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(Information)

COMMISSION

COMMISSION NOTICE

Guidelines on Vertical Restraints

(2000/C 291/01)

(Text with EEA relevance)

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I. INTRODUCTION

1. Purpose of the Guidelines

(1) These Guidelines set out the principles for the assessment of vertical agreements under Article 81 of the EC Treaty. What are considered vertical agreements is defined in Article 2(1) of Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices⁽¹⁾ (Block Exemption Regulation) (see paragraphs 23 to 45). These Guidelines are without prejudice to the possible parallel application of Article 82 of the Treaty to vertical agreements. The Guidelines are structured in the following way:

- Section II (paragraphs 8 to 20) describes vertical agreements which generally fall outside Article 81(1);
- Section III (paragraphs 21 to 70) comments on the application of the Block Exemption Regulation;
- Section IV (paragraphs 71 to 87) describes the principles concerning the withdrawal of the block exemption and the disapplication of the Block Exemption Regulation;
- Section V (paragraphs 88 to 99) addresses market definition and market share calculation issues;
- Section VI (paragraphs 100 to 229) describes the general framework of analysis and the enforcement policy of the Commission in individual cases concerning vertical agreements.

(2) Throughout these Guidelines the analysis applies to both goods and services, although certain vertical restraints are mainly used in the distribution of goods. Similarly, vertical agreements can be concluded for intermediate and final goods and services. Unless otherwise stated, the analysis and arguments in the text apply to all types of goods and services and to all levels of trade. The term 'products' includes both goods and services. The terms 'supplier' and 'buyer' are used for all levels of trade.

(3) By issuing these Guidelines the Commission aims to help companies to make their own assessment of vertical agreements under the EC competition rules. The standards set forth in these Guidelines must be applied in circumstances specific to each case. This

rules out a mechanical application. Each case must be evaluated in the light of its own facts. The Commission will apply the Guidelines reasonably and flexibly.

(4) These Guidelines are without prejudice to the interpretation that may be given by the Court of First Instance and the Court of Justice of the European Communities in relation to the application of Article 81 to vertical agreements.

2. Applicability of Article 81 to vertical agreements

(5) Article 81 of the EC Treaty applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition (hereinafter referred to as 'vertical restraints')⁽²⁾. For vertical restraints, Article 81 provides an appropriate legal framework for assessment, recognising the distinction between anti-competitive and pro-competitive effects: Article 81(1) prohibits those agreements which appreciably restrict or distort competition, while Article 81(3) allows for exemption of those agreements which confer sufficient benefits to outweigh the anti-competitive effects.

(6) For most vertical restraints, competition concerns can only arise if there is insufficient inter-brand competition, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels. If there is insufficient inter-brand competition, the protection of inter- and intra-brand competition becomes important.

(7) The protection of competition is the primary objective of EC competition policy, as this enhances consumer welfare and creates an efficient allocation of resources. In applying the EC competition rules, the Commission will adopt an economic approach which is based on the effects on the market; vertical agreements have to be analysed in their legal and economic context. However, in the case of restrictions by object as listed in Article 4 of the Block Exemption Regulation, the Commission is not required to assess the actual effects on the market. Market integration is an additional goal of EC competition policy. Market integration enhances competition in the Community. Companies should not be allowed to recreate private barriers between Member States where State barriers have been successfully abolished.

⁽²⁾ See *inter alia* judgment of the Court of Justice of the European Communities in Joined Cases 56/64 and 58/64 Grundig-Consten v Commission [1966] ECR 299; Case 56/65 Technique Minière v Maschinenbau Ulm [1966] ECR 235; and of the Court of First Instance of the European Communities in Case T-77/92 Parker Pen v Commission [1994] ECR II 549.

⁽¹⁾ OJ L 336, 29.12.1999, p. 21.

II. VERTICAL AGREEMENTS WHICH GENERALLY FALL OUTSIDE ARTICLE 81(1)

1. Agreements of minor importance and SMEs

(8) Agreements which are not capable of appreciably affecting trade between Member States or capable of appreciably restricting competition by object or effect are not caught by Article 81(1). The Block Exemption Regulation applies only to agreements falling within the scope of application of Article 81(1). These Guidelines are without prejudice to the application of the present or any future 'de minimis' notice⁽¹⁾.

(9) Subject to the conditions set out in points 11, 18 and 20 of the 'de minimis' notice concerning hardcore restrictions and cumulative effect issues, vertical agreements entered into by undertakings whose market share on the relevant market does not exceed 10 % are generally considered to fall outside the scope of Article 81(1). There is no presumption that vertical agreements concluded by undertakings having more than 10 % market share automatically infringe Article 81(1). Agreements between undertakings whose market share exceeds the 10 % threshold may still not have an appreciable effect on trade between Member States or may not constitute an appreciable restriction of competition⁽²⁾. Such agreements need to be assessed in their legal and economic context. The criteria for the assessment of individual agreements are set out in paragraphs 100 to 229.

(10) As regards hardcore restrictions defined in the 'de minimis' notice, Article 81(1) may apply below the 10 % threshold, provided that there is an appreciable effect on trade between Member States and on competition. The applicable case-law of the Court of Justice and the Court of First Instance is relevant in this respect⁽³⁾. Reference is also made to the particular situation of launching a new product or entering a new market which is dealt with in these Guidelines (paragraph 119, point 10).

(11) In addition, the Commission considers that, subject to cumulative effect and hardcore restrictions, agreements between small and medium-sized undertakings as defined in the Annex to Commission Recommendation 96/280/EC⁽⁴⁾ are rarely capable of appreciably affecting trade between Member States or of appreciably restricting competition within the meaning of Article 81(1), and therefore generally fall outside the scope of Article 81(1). In cases where such agreements nonetheless meet the conditions for the application of Article 81(1), the Commission will normally refrain from opening proceedings for lack of sufficient Community interest unless those undertakings collectively or individually hold a dominant position in a substantial part of the common market.

2. Agency agreements

(12) Paragraphs 12 to 20 replace the Notice on exclusive dealing contracts with commercial agents of 1962⁽⁵⁾. They must be read in conjunction with Council Directive 86/653/EEC⁽⁶⁾.

Agency agreements cover the situation in which a legal or physical person (the agent) is vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the:

- purchase of goods or services by the principal, or
- sale of goods or services supplied by the principal.

(13) In the case of genuine agency agreements, the obligations imposed on the agent as to the contracts negotiated and/or concluded on behalf of the principal do not fall within the scope of application of Article 81(1). The determining factor in assessing whether Article 81(1) is applicable is the financial or commercial risk borne by the agent in relation to the activities for which he has been appointed as an agent by the principal. In this respect it is not material for the assessment whether the agent acts for one or several principals. Non-genuine agency agreements may be caught by Article 81(1), in which case the Block Exemption Regulation and the other sections of these Guidelines will apply.

(1) See Notice on agreements of minor importance of 9 December 1997, OJ C 372, 9.12.1997, p. 13.

(2) See judgment of the Court of First Instance in Case T-7/93 Langnese-Iglo v Commission [1995] ECR II-1533, paragraph 98.

(3) See judgment of the Court of Justice in Case 5/69 Völk v Vervaecke [1969] ECR 295; Case 1/71 Cadillon v Höss [1971] ECR 351 and Case C-306/96 Javico v Yves Saint Laurent [1998] ECR I-1983, paragraphs 16 and 17.

(4) OJ L 107, 30.4.1996, p. 4.

