

VERTICAL RESTRAINTS - RESPONSE TO CONSULTATION

1. INTRODUCTION

1.1 Baker & McKenzie is grateful for the opportunity to contribute to the debate on the reform of the Verticals Block Exemption and Guidelines - a set of rules which clearly impact on the every day activities of our clients.

1.2 The VBE marked the beginning of the Commission's 'effects-based' approach (replacing the form-based exemptions) and has, in general, worked very well. We are keen to assist in enhancing the regime further:

- **Economics-based rules:** the review is clearly an opportunity to modify the rules to reflect economic thinking. Competition law should be applied only so as to ensure a competitive market, and not to enforce other regulatory goals, however worthy those goals may be. The guiding principle must be that, absent market power, vertical agreements and vertical restraints do not significantly restrict competition and should not be regulated by competition law. An approach based on economics will also ensure that the VBE is sufficiently robust to withstand ten years of technological and other market developments. At the same time, it is crucial to ensure an appropriate balance between ensuring that the rules reflect economic thinking and that they can reasonably be applied by businesses and provide legal certainty. There is a risk that more prescriptive regimes result, ultimately, in greater complication and less legal certainty. In any event, it is key that any modifications which are based on economics are explained fully and followed through in the VBE and Guidelines so that they can be understood and applied.
- **Incorporating new case law:** the review also gives the Commission an opportunity to update its Guidelines to reflect recent case law. Increasingly, Commission Notices (e.g. Notice on Non-horizontal Mergers) are updated by adding references to Court judgments - and this greatly assists in-house counsel and their advisers. However, there can be a danger - especially when factually and legal complicated cases are concerned - that Guidelines go beyond the meaning of the jurisprudence despite a good faith attempt to explain in it in simple terms. There will be situations where it is preferable to leave the parties and their advisers to consult the case law directly.
- **Enforcement:** the need for a clear set of rules at EU level is obvious given that the majority of the enforcement of the vertical rules tends to be carried out at national level. This pattern of enforcement has led to conflicting treatment of key commercial practices across the EU - often because national authorities and courts are guided by policy considerations beyond the remit of the competition rules. This consultation is therefore a crucial opportunity for the Commission to 'level' the playing field - to ensure that a company implementing a distribution system across the EU does not need to take specialist local advice in a particular country.

1.3 As a final general remark, we recommend that the Commission abstains from changing the language in one language version while leaving other language versions unchanged. This will give room for speculation in practice that the Commission intended to change the content of the respective provision as well. A good example is Article 4(b) fourth indent in the draft

VBE in which the Commission has changed the German wording but kept the English version unchanged.

2. NEW CONDITION: 30 PER CENT BUYER'S MARKET SHARE

- 2.1 By linking the availability of the safe harbour with a 30 per cent market share requirement for the supplier (with the narrow exception of "exclusive supply" obligations where the buyer's market share is relevant) the existing VBE achieves a pragmatic balance between economic and practical considerations.
- 2.2 The draft VBE proposes to add a general 30 per cent market share limit for the buyer on any relevant market affected.
- 2.3 In our view, there is no clear economics-based justification for this proposal. An obligation to consider the buyer's market share would also give rise to major practical issues for companies, reducing legal certainty.

