

Main changes to the EU Vertical Block Exemption Francesca R. Turitto

Introduction

On April 20, 2010 the Commission has adopted a new Block Exemption Regulation for agreements between manufacturers and distributors for the sale of products and services (VBER) and accompanying guidelines (Guidelines). The old rules were established ten years ago by Regulation 2790/1999 expiring on 31 May 2010 and by Commission Notice 2000/C 291/01, (Guidelines on vertical restraints). The new VBER and Guidelines will enter into force on 1 June 2010 for a further ten years period, with a one-year transitional phase. At the time this paper is drafted, the text of the new VBER has just been published while the Commission has only agreed in principle on the content of the English version of the Guidelines. The Notice containing the Guidelines is expected to be formally adopted in all Union languages, after legal linguistic revision, and then be published in the Official Journal.

The adoption of the new rules follows a public consultation launched by the Commission on July 2009 and closed on 28 September 2009 on a draft proposal of VBER and Guidelines. The Commission, based on its experience and feedback from the national competition authorities and stakeholders, recognized that the current rules worked well in practice as they provided the right balance between the need for legal certainty for presumptively non dangerous agreements and the need to ensure a positive impact on the competitive environment of vertical agreements; therefore the Commission intended to prolong the established principles.

The current VBER

The current regulation basically exempts all types of vertical agreements from the application of Article 101(1) of the Treaty (formerly Article 81(1)) on condition that (i) the market share held by the supplier does not exceed 30% of the relevant market and (ii) the agreement does not contain any "hardcore restrictions". An agreement containing just one black clause will lose the benefit of the block exemption. However, undertakings have the possibility to demonstrate pro-competitive effects of hard-core restrictions in an individual case.

A typical hardcore restriction is the one on the buyer's ability to fix sale prices (minimum resale price maintenance "RPM"), i.e. establishing a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer. The Guidelines clarify that agreements fixing distribution margins or the maximum level of discounts or rebates should be treated as

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indirect means of achieving the establishment of resale price. There is in fact the concern that RPM may facilitate cartel behavior, although the Commission does not explain in detail in which scenarios a competitive harm may derive from RPM. In light of the changed approach in the US regarding minimum RPM adopted in the *Leegin* decision, where the U.S. Supreme Court abandoned the view that minimum RPM agreements are per se illegal, one must carefully examine if a US drafted franchise agreement may be adopted in a member state of the European Union, if containing a provision considered as a RPM under the Guidelines.

Other hardcore restrictions concern market partitioning by territory or by customer group. That may be the result of a direct obligation (the obligation not to sell to certain customers or the obligation to refer orders from these customers to other distributors). Or the result of indirect measures aimed at inducing the distributor not to sell to such customers (refusal or reduction of bonuses or discount, termination of supply). However, these restrictions are permitted in certain specific circumstances. The first exception allows a supplier to restrict active sales by a buyer party to the agreement, to a territory or a customer group which has been allocated exclusively to another buyer or which the supplier has reserved to itself. This protection of exclusively allocated territories or customer groups if allowing restriction on active sales, must however permit passive sales to such territories or customer groups. We will see in the following paragraph how the Commission clarified to what extent the use of the internet and online sales are considered passive sales which cannot be restricted. Online sales (and their restriction) are also another important topic to consider for the implementation in the European Union of a US drafted franchise agreements.

There are three other exceptions to the hardcore restrictions concerning market partitioning by territory or by customer group and allowing for the restriction of both active and passive sales. Under the first exception it is permissible to restrict a wholesaler from selling to end users, which allows a supplier to keep the wholesale and retail level of trade separate. The second exception allows a supplier to restrict an appointed distributor in a selective distribution system from selling, at any level of trade, to unauthorized distributors located in any territory where the system is currently operated or where the supplier does not yet sell the contract products. The third exception allows a supplier to restrict a buyer of components, to whom the components are supplied for incorporation, from reselling them to competitors of the supplier.

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Returning to the topic of restrictions considered as hardcore restrictions by the VBER, specific provisions are set out in respect of selective distribution systems. In fact, certain restrictions cannot be established if in the context of a selective distribution system. In particular, it is not exempted the restriction of active or passive sales to end users, whether professional end users or final consumers, by members of a selective distribution network, with the exception of sales operated by the member out of its authorized shop. To the extent the Commission considers that such restraints within a franchise agreement trigger the application of the rules and guidance on selective distribution systems, franchisee's online sales (whether active or passive) cannot be restricted except where the franchisee operates out of an unauthorized shop. This of course subject to the "efficiency defense" (demonstration of pro-competitive effects of the restraint). Again, the provisions on online sales contained in a US drafted franchise agreement must be carefully taken into account before implementation in Europe.

The main changes to the current VBER and its interpretative Guidelines

The changes that the Commission will implement address two major developments occurred in the ten-year period following the application of the current rules: the increase in large retailers' market power and the evolution of internet-based sales.

