

European Commission Releases Long-Awaited Revisions to Vertical Restraints Block Exemption Regulation and Guidelines

April 27, 2010

After a long and somewhat contentious review process, the European Commission (the Commission) published its long-awaited new Vertical Restraints Block Exemption Regulation (VBER) and Guidelines (the Guidelines) on April 20. The new texts replace the existing VBER, which will expire on May 31, 2010. Vertical restraints are restrictions in agreements between companies at different levels of the supply chain (for example, manufacturers and distributors) that limit the commercial freedom of one or both parties with respect to dealing with third parties (for example, exclusive distribution territories).

Although vertical restraints usually promote competition by aligning the buyers' and sellers' incentives to invest in their relationship and to compete more vigorously against third parties, by their very nature they have the potential to violate Article 101 of the Treaty on the Functioning of the European Union (formerly Article 81 of the EC Treaty), which prohibits restrictive agreements affecting EU trade. The VBER operates to "exempt" automatically from Article 101 agreements that fall within the specified "safe harbor." Agreements that fall outside the VBER's safe harbor are not necessarily illegal, but must be assessed on a case-by-case basis. The Guidelines, although not legally binding, must be taken into account by national courts and competition authorities when examining the legality of vertical restraints in individual cases.

The new VBER makes two significant changes over the existing VBER:

- The safe harbor under the existing VBER applied to supply and/or distribution agreements between noncompetitors, provided that the supplier's share of supply (or the buyer's share if the seller is prohibited from selling to third parties) did not exceed 30% of the relevant market. Under the new VBER, the safe harbor only applies if **both** the seller's share of supply and the buyer's share of purchases are below 30%. Although the new thresholds are more restrictive than the current rules, they are a significant improvement over those in the draft that was circulated in July 2009, which would have required the purchaser's share of products incorporating the contract goods to be less than 30%.
- The existing VBER excluded agreements between competitors from the safe harbor, except where (a) the agreement was not reciprocal and the buyer's EEA revenues were below €100 million, or (b) the seller sold both directly and through distributors, and the distributors did not produce the same goods or services. The new VBER removes the first exception and limits the exception for dual distribution of services to services provided at the retail level.

The new Guidelines extend the existing Guidelines in a number of key respects:

- The new Guidelines push the boundaries of the concept of agreement to the breaking point, if not beyond.
 - The Guidelines declare that “tacit acquiescence” to a party’s unilateral policy is an agreement if acquiescence is necessary to achieve the object of the policy.
 - An agreement would be deemed to exist if a manufacturer announces that it is reducing supplies to distributors to prevent them from engaging in parallel trade (i.e., gray-market selling), and the distributors stop engaging in parallel trade.
 - Similarly, manufacturers that set up a system of monitoring and implicit penalties for distributors that do not comply with those policies will be deemed to have entered into an agreement.
- The new Guidelines emphasize that “hardcore” restraints are presumptively illegal, but that the presumption can be rebutted (at least in the case of vertical restraints).
 - Although resale price maintenance and limits on passive sales (i.e., sales solicited by customers) are hardcore restraints, parties can rebut the presumption of illegality by demonstrating that the restraints are necessary to create offsetting efficiencies, such as launching products in new markets or organizing franchising systems.
- The new Guidelines take a more restrictive view of what constitutes an agency agreement (which usually is not covered by EU competition rules because the agent is not independent from the principal).
 - An agreement will not be considered an agency agreement if the “agent” bears any contract-specific risks (for example, inventory financing), market-specific risks (for example, investment in specialized equipment to be able to sell the products in question), or any risks relating to ancillary services (for example, after-sale servicing).
- The new Guidelines set out the Commission’s view that online sales are generally “passive sales” and therefore restrictions that serve to allocate online customers to different distributors are considered hardcore.
 - Examples of prohibited restrictions include requiring distributors to automatically reroute customers to the website of another distributor, or terminating a sale transaction if the credit card reveals an address outside the designated territory.
 - Manufacturers are allowed to restrict distributors’ use of the Internet “to the extent that promotion on the Internet or use of the Internet would lead to active selling into, for instance, other distributors’ exclusive territories or customer groups.” This varies from the draft version, which prohibited any restrictions where the use of the Internet was a reasonable way to reach customers within the distributor’s territory.
- The new Guidelines try to strike a balance between the manufacturer’s legitimate interest in maintaining a degree of control over its distribution channels and the distributors’ freedom to sell online (whether they struck that balance remains to be seen).
 - Manufacturers may not prohibit distributors from selling from their websites or limit online sales as a proportion of their total sales.
 - Manufacturers may not agree to higher prices for products that are sold online than for products sold offline (except where the manufacturer can demonstrate that online sales lead to higher costs).

- However, manufacturers may require distributors to have one or more “brick-and-mortar” outlets, and subject any online sales outlets to equivalent quality requirements, and may require distributors to make at least a minimum quantity of sales offline.
- The Guidelines recognize that two common practices in the retail sector are generally legitimate and capable of falling within the VBER:
 - Upfront access payments, under which suppliers pay distributors for access to the distribution network. These are normally valid, unless they create strong disincentives for the supplier to use other distribution outlets, create entry barriers for smaller suppliers, or facilitate collusion between distributors.
 - Category management agreements, where a retailer entrusts a supplier with marketing a category of products, including both the supplier’s and competing products. Such agreements are normally valid, unless the agreements foreclose competing suppliers’ access to market.

The new rules are likely to please some parties and aggravate others, depending on where they stand in their relationship. The new rules are valid until May 31, 2022. However, the Commission will monitor their application closely and will consider revising the package as needs be prior to its expiry, which may be some consolation for companies that have “lost out” under the new rules.

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact any of the Morgan Lewis attorneys below:

Brussels

Jonathan N.T. Uphoff	32 (0)2 507 7543	juphoff@morganlewis.com
Izzet M. Sinan	32 (0)2 507 7522	isinan@morganlewis.com

Frankfurt

Juergen Beninca	49 69 7140 0719	jbeninca@morganlewis.com
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Paris

Jean Leygonie	33 (0)1 53 30 44 10	jleygonie@morganlewis.com
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