

Review of Antitrust Rules Applicable to Vertical Distribution Agreements in Europe: Proposed Changes and Their Likely Impact on Companies' Day-to-Day Business

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On June 1, 2010, new antitrust rules on vertical distribution agreements are scheduled to become effective in Europe. Companies which distribute their products in countries belonging to the European Economic Area (EEA)², including multinationals which are not based in those countries, will need to verify that their current distribution agreements comply with such new rules.

Article 101 paragraph 1 of the Treaty on the Functioning of the European Union (TFEU)³, prohibits agreements that have as their object or effect the prevention, restriction, or distortion of competition. Vertical distribution agreements⁴ may breach the above prohibition, if, for example, they contain clauses that restrict the buyer's ability to determine its sale price or the territory where (or the customers to whom) it may sell the contract goods or if the latter is required to purchase all or most of its requirement from a supplier. Under Article 101 paragraph 3 of the TFEU, potentially restrictive agreements may, however, be exempted from paragraph 1's prohibition if they produce substantial efficiencies that benefit customers.

The European Commission has adopted a number of block exemption regulations, which provide a safe harbor for agreements that meet a set of specific requirements. One of the Commission's block exemption regulations applies to vertical distribution agreements (Vertical Block Exemption). The Vertical Block Exemption is complemented by a set of guidelines on its interpretation and on the assessment of agreements that do not meet the requirements for the safe harbor and, therefore, cannot benefit from the block exemption ("Vertical Guidelines").

Since May 2004, the guidance provided by the Vertical Block Exemption and the Vertical Guidelines has become even more important, because companies may no longer notify the Commission or national competition authorities of their distribution agreements to obtain a declaration that the agreements are compatible with competition rules. Therefore, companies must self-assess whether their agreements are in breach of competition rules. The current Vertical Block Exemption is often criticized by members of the business community as being a compromise solution, never entirely satisfactory and sometimes difficult to apply, given that it is unable to capture the multifarious nature of the provisions in use in distribution agreements.

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On May 31, 2010, the Vertical Block Exemption will be replaced by a revised version, along with a new version of the Vertical Guidelines (the "New Rules").⁵ On April 20, the Commission published on its official website the final text of the New Rules, which will become effective June 1, 2010, following their publication on the EU Official Journal. However, companies will have a 1-year transitional period to ensure compliance with the New Rules, for agreements in force, which satisfy the conditions for exemption under the current rules.⁶

The main New Rules are commented upon below, particularly on the issues of buyer's power, online sales, and resale price maintenance.

Buyer's power

Under the current rules, the Vertical Block Exemption applies to vertical agreements that do not contain certain particularly serious "hardcore" restrictions and is conditioned on the market share of the supplier not exceeding 30 percent of the market where it sells its products. The above mentioned 30 percent market share threshold applies buyers in their purchasing markets, only in cases of exclusive supply (i.e., where there is only one buyer for the whole of the European Community).

In order to take into account the increase, in recent years, of buyers' power (especially big retail chains), under the new Vertical Block Exemption, the supplier and the buyer are each required to have a market share below 30 percent, respectively, in the market where the supplier sells its products and the market where the buyer purchases the products (see Table 1 below).

Table 1 - Market Share Thresholds

Current Vertical Block Exemption	New Vertical Block Exemption (June 1, 2010)
30% market share of the supplier in the market where it sells its products	30% market share of the supplier in the market where it sells its products
except for	and
30% market share of the buyer in the market where it purchases the product, in case of exclusive supply	30% market share of the buyer in the market where it purchases the products

The reasoning behind this change is obviously related to the Commission's concern that some agreements that currently benefit from the block exemption may nonetheless have anticompetitive effects due to the buyer's market power (even if the supplier's market share is below 30 percent). Such additional screening is, however, not entirely convincing if one considers that the buyer's higher market share may represent a source of countervailing power, vis à vis strong suppliers, and may, therefore, benefit competition. Under the draft Vertical Block Exemption, which was subject to public consultation, the market share threshold of the buyer was

referred to its downstream resale market, rather than its purchasing market (as indicated in the final text). This last minute amendment was suggested during the public consultation, to better take into consideration the buyers' market position vis à vis their suppliers.⁷

The existence of a serious risk that the current system may protect agreements that are dangerous to competition has also been questioned, given that, in the last 10 years, when the current Vertical Block Exemption has been in force, the Commission has never withdrawn the benefit of the block exemption over concerns about the buyer's market power.

In addition, the introduction of this second market share threshold very likely will raise significant practical application problems. Currently, in most cases, the supplier can rely on the applicability of the Vertical Block Exemption on the basis of its own market share. Under the new regime, the supplier also will be required to identify (on the basis of the antitrust methodology of assessment, which is not necessarily the same as the one commonly used by the market) the market shares of his distributors.

Online sale

Under the current Vertical Block Exemption, online sales are considered "passive" sales, and therefore, in principle, cannot be restricted by suppliers using an exclusive distribution system. This principle has been reaffirmed in the New Rules. The debate over online sales has focused, instead, on the restrictions that suppliers using a selective distribution system should be able to apply to online selling of their brands.

