

**EU Update. (April 2010)**  
**Competition Law**  
**The new EU Verticals Block Exemption – and Guidelines**

The European Commission has adopted the new Regulation which will replace the existing Block Exemption Regulation for Vertical agreements (VBE) – covering agreements between parties at different levels in the market eg. distribution agreements, franchising agreements – which expires after 10 years of operation on 31 May 2010<sup>1</sup>.

The new Regulation will be of considerable significance to all companies with distribution activities in the EU - this despite the fact that the Commission has branded the changes incorporated as “revisions” and “tweaks”.

Since 2004, the EU system of competition control for verticals has been based on a principle of “self-assessment” and this has tended to increase the importance of all block exemptions<sup>ii</sup>. Self-assessment requires participants to an agreement to decide for themselves whether the agreement contains restrictions of competition and if so whether these meet the four cumulative tests of exemption set out in Article 101.3. This is not at all an easy task as the 101.3 test requires a comparison to be made of the impact of the restrictions compared to the benefits they provide to consumers. The Commission has already published a separate 22 page guidance note describing how it considers this balancing act should be carried out.

Given that the consequences of breach of Article 101.1 are not limited to the nullity of the agreement, but include the potential for both administrative investigation and fines as well as increasingly the risk of civil claims for damages, it is no surprise that companies are very keen to keep all of their agreements within the “safe harbour” of a block exemption.

The VBE serves two functions: providing the certainty of exemption for a defined category of agreements; and in relation to all other agreements, providing guidance in relation to the principles that will be applied by the Commission, National Competition Authorities and national courts in the event that a non-VBE agreement is reviewed or challenged.

In some senses then the growing complexity of the VBE package – the Regulation of 11 pages is accompanied by Guidelines of 63 pages, is proof that the Commission’s intentions to wean companies off certainty in favour of self-assessment may not in fact be working. The certainty of the VBE’s “safe harbour” provides such benefits (certainty and risk reduction) that most companies will simply decide to make their distribution structures fit within what is available under the VBE. Thus the new VBE will likely define the nature of distribution in the EU for the foreseeable future (this VBE will remain in force until 2022).

The VBE covers various types of vertical agreements – this note focuses only on issues of

general significance not limited to specific types of agreement.

**Question 1 : Does the VBE increase or decrease the “safe harbour”.**

By requiring that the basic 30% market share test is applied to both supplier and now buyer of the goods, the new VBE will take outside scope a large number of agreements with buyers who have large market presence<sup>iii</sup>. The size of the “safe harbour” has therefore been reduced.

The Commission has however stressed that there is no presumption that an agreement with parties who exceed the threshold is not capable of exemption.

Suppliers in particular will need to consider whether their buyers fall within this market share test – and if not what the impact of that high market share might be. For those agreements that fall outside the VBE, some form of self-assessment procedure should be followed.

**Question 2: Does the VBE permit the inclusion of hardcore restrictions ?**

The Commission uses a more modern formulation (used both with Art 101 and 102) that distinguishes its position in theory from a US style “per se” approach. The Commission states that even for hardcore restrictions parties may be able to show that specific efficiency gains justify the inclusion of an otherwise unacceptable restriction.

The Commission therefore does not exclude that exemption may be possible even for eg Resale Price Maintenance, or total bans on active and passive selling. Possible but unlikely. More likely in fact to lead most participants quickly into deep and difficult waters.

**Question 3: Can distributors be restricted in their use of Internet sales?**

The first part of the answer is no. The Commission maintains its view that internet sales are now part and parcel of the business of distribution – and that they fit within the scope of the traditional distinction between active and passive sales.

The Commission recognises that although Internet sales are consistent with the rules on “passive sales”, they can also be used to disguise active sales techniques – eg using search engines to target advertising to customers in specific territories or countries. Such use can indeed be restricted.

The Commission confirms that the following are not compatible with the rules on passive sales ie would be prohibited restrictions – mandatory redirection of enquiries from countries outside Territory; blocking payments using credit cards from outside Territory and restricting the proportion of sales that can be made by internet.

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#### **Question 4: Panic now or panic later ?**

Although the new VBE enters into force on 1 June 2010, a one year grace period is included before the new rules are definitively applied. Now is the moment to take a look at distribution policies and practices in some detail both to determine whether action is needed to comply with the new VBE but also to check whether current implementation is consistent with the existing rules (most compliance issues arise not from the written word but from spoken words and actions).

#### **NOTES**

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<sup>i</sup> The VBE does not however cover all vertical agreements, Motor Vehicle Distribution still has its own rules and block exemption, as do IP licensing agreements under the TTBE.

<sup>ii</sup> Block exemptions are statements of law adopted by the Commission confirming situations in which certain categories of agreements will always meet the requirements of Article 101.3 and can therefore be automatically exempted from the prohibition of Article 101.1

<sup>iii</sup> The issue to consider here will be how to define the relevant markets in geographic terms – to determine whether that buyer power is only local, regional, national or EU wide. Of course the most problematic outcome would be an assessment suggesting that a buyer has strong local or regional power as evidenced by high market shares.

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