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The New EU Verticals Block Exemption Regulation and Guidelines

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Earlier today, the European Commission finally adopted the new Block Exemption Regulation on Vertical Restraints^[1] (the “new VBER”) and accompanying Guidelines,^[2] (the “new Guidelines”).

This followed a very lengthy, high-level and public debate, which has only intensified since the Commission put its draft Block Exemption Regulation (the “draft VBER”) and accompanying Guidelines (the “draft Guidelines”) to public consultation in July 2009.^[3] After another 6 months of extensive discussion, revision of the text, and various last-ditch attempts by interested parties representing diverging views to persuade Commission officials (up to and including last week), the final text has finally been approved by the College of Commissioners, and is due to come into force on 1 June 2010.

The new VBER constitutes a continuation of the old VBER with two important modifications:

- A new (more restrictive) market share threshold for the application of the VBER; and
- Clarification of how the VBER applies to restriction of internet sales.

In addition, as a result of the vivid debate between the luxury brands and online retailers, the rules covering selective distribution networks have been clarified.

Finally, the Commission has provided some guidance on the (very limited) circumstances under which resale price maintenance may be justified.

The background to the “online commerce v. luxury brands” VBER debate

The new VBER replaces the previous Block Exemption Regulation on Vertical Restraints^[4] (the “old VBER”) and accompanying Guidelines^[5] (the “old Guidelines”), which have been in force for the last decade and are set to expire on 31 May 2010. While the old VBER and Guidelines were largely regarded as working well, they had recently become the subject of increasing criticism, particularly due to the fact that they traditionally favoured luxury brands. It was also apparent that the old VBER and Guidelines were simply not drafted to deal with vertical distribution issues in the current age of internet shopping, due to their lack of clarity on material concepts such as online advertising, sales and distribution.

Back in September 2008, Competition Commissioner Neelie Kroes set up an Online

Commerce Roundtable debate[6] with a group of senior consumer and industry representatives, in order to examine ways to reduce barriers to online commerce, so that consumers could take better advantage of the opportunities offered by the internet.[7] The Commission stated at the time that it would use the relevant input regarding the online distribution of goods in its ongoing review of the old VBER and Guidelines.

Thereafter, in July 2009 the Commission presented its draft VBER and Guidelines for public consultation. While the Commission claimed that the old rules were “*working well overall and should not be fundamentally modified*” in an accompanying statement, it nevertheless proposed a number of material amendments to the existing legislation. A number of these proposals were fiercely criticised by respondents to the consultation, with two very opposing sides emerging on the specific issues of online distribution, and selective distribution systems.

On the one hand, luxury brand manufacturers argued that the requirement for a traditional “bricks and mortar” style shop (i.e. a physical shop) in a selective distribution system would allow them to maintain control over customer shopping experiences, and protect consumers against counterfeit goods, both of which are vital to protect the image and value of their luxury products. Such a requirement was also necessary to prevent internet retailers taking unfair advantage or “free riding” on luxury brand manufacturers’ investment, and depriving “bricks and mortar” sellers of income by offering lower prices.

On the other hand however, the online retailers argued that consumers should have the right to benefit from fair competition in a wider online marketplace, even in the context of a selective distribution system. This would allow the buyer to benefit from economic efficiency gains achieved via internet sales. It was further highlighted that selective distribution leads to market segmentation, price discrimination and the foreclosure of online retailers.

Consequently, in announcing the adoption of the new VBER and Guidelines today, the Commission stated that the “*Regulation and accompanying Guidelines take into account the development, in the last 10 years, of the internet as a force for online sales and for cross-border commerce, something that the Commission wants to promote as it increases consumer choice and price competition*”. Nevertheless, it went on to also confirm that “*the basic principle remains that companies are free to decide how their products are distributed, provided their agreements do not contain price-fixing or other hard-core restrictions*” within the safe-harbour of the new VBER.

The changes introduced by the new VBER

Like its predecessor, the new VBER “block exempts” supply and distribution agreements at different levels of the production and distribution chain by creating a safe harbour, where the applicable market share threshold is not exceeded and the agreement in question does not contain any “hardcore” restrictions. A number of the main changes and clarifications provided by the new VBER and Guidelines are set out below:

- One of the material changes is a revised market share threshold for the application of the VBER. The new market share test imposes a 30% market share limitation on each of the distributor and retailer (as opposed to only the party imposing the restriction in question, as was applied in the old VBER). Despite criticism during the consultation phase, the Commission believes that this change is beneficial for SMEs (both manufacturers and retailers) which could otherwise be excluded from the distribution market. In principle, this could significantly reduce the agreements that may benefit from the VBER but in practice is unlikely to have a significant effect.
- The hardcore restrictions listed under Article 4 of the old VBER remain generally unchanged, among others, prohibiting resale price maintenance and territorial/customer resale restrictions (subject to certain limited exceptions).
- However, the new Guidelines state that in principle, every distributor must be allowed to use the internet to sell products, and that in general, having a website is considered a form of “passive selling” (i.e. responding to an unsolicited request). This clarifies the previous position set out in the draft VBER.
- Consequently, the new Guidelines provide further examples of restrictions on “passive”

online sales, which amount to hardcore restrictions of competition. These include the obligation on a distributor to automatically re-route customers to the website of another distributor, or to terminate a sales transaction in the case that the customer's credit card reveals an address outside the relevant territory.

