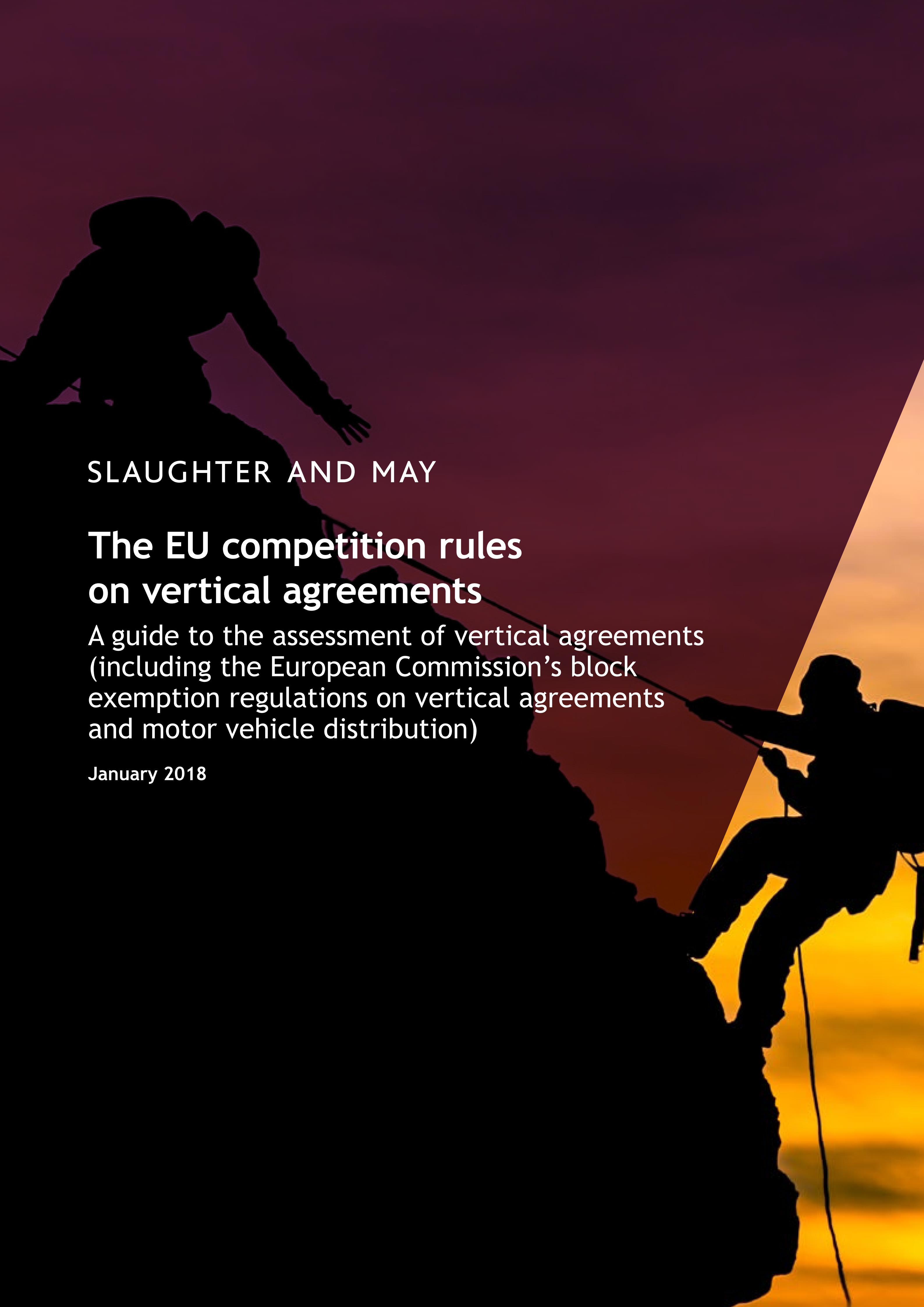

SLAUGHTER AND MAY

The EU competition rules on vertical agreements

A guide to the assessment of vertical agreements (including the European Commission's block exemption regulations on vertical agreements and motor vehicle distribution)

January 2018

Contents

1. Introduction

1.1 This publication explains how the European competition rules are applied to "vertical agreements", i.e. agreements for the sale or purchase of goods or services between parties operating (for the purpose of the particular agreement) at different levels of the supply chain.

1.2 It considers the operation of the European Commission's vertical agreements block exemption regulation (VABER)[1] and the Commission's accompanying Vertical Guidelines which set out principles for the assessment of vertical agreements under Article 101 of the Treaty on the Functioning of the European Union.[2] It also considers the stricter rules applicable to the motor vehicle sector in the Commission's motor vehicle block exemption regulation (MVBER).[3] Further detail on key stages of the analysis of vertical agreements is provided in the Annexes to this publication.

1.3 Businesses use various different types of vertical agreements to get their goods and services to market. The concept of "vertical agreement" covers the purchase or supply of intermediate goods (e.g. raw materials or goods subjected to further processing by the customer), finished goods (e.g. for resale by a dealer active at the wholesaling or retailing level) or services. It also covers agency agreements. Vertical agreements that look similar in form can have very different substantive effects on competition – just as different types of agreements can have similar competitive effects – depending on factors such as the conditions of competition in the markets concerned, and the parties' strengths in those markets.

1.4 The Article 101(1) prohibition applies where an agreement or concerted practice – formal or informal, written or unwritten – between two or more "undertakings" (businesses), which may affect trade between Member States, has the object or effect of preventing, restricting or distorting competition to an appreciable extent. Even if an agreement falls within the scope of Article 101(1), it may be exempt from the prohibition if it has countervailing competitive benefits or efficiencies under Article 101(3). Some vertical agreements fall outside the scope of Article 101(1), such as agreements with final customers (not operating as undertakings), intra-group agreements and some agency agreements: see Annex 1.

1.5 "Vertical restraints" (restrictions in vertical agreements) tend to be considered less harmful than "horizontal restraints" (restrictions in agreements between companies operating at the same level(s) of production or distribution). This reflects the following:

- **Vertical agreements:** In a vertical relationship the product of one party is the input of the other. This means that the exercise of market power by one party – whether the upstream supplier or the downstream buyer – may harm the commercial position of the other party. Parties to a vertical agreement therefore usually have an incentive to prevent each other from imposing unreasonable restrictions. For most vertical agreements, serious competition concerns only arise if there

[1] Commission Regulation (EU) 330/2010 (OJ 2010 L102/1, 23.4.2010). This block exemption replaced Commission Regulation (EC) 2790/1999 and came into force on 1 June 2010 expires on 31 May 2022. It was incorporated into the EEA competition rules by EEA Joint Committee Decision No. 077/2010 (amending Annex XIV to the EEA Agreement).

[2] Guidelines on Vertical Restraints (OJ 2010 C131/01, 19.5.2010). The EFTA Surveillance Authority has adopted equivalent guidelines. The Commission has also published a more concise brochure on *The competition rules for supply and distribution agreements*.

[3] Commission Regulation (EU) 461/2010 (OJ 2010 L129/52, 28.5.2010) MVBER applies to vertical agreements relating to the motor vehicle aftermarket, which includes the purchase, sale or resale of spare parts or provision of repair and maintenance services. The general VABER applies to the purchase, sale or resale of motor vehicles.

is insufficient inter-brand competition in the markets affected by the agreement, i.e. if the supplier (and/or buyer) has a high degree of market power.

- **Horizontal agreements:** In a horizontal relationship – in particular between actual or realistic potential competitors – the exercise of market power by one party (to the potential detriment of third parties) may actually also benefit the other party. The Commission is therefore generally more wary of cooperation between parties active at the same level in the supply chain, particularly where the agreement has the object of fixing prices, limiting production or sharing markets or customers.[4]

1.6 Accordingly, many vertical agreements either fall outside the Article 101(1) prohibition altogether or satisfy the exemption criteria of Article 101(3).[5] Where this is not the case, restrictive provisions in the agreement will be void by virtue of Article 101(2) (and possibly under Article 102 in the case of dominant companies). In serious cases, the European Commission's Directorate-General for Competition and/or the Member States' national competition authorities (NCAs) may investigate, and declare the restrictive provisions, and possibly the whole agreement, void and may impose fines. The NCAs play a significant role in the enforcement of Articles 101 and 102 in accordance with Council Regulation 1/2003.[6] The Commission and NCAs cooperate with each other within the framework of the European Competition Network (ECN) to coordinate investigations or allocate cases. Third parties may also bring claims for damages in courts in Member States.

1.7 The VABER and MVBER provide "safe harbours" for agreements if certain formal conditions are satisfied, regardless of whether they may have positive or negative effects on competition in the relevant market. The VABER and Vertical Guidelines are available for any vertical agreement, including industrial supply contracts, selective distribution systems, agency arrangements or non-exclusive purchasing and distribution arrangements. Companies are not expected to squeeze their vertical arrangements into the straitjackets of agreements covered by previous block exemptions (on exclusive distribution, exclusive purchasing or franchising, for example). That said, the MVBER impose stricter requirements on the motor vehicle sector.

[4] In the field of "horizontal cooperation", block exemptions are available for R&D agreements and specialisation agreements. The Commission has also adopted guidelines on the applicability of Art. 101 to horizontal cooperation. These block exemptions and Horizontal Guidelines are considered in more detail in the Slaughter and May publication on *The EU competition rules on horizontal agreements*. The Horizontal Guidelines focus in particular on agreements on R&D, production agreements (e.g. joint production, specialisation and outsourcing agreements, subcontracting between competitors), purchasing agreements, commercialisation agreements, agreements on standards. They do not cover other forms of agreements between competitors such as minority shareholdings and strategic alliances; nor do they cover joint ventures notifiable under the EU Merger Regulation (see the Slaughter and May publication on *The EU Merger Regulation*).

[5] Agency agreements are not caught by Art. 101(1) if the principal bears the commercial and financial risks related to the selling and purchasing of contract goods and services and obligations imposed on the agent in relation to the contracts concluded and or negotiated on behalf of the principal (see also Annex 1). However, agency agreements containing single branding provisions and post-term non-compete provisions may infringe Art. 101(1) if they lead to or contribute to a (cumulative) foreclosure effect. Agency agreements may also fall within the scope of Art. 101(1) where a number of principals coordinate their activities by using the same agent.

[6] This Implementing Regulation fundamentally changed the way in which Arts. 101 and 102 are enforced (Council Regulation (EC) 1/2003; OJ 2003 L1/1, 4.1.2003). Its objectives were: to facilitate more rigorous enforcement against blatant infringements such as cartels (*inter alia* by abolishing the system of notifying agreements to the Commission to obtain individual exemptions under Art. 101(3)); to allow decentralisation of the application of the rules (in particular the Art. 101(3) exemption criteria) to the NCAs and national courts; and to simplify enforcement procedures.

1.8 Despite the general improvements brought about by this effects-focused approach, the Commission continues to proceed on the basis that some vertical agreements can raise serious competition concerns (depending on the relevant market structure and the market positions of the parties). The VABER has fixed an Article 101 “market power” threshold at 30% – well below the level of 40-50% at which issues of Article 102 “dominance” generally arise. It is rarely easy to determine with certainty the precise extent of the product and geographic markets affected by a vertical agreement. Often it will be necessary to consider the potential effects of an agreement by reference to various alternative relevant markets. The relevant party might satisfy the 30% threshold by reference to one market analysis, but a narrower market definition may mean that the threshold is exceeded. If so, a more detailed assessment of the applicability of Article 101(1) and (3) will generally need to be undertaken.

