

Going vertical

Existing EU rules on supply and distribution agreements have worked well but, nonetheless, reform from the European Commission is on the horizon as the current regulations are set to expire this spring. **Evelyne Friedel** reports



Major retailers: Commission concern over increasing buying power

Supply and distribution agreements are still currently governed by the European Commission's 1999 regulation and 2000 guidelines – but as provided by article 13 of the regulation, this arrangement will expire at the end of May 2010. Therefore, the Commission has launched a public consultation on a new draft regulation and guidelines, to which there have been many responses from stakeholders.

The Commission and most of these stakeholders recognise that the existing rules should not be extensively modified. Indeed, these rules already constitute a clear framework offering legal certainty to companies in charge of self-assessing their agreements with article 101 of the Treaty on the Functioning of the EU (TFEU), ex article 81 of the Treaty of the European Community).

Future rules

Notwithstanding 10 years of successful application of the

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existing rules, there is strong opinion that the future rules should go further and underline the possible positive and pro-competitive effects of vertical restraints, including resale price maintenance. The future rules should also take into account on-line market developments.

For its part, the Commission also considers that the turnover thresholds of the 1999 regulation should be amended in light of the increasing buying power of major retailers.

As underlined by the draft guidelines, 'it is important to recognise that vertical restraints often have positive effects by, in particular, promoting non-price competition and improved quality of services'. That said, the draft regulation still includes in its article 4 a list of hardcore restraints. Where an agreement includes such a restraint, not only can it not benefit from the block exemption, but it is also presumed that it cannot benefit from an individual exemption

under article 101.3 of the TFEU.

However, as underlined by the Commission, this is a rebuttable presumption. The enterprise concerned can indeed bring evidence that efficiencies result from restraint and that all other requirements set forth by article 101.3 are fulfilled. In this respect, although resale price maintenance (RPM) belongs to the category of hardcore restrictions, the Commission admits that 'RPM may not only restrict competition, but may also sometimes lead to efficiencies'. The position of the Commission undoubtedly indicates that it retains an economics-based approach.

Aside from examples of efficiencies presented by the Commission, imposing fixed resale prices may indeed safeguard the existence of medium-sized and small-sized shops and permit manufacturers to prevent any qualitative devaluation of their products by discount retailers offering no services and assistance.

As pointed out by the International Chamber of Commerce (ICC), 'this recognition of RPM's potential efficiencies is positive. However, it is questionable how sympathetic the Commission will be towards such efficiencies, given that agreements containing RPM will still be hardcore restraints under the regulation. It is to be hoped that the Commission, national competition authorities and the courts will not require an unattainable quantum of evidence before accepting that the presumption of RPM's illegality has been rebutted. In particular, national judges are unlikely to consider or accept complex economic justifications for any restriction that falls within the hardcore category'.

On-line trade

In addition, according to the French Competition Authority, on-line trade has a positive impact on inter-brand competition by increasing total sales and by sometimes

Analysis: EC consultation

diversifying the services rendered to consumers. Taking into account the expansion of the on-line trade, the draft guidelines update the distinction between passive sales and active sales. In this respect, they specify that a website is considered passive selling if it is not targeted to certain customers, but on-line advertising addressed to certain customers and the sending of unsolicited e-mails constitute active selling.

Regarding restraints on on-line sales, the Commission maintains that 'every distributor must be free to use the internet to advertise or to sell products'. It also considers as hardcore restrictions the following:

- requiring a distributor to prevent customers located in another territory from viewing its website or requiring the distributor to put on its website automatic re-routing of customers to the manufacturer's or other distributors' websites;
- requiring a distributor to terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's territory;
- requiring a distributor to limit the proportion of overall sales made over the internet, however, noting that the supplier may nonetheless require, without limiting the on-line sales, that the buyer sells, under objective criteria, a certain amount of products offline to ensure an efficient operation of its brick and mortar shop;
- requiring a distributor to pay a higher price for products intended to be resold by the distributor on-line than for products intended to be resold off line.

The Commission states that in selective distribution, the supplier may require its distributors to have a brick and mortar shop or showroom before engaging in on-line distribution, and may require equivalent quality standards not only for their shop or for advertising and promotion, but also for the use

of their internet site to resell their products.

As highlighted by the French Competition Authority: 'The deployment and continued existence of a distribution network is based first and foremost on the solidarity and collective investment of its members; it would thus hardly be acceptable, particularly when the manufacturer's competitive strategy focuses not only on the brand image and quality of the products, but also on the existence of qualified services of proximity such as professional advice, that some retailers do not play along with the rule of the game, thus benefiting from the effort of their peers without contributing to it in due proportion. Belonging to such a network implies duties and not only rights.'

Of course, the position retained by the Commission does not preclude suppliers from justifying, in individual cases, that a ban on internet sales results in efficiency gains and that the requirements of article 101.3 of the TFEU are fulfilled. In some limited cases (sale of dangerous substances, and taking account of safety or health issues) such a ban may fall outside of the scope of article 101.1 of the TFEU.

Buying power

Considering the increasing buying power of retailers, the Commission proposes that a vertical agreement may benefit from the block exemption if both the supplier's market share and the buyer's market share do not exceed 30 per cent. Of course, this does not mean that an agreement between companies having market shares higher than 30 per cent is illegal. But in such a case, an individual analysis needs to be carried out for making sure either that the agreement falls out of the scope of article 101.1 or fulfils the requirements set forth by article 101.3.

Many commentators do not favour such an amendment to the existing rules. In particular,

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the ICC points out that the buyer's 30 per cent market share threshold is an inadequate tool to deal with the anticompetitive effects of demand-led vertical restraints. The major criticism is that the new requirement for benefiting from the block exemption regulation will generate practical problems since suppliers will have difficulties determining with certainty their distributors' market shares, especially when they operate in local markets.

In addition, benefiting from a strong position on a local market does not mean that the buyer enjoys a strong buying power towards its supplier. Suppliers may then be unable to determine whether their agreements fall within the scope of the block exemption or not.

And, as noted by the *Ligue Internationale du Droit de la Concurrence*: 'By focusing on the market share of the buyer in downstream markets, the Commission risks defining the scope of the safe harbour too narrowly. There is a risk that a large number of inoffensive agreements will be excluded from the benefit of the block exemption (...) If the proposed dual market share threshold is intended to focus on anti-competitive foreclosure effects, then the draft [regulation] should instead seek to exclude from its safe harbour agreements of real concern, which are more likely to exist where the buyer has high market shares on the upstream market for purchasing the contract goods or services.'

Agreements that currently benefit from the block exemption may no longer be covered if they concern buyers with a market share higher than 30 per cent. Therefore, if this dual market share threshold is maintained in the final text, there will be a need for a transitional period for the sake of practical adjustment to the new regime.

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