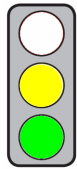


MAIN ISSUES

Objectives: Certain agreements between undertakings from which the Commission expects positive competitive effects are to remain in line with competition law as before.

Groups Affected: Manufacturers of luxury goods, trade associations and online distributors



Pros: (1) A Block Exemption Regulation increases legal certainty and relieves antitrust authorities of their obligation to assess individual agreements.

(2) Certain agreements can only be regarded as being in line with competition law if the market shares of both supplier and buyer are taken into account.

Cons: The guidelines contain pragmatic solutions for several issues raised by e-commerce, but do not address the question of how to deal with online auction platforms.

CONTENT

Title

Draft Commission Regulation C(2009) 5365/23 of 28. July 2009 **on the application of Article 81 (3) of the Treaty to categories of vertical agreements** and concerted practices **and Draft Communication by the Commission** of 28. July 2009 **on Guidelines on vertical restraints SEC(2009) 946**.

Brief Summary

► Content and aims

- Vertical agreements are arrangements and concerted practices
 - which relate to the purchase, sale or resale of certain goods and services and
 - which are entered into by undertakings which operate in the production or distribution chain at different levels (Art. 2 (1) of the Regulation (EC) No. 2790/1999).
- Vertical agreements which impede competition within the common market are generally prohibited (Art. 81 (1) TEC). However, exemptions from this prohibition are possible if the effect of an agreement on consumers is generally positive (Art. 81 (3) TEC).
- The Draft Block Exemption Regulation aims at defining categories of vertical agreements which are in compliance with Art. 81 (3) TEC. The Regulation is to replace the existing Block Exemption Regulation (EC) No. 2790/1999 and to come into force on 1. June 2010. As for special cases of vertical agreements the existing special block exemption regulations shall apply respectively (Art. 2 (5)).
- The Draft Guidelines aim to “help” companies to make their “own assessment” of vertical agreements under the EC competition rules. In particular, they are to take into account the latest developments in e-commerce [SEC(2009) 946, No. 3].
- Articles quoted refer to the Draft Regulation, whereas numbers (No.) refer to the Draft Guidelines.

► Basic principles

- Vertical agreements are deemed to be in line with competition rules if:
 - they do not contain any clauses which have been explicitly prohibited by the Regulation;
 - neither of the undertakings party to the vertical agreement holds a market share exceeding 30% and
 - the undertakings are not in competition (Art. 2 (1), (4); Art. 3, Recital 8).
- Undertakings that are in competition may conclude “non-reciprocal” vertical agreements by way of exception if:
 - the supplier is manufacturer and dealer at the same time, but is only in competition with the buyer at the distribution level (Art. 2 (4) lit. a) or
 - the vertical agreement relates to a level of trade at which the supplier and buyer do not act as competitors (Art. 2 (4) lit. b).
- Vertical agreements between an association of undertakings and its members, or between such an association and its suppliers are admitted only if all members of the association are retailers of goods and their total annual turnover does not exceed EUR 50 million (Art. 2 (2)).

► Anticompetitive clauses

- The following clauses substantiate the rebuttable presumption that a vertical agreement is altogether anticompetitive and thus leads to the invalidity of the entire agreement (“hardcore restrictions”) (No. 47):
 - determination of sales prices exceeding the permitted fixed maximum prices or non-binding price recommendations (Art. 4 lit. a);
 - restrictions of so-called “cross-supplies” between dealers within a distribution system whose members are selected by the supplier of products according to defined criteria and supplies them exclusively (“selective distribution system”) (Art. 4 lit. d),

