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I. INTRODUCTION

The new verticals block exemption Regulation[2] and Guidelines came into force on June 1, 2010. Agreements which as of May 31, 2010 satisfied the exemption criteria of Regulation 2790/99 will continue to be exempt for another year, but any new agreements will need to comply with the new Regulation in order to benefit from the automatic exemption. The aim of this article is to look at the practical implications of the new regime for businesses.

The Commission's decision to renew the block exemption Regulation and Guidelines for vertical agreements has been widely welcomed. A clear analytical framework that provides guidance on the Commission's approach to vertical agreements is particularly important in the post-notification era where businesses need to assess by themselves the compatibility of their agreements with competition rules. The regime is also important for national competition authorities and national courts, by providing them with a common framework that contributes to a European wide level playing field.

Although it had been widely accepted that the previous regime has worked well in practice, the Commission, understandably, wanted to take the opportunity of the need to renew the block exemption Regulation and Guidelines to reflect its experience and introduce a number of changes that take account of market developments over recent years. The key changes, some of which were hotly debated during the consultation period, relate to the calculation of the relevant market share threshold, which now applies to both the supplier's and the buyer's market shares, additional guidance regarding online sales restrictions, and additional guidance on the efficiency defense under Article 101(3) which continues the theme of the Commission moving to a more economic, effects-based approach.

Some of these changes seem to have resulted in a stricter approach to vertical agreements whereas others would appear to indicate a relaxation of the rules. It is too early to tell whether on balance the new regime will be more or less strict than the previous one, as much will depend on how the framework is used in practice by businesses and their advisers and how competition authorities, in particular at the national level, apply the new rules.

Guidance from the Commission that even the most hardcore restriction is capable of exemption under Article 101(3) is encouraging, but it will depend on businesses' appetite for risk (and the reaction of regulators) whether much use will be made of this approach in practice. The inversion of the burden of proof remains a high hurdle in a system where companies have to

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[2] Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the TFEU to categories of vertical agreements and concerted practices.

engage in self-assessment and have to face competition authorities and national courts where they still have to bear the heavier burden of rebutting a presumption that the agreement does not fulfill the conditions of Article 101(3).

II. NEW MARKET SHARE THRESHOLD

The previous verticals block exemption Regulation was the first to introduce a market share threshold to cap the benefit of a block exemption. This allowed a more effects-based approach to be adopted and introduced a new type of block exemption that moved away from the "straight jacket" effect of the old style regulations with their long lists of white, grey, and blacklisted clauses. A safe harbor of a 30 percent market share was introduced, creating the presumption that an agreement below this threshold benefits from the block exemption provided the other conditions are also met, on the basis that there is no market power. Above the 30 percent market share there is no presumption of illegality but companies lose the automatic benefit of the block exemption and need to make their own assessment of the validity of their agreement.

Under the previous regime, the 30 percent market share threshold generally only applied to the supplier (except in the case of exclusive supply, where the market share of only the buyer was relevant).

In order to reflect the increase in recent years of the number of large retailers with market power, the new block exemption Regulation, while maintaining the 30 percent market share threshold, provides that this 30 percent market share threshold must be applied to both the supplier and the buyer (individually, not cumulatively). According to the Commission, where a buyer with an important market position enters into supply agreements with a number of smaller suppliers, it can not be assumed that any vertical restrictions in the agreement will not harm competition.

In response to the many concerns expressed during the consultation period that assessing the buyer's market share on the downstream market would be too burdensome, in particular in cases where there are many local markets, the Commission agreed to change the relevant market for the buyer to the market on which it purchases the goods or services. Indeed, Article 3 of the new Regulation now provides that for the purpose of the 30 percent market share threshold the relevant market for the supplier is that on which it sells the contract goods or services and the relevant market for the buyer is that on which it purchases the goods or services.

Despite these changes, the introduction of the dual market share threshold is likely to have the greatest impact on the availability of the Regulation and many agreements that were previously covered by the block exemption will no longer be able to rely on its safe harbor. There are always inherent uncertainties in calculating relevant market shares, particularly in cases where there are no established precedents on which to rely. These difficulties are likely to be exacerbated following the introduction of the second market share threshold.

There are also concerns that this amendment will make it much harder for an EU-wide supplier to operate a uniform distribution system throughout the EU, as most EU-wide arrangements will fall outside the new Regulation somewhere in the EU, mainly because of the buyer's market share, which could exceed the relevant threshold in individual markets. Suppliers may therefore be forced to operate under a different regime for those countries where the buyer's share exceeds 30 percent, even if this is the case simply because there are no other suitable distributors for a particular territory.

