The New EU Rules On Vertical Restraints

Law360, New York (May 07, 2010) -- On April 20, 2010, the European Commission adopted a new Regulation (No 330/2010) listing the conditions under which vertical restraints are exempt from the prohibition on anti-competitive agreements (defined by Article 101(1) of the Treaty on the Functioning of the European Union, "TFEU", formerly known as Article 81(1) of the EC Treaty), as well as new Guidelines providing guidance to firms on how to self-assess the compatibility with Article 101 of vertical agreements falling outside the scope of the Regulation’s safe harbor. The new rules will replace Regulation No 2790/1999 and the previous guidelines as of June 2010 and will remain in force until May 2022.

The most significant novelties introduced by the new Regulation and by the new Guidelines consist of: the addition of a new market share thresholds necessary to qualify for the "safe harbor" exemption; the clarification of the admissible restrictions to Internet sales; the modification of the definition of selective distribution; and the Commission’s view about the legal effects arising from the inclusion of hardcore restrictions in distribution agreements.

As explained below, although the first two changes appear in line with the Commission’s more economic-oriented approach in the area of competition law and with the need to ensure an adequate degree of legal certainty, the changes concerning selective distribution and hardcore restraints do not appear, in our view, entirely consistent with these objectives.

Additional Market Share Threshold

As did Regulation 2790/1999, also Regulation 330/2010 provides a "safe harbor" for vertical restraints if the market share of the supplier does not exceed 30 percent in the market in which it sells the contract goods or services. For this "safe harbor" to apply, however, Regulation 330/2010 also requires that the market share of the buyer not exceed 30 percent in the "relevant" market.
Following the Commission’s publication of a draft version of the new Regulation in July 2009, the definition of “relevant” buyer market was fiercely debated. Based on the 2009 draft, the market share of the buyer would have had to be calculated in relation to “any of the relevant markets affected by the agreement.” Business and the legal community raised the concern that this provision would have resulted in a significant loss of legal certainty and would have been inconsistent with other EU instruments. Therefore, the final text of the new Regulation now relates the relevant market share of the buyer to the market “on which it purchases the contract goods or services” (Article 3(1)).

We believe this market share test will suffice to ensure that the Commission achieves its objective of not applying the “safe harbor” to restrictions of competition resulting from buyer power, while maintaining an adequate level of legal certainty for the businesses involved.

**Selective Distribution**

According to Regulation 2790/1999 a distribution system was “selective” if the supplier selected its distributors on the basis of specified criteria and prevented them from reselling to any unauthorized (i.e. nonselected) distributor across the EU. Under Regulation 330/2010, suppliers will be able to prevent the members of a selective distribution network from selling to unauthorized distributors only “within the territory reserved by the supplier to operate that system” (Article 1(1)(e), and Article 4(b)), i.e. the territory “where the system is currently operated or where the supplier does not yet sell the contract products” (Guidelines, paragraph 55).

This new rule, the rationale of which is not entirely clear if not to entice the adoption of EU-wide selective distribution networks, may have a chilling effect on the suppliers’ ability to establish a selective distribution system in certain EU countries while using other forms of distribution (for instance exclusive distribution) in other EU countries.

**Internet Sales**

While, apart from those mentioned above, Regulation 330/2010 does not contain other significant changes compared to Regulation 2790/1999, the new Guidelines contain a great number of adjustments and changes to the rules for how vertical restraints need to be assessed, from the Commission’s perspective, in light of Article 101 TFEU. The most significant changes relate to Internet sales and hardcore restraints. The Guidelines are legally binding only on the Commission but heavily influence how national courts and antitrust agencies apply Article 101 TFEU in the 27 EU member states.
With regard to Internet sales, the new Guidelines strike a compromise between the opposing interests of online commercial platforms and luxury goods producers.

On the one hand, they confirm that an outright prohibition to sell or advertise a product over the Internet is a hardcore restraint that would deprive the agreement of the safe harbor granted by the Regulation (Guidelines, paragraph 52). Similarly, they clarify that restrictions on how a distributor can sell through the Internet are hardcore restraints if they limit the distributor’s ability to make “passive sales” (i.e. unsolicited sales). The following examples are provided of Internet sales restrictions that are considered hardcore:

(1) requiring the distributor to make its website inaccessible, or transactions through its website impossible, to customers depending on their place of residence;

(2) requiring a distributor to limit the proportion of overall sales made over the internet (without excluding, however, the possibility for the supplier to require the buyer to sell at least a certain absolute amount, in value or volume, of the products off-line to ensure an efficient operation of its brick and mortar shop);

(3) requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line (Guidelines, paragraph 50).