The main changes regard (i) the introduction of a buyer's market share threshold (30%) in addition to the existing supplier's market share threshold; and (ii) online sales. This paper will also comment shortly on some other changes regarding the definition of know-how (which is important in the franchise context), and the new guidance on Resale Price Maintenance.

The new dual market share threshold

In the future, all agreements where either the supplier or the buyer will have a market share of 30% or more will not benefit from the block exemption and will need a specific assessment to check if they are in compliance with competition rules. The relevant market share of the buyer has to be evaluated on the downstream market on which it re-sells the contract goods or services. The intention of the Commission was to protect medium and small-sized enterprises as competitors of powerful buyers, or as suppliers unable to countervail the market power

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of the buyer. However, the public consultation showed that in practice this further requirement will lead to a significant level of uncertainty for the parties to a vertical agreement as it is often difficult for suppliers (or franchisors) to assess the market shares of other parties (i.e. each franchisee) particularly if operating on a downstream market where suppliers are not active. Market shares for certain type of businesses are likely to be assessed on a local level and in practice it would be impossible to require suppliers to conduct an analysis of each local market. Also, in the framework of a single franchise network, some franchise contracts could be exempted whilst other not. This would create discrepancies within one franchise network and there is the risk that this is viewed as a deterrent to the adoption of the franchise distribution model.

Online commerce

Within the context of the hardcore restrictions concerning market partitioning by territory or by customer group, the Commission indicated in the previous VBER the distinction between “active” and “passive” selling. The Guidelines established that protection of exclusively allocated territories or customer groups must permit passive sales to such territories or customer group. The new Guidelines introduce clarifications as to certain restrictions on internet sales qualifying them as restrictions to passive sales preventing the block exemption to apply. In practice, restrictions on internet sales will be regarded less favorably.

Examples of restrictions on online sales that are considered hardcore restrictions of competition are the following: an obligation imposed on a distributor to automatically re-route customer to the web-site of another distributor, or to terminate a sales transaction if the credit card data shows an address outside the area to which a given distributor is assigned; limiting the proportion of overall sales made over the internet; imposing to distributor a higher price for products intended to be re-sold through internet. However, restrictions may be allowed to the extent that use of the internet or promotion on the internet would lead to active selling into other distributors' exclusive territory (i.e. sending unsolicited emails to individuals, paying a search engine or online advertisement provider to have advertisement displayed specifically to users in a particular territory).

We have already explained that if selective distribution restraints are included in a franchise agreement, restrictions to both active and passive (internet) sales to end users are

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generally not exempted, unless the restrictions fulfill the conditions for individual exemption as they are indispensable to protect know how or create efficiencies. Franchisors should be aware of the distinction and the different approach of the Commission regarding active and passive online sales (i) for franchise arrangements which do not include selective distribution restraints and (ii) to assess if a restriction may be individually exempted.

Definition of know-how

Definition of know-how (article 1 letter (g) of the new VBER) has been changed as information need to be “significant and useful” in lieu of “indispensable” to qualify as know-how. The change broadens the definition of know-how and is therefore of help in justifying the restriction on the buyer after termination of the agreement in respect of the manufacturing, purchase, sale or resale of goods and services otherwise prohibited (see article 5.3 letter (c) of the new VBER). The restriction is in fact permitted if indispensable to protect the know-how transferred to the buyer and if limited to one year after termination. Also, the supplier may impose such a restriction unlimited in time on the use and disclosure of know-how which has not entered the public domain. On the other hand, now each element of the know how has to be “not generally known or accessible” to be considered “secret”; previously the requirement concerned elements of the know how not to be generally known or easily accessible.

Resale Price maintenance

Under the new Guidelines, Resale Price Maintenance may meet the criteria for individual exemption, if in the context of promotional activities or short term low price campaign. For instance, fixed resale prices are recognized to be necessary to organize in a franchise system a coordinated short term low price campaign (2 to 6 weeks).

Conclusion

Foreign franchisors must, with the new VBER, theoretically assess that their market share and the one of each franchisee in its territory is not in excess of 30%, in order to verify if the franchise agreement falls within the block exemption. Franchisors should be aware of the distinction and the different approach of the Commission regarding active and passive online sales while considering (i) a franchise agreement not including distribution restraints and (ii) if a restriction fulfills the

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conditions for individual exemption as it is indispensable to create efficiencies.

Definition of know-how has been broadened (know how to be significant and useful); this may be of help in justifying the restriction on the buyer after termination of the agreement (limited to one year period).

Provisions regarding RPM must be carefully evaluated, taking into account that promotional activities or short term low price campaign now meet the criteria for individual exemption.

The new Block Exemption Regulation, the unofficial version of the Guidelines on Vertical Restraints and previous regulation and guidelines can be found at: <http://ec.europa.eu/competition/antitrust/legislation/vertical.html>