1.9 One of the aims of the more effects-focused approach was to reduce the Commission’s workload of relatively non-controversial vertical arrangements. For companies with market shares above the 30% threshold, however, there remains the risk of litigation and/or third party complaints seeking to take advantage of some of the uncertainties raised by the market share tests for block exemption treatment. That said, it should be remembered that the Commission’s Vertical Guidelines are merely a tool to be deployed by parties (and the Commission, NCAs and courts) in undertaking the case-by-case analysis of whether a particular agreement is compatible with the principles of Articles 101 and 102. Further guidance can also be drawn from the European Courts’ judgments and from Commission practice in other cases. Thus, for example, there are a number of useful precedents analysing vertical restraints in selective distribution networks, franchising agreements and agency schemes. Where appropriate, these should be considered in addition to the Commission’s own Guidelines.

2. Focus on effects on competition

2.1 Vertical agreements which merely establish basic terms for a specific sale and purchase transaction (price, quantity, quality etc.) will not normally restrict competition within the meaning of Article 101; however, restrictive effects on competition may arise where an agreement involves restraints on the supplier or buyer (e.g. on the customers to whom the buyer may resell the products). The Vertical Guidelines (at paragraphs 100 to 105) describe the potential negative effects of vertical restraints which EU competition law aims to prevent. These potential effects on competition all relate essentially to the possibility of market foreclosure of competitors and/or the prospect of consumers having to pay higher prices (or receiving lower quality goods or services):

- **Entry barriers:** The raising of barriers to market entry or expansion may foreclose other suppliers or buyers from the market. If competitors are partially or completely foreclosed from a significant part of the market, this may result in prices being higher and consumers having less choice than would otherwise have been the case;

- **Inter-brand competition:** The reduction of inter-brand competition may facilitate collusion between competing suppliers (or buyers) on matters such as pricing. This extends not only to explicit collusion (unlawful price-fixing or market sharing) but also to tacit collusion (conscious parallel behaviour in oligopolistic markets);

- **Intra-brand competition:** Some vertical restraints may reduce intra-brand competition (i.e. between distributors of the same brand). These potential negative effects are generally less harmful if there is a significant degree of inter-brand competition; and

- **Barriers to cross-border trade:** Some vertical restraints may result in market partitioning and the creation of obstacles to EU market integration, in particular limitations on the freedom of consumers to purchase goods/services in any Member State they choose.

2.2 If a vertical agreement (or a network of agreements) has any of these negative effects to an appreciable extent on a relevant market within the EU, the Article 101(1) prohibition is likely to be applicable. Appraising whether particular arrangements have any of these effects involves looking at the conditions of competition in the markets concerned and the parties' strengths in those markets. The Commission's 1997 Market Definition Notice describes factors to take into account when defining relevant markets for these and other purposes: see Annex 2.[7] For most vertical restraints, competition concerns only arise if at least one of the parties has a significant level of market power. Market power (which can exist below levels of Article 102 dominance) describes the situation where the constraints which would usually ensure that an undertaking behaves in a competitive manner are not working effectively. It implies the ability to raise prices consistently and profitably above competitive levels (resulting in supra-competitive prices and supra-normal profits).[8]

[7] OJ 1997 C372/5, 9.12.1997.

[8] If one of the parties enjoys a dominant position in any relevant product or service market (whether across Europe as a whole or within a relevant national or regional market which constitutes a substantial part of the EU), it may also be vulnerable under Art. 102.

2.3 Some vertical agreements may be able to benefit from the Commission's 2014 Notice on agreements of minor importance.[9] This *De Minimis* Notice states that the Commission will not normally initiate proceedings under Article 101 against agreements between SMEs (small and medium-sized enterprises with fewer than 250 employees, and annual turnover not exceeding €50 million or assets not exceeding €43 million).[10] The Notice also states that larger companies should not face investigation where the parties' combined market shares in the relevant markets do not exceed the following thresholds:

- 15% for agreements between non-competitors, i.e. between parties who are not actual or realistic potential competitors in the same product market (irrespective of whether they are active in the same geographic market);
- 10% for agreements between competitors (including situations of "dual distribution", e.g. where the supplier is also active at the buyer's level of distribution). This 10% threshold also applies where it is difficult to classify the agreement as being between competitors or non-competitors); and
- 5% where access to the market is foreclosed by the cumulative effect of parallel networks of similar vertical agreements by several companies.

2.4 An agreement can only benefit from the *De Minimis* Notice if it does not have as its object the prevention, restriction or distortion of competition. Agreements containing price fixing, output limitation or market sharing restrictions will therefore not benefit from the Notice. Similarly, agreements containing any hardcore restrictions as defined by current or future Commission block exemption regulations will not benefit from the Notice.

2.5 A vertical agreement between parties whose market shares exceed the relevant market share threshold may nevertheless fall outside Article 101(1) if the agreement does not have an appreciable effect on competition.

2.6 It should also be remembered that the prohibitions under Articles 101(1) and 102 only apply if the agreement or conduct may affect trade between Member States. For these purposes, the CJ has confirmed that *"it must be possible to foresee with a sufficient degree of probability, on the basis of a set of objective factors of law or of fact, that they may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States in such a way as to cause concern that they might hinder the attainment of a single market between Member States. Moreover, that effect must not be insignificant"*. For further details, see the Commission's 2004 Notice setting out Guidelines on the effect on trade concept.[11] Insofar as vertical restraints are intended to apply outside the EEA, they will not be capable of affecting trade between Member States and so should not be caught by the EU competition rules. If the agreement does not affect trade between Member States (e.g. because it relates to trade purely within a Member State), national competition legislation may be applicable.

[9] OJ 2014 C291/1, 30.8.2014.

[10] This definition is based on the definition of SME in the Annex to Commission Recommendation of 6 May 2003 (OJ 2003 L124/36, 20.5.2003).

[11] OJ 2004 C101/81, 27.4.2004. This Notice is of particular relevance for the regime under Regulation 1/2003. If a NCA is applying national competition law to an agreement or contract which has an effect on trade between Member States, it is required also to apply Arts. 101 and/or 102; if an agreement meets the criteria of Art. 101(3) or comes within a Commission block exemption, it may not be prohibited by national competition law, except that an NCA may apply stricter national laws prohibiting or sanctioning unilateral conduct.

3. The "safe harbours" of the VABER and MVBER

3.1 The various steps involved in the application of the EU competition rules to vertical agreements are illustrated by the flowchart at Annex 3.

3.2 The VABER and MVBER are not available for agreements relating to the licensing or assignment of intellectual property rights if those IPR provisions constitute the primary object of the agreement: see Annex 4 (and the separate Slaughter and May publication on *The EU competition rules on intellectual property licensing*). The availability of the block exemptions is also limited in the case of vertical agreements involving competing undertakings or retailer buying groups.

3.3 The VABER and MVBER each set out various categories of "hardcore" (or "blacklisted") restrictions including price-fixing or resale price maintenance, as well as certain territorial or sales restrictions: see Annex 5. These are restrictions which are considered to have such an obvious restrictive effect on competition that they can be presumed to be caught by the Article 101(1) prohibition irrespective of the market shares of the undertakings concerned and are unlikely to meet the Article 101(3) exemption criteria: however this is a rebuttable presumption and is not a *per se* rule. This leaves open the possibility for undertakings to plead an efficiency defence under Article 101(3) in an individual case. Conversely, a vertical agreement which does not contain any of these hardcore restrictions is automatically eligible for the Article 101(3) exemption through the "safe harbour" of the applicable block exemption, provided it meets the block exemption's other conditions (see Annex 3).

3.4 Among the VABER's other conditions is a requirement that the market share threshold held by each of the parties to the agreement (both buyer and supplier) does not exceed 30% on any of the relevant markets affected by the agreement. When considering the market share of the supplier, the relevant market is that where it sells the contract products to the buyer; when considering the market share of the buyer, the relevant market is that where it buys the contract products (see Annex 2).

3.5 Finally, in order to benefit from the VABER, the agreement must not contain certain non-exempted restrictions: see Annex 6. For example, non-compete provisions or obligations imposed on the buyer are generally only permitted under the VABER if their duration is limited to a period of five years or less. However, if an agreement contains any such restrictions and they are severable from the rest of the agreement, the remainder of the agreement may benefit from the VABER.

3.6 The "safe harbours" provided by the VABER and MVBER are subject to the following caveats:

- **Commission withdrawals:** The Commission may by decision withdraw the benefit of the relevant block exemption if it finds in a particular case that the vertical agreement, whether in isolation or in conjunction with other similar agreements, nevertheless has certain effects which are incompatible with the Article 101(3) exemption criteria.[12] In these circumstances the Commission has the burden of proof that the agreement infringes Article 101(1) and does not meet the Article 101(3) criteria. In particular, the VABER and MVBER provide that the Commission may withdraw the benefit of the block exemption where access to the relevant market (or competition therein) is significantly restricted by the "cumulative effect" of parallel networks of vertical agreements with similar substantive effects operated by competing suppliers/buyers;

[12] Recital 13 VABER; Vertical Guidelines, paras. 74 to 78; Recital 21 MVBER; Art. 29(1) of Council Regulation 1/2003.

- **Member State withdrawals:** A NCA may likewise withdraw the benefit of the relevant block exemption in respect of its territory for any particular case where vertical agreements have effects incompatible with the Article 101(3) exemption criteria in that Member State (or a part thereof) – but only if the territory has all the characteristics of a distinct geographic market;[13] and

- **Network effects:** The Commission may by Regulation declare that the relevant block exemption does not apply to specified types of agreements on a particular market where:

  - there are parallel networks of vertical agreements with similar substantive effects, and

  - these networks together cover more than 50% of the relevant market.[14]

[13] Recital 14 VABER; Vertical Guidelines, para. 78; Recital 22 MVBER; Art. 29(2) of Council Regulation 1/2003.
[14] Art. 6 VABER; Vertical Guidelines, paras. 79 to 85; Art. 6 MVBER.

4. Outside the "safe harbours" - case-by-case analysis

4.1 Where a vertical agreement does not qualify for exemption under the VABER, it may still be appraised favourably in accordance with the principles of Articles 101 and, if applicable, 102.[15] This appraisal involves a full analysis of the agreement's effects on competition. The Vertical Guidelines – together with the Commission's 2004 Guidelines on the application of Article 101(3)[16] – aim to assist business in undertaking this assessment.[17] For a summary of the issues which the Guidelines suggest should be taken into account, see Annex 7. As already indicated, the key issues for this assessment tend to be:

- the structure of competition on the relevant markets and degree of market power exercised by the parties; and
- whether the operation of the vertical agreement (or network of agreements) will have appreciable market foreclosure effects on competitors and/or result in higher prices to consumers.

4.2 This full Article 101 analysis first involves identifying whether Article 101(1) is applicable at all, i.e. whether the vertical agreement (or network of agreements) appreciably restricts or limits competition. This is a question of fact and degree requiring an examination of all relevant surrounding market circumstances (taking account of the factors listed at Part A of Annex 7).

4.3 If the Commission or a NCA investigates a vertical agreement, they have the burden of proof that the agreement is caught by Article 101(1). If they find that Article 101(1) is applicable, the parties may still be able to substantiate efficiency claims and benefits (i.e. to fall within Article 101(3)) in which case the Commission or NCA must examine whether the Article 101(3) criteria are met. This is a four-limb test (considered further at Part B of Annex 7), requiring the parties to demonstrate that the vertical agreement:

- offers efficiency gains by contributing to improving production and/or distribution or to promoting technical or economic progress. The Vertical Guidelines identify nine potential positive efficiency effects (as listed at Part B.1 of Annex 7);
- offers consumer a fair share of these efficiency gains;
- does not impose on the undertakings concerned any vertical restraints which are not indispensable to the attainment of these efficiency benefits; and
- does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.