Unnecessary from an economics perspective

- 2.4 In our view, the main concerns flowing from a market share of more than 30 per cent on the buyer's side are likely to be confined to single branding (i.e. exclusive purchasing) and exclusive supply obligations. However, we do not consider it necessary to amend the VBE in the manner proposed:, even in respect of these areas.
- 2.5 Exclusive purchasing: the buyer's market share is clearly relevant for assessing the likelihood of supplier foreclosure arising from an exclusive purchasing arrangement. However, the supplier would also need to wield market power in order for there to be foreclosure in these circumstances (as a major purchaser would only agree to buy exclusively from a supplier that was sufficiently large to meet its needs).
- 2.6 Accordingly, in situations where the buyer's market share is relevant, the size of the supplier will also be relevant - making an assessment of the buyer's position superfluous. Indeed, this explains why paragraphs 125 *et seq* of the Guidelines which deal with 'single branding' issues emphasise that the market position of the supplier is of "main importance" and do not mention the significance of the buyer's market share - except to indicate in paragraph 133 that a major buyer is unlikely to allow anticompetitive foreclosure because it would not easily allow itself to be cut off from competing suppliers.
- 2.7 Exclusive supply: it is conceivable that a major purchaser could foreclose rival purchasers by requiring a number of suppliers (each individually having a market share of less than 30 per cent but collectively representing a substantial share) to supply it exclusively in a given territory within the EU. This would not constitute "exclusive supply" within the meaning of the current VBE - meaning that the supplier's market share (and not that of the buyer) would be relevant for assessing the availability of the VBE.
- 2.8 Overall, however, we are not aware of any major cases where the application of the VBE (notwithstanding a high buyer market share) has led to potentially anti-competitive outcomes of the type indicated above (or indeed under any other theory of harm) - anywhere in the EU. If the Commission has identified such significant concerns so as to justify a shifting of the balance to be struck since the introduction of the current regime then it is incumbent on the Commission to identify those concerns / how they are addressed by the introduction of the 30% buyer share. We also note that the worked examples contained in the second part of the Guidelines have not changed materially despite the inclusion of the new buyer market share threshold. If the additional threshold is being included for sound economic reasons, these should be explained here.

2.9 In any event, the withdrawal mechanism in the current VBE provides a 'safety valve' for unforeseen anticompetitive outcomes, confirming that there is no pressing need to add a buyer's market share criterion to the VBE.

2.10 This is acknowledged by the Commission in paragraph 22 of the current Guidelines:

"The simplified approach of the Block Exemption Regulation, which only takes into account the market share of the supplier or the buyer (as the case may be) on the market between these two parties, is justified by the fact that below the threshold of 30 % the effects on downstream markets will in general be limited. In addition, only having to consider the market between supplier and buyer makes the application of the Block Exemption Regulation easier and enhances the level of legal certainty, while the instrument of withdrawal (see paragraphs 71 to 87) remains available to remedy possible problems on other related markets."

2.11 Whilst we agree that buyer power may give rise to concerns in particular circumstances, examples where buyer power may cause a competition problem are likely to involve complex factual scenarios which involve a mixture of concerns - e.g. network effects/ collective position of large purchasers at the downstream level etc. which are best addressed on a case by case basis as and when they arise.

Increasing complexity - decreasing legal certainty

2.12 From a practical perspective, the 30 per cent buyer market share condition is concerning. It will frequently be difficult for a supplier to calculate the downstream market shares of its customers (in multiple product/geographic markets which might be narrowly defined) and then to monitor market shares to verify that the protection of the VBE remains available. The difficulties will be even greater given that the analysis of the buyer's market position must be carried out in respect of all "markets affected by the agreement" (to use the wording of Article 3 of the draft VBE) and not just those markets on which the contract goods/services are bought/sold.

2.13 The practical difficulties will be compounded if a supplier must interrogate a competitor (at the downstream level) for sensitive market share information.

2.14 The requirement to assess a buyer's market share becomes even more challenging if the buyer is incorporating the input into another product. Note also that the Commission itself recognises, in paragraph 115 of the Guidelines, that competition may suffer more when distributors are foreclosed from particular brands than when buyers of *intermediate* products are prevented from buying competing products from certain sources of supply. With this in mind, the burden of calculating the buyer's market share is even more disproportionate.

2.15 Including a buyer's market share criterion is also likely to make it extremely difficult for a supplier to establish one distribution system that works across Europe (in the interests of pan-European markets). The current challenge (with a supplier market share that may vary country to country and with different interpretations across Member States) would be significantly increased as a result of the introduction of a buyer market share.

2.16 In summary, the buyer's market share requirement will undoubtedly add a layer of unnecessary complexity to the assessment that the supplier has to carry out. This will inevitably lead to greater legal uncertainty - particularly as enforcement tends to take place at a national level. Although the VBE is merely a block exemption - leaving businesses the freedom to self-assess - this is an unrealistic proposition. In reality, the unnecessary additional condition will significantly reduce legal certainty at significant expense as suppliers attempt to assess a 'moving target'.

