The new EU Vertical Restraints Regulation: Navigating the vast seas beyond safe harbours and hardcore restrictions

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Reprinted from European Competition Law Review
Issue 12, 2010

Sweet & Maxwell
100 Avenue Road
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London
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(Law Publishers)
The new EU Vertical Restraints Regulation: Navigating the vast seas beyond safe harbours and hardcore restrictions

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EU law; Vertical agreements

On April 20, 2010, the European Commission adopted a new Regulation exempting certain supply and distribution agreements from the European Union’s prohibition against anti-competitive arrangements (the “New Regulation”).

The adoption of the New Regulation constitutes an important development for all companies that are involved in the distribution of goods or services in the European Union. The New Regulation, and accompanying set of New Guidelines (the “New Guidelines”), as before, do not replace the need for an independent legal assessment of the competitive effects of vertical arrangements. However, they provide additional insight into the Commission’s current thinking and can be one effective tool when identifying and minimising antitrust risk.

Companies involved in the distribution of goods or services in the European Union will want to consider the effect of the New Regulation on their existing agreements, in particular those relating to online sales or involving one or more companies that might have buying power. They will want to do so soon since the New Regulation came into force on June 1, 2010, and will be valid until 2022. There will be a one-year transitional phase for those agreements which, on May 31, 2010, satisfied the conditions for exemption set out in the former Regulation.

The safe harbour

With few exceptions, the New Regulation exempts from art.101 TFEU supply and other vertical agreements where: (i) both the seller and the buyer have up to a 30 per cent share on the relevant market where they respectively sell and purchase the goods or services; and (ii) the agreement does not contain one of the listed “hardcore” restrictions discussed below.

Although safe harbours have their benefits, their usefulness in assessing the actual risks of a given arrangement should be kept in perspective. Like most safe harbours issued by enforcement authorities, the New Regulation’s exemption is conservative, covering only those arrangements that are most obviously unlikely to raise competition concerns. The New Regulation thus acknowledges that the safe harbour covers only a subset of lawful agreements and, as the case law of the European courts makes clear, agreements falling outside the exemption carry no presumption of unlawfulness.

At the same time, the safe harbour is not as safe as it might appear. Because it depends on a certain market-share threshold, much depends on how the relevant market is defined, an exercise that often remains inconclusive without the sort of extensive (and expensive) factual and economic analysis that is rarely justified under the circumstances. Furthermore, market shares can increase during the life of an arrangement, causing the safe harbour to be lost after a short grace period. Finally, though rarely exercised, the Commission has the power to “withdraw the benefit” of an otherwise applicable safe harbour when a particular arrangement nevertheless appears to threaten competition. This can happen, for example, if the cumulative effect of several vertical arrangements might be problematic.

The safe harbour nevertheless has its uses. Falling within it, for example, can help alleviate concerns by reluctant trading partners. It also can help dispose of any Commission or Member State investigation quickly and with little need for detailed competitive arguments. And it can dissuade private plaintiffs from trying their luck in the courts. Any risk assessment of a proposed vertical arrangement therefore should include determining whether the safe harbour might apply.

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1 The author is indebted to Howard Rosenblatt and Eric Barbier de la Serre, partners at Latham & Watkins LLP, for their comments and review. The views expressed remain those of the author.
3 The Guidelines on Vertical Restraints (“New Guidelines”) can be found at: http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf [Accessed September 21, 2010]. The New Guidelines constitute mere “soft law” and are therefore without prejudice to the interpretation that may be given by the courts of the European Union. However, as national courts and national competition authorities often follow the Commission’s guidance, the New Guidelines will play an important role in practice.
5 Regulation 330/2010 art.7(d).
Extending the 30 per cent threshold to the buyer

The New Regulation narrowed the scope of the safe harbour. For an agreement to benefit from the exemption it will not be sufficient that the supplier’s share does not exceed 30 per cent; it will also be necessary that the buyer share does not exceed 30 per cent of the customer base.4 Previously, the purchaser’s share in the buyer’s market was relevant only when assessing whether the safe harbour applied to exclusive supply arrangements, where the concern is whether such an arrangement forecloses the seller’s rivals from an ability to compete for a substantial portion of available customers.7

It is not easy to justify imposing the same limitation on the safe harbour for the many other types of vertical arrangements. Yet even this new restriction represents a compromise of the draft regulation published for consultation, which applied the threshold even more broadly to the seller’s and the buyer’s shares on “any of the relevant markets affected by the agreement”, including presumably the buyer’s downstream market. The new restriction nevertheless will cause problems as the companies try to measure shares in a purchasing market and thus will decrease the safe harbour’s utility.

The hardcore restrictions

The New Regulation continues the practice of listing a series of specific arrangements, labelled “hardcore” restrictions, which will deprive an arrangement of the safe harbour regardless of the parties’ market shares.4 These practices sometimes were mistakenly confused with “restrictions by object”, which are roughly analogous to per se restrictions in the United States. In truth, a “hardcore” restriction merely is an arrangement which precludes the exemption of the whole agreement containing it. However, these so-called hardcore restrictions provide insight into practices the Commission considers most likely to raise competition concerns.

