

WILMER, CUTLER & PICKERING

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11 January 2000

COMMISSION ADOPTS BLOCK EXEMPTION ON VERTICAL RESTRAINTS

On 29 December 1999, the Commission published its newly-adopted block exemption Regulation on the application of Article 81(3) of the EC Treaty ("EC") to categories of vertical agreements and concerted practices (the "Regulation")¹.

All companies using independent business parties for distribution in the European Union should now therefore:

- (a) check their market share(s) in the EU countries;
- (b) if below 30%, market share, check to see if their agreements contain any "black-listed" clauses (preventing block exemption);
- (c) if above 30%, consider to what extent further action is required to secure EC competition compliance.

I. Overview

The block exemption ("BE") is the result of an in-depth policy review the main public steps of which were the publication of a Green Paper in January 1997² and the publication, in September 1998, of a Communication on the application of EC competition rules to vertical restraints³.

The BE concerns supply and distribution agreements concerning final and intermediary goods as well as services and allows companies whose market share is below 30% to benefit from a "safe harbour" under the Community competition rules. Above this threshold, agreements will not be covered by the BE, but are also not presumed to be illegal. They may require individual examination under Article 81 EC.

The basic aim of this new approach is to simplify the rules applicable to supply and distribution agreements and to reduce the regulatory burden, especially for companies lacking market power, while ensuring a more effective control of agreements entered into by companies holding significant market power.

From 1 June 2000, the Regulation will replace the three block exemption regulations currently applicable to exclusive distribution, exclusive purchasing and franchising agreements⁴. Further guidelines on the application of the EC Competition rules will also be finalised shortly. A draft was already published in December 1999⁵.

¹ Commission Regulation (EC) No 2790/1999 of 22 December 1999 (O.J. L336/21, 29 December 1999).

² COM(96)721 final.

³ COM(98)544 final.

⁴ Commission Regulations (EEC) No 1983/83 (O.J. L173/1, 30 June 1983), (EEC) No 1984/83 (O.J. L173/5, 30 June 1983) and (EEC) No 4087/88 (O.J. L359/46, 28 December 1998).

⁵ OJ C270/7, 24 September 1999.

II. Scope of application

The BE applies to all vertical agreements, *i.e.* agreements between undertakings at different levels of the production or distribution chain for the purchase and resale of goods and services, with certain defined exceptions.⁶ The BE concerns, in particular, industrial supply agreements, exclusive and selective distribution agreements, exclusive purchasing agreements and franchising agreements.

The BE reflects the “graded” economic approach to competition review, *i.e.* that restraints in more competitive markets are not considered serious and can be exempted by category, but where a supplier starts to have significant market share, and therefore may have market power, more individual review is required.

As a result, agreements where the market share of the supplier is not more than 30% are covered by the BE.⁷ In the case of exclusive supply obligations, the buyer's market share is considered (insofar as the latter may have market power through its own position or the cumulation of several distributorships) and, where it exceeds 30%, individual review is required.

III. Restrictions which are not covered by the BE

The Regulation contains some important limitations to its application which may be summarised as follows:

First, the BE does not apply, if the agreement contains certain severe anti-competitive vertical restraints, irrespective of market share (so-called “hard-core or “black-listed” restrictions”).⁸ Moreover, individual exemption of such clauses will be unlikely. These “black-listed” restraints are:

- (a) ***resale price maintenance provisions*** (however, maximum prices can be fixed and non-binding price recommendations can be made, provided these do not result in practice in price fixing or resale price maintenance as a result of pressure or incentives by the parties);
- (b) ***territorial protection***, where it restricts the territory into which, or the customers to whom, the buyer may sell the contract goods or services, except:
 - ?? restrictions on active sales into an exclusive territory or exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such restrictions do not limit sales by the customers of the buyer;
 - ?? restrictions on sale to end-users by a buyer operating at the wholesale level of trade;
 - ?? restrictions on sales to unauthorised distributors by members of a selective distribution system;
 - ?? restrictions on sales of goods which are supplied for the purposes of incorporation;

⁶ Article 2 of the Regulation.

⁷ Article 3.1 of the Regulation.

⁸ Article 4 of the Regulation.

