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New EU Antitrust Rules for Distribution and Supply Agreements

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The European Commission ("Commission") published the long-awaited revised Vertical Block Exemption Regulation ("2010 VBER")[1] and the revised Guidelines on Vertical Restraints ("2010 Guidelines")[2] in April 2010. The 2010 VBER and Guidelines entered into force on June 1, 2010 and will be effective until May 31, 2022.

The 2010 VBER and Guidelines amend and restate previous versions that were in force for ten years. In the EU, these rules and guidelines are the primary source for the antitrust assessment of vertical agreements, i.e. agreements between businesses that operate at different levels of the production or distribution chain. The changes that the 2010 VBER and Guidelines bring about for supply and distribution agreements are limited in scope but nonetheless significant for companies doing business in Europe. This article summarizes some of the key changes that apply since June 2010.

1. Prohibition and Exemption: The Role of Block Exemptions in the EU Antitrust System

The phenomenon of "block exemptions" is particular to the EU antitrust system. They are a reflection of the mechanics of Article 101 of the Treaty on the Functioning of the European Union ("TFEU"),[3] the EU equivalent to Section 1 of the U.S. Sherman Act.

Article 101(1) TFEU prohibits agreements and businesses practices that have as their object or effect the prevention, restriction or distortion of competition and, additionally, may affect trade between EU member states. Article 101(3) TFEU exempts such restraints of trade from the prohibition if they (i) improve the production or distribution of goods or promote technical or economic progress; (ii) allow consumers a fair share of the resulting benefit; (iii) do not impose restrictions on the parties to the agreement or businesses practice that are not indispensable to the attainment of objectives (i) and (ii); and (iv) are unable to eliminate competition with respect to substantial parts of the market involved.

Whether an agreement or business practice satisfies these four conditions for exemption either needs to be assessed individually on a case-by-case basis or follows from the Commission's regulations. If the agreement or business practice satisfies the specific criteria set forth in one of those regulations, the exemption applies irrespective of whether the general exemption criteria of Article 101(3) TFEU are satisfied. There are several of those regulations, and they contain specific criteria for the type of agreement ("block") to which they apply.[4]

The Commission issued the first block exemption for vertical restraints in 1999 ("1999 VBER").[5] The 1999 VBER was the first of a series of block exemptions in which the Commission defined a safe harbor based on market shares and granted an exemption in the absence of severe restraints of competition. Additionally, the Commission published Guidelines for vertical restraints ("2000 Guidelines")[6] that summarized the Commission's perspective on the 1999 VBER and on vertical restraints that were not exempt by operation of the 1999 VBER.

[1] Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, [2010] OJ L142/1.

[2] Commission, Guidelines on vertical restraints, [2010] OJ C130/1.

[3] The text of Article 101(1) TFEU is identical to Article 81 of the EC Treaty, as amended by the Treaty of Lisbon effective December 1, 2009.

[4] In addition to the block exemption for vertical agreements in general, there are block exemptions inter alia for distribution agreements in the motor vehicle sector, IP licensing transactions, specialization agreements and R&D agreements.

[5] 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, [2009] OJ L 336/21.

[6] Commission, Guidelines on Vertical Restraints, [2000] OJ C 291/1.

The 1999 VBER expired on May 31, 2010. The Commission believed that the regulation has worked well, as it reduced compliance costs and bureaucracy. However, the Commission was well aware that antitrust concepts and markets have changed since 1999/2000 so that certain changes needed to be made to both the regulation and the guidelines.

While each of the 27 EU member states has its own competition rules, these rules may not prohibit agreements or business practices that are legal under the EU competition rules. Conversely, national competition rules may not legalize agreements and business practices that are prohibited by the EU competition rules.[7]

2. Safe Harbor: The New Market Share Threshold

The 1999 VBER set forth a market share threshold of 30% for the supplier. If the supplier was below that threshold, any and all restraints of trade were exempt from the Article 101(1) TFEU prohibition, unless the agreement contained any of the particularly severe types of restraint of trade that the 1999 VBER black-listed in Article 4 (often referred to as "hardcore" restraints). Certain non-compete provisions are not exempt but must be assessed on a case-by-case basis.

The 2010 VBER maintains the structure of the "safe harbour," together with the 30% threshold. However, it applies the threshold to both suppliers and buyers (Article 3(1)). The Commission found this approach necessary to respond to the increasing bargaining power of large retailers.

