
1 June 2010

Review

Revised European competition framework for assessing sales and distribution agreements comes into force today

Ten years after the adoption of the original Block Exemption Regulation for Vertical Agreements (Regulation 2790/1999), the European Commission (the “**Commission**”) has adopted a new framework (Regulation and accompanying Guidelines) for assessing vertical agreements (in other words, agreements entered into by businesses operating at different levels of the supply chain).

The new vertical agreements block exemption regulation (“**VABE**”) and Guidelines will replace the existing rules from 1 June 2010.

The Commission launched an extensive review of the existing regime and found that, overall, past experience had been positive and there was little need to fundamentally modify the current rules. The new VABE therefore retains much of the same content as its predecessor. However, it does reflect certain market developments of the past 10 years, in particular, the perceived increase in large distributors’ market power, and the evolution of sales on the Internet.

The VABE contains a transitional period of one year, during which agreements made before 31 May 2010, which satisfied the conditions of the previous vertical block exemption, will remain exempted. The purpose of this transitional period is to allow the parties to digest the changes, perform the necessary due diligence of their agreements concluded under the old regime and to bring them in line, where needed, with the new regime.

BACKGROUND

In general, vertical agreements are considered to be less harmful to competition than agreements between competitors. For most vertical restraints, competition concerns arise only 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 both.

Article 101(1) Treaty on the Functioning of the European Union (**TFEU**) (formerly Article 81 EC Treaty) applies to vertical agreements as it does to all other

agreements, namely, it prohibits agreements which have as their object or effect the prevention, restriction or distortion of competition in the EU.

VABE creates a 'safe harbour' for vertical agreements satisfying certain specified criteria: where both the supplier's and the purchaser's market share does not exceed 30% (see further below) and provided the agreement does not contain any hardcore restrictions, the agreement is automatically exempted under VABE. If the block exemption does not apply, the agreement is not illegal *per se* but is not automatically exempted and must be assessed under Article 101(1)(3) TFEU, in other words, the parties to the agreement will have to defend the economic merits of their agreements, in particular based on efficiencies and pro-competitive benefits.

WHAT HAS CHANGED?

Market Share Test

The 30% market share threshold used to determine the applicability of VABE now takes into account not only the supplier's share of the relevant supply market but also the purchaser's share on the relevant purchasing market.

Online Sales

The new regime recognises the increased use of the Internet over the last 10 years and specifically addresses the question of online sales, limiting a supplier's ability to restrict sales over the Internet. The general principle is that, once authorised, distributors must be free to sell on their websites as they do in their traditional shops and physical points of sale, i.e. without limitation on quantities, customers' location and restrictions on prices. For example, suppliers may not impose a higher price for products sold online as opposed to offline; or automatically re-route online customers to distributors in other territories or forcing the termination of Internet sales if the credit card address is located outside a distributor's territory.

However, brand owners may impose certain minimum quality requirements on their online resellers such as setting quality standards for the website or requiring that a distributor has a "bricks and mortar" shop presence in addition to a website.

Hardcore Restrictions

The new Guidelines provide clarification regarding hardcore restrictions. The most significant hardcore restrictions are resale price maintenance and territorial and customer re-sales restrictions. The key concept is that the presence of hardcore restrictions in an agreement will mean that VABE does not apply and there is a presumption of negative effects under Article 101(1) and that the conditions of Article 101(3) are not fulfilled.

However, the Guidelines leave open that the parties may provide convincing evidence of likely efficiencies rebutting the presumption of infringement. For example, active and passive re-sale restrictions necessary to protect the distributor's entry in the relevant market are stated as falling outside Article 101(1) for the first two years. This gives distributors entering new markets an incentive to recoup their sunk costs associated with starting up and/or developing a new market.

Other Provisions

The new vertical Guidelines for the first time clarify the appropriate framework for the assessment of category management and upfront access payments outside VABE (if VABE applies, such restrictions are block exempted).

Non-compete clauses lasting for a period of up to five years are still within the scope of VABE and will automatically benefit from the safe harbour if the market share thresholds are not exceeded. Non-compete obligations include arrangements that require the buyer to purchase from the supplier more than 80% of the buyer's total purchases of the contract goods or services. Non-compete obligations are not covered by VABE where their duration is indefinite or exceeds 5 years. Unlike hardcore restrictions, the rule of severability does apply to non-compete obligations, in other words, the benefit of VABE is lost only in relation to the offending non-compete clause and not for the whole agreement.

CONCLUSIONS

The transitional period means that parties have until 1 June 2011 to ensure their agreements comply with the provisions of VABE; however, firms may wish to start reviewing their existing agreements now in order that the appropriate changes can be made and the agreements remain enforceable under the new rules.

FURTHER INFORMATION

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