- (c) *the restriction of active or passive sales to end-users by members of a selective distribution system operating at the retail level of trade;*
- (d) *the restriction of cross-supplies between distributors within a selective distribution system;*
- (e) *the restriction of sales of spare parts to end-users and independent repairers and service providers, if agreed between a supplier of such parts and a buyer which incorporates and resells those parts.*

Second, the BE does not apply to certain specific obligations contained in vertical agreements.⁹ Inclusion of such clauses does not take an agreement outside the BE, but the provisions are not exempt even though they may be compatible with the EC competition rules under certain circumstances. These obligations include:

- (a) *direct or indirect non-compete obligations (i.e. for more than 80% of a buyer's purchases) for an indefinite duration or for more than 5 years;* unless the buyer's premises are owned by or leased from the supplier, in which case the non-compete clause can be for the duration of the buyer's occupancy. Automatic renewal or "tacit reconduction" is treated as indefinite duration;
- (b) *post-termination non-compete obligations for more than one year,* unless such an obligation (i) relates to goods or services which compete with the contract goods or services, (ii) is limited to the premises and land from which the buyer has operated during the contract period, and (iii) is indispensable to protect know-how transferred by the supplier to the buyer;¹⁰
- (c) *any direct or indirect obligation imposed on the members of a selective distribution system not to sell the brands of particular competing suppliers.*

Third, the Commission may also declare by regulation that the BE will not apply to vertical agreements containing specific restraints in a relevant market.¹¹ This is where parallel networks of similar vertical restraints cover more than 50% of that market. Such a regulation is only to enter into force six months after its adoption.

IV. Withdrawal of the benefit of the Regulation

The Commission may withdraw the benefit of the BE in individual cases¹². This is where vertical agreements have effects incompatible with the conditions in Article 81(3) EC, in particular where access to the relevant market or competition therein is significantly restricted by cumulative effects of parallel networks of similar vertical restraints practised by competing suppliers or buyers.

⁹ Article 5 of the Regulation.

¹⁰ This does not reverse the policy in Regulation 1983/83 against such post-termination non-competes, rather it is designed as a solution to cover systems such as franchising which may need such protection.

¹¹ Article 8 of the Regulation.

¹² Article 6 of the Regulation.

A national competition authority may also withdraw the BE, under the conditions set out above for the Commission, if such effects are identified in the territory of an EU Member State or in a part thereof which has all the characteristics of a distinct geographic market¹³.

V. Calculation of market shares

The market share of 30% above which the BE does not apply, is to be calculated on the basis of the market sales value, relating to the preceding calendar year, of the goods or services sold by the supplier, which are regarded as interchangeable or substitutable by the buyer¹⁴.

Pursuant to Article 9.2 of the Regulation, if the market share is initially not more than 30% but subsequently rises above that level without exceeding 35%, the BE will continue to apply for a period of two consecutive calendar years following the year in which the 30% market share threshold was first exceeded. If the market share is initially not more than 30% but subsequently rises above 35%, the exemption will continue to apply for one calendar year following the year in which the level of 35% was first exceeded.

VI. Entry into force

The Regulation is to enter into force on 1 June 2000 and to expire on 31 May 2010. As the current block exemption regulations No 1983/83, 1984/83 and 4087/88 expire on 31 December 1999, in order to avert a legal vacuum the new Regulation prolongs them until 31 May 2000. Existing agreements between companies will continue to benefit from these three regulations until the end of 2001. The block exemption regulation for motor vehicle distribution and servicing agreements is not affected by the new rules¹⁵.

VII. Conclusion

The new block exemption will have major consequences for companies with market shares above 30% and their supply and distribution agreements may need to be revised or notified to the European Commission as a result. The days of EC competition compliance review of a distribution agreement for Europe without regard for market share are now over.

The Regulation will also affect companies with shares below 30%. The black-listed clause approach leaves far greater freedom than the more elaborate approach of previous regulations. However, distribution arrangements will still need careful review to ensure that clauses are not black-listed and, if so, to clarify whether alternative solutions can be found.

Clearly also, companies should also review carefully the facts and available precedents to see how markets and market shares are likely to be defined.

If your company is likely to be affected by the new Regulation and you need further assistance, please do not hesitate to contact John Ratliff or James S. Venit.

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¹³ Article 7 of the Regulation.

¹⁴ Article 9 of the Regulation.

¹⁵ The automobile sector is excluded from the scope of the Regulation and will continue to be regulated by Regulation No 1475/95 concerning motor vehicle distribution until 30 September 2002.