In its first draft of the 2010 VBER, the Commission went even further. There, it applied the market share threshold to “any of the relevant markets affected by the agreement.” This would have meant that the parties would have had to assess the buyer’s downstream market share in its selling market(s). The Commission's proposal triggered severe criticism by stakeholders, and the final version of the 2010 VBER pursues a narrower approach. Regardless, the new two-level threshold obviously increases the burden of assessing the market shares involved. Even more importantly, as a result of the new test, the block exemption no longer applies to agreements with buyers in concentrated markets. This may benefit small and medium-sized distributors by making them more attractive as distribution partners.

3. "Hardcore" Restraints: Old Concepts for New Issues

The 2010 VBER carries over the Commission's time-tested "black list" approach and lists restrictions that are considered particularly harmful to competition. If a vertical agreement contains one (or several) such restraint(s), the exemption that would have been available in the absence of the restraint is unavailable with respect to any and all restraints of trade that the vertical agreement contains.

The 2010 VBER left the definitions of hardcore restraints largely unchanged but the 2010 Guidelines provide additional and, in parts, novel guidance on how the Commission interprets those definitions.

3.1 Internet Distribution

Mirroring the 1999 VBER, Article 4(b) of the 2010 VBER prohibits any "restriction of the territory into which, or of the customers to whom, a buyer […] may sell the contract goods or services." Article 4(b)(i) allows restraints on "active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer."[8] The 2010 Guidelines define "active sales" as sales resulting from actively approaching individual customers, while "passive sales" respond to unsolicited requests from individual customers (¶ 51).

All of this was already contained in the 1999 VBER and the 2000 Guidelines. In addition, the 2000 Guidelines clearly stated that "(e)very distributor must be free to use the Internet to advertise or to sell products" (¶ 51). However, under the 2000 Guidelines, the Commission's

[7] Article 3(2) of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, [2003] OJ L 1/1 ("Regulation No 1/2003"). This level playing field does not extend to unilateral conduct, in relation to which EU member states are free to enact rules that are more restrictive than Article 101 TFEU. Article 3(3) Regulation 1/2003.

[8] In selective distribution systems, i.e. distribution systems in which suppliers sell goods or render services only to those distributors they selected on the basis of specified criteria, Article 4(c) of the 2010 VBER prohibits restrictions on active and passive sales to end customers.

perspective on restrictions imposed on Internet distributors was quite unclear.[9]

The 2010 Guidelines attempt to strike a balance between the business interests of producers of quality (branded) products and Internet distributors, in light of the Commission's perception of the underlying risks for competition in the EU. The general rule continues to be that online sales qualify as passive sales and, therefore, cannot be prohibited. However, the 2010 Guidelines contain a number of important exceptions and qualifications (¶¶ 52 to 54).

In particular, suppliers may not request that online distributors:

- Prevent customers in territories that are exclusively reserved for other distributors from viewing their website;
- Re-route such customers to other websites;
- Terminate website transactions once the credit card data reveal an address that is not within the distributor's exclusive territory;
- Limit their proportion of overall sales made over the internet; and
- Pay higher prices for products intended to be resold offline than for products intended to be resold offline by the distributor.

By contrast, suppliers may request that online distributors:

- Not use offline advertisements that are specifically addressed to certain customers outside their own exclusive territory (e.g. territory-based banners on third party websites);
- Place links on their websites to websites of other distributors that are responsible for other territories and/or of the supplier;
- Agree to a fixed fee for the support of the distributor's offline or online sales efforts;
- Sell at least a certain absolute amount (in value or volume) of the supplier's products offline; and
- Operate their business in a manner that is consistent with the supplier's distribution model, in particular, complies with the quality and service standards imposed by the supplier.

When the 2010 VBER was published, some E-sellers found the last criteria particularly troublesome. Until a few days before publication, their industry associations continued to submit further expert opinions and press releases in an attempt to persuade the Commission to drop this provision. The Commission remained unimpressed. The 2010 VBER allows a supplier to impose a requirement on re-sellers to operate from "brick and mortar" shops, if the supplier finds that this way of distributing their products best reflects the quality standards suppliers are free to define. Moreover, this applies not only to selective distribution systems but also to exclusive distribution, which is the type of distribution system in which many if not most products are marketed in the EU. However, suppliers are not allowed to dissuade distributors from using the Internet by imposing criteria for online sales which are not "overall equivalent" to the criteria imposed for the sales from the brick and mortar shop (¶ 54).

3.2 Efficiency Defense

Under the 1999 VBER, it used to be the general understanding that hardcore restraints were very unlikely, if not downright unable, to benefit from an individual exemption pursuant to Article 101(3) TFEU. This has changed. On the one hand, pursuant to the 2010 Guidelines, hardcore restraints give rise to a presumption that an individual exemption by Article 101(3) TFEU is not available. On the other hand, the 2010 Guidelines provide that such restraints can be defended on the basis of "likely efficiencies" (¶ 47).