[15] While the same is technically true for vertical agreements in the motor vehicle sector if they do not automatically qualify for exemption under the MVBER, the nature of that block exemption (specifically devised to take account of the dynamics of competition in that sector, including the cumulative effect of distribution networks operated by the motor vehicle industry) is such that there will be greater pressures to come within its strict terms.

[16] OJ 2004 C101/97, 27.4.2004.

[17] Companies are encouraged to do their own assessment without involving the Commission or NCAs (Vertical Guidelines, paras. 3 and 96). Where a case nevertheless gives rise to genuine uncertainty because it presents novel or unresolved questions regarding the application of Arts. 101 or 102, the parties may wish to seek informal guidance from the Commission. In 2004 the Commission issued a Notice setting out the framework within which it will assess whether to issue such a guidance letter. The Commission publishes non-confidential versions of such guidance letters on its website.

4.4 Where there is litigation over a vertical agreement, the national court must first assess whether it is caught by Article 101(1) and, if so, whether it comes within the relevant block exemption. If it does not qualify for block exemption treatment, the court must assess whether it meets the Article 101(3) criteria. Under the regime established by Council Regulation 1/2003, national courts are able to rule directly on whether the criteria are satisfied.

4.5 In seeking to identify which types of vertical agreements are likely to have the negative effects and potential benefits outlined above, the Commission's Vertical Guidelines provide guidance on how 10 common types of vertical restraints are analysed. The main elements and examples of each of these common vertical restraints are outlined at Annex 8, which also considers issues relevant to their competitive assessment. A particular vertical agreement may contain combinations of these different type of restraints:

- **Single branding:** where the buyer is restricted to placing all or most of its orders with one particular supplier.
- **Exclusive distribution:** where the supplier sells the contract goods to only one distributor for resale in a particular territory. The distributor is usually limited in its active selling into other (exclusively allocated) territories.
- **Exclusive customer allocation:** where the supplier sells its products to only one distributor for resale to a particular group of customers. The distributor is usually limited in its active selling to other (exclusively allocated) groups of customers.
- **Selective distribution:** where the supplier restricts the number of authorised distributors and their possibilities of resale to non-authorised distributors.
- **Franchising:** where the supplier licenses intellectual property rights relating in particular to trade marks or signs and know-how for the use and distribution of goods or services. Such agreements often contain a combination of clauses concerning selective and exclusive distribution as well as non-compete clauses.
- **Exclusive supply:** where the supplier is obliged or induced to sell the contract products only or mainly to one buyer.
- **Upfront access payments:** where the supplier pays a fixed fee to a distributor in order to get access to its distribution network and remunerate services provided to the suppliers by the retailers.
- **Category management:** where the distributor entrusts the supplier with the marketing of a category of products, including those of competitors.
- **Tying:** where a customer of one product is obliged to purchase another distinct product. This will fall under Article 101(1) if it results in a single-branding obligation.
- **Resale price maintenance:** where the buyer's freedom to determine its resale prices is restricted.

Annex 1: What are vertical agreements and vertical restraints?

Agreement: Is there an agreement (or concerted practice) between two or more independent undertakings?

NB Even if there is no explicit agreement (formal or informal, written or unwritten) expressing the concurrence of wills, it is sufficient that there is a unilateral policy of one party that receives the ***acquiescence*** *of the other party.*

NB ***Intra-group agreements*** *are usually outside Art. 101, so should only raise EU competition issues if the group as a whole may be engaging in abusive behaviour in a market where it enjoys a dominant position under Art. 102 (e.g. by discriminating between customers and its own downstream operations)*

NB Agreements with ***final consumers*** *(not operating as undertakings) are likewise outside Art. 101 (Vertical Guidelines, para. 25(b)).*

NB ***Agency agreements*** *are covered by the concept of a "vertical agreement". Under an agency agreement one party (the principal) appoints another (the agent) to negotiate and/or conclude contracts, on behalf of the principal, for the purchase or supply of goods/services. An agent will often act for more than one principal. It is important to distinguish the following:*

- *restrictions and obligations imposed under a "genuine agency" agreement will generally not be caught by Art. 101(1), i.e. if the agent does not assume any (or only an insignificant part) of the financial or commercial risks in relation to (a) the contracts concluded and/or negotiated on behalf of the principal (e.g. costs and or risks of supply/purchase, storage or advertising of the contract goods or services), (b) the market-specific investments for the agency activity in question (e.g. costs of premises, such as petrol storage tanks for petrol retailing, or training of personnel) or (c) other activities required by the principal to be undertaken on the same product market (Vertical Guidelines, paras. 14-16). In such circumstances, the agent's selling/purchasing function is effectively "integrated" within the principal's business activities, so should not be treated as being between independent undertakings;*
- *if the agent does bear such financial or commercial risks, the agent will be treated as an independent dealer (Vertical Guidelines, paras. 12 to 21). Where an agent sells goods/services on behalf of the principal under an agreement falling within Art. 101(1), the agent is treated as operating as a downstream "buyer" (Art. 1(h) VABER; Vertical Guidelines, paras. 12 to 21).*

Yes → Economic relationship

No → The Art. 101(1) prohibition is not applicable.

Economic relationship: Do the undertakings each operate, for the purposes of the agreement, at a different level of the production or distribution chain? Examples include:

- sale or wholesale of finished goods (e.g. consumer goods) that buyer will resell (or rent) to third parties;
- sale of raw materials or semi-finished goods that buyer will further process before reselling.

NB The concept of a "vertical agreement" does not preclude an undertaking from being active at more than one level of the production/distribution chain (Vertical Guidelines, para. 25(c)).

NB An agreement for the ***lease or rental of goods*** *is not assessed as a "vertical agreement" (Vertical Guidelines, para. 26), as no good or service is being sold by the supplier to the buyer*

Yes → Nature of the agreement

No → Any restrictions and obligations are not able to benefit from the VABER or MVBER

Nature of the agreement: Do restrictions and obligations in the vertical agreement relate to the conditions under which the parties may purchase, sell or resell certain goods (or obtain or provide certain services)?

NB Special considerations apply to agreements dealing with intellectual property rights (see Annex 4).

NB To the extent that the agreement includes restrictions or obligations that do not relate to such conditions of purchase, sale or resale - e.g. if it prevents parties carrying out independent R&D - it will not be covered by the VABER (Vertical Guidelines, para. 26).

Yes → The agreement is a "vertical agreement". Any restrictions and obligations (to extent that they are caught by Art. 101(1)) are "vertical restraints" (Art. 2(1) VABER; Art. 4 MVBER).

No → Any restrictions and obligations are not able to benefit from the VABER or MVBER, so remain subject to full analysis under Art. 101. For horizontal cooperation agreements (i.e. between companies operating at the same level(s) of production or distribution in the market), including between actual or potential competitors, see Slaughter and May publication on *The EU competition rules on horizontal agreements*. For agreements relating to the licensing of intellectual property rights, see Slaughter and May publication on *The EU competition rules on intellectual property licensing*.

Annex 2: Relevant market definition issues

A. Defining the relevant market for competition law purposes - generally

Market definition is a familiar concept under European competition law, serving to identify in a systematic way the competitive constraints that undertakings face. The Commission's 1997 Market Definition Notice – referred to in the Vertical Guidelines (para. 86) – describes factors to take into account when defining markets for competition law purposes.[17] These aim to identify:

- **The relevant product market:** all goods/services which are regarded as interchangeable or substitutable by the consumer by reason of their characteristics, prices and intended use; and
- **The relevant geographic market:** the area in which the undertakings concerned are involved in the supply of relevant goods/services, in which conditions of competition are sufficiently homogeneous, and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas.

B. Relevant factors for calculating whether VABER's 30% market share threshold met[18]

- **Supplier's market share:** Calculate supplier's share on the relevant product and geographic market on which it sells the contract products to the buyer;
- **Buyer's market share:** Calculate buyer's share of the relevant product and geographic market on which it purchases the contract products;
- In an agreement between **three parties at different levels of the supply chain** (e.g. manufacturer, wholesale and retailer), calculate the reseller's market share both as buyer and seller. The VABER applies only if it does not exceed 30% both as buyer and seller;
- **Value basis in preceding calendar year:** Market shares should be calculated on the basis of the market sales value data in the preceding calendar year. If these are not available, estimates based on other reliable market information (including market sales volumes) can be used;[19]
- **In-house production:** In-house production (i.e. production of intermediate products for own use) should not be included in the calculation of the size of the relevant market – although it may be an important part of the analysis of the competitive structure of the marketplace. However, the relevant market should include supplies made to vertically integrated distributors (and agents) (i.e. where the undertaking is involved in production and distribution) for the purposes of sale;[20]
- **Use of same agreement for different products/services:** If the 30% threshold is met for some products but not others, the VABER is applicable to those goods/services where the conditions are fulfilled. For the non-covered goods/services, it is necessary to appraise whether the Art. 101(1) and (3) criteria are met;[21]

[17] Further guidance on the relevant market in the context of vertical agreements is provided at paras. 87 to 92 of the Vertical Guidelines.

[18] Art. 8 VABER, Vertical Guidelines, in particular paras. 87 to 95.

[19] Art. 7(a)-(b) VABER, Vertical Guidelines, para. 93.

[20] Integrated distributors are connected undertakings within the meaning of Art. 1(2) of the VABER (VABER, Art. 7(c) and Vertical Guidelines, paras. 94 to 95).

[21] Vertical Guidelines, paras. 72 to 73.

- **Short-term increases above 30%:** If the relevant market share (while initially within the 30% threshold) subsequently exceeds 30% but does not exceed 35%, the VABER can continue to apply for two consecutive calendar years. If the relevant market share (while initially within the 30% threshold) subsequently exceeds 35%, the block exemption can continue to apply for one calendar year (provided that this exception cannot be combined with the 30-35% exception so as to exceed a period of two calendar years);[22]
- **New products:** Where a distributor has to commit substantial investment to start up and/or develop a new market (e.g. a new brand or an existing brand in a new market) where there was previously no demand for that type of product in general, or for that type of product from that producer, restrictions of passive sales by other distributors into such a territory or to such a customer group generally fall outside Art. 101(1), irrespective of market share, for the first two years after putting the product on the market.[23]

[22] VABER, Art. 7(d)-(f).

[23] Vertical Guidelines, para. 61.

Annex 3: Analysing vertical agreements

Is it a "vertical agreement"? (See Annex 1 – including for observations on agency agreements)

No

Neither the VABER nor the MVBER is available.

Yes

Does it fall within the scope of another Commission block exemption? The VABER and MVBER do not apply to vertical agreements the subject matter of which falls within the scope of any other current or future block exemption regulation (Art. 2(5) VABER; Vertical Guidelines, para. 46). Consider:

a. Technology transfer block exemption (see Slaughter and May publication on *The EU competition rules on intellectual property licensing)*;

b. Block exemptions covering horizontal agreements (see Slaughter and May publication on *The EU competition rules on horizontal agreements*), in particular the R&D and Specialisation block exemptions.

Yes

The VABER/MVBER are not applicable to the agreement.