However, the New Guidelines take hardcore restrictions one step further. They say that such restrictions carry a “presumption” that the arrangement will be anti-competitive and infringe art.101 TFEU and unlikely to fulfil the conditions of art.101(3) TFEU.9 This may create a tension with the applicable rules on the burden of proof which require the party or authority alleging the violation of art.101(1) TFEU to establish the infringement.10 In addition, the presumption that the agreement is unlikely to meet the conditions of art.101(3) TFEU must be read in light of the principle that no agreement is per se excluded from the exemption contained in this provision.11

On the other hand, the New Guidelines also acknowledge that certain “hardcore” restrictions may “exceptionally be objectively necessary for the existence of an agreement” and therefore fall outside of art.101(1) TFEU.12 A novel example is the restriction of “passive sales” outside of a contractual territory for the first two years, in cases where a distributor must make substantial investments to launch the product.13 This is a significant and useful development given the view that restricting passive sales is almost always found to be unlawful.

New guidelines for online distribution

The Commission’s policy is that every distributor must be free to use the internet to advertise and sell products.14 The New Guidelines clarify how this general principle applies to exclusive distribution and selective distribution.

Regarding exclusive distribution in the context of online commerce, the New Guidelines clarify the distinction between sales outside of the contractual territory resulting from active marketing (“active sales”) and sales resulting from the consumer taking the initiative (“passive sales”).15 Typically, a seller may restrict active sales outside of the reserved territory or customer group, but not passive sales.

The New Guidelines provide that use of the internet is a form of passive sales, and therefore cannot be restricted, as it is “a reasonable way to allow customers to reach the distributor”. A website is not considered to be a form of active selling unless it specifically targets certain groups of customers (for example, by using territory based banners on a third-party website or paying a search engine to display advertising specifically to users in a particular territory). Accordingly, most sellers’ restrictions in vertical agreements regarding online sales will not be exempted. The New Guidelines list the following restrictions of passive sales over the internet as hardcore restrictions16:

- requiring a distributor to prevent customers located in another exclusive territory from viewing its website or to reroute them to the manufacturer’s or other distributors’ websites;

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4 See Regulation 330/2010 art.3 and New Guidelines, paras 87–92.

5 For exclusive supply agreements, the New Guidelines state that: “Where the market share of the buyer on the upstream market does not exceed 30 %, significant foreclosure effects may still result, especially when the market share of the buyer on his downstream market exceeds 30 % and the exclusive supply relates to a particular use of the contract products.” (Paragraph 194.)


7 New Guidelines, paras 47 and 223.


9 Mata Hachette v Commission of the European Communities (T-17/93) [1994] E.C.R. II-595 at [85]: “[N]o 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) of the Treaty are satisfied.”

10 New Guidelines, s.III A, paras 60–62. The same section includes specific cases where undertakings have the possibility to plead an efficiency defense under art.101(3) TFEU in an individual case (paras 63–64).

11 New Guidelines, para 61.

12 New Guidelines, para 52.


14 New Guidelines, para 52.

15 See Regulation 330/2010 art.4, and New Guidelines, paras 47–64.
• requiring a distributor to terminate transactions when the client’s credit-card data reveal an address outside of the distributor’s territory;
• requiring a distributor to limit its overall internet sales (although a supplier may require a “certain absolute amount” of sales by the brick and mortar shops if this does not limit the online sales of the distributor); or
• requiring a distributor to pay a higher price for products to be sold online (although this practice may be exempted under art.101(3) TFEU when online sales cause the supplier to incur substantially higher costs).

Selective distribution arrangements are agreements by which a seller adopts a list of criteria that its distributors must meet to resell the product, and are commonly used in the distribution of luxury items for which the seller wants to maintain a certain image or technical products for which the seller wants to use knowledgeable distributors. Selective distribution arrangements have generally been considered competitively harmless when sufficient inter-brand competition exists and there is no cumulative effect.

The New Regulation identifies certain types of selective distribution arrangements as deserving of safe-harbour treatment and takes the opportunity to list hard core restrictions that will deprive them of that comfort. For example, the New Regulation gives a safe harbour to companies that require resellers to have “one or more brick and mortar shops or showrooms” to avoid free riding by pure online companies, a common concern among luxury good manufacturers. Suppliers also get a safe harbour when requiring distributors to abide by certain standards and conditions when using third-party platforms (such as requiring that the third-party platform does not direct customers to the distributor’s website).

Yet, granting these safe harbours for competitively benign activities also creates an opportunity to list “hardcore” restrictions or other circumstances that will forfeit the comfort. For example, the Commission regards as a hardcore restriction any obligation that dissuades selected dealers from using the internet by imposing criteria for online sales that overall are not equivalent to the criteria imposed for the sales from the brick-and-mortar shop. However, this does not mean that the criteria imposed for online sales must be identical to those imposed for off-line sales, but rather that any difference should be justified by the different nature of these two distribution modes.