(5) OJ L 139, 24.12.1962, p. 2921/62.

(6) OJ L 382, 31.12.1986, p. 17.

- (14) There are two types of financial or commercial risk that are material to the assessment of the genuine nature of an agency agreement under Article 81(1). First there are the risks which are directly related to the contracts concluded and/or negotiated by the agent on behalf of the principal, such as financing of stocks. Secondly, there are the risks related to market-specific investments. These are investments specifically required for the type of activity for which the agent has been appointed by the principal, i.e. which are required to enable the agent to conclude and/or negotiate this type of contract. Such investments are usually sunk, if upon leaving that particular field of activity the investment cannot be used for other activities or sold other than at a significant loss.
- (15) The agency agreement is considered a genuine agency agreement and consequently falls outside Article 81(1) if the agent does not bear any, or bears only insignificant, risks in relation to the contracts concluded and/or negotiated on behalf of the principal and in relation to market-specific investments for that field of activity. In such a situation, the selling or purchasing function forms part of the principal's activities, despite the fact that the agent is a separate undertaking. The principal thus bears the related financial and commercial risks and the agent does not exercise an independent economic activity in relation to the activities for which he has been appointed as an agent by the principal. In the opposite situation the agency agreement is considered a non-genuine agency agreement and may fall under Article 81(1). In that case the agent does bear such risks and will be treated as an independent dealer who must remain free in determining his marketing strategy in order to be able to recover his contract- or market-specific investments. Risks that are related to the activity of providing agency services in general, such as the risk of the agent's income being dependent upon his success as an agent or general investments in for instance premises or personnel, are not material to this assessment.
- (16) The question of risk must be assessed on a case-by-case basis, and with regard to the economic reality of the situation rather than the legal form. Nonetheless, the Commission considers that Article 81(1) will generally not be applicable to the obligations imposed on the agent as to the contracts negotiated and/or concluded on behalf of the principal where property in the contract goods bought or sold does not vest in the agent, or the agent does not himself supply the contract services and where the agent:
- does not contribute to the costs relating to the supply/purchase of the contract goods or services, including the costs of transporting the goods. This does not preclude the agent from carrying out the transport service, provided that the costs are covered by the principal;
 - is not, directly or indirectly, obliged to invest in sales promotion, such as contributions to the advertising budgets of the principal;
 - does not maintain at his own cost or risk stocks of the contract goods, including the costs of financing the stocks and the costs of loss of stocks and can return unsold goods to the principal without charge, unless the agent is liable for fault (for example, by failing to comply with reasonable security measures to avoid loss of stocks);
 - does not create and/or operate an after-sales service, repair service or a warranty service unless it is fully reimbursed by the principal;
 - does not make market-specific investments in equipment, premises or training of personnel, such as for example the petrol storage tank in the case of petrol retailing or specific software to sell insurance policies in case of insurance agents;
 - does not undertake responsibility towards third parties for damage caused by the product sold (product liability), unless, as agent, he is liable for fault in this respect;
 - does not take responsibility for customers' non-performance of the contract, with the exception of the loss of the agent's commission, unless the agent is liable for fault (for example, by failing to comply with reasonable security or anti-theft measures or failing to comply with reasonable measures to report theft to the principal or police or to communicate to the principal all necessary information available to him on the customer's financial reliability).
- (17) This list is not exhaustive. However, where the agent incurs one or more of the above risks or costs, then Article 81(1) may apply as with any other vertical agreement.

- (18) If an agency agreement does not fall within the scope of application of Article 81(1), then all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 81(1). The following obligations on the agent's part will generally be considered to form an inherent part of an agency agreement, as each of them relates to the ability of the principal to fix the scope of activity of the agent in relation to the contract goods or services, which is essential if the principal is to take the risks and therefore to be in a position to determine the commercial strategy:
- limitations on the territory in which the agent may sell these goods or services;
 - limitations on the customers to whom the agent may sell these goods or services;
 - the prices and conditions at which the agent must sell or purchase these goods or services.
- (19) In addition to governing the conditions of sale or purchase of the contract goods or services by the agent on behalf of the principal, agency agreements often contain provisions which concern the relationship between the agent and the principal. In particular, they may contain a provision preventing the principal from appointing other agents in respect of a given type of transaction, customer or territory (exclusive agency provisions) and/or a provision preventing the agent from acting as an agent or distributor of undertakings which compete with the principal (non-compete provisions). Exclusive agency provisions concern only intra-brand competition and will in general not lead to anti-competitive effects. Non-compete provisions, including post-term non-compete provisions, concern inter-brand competition and may infringe Article 81(1) if they lead to foreclosure on the relevant market where the contract goods or services are sold or purchased (see Section VI.2.1).
- (20) An agency agreement may also fall within the scope of Article 81(1), even if the principal bears all the relevant financial and commercial risks, where it facilitates collusion. This could for instance be the case when a number of principals use the same agents while collectively excluding others from using these agents, or when they use the agents to collude on marketing strategy or to exchange sensitive market information between the principals.
- III. **APPLICATION OF THE BLOCK EXEMPTION REGULATION**
1. **Safe harbour created by the Block Exemption Regulation**
- (21) The Block Exemption Regulation creates a presumption of legality for vertical agreements depending on the market share of the supplier or the buyer. Pursuant to Article 3 of the Block Exemption Regulation, it is in general the market share of the supplier on the market where it sells the contract goods or services which determines the applicability of the block exemption. This market share may not exceed the threshold of 30 % in order for the block exemption to apply. Only where the agreement contains an exclusive supply obligation, as defined in Article 1(c) of the Block Exemption Regulation, is it the buyer's market share on the market where it purchases the contract goods or services which may not exceed the threshold of 30 % in order for the block exemption to apply. For market share issues see Section V (paragraphs 88 to 99).
- (22) From an economic point of view, a vertical agreement may have effects not only on the market between supplier and buyer but also on markets downstream of the buyer. The simplified approach of the Block Exemption Regulation, which only takes into account the market share of the supplier or the buyer (as the case may be) on the market between these two parties, is justified by the fact that below the threshold of 30 % the effects on downstream markets will in general be limited. In addition, only having to consider the market between supplier and buyer makes the application of the Block Exemption Regulation easier and enhances the level of legal certainty, while the instrument of withdrawal (see paragraphs 71 to 87) remains available to remedy possible problems on other related markets.
2. **Scope of the Block Exemption Regulation**
- (i) *Definition of vertical agreements*
- (23) Vertical agreements are defined in Article 2(1) of the Block Exemption Regulation as 'agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services'.

(24) There are three main elements in this definition:

- the agreement or concerted practice is between two or more undertakings. Vertical agreements with final consumers not operating as an undertaking are not covered; More generally, agreements with final consumers do not fall under Article 81(1), as that article applies only to agreements between undertakings, decisions by associations of undertakings and concerted practices. This is without prejudice to the possible application of Article 82 of the Treaty;
- the agreement or concerted practice is between undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain. This means for instance that one undertaking produces a raw material which the other undertaking uses as an input, or that the first is a manufacturer, the second a wholesaler and the third a retailer. This does not preclude an undertaking from being active at more than one level of the production or distribution chain;
- the agreements or concerted practices relate to the conditions under which the parties to the agreement, the supplier and the buyer, 'may purchase, sell or resell certain goods or services'. This reflects the purpose of the Block Exemption Regulation to cover purchase and distribution agreements. These are agreements which concern the conditions for the purchase, sale or resale of the goods or services supplied by the supplier and/or which concern the conditions for the sale by the buyer of the goods or services which incorporate these goods or services. For the application of the Block Exemption Regulation both the goods or services supplied by the supplier and the resulting goods or services are considered to be contract goods or services. Vertical agreements relating to all final and intermediate goods and services are covered. The only exception is the automobile sector, as long as this sector remains covered by a specific block exemption such as that granted by Commission Regulation (EC) No 1475/95⁽¹⁾. The goods or services provided by the supplier may be resold by the buyer or may be used as an input by the buyer to produce his own goods or services.