On the other hand, the Guidelines state that an outright ban on Internet sales may be objectively justified in exceptional circumstances (such as when necessary to align on a public ban on selling dangerous substances to certain customers for reasons of safety or health), and that undertakings have always the possibility to plead an “efficiency defense” of Internet sales hardcore restrictions (Guidelines, paragraph 60).

For instance, requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line may be justified if the sales online lead to substantially higher costs for the manufacturer than sales made off-line (Guidelines, paragraph 64).

Finally and most importantly, the Guidelines clarify that a supplier may impose quality standards for the use of an Internet site and, in particular, “require its distributors to have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system” (Guidelines, paragraph 54). The quality standards, however, must be proportionate, that is, they should be “overall equivalent to the criteria imposed for the sales from the brick and mortar shop” and should not consist of
obligations that “dissuade appointed dealers from using the Internet to reach more and different customers” (Guidelines, paragraph 56).

**Hardcore Restraints**

According to Article 4 of Regulation 330/2010 (substantially identical to Article 4 of the previous Regulation), an agreement containing "hardcore" restraints cannot benefit from the safe harbor. The following restraints are considered hardcore: resale price maintenance; territorial and customer restrictions (with some exceptions); restrictions on selling to end-users imposed on authorized retailers in a selective distribution system; restrictions on cross supplies within a selective distribution system; and restrictions on component suppliers to sell the components they produce to independent repairers or service providers.

The new Guidelines adopt a much harsher approach towards hardcore restraints than the previous guidelines, by establishing a non-rebuttable presumption of incompatibility with Article 101(1) TFEU of any vertical agreement containing these restraints (Guidelines, paragraphs 47 and 223).

In our view, a non-rebuttable presumption of violation of Article 101(1) TFEU established by means of “soft”-law, like the Guidelines, is clearly incompatible with the burden of proof laid down in Regulation 1/2003 (Article 2), according to which “[i]n any national or Community proceedings for the application of [Article 101 TFEU], the burden of proving an infringement of [Article 101(1) TFEU] shall rest on the party or the authority alleging the infringement.”

This presumption also appears inconsistent with other sections of the new Guidelines, that — in line with the Commission’s generally more economic-oriented approach to competition law — recognize that certain hardcore restraints, such as absolute territorial restrictions (restrictions of active and passive sales imposed by a supplier upon its distributors), may be compatible with Article 101(1) TFEU (Guidelines, paragraph 61).

Last but not least, a presumption of incompatibility with Article 101(1) TFEU of certain vertical agreements also appears contrary to the case law of the European Court of Justice, which recently stated that also agreements containing resale price maintenance are “caught by the prohibition set out in [Article 101(1)] only where all the other conditions for applying that provision are met” (Judgment of 2 April 2009, Case C-260/07, Pedro IV Servicios c. Total España SA, paragraph 82).

It is true that the new Guidelines state that the parties to vertical agreements containing
hardcore restraints can always “plead an efficiency defence under Article 101(3) in an individual case” (Guidelines, paragraph 60). However, in our view, by introducing a non-rebuttable presumption that these agreements are incompatible with Article 101(1) TFEU the new Guidelines greatly limit, rather than increase, the rights of defense, since:

(1) the parties to an agreement will generally find it difficult to show that all four conditions of Article 101(3) TFEU are satisfied;

(2) it was already established case law that “in principle, 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” (Case T-17/93, Matra Hachette v Commission, [1996] ECR II-595, paragraph 85); and

(3) the new Guidelines provide very little guidance on what type of evidence should be provided to show that the conditions of Article 101(3) TFEU are satisfied in real-life situations.

In light of the above, it is submitted that with regard to vertical agreements containing hardcore restraints, the new Guidelines not only do not bring about significant improvements in terms of legal certainty but also depart from the Commission’s predicated more economic-oriented approach in the area of competition law.

**Transitional Period**

The new Regulation and Guidelines will have a significant impact on the distribution sector and business in general in the EU. Suppliers and distributors whose agreement fall, on May 31, 2010, within the safe harbor of the previous Regulation must comply with the new Regulation only by May 31, 2011. However, they need to review and assess their distribution arrangements affecting the EU promptly to ensure timely legal compliance with the new and relatively detailed provisions of this new antitrust system for the supply of products in and to the EU.

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