BLOCK EXEMPTION (VERTICAL RESTRAINTS): COMMISSION REGULATION

Subject: Block exemption
Vertical restraints
Concerted Practices
Distribution agreements
Selective distribution
Supply agreements
Franchising agreements
Intellectual Property
Know-how
Non-competition clauses
Market share

Industry: All industries concerned with supply and distribution

Source: Commission Regulation 1999/2790/EC of 22 December 1999, published in the Official Journal of the European Communities, L.336, of 29 December 1999, on the application of Article 81(3) of the EC Treaty to categories of vertical agreements and concerted practices

(Note. In our October, 1999, issue, we reported on the draft Commission Regulation; and, in the normal way, we would simply have carried a report in the present issue confirming the adoption of the Regulation and the relevant dates, for example, of repeals and entry into force. However, publication of the draft Regulation resulted in a flood of comments from interested parties, as the result of which the Regulation was recast before being adopted on 22 December. Most of the changes are largely formal; and our comments on the policy implicit in the draft Regulation still apply. But the formal changes, and especially the shifting of the provisions to different Articles, make it necessary to republish the text in its final form. We have added two purely explanatory comments in the body of the text: these are clearly differentiated by being in italics and square brackets.

In our earlier report we included the text of a Commission Statement setting out the purpose of the Regulation. A similar Statement, much of it word-for-word, was issued when the Regulation was adopted. But there were one or two additional paragraphs, as follows.

"The new Commission Regulation will replace three block exemption regulations currently applicable to exclusive distribution, exclusive purchasing and franchising agreements from 1 June 2000, when the accompanying guidelines will also have been adopted. These current block exemption regulations expire on 31 December 1999 and in order to avert a legal vacuum the new Regulation prolongs them until 1 June 2000. Existing agreements between companies will continue to benefit from the current block exemption regulations until the end of 2001. The block exemption regulation for motor vehicle distribution and servicing agreements which expires in September 2002 is not affected by the new rules. The

basic aim of this new approach is to simplify the rules applicable to supply and distribution agreements and to reduce the regulatory burden, especially for companies lacking market power like SMEs (small and medium-sized enterprises)), while ensuring a more effective control of agreements entered into by companies holding significant market power. The new policy is based on a single Regulation with a wide scope of application, which block-exempts supply and distribution agreements concerning final and intermediary goods as well as services. The new block exemption Regulation allows companies whose market share is below 30% to benefit from a "safe harbour" under the Community competition rules. Above this threshold agreements will not be covered by the new block exemption Regulation, but are also not presumed to be illegal. They may require an individual examination under Article 81 of the Treaty. The Guidelines will assist undertakings in carrying out an evaluation as to the compliance of their agreements with the competition rules.

"The safe harbour below 30% market share offers companies the freedom to create supply and distribution arrangements best suited to their individual commercial interests and to adapt to the changing economic conditions. However, the block exemption Regulation does not apply to two sets of restrictions. The first set concerns a limited number of so-called hard-core restrictions. These include the imposition of resale prices and certain types of territorial and customer protection leading to a partitioning of markets. Companies are advised not to use these restrictions in their agreements, particularly as individual exemption of such clauses will be unlikely. The second set concerns certain restrictions which are not automatically exempted but which may under certain circumstances nonetheless be compatible with the EC competition rules. The most important restriction of this kind concerns non-compete obligations - requiring distributors to resell only the brands of one supplier when their duration exceeds five years. Such agreements are not covered by the new block exemption Regulation as they may have a strong foreclosing effect on the market. In the Guidelines it will be described under which circumstances long-term investments may justify a longer duration of non-compete obligations."

The Guidelines referred to here are not those referred to in our October report; the Commission has promised to publish them by June, 2000.)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, as last amended by Regulation (EC) No 1215/1999, and in particular Article 1 thereof,

Having published a draft of this Regulation,

Having consulted the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas:

(1) Regulation No 19/65/EEC empowers the Commission to apply Article 81(3) of the Treaty (formerly Article 85(3)) by regulation to certain categories of vertical agreements and corresponding concerted practices falling within Article 81(1).

(2) Experience acquired to date makes it possible to define a category of vertical agreements which can be regarded as normally satisfying the conditions laid down in Article 81(3).