(25) The Block Exemption Regulation also applies to goods sold and purchased for renting to third parties. However, rent and lease agreements as such are not

covered, as no good or service is being sold by the supplier to the buyer. More generally, the Block Exemption Regulation does not cover restrictions or obligations that do not relate to the conditions of purchase, sale and resale, such as an obligation preventing parties from carrying out independent research and development which the parties may have included in an otherwise vertical agreement. In addition, Articles 2(2) to (5) directly or indirectly exclude certain vertical agreements from the application of the Block Exemption Regulation.

(ii) *Vertical agreements between competitors*

(26) Article 2(4) of the Block Exemption Regulation explicitly excludes from its application 'vertical agreements entered into between competing undertakings'. Vertical agreements between competitors will be dealt with, as regards possible collusion effects, in the forthcoming Guidelines on the applicability of Article 81 to horizontal cooperation⁽²⁾. However, the vertical aspects of such agreements need to be assessed under these Guidelines. Article 1(a) of the Block Exemption Regulation defines competing undertakings as 'actual or potential suppliers in the same product market', irrespective of whether or not they are competitors on the same geographic market. Competing undertakings are undertakings that are actual or potential suppliers of the contract goods or services or goods or services that are substitutes for the contract goods or services. A potential supplier is an undertaking that does not actually produce a competing product but could and would be likely to do so in the absence of the agreement in response to a small and permanent increase in relative prices. This means that the undertaking would be able and likely to undertake the necessary additional investments and supply the market within 1 year. This assessment has to be based on realistic grounds; the mere theoretical possibility of entering a market is not sufficient⁽³⁾.

(27) There are three exceptions to the general exclusion of vertical agreements between competitors, all three being set out in Article 2(4) and relating to non-reciprocal agreements. Non-reciprocal means, for instance, that while one manufacturer becomes the distributor of the products of another manufacturer, the latter does not become the distributor of the

⁽¹⁾ OJ L 145, 29.6.1995, p. 25.

⁽²⁾ Draft text published in OJ C 118, 27.4.2000, p. 14.

⁽³⁾ See Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5, at paras. 20-24, the Commission's Thirteenth Report on Competition Policy, point 55, and Commission Decision 90/410/EEC in Case No IV/32.009 — Elopak/Metal Box-Odin, OJ L 209, 8.8.1990, p. 15.

products of the first manufacturer. Non-reciprocal agreements between competitors are covered by the Block Exemption Regulation where (1) the buyer has a turnover not exceeding EUR 100 million, or (2) the supplier is a manufacturer and distributor of goods, while the buyer is only a distributor and not also a manufacturer of competing goods, or (3) the supplier is a provider of services operating at several levels of trade, while the buyer does not provide competing services at the level of trade where it purchases the contract services. The second exception covers situations of dual distribution, i.e. the manufacturer of particular goods also acts as a distributor of the goods in competition with independent distributors of his goods. A distributor who provides specifications to a manufacturer to produce particular goods under the distributor's brand name is not to be considered a manufacturer of such own-brand goods. The third exception covers similar situations of dual distribution, but in this case for services, when the supplier is also a provider of services at the level of the buyer.

(iii) *Associations of retailers*

(28) Article 2(2) of the Block Exemption Regulation includes in its application vertical agreements entered into by an association of undertakings which fulfils certain conditions and thereby excludes from the Block Exemption Regulation vertical agreements entered into by all other associations. Vertical agreements entered into between an association and its members, or between an association and its suppliers, are covered by the Block Exemption Regulation only if all the members are retailers of goods (not services) and if each individual member of the association has a turnover not exceeding EUR 50 million. Retailers are distributors reselling goods to final consumers. Where only a limited number of the members of the association have a turnover not significantly exceeding the EUR 50 million threshold, this will normally not change the assessment under Article 81.

(29) An association of undertakings may involve both horizontal and vertical agreements. The horizontal agreements have to be assessed according to the principles set out in the forthcoming Guidelines on the applicability of Article 81 to horizontal cooperation. If this assessment leads to the conclusion that a cooperation between undertakings in the area of purchasing or selling is acceptable, a further assessment will be necessary to examine the vertical agreements concluded by the association with its suppliers or its individual members. The latter assessment will follow the rules of the Block Exemption Regulation and these Guidelines. For instance, horizontal agreements concluded between the members of the association or decisions adopted by the association, such as

the decision to require the members to purchase from the association or the decision to allocate exclusive territories to the members have to be assessed first as a horizontal agreement. Only if this assessment is positive does it become relevant to assess the vertical agreements between the association and individual members or between the association and suppliers.

(iv) *Vertical agreements containing provisions on intellectual property rights (IPRs)*

(30) Article 2(3) of the Block Exemption Regulation includes in its application vertical agreements containing certain provisions relating to the assignment of IPRs to or use of IPRs by the buyer and thereby excludes from the Block Exemption Regulation all other vertical agreements containing IPR provisions. The Block Exemption Regulation applies to vertical agreements containing IPR provisions when five conditions are fulfilled:

— The IPR provisions must be part of a vertical agreement, i.e. an agreement with conditions under which the parties may purchase, sell or resell certain goods or services;

— The IPRs must be assigned to, or for use by, the buyer;

— The IPR provisions must not constitute the primary object of the agreement;

— The IPR provisions must be directly related to the use, sale or resale of goods or services by the buyer or his customers. In the case of franchising where marketing forms the object of the exploitation of the IPRs, the goods or services are distributed by the master franchisee or the franchisees;

— The IPR provisions, in relation to the contract goods or services, must not contain restrictions of competition having the same object or effect as vertical restraints which are not exempted under the Block Exemption Regulation.

(31) These conditions ensure that the Block Exemption Regulation applies to vertical agreements where the use, sale or resale of goods or services can be performed more effectively because IPRs are assigned to or transferred for use by the buyer. In other words, restrictions concerning the assignment or use of IPRs can be covered when the main object of the agreement is the purchase or distribution of goods or services.

(32) The first condition makes clear that the context in which the IPRs are provided is an agreement to purchase or distribute goods or an agreement to purchase or provide services and not an agreement concerning the assignment or licensing of IPRs for the manufacture of goods, nor a pure licensing agreement. The Block Exemption Regulation does not cover for instance:

- agreements where a party provides another party with a recipe and licenses the other party to produce a drink with this recipe;
- agreements under which one party provides another party with a mould or master copy and licenses the other party to produce and distribute copies;
- the pure licence of a trade mark or sign for the purposes of merchandising;
- sponsorship contracts concerning the right to advertise oneself as being an official sponsor of an event;
- copyright licensing such as broadcasting contracts concerning the right to record and/or the right to broadcast an event.

