

The New Vertical Agreements Block Exemption

Commission Regulation (EU) No. 330/2010.

The New Regulations, in force 1 June 2010

The new vertical agreements block exemption, Commission Regulation (EU) No. 330/2010 (“the New Regulations”) was published on 20 April 2010 and came **into force on 1 June 2010**. It replaces Commission Regulation (EC) No. 2790/1999, (“the Old Regulations”), which expired on 31 May 2010¹.

Transitional Period

There is a transitional period from 1 June 2010 to 31 May 2011 for agreements already in force on 31 May 2010, which do not satisfy the requirements of the New Regulations but which did satisfy the requirements of the Old Regulations²

Scope

The New Regulations apply to all kinds of vertical agreements (as defined), namely:

“...an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, 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.”³

Such agreements include agency agreements and distribution agreements, not just franchise agreements. The New Regulations are broadly similar to the Old Regulations they replace but there are some significant differences.

The European Commission’s Guidelines

The European Commission’s Guidelines on Vertical Restraints (2010/C 130/01) (“the Guidelines”) were published on 19 May 2010. Their stated purpose is to set out the principles for the assessment of vertical agreements under Article 101 of the Treaty on the functioning of the European Union⁴. They contain extensive guidance as to the Commission’s thinking on the New Regulations and are an essential companion to them, to which reference should be made.

This article considers the New Regulations and the Guidelines as they apply to franchising.

¹ Article 10.

² Article 9.

³ Article 1(a).

⁴ With effect from 1 December 2009, Articles 81 and 82 of the EC Treaty became Articles 101 and 102 respectively of the Treaty on the Functioning of the European Union.

Summary of Key Points

In summary, the key points of interest for franchisors and franchisees are as follows:

The New Regulations

Definition of Market Share Threshold

The definition of the market share threshold of not exceeding 30%, by reference to which the block exemption in the New Regulations applies (subject to compliance with their other requirements), is now tested against the relevant markets of both the franchisor and the franchisee⁵. The Guidelines give some assistance as to how that 30% share is to be calculated, particularly as regards a franchisor's market share⁶.

Definition of 'know-how'

The definition of 'know-how', by reference to which a post-termination non-compete clause may be enforced has been revised. The know-how need only be 'substantial', meaning 'significant and useful for those purposes'⁷. However, there is now a requirement for the obligation itself to be 'indispensable' in order to protect that know-how⁸.

The Guidelines

Hardcore restrictions

The Guidelines accepts that a 'hardcore restriction' may be objectively necessary in exceptional cases for an agreement of a particular type or nature.⁹ They give a number of examples including the restriction of passive sales in order to start up or develop a new market during its first 2 years¹⁰ and, importantly for franchisors/franchisees, fixed resale prices in order to organise a coordinated short term low price campaign, of two to six weeks in most cases, which will also benefit consumers¹¹.

Internet Sales

The Guidelines analyse, in detail, a number of aspects of internet selling, both as to what are or are not active or passive sales and as to the restrictions that may or may not be imposed on them¹².

⁵ Article 3.

⁶ Paragraphs (87) – (95) and in particular paragraph (92).

⁷ Article 1(g).

⁸ Article 5.3(c).

⁹ Paragraphs (60)-(64).

¹⁰ Paragraph (61).

¹¹ Paragraph (225).

¹² Paragraphs (52)-(54) but also (56), (57) and (64).

Internet selling –the details

The paragraphs of the Guidelines dealing with internet selling are, for me, both the most interesting and, potentially, significant, paragraphs of the Guidelines and the ones on which I shall focus in detail.

Before turning to them, it is important to note that the ‘hardcore restriction’ against agreements that prevent passive sales into the exclusive territory or to an exclusive customer group reserved to the supplier (the franchisor) or allocated by the supplier to another buyer (another franchisee), is retained in the New Regulations¹³.

“The exemption ... 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:

...

(b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services, except:

(i) 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 sale by the customers of the buyer.

...”

This is a roundabout way of saying that passive sales cannot be restricted.

Further, the Guidelines maintain the existing distinction between active and passive sales as follows¹⁴:

‘Active’ sales means:

“...actively approaching individual customers by for instance direct mail, including the sending of unsolicited emails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory.”

‘Passive’ sales means:

“... responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion

¹³ Article 4(b)(i).

¹⁴ Paragraph (51).

that reaches customers in other distributors' (exclusive) territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in one's own territory, are considered passive selling. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' (exclusive) territories or customer groups."

General Statements of principle about internet selling¹⁵

First of all, the Guidelines state that, **in principle, every distributor** (which includes a franchisee) **must be allowed to use the internet to sell products.**

Second, they make the statement that, **in general, where a distributor** (franchisee) **uses a website to sell products, that is considered a form of passive selling**, since it is a reasonable way to allow customers to reach the distributor (franchisee).

