

JOINT WORKING PARTY OF THE BARS AND LAW SOCIETIES OF THE  
UNITED KINGDOM ON COMPETITION LAW (JWP)

COMMENTS ON THE COMMISSION PROPOSAL FOR A  
REVISED BLOCK EXEMPTION AND GUIDELINES ON  
VERTICAL AGREEMENTS AND RESTRAINTS

28 SEPTEMBER 2009

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1. The Joint Working Party (“JWP”<sup>1</sup>) welcomes the Commission’s consultation and suggestions for reform of the current block exemption.
  2. The JWP’s remit is to consider draft competition legislation from the perspective of UK practitioners. The JWP does not seek to advance views based on any particular policy perspective (of which there are of course many in relation to the treatment of vertical restraints<sup>2</sup>).
  3. Moreover, the Commission itself is constrained as to how it may block exempt vertical restraints and as to the guidance it may give by the case law of the European Court of Justice.
  4. Therefore, there ought to be little need or scope for any radical departure from the current regime under Regulation 2790/99.
  5. This response follows the order of the draft revised block exemption, together with the JWP’s principal comments on the draft revised guidance.
  6. For the avoidance of doubt, the JWP does not comment on the wording of the current regime, but this should not be taken as an endorsement or otherwise of

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<sup>1</sup> The members of the Joint Working Party of the Bars and Law Societies of the United Kingdom on Competition Law comprises barristers, advocates and solicitors from all three UK jurisdictions; the membership includes both those in private practice and in-house. Its secretary is Louise Speke of the Law Society, 113 Chancery Lane, London WC2A 1PL (telephone: 020 7242 1222).

<sup>2</sup> Thus until May 2004 all vertical restraints, save for minimum resale price maintenance (“RPM”), were lawful under UK law, as a consequence of a policy choice by the UK government in the late 1990s. More recently, the decision of the US Supreme Court in *Leegin Creative Leather Products* 127 S Ct 2705 (2007) reflects a vigorous debate about the extent to which economic theory justifies regulation of vertical restraints.

the legislation or guidance. It reflects a decision by the JWP to limit itself in this paper to commenting on proposed changes to the current regime.

7. As a general point, it is to be regretted that the Commission has not issued an explanatory memorandum to explain why changes are proposed to the current block exemption. The explanation given in Press Release IP/09/1197 is very limited.
8. The Press Release states that:

*Two major developments have marked the ten-year period following the entry into force of the current rules: a further increase in large distributors' market power and sales on the Internet.*

*To take account of these developments, the Commission proposes that for a vertical agreement to benefit from the block exemption, not only the supplier's market share (as is currently the case) but also the buyer's market share should not exceed 30%.*

*Regarding on-line sales, on the one hand there is a need to protect consumers' possibilities to purchase to their advantage across borders, which is greatly facilitated by the Internet. On the other hand, certain sales restrictions that aim at limiting or preventing distributors from taking unfair advantage of marketing and brand promotion undertaken by others (i.e. free riding) may enable consumers to benefit from better services. The Commission's suggested approach therefore refines, in the on-line context, the distinction, between sales made as a result of active marketing and sales made as a result of the consumer taking the initiative (i.e. between active and passive sales), and explains how the revised Regulation would deal with conditions imposed in relation to internet sales, such as a requirement imposed by a supplier that the distributor should have a "brick and mortar" shop before engaging in online sales.*

9. On the basis of these brief explanations the draft regulation proposes changes to the market share threshold in Article 3; and changes in relation to on-line sales which are set out in the draft guidance.

**(i) Proposed changes to the regulation**

*Market share threshold (or “safe harbour”)*

10. The Commission proposes a major change to the market share threshold.
11. Recital 8 of the current block exemption provides that *“in the case of vertical agreements containing exclusive supply obligations, it is the market share of the buyer which is relevant in determining the overall effects of such vertical agreements on the market”*.
12. The Commission proposes to omit recital 8 and the definition of *“exclusive supply obligation”* currently in Article 1(c). The Commission proposes to replace Articles 3(1) and 3(2) of the current regulation with the following market share threshold requirement:

*“The exemption provided for in Article 2 shall apply on condition that the market share held by each of the undertakings party to the agreement does not exceed 30% on any of the relevant markets affected by the agreement.”*
13. There is no recital explaining this requirement or the change from the current market share threshold. Draft recitals 8 and 9 are simply assertions, as is the reference in the Press Release to *“further increase in large distributors’ market power”*. Nor is there any explanation in the draft revised guidance, only an assertion that it is a safe harbour at §23 without any acknowledgement that the harbour is smaller than previously the case. Contrast the current recital 8 which succinctly sums up the risk of foreclosure reasoning behind the current Articles 3(1) and 3(2).
14. In the absence of any explanation for this change, the JWP is not in a position to offer any analysis of the Commission’s reasoning.
15. The JWP considers that it is incumbent on the Commission to provide an adequate explanation for this change. In particular, the Commission ought to be able to explain the operation of the current block exemption in practice and what evidence of shortcomings with the current provision has prompted the Commission to propose this change.

16. Article 3 as currently drafted is generally considered to be workable in practice and in the absence of good reason for departing from the current Article 3, it might be thought that there is no good reason for so doing.
17. As a matter of law, the new Regulation might be open to challenge under Article 253 EC for lack of such reasons. Reasons are particularly important where the Commission is proposing to narrow down the scope of a current exemption and thereby inevitably removing exemption from currently block exempt agreements (thus as a matter of English law rendering such agreements potentially void and unenforceable in accordance with the English Court of Appeal's ruling in *Passmore v Morland* [1999] 3 All ER 1005).
18. From the JWP's perspective of UK practice, there does not appear to be any good case yet made out for changing the current market share thresholds.
19. In addition the JWP considers that there are important practical objections to the proposed change.
20. First, the change would add greater uncertainty to the application of the proposed block exemption than is currently the case because suppliers would have to satisfy themselves not only as to their own but as to their buyer's market share (and *vice versa*). This may not be a simple matter where the parties do not operate in the same geographic areas. This uncertainty may discourage use of such agreements and hence impede intra-EU trade. And even where the parties operate in the same geographic market, significant difficulties may still arise in assessing market share where the buyer is operating in a number of narrowly defined local markets such that the effort and expense of calculating local market shares would be disproportionate.
21. Second, this would discourage suppliers from making use of the most successful distributors with market shares arguably above the 30% threshold to penetrate new markets in areas not currently served by such suppliers. This would be a perverse impediment to expansion by suppliers and thus to intra-EU trade.
22. Third, it would require suppliers and distributors to carry out almost constant surveillance of markets to monitor compliance with the 30% threshold. A

potentially undesirable element of this would be that it would promote the flow of market information between suppliers and distributors, leading to potential concerns about ‘hub and spoke’ exchanges of information of the type which caused the UK’s Competition Commission concern in the UK *Groceries Market* report (30<sup>th</sup> April 2008, see Appendix 8, §30 “*Given the level of interaction among suppliers, and the large amount of information that is passed between retailers and suppliers, an opportunity for harm exists*”) and which are currently under extensive investigation by the UK’s Office of Fair Trading in its on-going Article 81 investigation into the Grocery Retail Sector (Case CE/8905-08).

23. Further, the draft regulation contains no transitional provisions to deal with agreements within the current Article 3 safe harbour but pitched out on to the stormy seas of Article 81(3) EC by the introduction of the new and more limited Article 3 safe harbour on 1<sup>st</sup> June 2010 (Article 10). That is clearly contrary to the principle of legal certainty and transitional provisions will be required to safeguard parties to existing agreements if this change is made.
24. Indeed, there is no recognition of the possibility that large numbers of agreements that benefit from the current block exemption could cease to do so as a consequence of the proposed market share changes; and, so far as the JWP is aware, the Commission does not have any evidence about the scale of this possible effect on existing agreements. The JWP would have expected the Commission to have sought such evidence in order to determine not only the need for transitional measures, but also to assess the case for change itself.
25. The JWP’s view is that in the absence of any convincing explanation for it the Commission should seriously consider not making the proposed change; and that instead the Commission should consider retaining the current market share thresholds in the new regulation, perhaps extending the current block exemption for a period (as has been done with other block exemptions on previous occasions) in order to enable a full and proper (i.e. evidence based) consultation to be carried out.