(33) The second condition makes clear that the Block Exemption Regulation does not apply when the IPRs are provided by the buyer to the supplier, no matter whether the IPRs concern the manner of manufacture or of distribution. An agreement relating to the transfer of IPRs to the supplier and containing possible restrictions on the sales made by the supplier is not covered by the Block Exemption Regulation. This means in particular that subcontracting involving the transfer of know-how to a subcontractor⁽¹⁾ does not fall within the scope of application of the Block Exemption Regulation. However, vertical agreements under which the buyer provides only specifications to the supplier which describe the goods or services to be supplied are covered by the Block Exemption Regulation.

(34) The third condition makes clear that in order to be covered by the Block Exemption Regulation the primary object of the agreement must not be the assignment or licensing of IPRs. The primary object must be the purchase or distribution of goods or services and the IPR provisions must serve the implementation of the vertical agreement.

(35) The fourth condition requires that the IPR provisions facilitate the use, sale or resale of goods or services by the buyer or his customers. The goods or services for use or resale are usually supplied by the licensor but may also be purchased by the licensee from a third supplier. The IPR provisions will normally concern the marketing of goods or services. This is for instance the case in a franchise agreement where the franchisor

sells to the franchisee goods for resale and in addition licenses the franchisee to use his trade mark and know-how to market the goods. Also covered is the case where the supplier of a concentrated extract licenses the buyer to dilute and bottle the extract before selling it as a drink.

(36) The fifth condition signifies in particular that the IPR provisions should not have the same object or effect as any of the hardcore restrictions listed in Article 4 of the Block Exemption Regulation or any of the restrictions excluded from the coverage of the Block Exemption Regulation by Article 5 (see paragraphs 46 to 61).

(37) Intellectual property rights which may be considered to serve the implementation of vertical agreements within the meaning of Article 2(3) of the Block Exemption Regulation generally concern three main areas: trade marks, copyright and know-how.

Trade mark

(38) A trade mark licence to a distributor may be related to the distribution of the licensor's products in a particular territory. If it is an exclusive licence, the agreement amounts to exclusive distribution.

Copyright

(39) Resellers of goods covered by copyright (books, software, etc.) may be obliged by the copyright holder only to resell under the condition that the buyer, whether another reseller or the end user, shall not infringe the copyright. Such obligations on the reseller, to the extent that they fall under Article 81(1) at all, are covered by the Block Exemption Regulation.

(40) Agreements under which hard copies of software are supplied for resale and where the reseller does not acquire a licence to any rights over the software but only has the right to resell the hard copies, are to be regarded as agreements for the supply of goods for resale for the purpose of the Block Exemption Regulation. Under this form of distribution the licence of the software only takes place between the copyright owner and the user of the software. This may take the form of a 'shrink wrap' licence, i.e. a set of conditions included in the package of the hard copy which the end user is deemed to accept by opening the package.

⁽¹⁾ See Notice on subcontracting, OJ C 1, 3.1.1979, p. 2.

(41) Buyers of hardware incorporating software protected by copyright may be obliged by the copyright holder not to infringe the copyright, for example not to make copies and resell the software or not to make copies and use the software in combination with other hardware. Such use-restrictions, to the extent that they fall within Article 81(1) at all, are covered by the Block Exemption Regulation.

Know-how

(42) Franchise agreements, with the exception of industrial franchise agreements, are the most obvious example where know-how for marketing purposes is communicated to the buyer. Franchise agreements contain licences of intellectual property rights relating to trade marks or signs and know-how for the use and distribution of goods or the provision of services. In addition to the licence of IPR, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance, such as procurement services, training, advice on real estate, financial planning etc. The licence and the assistance are integral components of the business method being franchised.

(43) Licensing contained in franchise agreements is covered by the Block Exemption Regulation if all five conditions listed in point 30 are fulfilled. This is usually the case, as under most franchise agreements, including master franchise agreements, the franchisor provides goods and/or services, in particular commercial or technical assistance services, to the franchisee. The IPRs help the franchisee to resell the products supplied by the franchisor or by a supplier designated by the franchisor or to use those products and sell the resulting goods or services. Where the franchise agreement only or primarily concerns licensing of IPRs, such an agreement is not covered by the Block Exemption Regulation, but it will be treated in a way similar to those franchise agreements which are covered by the Block Exemption Regulation.

(44) The following IPR-related obligations are generally considered to be necessary to protect the franchisor's intellectual property rights and are, if these obligations fall under Article 81(1), also covered by the Block Exemption Regulation:

- (a) an obligation on the franchisee not to engage, directly or indirectly, in any similar business;

(b) an obligation on the franchisee not to acquire financial interests in the capital of a competing undertaking such as would give the franchisee the power to influence the economic conduct of such undertaking;

(c) an obligation on the franchisee not to disclose to third parties the know-how provided by the franchisor as long as this know-how is not in the public domain;

(d) an obligation on the franchisee 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;

(e) an obligation on the franchisee to inform the franchisor of infringements of licensed intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers;

(f) an obligation on the franchisee not to use know-how licensed by the franchisor for purposes other than the exploitation of the franchise;

(g) an obligation on the franchisee not to assign the rights and obligations under the franchise agreement without the franchisor's consent.

(v) Relationship to other block exemption regulations

(45) Article 2(5) states that the Block Exemption Regulation does 'not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation.' This means that the Block Exemption Regulation does not apply to vertical agreements covered by Commission Regulation (EC) No 240/96⁽¹⁾ on technology transfer, Commission Regulation (EC) No 1475/1995⁽²⁾ for car distribution or Regulations (EEC) No 417/85⁽³⁾ and (EEC) No 418/85⁽⁴⁾ exempting vertical agreements concluded in connection with horizontal agreements, as last amended by Regulation (EC) No 2236/97⁽⁵⁾ or any future regulations of that kind.

⁽¹⁾ OJ L 31, 9.2.1996, p. 2.

⁽²⁾ OJ L 145, 29.6.1995, p. 25.

⁽³⁾ OJ L 53, 22.2.1985, p. 1.

⁽⁴⁾ OJ L 53, 22.2.1985, p. 5.

⁽⁵⁾ OJ L 306, 11.11.1997, p. 12.