Finally, companies should be alert to the fact that the block exemption will only apply as long as the market share threshold continues to be met. Given the fact that market shares can change over the years, careful monitoring will be necessary to ensure that the relevant threshold is not exceeded. This will be particularly true in situations where the original market share of either the supplier or buyer is close to the 30 percent threshold. Although the Regulation specifies some limited situations where a temporary increase in the market share above the relevant threshold will not remove the benefit of the block exemption, it is nevertheless important to ensure careful monitoring.

The new market share threshold is undoubtedly the change that will have the most immediate impact on the verticals regime, and it is this change that prompted the Commission to introduce a one-year transitional period in the final version of the Regulation. Companies will need to make sure that they carry out a careful assessment of their agreements which were previously exempt in order to identify whether any changes are required to ensure that they continue to benefit from the new block exemption or, alternatively, can be justified under Article 101(3).

III. GUIDANCE ON ONLINE SALES RESTRICTIONS

When the 1999 regime was adopted online sales were, by today's standards, fairly limited. In contrast, the adoption of the new Regulation and Guidelines has taken place against a backdrop of ever-increasing online sales in the EU. This development is reflected in the new Guidelines which contain much more detailed guidance on when restrictions on online sales will be permitted within the scope of the block exemption.

The Commission's stated aim in respect of online sales restrictions was to strike a balance between, on the one hand, ensuring that consumers throughout the EU can enjoy the benefits of the internet (including access from everywhere) while, at the same time, allowing suppliers to choose a distribution format that best suits their business and individual needs and requirements. The Commission accepts that this area was the most difficult part of the review and a difficult balance to strike.

Some businesses, in particular brand owners, have argued that the balance has been unfairly tilted in favor of online sales, a criticism that is understandable given the starting point in the new Guidelines that, in principle, every distributor must be allowed to use the internet to sell its goods or services. Therefore, in principle, an outright ban on internet sales is impermissible under the block exemption and very unlikely to be justified under Article 101(3). The same applies to other restrictions falling short of a ban that would discourage the use of the internet by distributors in practice, for example dual pricing whereby higher prices are charged for goods intended to be resold on-line.

But there are also a number of important exceptions to this principle:

- A supplier can impose an outright ban on online sales where this is objectively necessary e.g. where this is necessary to align on a public ban on selling dangerous substances to certain customers for reasons of safety or health.
- A supplier can require "quality standards" for the use of a website to resell his goods, just as a supplier may require quality standards for a shop or for advertising or promotion in general. The new Guidelines do not provide comprehensive guidance as to exactly what is meant by "quality standards," but they do make it clear that a supplier can, for

example, require that customers not visit the distributor's website through a site carrying the name or logo of a third party platform.

- A supplier can require its distributors to have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system, at least where the characteristics of the product require it.

To the extent that online sales practices amount to active sales, a supplier can restrict an exclusive distributor from engaging in such online sales into the territory allocated to another exclusive distributor or reserved to the supplier. As with offline sales it will therefore be important to determine whether online sales will be deemed to constitute "active" selling, which can be restricted in the context of an exclusive distribution system, or "passive" selling, which cannot.

The starting point in respect of online sales is that they will generally be treated as passive sales—and it will therefore not be permissible to restrict them. However, notwithstanding this general approach, there are some limited circumstances in which restrictions on online sales will be treated as restrictions on active sales—and it will be hence permissible to restrict them. For example, online advertisements, which are specifically addressed to certain customers exclusively allocated to another distributor, will be treated as "active" selling. This leaves the question as to when an online advertisement can be said to be specifically targeted at certain customers. The Guidelines provide some guidance on this point, but there remains some uncertainty over how it could be demonstrated in practice. The Guidelines give the example of targeted advertising of a distributor paying a search engine or online advertisement provider to have an advertisement displayed specifically to users in a particular territory both as being treated as active selling into that territory, but do not deal with issues such as a distributor's website that gives different currency options, which remains a grey area.

The equivalence principle for selective distribution raises similar issues. Suppliers cannot prevent distributors from selling goods or services online, even in a selective distribution context, but they are allowed to impose criteria for online sales that are overall equivalent to the criteria imposed for sales from bricks and mortar shops. It will not always be easy to determine to what extent a restriction imposed on online sales has its equivalent in the offline world.