- restrictions of the sales territory or customer groups to whom goods may be supplied (Art. 4 lit. b),
- restrictions of the products which members of the selective distribution system may sell (Art. 4 lit. c),
- restrictions of the resale of components as spare parts to end users or repairers (Art. 4 lit. e).
- The following clauses substantiate the rebuttable presumption of anti-competitiveness without affecting the validity of the entire agreement (No. 61):
 - any direct or indirect non-compete obligations with a duration of more than five years or which have been concluded for an indefinite period of time (Art. 5 lit. a);
 - provisions which directly or indirectly cause the members of a selective distribution system not to sell brands of certain competing suppliers (Art. 5 lit. c),
 - any direct or indirect obligations that cause the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services. An indefinite obligation of that kind can, however, be justified as a means to protect confidential know-how transferred by the supplier to the buyer. (Art. 5 lit. b).
- ▶ **Competition clauses deemed in line with competition law**
 - Despite the general prohibition of restrictions relating to territory or customers, vertical agreements may contain the following restrictions (Art. 4 lit. b):
 - the sale in certain territories or to certain customer groups reserved by the supplier itself or exclusively allocated by the supplier to a certain buyer;
 - the resale of components which may be used to manufacture the same type of goods;
 - if the buyer is a wholesaler, the sale to end customers;;
 - if the buyer is a member of the selective distribution system, the resale to unauthorised dealers.
 - The transfer and use of intellectual property rights through the buyer and its customers may be restricted, provided that this neither constitutes the main subject of the agreement nor serves the evasion of prohibited restrictions (Art. 2 (3)).
- ▶ **Benefit withdrawal in exceptional cases**

The Commission or national antitrust authorities may, in exceptional cases, claim the profits of exempted agreements if their effects are incompatible with the internal market (Art. 6).
- ▶ **Exclusive distribution and e-commerce**
 - To protect exclusive distribution systems, suppliers may prohibit their distributors from selling to their customers "actively" but not "passively" if these have been allocated to other distributors.
 - "Active" sale means actively approaching single customers, e.g. by mass e-mailing or targeted online advertising (No. 51).
 - "Passive" sale means processing unsolicited orders by customers. Even if it appears in different languages, "normally" an internet website is not an indication for an individualised customer approach (No. 51 to 53).
 - Restrictions of passive sales are deemed anticompetitive if they force the distributor to:
 - prevent the online access of customers from territories not allocated exclusively to the distributor or to forward the customer to the website of a manufacturer or other distributors;
 - terminate internet transactions once it is revealed that the customer's residence is outside the exclusively allocated territory of the distributor;
 - limit the percentage of overall sales made via the internet;
 - pay higher prices for products intended to be sold over the internet (No. 52).
 - Suppliers of goods and services may oblige buyers to resell certain minimum volumes offline. They may also support their buyers' offline or online sales efforts by offering them a "fixed fee" (No. 52, Footnote 29 and 30).
 - If a distributor has to "commit substantial investments" to launch a new brand or establish an existing brand in a new market, then restrictions of passive sales may be admitted as an exception during the first two years in order to protect the distributor from competition from other distributors (Nos. 51 and 56).
 - Provisions on quality standards for the internet presence of distributors are permitted. Moreover, in the case of selective distribution systems, the supplier may ask the buyer to open a shop before engaging in e-commerce (No. 54).

Changes Compared to the Status Quo

- ▶ To date, vertical agreements are considered consistent with competition rules if the supplier's market share does not exceed 30%. Only in the case of exclusive supply agreements does the 30% threshold apply also to the buyer. Now, the 30% threshold is to apply to both parties at all times.
- ▶ Detailed rules concerning the anticompetitive limitations in e-commerce are new.
- ▶ Until now the Guidelines have not explicitly allowed restrictions with passive sales if a distributor was investing in the introduction of a new brand or of an existing brand into a new market. Now, however, such restrictions are to be permitted for a period of two years.
- ▶ Also new is that suppliers may now define a minimum amount of goods being sold offline.
- ▶ Until now there have been no provisions in the Guidelines stipulating that a supplier may ask a distributor to open a shop before engaging in e-commerce. Now this is possible.