3. **Hardcore restrictions under the Block Exemption Regulation**

- (46) The Block Exemption Regulation contains in Article 4 a list of hardcore restrictions which lead to the exclusion of the whole vertical agreement from the scope of application of the Block Exemption Regulation. This list of hardcore restrictions applies to vertical agreements concerning trade within the Community. In so far as vertical agreements concern exports outside the Community or imports/re-imports from outside the Community see the judgment in *Javico v Yves Saint Laurent*. Individual exemption of vertical agreements containing such hardcore restrictions is also unlikely.
- (47) The hardcore restriction set out in Article 4(a) of the Block Exemption Regulation concerns resale price maintenance (RPM), that is agreements or concerted practices having as their 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. In the case of contractual provisions or concerted practices that directly establish the resale price, the restriction is clear cut. However, RPM can also be achieved through indirect means. Examples of the latter are an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level. Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price monitoring system, or the obligation on retailers to report other members of the distribution network who deviate from the standard price level. Similarly, direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as the supplier printing a recommended resale price on the product or the supplier obliging the buyer to apply a most-favoured-customer clause. The same indirect means and the same 'supportive' measures can be used to make maximum or recommended prices work as RPM. However, the provision of a list of recommended prices or maximum prices by the supplier to the buyer is not considered in itself as leading to RPM.
- (48) In the case of agency agreements, the principal normally establishes the sales price, as the agent does not become the owner of the goods. However, where an agency agreement falls within Article 81(1) (see paragraphs 12 to 20), an obligation preventing or restricting the agent from sharing his commission, fixed or variable, with the customer would be a hardcore restriction under Article 4(a) of the Block Exemption Regulation. The agent should thus be left free to lower the effective price paid by the customer without reducing the income for the principal⁽¹⁾.
- (49) The hardcore restriction set out in Article 4(b) of the Block Exemption Regulation concerns agreements or concerted practices that have as their direct or indirect object the restriction of sales by the buyer, in as far as those restrictions relate to the territory into which or the customers to whom the buyer may sell the contract goods or services. That hardcore restriction relates to market partitioning by territory or by customer. That may be the result of direct obligations, such as the obligation not to sell to certain customers or to customers in certain territories or the obligation to refer orders from these customers to other distributors. It may also result from indirect measures aimed at inducing the distributor not to sell to such customers, such as refusal or reduction of bonuses or discounts, refusal to supply, reduction of supplied volumes or limitation of supplied volumes to the demand within the allocated territory or customer group, threat of contract termination or profit pass-over obligations. It may further result from the supplier not providing a Community-wide guarantee service, whereby all distributors are obliged to provide the guarantee service and are reimbursed for this service by the supplier, even in relation to products sold by other distributors into their territory. These practices are even more likely to be viewed as a restriction of the buyer's sales when used in conjunction with the implementation by the supplier of a monitoring system aimed at verifying the effective destination of the supplied goods, e.g. the use of differentiated labels or serial numbers. However, a prohibition imposed on all distributors to sell to certain end users is not classified as a hardcore restriction if there is an objective justification related to the product, such as a general ban on selling dangerous substances to certain customers for reasons of safety or health. It implies that also the supplier himself does not sell to these customers. Nor are obligations on the reseller relating to the display of the supplier's brand name classified as hardcore.

⁽¹⁾ See, for instance, Commission Decision 91/562/EEC in Case No IV/32.737 — *Eirpage*, OJ L 306, 7.11.1991, p. 22, in particular point (6).

(50) There are four exceptions to the hardcore restriction in Article 4(b) of the Block Exemption Regulation. The first exception allows a supplier to restrict active sales by his direct buyers to a territory or a customer group which has been allocated exclusively to another buyer or which the supplier has reserved to itself. A territory or customer group is exclusively allocated when the supplier agrees to sell his product only to one distributor for distribution in a particular territory or to a particular customer group and the exclusive distributor is protected against active selling into his territory or to his customer group by the supplier and all the other buyers of the supplier inside the Community. The supplier is allowed to combine the allocation of an exclusive territory and an exclusive customer group by for instance appointing an exclusive distributor for a particular customer group in a certain territory. This protection of exclusively allocated territories or customer groups must, however, permit passive sales to such territories or customer groups. For the application of Article 4(b) of the Block Exemption Regulation, the Commission interprets 'active' and 'passive' sales as follows:

- 'Active' sales mean actively approaching individual customers inside another distributor's exclusive territory or exclusive customer group by for instance direct mail or visits; or actively approaching a specific customer group or customers in a specific territory allocated exclusively to another distributor through advertisement in media or other promotions specifically targeted at that customer group or targeted at customers in that territory; or establishing a warehouse or distribution outlet in another distributor's exclusive territory.
- 'Passive' sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion in media or on the Internet that reaches customers in other distributors' exclusive territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in non-exclusive territories or in one's own territory, are passive sales.

(51) Every distributor must be free to use the Internet to advertise or to sell products. A restriction on the use of the Internet by distributors could only be compatible with the Block Exemption Regulation to the extent that promotion on the Internet or sales over the Internet would lead to active selling into other distributors' exclusive territories or customer groups. In

general, the use of the Internet is not considered a form of active sales into such territories or customer groups, since it is a reasonable way to reach every customer. The fact that it may have effects outside one's own territory or customer group results from the technology, i.e. the easy access from everywhere. If a customer visits the web site of a distributor and contacts the distributor and if such contact leads to a sale, including delivery, then that is considered passive selling. The language used on the website or in the communication plays normally no role in that respect. Insofar as a web site is not specifically targeted at customers primarily inside the territory or customer group exclusively allocated to another distributor, for instance with the use of banners or links in pages of providers specifically available to these exclusively allocated customers, the website is not considered a form of active selling. However, unsolicited e-mails sent to individual customers or specific customer groups are considered active selling. The same considerations apply to selling by catalogue. Notwithstanding what has been said before, the supplier may require quality standards for the use of the Internet site to resell his goods, just as the supplier may require quality standards for a shop or for advertising and promotion in general. The latter may be relevant in particular for selective distribution. An outright ban on Internet or catalogue selling is only possible if there is an objective justification. In any case, the supplier cannot reserve to itself sales and/or advertising over the Internet.

(52) There are three other exceptions to the second hardcore restriction set out in Article 4(b) of the Block Exemption Regulation. All three exceptions allow for the restriction of both active and passive sales. Thus, it is permissible to restrict a wholesaler from selling to end users, to restrict an appointed distributor in a selective distribution system from selling, at any level of trade, to unauthorised distributors in markets where such a system is operated, and to restrict a buyer of components supplied for incorporation from reselling them to competitors of the supplier. The term 'component' includes any intermediate goods and the term 'incorporation' refers to the use of any input to produce goods.

(53) The hardcore restriction set out in Article 4(c) of the Block Exemption Regulation concerns the restriction of active or passive sales to end users, whether professional end users or final consumers, by members of a selective distribution network. This means that dealers in a selective distribution system, as defined in Article 1(d) of the Block Exemption Regulation, cannot be restricted in the users or purchasing agents acting on behalf of these users to whom they may sell. For instance, also in a selective distribution system the

dealer should be free to advertise and sell with the help of the Internet. Selective distribution may be combined with exclusive distribution provided that active and passive selling is not restricted anywhere. The supplier may therefore commit itself to supplying only one dealer or a limited number of dealers in a given territory.

(54) In addition, in the case of selective distribution, restrictions can be imposed on the dealer's ability to determine the location of his business premises. Selected dealers may be prevented from running their business from different premises or from opening a new outlet in a different location. If the dealer's outlet is mobile ('shop on wheels'), an area may be defined outside which the mobile outlet cannot be operated.

(55) The hardcore restriction set out in Article 4(d) of the Block Exemption Regulation concerns the restriction of cross-supplies between appointed distributors within a selective distribution system. This means that an agreement or concerted practice may not have as its direct or indirect object to prevent or restrict the active or passive selling of the contract products between the selected distributors. Selected distributors must remain free to purchase the contract products from other appointed distributors within the network, operating either at the same or at a different level of trade. This means that selective distribution cannot be combined with vertical restraints aimed at forcing distributors to purchase the contract products exclusively from a given source, for instance exclusive purchasing. It also means that within a selective distribution network no restrictions can be imposed on appointed wholesalers as regards their sales of the product to appointed retailers.

(56) The hardcore restriction set out in Article 4(e) of the Block Exemption Regulation concerns agreements that prevent or restrict end-users, independent repairers and service providers from obtaining spare parts directly from the manufacturer of these spare parts. An agreement between a manufacturer of spare parts and a buyer who incorporates these parts into his own products (original equipment manufacturer (OEM)), may not, either directly or indirectly, prevent or restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers. Indirect restrictions may arise in particular when the supplier of the spare parts is restricted in supplying technical information and special equipment which are necessary for the use of spare parts by users, independent repairers or service providers.

However, the agreement may place restrictions on the supply of the spare parts to the repairers or service providers entrusted by the original equipment manufacturer with the repair or servicing of his own goods. In other words, the original equipment manufacturer may require his own repair and service network to buy the spare parts from it.