3. AGENCY - A THIRD CATEGORY OF RISK

3.1 Paragraph 14 of the draft Guidelines indicates that, when distinguishing between genuine agency and relationships to which Article 81 would apply in full, it is necessary to consider a third type of risk (in addition to contract-specific risks and market-specific investments):

"risks related to other product markets, to the extent that the principal requires the agent to undertake such activities – but not as an agent on behalf of the principal - and these activities are indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal."

3.2 This "third risk" is referred to again in paragraph 15 and paragraph 16 (7th and 8th indent) and paragraph 17. However there are some variations. Whereas paragraphs 14, 15 and 17 each refer to risks which the principal requires the agent to take in other markets and which are indispensable for the agency activity, paragraph 16, 8th indent simply refers to operations on other product markets where they are indispensable for the agency activity.

3.3 There is a lack of clarity regarding the third category of risk. The position does not appear to be clarified by the EC Court cases cited in the draft Guidelines, as authority:

- paragraph 113 of Daimler Chrysler (mentioned in footnote 11 of the draft Guidelines) does not (contrary to that footnote) state that risks in other markets are relevant if those risks are indispensable to engage in the agency activity.
- in the (more recent) CEPSA cases the ECJ mentions only the two classic categories and not the third type of risk at all.

3.4 A review of the different language versions of the relevant paragraph indicates even more conflicting language (see attached).

3.5 It seems to us that the Guidelines simply intend to convey the reasoning of the CFI in Daimler Chrysler - i.e. the notion implicit in paragraph 113 that risks taken on by the agent in markets other than the market for the agency goods sometimes could be capable of affecting the relationship between the principal and the other party in the agency market.

3.6 In our view, the Guidelines should be limited to making that point. The test of indispensable restrictions etc is not set out in DaimlerChrysler. Accordingly, we do not believe that it is appropriate for the Guidelines to complicate this area with ambiguous concepts with no clear basis in the case law.

3.7 Finally, we note that paragraph 3.15 in the draft Guidelines indicates, correctly, that the assessment involves looking at whether the agent takes on "some or all" of the risks listed. However, it is also necessary to correct the wording in paragraph 17 which still refers to "one or more" of the risks (in order to determine whether an agency or a reseller relation exists).

4. CONCEPT OF AGREEMENT

4.1 The draft Guidelines clarify when a vertical agreement can arise despite there being no explicit agreement between the parties. According to the draft Guidelines, the required "concurrence of wills" can result from explicit acquiescence (e.g. where an agreement drawn up in advance provides for a party to adopt a specific unilateral policy which will be binding on the other party) or when there is tacit acquiescence - which may be deduced from the level of coercion exerted by a party to impose its unilateral policy.

4.2 However the Guidelines indicate in paragraph 25 that a system of monitoring and penalties set up to penalise non-compliance with a unilateral policy "points to tacit acquiescence with

the supplier's unilateral policy if this system allows the supplier to implement in practice its policy". In our view, this somewhat circular reasoning risks overstating the significance of a monitoring system. The key issue is whether it results in compliance. The ECJ in *Bayer*²¹ recognised that departing from the supplier's policy demonstrated a firm intention of wholesalers not to comply with the unilateral policy in question, casting further doubt on the existence of tacit acquiescence.

- 4.3 Nor are we aware of any EC case law supporting the notion that a quantitative approach - i.e. assessing how many dealers implement a policy - can distinguish between unilateral conduct and a concerted practice/agreement. The new wording in the draft Guidelines could mischaracterise unilateral recommended pricing as resale price maintenance simply because dealers have decided (unilaterally) that the recommendation is appropriate for their own business model and that resale price information is collected .
- 4.4 While business and advisers stand to benefit greatly from the Commission's Guidelines and Notices, there is a risk that an attempt to crystallise the meaning of complex case law results in guidance which is easily misinterpreted or even inconsistent with the case law. In our view, guidance should explain and not extrapolate from the case law. Where there is a risk of this - as is the case in relation to unilateral conduct - the Commission should allow companies and their advisers to rely on the case law directly.
- 4.5 In the context of the discussion of unilateral conduct it would be helpful if the Commission could also include additional wording on the relation between national and European law rules with a reference to Art. 3 (2) Reg. 1/2003. Some national competition authorities (e.g. Germany) have a tendency to be too quick to characterise certain conduct as unilateral in order to apply stricter national rules. In this context it would be helpful if the Commission could clarify that an obligation on the buyer agreed with the supplier in the context of a distribution or supply agreement, such as an exclusive purchasing obligation, cannot constitute unilateral conduct by the supplier.

