



Vertically challenging?

New competition rules for the distribution sector

May 2010

Overview

On **1 June 2010**, the new Vertical Agreements Block Exemption Regulation 330/2010 (the "New Regulation") will enter into force, replacing the current block exemption, Regulation 2790/1999 (the "Old Regulation") which has been in force since 1 June 2000.

The European Commission (the "Commission") has also released new guidance notes¹ to assist with interpretation and application of the New Regulation (the "New Guidelines").

The New Regulation and Guidelines reflect developments that have occurred since 2000, in particular the increased market power of certain large retailers and the rapid growth of the internet as a sales platform.

However, as observed by the EU Commissioner for Competition policy Joaquin Almunia: "...evidence supports the view that the current block exemption has worked well. The renewal of the block exemption will, therefore consist of an updating and clarification, not a rewriting".² Accordingly, the New Regulation and Guidelines make only limited changes to the existing legal framework.

their object or effect the prevention, restriction or distortion of competition in the EU. Vertical agreements are considered to be less of a threat to competition than "horizontal agreements" (i.e. agreements between competitors operating at the same level of the supply chain). Competition concerns tend only to arise with vertical agreements when there are a small number of competing brands or products in a market, thereby giving suppliers or distributors a higher degree of market power.

Given that there are millions of vertical agreements in place across the EU, it is essential that there is an effective system ensuring the clear and predictable application of the competition rules and allowing, as Commissioner Almunia put it, "...customers to buy goods and services at the best prices wherever they are located in the EU while leaving companies without market power essentially free to organise their sales networks as they see best."

The core purpose of the New Regulation is to create a "safe harbour" for agreements between companies whose market shares do not exceed a 30% threshold and which do not contain certain "hardcore restrictions", such as price fixing or prohibitions on passive sales (see below). If an agreement does not fall within the "safe harbour" criteria, there is **not** a presumption of illegality, but the company will need to individually assess whether the agreement is caught by the prohibition under Article 101(1) or whether it is exempt under Article 101(3) TFEU because, broadly speaking, the benefits to which it gives rise outweigh its anti-competitive effects.

Vertical agreements and the New Regulation

Distribution agreements entered into between businesses operating at different levels of the supply chain, for example between a manufacturer and a distributor or between a distributor and a retailer, are referred to as "vertical agreements".

Article 101(1) of the Treaty on the Functioning of the EU ("TFEU")³ prohibits restrictions in agreements which have as

Key changes introduced by the New Regulation

The Commission launched a formal consultation on its proposals for the New Regulation and Guidelines in July 2009. After receiving more than 150 submissions, the general feedback was that the existing rules reduced costs and bureaucracy, so only limited changes were required.

¹ 05 2010 C130/1.

² SPEECH/10/172, 20 April 2010.

³ Formerly Article 81(1) of the EC Treaty (change in terminology introduced by the Lisbon Treaty from 1 December 2009).

The key changes which have been made are set out below:

■ **Test for market power includes the distributor's market share**

Under the Old Regulation, the "safe harbour" would apply to a vertical agreement provided that the supplier's market share did not exceed 30% on the relevant market, regardless of the market share enjoyed by the distributor.

Under the New Regulation, the distributor's market share on the relevant market must also not exceed 30%.

This change was predicated on the Commission's finding that certain large distributors and retailers were able to impose anti-competitive contractual clauses on suppliers, to the ultimate detriment of consumers.

■ **Provisions added to reflect expanding internet sales**

In recent years there has been a sustained growth in internet sales, resulting in increased cross-border trading. The New Regulation and Guidelines therefore address the issue of online sales in greater detail than previously. Provisions have been included specifying that once online retailers have been authorised by a supplier they should be able to sell their goods and services on the internet as freely as if they were selling them from a physical outlet. Coupled with this, the New Guidelines make clear that it is not permissible for suppliers to limit the quantities sold over the internet or to insist that higher prices are charged for online products.

However, and much to the annoyance of several large online distributors, the New Regulations continue to permit suppliers to require distributors to sell at least a certain absolute amount (in value or volume) of products from a physical outlet. The exact requirement for such off-line sales can vary for each buyer on the basis of objective criteria such as the buyer's network size or location.

■ **Active and passive sales defined in the context of internet sales**

The New Guidelines have clarified the distinction between 'active' and 'passive' sales. Active sales are where distributors approach individual customers, whereas passive sales result from unsolicited requests from a customer to the distributor, usually in response to untargeted advertising.

A supplier may restrict active sales but not passive sales. The New Guidelines state that once an exclusive distributor has been

appointed in a territory, that distributor should be able to sell to a consumer that has approached it from another EU country.

Specifically, there is a prohibition on companies terminating or re-routing transactions once a foreign address has been detected, e.g. through credit card details. The New Guidelines also do not permit suppliers to require distributors to set up website re-routing programmes generally, or to restrict access to websites from certain areas of the EU.

Transitional period - what to do now

There is a transitional period from 1 June 2010 until 31 May 2011 during which agreements will remain exempted, provided that they were agreed on or before 31 May 2010 and satisfy the conditions for exemption under the Old Regulation.

However, after this transitional period expires, all agreements, regardless of when they were entered into, must comply with the New Regulation in order to benefit from the "safe harbour".

Please do not hesitate to contact us if you have any concerns about the compatibility with the New Regulation of an existing or proposed distribution agreement.

Contact

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