- However, in the context of the *luxury brands v. online commerce* debate, the new Guidelines further provide that under the new VBER, the supplier may require its distributors to have one or more "bricks and mortar" shops or showrooms as a condition for becoming a member of its selective distribution system.
- Nevertheless, the new Guidelines also state that where the characteristics of the product do not require selective distribution, or do not require the applied criteria, such as for instance the requirement for a "bricks and mortar" shop, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in competition within the same brand. Consequently, the Guidelines warn that if appreciable anti-competitive effects occur, the benefit of the new VBER is likely to be withdrawn.
- Finally, the new Guidelines provide increased legal analysis of particular occasions when resale price maintenance, which is listed as a hardcore restriction may lead to efficiencies, and thereby be assessed under Article 101(3). The draft Guidelines had initially provided some text on this point, which is further clarified in the new Guidelines.

The impact the new VBER will have on self-assessments

In general, the revised market share threshold is likely to make it more difficult for undertakings to ascertain whether their agreements will fall within the safe-harbour of the new VBER during the negotiation phase (and even after), since they will now need to assess both their own market share *and* the market share of their trading partner. In particular, suppliers are not in an easy position to assess the market share of the buyer, and a more detailed review of the buyer's position on the market for purchasing the contract products (and also in the case of multi-party agreements on downstream markets where they re-sell the products) will now be necessary. This may increase the administrative burden and costs of compliance for the parties undertaking self-assessment or at the very least decreases legal certainty (since it will be much harder to know if the agreement is covered by the VBER).

In addition, undertakings will need to review any existing agreements which currently benefit from exemption under the old VBER, as many will now fall outside its narrower scope by exceeding the new market share thresholds. While agreements that no longer benefit from exemption are not automatically rendered illegal, they will instead require individual review under Article 101 to assess their compliance with EU competition law.

The level of detail provided on the inter-relationship between online commerce and the new VBER in the new Guidelines will greatly assist undertakings self-assess whether online commerce restraints contained in their vertical arrangements could amount to a hardcore restriction of competition. While both sides of the *luxury brands v. online commerce* debate will presumably have wished for something more than the "*equilibrium between the different interests involved in the agreements*" approach, as pledged by the new Competition Commissioner Almunia, the developments have at least provided the requisite clarity necessary for the current age of the internet.

Moreover, where the Commission has swayed towards the luxury brands' position, the Guidelines contain clear warnings that where appreciable anti-competitive effects occur, this may result in the benefit of the exemption being withdrawn i.e. where "bricks and mortar" shops are a pre-requisite to join a selective distribution system, but the characteristics of the product do not require it. On that basis, it is clear that the *luxury brands v. online commerce* debate is not over, and it will be interesting to observe how the industry practice develops.

As set out above, while resale price maintenance is still considered to constitute a hardcore restriction under the new VBER, the new Guidelines do provide more substantial analysis and practical examples of potential efficiencies which would be

deemed to fulfill the conditions of Article 101(3). For example, the new Guidelines suggest that resale price maintenance may be helpful where a manufacturer is introducing a new product to the market in a period of expanding demand, to induce distributors to better take into account the manufacturer's interest to promote the product. It is stated that resale price maintenance may provide distributors with the means to increase sales efforts, and where the distributors are under competitive pressure, this may induce them to expand overall demand for the product, making the launch a success, also for the benefit of consumers. Similarly, it is recognised that fixed resale prices (as opposed to just maximum resale prices) may be necessary in a franchise system, or similar distribution system, applying a coordinated short term (2-6 weeks) low price campaign, which will also benefit consumers.

The new Guidelines also provide additional explanations in comparison to the draft Guidelines, and are thereby more useful for parties undertaking self-assessment of any proposed pro-competitive resale price maintenance under Article 101. While such a development is to be welcomed in relation to what had previously been regarded as effectively constituting a *per se* prohibition, it is not expected that significant numbers of market participants will realistically wish to take on the potential risk of inadvertently imposing a hardcore restriction without waiting to observe developments in this area.

Finally, the Commission has granted a one-year transitional phase during which market players must determine whether existing agreements fall within the new VBER safe harbour. It is recommended that undertakings wishing to benefit from the new VBER must therefore conduct an internal review of their existing arrangements to ascertain whether they fall within the new VBER before the Commission's 31 May 2011 deadline. As stated above, while agreements that no longer benefit from exemption are not automatically rendered illegal, they will instead require individual review under Article 101 to assess their compliance with EU competition law.

[1] The text may be accessed at:

http://ec.europa.eu/competition/antitrust/legislation/regulation_verticals_en.pdf.

[2] The text may be accessed at:

http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf.

[3] The European Commission's Consultation on the Review of the competition rules applicable to vertical agreements took place between the 28 July 2009 and 28 September 2009. The text of the Commission's draft Block Exemption Regulation and accompanying Guidelines, in addition to O'Melveny and Myers LLP comments may be accessed at:

http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html.

[4] Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. The text may be accessed at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1999:336:0021:0025:EN:PDF>.

[5] Commission notice - Guidelines on Vertical Restraints (2000/C 291/01). The text may be accessed at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2000:291:0001:0044:EN:PDF>.

[6] This resulted in the Group's Online Commerce Roundtable Report on opportunities and barriers to online retailing, which may be accessed at:

http://ec.europa.eu/competition/consultations/2009_online_commerce/roundtable_report_en.p

[7] In March 2009, Consumer Affairs Commissioner Meglena Kuneva also presented a report on cross-border e-commerce in the EU and announced that the Commission would continue its investigation of how and where consumers are being prevented from shopping online across borders. For more information, see <http://www.omm.com/heightened-antitrust-risk-in-the-eu-restriction-of-parallel-imports-03-05-2009/>.