5. LEGAL METHODOLOGY: HARDCORE RESTRICTIONS AND EXEMPTIONS

- 5.1 Paragraph 46 of the Commission's Guidelines on the application of Article 81(3) acknowledges that Art 81(3) does not exclude *a priori* any type of agreement from its scope. Paragraph 62 of the existing VBE Guidelines also reflects the caselaw, explaining that vertical agreements falling outside the VBE will not be presumed to be illegal.
- 5.2 However, the draft Guidelines depart from this position - stipulating (at paragraphs 47, 92 and 219) that the inclusion of a hardcore restriction will give rise to a presumption that Article 81(3) is inapplicable.
- 5.3 We make two points in connection with this:
 - (a) The draft Guidelines confuse 'hard-core' and 'object-based' restrictions. The Guidelines should be amended to reflect the fact that object-based restrictions - as opposed to all hardcore restrictions - give rise to the presumption of anticompetitive effect. For example, an active sales ban into a territory which has been exclusively allocated to two distributors but where passive sales are not restricted at all is unlikely to be treated as a restriction by object (see for example paragraph 23 of the Article 81(3) Notice).

¹ Joined cases C-2/01 P and C-3/01 P, *Bundesverband der Arzneimittel-Importeure eV and Commission of the European Communities v Bayer AG*, judgment of 6 January 2004

- (b) In any event, the Guidelines should be amended to reflect the fact that while the inclusion of a hardcore restriction precludes the application of the VBE there is no legal presumption operating against the parties that Article 81(3) will not be met. Of course, the parties bear the burden of proving that the cumulative conditions of Article 81(3) are met).

6. ONLINE SALES AND HARDCORE RESTRICTIONS

6.1 Suppliers clearly have legitimate interests in controlling the sale of their brands over the internet. Distributors that have invested in such brands will similarly have a legitimate interest in the control of those channels. While suppliers have certainly embraced the internet, it must be recognised that the internet brings new opportunities for counterfeiters/those that defraud customers and which can significantly damage a brand and consumers confidence etc.

6.2 It is critical that any intervention into a supplier's freedom to decide how to make use of the internet has a grounding in economics. There is a real risk that intervention which is not based on economics will distort the natural development of a dynamic market over the next ten years.

Proportion of sales test

6.3 Under the draft Guidelines, any requirement on a dealer to limit the proportion of overall sales made online will be viewed as hardcore. However, footnote 29 indicates that a requirement to sell a certain amount (in value or volume) of the products off-line is permitted. The acknowledgement of the legitimacy of such provisions is welcomed.

6.4 However where some dealers may make significant investments in the physical retail environment, in particular in the context of selective distribution, the Guidelines should go further and recognise that, in order to maintain the incentives for such investment, it is legitimate for a supplier to require the internet site to be an adjunct to the "bricks and mortar" store, and thus to set percentage limits on the amount of product that should be sold over the internet. This is necessary in order to prevent free-riding by an online seller that would otherwise attempt to 'game' the system by operating one store (so that it could be supplied and therefore take advantage of the significant investment of the more developed retail environment).

6.5 The Guidelines should also make it clear that this minimum offline sales requirement can be used in any distribution system - i.e. not just selective distribution.