No

Is the agreement between an association of distributors/dealers (e.g. retailers selling goods to final consumers, motor vehicle/spare parts dealers or repairers) and either (a) its members, or (b) its suppliers? (Art. 2(2) and Recital (3) VABER; Vertical Guidelines, paras. 29 and 30; Art. 2(2)(a) and Recital (6) MVBER): *NB The availability of the block exemptions to such associations of retailers is without prejudice to the application of Art. 101(1) to horizontal agreements between its members or to decisions adopted by such associations (for which see Horizontal Guidelines).*

Yes

Did any of the individual members have annual group turnover of more than €50 million in its last financial year? *NB This group turnover threshold may be exceeded by up to 10% (i.e. annual group turnover of no more than €55 million) for up to two consecutive financial years (Art. 9 VABER).*

Yes

No

No

Are the parties "competing undertakings"? (Arts. 1(1)(c) and 2(4) VABER; Vertical Guidelines, paras. 27 and 28): In general the VABER and MVBER do not cover agreements between actual or realistic potential competitors in the same product market (irrespective of whether they are active in the same geographic market). In considering whether goods/services are interchangeable or substitutable, regard must be had to their characteristics, prices and intended use (see Annex 2). *NB For cooperation between competitors (in particular "commercialisation agreements"), see Horizontal Guidelines.*

Yes

Is it a non-reciprocal agreement where the supplier is:

- a manufacturer and distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods (i.e. "dual distribution" of goods)? or
- a provider of services at several levels of trade, while the buyer operates at the retail level and does not provide services at the level of trade where it purchases the contract services (i.e. "dual distribution" of services)?

Yes

No

No

Does the agreement contain any "hardcore restrictions"? (Art. 4 and Recital (10) VABER; Vertical Guidelines, paras. 47 to 59; *De Minimis* Notice at point 13): These hardcore restraints are described at Annex 5. Consider whether the agreement has such objects, directly or indirectly, in isolation or in combination with other factors under the control of the parties. *NB If the agreement includes one or more hardcore restrictions, the benefit of the block exemption is lost for the entire vertical agreement. There is no severability for hardcore restrictions (Vertical Guidelines, para. 70).*

Yes

No

Buyer's market share (Art. 3 and Recital (8) VABER; Vertical Guidelines, para. 87; Arts 3(2)): Does the buyer (including connected undertakings) have a market share of less than 30% on the market where it (re)sells the contract products? For guidance on calculating market shares, see Part B of Annex 2.

No

Yes

Supplier's market share (Art. 3 and Recital (8) VABER; Vertical Guidelines, para. 87): Does the supplier (including connected undertakings) have a market share of less than 30% on the market where it sells the contract products to the buyer? For guidance on calculating market shares, see Part B of Annex 2.

No

Yes

Does the agreement contain any specifically non-exempted vertical restrictions? (Art. 5 VABER; Vertical Guidelines, paras. 65 to 69): These non-exempted restrictions are described at Annex 6.

No

Yes

Are these provisions severable? Even if the agreement includes one or more of these expressly non-exempted vertical restrictions, the benefit of the VABER is only lost in relation to that part of the vertical agreement which does not comply with those conditions. It is thus possible to sever such restrictions from the agreement, if this is permitted under the terms of the agreement between the parties (including relevant national law), thereby treating the agreement as not containing any such restrictions (Vertical Guidelines, paras. 65 and 71).

Yes

No

The agreement meets the criteria of the block exemption. The parties can take advantage of this "safe harbour" and there is no need to undertake more detailed Art. 101 analysis.

The agreement does NOT meet the criteria of the block exemption. It should therefore be subject to more detailed Art. 101 analysis (see Annex 7).

Annex 4: Treatment of intellectual property rights

Does the agreement contain provisions relating to the licensing or assignment of IPRs? (Art. 2(3) VABER; Vertical Guidelines, paras. 31 to 45; Art. 2(2)(b) and Recital (6) MVBER).

No

Yes

Are those IPRs licensed or assigned to the buyer for the purpose of using, selling or reselling the contract goods/services? *NB For example, the VABER does not apply where the buyer licenses IPRs (or provides equipment) to the supplier to enable it to manufacture/supply the contract goods/services. However, it may still apply where the buyer supplies specifications to the supplier which merely describe the contract goods/services to be supplied (including e.g. a subcontracting agreement between non-competitors, a licence agreement under which the licensee is licensed to dilute and bottle concentrated extract for a drink, or a licence agreement to reproduce software for resale).*

Yes

No

Whether IPR provisions are ancillary to the agreement: Are the provisions on IPRs directly related to the use, sale or resale of goods/services by the buyer or its customers? The VABER is not available if the provisions on IPRs constitute the primary object of the agreement. IPR licences which may be considered directly related include:

- Trade mark licences (Vertical Guidelines, para. 39): e.g. to a distributor in relation to the distribution of the licensor's goods/services in the territory (and, if on an exclusive basis, amounts to exclusive distribution);
- Copyright licences (Vertical Guidelines, paras. 40 to 42): e.g. where the contract goods are books, shrink-wrapped software, etc.;
- Know-how licences (Vertical Guidelines, paras. 43 to 45): e.g. in relation to a franchise agreement which may generally involve trade marks, signs and know-how for the distribution of goods/services.

*NB In a **franchise** agreement, the following obligations on the franchisee are generally considered necessary to protect the franchisor's IPRs and the uniformity and reputation of the franchise system (Vertical Guidelines, paras. 45 and 189 to 190; 2004 Guidelines on the application of Art. 101(3), para. 31):*

- *not to engage directly or indirectly in any similar business;*
- *not to acquire financial interests in the capital of a competing undertaking (if this would give the franchisee the power to influence the economic conduct of such undertaking);*
- *not to disclose the know-how to third parties (as long as the know-how is not in the public domain);*
- *to communicate to the franchisor any experience gained in exploiting the franchise, and to grant it (and other franchisees) a non-exclusive licence for the know-how resulting from that experience;*
- *to inform the franchisor of infringements of licensed IPRs, take legal action against infringers, or assist the franchisor in such actions;*
- *not to use the licensed know-how for purposes other than the exploitation of the franchise;*
- *not to assign the rights and obligations under the franchise agreement without the franchisor's consent.*

Yes

No

- Do IPR provisions involve restrictions on competition with the same object or effect as:
- "hardcore" vertical restraints?: See Annex 5;
- "non-exempted" vertical restraints?: See Annex 6.

No

Yes

The availability of the VABER (or MVBER) is not excluded.

The VABER and MVBER are not applicable to the agreement (but the technology transfer block exemption may be available: see separate Slaughter and May publication on *The EU competition rules on intellectual property licensing*).

Annex 5: Hardcore restrictions

5.1 Hardcore restrictions under the VABER and MVBER

A. Price-fixing or resale price maintenance (RPM)
Price-fixing restrictions on the buyer, including RPM, are not permitted under the VABER (Art. 4(a); Vertical Guidelines, paras. 48 to 49 and 222 to 229); also *De Minimis* Notice at point 13. Price-fixing extends to any attempt by a supplier, directly or indirectly, to restrict the buyer's ability to determine its resale prices, e.g.: • fixing the distribution margin or maximum level of discount the buyer can grant from a prescribed price level; • making the grant of rebates or reimbursement of promotional costs conditional upon respecting certain price levels; • linking resale prices to competitors' resale prices; • threatening to delay or withhold supplies (or impose other penalties) for failure to observe certain price levels; or • taking measures to identify price-cutting dealers (e.g. price monitoring systems, obligation to report other buyers engaging in discounting). *NB Providing a list of recommended selling prices, imposing maximum selling price, or using a particular supportive measure (such as price marked packs), does not constitute a hardcore restriction, provided these do not amount to fixed/minimum selling prices as a result of pressure from, or incentives offered by, the supplier.* *NB For agency agreements caught by Art. 101(1), it would be a "hardcore" restriction for the principal to prevent the agent from sharing its commission with the customer (Vertical Guidelines, para. 49).*

B. Certain territorial/customer sales restrictions (generally)

Certain territorial or customer restrictions on the buyer are generally not permitted under the VABER (Art. 4(b); Vertical Guidelines, paras. 50 to 55); also *De Minimis* Notice at point 13. Subject to the exceptions considered below, this applies to any direct or indirect restrictions on the territories in which, or customers to whom, the buyer may sell the contract goods or services (such as obligations to refer orders from such customers to the supplier or other dealers).

NB This hardcore restriction does not apply if:

- *the supplier restricts the buyer's distribution outlet(s) and warehouse(s) to a particular address, place or territory (Art. 4(b) VABER; para. 50 Vertical Guidelines);*
- *substantial investment by a distributor is necessary to start up and/or develop a new market, in which case restrictions on passive sales by other distributors into that market may fall outside Art. 101(1) for a period of two years (Vertical Guidelines, para. 61; 2004 Guidelines on the application of Art. 101(3), para. 18(2)); or*
- *the prohibition is objectively necessary, e.g. a ban on selling dangerous substances to certain customers on safety or health grounds (Vertical Guidelines, para. 60; 2004 Guidelines on the application of Art. 101(3), para. 18(2)).*

NB Indirect restrictions (having the same object or effect as a sales restriction) would include practices such as (Vertical Guidelines, para. 50):

- *refusal or reduction of bonuses or discounts,*
- *termination of supply or reducing volumes supplied,*
- *threat of contract termination,*
- *profit pass-over obligations,*
- *failure to provide an EU-wide guarantee service (under which normally all dealers are obliged to provide the guarantee service and are reimbursed for this service by the supplier even in relation to products sold by other dealers into their territory), in particular if these practices are combined with the implementation by the supplier of a monitoring system aimed at verifying the actual destination of the supplied goods (e.g. differential labels or serial numbers).*

This hardcore restriction is subject to the following permitted sales restrictions (a "white list") (Vertical Guidelines, paras. 51 to 55):

- **Qualified protection of supplier or its other dealers:** Restrictions on "active" sales (such as the sending of unsolicited emails or targeted online advertising) into the exclusive territory and/or exclusive customer group reserved to the supplier or another of its dealers, provided such restrictions do not limit sales by the buyer's customers. Dealers must, however, be free to make "passive" sales in response to orders from such territories or customer groups (such as responding to unsolicited requests).

  NB Where a dealer uses the internet to advertise/sell the contract goods/services, this is generally considered as a form of "passive" sales (regardless, for example, of the language used) (Vertical Guidelines, para. 52). Accordingly, examples of prima facie hardcore restrictions on passive selling include requiring a dealer:

  - *to prevent customers located in another part of the EU from viewing its website or to automatically re-route customers to the supplier's or other dealers' websites (NB a supplier may require the dealer's website to have links to websites of other dealers and/or the supplier);*
  - *to terminate customers' internet transactions once their credit card data reveal an address that is not within the distributor's territory (NB a supplier may demand a minimum amount of offline sales);*
  - *to limit the proportion of overall sales made over the internet;*
  - *to pay a higher price for products intended to be resold online (NB a supplier can offer a fixed fee to support offline or online sales efforts).*

  NB A supplier may require quality standards for the use of the internet to resell goods (in particular for selective distribution, a supplier may require its dealers to have a physical outlet before engaging in internet selling provided that the object is not to limit online sales).

- **Wholesalers:** For sales to buyers operating at the wholesale level of trade, it is permitted to restrict sales (active or passive) to end users (allowing a supplier to keep the wholesale and retail level of trade separate).
- **Selective distribution systems:** It is permitted to restrict authorised dealers from active or passive sales to unauthorised dealers. Also selective and exclusive distribution can be combined (i.e. where the supplier commits to supply only one or a limited number of dealers in a given territory), provided that active and passive selling is not restricted anywhere (Vertical Guidelines, paras. 56 and 185). See Part C below for sales restrictions in selective distribution systems which are not permitted under the VABER.
- **Supply of components:** Where a supply contract covers components to be incorporated into finished goods, it is permitted to restrict the buyer from active or passive sales of the contract goods to competitors of the supplier (i.e. to customers who would use them to manufacture the same type of goods as those produced by the supplier).

