Published on 1 May 2010 by **Thomas Caveng**, Legal Translator / Marketing Director
t.caveng@soulier-avocats.com
Tel.: + 33 (0)4 72 82 20 80

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Adoption of the new EU vertical agreements block exemption regulation

Adopted on April 20, 2010, the EU Regulation n°330/2010[1], known as the vertical agreements Block Exemption Regulation (the "New Regulation"), shall enter into force on June 1, 2010. It shall apply to all agreements entered into after May 31, 2010 and shall remain effective up to May 31, 2022. During a transitional period of one year (i.e. from June 1, 2010 to May 31, 2011), the New Regulation shall not apply to agreements already in force as of May 31, 2010 that meet the conditions for exemption provided for in the previous Regulation 2790/1999.

On the whole, the New Regulation perpetuates the previously existing rules. As such, this article will focus on the main changes brought forth by the New Regulation insofar as such changes extend or, as the case may be, restrict the eligibility for the exemption regime. The New Regulation shall, therefore, be considered more restrictive or more flexible, depending on the relevant factual circumstances.

1- Agreements likely to fall outside the scope of the exemption

a) Agreements in which the market share of either contracting party exceeds 30 %

Pursuant to Article 3§1 of Regulation 2790/1999, an agreement was eligible for the exemption regime if it did not contain any hardcore restrictions, as defined in Article 4 of said Regulation, and "*on condition that the market share held by the supplier does not exceed 30 % of the relevant market on which it sells the contract goods or services.*" The buyer's market share was only taken into account in case of exclusive supply agreements (Article 3§2).

The new rules maintain the 30% threshold under which exemption applies but the difference lies in the fact that this threshold applies to both the supplier and the buyer. Pursuant to Article 3§1 of the New Regulation, "*the exemption shall apply on condition that the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services AND the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services*[2]".

As such, a vertical agreement may no longer benefit from the exemption if the market share of either the supplier or the buyer exceeds 30% on the relevant market. This new provision considerably restricts the scope of the exemption. Through this modification, the European Commission wished to take into account the producers forced to enter into one-sided agreements with superstores/big retailers.

The Commission's will to consider the buyer's purchasing power – through the use of a market share threshold – is also apparent in the Commission's new guidelines on vertical restraints (the "New Guidelines"): specific attention is given to slotting fees (or "upfront access payments") imposed by the superstores/big retailers (#203 to #208 of the New Guidelines) and to category management agreements (#209 to #213 of the New Guidelines).

Please keep in mind that an agreement that does not benefit from the block exemption (which will be increasingly the case given the threshold that now applies) is not null and void. Simply, the contracting parties must be very careful with the restrictions set forth in their agreements since such restrictions shall be more severely assessed in the absence of a block exemption.

b) Franchise agreements

Regulation 2790/1999 was applicable, by essence, to franchise agreements insofar as it replaced the previous exemption regulation 4087/88 applicable thereto.

The guidelines attached to Regulation 2790/1999 themselves dealt with the application of the Reguation 2790/1999 to franchise agreements (#42-44 and #199-201 of such guidelines).

A change brought forth by the New Regulation could substantially change the playing field. Indeed, pursuant to Article 1(f) of the New Regulation, the "know how" is now included in the definition of "intellectual property rights" (whereas former Article 1(f) did not include this notion). By doing so, the Commission opens the way for an exclusion of franchise agreements from the block exemption regime.

Indeed, a franchise is notably characterized by the transfer of a know-how. Henceforth, the know-how is included in the intellectual property rights and any agreement, the primary object of which focuses on such rights, will not, under Article 2§3 of the New Regulation, benefit from the exemption: "*The exemption (…) shall apply to vertical agreements containing provisions which relate to assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers*".

As such, the amendments to the exemption regime brought forward by the New Regulation are likely to make certain agreements ineligible for exemption.

To counterbalance the restrictions on exemption eligibility, in certain cases, the Commission offers the parties to an agreement that contains hardcore restrictions the possibility of rebutting the non-exemption presumption applicable so far.

2- Modifications in respect of hardcore restrictions

Under the provisions set forth in the New Regulation n°330/2010, certain restrictions can escape the non-exemption presumption provided for under the former regulation (a) ; yet, at the same time, the Commission clearly ranks the prohibition of online sales as a hardcore restriction that irreversibly excludes the relevant agreement from the scope of the exemption regime (b).

a) Certain hardcore restrictions may not automatically exclude the application of the exemption regime

Pursuant to the New Regulation, an agreement that contains hardcore restrictions, as set forth in Article 4 of said New Regulation, remains ineligible for the block exemption regime, insofar as (i) such restrictions create the presumption that the agreement falls within the scope of Article 101§1 of the Treaty on the Functioning of the European Union ("TFEU") and (ii) it is unlikely that the agreement meet the conditions set out in Article 101§3 of TFEU.