Quality criteria

6.6 Footnote 29 also indicates that a supplier can ensure that the online activities of a distributor remain consistent with the supplier's distribution model - referring to the possibility of quality standards for the use of an internet site to resell goods. This idea - which we think should be reflected in the main body of the Guidelines, not just a footnote - is expanded upon in paragraph 57 where the Commission explains that the imposition of online sales criteria which are not "equivalent" to the criteria imposed for sales from brick and mortar shops will be a hardcore restriction. The draft Guidelines clarify that this does not mean that the same criteria must be imposed for online and offline sales. Rather, the criteria must "pursue the same objectives and achieve comparable results and the difference between the criteria must be justified by the different nature of the two distribution models".

6.7 The flexibility is welcome but there is a real risk that the reference to "equivalence" will result in protracted disputes and litigation. In our view, the Guidelines introduce a degree of interference which is inappropriate. It is sufficient that retailers have the ability to make

internet sales. It is inappropriate to interfere any further unless there is a clear object/effect of restricting the internet selling by putting in place unattainable criteria.

- 6.8 In any event, the Guidelines should go further by acknowledging that there are many other criteria that are commonly imposed in relation to internet selling and that should not fall within the scope of Article 81(1) such as: requiring a proven track record in not selling counterfeit products; provision of a very high standard of customer before and after sales services in order to inspire confidence in internet buying, ease of navigation (e.g. maximum clicks) etc.
- 6.9 The Guidelines should make it clear that quality standards can be used in any distribution system. Clearly, a supplier's concerns about quality standards are not confined to selective distribution systems. Suppliers using open systems will similarly be keen to ensure that minimum standards are met - when selling online or otherwise.
- 6.10 Finally, the guidance in footnotes 30 and 31 is also sufficiently important to be included in the main body of the Guidelines.

Dual pricing schemes

- 6.11 The draft Guidelines propose to treat dual pricing as a 'hardcore' restriction but recognise that a supplier may wish to offer a buyer a "fixed fee" to support its off-line sales efforts.
- 6.12 This is a potentially significant administrative burden which is inappropriate to impose on companies lacking market power.
- 6.13 Suppliers legitimately wish to encourage continued investment in the physical retail environment in the interests of consumers. If the most efficient way to allocate funds to ensure such investment is to introduce a price differential (which takes into account, for example, the average additional costs of a bricks and mortar sales environment and any additional costs to the supplier/ traditional retailer in dealing with customer complaints etc. when the product has been sold over the internet), then suppliers should be free to do so. Fixed fees may be of limited attraction and do not make commercial sense to drive the investment sought. If a supplier can not link the payment of the fee/ the reduction in the price to the actual sale then the supplier can not appropriately incentives and manage the return on the investment.

Active vs passive online sales

- 6.14 The Commission has not taken this opportunity to update the Guidelines in so far as it applies to online sales. In particular, the distinction between active and passive selling in the context of online selling is now outdated and effectively undermines many of the benefits that exclusive territorial allocation is intended to achieve in terms of incentivizing the exclusive distributor to invest in the brand and the retail network.
- 6.15 It can no longer be argued that the language used on a website plays no role. Distributors will not bear the expense of setting up a website in a language that is not spoken in their territory unless they are targeting customers from outside that territory. Similarly, to qualify targeted emails and other online sales promotions as active selling has been rendered redundant by the development of powerful search tools and other techniques.
- 6.16 At the very least, any steps that a dealer takes to proactively seek search engine listings (outside a search engines national site) should be considered active selling. Indeed, the use of the internet should be viewed as active selling *per se* given the pervasiveness of free of charge global search engines that operate regardless of national boundaries.

- 6.17 In fact, the draft Guidelines seems committed to raising the threshold for characterising online sales as 'active'. For example, paragraph 52 indicates that general advertising will be passive if it would be "attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' exclusive territories or customer groups". The precise meaning of this is unclear but it appears to validate any form of advertising which would be a commercially viable way of targeting customers in the distributor's home territory (even if a foreseeable and intended consequence could be that customers in other (exclusively allocated) territories are exposed too). Indeed, the outcome is that an intention to make active sales into a distributor's 'home' territory will always shield a distributor against allegations of active selling into other territories even if that was also the intention of the distributor. The Commission seems unreasonably to take the view that only techniques whose sole purpose is to target customers in another territory can be regarded as 'active'.