4. **Conditions under the Block Exemption Regulation**

(57) Article 5 of the Block Exemption Regulation excludes certain obligations from the coverage of the Block Exemption Regulation even though the market share threshold is not exceeded. However, the Block Exemption Regulation continues to apply to the remaining part of the vertical agreement if that part is severable from the non-exempted obligations.

(58) The first exclusion is provided in Article 5(a) of the Block Exemption Regulation and concerns non-compete obligations. Non-compete obligations are obligations that require the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80 % of the buyer's total purchases during the previous year of the contract goods and services and their substitutes (see the definition in Article 1(b) of the Block Exemption Regulation), thereby preventing the buyer from purchasing competing goods or services or limiting such purchases to less than 20 % of total purchases. Where for the year preceding the conclusion of the contract no relevant purchasing data for the buyer are available, the buyer's best estimate of his annual total requirements may be used. Such non-compete obligations are not covered by the Block Exemption Regulation when their duration is indefinite or exceeds five years. Non-compete obligations that are tacitly renewable beyond a period of five years are also not covered by the Block Exemption Regulation. However, non-compete obligations are covered when their duration is limited to five years or less, or when renewal beyond five years requires explicit consent of both parties and no obstacles exist that hinder the buyer from effectively terminating the non-compete obligation at the end of the five year period. If for instance the agreement provides for a five-year non-compete obligation and 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; the repayment needs to be structured in equal or decreasing instalments and should not increase over time. This is without prejudice to the possibility, in the case

for instance of a new distribution outlet, to delay repayment for the first one or two years until sales have reached a certain level. The buyer must have the possibility to repay the remaining debt where there is still an outstanding debt at the end of the non-compete obligation. Similarly, when 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 at the end of the non-compete obligation.

(59) The five-year duration limit does not apply when the goods or services are resold by the buyer 'from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer.' In such cases the non-compete obligation may be of the same duration as the period of occupancy of the point of sale by the buyer (Article 5(a) of the Block Exemption Regulation). The reason for this exception is that it is normally unreasonable to expect a supplier to allow competing products to be sold from premises and land owned by the supplier without his permission. Artificial ownership constructions intended to avoid the five-year limit cannot benefit from this exception.

(60) The second exclusion from the block exemption is provided for in Article 5(b) of the Block Exemption Regulation and concerns post term non-compete obligations. Such obligations are normally not covered by the Block Exemption Regulation, unless the obligation is indispensable to protect know-how transferred by the supplier to the buyer, is limited to the point of sale from which the buyer has operated during the contract period, and is limited to a maximum period of one year. According to the definition in Article 1(f) of the Block Exemption Regulation the know-how needs to be 'substantial', meaning 'that the know-how includes information which is indispensable to the buyer for the use, sale or resale of the contract goods or services'.

(61) The third exclusion from the block exemption is provided for in Article 5(c) of the Block Exemption Regulation and concerns the sale of competing goods in a selective distribution system. The Block Exemption Regulation covers the combination of selective distribution with a non-compete obligation, obliging the dealers not to resell competing brands in general. However, if the supplier prevents his appointed dealers, either directly or indirectly, from buying products for resale from specific competing suppliers, such an obligation cannot enjoy the benefit of the Block Exemption Regulation. The objective of the exclusion of this obligation is to avoid a situation whereby a number of suppliers using the same selective distribution outlets prevent one specific competi-

tor or certain specific competitors from using these outlets to distribute their products (foreclosure of a competing supplier which would be a form of collective boycott)⁽¹⁾.

5. No presumption of illegality outside the Block Exemption Regulation

(62) Vertical agreements falling outside the Block Exemption Regulation will not be presumed to be illegal but may need individual examination. Companies are encouraged to do their own assessment without notification. In the case of an individual examination by the Commission, the latter will bear the burden of proof that the agreement in question infringes Article 81(1). When appreciable anti-competitive effects are demonstrated, undertakings may substantiate efficiency claims and explain why a certain distribution system is likely to bring about benefits which are relevant to the conditions for exemption under Article 81(3).

6. No need for precautionary notification

(63) Pursuant to Article 4(2) of Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty⁽²⁾, as last amended by Regulation (EC) No 1216/1999⁽³⁾, vertical agreements can benefit from an exemption under Article 81(3) from their date of entry into force, even if notification occurs after that date. This means in practice that no precautionary notification needs to be made. If a dispute arises, an undertaking can still notify, in which case the Commission can exempt the vertical agreement with retroactive effect from the date of entry into force of the agreement if all four conditions of Article 81(3) are fulfilled. A notifying party does not have to explain why the agreement was not notified earlier and will not be denied retroactive exemption simply because it did not notify earlier. Any notification will be reviewed on its merits. This amendment to Article 4(2) of Regulation No 17 should eliminate artificial litigation before national courts and thus strengthen the civil enforceability of contracts. It also takes account of the situation where undertakings have not notified because they assumed the agreement was covered by the Block Exemption Regulation.

⁽¹⁾ An example of indirect measures having such exclusionary effects can be found in Commission Decision 92/428/EEC in Case No IV/33.542 — Parfum Givenchy (OJ L 236, 19.8.1992, p. 11).

⁽²⁾ OJ L 13, 21.2.1962, p. 204/62.

⁽³⁾ OJ L 148, 15.6.1999, p. 5.

(64) Since the date of notification no longer limits the possibility of exemption by the Commission, national courts have to assess the likelihood that Article 81(3) will apply in respect of vertical agreements falling within Article 81(1). If such likelihood exists, they should suspend proceedings pending adoption of a position by the Commission. However, national courts may adopt interim measures pending the assessment by the Commission of the applicability of Article 81(3), in the same way as they do when they refer a preliminary question to the Court of Justice under Article 234 of the EC Treaty. No suspension is necessary in respect of injunction proceedings, where national courts themselves are empowered to assess the likelihood of application of Article 81(3)⁽¹⁾.

(65) Unless there is litigation in national courts or complaints, notifications of vertical agreements will not be given priority in the Commission's enforcement policy. Notifications as such do not provide provisional validity for the execution of agreements. Where undertakings have not notified an agreement because they assumed in good faith that the market share threshold under the Block Exemption Regulation was not exceeded, the Commission will not impose fines.

7. Severability

(66) The Block Exemption Regulation exempts vertical agreements on condition that no hardcore restriction, as set out in Article 4, is contained in or practised with the vertical agreement. If there are one or more hardcore restrictions, the benefit of the Block Exemption Regulation is lost for the entire vertical agreement. There is no severability for hardcore restrictions.

(67) The rule of severability does apply, however, to the conditions set out in Article 5 of the Block Exemption Regulation. Therefore, the benefit of the block exemption is only lost in relation to that part of the vertical agreement which does not comply with the conditions set out in Article 5.

8. Portfolio of products distributed through the same distribution system

(68) Where a supplier uses the same distribution agreement to distribute several goods/services some of these may, in view of the market share threshold, be covered by the Block Exemption Regulation while others may not. In that case, the Block Exemption Regulation applies to those goods and services for which the conditions of application are fulfilled.

(69) In respect of the goods or services which are not covered by the Block Exemption Regulation, the ordinary rules of competition apply, which means:

- there is no block exemption but also no presumption of illegality;
- if there is an infringement of Article 81(1) which is not exemptable, consideration may be given to whether there are appropriate remedies to solve the competition problem within the existing distribution system;
- if there are no such appropriate remedies, the supplier concerned will have to make other distribution arrangements.