Third, they accept that the use of a website may have effects that extend beyond the distributor's (franchisee's) own territory and customer group and simply state that such effects result from the technology allowing easy access from everywhere.

Fourth, as to what is to be considered to be passive selling:

If a customer visits the website of a distributor (franchisee), contacts the distributor (franchisee) and if such contact leads to a sale, including delivery, then that is considered to be passive selling.

If a customer opts to be kept automatically informed by the distributor (franchisee) and that leads to a sale.

Offering different language options on the website –that does not, of itself, change the passive character of such selling.

'Hardcore restrictions' on internet selling

Consequently, the Guidelines give a number of examples of what the Commission regards as 'hardcore restrictions' of passive selling on the internet:

- An agreement that the (exclusive) distributor (franchisee) shall prevent customers located in another (exclusive) territory from viewing its website or shall automatically re-route its customers to the manufacturer's (franchisor's) or other (exclusive) distributors' (franchisees') websites.

However, this does not exclude an agreement that the distributor's (franchisee's) website is able to offer a number of links to websites of other distributors (franchisees) and/or the supplier (franchisor).

¹⁵ Paragraph (52).

- An agreement that the (exclusive) distributor (franchisee) shall terminate consumers' transactions over the internet once their credit card date reveal an address that is not within the distributor's (franchisee's) (exclusive) territory.
- An agreement that the distributor (franchisee) shall limit its proportion of overall sales made over the internet.

However, this does not exclude the supplier (franchisor) requiring that the buyer (franchisee) sells at least a certain absolute amount (in value or volume) of the products offline to ensure an efficient operation of its bricks and mortar shop or physical point of sales.

Nor does it preclude the supplier (franchisor) from making sure the online activity of the distributor (franchisee) remains consistent with the supplier's (franchisor's) distribution model.

The absolute amount of required offline sales can be the same for all buyers (franchisees) or determined individually for each buyer (franchisee) on the basis of objective criteria. Examples are given of the buyer's (franchisee's) size in the network or its geographic location.

- An agreement that the distributor (franchisee) shall pay a higher price for products intended to be resold by the distributor (franchisee) online than for products intended to be resold offline.

However, this does not exclude the supplier (franchisor) agreeing with the buyer (franchisee) a fixed fee (not variable where the sum increases with the realised offline turnover) to support the buyer's (franchisee's) offline or online sales efforts.

Permissible restrictions on active selling on the internet¹⁶

What is compatible with the New Regulations is a restriction on the use of the internet by distributors (franchisees) to the extent that promotion on the internet or use of the internet would lead to active selling into other distributors' (franchisees') exclusive territories or customer groups.

The Commission gives as an example of a form of such active selling, an online advertisement specifically addressed to certain customers and illustrates that with the example of territory-based banners on third party websites as a form of active sales into the territory where these banners are shown.

In general, efforts to be found specifically in a certain territory or by a certain customer group is active selling into that territory or to that customer group. For example, paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory is active selling into that territory.

¹⁶ Paragraph (53).

Maintenance of Quality Standards¹⁷

What is also permitted is for the supplier (franchisor) to require quality standards for the use of the internet site to resell its goods, just as the supplier (franchisor) may require quality standards for a shop or for selling by catalogue or for advertising or promotion in general.

A supplier (franchisor) may require its distributor (franchisee) to have one or more brick and mortar shops or showrooms.

A supplier (franchisor) may require that its distributor (franchisee) uses third party platforms to distribute the contract products only in accordance with the standards and conditions agreed between the supplier (franchisor) and its distributor (franchisee) for the distributor's (franchisee's) use of the internet.

Comment

The application of the market share threshold test to both franchisor and franchisee seems to me to add an unwelcome additional level of complexity in determining whether the block exemption applies.

I suspect that the revised definition of 'know-how' may make little practical difference in the context of the enforceability of post-termination non-compete obligations, given the requirement for that obligation itself to be 'indispensable'.

The European Commission's exposition of its thinking on internet selling is a welcome clarification and consistent with the approach it has taken to the distinction between 'active' and 'passive' sales to date. I think that this is the area where franchisors will need to look at their existing arrangements to see whether they are trying to restrict their franchisees' internet usage in a way that will not be permitted for much longer.

I imagine that the acknowledgement that, in exceptional circumstances, 'hardcore restrictions' are capable of not being anti-competitive, will be very much limited to the instances the Commission has identified in the Guidelines.

Finally, it should be borne in mind that, even if the criteria in the New Regulations and the Guidelines are not satisfied, such that the block exemption does not automatically apply, then, unless the agreement in question contains one of the 'hardcore restrictions' this does no more than displace the presumption that the agreement is not anti-competitive, leaving such an agreement for individual assessment in each case.

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¹⁷ Paragraph (54).