The Commission’s approach in this regard may be impacted by the future judgment of the Court of Justice of the European Union in the Pierre Fabre Dermo-cosmétique case, in which the Court may rule on how far manufacturers may restrict appointed retailers from selling their products online.19

New features of selective distribution

The New Regulation and the New Guidelines also address selective distribution more generally. The New Regulation labels as hardcore restrictions on the selected dealers ability to sell to unauthorised distributors located in any territory where the system is currently operated or where the supplier does not yet sell the contract products (referred to as “the territory reserved by the supplier to operate that system”). This new rule may have the effect of chilling the supplier’s efforts to establish a selective distribution system in certain EU countries while using other forms of distribution (e.g. exclusive distribution) in others.

The New Guidelines also admonish that the safe harbour will likely be withdrawn if the selective distribution criteria were not required and appreciable anti-competitive effects occur.20

Justifying minimum resale price maintenance

Like the former Regulation, the New Regulation provides that resale price maintenance is a hardcore restriction and thus the safe harbour does not apply to vertical agreements that establish a fixed or minimum resale price.21

Nevertheless, the New Guidelines acknowledge three situations where minimum resale price maintenance could generate efficiencies. First, resale price maintenance may be necessary to induce distributors to promote a new product when it is not practical to achieve this result contractually. Secondly, resale price maintenance may be necessary to organise short-term (six to eight weeks) promotions in distribution agreements belonging to “a franchise system or similar distribution system applying a uniform distribution system” (arguably, selective distribution systems). Thirdly, the parties may demonstrate that resale price maintenance is a means to avoid free riding of pre-sale services in particular in case of experienced resellers or complex products; such pre-sale services need to benefit consumers overall, so as to demonstrate that all the conditions of art.101(3) TFEU are fulfilled.

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17 New Guidelines, para.54.
18 New Guidelines, para.56.
20 Regulation 330/2010 art.4(b)(iii) and New Guidelines, para.55.
21 New Guidelines, para.176.
22 Regulation 330/2010 art.4(a) and New Guidelines, paras 223–229.
These limited justifications should not be confused with the more dramatic shift adopted by the US Supreme Court in *Leegin* rejecting per se treatment and subjecting all forms of resale price maintenance to a “rule of reason” analysis. However, considering the long-standing opposition of the Commission to resale price maintenance, this can be considered as a significant change brought about by the New Regulation.

**Other new features**

The Commission provides guidance on concepts that seemed to be clear-cut under the jurisprudence of EU courts. For instance, the New Guidelines provide guidance on the definition of “agreement”, which clarifies the situations in which, according to the Commission, “tacit acquiescence” gives rise to an agreement (i.e. a distributor’s reduction of orders in response to a supplier’s announcement of a unilateral reduction of supplies in order to prevent parallel trade, or a system of monitoring and penalties set up by a supplier to penalise distributors not complying with its unilateral policy). This stance is in tension with the case law of the European courts, which have imposed on the Commission a high standard of proof to establish that tacit acquiescence constitutes an agreement. The examples provided in the Guidelines tend to oversimplify the crucial issue of whether in a given case the required concurrence of wills exists.

Finally, the Commission expresses concern over a perceived increase in the market power of the buyers. The new set of rules therefore introduce—in addition to the 30 per cent market-share safe-harbour threshold for distributors discussed above—new guidance for buyer-related vertical restraints such as *upfront access payments* (i.e. fixed fees that suppliers pay to distributors at the beginning of their relationship in order to obtain access to their shelves) and *category management* (i.e. agreements whereby where a supplier advises a retailer on how best to organise a product category on its shelves).

**Conclusion**

The New Regulation and the New Guidelines will govern vertical agreements in the European Union until 2022. Do they give companies sufficient insight into the Commission’s approach for the next 12 years and a useful degree of legal certainty without chilling potentially pro-competitive behaviour? This is far from certain. On the one hand, the clarification of the rules concerning online sales, albeit limited, is a positive development. On the other, the New Regulation and the New Guidelines still constitute a complex set of rules for companies to navigate around. In addition, the situation is now worse for certain agreements concluded with a powerful buyer since, by disqualifying from the exemption those arrangements where the buyer has a market share above 30 per cent, the Commission sends a strong signal that such arrangements must be entered into with caution. Additional complications may result from the fact that, on certain points, the New Guidelines may depart from the established case law of the EU courts, such as the circumstances when “tacit acquiescence” constitutes an agreement.

Regardless of the precise boundaries of safe harbours and hardcore restrictions, vertical arrangements require a knowledgeable independent assessment that takes into account the facts and circumstances of their likely competitive effects. As the Guidelines acknowledge:

“For most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels.”

In most cases, the overriding question in that assessment will be whether the arrangement is likely to “foreclose” rivals, either at the supplier or distributor level. The new set of rules is not a substitute for that assessment but, in certain circumstances, may help successfully manage antitrust risk.

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23 On June 28, 2007, in *Leegin Creative Leather Prods Inc v PSKS Inc*, 127 S.Ct. 2705 (2007), the Supreme Court overruled nearly 100 years of precedent and held that resale price maintenance agreements are not per se violations of s.1 of the Sherman Act and must be evaluated under the rule of reason.


26 New Guidelines, para. 6.