This situation can also arise where Article 82 applies in respect of some products but not in respect of others.

9. Transitional period

(70) The Block Exemption Regulation applies from 1 June 2000. Article 12 of the Block Exemption Regulation provides for a transitional period for vertical agreements already in force before 1 June 2000 which do not satisfy the conditions for exemption provided in the Block Exemption Regulation, but which do satisfy the conditions for exemption under the Block Exemption Regulations which expired on 31 May 2000 (Commissions Regulations (EEC) No 1983/83, (EEC) No 1984/83 and (EEC) No 4087/88). The Commission Notice concerning Regulations (EEC) Nos 1983/83 and 1984/83 also ceases to apply on 31 May 2000. The latter agreements may continue to benefit from these outgoing Regulations until 31 December 2001. Agreements of suppliers with a market share not exceeding 30% who signed with their buyers non-compete agreements with a duration exceeding five years are covered by the Block Exemption Regulation if on 1 January 2002 the non-compete agreements have no more than five years to run.

⁽¹⁾ Case C-234/89 *Delimitis v Henninger Bräu* [1991] ECR I-935, at paragraph 52.

IV. **WITHDRAWAL OF THE BLOCK EXEMPTION AND DISAPPLICATION OF THE BLOCK EXEMPTION REGULATION**

1. **Withdrawal procedure**

(71) The presumption of legality conferred by the Block Exemption Regulation may be withdrawn if a vertical agreement, considered either in isolation or in conjunction with similar agreements enforced by competing suppliers or buyers, comes within the scope of Article 81(1) and does not fulfil all the conditions of Article 81(3). This may occur when a supplier, or a buyer in the case of exclusive supply agreements, holding a market share not exceeding 30%, enters into a vertical agreement which does not give rise to objective advantages such as to compensate for the damage which it causes to competition. This may particularly be the case with respect to the distribution of goods to final consumers, who are often in a much weaker position than professional buyers of intermediate goods. In the case of sales to final consumers, the disadvantages caused by a vertical agreement may have a stronger impact than in a case concerning the sale and purchase of intermediate goods. When the conditions of Article 81(3) are not fulfilled, the Commission may withdraw the benefit of the Block Exemption Regulation under Article 6 and establish an infringement of Article 81(1).

(72) Where the withdrawal procedure is applied, the Commission bears the burden of proof that the agreement falls within the scope of Article 81(1) and that the agreement does not fulfil all four conditions of Article 81(3).

(73) The conditions for an exemption under Article 81(3) may in particular not be fulfilled when access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar vertical agreements practised by competing suppliers or buyers. Parallel networks of vertical agreements are to be regarded as similar if they contain restraints producing similar effects on the market. Similar effects will normally occur when vertical restraints practised by competing suppliers or buyers come within one of the four groups listed in paragraphs 104 to 114. Such a situation may arise for example when, on a given market, certain suppliers practise purely qualitative selective distribution while other suppliers practise quantitative selective distribution. In such circumstances, the assessment must

take account of the anti-competitive effects attributable to each individual network of agreements. Where appropriate, withdrawal may concern only the quantitative limitations imposed on the number of authorised distributors. Other cases in which a withdrawal decision may be taken include situations where the buyer, for example in the context of exclusive supply or exclusive distribution, has significant market power in the relevant downstream market where he resells the goods or provides the services.

(74) Responsibility for an anti-competitive cumulative effect can only be attributed to those undertakings which make an appreciable contribution to it. Agreements entered into by undertakings whose contribution to the cumulative effect is insignificant do not fall under the prohibition provided for in Article 81(1)⁽¹⁾ and are therefore not subject to the withdrawal mechanism. The assessment of such a contribution will be made in accordance with the criteria set out in paragraphs 137 to 229.

(75) A withdrawal decision can only have *ex nunc* effect, which means that the exempted status of the agreements concerned will not be affected until the date at which the withdrawal becomes effective.

(76) Under Article 7 of the Block Exemption Regulation, the competent authority of a Member State may withdraw the benefit of the Block Exemption Regulation in respect of vertical agreements whose anti-competitive effects are felt in the territory of the Member State concerned or a part thereof, which has all the characteristics of a distinct geographic market. Where a Member State has not enacted legislation enabling the national competition authority to apply Community competition law or at least to withdraw the benefit of the Block Exemption Regulation, the Member State may ask the Commission to initiate proceedings to this effect.

(77) The Commission has the exclusive power to withdraw the benefit of the Block Exemption Regulation in respect of vertical agreements restricting competition on a relevant geographic market which is wider than the territory of a single Member State. When the territory of a single Member State, or a part thereof, constitutes the relevant geographic market, the Commission and the Member State concerned have concurrent competence for withdrawal. Often, such cases lend themselves to decentralised enforcement by national competition authorities. However, the Commission reserves the right to take on certain cases displaying a particular Community interest, such as cases raising a new point of law.

⁽¹⁾ Judgment in the *Delimitis* Case.

- (78) National decisions of withdrawal must be taken in accordance with the procedures laid down under national law and will only have effect within the territory of the Member State concerned. Such national decisions must not prejudice the uniform application of the Community competition rules and the full effect of the measures adopted in implementation of those rules⁽¹⁾. Compliance with this principle implies that national competition authorities must carry out their assessment under Article 81 in the light of the relevant criteria developed by the Court of Justice and the Court of First Instance and in the light of notices and previous decisions adopted by the Commission.
- (79) The Commission considers that the consultation mechanisms provided for in the Notice on cooperation between national competition authorities and the Commission⁽²⁾ should be used to avert the risk of conflicting decisions and duplication of procedures.

2. Disapplication of the Block Exemption Regulation

- (80) Article 8 of the Block Exemption Regulation enables the Commission to exclude from the scope of the Block Exemption Regulation, by means of regulation, parallel networks of similar vertical restraints where these cover more than 50 % of a relevant market. Such a measure is not addressed to individual undertakings but concerns all undertakings whose agreements are defined in the regulation disapplying the Block Exemption Regulation.
- (81) Whereas the withdrawal of the benefit of the Block Exemption Regulation under Article 6 implies the adoption of a decision establishing an infringement of Article 81 by an individual company, the effect of a regulation under Article 8 is merely to remove, in respect of the restraints and the markets concerned, the benefit of the application of the Block Exemption Regulation and to restore the full application of Article 81(1) and (3). Following the adoption of a regulation declaring the Block Exemption inapplicable in respect of certain vertical restraints on a particular market, the criteria developed by the relevant case-law of the Court of Justice and the Court of First Instance and by notices and previous decisions adopted by the Commission will guide the application of Article 81 to individual agreements. Where appropriate, the Commission will take a decision in an individual case, which can provide guidance to all the undertakings operating on the market concerned.
- (82) For the purpose of calculating the 50 % market coverage ratio, account must be taken of each individual network of vertical agreements containing restraints, or combinations of restraints, producing similar effects on the market. Similar effects normally result when the restraints come within one of the four groups listed in paragraphs 104 to 114.
- (83) Article 8 does not entail an obligation on the part of the Commission to act where the 50 % market-coverage ratio is exceeded. In general, disapplication is appropriate when it is likely that access to the relevant market or competition therein is appreciably restricted. This may occur in particular when parallel networks of selective distribution covering more than 50 % of a market make use of selection criteria which are not required by the nature of the relevant goods or discriminate against certain forms of distribution capable of selling such goods.
- (84) In assessing the need to apply Article 8, the Commission will consider whether individual withdrawal would be a more appropriate remedy. This may depend, in particular, on the number of competing undertakings contributing to a cumulative effect on a market or the number of affected geographic markets within the Community.
- (85) Any regulation adopted under Article 8 must clearly set out its scope. This means, first, that the Commission must define the relevant product and geographic market(s) and, secondly, that it must identify the type of vertical restraint in respect of which the Block Exemption Regulation will no longer apply. As regards the latter aspect, the Commission may modulate the scope of its regulation according to the competition concern which it intends to address. For instance, while all parallel networks of single-branding type arrangements shall be taken into account in view of establishing the 50 % market coverage ratio, the Commission may nevertheless restrict the scope of the disapplication regulation only to non-compete obligations exceeding a certain duration. Thus, agreements of a shorter duration or of a less restrictive nature might be left unaffected, in consideration of the lesser degree of foreclosure attributable to such restraints. Similarly, when on a particular market selective distribution is practised in combination with additional restraints such as non-compete or quantity-forcing on the buyer, the disapplication regulation may concern only such additional restraints. Where appropriate, the Commission may also provide guidance by specifying the market share level which, in the specific market context, may be regarded as insufficient to bring about a significant contribution by an individual undertaking to the cumulative effect.