7. RESALE PRICE MAINTENANCE

- 7.1 It is a positive step that the Commission is moving away from its near total opposition to RPM - by acknowledging in paragraph 221 that RPM will sometimes generate Article 81(3) efficiencies and be in the interests of consumers.
- 7.2 However, different parts of the Guidelines now pull in opposite directions. While paragraph 47 indicates that RPM is a hardcore restriction giving rise to a presumption against the availability of an Article 81(3) exemption, paragraph 221 describes a number of pro-competitive effects flowing from RPM - including a relatively common situation where a supplier wishes to develop demand for a new product or address loss-leading.
- 7.3 In order to address this confusion, it is necessary for the VBE itself to recognise that RPM is sometimes permissible by including express derogations (e.g. for short promotional campaigns; addressing loss-leading etc).
- 7.4 There is also a need to clarify when RPM can be expected to lead to efficiencies. The circumstances sketched out in paragraph 220 above are of extremely limited guidance to companies and their advisers. It is critical that the Commission improves the Guidelines- e.g. by explaining when RPM for a price campaign may be justifiable because of the efficiencies generated - not just because it does not have an appreciable effect on competition.
- 7.5 Similarly, the Guidelines should define what is meant by "loss leading" and endeavour to map out precisely when a company could take steps to oppose this. The Commission has clearly come to the view that RPM can be advantageous for consumers. It is essential that these inevitably narrow circumstances are explained in the Guidelines so that consumers can enjoy those advantages.
- 7.6 The Guidelines could also usefully give further guidance on what is meant by developing new demand - for example explaining whether the launch of new models incorporating new technology would qualify for RPM.
- 7.7 At the very least the examples of 'acceptable' RPM should be expressed in the Guidelines to be presumptively outside Article 81(1). If restrictive, then an effects-based analysis would apply.

8. TERRITORIAL EXCLUSIVITY

- 8.1 Under the current VBE, it is only possible to restrict active sales when they are being made into territories/customer groups exclusively allocated to other distributors or reserved to the supplier.
- 8.2 The economic justification for this caveat is not clear. For example, there does not seem to be

an obvious reason for protecting sales into a territory allocated to one distributor as compared to two or three. Clearly, the free-riding concern is less clear-cut than in the situation where there is an exclusive distributor. However, that free-rider concern does not disappear: the incentives to invest of, say, two distributors in a territory will clearly be greater when they are protected from active sales by distributors in 26 more established EU countries.

- 8.3 The caveat is also very difficult to comply with in practice - as distribution systems are very often dynamic (i.e. subject to change) and can involve thousands of sales channels.
- 8.4 The Guidelines should reflect the guiding principle that an exclusive distributor can be expected to concentrate his efforts on developing sales in the territory exclusively allocated to him and not to "cherry pick" sales elsewhere -i.e. all active sales restrictions should be permitted without further caveats.
- 8.5 Previous Commission thinking indicated that the Commission was minded to delete the narrow exception for active sales bans. However, these draft Guidelines revert to the wording of the current VBE.
- 8.6 This would be a missed opportunity to eliminate caveats which introduce great complexity and a significant compliance burden. A total active sale ban outside allocated territory/group should therefore be permitted.

9. CATEGORY MANAGEMENT

- 9.1 The Commission's approach to category management in the Guidelines suggests a fundamental misunderstanding about the broad range of different ways in which category management operates and impacts competition:
- First, it is incorrect to state, in paragraph 205, that the distributor "entrusts" the supplier with the marketing of products. In reality, category management is generally an advisory merely a service supplied by one or perhaps multiple (competing) suppliers to a highly sophisticated retailer.
 - Secondly, the Guidelines approach category management with the same degree of 'suspicion' as RPM - setting out the multiple theories of harm before alluding briefly to possible efficiencies. A more appropriate way to approach this area - recognising the major benefits to retailers and consumers - would be set out the benefits and efficiencies before turning to the potential competition issues.
- 9.2 In any event, we query whether it is appropriate to include a section on category management (or listing fees) in the VBE Guidelines at all:
- First, there is no 'restriction' involved in category management which requires to be block exempted²
 - Secondly, the Commission has not consulted with industry on these developing issues. In our view, if the Commission thinks there is a significant issue to be addressed then it would be appropriate to consult fully with relevant businesses as to whether separate guidance etc. is necessary and then to deal with the matter from a position of fuller knowledge and understanding.

