

REVIEW OF THE COMPETITION RULES APPLICABLE TO VERTICAL AGREEMENTS: RESPONSE TO CONSULTATION

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1. INTRODUCTION

1.1. LAWIN welcomes the opportunity to respond to the review of the competition rules applicable to vertical agreements initiated by the Commission and to submit our ideas and suggestions in relation to the Draft Commission Regulation on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (hereinafter “**draft VBER**”) and Draft Commission Notice - Guidelines on Vertical Restraints (hereinafter “**Guidelines**”).

2. BUYERS WITH ABOVE 30% MARKET SHARE. ARTICLE 3 OF THE DRAFT VBER

- 2.1. Automatic exclusion of the application of the draft VBER to agreements by buyers having above 30% market share in the relevant market adds a further burden on the companies. Even though the market share of the buyers may be relevant on some specific occasions, the exclusion of the safe harbour for all agreements, where the buyer has above 30% market share, is not proportionate. While it is already difficult for companies to assess their own market share, it is even more cumbersome to assess the market share of a business partner. Therefore, this change in the draft VBER principles adds a significant burden on companies in the assessment of the competition law compliance of their agreements. Since there are numerous vertical restraints where high market share of the buyer does not have a negative influence on the competition, it is not appropriate to create a general rule of non-application of VBER to all vertical agreements with buyers having above 30% market share.
- 2.2. Furthermore, it should be noted that the exclusion of the safe harbour for all agreements, where the buyer has above 30% market share, would be particularly cumbersome for buyers from small economies. Due to the limited demand in small economies, markets in small economies can only accommodate a small number of market players who would be able to achieve minimal efficient scale for their operations. Therefore, markets in small economies tend to be more concentrated than in large economies and hence. In the context of distribution sector, small economies can host only a limited number of motivated distributors in some markets to cover the costs and yet allow earning some reasonable profit. Hence, from the perspective of the distributors in small economies, the full exclusion of the safe harbour where the distributor’s market share exceeds 30% may have detrimental effects; and consequently, if no distributor will be able to operate efficiently, consumers in small economies would be worse off.
- 2.3. The market share of the both parties might be relevant either in case of exclusive supply obligation or in situation where vertical restraint might have an effect of preventing entry into the market. The latter concerns the situation where the buyer operates the distribution channel. In such case the effect of non-compete or outlet exclusivity arrangements might depend on the market shares of both parties.
- 2.4. Consequently, instead of an outright exclusion of VBER application to above 30% buyer agreements, the VBER could include a list of types of vertical restraints when buyer’s market share is relevant for the exclusion of application of VBER. This should be a closed, not an open ended list and could include non-compete, exclusive supply and upfront access payments, but should not include exclusive distribution.

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3. SELECTIVE DISTRIBUTION NETWORK. ARTICLE 4(B) OF THE DRAFT VBER

- 3.1. Article 4(b)iii of the draft VBER sets out that the restriction of sales by the members of a selective distribution system to unauthorised distributors in markets where such a system is operated is not a hard-core restriction. We would like to comment on the part of the sentence - “in the markets where such a system is operated”. From the practical point it might be difficult for the seller to control into which market the products are sold. Besides, if the supplier operating selective distribution system or the members of the system would start investigating where the goods will be delivered too zealously, it might raise the suspicion of obstruction of parallel trading. Therefore following wording of Article 4(b)iii is more appropriate: *The restriction of sales by the members of a selective distribution system to unauthorised distributors.*

4. NON-COMPETE OBLIGATION. ARTICLE 5(B) OF THE DRAFT VBER

- 4.1. Article 5(b)ii limits post-termination non-compete undertaking to the premises and land which the buyer operated. From the practical point of view it means that the buyer may escape this non-compete undertaking by e.g. moving its business to another side of the street. It would be advisable to extend the applicability of the non-compete provision to the whole market where the buyer was active, i.e. on the terms similar to those applicable to ancillary restraints imposed in the context of concentration.
- 4.2. It is well established practice that non-competition is allowed for the entire contract period of franchise agreements. In order to increase legal certainty with respect to this it would be advisable to transform this into legislation and supplement Article 5(a) with such a further exception.