C. Further territorial/customer sales restrictions in selective distribution systems

In a selective distribution system (as defined in Art. 1(c) VABER), two further categories of restrictions are not permitted:

- **Sales to end users:** Any restriction on authorised dealers operating at the retail level of trade making sales (active or passive) to end users, whether business users or final consumers (Art. 4(c) VABER; Vertical Guidelines, para. 56); also *De Minimis* Notice at point 13).
- **Cross-supplies between authorised dealers:** Any restriction on authorised dealers making cross-supplies to other authorised dealers (Art. 4(d) VABER; Vertical Guidelines, para. 58); also *De Minimis* Notice at point 13. Dealers must remain free to purchase the contract goods/ services from other authorised dealers within the network (at the same or different levels of trade). Thus "exclusive purchasing" commitments cannot be imposed on authorised dealers (nor may territorial/customer restrictions be imposed on authorised wholesalers' sales to authorised dealers).

  NB The authorised dealer should be free to sell, both actively and passively to all end users, including with the help of the internet. The supplier may require quality standards for the use of the internet site to resell its goods, but they cannot impose criteria for internet selling that are not "equivalent" to those imposed for sales from physical outlets. This does not mean that the criteria must be the same, but that any differences must be justified by the different nature of the two channels. As noted above, an outright ban on internet selling is only possible if there is an objective justification.

  NB It is however permitted to restrict the authorised retailer's ability to determine the location of its business premises or to open a new outlet in a different location (although the use of the internet cannot be assimilated to the opening of a new outlet in a different location). If the retailer's outlet is mobile ("shop on wheels"), the supplier may define an area outside which the mobile outlet cannot be operated. Also, the supplier may commit to supplying only one dealer or a limited number of dealers in a particular part of the territory where the selective distribution system is applied (Vertical Guidelines, para. 57).

D. Certain sales restrictions affecting spare parts

Where a supplier supplies components to a buyer who incorporates them in a product, any restrictions on the supplier selling those components as spare parts to end users or to independent repairers or other service providers are not permitted under the block exemption (Art.4(e) VABER; Vertical Guidelines, para. 59; also *De Minimis* Notice at point 13). For example, if a component manufacturer sells parts to an OEM (original equipment manufacturer) who incorporates them into its own products, that OEM cannot directly or indirectly prevent or restrict the upstream component manufacturer from selling to end users, independent repairers or service providers.

NB This does not concern access to supply of spare parts through the OEM's own network of retailers/ repairers; it is therefore acceptable for the OEM to require its own repair and service network to buy spare parts from it.

5.2 Additional hardcore restrictions under the MVBER

A. Restriction of sale by members of a selective distribution system

Members of a selective distribution system must not be restricted from selling spare parts for motor vehicles to independent repairers which use those parts for the repair and maintenance of motor vehicles (Art. 5(a), Recital (16) MVBER). *NB This aims to give independent repairers access to so-called "captive parts" in a selective distribution system (for example, a motor vehicle manufacturer's network of authorised dealerships). Without this access, independent repairers would not be able to compete effectively with authorised repairers.*

B. Restriction of sale by suppliers of spare parts

An agreement, between a supplier of spare parts, repair tools or diagnostic equipment and a motor vehicle manufacturer, must not restrict the supplier's ability to sell those goods to authorised or independent distributors or repairers, or to end users (Art. 5(b), Recital (17) MVBER).

NB This does not affect the ability of motor vehicle manufacturers to require authorised repairers within their distribution system to only use spare parts that match the quality of the components used for the assembly of a certain motor vehicle. In addition, in view of the vehicle manufacturers' direct contractual involvement in repairs under warranty, free servicing, and recall operations, it is permitted to require authorised repairers to use only spare parts supplied by the vehicle manufacturer for those repairs.

NB Tooling Arrangements: Art. 101(1) does not normally apply to a subcontracting arrangement whereby a motor vehicle manufacturer provides a tool to a component manufacturer for the production of certain components, shares in the product development costs, or contributes necessary IPRs or know-how, and does not allow this contribution to be used for the production of parts to be sold directly in the aftermarket. However, if a motor vehicle manufacturer obliges a component supplier to transfer its ownership of such a tool, IPRs, or know-how, bears only an insignificant part of the product development costs, or does not contribute any necessary tools, IPRs, or know-how, the agreement may be caught by Art. 101(1) (see Commission's Supplementary Guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles (OJ 2010 C138/05), para. 23).

C. Restriction on supplier's ability to place trade mark or logo on component parts

An agreement, between a supplier of components and a motor vehicle manufacturer which uses those components in the assembly process, must not restrict the supplier's ability to place its trade mark or logo in an easily visible manner on such components or spare parts (Art. 5(c), Recital (18) MVBER).
NB Having visible trade marks or logos on vehicle components is seen as important since it allows repairers or end users to identify the manufacturer of the component and to choose between alternative parts.

Annex 6: Other non-exempted vertical restraints under the VABER

The following vertical restraints cannot benefit from the VABER. However, if they are severable from the rest of the agreement (under relevant national law), the remaining part of the agreement may benefit from the VABER.

A. Buyer non-compete obligations (including requirement obligations or quantity-forcing obligations above 80%) if these extend beyond five years

Any direct or indirect obligation which extends beyond a maximum period of five years and causes the buyer (VABER Arts. 1(1)(d) and 5(1)(a); Vertical Guidelines, paras. 66 to 67):

- not to manufacture, purchase or resell goods/services competing with the contract goods/services; or
- to purchase from the supplier (or designated third parties) goods/services equivalent to the value of more than 80% of the buyer's total purchases in the preceding calendar year (of the contract goods/services and their substitutes on the relevant market).

NB Such quantity-forcing obligations are treated as non-competes since they prevent the buyer from purchasing more than 20% of its total purchases from competing suppliers. This includes a prohibition on selling competing goods or services over the internet if it has this effect. If no relevant purchasing data is available for the year prior to the contract, the 80% maximum should be calculated by reference to the buyer's best estimates of its annual total requirements.

NB An indefinite non-compete/requirement obligation (or one tacitly renewable beyond five years) will be treated as extending beyond five years.

NB Even if the duration of the non-compete obligation is five years or less, if obstacles are raised that hinder the buyer from effectively terminating the non-compete obligation after five years, it will not be treated as so limited. For example, if the supplier provides a loan to the buyer, the repayment of that loan should not hinder the buyer from effectively terminating the non-compete obligation at the end of the five year period. Similarly, where the supplier provides the buyer with equipment which is not relationship-specific, the buyer should have the possibility to take over the equipment at its market asset value once the non-compete obligation expires.

Exception: If the contract goods/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, the duration of the non-compete/requirement obligation may extend up to a maximum of the period of occupancy of the point of sale by the buyer. *NB This is relevant e.g. to the situation where the operator of a public house or petrol station obtains its supplies of beer or petrol from a supplier which owns/leases the premises.*

B. Post-termination buyer non-compete obligations

Any direct or indirect obligation requiring the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods/services **unless** (VABER Art. 5(1(b)); Vertical Guidelines, para. 68):

- the obligation is limited to a maximum period of one year post-termination;
- the obligation is limited to goods/services which compete with the contract goods/services;
- the obligation is limited to the point of sale from which the buyer has operated during the contract period; and
- the obligation is indispensable to protect substantial know-how transferred by the supplier to the buyer (for the operation of the vertical agreement).

NB This is without prejudice to the possibility to impose a post-termination restriction (which may be unlimited in time) on the use and discharge of know-how which has not fallen into the public domain. Know-how covers any package of non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified (VABER Art. 1(1)(g)).

C. Restrictions on sales of particular competing products (in a selective distribution system)

Any direct or indirect obligation restricting an authorised dealer in a selective distribution network from selling the brands of particular competing suppliers (VABER Art. 5(1)(c); Vertical Guidelines, para. 69).

NB A combination of selective distribution with a general non-compete (ie. preventing the dealer from selling competing brands in general) can benefit from the VABER.

Annex 7: Issues for Article 101 case-by-case analysis of vertical agreements

A.	Checklist for Art. 101(1) analysis of whether a vertical agreement appreciably restricts or limits competition
1.	**Is there an appreciable effect on trade between Member States?** If the agreement is unlikely to be capable of appreciably affecting trade between Member States (the non-appreciable affectation of trade rule or "NAAT rule"), the EU competition rules are not applicable – although national competition rules may be. The Commission has published detailed guidelines on the effect on trade concept and the NAAT rule in a 2004 Notice (OJ 2004 C101/81, 27.4.2004). The *De Minimis* Notice (at point 4) acknowledges that agreements between SMEs are rarely capable of appreciably affecting trade between Member States.
2.	**Does the agreement include any "hardcore" restrictions** (See Annex 5)**?** If there are, and assuming there is an effect on trade between Member States, there is a presumption that Art. 101(1) is applicable – i.e. that the agreement has as its "object" the restriction of competition – and the criteria of Art. 101(3) are unlikely to be met (Vertical Guidelines, para. 47; 2004 Guidelines on the application of Art. 101(3), para. 23).
3.	**What are the relevant markets** (See Annex 2)**?** Defining the relevant markets is necessary for applying the block exemptions' market share thresholds, as well as for the general application of the competition rules (and the *De Minimis* Notice) where the block exemptions are not available.
4.	**Other factors**: In appraising whether a vertical agreement brings about an appreciable restriction of competition under Art. 101(1), the following factors are particularly relevant. The relative importance of the factors varies from case to case (Vertical Guidelines, paras. 111 to 121): • **nature of the agreement:** in terms of the restraints, their duration and the percentage of total sales on the affected market. Implicit restraints (outside the agreement) should also be taken into account. These may be derived from the way the agreement is implemented and the incentives of the parties; • **parties' market position:** by reference to market share, first mover advantage, patents, portfolio, strength of brands etc.; • **competitors' market positions:** by reference to similar criteria, for actual/potential competitors. The stronger the competitors are and the greater their number, the less risk that the parties will be able to exercise market power and foreclose the market or soften competition. Effective and timely counterstrategies competitors are likely to deploy are also relevant; • **entry barriers:** economies of scale and scope, government regulations, access to resources, essential facilities, brand loyalty, etc. Entry barriers can in general be said to be low if effective entry is likely to occur within one or two years (Vertical Guidelines, para. 117); • **maturity of the market:** negative effects are generally viewed as more likely in a stable or declining market; • **level of trade:** supply of intermediate goods, wholesale supply, retail supply etc. Buyers of intermediate goods/services are normally well informed customers, able to access quality and therefore less reliant on brand and image (Vertical Guidelines, para. 119). Final goods are sold directly or indirectly to final consumers who often rely more on brand or image, so distributors (retailers, wholesalers) having to respond to consumer demand may suffer more (than a buyer of intermediate products) if they are foreclosed from selling certain brands; • **buyer power:** may prevent the parties exercising market power, in particular when buyers can 'sponsor entry' by a new/smaller supplier;

- **nature of the goods/services:** whether commodities, high value, regular or one-off purchases. Vertical restraints for non-branded goods and services (or intermediate goods or services) are generally less harmful than restraints affecting the distribution of branded goods and services (or final goods or services)(Vertical Guidelines, para. 120);
- **other considerations:** e.g. whether there is a combination of different vertical restraints which may aggravate their negative effects or whether there is a cumulative effect of coverage of the market by similar agreements between different parties, whether the agreement is imposed or agreed, the regulatory environment, behaviour that may facilitate collusion (Vertical Guidelines, para. 121) etc.