*Other comments on the draft regulation*

26. The Commission proposes to omit the current exemption provided under Article 2(4) for non-reciprocal vertical agreements between competitors where the buyer has a total annual turnover of not more than €100m. This is a matter which can safely be left to the Notice on Agreements of Minor Importance.

**(ii) Proposed changes to the guidance***Online sales*

27. The Commission has flagged up the issue of online sales.
28. There is no reference in the draft regulation to online sales. The draft regulation retains the well-established distinction between active and passive sales in Article 4.
29. The proposed change is dealt with in the draft revised guidance at §§51-54.
30. In summary, the Commission gives guidance by way of examples where restrictions on internet sales will normally be deemed to be "hardcore" infringements. These include requiring a distributor to block or re-route customers from outside of the distributor's territory, requiring a distributor to reject transactions made on credit cards registered at an address outside of the distributor's territory, requiring a distributor to limit the number of sales made via the internet, and charging a higher price to distributors for goods that are intended to be sold online. However, this does not prevent a supplier offering its distributor a fixed fee to support its off-line trading (footnote 30). The JWP understands that it is not uncommon for suppliers to offer resellers a range of additional discounts depending upon the degree of support provided. It is not clear to the JWP that it is appropriate to limit provision of such support for off-line trading by way of fixed fees, as proposed.
31. A supplier may still require a retailer to operate a "bricks and mortar" shop but must not apply different conditions to online sales and sales from "bricks and mortar" stores. This does not mean that the criteria must be identical, but rather they must pursue the same objectives and any differences must be justified by the different nature of the distribution methods. For example, delivery may be required to be instantaneous for a "bricks and mortar" store,

however an identical requirement clearly cannot be placed on online sales. A supplier may, however, require delivery to be made within a specified and practicable time frame.

32. The JWP welcomes the fact that the Commission has given this guidance. The JWP would encourage the Commission to give more examples of what the Commission considers is permissible, while being conscious that the pace of technological change may in practice outstrip the Commission's ability to anticipate and give guidance on all practices.

*RPM*

33. The draft revised guidance continues to refer to RPM as a hardcore restriction but set out limited circumstances in which RPM may have pro-competitive effects (see §§219-225).
34. While it is understood why the Commission seeks to proceed here with caution, the JWP would encourage the Commission to be less restrictive as to the examples of efficiencies given. RPM is a practice which the JWP would expect to be less of a concern from a single market perspective than are territorial restrictions. In particular, it is difficult to see why parties would take the risk of agreeing RPM in reliance on Article 81(3) EC in the absence of specific 'confirmation' in the draft revised guidance
35. The Commission refers to examples of RPM when introducing a new brand or entering a new market, in order to organise and maintain a short term (2 to 6 week) low price campaign in a franchise type system, and to avoid large retailers using a particular brand as a loss leader.
36. As to the second of these examples, the JWP suggests that the Commission should not limit this to franchise type systems as it may be of broader relevance, for example in short term retail promotions.
37. As to the third example, the JWP does not understand why use of a branded good as a loss leader might be thought, of itself, to have any effect on competition. Indeed, the UK's Office of Fair Trading in relation to the equivalent provisions of UK law has described loss leading as normally constituting a legitimate commercial tactic (see §4.12, first indent, of the

OFT's consultation draft guidance *Assessment of Conduct*, OFT 414a, April 2004 – no final guidance has been published).

38. Finally, the JWP suggests that the Commission should make it clear in §223 that imposing maximum resale prices should not prevent application of the block exemption, so as to reflect the current state of the case law on this topic.

*Other additions*

39. The JWP notes that the Commission has added new sections relevant to mass retailing: 'category management' (agreements where the distributor entrusts the supplier with the marketing of a category of products – see §§205-209) and 'upfront access payments' (fixed fees paid by suppliers to distributors for access to their distribution network – see §§199-204). The JWP has no specific comments to make on these new sections but assumes that the Commission is satisfied that it has sufficient practical experience of such arrangements to be confident about the approach it is proposing to adopt and that such an approach is appropriate Community-wide.

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