5. ACTIVE/PASSIVE SALES THROUGH INTERNET

- 5.1. Guidelines are not clear enough in relation to the use of Internet as sales channel. Internet sales are more developed in the Baltic countries than in Europe on average. Arising from this, there is a need on the market for the possibility to limit Internet sales in such markets and in relation to such goods, where large investments are needed for the operation of brick and mortar shops, but large revenues are accrued by the Internet sellers who free-ride on the investments of the shops.
- 5.2. Paragraph 52 of the Guidelines notes that the language options used on the website or in communication normally do not render sales to be qualified as “active” sales. While this may be true in case of using English (and French, German, other large languages), it would not be appropriate to apply the same rule in relation to the use of languages of small countries. Use of the languages of small countries on the website and in communication should be considered as active sales, as this cannot be considered as a reasonable way to reach the customers of a small country in foreign countries. The following could serve as an example. If an Estonian distributor would have its website in Latvian and Lithuanian, then in reality the website in Latvian and Lithuanian languages would not be a reasonable way to reach Estonian customers since only very few people in Estonia speak Latvian or Lithuanian.
- 5.3. The insertion of general information about the company (contact details, location, etc.) in foreign languages could still be considered as form of passive sales, however listing of promotional information in foreign language search engines should be treated as active sales.

6. TWO-YEAR RESTRICTION ON PASSIVE SALES

- 6.1. Paragraph 56 of the Guidelines sets out an important principle, according to which restrictions on passive sales fall outside Article 81(1) during first 2 years, if the distributor has made substantial

investments to start up and/or developing into new market. This is a rather bold and significant principle, which is welcomed by the businesses. It could be argued that this rule should qualify as Article 81(3) exception and should be included in the Block Exemption Regulation itself. This would increase legal certainty.

7. GENUINE AGENCY. PARAGRAPH 17 OF THE GUIDELINES

- 7.1. According to paragraph 17 of the Guidelines, the fact that the agent incurs one risk or cost, will preclude the agency from being regarded as genuine agency. In practice, there are cases where an agent may bear some minor costs, e.g. warehousing costs on account of his commission. If such costs are insignificant and the agent does not bear other risks and does not get the title to the goods, it would not be appropriate and proportional to subject to Article 81 agreements where only one risk or cost is incurred by the agent.
- 7.2. Further, it must be noted that while paragraph 17 of the Guidelines uses the term “one or more”, paragraph 21 of the Guidelines refers to “some or all” when referring to the number of risks that need to be incurred by the agent to trigger the application of Article 81. This inconsistency complicates the interpretation of the agency agreements from Article 81 perspective.
- 7.3. Arising from the above, we suggest replacing “one or more” with “some or all” in paragraph 17 of the Guidelines. Thus, the second sentence of paragraph 17 of the Guidelines could read as follows (amended part is underlined):

However, where the agent incurs some or all of the above risks or costs, the agreement between agent and principal will not be qualified as an agency agreement.

- 7.4. In addition to the above proposal, we would suggest to consider a possibility to provide in the Guidelines a more thorough explanation of the “insignificant risk” concept. In particular, whether the significance of the risk should be assessed by evaluating the amount of expenses or potential liabilities as such, or should the amount of such expenses or risk be assessed in comparison to the value of e.g. entire business of an agent or the value of the particular contract.

8. BUYER POWER

- 8.1. Buyer power has been analysed in paragraph 112 of the Guidelines. It is not clear what the possible applications of this paragraph are. The analysis relates to dominant position issues and the relevance of this for analysis of vertical restraints is not clear. Further explanation of the relevance of this analysis would be most helpful.

9. RPM ALLOWED IN RELATION TO “LOSS-LEADER”

- 9.1. Paragraph 221 of the Guidelines explains that RPM can be allowed for a limited term in case of use of “loss-leader” products by large retail chains. This development is very much welcomed by the businesses.
- 9.2. Furthermore paragraph 221 of the Guidelines states that fixed resale prices may be necessary to organize a coordinated short term low price campaign in a franchise system or similar distribution system. It is stated that such price campaigns attained by fixing resale prices may not have any appreciable negative effects on competition if such are of short duration (2 to 6 weeks in most cases). This express approval that fixing resale prices during short term price campaigns should be viewed in principle as permissible is a welcome addition to the Guidelines. It would also be helpful to indicate the applicable time frame of exemption in more detail, for example, 2-6 weeks during a period of 6 consecutive months.

10. CONCLUSION

10.1. LAWIN offices in Baltic countries thank the Commission for taking these comments and suggestions into consideration. If any further explanations of the above comments are required, we would be happy to answer them. If there are any queries, please kindly address all correspondence initially to Elo Tamm at the address of Lepik & Luhaäär LAWIN.

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