

**EVERSHEDS LLP:**

**RESPONSE TO THE EUROPEAN COMMISSION PROPOSAL FOR A REVISED BLOCK EXEMPTION AND GUIDELINES ON VERTICAL AGREEMENTS AND RESTRAINTS**

**SEPTEMBER 2009**

***Introduction***

1. Eversheds LLP welcomes the opportunity to comment on the Commission's proposal to revise the current regime for vertical agreements.
2. Eversheds LLP has extensive practical experience in advising clients implementing distribution strategies across a range of sectors in the EU. These comments reflect our experience in applying the current rules and are not confidential.
3. This response comments first on the proposed changes to the block exemption regulation ("VBER") and second on the proposed changes to the Guidelines.

***Comments on the Proposed VBER***

*Market Share Thresholds*

4. We have strong reservations about the proposed changes to the market share thresholds.
5. First, we are unconvinced as to the need for such a fundamental change. The recitals to the draft VBER merely refer to "further increase in large distributors' market power" without further justification or explanation about the competition risks that might justify the proposed change to the market share thresholds.
6. Second, we are concerned that the proposed change introduces unnecessary complexity for companies seeking to apply the VBER. The VBER is useful to business because companies can ascertain whether their agreements fall within its safe harbour comparatively easily and cheaply. In practice, the 30% market share threshold based on the supplier's market appears to have worked well because suppliers typically have the data to hand to determine their market share.
7. However, the revised thresholds based on the buyer's share would make it much more difficult for companies to determine whether the VBER would benefit their agreements. We see the following practical problems for companies and, in particular, suppliers:
  - inability confidently to assess market share of the contracting party. This will be particularly difficult for suppliers which appoint a large number of distributors in local markets in the EU of which they may

have no detailed knowledge and for which there may be no data available on market sizes or share;

- additional legal cost and burden of assessing and monitoring the market share not just of the supplier, but of tens or even hundreds of distributors in order to be certain that relevant distribution agreements benefit from the safe harbour;
  - increased risk that, over the life of the agreement, any particular distribution agreement might lose the benefit of the VBER as a result a change in the market share of a distributor. This would also add uncertainty and significant legal costs since the supplier would, at least in theory, then be obliged to conduct a self-assessment exercise in respect of each relevant agreement falling outside the VBER by virtue of the distributor's market share;
  - distortion of the choice of reseller since the legal uncertainty and burden referred to above may discourage suppliers from appointing the largest and most efficient distributors in a given territory if their shares may exceed 30%;
  - risk of competition problems stemming from the exchange and discussion of market share information and sales information required for purposes of both parties satisfying themselves that the market share test is met.
8. Our alternative proposal would be to retain the current market share threshold based only on the market share of the supplier (except in the case of exclusive supply) but to include in the Guidelines an expanded section which addresses the problems that would arise from agreements entered into with buyers with high market share. It may also be appropriate to identify the high market share of a buyer as a ground on which the benefit of the VBER might be withdrawn and this could usefully be included in Section IV of the Guidelines.

#### *Exclusive territory/customer allocation*

9. We are concerned that the proposed draft VBER carries over a problem from the current regulation which it would be desirable to correct. The first indent of Article 4(b) allows a supplier to restrict active sales by a buyer to an exclusive territory or exclusive customer group reserved to the supplier or allocated to another buyer. Whilst we understand that the hardcore restriction in Article 4(b) is aimed at preventing market partitioning and therefore that the carve-outs

from it are narrow, we consider that the first indent can cause the following unintended consequences because it is so narrowly drafted:

- A supplier wishing to appoint a distributor to a specific territory or customer group, without allowing that distributor actively to sell outside of that territory or customer group, may artificially reserve all other territories or customer groups to itself. Such a reservation would then prevent the supplier from appointing non-exclusive distributors who may be better placed to serve the territories or customer groups in question.
- A supplier may use exclusive distribution throughout the network, even in territories or for customer groups where they otherwise might appoint more than one distributor, in order to take advantage of the carve-out in the first indent, thereby resulting in a network that is more restrictive of intra-brand competition than it might otherwise be.

10. Our proposal is that the Commission consider amending this indent in the new VBER. Possible alternatives would include aligning this provision with the equivalent provision in either Regulation 772/2004/EC (the "Technology Transfer Block Exemption" or "TTBER") or the old Regulation 1983/83/EEC (the "Exclusive Distribution Block Exemption"), both of which allow a restriction on active sales outside of a distributor's allocated territory. These provisions are (essentially) as follows:

- The Technology Transfer Block Exemption (when applied to an agreement between parties who are not competing undertakings) does not prohibit the restriction of *active* sales except within a selective distribution network. Article 4(2)(b) of the TTBER prohibits only the restriction of the territory into which or the customer to whom the licensee may *passively* sell the contract products.
- The Exclusive Distribution Block Exemption under Article 2(2)(c) permitted a restriction on a distributor, outside of its exclusive territory, from seeking customers or establishing any branch or maintaining any distribution depot.