(3) This category includes vertical agreements for the purchase or sale of goods or services where these agreements are concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods; it also includes vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights; for the purposes of this Regulation, the term 'vertical agreements' includes the corresponding concerted practices.

(4) For the application of Article 81(3) by regulation, it is not necessary to define those vertical agreements which are capable of falling within Article 81(1): in the individual assessment of agreements under Article 81(1), account has to be taken of several factors, and in particular the market structure on the supply and purchase side.

(5) The benefit of the block exemption should be limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 81(3).

(6) Vertical agreements of the category defined in this Regulation can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings; in particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels.

(7) The likelihood that such efficiency-enhancing effects wfll outweigh any anti-competitive effects due to restrictions contained in vertical agreements depends on the degree of market power of the undertakings concerned and, therefore, on the extent to which those undertakings face competition from other suppliers of goods or services regarded by the buyer as interchangeable or substitutable for one another, by reason of the products' characteristics, their prices and their intended use.

8) It can be presumed that, where the share of the relevant market accounted for by the supplier does not exceed 30%, vertical agreements which do not contain certain types of severely anti-competitive restraints generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits; 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

(9) Above the market share threshold of 30%, there can be no presumption that vertical agreements falling within the scope of Article 81(1) will usually give rise to objective advantages of such a character and size as to compensate for the disadvantages which they create for competition.

(10) This Regulation should not exempt vertical agreements containing restrictions which are not indispensable to the attainment of the positive effects mentioned above; in particular, vertical agreements containing certain types of severely anti-competitive restraints such as minimum and fixed resale-prices, as well as certain types of territorial protection, should be excluded from the benefit of the block exemption established by this Regulation irrespective of the market share of the undertakings concerned.

(11) In order to ensure access to or to prevent collusion on the relevant market, certain conditions are to be attached to the block exemption: to this end, the exemption of non-compete obligations should be limited to obligations which do not exceed a definite duration; for the same reasons, any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers should be excluded from the benefit of this Regulation.

(12) The market-share limitation, the non-exemption of certain vertical agreements and the conditions provided for in this Regulation normally ensure that the agreements to which the block exemption applies do not enable the participating undertakings to eliminate competition in respect of a substantial part of the products in question.

(13) In particular cases in which the agreements falling under this Regulation nevertheless have effects incompatible with Article 81(3), the Commission may withdraw the benefit of the block exemption; this may occur in particular where the buyer has significant market power in the relevant market in which it resells the goods or provides the services or where parallel networks of vertical agreements have similar effects which significantly restrict access to a relevant market or competition therein; such cumulative effects may for example arise in the case of selective distribution or non-compete obligations.

(14) Regulation 19/65/EEC empowers the competent authorities of Member States to withdraw the benefit of the block exemption in respect of vertical agreements having effects incompatible with the conditions laid down in Article 81(3), where such effects are felt in their respective territory, or in a part thereof, and where such territory has the characteristics of a distinct geographic market; Member States should ensure that the exercise of this power of withdrawal does not prejudice the uniform application throughout the common market of the Community competition rules or the full effect of the measures adopted in implementation of those rules.

(15) In order to strengthen supervision of parallel networks of vertical agreements which have similar restrictive effects and which cover more than 50% of a given market, the Commission may declare this Regulation inapplicable to vertical agreements containing specific restraints relating to the market concerned,

thereby restoring the full application of Article 81 to such agreements.

(16) This Regulation is without prejudice to the application of Article 82.

(17) In accordance with the principle of the primacy of Community law, no measure taken pursuant to national laws on competition should prejudice the uniform application throughout the common market of the Community competition rules or the full effect of any measures adopted in implementation of those rules, including this Regulation,

HAS ADOPTED THIS REGULATION:

Article 1

For the purposes of this Regulation:

(a) 'competing undertakings' means actual or potential suppliers in the same product market; the, product market includes goods or services which are regarded by the buyer as interchangeable with or substitutable for the contract goods or services, by reason of the products' characteristics, their prices and their intended use;

(b) 'non-compete obligation' means any direct or indirect obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or indirect obligation on the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80 % of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market, calculated on the basis of the value of its purchases in the preceding calendar year;

(c) 'exclusive supply obligation' means any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only to one buyer inside the Community for the purposes of a specific use or for resale;

(d) 'Selective distribution system' means a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors;

(e) 'intellectual property rights' includes industrial property rights, copyright and neighbouring rights;

(f) 'know-how' means a package of non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified: in this context, 'secret' means that the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible; 'substantial' means that the know-how includes information which is indispensable to the buyer for the use, sale or resale of the contract goods or services; 'identified' means that the know-how must be described in a /

sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality;

'buyer' includes an undertaking which, under an agreement falling within Article 81(1) of the Treaty, sells goods or services on behalf of another undertaking.