[9] This has lead to inconsistencies in judicial reasoning. For instance, in Germany, the Federal Court of Justice found that the supplier of quality products may prohibit its distributors from selling these products solely online if the supplier operates its distribution system based on specific criteria designed to ensure brand recognition and customer service (November 4, 2003, KZR 2/02). With regard to offline distribution through auction platforms, the Higher Regional Court of Karlsruhe found that a prohibition on using such platforms does not amount to a prohibition on sales in the meaning of the 1999 VBER but, instead, merely reflects quality criteria a supplier may use for selecting distributors for branded products (November 25, 2010, 6 U 47/08 Kart.). The Higher Regional Court of München does also not apply the 1999 VBER to prohibition on the offline distribution through auction platforms, although for different reasons. It regards such prohibitions as too vague and volatile for them to amount to a restriction on the type of customers as defined in the 1999 VBER (July 2, 2009, U (K) 4842/08). By contrast, for a largely similar distribution arrangement, the Regional Court of Berlin did not allow a supplier to prohibit internet sales (July 24, 2007, 16 O 412/07 Kart).

For instance, pursuant to the 2010 Guidelines (¶¶ 61-64), the efficiency defense is likely to succeed if the parties prove that the restraint is necessary:

- To ensure a "genuine entry into a new market," in order to protect investments in promotional activities;
- For the purpose of testing a new product in a limited territory or a limited customer group;
- To recoup the investments in offline distribution such that products must be sold online at higher prices than products sold offline (dual pricing).

In addition, the 2010 Guidelines take a novel position on certain types of resale price maintenance ("RPM"). Article 4(a) 2010 VBER prohibits fixed or minimum resale prices that restrain the distributor's ability to determine its sales price. Maximum resale prices and recommended resale prices are legal. In its administrative practice, the Commission has pursued a rigorous approach to RPM.[10]

Unlike the 2000 Guidelines, the 2010 Guidelines specifically state that RPM can be justified according to Article 101(3) TFEU if efficiencies exist (¶ 225). Examples are RPM needed to increase the distributors' sales efforts:

- To support the introduction of a new product;
- To enable coordinated low-price campaigns in franchise systems (for two to six weeks); and
- For high-quality services in case of complex products.

One wonders if this (new) part of the 2010 Guidelines is the Commission's way of responding to *Leegin*[11]. Important differences between the 2010 Guidelines and the U.S. federal antitrust laws remain. Most notably, the burden of proof regarding efficiencies rests with the defendant, and the standard of proof is particularly high for the efficiency defense under EU law. It remains to be seen whether defendants will be able to raise the efficiency defense successfully.

The 2010 Guidelines, therefore, do not grant much leeway for the efficiency defense. Contrary to the 2010 Guidelines' "presumption" of illegality for hardcore restraints such as RPM, however, the Court of Justice of the European Union found that "no anti-competitive practice can exist which, whatever the extent of its effects on a given market, cannot be exempted, provided that all the conditions laid down in Article [101(3)] are satisfied."[12] Notably, the 2010 Guidelines are legally binding only on the Commission, and not on the courts or the antitrust agencies of EU member states.

4. Conclusions

The Commission has often been applauded for its "more economic approach," which is also reflected in the 2010 VBER and Guidelines. However, this approach means nothing more than the proposition that the EU desires to come to economically sound decisions. The fact that the 2010 VBER applies this approach to the web 2.0 world and RPM within a framework it set more than ten years ago demonstrates the shortcomings of the Commission's attempt, in the 2010 VBER and Guidelines, to fit modern antitrust concepts into a rather mechanic structure defined by lists of prohibited clauses, with vast areas left for self-assessment in light of fairly generic Commission guidance. Regardless, the new rules for vertical restrains of trade are to be welcomed as they provide business with somewhat increased levels of flexibility compared to the 2000 Guidelines, and overall strike a reasonably well structured balance between the commercial interests involved.

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[10] *See, e.g.*, July 5, 2000, COMP/36.516 – Nathan-Bricolux; June 29, 2001, COMP/36.693 – Volkswagen (overturned by the General Court in T-208/01 [2003] ECR II-5141); June 24, 2002, COMP/37.7709 – B&W Loudspeakers; July 16, 2003, COMP/37.975 – Yamaha. These decisions are available at the Commission's website.

[11] Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877 (2007).

[12] Case T-17/93 – Matra Hachette [1996] ECR II-595 ¶ 85.