However, the New Regulation (#47 of the New Guidelines) offers companies the possibility *"to demonstrate pro-competitive effects under 101§3 of the TFEU in an individual case"*. In other words, companies are given the possibility to prove that efficiencies will result from the introduction of hardcore restrictions in their agreement.

In the New Guidelines, the Commission draws up a non-exhaustive list (#106 to #109 of the New Guidelines) of reasons that may be put forth by contractual parties to justify the application of certain vertical restraints. But the new feature of the remodeled exemption regime can be found in the list of "*individual cases of hardcore restrictions that may fall outside Article 101§1 (TFEU) or may fulfill the conditions of Article 101§3 (TFEU)"* (#60 to #64 of the New Guidelines).

Examples of hardcore restrictions that fall outside the scope of Article 101§1 (TFEU):

- Prohibiting passive sales within the territory of an exclusive distributor during the first two years, given the investments made by the latter to launch and establish a brand on a new market;
- In case of staggered introduction of a new product or testing of a new product on a limited territory, restricting active sales to distributors outside said territory.

Examples of hardcore restrictions that may fulfill the conditions of Article *101§3 (TFEU)*:

- Restricting active sales by a wholesaler to appointed retailers in other wholesalers' territories to overcome possible free riding, insofar as these wholesalers invest in promotional activities in their respective territories;
- "Dual pricing system" (i.e. fixing a higher price for products sold online than for products sold off-line) can sometimes meet the exemption requirements when dual pricing is justified because online sales lead to substantially higher costs for the manufacturer/distributor.

In addition, regarding the imposition of a resale price (that used to be a hardcore restriction unlikely to be "saved"), #223 to #229 of the New Guidelines offer companies the possibility to plead an efficiency defense under Article 101§3 (TFEU), notably because imposed pricing can sometimes enable distributors, in the framework of the launch of a new product, to increase their efforts and oblige them to better take into account the manufacturer's interest to promote the product.

b) Prohibiting online sales is a hardcore restriction

As the Internet is a powerful means to reach more and different customers, restricting the use of the Internet for sales is considered as a hardcore restriction of passive selling forbidden in the four cases set forth below that are listed in #52 of the New Guidelines:

1. an exclusive distributor prevents customers located in another territory to view its website or automatically re-routes such consumers to the manufacturer's or other exclusive distributors' websites;
2. an exclusive distributor terminates consumers' transactions over the Internet once their credit card data reveals an address that is not within the distributor's exclusive territory;
3. a distributor limits its proportion of overall sales made over the Internet;
4. a distributor pays a higher price for products intended to be resold online than for products to be resold off-line

However, certain provisions temper these strict restrictions:

- the prohibition to force the distributor to limit its proportion of overall sales made over the Internet (see (c) above) does not preclude the supplier from (i) requiring that the buyer sells a certain amount of the products off-line (from its brick and mortar shop) or (ii) ensuring that the distributor's activity remains consistent with the supplier's distribution model;
- the prohibition to impose upon a distributor a higher price for products intended to be resold online than for products intended to be resold off-line (see (d) above) does not preclude the supplier from fixing a fixed-fee or implementing the dual pricing system in the conditions explained above.

Further, the New Guidelines maintain the limits imposed under the previous exemption regime in relation to online sales:

- A restriction on the use of the Internet for sales by a distributor is compatible with the Block Exemption Regulation to the extent that promotion (through advertisement banners) or the sales made online

would lead to active selling in other distributors' exclusive territories or to their consumers.
- In a selective distribution network, the supplier may require quality standards for the use of the Internet site to resell its goods or require its distributors to have one or more brick and mortar shops as a preliminary condition to make online sales.

To conclude, Regulation 330/2010 maintains the principle of the block exemption regime, with a few minor exceptions: any company may implement the distribution mode of its choice on condition that the agreements entered into with its commercial partners do not include hardcore restrictions unlikely to be justified and that neither the producer nor the distributor holds a market share exceeding 30% on the relevant market. The new exemption regime also gives online distribution an important place by facilitating and protecting the implementation of this distribution mode for economic operators wishing to develop their sales via the Internet.

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[1] Commission Regulation (EU) n°330/2010 of April 20, 2010 on the application of Article 101§3 (formerly Article 81§3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

[2] It should be noted that the market used for the calculation of the buyer's market share is not the upstream market but exclusively the downstream market, i.e. the market on which the buyer purchases the contract goods or services.