[For further definitions, see Article 11.]

Article 2

1. Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) shall not apply to agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services ('vertical agreements'). This exemption shall apply to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1) ('vertical restraints').

2. The exemption provided for in paragraph 1 shall apply to vertical agreements entered into between an association of undertakings and its members, or between such an association and its suppliers, only if all its members are retailers of goods and if no individual member of the association, together with its connected undertakings, has a total annual turnover exceeding € 50 million; vertical agreements entered into by such associations shall be covered by this Regulation without prejudice to the application of Article 81 to horizontal agreements concluded between the members of the association or decisions adopted by the association.

3. The exemption provided for in paragraph 1 shall apply to vertical agreements containing provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers. The exemption applies on condition that, in relation to the contract goods or services, those provisions do not contain restrictions of competition having the same object or effect as vertical restraints which are not exempted under this Regulation.

4. The exemption provided for in paragraph 1 shall not apply to vertical agreements entered into between competing undertakings; however, it shall apply where competing undertakings enter into a non-reciprocal vertical agreement and:

(a) the buyer has a total annual turnover not exceeding € 100 million, or

(b) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods, or

(c) the supplier is a provider of services at several levels of trade, while the buyer does not provide competing services at the level of trade where it purchases the /

contract services.

5. This Regulation shall not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation.

Article 3

1. Subject to paragraph 2 of this Article, the exemption provided for in Article 2 shall apply on condition that the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services.

2. In the case of vertical agreements containing exclusive supply obligations, the exemption provided for in Article 2 shall apply on condition that the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services.

Article 4

The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier's imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

(b) the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except:

- the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer,

- the restriction of sales to end users by a buyer operating at the wholesale level of trade,

- the restriction of sales to unauthorised distributors by the members of a selective distribution system, and

- the restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier;

(c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment;

(d) the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade;

(e) the restriction agreed between a supplier of components and a buyer who incorporates those components, which limits the supplier to selling the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.

Article 5

The exemption provided for in Article 2 shall not apply to any of the following obligations contained in vertical agreements:

(a) any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years. A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration. However, the time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer:

(b) any direct or indirect non-compete obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services, unless such obligation:

- relates to goods or services which compete with the contract goods or services, and

- is limited to the premises and land from which the buyer has operated during the contract period, and

- is indispensable to protect know-how transferred by the supplier to the buyer,

and provided that the duration of such non-compete obligation is limited to a period of one year after termination of the agreement; this obligation is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain;

(c) any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.

Article 6

The Commission may withdraw the benefit of this Regulation, pursuant to Article 7(1) of Regulation 19/65/EEC, where it finds in any particular case that vertical agreements to which this Regulation applies nevertheless have effects /

which are incompatible with the conditions laid down in Article 81(3) of the Treaty, and in particular where access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar vertical restraints implemented by competing suppliers or buyers.

Article 7

Where in any particular case vertical agreements to which the exemption provided for in Article 2 applies have effects incompatible with the conditions laid down in Article 81(3) of the Treaty in the territory of a Member State, or in a part thereof, which has all the characteristics of a distinct geographic market, the competent authority of that Member State may withdraw the benefit of application of this Regulation in respect of that territory, under the same conditions as provided in Article 6.

Article 8

1. Pursuant to Article 1a of Regulation 19/65/EEC, the Commission may by regulation declare that, where parallel networks of similar vertical restraints cover more than 50% of a relevant market, this Regulation shall not apply to vertical agreements containing specific restraints relating to that market.