#### *Transitional Period*

11. We are concerned that no transitional period is included in the VBER.
12. Our alternative proposal would be to include a transitional period of either six months or a year to allow companies to conduct a thorough assessment of

market shares of relevant distributors (on the assumption that the market share test is retained as proposed) and to adapt their online selling practices.

### ***Proposed Changes to the Guidelines***

#### *Agency*

13. We are concerned that the draft guidance does not expand on the implications of case law since 1997 and in particular the *Daimler Chrysler* and *CEPSA* cases. As the *Daimler Chrysler* case illustrates, there is room for reasonably held but diametrically opposed views as to whether a particular agency arrangement is caught by Article 81(1). In that case, the Commission fined Daimler Chrysler €71 million but the fine was annulled because the Court took a different view on the allocation of risk between the parties.
14. In light of the uncertainty of the "risk based" test, our proposal would be for the Commission to include further guidance following *Daimler Chrysler* and also a statement in the Guidelines to the effect that they would not impose fines on companies that have set up an agency agreement on the basis of a reasonably held belief (supported by legal advice) that the agency falls outside Article 81(1), even if the Commission were subsequently to take a different view.
15. We are also concerned that the new paragraph 21 could be confusing insofar as it fails to make reference to the clarification subsequently set out in paragraph 49 in relation to principals setting the price for their agents.
16. Our proposal would be to add a footnote at paragraph 21 to refer to the clarification set out in paragraph 49.

#### *Online Sales*

17. We are concerned that the new language on online sales is overly prescriptive and takes no account of economic efficiencies. We consider this to be a retrograde step for an effects based system, especially in such a dynamic area. It would be unfortunate if an overly prescriptive approach chilled innovation or denied suppliers the opportunity to opt for the most efficient distribution route, particularly where market shares may indicate the lack of any real market power.
18. We are also concerned that the examples included in paragraphs 52-54 raise more questions than they answer. For example, footnote 30 reasonably suggests that a supplier may offer the buyer a fixed fee to support its off-line or online sales efforts. But why must the support be a fixed fee? Would it be permissible to pay a fixed amount per unit sold off-line? Should the fee reflect or be commensurate with specific investments by the buyer? Is there an upper limit to the amount that might be paid?

19. Our alternative proposal would be to expand the detail on the examples and make it clear that this is a non-exhaustive list of how companies might comply with the basic principles.

#### *Non-Compete*

20. We are concerned that the post term non-compete as currently permitted in Article 5 of the VBER and described in paragraph 64 of the Guidelines is too narrowly drawn to be of any practical use. Our experience is that the requirement that the non-compete be limited to the premises from which the reseller operated is too limited. In practice, companies almost never include a clause drafted in this way as it is commercially useless to protect know-how as the reseller could open up in the vicinity the next day.
21. Our proposal would be to expand the permitted geographic scope of the post term non-compete in Article 5 or, alternatively, to expand the guidance to make clear that a post term non-compete could be compatible with Article 81 in circumstances where it was limited to a reasonable area around the former premises in which the buyer operated, as necessary to protect know-how. The precise ambit of the area will vary from case to case depending on the business in question, but it might be a town, a region or even a country.

#### *Franchising*

22. We are concerned that the analysis of franchising carries over a confusion from the current Guidelines. Paragraph 185 of the Guidance reads: "Franchise agreements usually contain a combination of different vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof." .
23. This implication of this sentence seems to be that many franchise agreements might fall outside the VBER because they combine selective and exclusive distribution (see paragraph 58). In practice this is not the case because the majority of franchise agreements that we encounter should not be regarded as selective distribution systems since the franchisor does not select franchisees on the basis of "specified criteria". Accordingly most franchise agreements do not meet the definition of selective distribution in the VBER.
24. Our proposal would be to delete the reference to selective distribution in the quoted extract of paragraph 185 to remove this confusion and/or to clarify that where franchise agreements do not meet the definition of a selective distribution system, exclusive territories would be permitted.

### *Resale Price Maintenance*

25. We welcome the additional comments in relation to resale price maintenance which reflect the reality that efficiencies can flow from resale price maintenance. Our concern is that the guidance is too limited and that in practice few companies will feel sufficiently confident to rely on an efficiencies defence.
26. Our proposal would be to include a statement to the effect that resale price maintenance may also be justified in circumstances other than those listed in paragraph 221. In relation to loss leading, it would be helpful if the Commission were able to give a higher level of comfort to brand owners with small shares which find their brands damaged by loss leading of powerful retailers even where it does not result in delisting.