Political Context

The Commission has called for statements on its drafts by way of a consultation procedure. It will adopt a new Block Exemption Regulation without the participation of the European Parliament and the Council by the beginning of 2010 at the latest.

Beside the general Block Exemption Regulation, the Commission has further adopted special regulations on technology transfer agreements [(EC) No. 772/2004], agreements on research and development [(EC) No. 2658/2000 and (EC) No. 2659/2000] as well as on motor vehicle block exemption [(EC) No. 1400/2002]. The latter, which allows for exclusive agreements between car makers and authorised dealers, shall be extended until 2013. To this end, the Commission instigated a public consultation in July 2009.

According to the Commission, vertical agreements between non-competing undertakings whose market shares do not exceed 15% do not generally constitute any competitive restraint pursuant to Art. 81 (1) TEC ("de minimis" notice, Bulletin of 22. December 2001, ABl. C 368, p. 13). The same applies to vertical agreements between small-sized and medium-sized undertakings (Recommendation 2003/361/EC).

Options for Influencing the Political Process

Leading Directorate General: DG Competition

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

From an ordoliberal point of view, interfering with the freedom of contract by prohibiting vertical agreements is justifiable. For price agreements, agreements on non-competition and other forms of trusts weaken competition by impeding market access for third parties or the development of their market positions. This effect becomes more likely the higher the market shares of the undertakings involved. However, vertical agreements can also have a positive impact: by establishing reliable supplier relations they can lead to investments from which customers benefit, e.g. in the form of improved services or an exclusive brand image.

A Block Exemption Regulation, in which the Commission defines case categories deemed to generate positive effects, **increases the safe harbour of companies and relieves antitrust authorities of the burden of having to assess individual agreements**. It is therefore all the more important that exempted agreements are defined very precisely.

In terms of the presumption of legality regarding competition law, it is appropriate to take into account not only the market share of the supplier but also of the buyer in future, since the market share of the latter also increases the likelihood of anticompetitive behaviour. According to the "de minimis" rules already adopted in 2001, the market shares of both contract parties are with good reason decisive for the presumption.

In principle, there is a trade off implicit in the choice of the amount of the threshold: the higher the admitted market share is, the stricter must a Block Exemption Regulation be, e.g. by reducing anticompetitive effects through broader definitions of anticompetitive clauses. However, this reduces legal certainty since many agreements must first be assessed before being classified as legally valid. In the past, a value of 30% has proven itself a good compromise for this trade off, especially as vertical agreements of undertakings with higher market shares are not per se legally invalid but are, in some individual cases, subject to an assessment.

The Guidelines contain pragmatic answers to certain - but not all - issues relating to e-commerce. "Conventional" distributors, for instance, fear that e-commerce distributors might poach customers with lower prices as they do not have to pay shop rents etc. At the same time, however, e-commerce distributors benefit from those brick-and-mortar shops as customers can come there to gather information directly on products before buying them over the internet, or are even made aware of products through the marketing of conventional distributors. Such "free riding" could lead to conventional dealers disappearing from the market. Others, however, argue that the internet not only constitutes a threat to conventional trade, but that information provided by the internet might precede the purchase in a brick-and-mortar shop. The Commission also refers to this argument in its Study on e-commerce in Europe [SEC(2009) 283, p. 6].

The distinction between indefensible active and defensible passive e-commerce as part of exclusive distribution systems **is suitable in addressing this problem**: On the one hand, it acknowledges e-commerce as a reality; on the other hand, it protects the investments of conventional dealers by defining e-commerce as an additional business and also relating it to certain conditions. **The concrete limits determined by the Commission, however, are not comprehensible in all cases**: It is not understandable why a multilingual internet presence does not constitute an indication of an active sale. This would be comprehensible only for internet websites in the language that is actually used in the territory of the e-commerce dealer.