2. A regulation pursuant to paragraph 1 shall not become applicable earlier than six months following its adoption.

Article 9

1. The market share of 30% provided for in Article 3(1) shall be calculated on the basis of the market sales value of the contract goods or services and other goods or services sold by the supplier, which are regarded as interchangeable or substitutable by the buyer, by reason of the products' characteristics, their prices and their intended use; if market sales value data are not available, estimates based on other reliable market information, including market sales volumes, may be used to establish the market share of the undertaking concerned. For the purposes of Article 3(2), it is either the market purchase value or estimates thereof which shall be used to calculate the market share.

2. For the purposes of applying the market share threshold provided for in Article 3, the following rules shall apply:

(a) the market share shall be calculated on the basis of data relating to the preceding calendar year;

(b) the market share shall include any goods or services supplied to integrated distributors for the purposes of sale;

(c) if the market share is initially not more than 30% but subsequently rises above that level without exceeding 35%, the exemption provided for in Article 2 shall continue to apply for a period of two consecutive calendar years following the year in which the 30% market share threshold was first exceeded;

(d) if the market share is initially not more than 30% but subsequently rises above 35%, the exemption provided for in Article 2 shall continue to apply for one calendar year following the year in which the level of 35% was first exceeded;

(e) the benefit of points (c) and (d) may not be combined so as to exceed a period of two calendar years.

Article 10

1. For the purpose of calculating total annual turnover within the meaning of Article 2(2) and (4), the turnover achieved during the previous financial year by the relevant party to the vertical agreement and the turnover achieved by its connected undertakings in respect of all goods and services, excluding all taxes and other duties, shall be added together. For this purpose, no account shall be taken of dealings between the party to the vertical agreement and its connected undertakings or between its connected undertakings.

2. The exemption provided for in Article 2 shall remain applicable where, for any period of two consecutive financial years, the total annual turnover threshold is exceeded by no more than 10%.

Article 11

1. For the purposes of this Regulation, the terms 'undertaking', 'supplier' and 'buyer' shall include their respective connected undertakings.

2. 'Connected undertakings' are:

(a) undertakings in which a panty to the agreement, directly or indirectly:

- has the power to exercise more than half the voting rights, or
- has the power to appoint more than half the members of the supervisory board, board of management or bodies legally representing the undertaking, or
- has the right to manage the undertaking's affairs;

(b) undertakings which directly or indirectly have, over a party to the agreement, the rights or powers listed in (a);

(c) undertakings in which an undertaking referred to in (5) has, directly or indirectly, the rights or powers listed in (a);

(d) undertakings in which a party to the agreement together with one or more of the undertakings referred to in (a), (5) or (c), or in which two or more of the latter undertakings, jointly have the rights or powers listed in (a);

(e) undertakings in which the rights or the powers listed in (a) are jointly held by:

- parties to the agreement or their respective connected undertakings /

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referred to in (a) to (d), or

- one or more of the parties to the agreement or one or more of their connected undertakings referred to in (a) to (d) and one or more third parties.

3. For the purposes of Article 3, the market share held by the undertakings referred to in paragraph 2(e) of this Article shall be apportioned equally to each undertaking having the rights or the powers listed in paragraph 2(a).

Article 12

1. The exemptions provided for in Commission Regulations 1983/83/EEC, 1984/83/EEC and 4087/88/EEC shall continue to apply until 31 May 2000.

2. The prohibition laid down in Article 81(1) of the EC Treaty shall not apply during the period from 1 June 2000 to 31 December 2001 in respect of agreements already in force on 31 May 2000 which do not satisfy the conditions for exemption provided for in this Regulation but which satisfy the conditions for exemption provided for in Regulations 1983/83/EEC, 1984/83/EEC or 4087/88/EEC.

[Regulations 1983/83/EEC, 1984/83/EEC and 4087/88/EEC, deal respectively with exclusive distribution, exclusive supply and franchising.]

Article 13

This Regulation shall enter into force on 1 January 2000.

It shall apply from 1 June 2000, except for Article 12(1) which shall apply from 1 January 2000.

This Regulation shall expire on 31 May 2010.

This Regulation shall be binding in its entirety and directly applicable in all Member States. ■

Much of the material used for the purposes of the foregoing reports has been obtained from the web-sites of the Court of Justice and the Commission of the European Communities; access to these web-sites is freely available.

Both the web-sites are good, particularly the Commission's. It is a disadvantage of the Court web-site that much of the material is in French. A small criticism of the Commission's web-site is that the competition material is somewhat scattered.