

# Client Alert.

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## European Commission Revises Competition Rules for Supply and Distribution Agreements

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### INTRODUCTION

On April 20, 2010, the European Commission (“Commission”) adopted a new block exemption Regulation that revises existing EU competition law rules for certain categories of “vertical agreements” between manufacturers and distributors, including Internet or online distribution arrangements. The Commission also published new Guidelines that provide further insight into how it assesses the lawfulness of common restrictions in such agreements, including arrangements that fall outside of the Regulation’s safe harbour.

Firms doing business in the EU which are parties to new or existing supply and distribution agreements should carefully review the new Regulation and Guidelines. In particular, the new rules contain some changes that provide firms with greater flexibility to use certain restraints than existing regulations. Thus, continuing to use existing form agreements compatible with prior EU regulations may limit a firm’s ability to accomplish desired business objectives. In other areas, however, the revised rules provide greater clarity on the types of restrictions that the Commission will likely consider problematic under EU competition rules. Accordingly, some firms may wish to eliminate such restraints to minimize any potential risks.

### KEY BUSINESS IMPLICATIONS OF REVISED VERTICAL RESTRAINTS REGULATION AND GUIDELINES

**1. Scope of Block Exemption Safe Harbour.** Like the existing block exemption rules, the new Regulation exempts certain types of “vertical agreements” (*i.e.*, primarily agreements between non-competitors operating at different levels of the supply chain) from being considered an anticompetitive agreement that violates EU competition law. To qualify for the exemption, the parties must satisfy a market share threshold, and the agreement cannot contain any “hard core” restrictions.

**1.1. New Market Share Threshold.** The new Regulation modifies the existing market share threshold. Under the new rules, a block exemption is only available if *both* the supplier’s share of the market in which it sells and the buyer’s share of the market in which it purchases does not exceed 30%. In the past, the market share threshold for a block exemption usually applied only to the supplier’s share.

In changing this threshold, the Commission specifically noted its concern that “buyers can use their market power to put in place vertical restraints to the ultimate detriment of consumers,” particularly by foreclosing smaller and medium sized competitors. Notably, the Commission amended its original proposal to base the buyer’s market share threshold on its share of sales, as many commentators had argued that it would be extremely difficult for suppliers to assess the buyer’s market share in this manner. Nonetheless, suppliers may have similar challenges determining a particular buyer’s share of purchases of the relevant goods, as it may not have sufficiently clear or detailed information regarding the amount of goods the buyer purchases from other suppliers.

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**1.2. Hard core restrictions.** The list of hard core clauses in the Regulation has not been substantially modified; however, there are several noteworthy changes in the new rules regarding the type of restraints that are presumed to be unlawful under EU competition law.

- **Resale Price Maintenance.** Although minimum or fixed resale price maintenance (RPM) provisions are still considered hard core restrictions that are presumed unlawful and prevent the agreement from qualifying from the Regulation's block exemption, the new Guidelines expressly note that RPM arrangements can facilitate new entry or the launch of new products, generate efficiencies by preventing "free-riders" and benefit customers by providing incentives to offer pre-sale services. As a result, the new Guidelines leave open the possibility that the Commission (or a national competition authority or court) could conclude that an RPM arrangement does not infringe EU competition law. Nevertheless, the parties to such arrangements will likely need to "convincingly demonstrate" the benefits to consumers to overcome the longstanding presumption against such arrangements under EU competition law.
- **Territorial or Customer Sales Restrictions.** The EU has historically been less tolerant than other jurisdictions of restrictions on a distributor's ability to sell to certain territories and customers, as these restraints are in tension with the EU's goal of integrating the markets and economies of the Member States. Indeed, many territorial or customer restrictions that would clearly be permissible in the U.S. have been considered "hard core" restrictions under EU law.

The New Regulation and Guidelines, however, expand the available exceptions to this type of "hard core" restriction and thereby give firms greater flexibility to incorporate certain limitations. For instance, the new Regulation specifically states that the benefit of the block exemption "is not lost if it is agreed that the buyer will restrict its distribution outlet(s) and warehouse(s) to a particular address, place or territory."

In addition, under the existing rules, suppliers are generally only able to restrict "active" sales by distributors to a territory or customer group exclusively reserved to the supplier or another distributor; however, absolute restrictions that prohibit "passive" or unsolicited sales have been considered virtually *per se* unlawful. The new Guidelines indicate a ban on "passive" sales would be permitted for a short period (*i.e.*, less than 2 years) in some limited circumstances, including to facilitate new entry and/or provide appropriate incentives to a distributor to make investments necessary to launch a new product or an existing brand in a new territory.

- **Internet and Online Sales.** Online sales activities by buyers/distributors via a website on the Internet have historically been considered to be a form of passive sales that could not be absolutely prohibited by suppliers/manufacturers. Under EU law, distributors must generally be free to sell on their websites. Indeed, the new Regulation and Guidelines provide specific examples of the types of arrangements that will be considered hard core restrictions on passive online sales, including:
  - obliging distributors to automatically reroute customers located outside their territory to another website;
  - terminating consumers' transactions over the Internet if their credit card data reveal addresses that are not within the distributors' territory;
  - limiting the number or proportion of units that may be sold online, or

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- charging higher prices for units to be sold online (*i.e.*, “dual pricing”).

At the same time, the new Guidelines provide more detailed guidance regarding what types of arrangements impacting online sales activities will not be considered a hard core restriction and usually permissible. For example, as in the offline world, suppliers can impose restrictions on the use of the Internet to protect their exclusive distributors from “active” sales in reserved territories, including restrictions on (i) the use of online advertisements to target specific customers (such as territory based banners on third party websites) and (ii) paying a search engine or online advertisement provider to have an advertisement displayed specifically to users in a particular territory.

Likewise, the new Guidelines indicate it will be permissible in selective distribution arrangements to impose quality standards on a buyer/distributor’s website and online sales activities. Suppliers may also require their distributors to maintain one or more “brick and mortar” stores or showrooms.

**2. New Guidance on Upfront Payments and Category Management Agreements.** The revised Guidelines also devote two new sections to upfront payments and category management agreements.

- Upfront access payments (aka “slotting allowances” or “pay-to-stay” fees) are fixed fees that suppliers pay to distributors in order to get access to their distribution network and obtain some retail services.
- In category management agreements, the distributor entrusts a particular supplier to be a “category captain” responsible for the marketing of a group of products, including products of the supplier’s competitors.
- Under the new Guidelines, both upfront payment and category management agreements will generally be exempt when the 30% market threshold is satisfied. However, when one or more of the parties have a market share above this threshold, the Guidelines note that these arrangements can sometimes (a) result in anticompetitive foreclosure of other suppliers or distributors or (b) facilitate collusion between distributors or between suppliers.
- The ultimate analysis of these arrangements’ compatibility with EU competition law will depend on a number of factors besides the parties’ market share/position, including the market coverage of these agreements and the possible cumulative use of such agreements.

**3. Effective Date and Transition Period.** The new rules will come into force on June 1, 2010 and remain effective for 12 years until May 31, 2022. There will be a one-year transitional period during which existing agreements can continue to qualify for the block exemption available under the existing regulation.

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