If a manufacturer launches a new brand, he or she is absolutely justified at first in prohibiting its sale online, in order to protect the high start-up investments of conventional dealers. However, the defensible time period should not be categorically set at two years, but should differ from market to market since the volume of investments also varies.

Suppliers are free to make conventional distribution cheaper by paying "fixed fees", although lower purchase prices are deemed critical at the same time. This ambiguity needs clarification.

A critical view must be taken of the fact that the important question of the admissibility of sales through online auction platforms such as Ebay remains open. Suppliers may impose quality requirements on dealers, but the Guidelines do not clarify whether or not those quality requirements may also contain a prohibition to sell the goods through online auction platforms.

Impact on Efficiency and Individual Freedom of Choice

Vertical agreements can, by improving the coordination of decisions, reduce transaction costs along the supply and distribution chain and thus **increase overall economic efficiency**. However, this is true only if they do not impede the establishment of cheaper distribution structures and product innovations. **This is the dilemma of e-commerce**: on the one hand, it lowers search and distribution costs, but on the other hand, e-commerce dealers participate in the investments of manufacturers and conventional dealers trying to develop their market position.

Impact on Growth and Employment

Conventional trade is expected to suffer from job losses. It is questionable whether or not they might be compensated by new jobs in e-commerce. The saved purchasing power will become effective in other sectors.

Impact on Europe as Business Location

The Block Exemption Regulation increases legal certainty and therewith the quality of Europe as a business location.

Legal Assessment

Legal Competence

The EU is empowered to exempt vertical agreements from the prohibition specified in Art. 81 (1) TEC (Art. 81 (3) EGV). Pursuant to Art. 83 TEC, the Council has the power to do so; however, the Council has conferred that competence to the Commission through the Regulation 19/65/EEC.

Subsidiarity

Since presumptions regarding the conformity of vertical agreements with competition law affect the entire internal market, they can be made only through EU rules.

Proportionality

The far-reaching effects of the rules set forth by the Block Exemption Regulation and the Guidelines do not exceed the necessary limits.

Compatibility with EU Law

The admissibility of quality requirements in e-commerce (Guidelines, Footnote 54) is in line with German case law of the ECJ under trademark law (ECJ, Judgement of 23. April 2009, Copad./Dior, C-59/08). According to this, the owner of a trademark can forbid dealers who belong to a selective distribution system from selling to discounters if this would damage the reputation of the product.

Compatibility with German Law

The German Federal Court of Justice (BGH) deems it admissible to limit the percentage of total sales traded through e-commerce (BGH, Judgement of 4. November 2003 – KZR 2/02), **while the Guidelines assume the opposite** (No. 52).

The High Regional Court of Munich (Judgement of 2. July 2009, Az: U (K) 4842/08) has decided that a “complete exemption” of e-commerce is illegal. An overall prohibition of the distribution through internet auction platforms such as Ebay, however, as well as quality requirements for e-commerce in the scope of selective distribution systems is lawful. A limited clientele (Art. 4 lit. b) was not available since customers may be reached through other internet distribution channels. In a not yet legally binding judgement the Regional Court of Berlin (Judgement of 5. August 2008, Az: 16 O 287/08), however, decided that an overall prohibition of the distribution through Ebay is not legitimate. According to the court, a prohibition is admissible only if the quality standards of the goods supplier are disregarded. The Guidelines also deem it consistent with competition rules if e-commerce is related to the compliance with certain quality requirements. However, the Guidelines do not clarify whether or not this rule exempts the distribution through auction platforms.

Possible Future EU Options

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Conclusion

The proposed Block Exemption Regulation increases legal certainty and relieves antitrust authorities of the burden of assessing individual agreements. Regarding the presumption of legality in terms of competition law, it is appropriate to take into account the market shares of both market parties. The distinction between indefensible active and defensible passive e-commerce is reasonable in principle, but not really comprehensible in its actual design. A critical point is that it remains unclear whether or not sales through online auction platforms may be prohibited.