The practical implications of such a prescriptive approach to online sales are that, although the additional guidance is well intended and aimed at increasing certainty, there will inevitably be a number of grey areas as it is impossible to anticipate every possible scenario that may arise in practice. In addition, the position is likely to shift over time, given modern techniques used by internet sellers, and any such specific guidance will quickly become outdated.

IV. HARDCORE RESTRICTIONS AND EFFICIENCY DEFENCE

Even if both the buyer's and the supplier's relevant market shares are below the 30 percent threshold, it is not possible to rely on the safe harbor of the block exemption if the agreement contains any so-called hardcore vertical restraints. This does not mean that the agreement will necessarily infringe the competition rules, it simply means that the automatic exemption is not available and that the parties will have to carry out their own assessment of the effects of their agreement and whether or not the exemption criteria of Article 101(3) are met.

This is not different to the old regime but in the new Guidelines the Commission was keen to dispel the misconception that hardcore is equivalent to a *per se* prohibition. The new

Guidelines now explicitly state that hardcore restrictions can meet the exemption criteria of Article 101(3). Paragraph 47 of the Guidelines provides that:

> where a hardcore restriction is included in an agreement, that agreement is presumed to fall within Article 101(1). It is also presumed that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reasons the block exemption does not apply. However, undertakings may demonstrate pro-competitive effects under Article 101(3) in an individual case. Where the undertakings substantiate that likely efficiencies result from including the hardcore restrictions in the agreement and demonstrate that in general all the conditions of Article 101(3) are fulfilled, the Commission will be required to effectively assess the likely negative impact on competition before making an ultimate assessment of whether the conditions of Article 101(3) are fulfilled.

The Commission has described this approach as a "rule of reason" approach where the burden of proof is reversed: there is a negative presumption, but it is rebuttable. It will be up to the parties to demonstrate likely efficiencies, which the Commission will have to assess. This approach reflects the European Court's ruling in the *GlaxoSmithKline* case,[3] where the Court made it clear that although parallel trade restrictions are restrictions by object (which means the Commission does not need to demonstrate the anticompetitive effects of such restrictions in order to reach an infringement decision) the Commission still has a duty to adequately examine the arguments and evidence presented by the parties under Article 101(3) in order to determine whether the conditions set out in that provision are met.

Although this does not represent a material change but is more a clarification of the correct legal position, the fact that it is now explicitly set out in the Guidelines may provide some comfort to businesses and could be interpreted as a softening of the Commission's position in respect of hardcore restrictions. More importantly, it will clarify the position in respect of hardcore restrictions with national courts and national competition authorities, who are more likely to need to assess the enforceability of vertical agreements under the EU competition rules.

A new section in the Guidelines (at paragraph 60) now also lists a number of individual cases of hardcore sales restrictions that will either fall outside the scope of Article 101(1) or may fulfill the conditions of Article 101(3).

The list of hardcore restrictions in the new block exemption remains itself largely unchanged, but in a number of instances the new Guidelines provide either more detailed or new guidance on the analysis of specific restrictions. This is, in particular, the case for resale price maintenance. Although RPM remains a hardcore restriction, the Commission also acknowledges that RPM may lead to efficiencies, in particular where it is supplier driven and facilitates the entry of a new brand or entry on a new market. This is helpful, but suppliers wishing to impose RPM in a vertical agreement will still need to carry out a full Article 101(3) analysis and assessment of the potential efficiency justifications in the particular circumstances of their agreement.

V. CONCLUSION

The new regime is arguably less permissive (due to the dual market share threshold requirement) and more interventionist (in respect of online sales restrictions) although this is potentially counterbalanced by the greater emphasis on efficiencies for agreements and restraints

[3] Case C-501/06 of 6 October 2009.

that fall outside the block exemption. It remains to be seen how many companies will be prepared to take the risk of including and justifying a hardcore restriction in their agreements. For many the compliance risk where agreements fall outside the safe harbor of the block exemption may be too great and this could potentially deter what would, on balance, nevertheless be pro-competitive agreements.

In addition, most vertical agreements will be scrutinized by national competition authorities and courts, some of which may feel less comfortable than others to accept an efficiency defense in respect of hardcore restraints. Whereas the block exemption Regulation is binding on them, the Guidelines are not.

The Commission has repeatedly stressed that the new rules are simply an evolution and adaptation of the previous regime, but it is ultimately the way in which businesses work with the regime in practice that will determine its success.