B. Issues for Art. 101(3) analysis of whether a vertical agreement has sufficient benefits to meet the exemption criteria (all four of which must be satisfied) (Vertical Guidelines, paras. 122 to 127; Commission 2004 Guidelines on the application of Art. 101(3)). The assessment is made on the basis of the facts at any given point in time, and is sensitive to material changes in the facts. When applying Art. 101(3) it is necessary to take into account the investments made by any of the parties and the time needed and restraints required to recoup an efficiency enhancing investment.

1. **Efficiency gains:** The agreement must contribute to improving production or distribution or to promoting technical or economic progress. The Vertical Guidelines include a non-exhaustive list of possible positive effects/efficiencies (paras. 106 to 109):
   - **To solve a "free-rider" problem:** This problem arises where one wholesaler or retailer (reseller B) "free-rides" on the promotional efforts of another reseller (reseller A), e.g. for relatively high value products where advice is required by the consumer (for new or technical products or where the reputation of the product is a major determinant of its demand). The supplier may agree to avoid this by appointing A on an exclusive or similar basis. Similar free-riding issues arise at the supplier level if supplier X invests in promotion at retailer A's premises, but this attracts customers for X's competitors. Again, this can be avoided by non-compete type restraints.
   - **To open up/enter new markets:** For example, when exporting for the first time to a new territory a manufacturer may need to persuade a local distributor to make "first time investments" to establish the brand. It may therefore be necessary to provide the local distributor with territorial protection from other dealers, so that it can recoup these investments (see also Vertical Guidelines, para. 61 as considered at Part B of Annex 1).
   - **The "certification free-rider" issue:** Where a retailer performs a valuable service by identifying good products, it may be of particular interest to a supplier to secure a listing at the time of launch. A short-term period of exclusivity (where the supplier agrees not to supply to other retailers) may be justified in these circumstances.
   - **The "hold-up" problem**: Distribution of a particular product may require the supplier or buyer to make "relationship-specific investments", e.g. in special equipment or training (see also Vertical Guidelines, para. 146). Where these investments may not be recovered in the short run, and one party may be required to invest more than the other, there may be good reason to have some form of vertical restraint. Where the supplier makes the investment, this will generally take the form of a non-compete/quantity-forcing obligation. Where the buyer makes the investment, some form of exclusive distribution/customer allocation or exclusive supply commitment may be appropriate.
   - **The specific hold-up problem in case of transfer of substantial know-how:** Restrictions to prevent secret and substantial know-how being used may be justifiable.

- **The “vertical externality” issue:** A retailer may not gain all the benefits of its action taken to improve sales; some may go to the manufacturer. If the retailer is pricing too high, this may lead to ‘double marginalisation’, which can be avoided by the imposition of a maximum resale price. Selective distribution, exclusive distribution or similar restrictions may increase the retailer’s sales efforts, benefiting the manufacturer if wholesale price exceeds its marginal production costs.
- **Economies of scale in distribution:** By concentrating the resale of its products through a limited number of dealers, a supplier may be able to achieve economies of scale (particularly at the wholesale level). This may be achieved through exclusive distribution, quantity-forcing (e.g. minimum purchasing requirements), selective distribution or exclusive sourcing.
- **Capital market imperfections:** Banks may be reluctant to lend to the parties. Where, because of better information, the supplier provides a loan to the buyer (or vice versa), this may justify a tighter relationship between the parties, including vertical restraints.
- **Uniformity and quality standardisation:** Creating a brand image and attractiveness to final consumers may require a certain measure of uniformity/quality standardisation between dealers. (e.g. restrictions in selective distribution and franchising networks).

Efficiency claims (e.g. regarding cost efficiencies flowing from the agreements or qualitative efficiencies in terms of product improvements) must be substantiated and must produce a net positive effect. Speculative claims on avoidance of free-riding or general statements on cost savings are not sufficient. Nor are cost savings that arise from the mere exercise of market power or from anti-competitive conduct. There may be strong justification for vertical restraints of a limited duration to help the introduction of new complex products or protect relationship-specific investments. According to the 2004 Guidelines on the application of Art. 101(3) (at para. 51 *et seq.*), substantiating the efficiency claims must enable verification of:

- the *nature* of the claimed efficiencies;
- the causal *link* between the agreement and the efficiencies;
- the *likelihood* and *magnitude* of each claimed efficiency; and
- *how* and *when* each claimed efficiency would be achieved.

2. **Fair share for consumers:** The arrangements must allow consumers a fair share of these benefits (they must be at least compensated for the negative effects of the agreement). This means that the efficiency gains must fully offset the likely negative impact on prices, output etc. This can normally be assumed to be fulfilled if there is sufficient residual competition on the market.

   The 2004 Guidelines on the application of Art. 101(3) describe (at para. 93 *et seq.*) the analytical framework for assessing consumer pass-on of efficiency gains distinguishing between the pass-on and balancing of cost efficiencies and the pass-on and balancing of other types of efficiencies (e.g. new or improved products).

3. **Indispensability:** The agreement as such must be reasonably necessary to achieve the efficiencies; furthermore, the individual restrictions must be reasonably necessary for the attainment of the efficiencies. This criterion plays a role in ensuring that the least anti-competitive restraints are chosen to obtain certain positive effects. For example, the Vertical Guidelines refer at para. 103 to how non-exclusive arrangements are generally less anti-competitive than exclusive dealing arrangements (e.g. compare “quantity-forcing” with “buyer non-compete obligations”: see Part 1 of Annex 8).

4. **No elimination of competition:** The arrangements must not afford the parties the possibility of eliminating competition in respect of a substantial part of the relevant market (e.g. by removing all or most existing sources of actual or potential competition). This criterion is related to the question of Art. 102 market dominance. If an undertaking is dominant, or becomes so as a result of the agreement, a vertical restraint with appreciable anti-competitive effects can in principle not meet the exemption criteria. However, the vertical restraint may well fall outside Art. 101(1), e.g. if necessary for the protection of client-specific investments or the transfer of substantial know-how without which the supply/purchase of certain goods/services may not take place.

Annex 8: Vertical Guidelines' analysis of specific vertical restraints

1. Single Branding

1.1 Main element: Buyer is obliged/induced to concentrate its orders for a particular type of product with one supplier – i.e. not to buy and resell (or not to incorporate) competing goods/services (Vertical Guidelines, para. 129). The following vertical restraints are classified as "single branding" (paras. 129 to 150):

- **Buyer non-compete obligations:** where the buyer is obliged/incentivised to purchase more than 80% of its requirements on a particular market from only one supplier. The buyer cannot buy and resell or incorporate competing goods or services.

  Example: *Vertical Guidelines (at para. 149) give a hypothetical example of a four-year non-compete obligation imposed on some retailers ("tied retailers") by a supplier of an impulse-purchase branded consumer products where: supplier has 40% of market (clear No. 1); and 90% of supplier's sales are through tied retailers to whom supplier provides special stocking cabinets.*

- **Quantity-forcing:** where an obligation or incentive scheme makes the buyer purchase its requirements only or mainly (Art. 1(d) VABER suggests if equivalent to more than 80% of its total purchases in the preceding calendar year) from one supplier. For these purposes:
  - Quantity-forcing is viewed as "a weaker form of non-compete" (Vertical Guidelines, para. 129). It may take the form of minimum purchasing requirements, stocking requirements or non-linear pricing, e.g. conditional rebate schemes or a two-part pricing structure (fixed fee plus price per unit);
  - An "English clause", requiring buyer to report any better offer and to give supplier an opportunity to match it, may have similar effects to a single branding obligation (particularly if buyer has to reveal who makes the better offer);

  Example: *Vertical Guidelines (at para. 150) give a hypothetical example of quantity-forcing operated by producer X where: X has 40% of market (clear No. 1); and 80% of X's sales are under five-year contracts which oblige reseller to purchase at least 75% of requirements from X, in return for which X offers financing and equipment at favourable rates. Contracts are terminable by customer after two years by repaying the outstanding loan.*

1.2 Competitive assessment of "single branding" restrictions: The Vertical Guidelines (para. 130) suggest that such vertical restraints have the following potential negative effects on competition:

- Other suppliers cannot sell to the particular buyer(s) – which may lead to **foreclosure** of actual/potential competing suppliers/buyers. This may result in reduction of **inter-brand competition.**
- When applied by several suppliers, the market share is made more rigid – which may facilitate collusion. This may result in reduction of **inter-brand competition.**
- In case of distribution of final goods, the particular retailers will only sell one brand. This may result in **reduction of inter-brand competition** in their stores (loss of in-store competition). Any reduction of inter-brand competition may be mitigated by stronger *ex ante* competition between suppliers to obtain the single branding contract. However, the longer the **duration**, the more likely this effect will not be strong enough to fully compensate for the reduction of inter-brand competition.

1.3 Key issues for Art. 101(1) analysis of "single branding" restrictions (also see factors at Part A of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- **Supplier's market position** (Vertical Guidelines, paras. 132): Single branding restraints are generally imposed by the supplier who may have a network of similar agreements with other buyers.
- **Market coverage and duration of restraint** (Vertical Guidelines, para. 133): The higher the share of the market covered by such agreements, and the longer the duration of the non-compete obligations, the more significant the likely foreclosure effect. Thus non-compete obligations:
  - *of less than one year by non-dominant companies are generally not caught by Art. 101(1);*
  - *of one to five years entered into by non-dominant companies usually require an analysis of pro- and anti-competitive effects;*
  - *of more than five years are likely to be found unnecessarily long;*
  - *entered into by dominant companies are more likely to result in anti-competitive foreclosure.*
- **Competitors' market positions** (Vertical Guidelines, para. 134): If competitors are sufficiently numerous and strong (compared with the supplier), Art. 101(1) should not be applicable (e.g. if competitors have similar market positions and can offer similarly attractive products). However, if a number of suppliers have similar agreements, there may be a "negative cumulative effect" (so, even if individually these suppliers are covered by the block exemption, there may be grounds for its withdrawal). Such a cumulative effect may also facilitate collusion.
- **Entry barriers** (Vertical Guidelines, para. 136): Establishing whether there is real foreclosure involves considering whether competing suppliers have sufficient opportunities to get their goods/services to market.
- **Buyer power** (Vertical Guidelines, para. 137): Absent the prospect of benefiting from efficiencies, powerful customers may not accept agreements which will deprive them of alternative sources of supply. However, even if such buyers are compensated for the loss of competition, consumers as a whole are unlikely to benefit if there are many customers and the single branding obligations have the effect of preventing the entry or expansion of competitors.
- **Level of trade** (Vertical Guidelines, paras. 138 to 141):
  - **Intermediate products:** Foreclosure effects are less likely for intermediate products. Where the supplier is not dominant, competing suppliers still have a substantial share of the remaining "free" market. A serious "cumulative effect" is unlikely to arise as long as less than 50% of the market is "tied";
  - **Wholesale level:** Where the agreement concerns the supply of a final product at the wholesale level and the supplier is not dominant, the analysis will depend on the type of wholesaling concerned (e.g. whether product-specific or covering a range of products) and entry barriers at the wholesale level;
  - **Retail level:** Foreclosure is more likely for final products where non-compete restraints affect the retail level, given the significant entry barriers to manufacturers setting up their own retail operations just for their own products (as well as reduction in in-store inter-brand competition). Significant anti-competitive effects may arise, taking account of other factors, if a non-dominant supplier ties 30% or more of the relevant market at the retail level. Where the supplier is dominant, even a modest tied market share may have significant anti-competitive effects. A serious "cumulative effect" (justifying withdrawal of the block exemption) is unlikely to arise where the individual suppliers each account for less than 30% of the market and the total tied market share is less than 40%. Even where some suppliers exceed the 30% level, a cumulative foreclosure effect is unlikely if the total tied market share is less than 30%.