² Indeed, this explains why the draft Guidelines inadvertently suggest that the collusive (horizontal) effects described in paragraph 207 would be block exempted provided the market share thresholds are not exceeded.

10. ARTICLE 5 'GREY' CLAUSES

- 10.1 The review presents a good opportunity to discuss whether the list of clauses in Article 5 should be amended or even retained.

5 year limitation of non-competes

- 10.2 The VBE takes an inflexible approach to non-compete agreements. In particular, it is unhelpful to ignore the fact that an agreement, although longer than 5 years, may actually allow termination, by either party, at very short notice. In any event, it is unclear why a supplier without market power should be prevented from entering into longer term non-competes - i.e. under the 30 per cent market share threshold non-competes should be block-exempted regardless of duration.
- 10.3 The result of the current VBE is that agreements are typically entered into for fixed five years at a time, so that suppliers can have legal certainty that the non-competes are enforceable. If a party had an "evergreen" clause (allowing for renewal of the agreement on a rolling basis but with the ability of either party to terminate on relatively short notice) under the current VBE this would be a non-compete of indefinite duration and not exempted. Suppliers are unsurprisingly reluctant to step outside the exemption and risk the entire non-compete being held to be unenforceable (especially given the risks of different results in different Member States).
- 10.4 In our view, the VBE should be amended to allow non-competes for the duration of the agreement. At the very least, the Guidance should explain that an agreement, which may have up to a 5 year fixed duration but which then renews for limited periods and allows termination by either party at short notice will not generally give rise to foreclosure concerns,

Limitation on post-term non-competes

- 10.5 Post-term non-competes are only permitted for one year and only in relation to premises from where the dealer previously operated. Again, a supplier without market power should not be subjected to such onerous conditions. The idea that a clause would be enforceable against one outlet but may not be in respect of a neighbouring store calls into question the economic rationale for this clause.
- 10.6 Under the 30 per cent market share threshold, post term non-competes of no more than one year should be exempted in all circumstances because of the need to protect know-how – note the expanded definition of know-how in the definition section. Clearly, such restrictions are unlikely to result in foreclosure (and Article 81 is about restriction of competition not about "restraint of trade" / "unfairness" concepts).

11. MISSED OPPORTUNITIES

Requirement to incorporate rather than resell is a "hard core" customer restriction

- 11.1 There is currently a lack of clarity relating to incorporation obligations under the block exemption - i.e. where a supplier requires a distributor to use the product as an input as opposed to re-selling into another product. These appear to be regarded as 'hardcore' restrictions under the block exemption even though the economic basis for this is not explained.

- 11.2 In any event, Commission practice appears to permit incorporation obligations - see for instance the obligation to incorporate IBM technology into AllVoice speech recognition products in *IBM/AllVoice*⁵³.
- 11.3 In our view, the VBE should be amended to provide an express exception permitting incorporation requirements.
- 11.4 On a related point, we note that Article 4(b), fourth indent allows a supplier to restrict a buyer's ability to sell components supplied for the purposes of incorporation to competitors of the supplier.
- 11.5 The language of this caveat does not envisage the incorporation of services. In many cases, this might not be possible because the service at issue would have been consumed by the buyer. However, some services are clearly capable of 'incorporation' (e.g. infrastructure services supplied to a customer in order to enable that customer to market a type of telecoms product). As such, it is appropriate to amend the wording of this caveat so as to encompass the supply of services too.