While the language of the Vertical Block Exemption has remained unchanged, some relevant changes have been included in the Vertical Guidelines, which try to strike a fair balance between the respective interests of internet platforms on the one hand and brand owners (especially suppliers of luxury goods) on the other. One of the main changes consists of permitting suppliers to require their "distributors to have a brick and mortar shop or showroom before engaging in online distribution". Other changes include a prohibition on the supplier from limiting the overall proportion of online sales to total sales (though the supplier is permitted to require a minimum volume or value of products to be sold offline) or requiring a distributor to pay a higher price for products intended to be resold online, or imposing any other restrictions that are not equivalent to those imposed on offline sales. In other words, the supplier may ensure that online retailers meet equivalent standards applied to physical outlets and any differences should be justified by the different nature of the distribution channel (e.g. differences in delivery time obligations might be acceptable) (see Table 2 below).

Table 2 - Balance of interests in the proposed changes relating to online sale

Supplier	Online distributor
Permitted to require their distributors to have a brick and mortar shop or showroom before engaging in online distribution.	
Permitted to require a minimum volume or value of products to be sold offline.	Supplier prohibited from limiting the overall proportion of the online sale.
	Supplier prohibited from requiring that a distributor pay a higher price for products intended to be resold online.
Allowed to apply different contractual terms to online distributors, if justified by the different nature of the distribution channel.	Supplier prohibited from imposing restrictions that are not equivalent to those imposed on the sale offline.

Internet platforms (such as Amazon, Pixmania, Price Minister, eBay, and others) did not seem happy with the above-mentioned changes (which were already envisaged by the draft New Rules) and have warned the Commission about the risks related to the fact that manufacturers of a range of everyday goods are increasingly using selective distribution systems for products which were not originally considered suitable for this kind of distribution system, for the sole purpose of restricting the availability online of such products, to the detriment of final customers. On the other hand, they have requested and obtained from the Commission a commitment to an informal review of the Vertical Guidelines after two years from their initial application to ensure that they are updated for the fast-moving e-commerce market.

Resale Price Maintenance (RPM)

Under the new Vertical Block Exemption, RPM (i.e. the supplier imposing upon its distributors a fixed or minimum resale price) continues to fall outside the scope of the block exemption. However, the Commission has inserted in the Vertical Guidelines a description of certain cases where RPM may increase efficiency and, therefore, might be exempted from the prohibition contained in Article 101(1) TFEU.

In particular, RPM may have beneficial effects in the (i) introduction of a new brand or entry into a new market, as it may be helpful to induce distributors to better take into account the manufacturer's interest in developing demand for the product; (ii) organization a coordinated short term low price campaign (in a franchise system or similar distribution systems); (iii) prevention of large distributors using a particular brand as a loss leader and the avoidance of sales below cost leading to the delisting of the product by other retailers, to the detriment of consumers.

RPM has traditionally been treated as a per se violation. The above mentioned changes included in the Vertical Guidelines follow a debate in Europe after the decision of the U.S. Supreme Court in the *Leegin* case, which stated that RPM shall no longer be considered a per se violation of the antitrust laws. It remains to be seen whether, in practice, the above changes will lead to a softer approach by the Commission (and national competition authorities) towards RPM.

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During the public consultation period, the New Rules have raised the comprehensible criticisms mentioned above, such as the lack of a transitional period, the potential problems of application of the new buyers' market share threshold, and the risk that selective distribution systems might be used for the purpose of restricting online selling. The final text of the New Rules seems to remedy only some of these criticisms.

In particular, the Commission has inserted a 1-year transitional period in the final text of the Vertical Block Exemption, which is essential to allow the business community to implement the New Rules. In addition, in relation to the new market share threshold applicable to the buyer, the final text of the Vertical Block Exemption considers the market share of the buyer on the purchasing market rather than on the downstream resale market (as originally indicated in the draft which was subject to consultation). This approach better takes into consideration buyers' market position vis à vis their suppliers.

The main concern which remains unresolved relates to the fact that suppliers will no longer be able to rely on the applicability of the Vertical Block Exemption on the basis of their own market shares; rather, they also will be required to identify the market shares of their distributors. This is the result of the Commission's practice in the assessment of vertical distribution agreements in the 10 years of application of the Vertical Block Exemption and Vertical Guidelines. That historical practice shows that, in cases of significant importance that could not benefit from the automatic exemption, the Commission already took into account, inter alia, the market position of the buyer (together with the one of the supplier). According to the New Rules, such additional screening is now also necessary for the purpose of the application of the Vertical Block Exemption, to account for the market power of the buyers and its potential negative effects on competition. It will, however, undoubtedly increase the complexity of the overall assessment on the applicability of the automatic exemption.

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² The European Union, plus Iceland, Liechtenstein and Norway.

³ Former Article 81 of the EC Treaty

⁴ Agreements entered between companies operating at different levels of the distribution chain.

⁵ From June 28 to September 29, 2009, the Commission held a public consultation on the drafts of the New Rules, during which it received over 150 contributions from companies, associations of companies, competition authorities, and legal practitioners.

⁶ Article 9 of the Vertical Block Exemption.

⁷ This was not the only criticism raised during the public consultation. Many of the contributions received by the Commission have questioned whether such new market share threshold is the appropriate means to deal with the issues related to buyers' power. According to many, the new threshold applicable to the buyer will exclude from the exemption many agreements which are not dangerous to competition. In particular, it was also proposed to make the two thresholds alternative (rather than cumulative), so that the one based on the market share of the buyer would apply only to potential restrictions to the benefit of the buyer (e.g. territorial exclusivity or customer group allocation), while the one based on the market share of the supplier would apply only to potential restrictions to the benefit of the supplier.