1.4 Key issues for Art. 101(3) analysis of "single branding" restrictions (also see factors at Part B of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(3) assessment:

- **Efficiency benefits:** To justify single branding vertical restraints – by reference to the list of efficiencies at Part B.1 of Annex 7 – may involve (Vertical Guidelines, para. 145):
  - *solving free-rider problems;*
  - *solving various hold-up problems;*
  - *addressing capital market imperfections.*
- **Indispensability:** Consider whether less restrictive alternatives are available to achieve the efficiency benefits. For example (again by reference to the list of efficiencies at Part B.1 of Annex 7):
  - quantity-forcing is preferable to a non-compete for the efficiencies relating to the free-rider problem, the hold-up problem generally and to capital markets imperfections. However for efficiency (e) (hold-up problem related to the transfer of know-how), a non-compete may be the only viable option (Vertical Guidelines, para. 145);
  - "relationship-specific investments" made by the supplier (efficiency (d)) will generally justify a non-compete or quantity-forcing agreement for the period of depreciation of the investment. More than five years may be justified for high relationship-specific investments.
  - the efficiency concerning the hold-up problem related to the transfer of know-how usually justifies a non-compete obligation for the whole duration of the supply agreement (e.g. in context of franchising).

2. Exclusive Distribution

2.1 **Main element:** Manufacturer/supplier sells the contract goods to only one buyer for resale in a particular territory in the EU (Vertical Guidelines, para. 151). Usually the distributor is restricted from active selling into other exclusively allocated territories.

Examples: *Vertical Guidelines (paras. 165 to 167) give three hypothetical examples:*

- *Exclusive distribution at wholesale level: Supplier A (market leader with 50% at EU level and 40-60% at national levels in supply of a consumer product) appoints different exclusive wholesalers for different Member States/regions but without any "non-compete obligation" on the wholesalers (who are free to distribute competitors' products) nor any "requirements obligation" on the wholesalers (who are free to purchase A's products from other sources);*
- *Exclusive distribution in oligopolistic market: Four suppliers of relatively straightforward branded consumer products (each with 20% market share) each appoint exclusive retailers within local territories, with high degree of overlap in their authorised dealers;*
- *Exclusive distribution combined with exclusive purchasing: Supplier A (market leader with 40-60% market share in most national markets) sells via its own subsidiaries in each Member State, giving an exclusive territory to each appointed retailer. In addition, an "exclusive purchasing" clause obliges each retailer to purchase all its requirements direct from the relevant A subsidiary.*

2.2 **Competitive assessment of "exclusive distribution" arrangements:** The Vertical Guidelines suggest that such vertical restraints may have the following potential negative effects on competition:

- Other buyers cannot buy from the particular supplier – which may lead to foreclosure of more efficient dealers (or dealers with a different distribution format) from the market.
- As fewer dealers will offer the product, this will lead to reduction of intra-brand competition and market partitioning (or total elimination in the case of wide exclusive territories). This may result in reduction of inter-brand competition.
- When applied by most or all competing suppliers, this may facilitate collusion (at distributor or supplier level), so resulting in reduction of inter-brand competition.

2.3 **Key issues for Art. 101(1) analysis of "exclusive distribution" arrangements (also see factors at Part A of Annex 7):** The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- **supplier's market position** (Vertical Guidelines, para. 153);
- **competitors' market positions** (Vertical Guidelines, para. 154);
- **entry barriers**, although "exclusive distribution" should not raise foreclosure issues unless it is combined with "single branding" (Vertical Guidelines, para. 155);
- distributor's position on **downstream** market (Vertical Guidelines, para. 156);
- **buyer power** (Vertical Guidelines, para. 157);
- **maturity of the market** (Vertical Guidelines, para. 158);
- **level of trade**, with wholesale arrangements less likely to have appreciable anti-competitive effects (Vertical Guidelines, para. 159 to 160);
- whether **combination** with "single branding" or "exclusive sourcing" (Vertical Guidelines, paras. 161 to 162).

2.4 **Key issues for Art. 101(3) analysis of "exclusive distribution" arrangements (also see factors at Part B of Annex 7):** The Vertical Guidelines (at para. 164) state that efficiencies under Art. 101(3) are most likely for new products, complex products, "experience products" and "credence products", and where savings in logistic costs due to economies of scale in transport and distribution can be demonstrated.

3. Exclusive Customer Allocation

3.1 **Main element:** Where the supplier agrees to sell its products to only one buyer for resale to a certain class of customer (Vertical Guidelines, paras. 168 to 173). At the same time, the Buyer is usually limited in its active selling to other (exclusively allocated) groups of customers.

Example: *Vertical Guidelines (para. 173) give a hypothetical example of a producer of sophisticated sprinkler installations (with 40% market share) which appoints different specialised dealers, each with five years' exclusivity, for different types of buildings (offices, chemical plants, hospitals, etc.).*

3.2 **Competitive assessment of "exclusive customer allocation" arrangements:** The Vertical Guidelines suggest that such vertical restraints may have the following potential negative effects on competition:

- Other buyers cannot buy from the particular supplier – which may lead to foreclosure of other buyers from the market.
- As fewer distributors will offer the product, this will lead to reduction of intra-brand competition and market partitioning, which may facilitate price discrimination.
- When applied by most or all competing suppliers, this may facilitate collusion (at distributor or supplier level), so resulting in reduction of inter-brand competition.

3.3 **Key issues for Art. 101(1) analysis of "exclusive customer allocation" arrangements (also see factors at Part A of Annex 7):** The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- the same factors relevant to the assessment of exclusive distribution (see 2.3 above);
- foreclosure of non-appointed distributors (Vertical Guidelines, para. 170).

3.4 **Key issues for Art. 101(3) analysis of "exclusive customer allocation" arrangements (also see factors at Part B of Annex 7):** Where the block exemption is not available, the Vertical Guidelines (at para. 172) indicate that "exclusive customer allocation" may lead to efficiencies in cases where the dealer invests in specific equipment, skills or know-how, in particular for new or complex products or those which require adaptation to the needs of the individual customer.

4. Selective Distribution

4.1 Main element: Where the supplier agrees to sell the contract goods/services (usually consumer goods), whether directly or indirectly, only to distributors selected on the basis of certain specified criteria and where those distributors agree not to sell to unauthorised distributors (Art. 1(e) VABER; Vertical Guidelines, paras. 174 to 188). Also, a distinction should be made between:

- Purely **"qualitative"** selective distribution – where the supplier selects the dealer only on the basis of objective criteria required by the nature of the product, such as training of sales personnel, the service provided at the point of sale, without directly limiting the number of distributors. In general considered to fall outside Art. 101(1) for lack of appreciable anti-competitive effects, provided:
  - *Nature of contract goods/services:* There must be a legitimate requirement for selective distribution, having regard to the nature of the goods, to preserve their quality and/or ensure their proper use;
  - *Objective criteria:* Resellers must be chosen on the basis of objective qualitative criteria laid down uniformly for all potential distributors/dealers/repairers and applied in a non-discriminatory manner (e.g. staff training, point-of-sale services, product range and display, dedicated space for brand in showroom); and
  - *Necessity:* Criteria must not go beyond what is necessary; *and*
- **"Quantitative"** selective distribution – where additional criteria more directly limit the potential number of distributors by, for instance, limiting the number of distributors in a given territory or imposing requirements which are in excess of what is required by the nature of the contract (e.g. unreasonable requirements for minimum/maximum sales/turnover, minimum annual purchases, quantified stock requirements) (Vertical Guidelines, para. 175).

  Examples: *Vertical Guidelines (paras. 187 to 188) give two hypothetical examples:*
  - Supplier of consumer durables (market leader with 35%) requires authorised dealers to satisfy certain qualitative criteria (e.g. on range-stocking, levels of customer service), but the system also involves quantitative limits on the number of dealers by area;
  - Selective distribution by a number of branded suppliers of a certain sports article requiring satisfaction of certain criteria (e.g. location of shops, training of sales personnel etc).

4.2 Competitive assessment of "selective distribution" arrangements: The Vertical Guidelines suggest that such vertical restraints may have the following potential negative effects on competition:

- Other buyers cannot buy from the particular supplier – which may lead to foreclosure of other buyers from the market.
- As fewer distributors will offer the product, this may lead to reduction of intra-brand competition, which may facilitate price discrimination.
- Facilitates collusion between suppliers or buyers.

4.3 Key issues for Art. 101(1) analysis of "selective distribution" arrangements (also see factors at Part A of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- supplier's market position (Vertical Guidelines, para. 177);
- competitors' market positions and potential foreclosure of more efficient distributors, including price discounters in downstream market (Vertical Guidelines, paras. 177 to 178);
- cumulative effect if selective distribution operated by several players on market (Vertical Guidelines, paras. 177 to 179);
- entry barriers for non-authorised dealers (Vertical Guidelines, para. 180);
- buyer power (Vertical Guidelines, para. 181);
- if combined with "single branding" obligations potentially foreclosure of other suppliers (Vertical Guidelines, paras. 182 to 183);
- maturity of the market (Vertical Guidelines, para. 184).

4.4 Key issues for Art. 101(3) analysis of "selective distribution" arrangements (also see factors at Part B of Annex 7): The Vertical Guidelines (at paras. 185 to 186) indicate that "selective distribution" may lead to efficiencies in situations concerning potential "free-rider" problems and "quality standardisation" required for brand image – particularly relevant for new products, complex products, "experience products" and "credence products". Combining selective distribution and a clause protecting an appointed dealer against other appointed dealers opening a shop in its vicinity may fulfil conditions of Art. 101(3) if combination indispensable to protect substantial and relationship-specific investment made by authorised dealer. The conditions of Art. 101(3) are unlikely to be fulfilled if new distributors capable of adequately selling the products in question (especially online sellers and price discounters) are foreclosed (Vertical Guidelines, para. 179).

5. Franchising

5.1 **Main element:** The franchisor licenses a business concept (consisting of IPRs – trade marks, signs, know-how) for payment of a franchise fee/royalties by the franchisee. A franchise agreement usually contains a combination of "selective distribution" and/or "non-compete" and/or "exclusive distribution" or weaker forms thereof (Vertical Guidelines, paras. 189 to 191).

Example: *Vertical Guidelines (para. 191) give example of franchising whereby the manufacturer franchises a method of selling sweets to franchisees who are only allowed to sell from agreed premises, to sell to end users or other franchises and are not allowed to sell other sweets.*

5.2 **Competitive assessment of "franchising" arrangements:** The Vertical Guidelines mention that if the franchising agreement contains non-compete obligations or exclusive or selective distribution arrangements, the negative effects on competition and the Art. 101(1) analysis will be the same as for these vertical restraints (see 1, 2 and 4 above). However, for the Art. 101(3) analysis (also see factors at Part B of Annex 7) where the block exemption is not available, there are specific remarks to be made for "franchising":

- The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or indispensable to protect the know-how;
- A non-compete obligation on the goods or services purchased by the franchisee falls outside the scope of Art. 101(1) where the obligation is necessary to maintain the common identity and reputation of the franchised network. Art. 101(1) will not apply so long as the duration of the non-compete obligation does not exceed the duration of the franchise agreement itself.