Tiered distribution

- 11.6 Currently, any restriction on active or passive sales within a selective distribution system, at all levels of supply, is a "hardcore" restriction. However, it is not uncommon for a supplier to wish to appoint an exclusive wholesaler who is then entrusted with implementing a selective distribution system downstream (at the retail level). This can be an effective way for a supplier to reduce the costs involved in organising an efficient distribution network.
- 11.7 At the moment, it is not possible to prevent a wholesaler in another territory from making active or passive sales to retailers in such a selective distribution network. This is a problem as the supplier may require an exclusive wholesaler to make a significant investment to set up the selective distribution system at the retail level. In our view, it should be possible for wholesalers to be protected from active sales (made by wholesalers in other territories).

Turnover threshold for agreements between competitors

- 11.8 Article 2(4)(a) of the current VBE provides that the VBE may apply to agreements between competitors if the buyer's turnover is below Euro 100 million. However the Commission proposes to delete this, without explanation. In our view this should be reinstated as a small measure to assist small buyers.
- 11.9 Any concern that a monetary threshold is inappropriate (because turnover beneath Euro 100 million may still represent a significant market presence) is unfounded. The VBE is a pragmatic instrument. Provisions such as the Euro 100 million threshold have provided certainty without, to our knowledge, raising major competition concerns.

BAKER & MCKENZIE (HB/GM)

28 September

³ Case COMP/C-3/36.824.

COMPARISON OF WORDING RELATING TO THE "THIRD RISK" RE AGENCY

This table shows differences when compared with the English version.

	English	German	Spanish	Italian
Paragraph 14	Thirdly, there are the risks related to other activities, such as after sales or repair services or activities undertaken in other product markets, to the extent that the principal requires the agent to undertake such activities – but not as an agent on behalf of the principal - and these activities are indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal.	-	Thirdly, there are the risks related to other activities, such as after sales or repair services or activities undertaken in other product markets, to the extent that the principal requires the agent to undertake such activities – but not as an agent on behalf of the principal - and these activities are indispensable to engage in selling or purchasing <u>for the sale or the purchase of</u> the contract goods or services on behalf of the principal.	Thirdly, there are the risks related to other activities, such as after sales or repair services or activities undertaken in other product <u>for the product</u> markets, to the extent that the principal requires the agent to undertake such activities – but not as an agent on behalf of the principal - and these activities are indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal.
Paragraph 15	For the purposes of applying Article 81(1) the agreement will be qualified as an agency agreement if the agent does not bear any, or bears only insignificant, risks in relation to the contracts concluded and/or negotiated on behalf of the principal, in relation to market-specific investments for that field of	For the purposes of applying Article 81(1) the agreement will be qualified as an agency agreement if the agent does not bear any, or bears only insignificant, risks in relation to the contracts concluded and/or negotiated on behalf of the principal, in relation to market-specific investments for that field of	For the purposes of applying Article 81(1) the agreement will be qualified as an agency agreement if the agent does not bear any, or bears only insignificant, risks in relation to the contracts concluded and/or negotiated on behalf of the principal, in relation to market-specific investments for that field of	-

	English	German	Spanish	Italian
	activity, and in relation to other activities required by the principal to be undertaken and indispensable to act as an agent in relation to the contract goods and services.	activity, and in relation to other activities <u>that are considered necessary and indispensable by the principal in relation to the contract goods and services</u> required by the principal to be undertaken and indispensable to act as an agent in relation to the contract goods and services..	activity, and in relation to other activities required by the principal to be undertaken and indispensable to act as an agent <u>for which it has been designated as such by the principal</u> in relation to the contract goods and services.	
Paragraph 16 - 7th Indent	Does not create and/or operate an after-sales service, repair service or a warranty service required by the principal unless these services are fully reimbursed by the principal or unless these services are not indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal.	-	- does not create and/or operate an after-sales service, repair service or a warranty service required by the principal unless these services are fully reimbursed by the principal or unless these services are not indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal;	-
Paragraph 16 - 8th Indent	Does not operate in other (product) markets unless this is not indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal.	-	- does not operate in other (product) markets unless this is not indispensable <u>for the sale or the purchase of</u> to engage in selling or purchasing the contract goods or services on behalf of the principal.	- does not operate in other <u>markets (for the product)</u> unless this is not indispensable to engage in selling or purchasing the contract goods or services on behalf of the principal.