will terminate consumers'

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[13] *See* the Guidelines at para 225.

[14] *See* Guidelines at para 226.

[15] *See* Guidelines at para 52.

transactions on its site once their credit card data reveal an address that is not within the distributor's territory is also prohibited.

Whilst a supplier is able to require that a distributor (or retailer) sells at least a certain amount of products off-line to ensure the efficient operation of its bricks and mortar shop, the distributor must not be restricted in its portion of overall sales made over the internet. Any provision as to the amount of requisite off-line sales may be applicable either to all distributors or assessed individually for each distributor only on the basis of objective criteria.[16]

Nor can the parties agree that the buyer pays a higher price for products intended to be re-sold online than for products intended to be re-sold off-line. A supplier can agree, however, to provide the buyer with a fixed fee to support the latter's off-line or on-line sales efforts provided that this does not vary depending on the volume of products sold.[17] The Commission may also consider a dual pricing strategy where it can be shown that sales over the internet lead to increased warranty claims for the supplier and such strategy merely involves the recoupment of costs incurred by the supplier in meeting such claims.

The Regulation also provides for the imposition of restrictions on active selling over the internet by members of a distribution system. The Commission will consider online advertising specifically addressed to certain customers as a form of active selling, which will include territory based banners on third party websites and paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory as active sales into that territory.[18] Restrictions relating to such activities may fall within the exemption.

Similarly provisions such as a requirement for a distributor to have a bricks and mortar shop or the setting of quality standards for websites for the resale of goods may also fall within the exemption when employed as part of a selective distribution system

Conclusion

In publishing its new exemption and guidelines, the Commission states that it is responding to both its own experience over the past 10 years and changing market conditions, particularly the increased use of the internet.[19]

The Commission has not only made substantial changes to the previous regime but also from the draft documents circulated back in July 2009. It now remains to be seen whether this will stand up to the changing nature of commerce over the next decade.

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[16] *Ibid*.

[17] *Ibid.*

[18] *See* the Guidelines at para 53.

[19] *See* Commission Press Release "Commission adopts revised competition rules for distribution of goods and services at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/445.