6. Exclusive Supply

6.1 Main element: Where the supplier is obliged or induced to sell only or mainly to one buyer (Vertical Guidelines, paras. 192 to 202). Quantity-forcing is a weak form of exclusive supply where an incentive scheme makes the supplier concentrate its sales mainly on the one buyer. Exclusive supply contracts can relate either to final goods/services or to intermediate goods/services (e.g. an industrial supply contract where there is only one buyer for a specific use for incorporation).

Example: *Vertical Guidelines (para. 202) give a hypothetical example of an industrial supply contract under which A (with 35% of relevant components market) supplies certain components to B on an exclusive basis for five years (and B agrees to take all its requirements from A for the five years). Under the agreement, A invests in new machines and produces components to B's specifications. B enjoys 40% of the upstream market for the purchase of components and 40% of the relevant downstream market.*

6.2 Competitive assessment of "exclusive supply" arrangements: The Vertical Guidelines (at para. 194) suggest that such vertical restraints may have the following potential negative effects on competition:

- Other buyers cannot buy from the particular supplier – which may foreclose buyers from the market.
- Similar to exclusive distribution arrangements, as fewer buyers will offer the product, this will lead to reduction of intra-brand competition and market partitioning (which may reduce inter-brand competition).

6.3 Key issues for Art. 101(1) analysis of "exclusive supply" arrangements (also see factors at Part A of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- buyer's market position on both the "upstream" market (on which it purchases the contract goods/services) and the "downstream" market (on which the buyer is active) (Vertical Guidelines, para. 194);
- duration of the exclusive supply obligation (Vertical Guidelines, para. 195). The higher the share of the market covered by such agreements, and the longer the duration of the obligation, the more significant the likely foreclosure effect. Thus:
  - exclusivity of less than five years by non-dominant companies will usually require a full Art. 101(3) analysis of pro- and anti-competitive effects;
  - exclusivity beyond five years is likely to be found unnecessarily long;
- competing buyers' market positions on the "upstream" market (Vertical Guidelines, para. 196);
- entry barriers (Vertical Guidelines, para. 197);
- countervailing supplier power (Vertical Guidelines, para. 198);
- whether combination with "non-compete" (Vertical Guidelines, para. 198);
- level of trade and whether an intermediate or final product (Vertical Guidelines, para. 199).

6.4 Key issues for Art. 101(3) analysis of "exclusive supply" arrangements (also see factors at Part B of Annex 7): The Vertical Guidelines (at paras. 200 to 201) state that efficiencies can be expected in the case of a hold-up problem – see Part B.1 of Annex 7 – and such efficiencies are more likely for intermediate products than for final products. Quantity-forcing on the supplier could be a less restrictive alternative, however.

7. Upfront Access Payments

7.1 Main element: Upfront access payments are fixed fees that suppliers pay to distributors at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. Includes slotting allowances, pay-to-stay fees, payments to have access to a distributor's promotional campaigns etc. (Vertical Guidelines, para. 203).

7.2 Competitive assessment of "upfront access payments": The Vertical Guidelines (paras. 204-206) suggest that upfront access payments may have the following negative effects on competition:

- foreclosure of other distributors, in particular when such payments induce the supplier to channel its products through only one or a limited number of distributors (similar to exclusive supply obligation);
- foreclosure of other suppliers, if widespread use increases barriers to entry for small entrants (similar to single branding obligations);
- facilitate collusion between distributors in a concentrated market. The payments may increase the price charged by the supplier, which may reduce retailers' incentives to compete on price on the downstream market, while the profits of distributors are increased as a result of the access payments.

7.3 Key issues for Art. 101(1) analysis of "upfront access payments" (also see factors at Part A of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment:

- For foreclosure of other distributors, the same factors apply as for the assessment of exclusive supply obligations (see 6.3 above).
- For foreclosure of other suppliers, the same factors apply as for the assessment of single branding obligations (see 1.3 above).

7.4 Key issues for Art. 101(3) analysis of "access payments" (also see factors at Part B of Annex 7): The Vertical Guidelines indicate that the following factors are relevant to the Art. 101(3) analysis (Vertical Guidelines, paras. 207 to 208):

- upfront access payments may contribute to an efficient allocation of shelf space for new products due to information asymmetry between the distributor and supplier on the potential for success of new products. Access payments explicitly allow suppliers to compete for shelf space, giving the distributor a signal of which products are most likely to be successful;
- the information asymmetry may give the supplier the incentive to free-ride on distributors' promotional efforts in order to introduce suboptimal products. Access payments shift the risk of product failure back to the suppliers, thereby contributing to an optimal rate of product introductions.

8. Category Management

8.1 **Main element:** The distributor entrusts the supplier (the "category captain") with the marketing of a category of products including competing products as well as those of the supplier (Vertical Guidelines, para. 209). The category captain may, for example, be able to influence product placement and product promotion in the shop and product selection for the shop.

8.2 **Competitive assessment of "category management agreements":** The Vertical Guidelines (paras. 210 to 212) state that "category management" agreements will not be problematic in most cases but sometimes may have the following negative effects on competition, relevant to the Art. 101(1) assessment:

- distortion of competition between suppliers, leading to foreclosure of other suppliers, in particular when the category captain is able to limit or disadvantage the distribution of products of competing suppliers. Moreover, this effect may be stronger where the distributor also sells own label products, and has incentives to exclude certain suppliers. The assessment of the upstream foreclosure effect is made by analogy to the assessment of single branding obligations (See Part 1 of Annex 8 above);
- collusion between distributors if supplier serves as category captain for all or most distributors;
- collusion between suppliers if increased opportunities to exchange information via retailers.

8.3 **Key issues for Art. 101(3) analysis of "category management agreements" (also see factors at Part B of Annex 7):** The Vertical Guidelines indicate that the following factors are relevant to the Art. 101(3) analysis (Vertical Guidelines, para. 213):

- Distributors may achieve economies of scale as they ensure that the optimal quantity of products is presented timely and directly on the shelves or by allowing them to better anticipate demand and to tailor their promotions accordingly;
- Category management agreements may lead to higher customer satisfaction as they better meet demand expectations;
- Benefits are more likely to arise where there is a high level of inter-brand competition and low consumers' switching costs.

9. Tying

9.1 Main element: Where buyer is required to purchase a "tied" good/service from the supplier (or a designated third party) as a condition of purchasing another distinct "tying" good/service. Two products are distinct if, in the absence of tying, a substantial number of customers would purchase the tying product without also buying the tied product from the same supplier. This analysis needs to take account of the nature of the products and commercial usage (e.g. it would not be "tying" to supply shoes with laces). Tying has similar effects to other single branding vertical restraints, amounting to a form of "quantity-forcing" on the buyer in respect of the tied product (and may sometimes be accompanied by a "non-compete obligation" in respect of the tied product) (Vertical Guidelines, paras. 214 to 215).

9.2 Competitive assessment of tying: The Vertical Guidelines (paras. 216 to 217) suggest that tying may have the following potential negative effects on competition:

- Anti-competitive foreclosure on the tied market, the tying market or both. The same analysis will be conducted as for single branding because tying involves a form of quantity-forcing (and may involve a non-compete obligation) on the buyer in respect of the tied product.
- Buyer may pay higher prices for the tied product than it would otherwise do. This occurs if the tying and tied product can be used in variable proportions as inputs to a production process, if the tying allows price discrimination according to the use the customer makes of the tying product and in the case of long-term contracts where it becomes difficult for the customers to calculate the consequences of the tying.

9.3 Key issues for Art. 101(1) analysis of tying (also see factors at Part A of Annex 7): The Vertical Guidelines refer to the following issues for the Art. 101(1) assessment (paras. 219 to 221):

- Supplier's market position: the importance of the supplier on the market of the tying product is the main reason why a buyer may find it difficult to refuse the tying obligation.
- Competitors' positions: as long as competitors are numerous and strong (compared to the supplier), buyers should have sufficient alternatives to purchase the tying product without the tied product.
- Buyer power: absent the prospect of obtaining at least part of the possible efficiencies, powerful customers may not accept agreements.

9.4 Key issues for Art. 101(3) analysis of tying (also see factors at Part B of Annex 7): The Vertical Guidelines (para. 222) refer to the following issues for the Art. 101(3) assessment:

- Efficiency gains: Tying may produce cost reductions (but these must be passed onto consumers) and may ensure a certain uniformity and quality standardisation.
- Indispensability: Where the supplier of the tying product designates which other suppliers the buyer must use for the tied product (e.g. because it is not possible to formulate minimum quality standards), this may fall outside Art. 101(1), e.g. if the supplier does not derive any direct financial benefit from so doing.

10. Resale Price Maintenance

10.1 Main element: An agreement or concerted practice having as its direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer. RPM is a hardcore restriction (Vertical Guidelines, para. 223). Whilst it is presumed that RPM falls within Art. 101(1) and is unlikely to fulfil the conditions in Art. 101(3), this is a rebuttable presumption (Vertical Guidelines, para. 223).

10.2 Competitive assessment of "resale price maintenance": The Vertical Guidelines (paras. 48-49 and 224) suggest that vertical restraints in the "resale price maintenance" group (including recommended resale prices) have the following potential negative effects on competition:

- facilitate collusion between suppliers (in particular in a tight oligopoly) by (i) enhancing price transparency in the market; (ii) undermining the supplier's incentive to cut its price;
- facilitate collusion between the buyers due to lack of intra-brand price competition. Strong or well organised distributors may be able to force/convince one or more suppliers to fix their resale price and thereby help them stabilise a collusive equilibrium;
- soften competition between manufacturers and/or between retailers, e.g. if manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them;
- price increase, as all or certain distributors are prevented from lowering their retail price;
- lower the pressure on the margin of the manufacturer, in particular where it has a commitment problem (an interest in lowering the price charged to subsequent distributors);
- lack of price competition may also reduce dynamism and innovation at the distribution level (e.g. new entry, or entry/expansion of price discounters).

10.3 Key issues for Art. 101(1) analysis of "resale price maintenance" restrictions (also see factors at Part A of Annex 7): Including RPM in an agreement gives rise to the presumption that the agreement restricts competition and thus falls within Art. 101(1) (Vertical Guidelines, para. 223).

Including a recommended resale price, or a maximum resale price may be covered by the VABER provided it does not amount to a minimum or fixed sale price as a result of pressure from, or incentives offered by, any of the parties. Where it is not, the Art. 101(1) assessment will assess the risk that it will have the same effect as RPM if it works as a focal point for the resellers, and/or facilitates collusion between suppliers (Vertical Guidelines, para. 227).

In practice, this will depend on:

- existence of a monitoring mechanism;
- possibility of retaliation in case a distributor deviates from the focal price;
- market position of the supplier.

10.4 Key issues for Art. 101(3) analysis of "resale price maintenance" restrictions (also see factors at Part B of Annex 7): Including RPM in an agreement gives rise to a rebuttable presumption that the agreement is unlikely to fulfil the conditions of Art. 101(3). The Vertical Guidelines refer to the following efficiencies as being relevant to the Art. 101(3) assessment (Vertical Guidelines, paras. 225 and 229):

- Where a supplier introduces a new brand or enters a new market, RPM may be helpful to induce distributors to develop demand;
- In a franchise network or similar distribution system, RPM may be necessary to facilitate short-term price promotions (e.g. two to six weeks);
- Extra margin provided by RPM may allow retailers to provide (additional) pre-sale services, in particular in case of experience or complex products. RPM may prevent free-riding at the distribution level where retailer provides pre-sale services but customers could purchase the product at lower prices from retailers who do not offer these services;
- For maximum resale prices, avoiding double marginalisation may be a particularly relevant efficiency (see Part B.1 of Annex 7).

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