(1) Judgment of the Court of Justice in Case 14/68 *Walt Wilhelm and Others v Bundeskartellamt* [1969] ECR 1, paragraph 4, and judgment in *Delimitis*.

(2) OJ C 313, 15.10.1997, p. 3, points 49 to 53.

(86) The transitional period of not less than six months that the Commission will have to set under Article 8(2) should allow the undertakings concerned to adapt their agreements to take account of the regulation disapplying the Block Exemption Regulation.

(87) A regulation disapplying the Block Exemption Regulation will not affect the exempted status of the agreements concerned for the period preceding its entry into force.

V. MARKET DEFINITION AND MARKET SHARE CALCULATION ISSUES

1. Commission Notice on definition of the relevant market

(88) The Commission Notice on definition of the relevant market for the purposes of Community competition law⁽¹⁾ provides guidance on the rules, criteria and evidence which the Commission uses when considering market definition issues. That Notice will not be further explained in these Guidelines and should serve as the basis for market definition issues. These Guidelines will only deal with specific issues that arise in the context of vertical restraints and that are not dealt with in the general notice on market definition.

2. The relevant market for calculating the 30 % market share threshold under the Block Exemption Regulation

(89) Under Article 3 of the Block Exemption Regulation, it is in general the market share of the supplier that is decisive for the application of the block exemption. In the case of vertical agreements concluded between an association of retailers and individual members, the association is the supplier and needs to take into account its market share as a supplier. Only in the case of exclusive supply as defined in Article 1(c) of the Block Exemption Regulation is it the market share of the buyer, and only that market share, which is decisive for the application of the Block Exemption Regulation.

(90) In order to calculate the market share, it is necessary to determine the relevant market. For this, the relevant product market and the relevant geographic market must be defined. The relevant product market comprises any goods or services which are regarded by the buyer as interchangeable, by reason of their characteristics, prices and intended use. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of relevant goods or services, in which

the conditions of competition are sufficiently homogeneous, and which can be distinguished from neighbouring geographic areas because, in particular, conditions of competition are appreciably different in those areas.

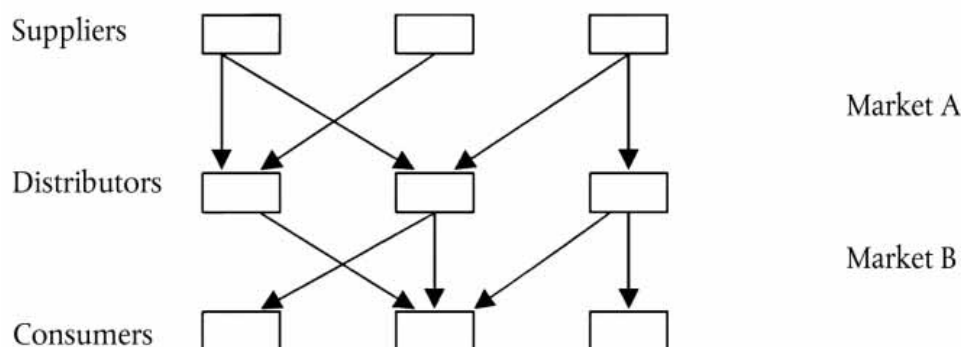
(91) For the application of the Block Exemption Regulation, the market share of the supplier is his share on the relevant product and geographic market on which he sells to his buyers.⁽²⁾ In the example given in paragraph 92, this is market A. The product market depends in the first place on substitutability from the buyers' perspective. When the supplied product is used as an input to produce other products and is generally not recognisable in the final product, the product market is normally defined by the direct buyers' preferences. The customers of the buyers will normally not have a strong preference concerning the inputs used by the buyers. Usually the vertical restraints agreed between the supplier and buyer of the input only relate to the sale and purchase of the intermediate product and not to the sale of the resulting product. In the case of distribution of final goods, what are substitutes for the direct buyers will normally be influenced or determined by the preferences of the final consumers. A distributor, as reseller, cannot ignore the preferences of final consumers when he purchases final goods. In addition, at the distribution level the vertical restraints usually concern not only the sale of products between supplier and buyer, but also their resale. As different distribution formats usually compete, markets are in general not defined by the form of distribution that is applied. Where suppliers generally sell a portfolio of products, the entire portfolio may determine the product market when the portfolios and not the individual products are regarded as substitutes by the buyers. As the buyers on market A are professional buyers, the geographic market is usually wider than the market where the product is resold to final consumers. Often, this will lead to the definition of national markets or wider geographic markets.

(92) In the case of exclusive supply, the buyer's market share is his share of all purchases on the relevant purchase market.⁽³⁾ In the example below, this is also market A.

⁽²⁾ For example, the Dutch market for new replacement truck and bus tyres in the Michelin case (Case 322/81 *Nederlandsche Banden-Industrie Michelin* Commission [1983] ECR 3461), the various meat markets in the Danish slaughter-house case: Commission Decision 2000/42/EC in Case No IV/M.1313 — Danish Crown/Vestjyske Slagterier, OJ L 20, 25.1.2000, p. 1.

⁽³⁾ For an example of purchase markets, see Commission Decision 1999/674/EC in Case No IV/M.1221 — *Rewe/Meinl*, OJ L 274, 23.10.1999, p. 1.

⁽¹⁾ OJ C 372, 9.12.1997, p. 5.



(93) Where a vertical agreement involves three parties, each operating at a different level of trade, their market shares will have to be below the market share threshold of 30% at both levels in order to benefit from the block exemption. If for instance, in an agreement between a manufacturer, a wholesaler (or association of retailers) and a retailer, a non-compete obligation is agreed, then the market share of both the manufacturer and the wholesaler (or association of retailers) must not exceed 30% in order to benefit from the block exemption.

(94) Where a supplier produces both original equipment and the repair or replacement parts for this equipment, the supplier will often be the only or the major supplier on the after-market for the repair and replacement parts. This may also arise where the supplier (OEM supplier) subcontracts the manufacturing of the repair or replacement parts. The relevant market for application of the Block Exemption Regulation may be the original equipment market including the spare parts or a separate original equipment market and after-market depending on the circumstances of the case, such as the effects of the restrictions involved, the lifetime of the equipment and importance of the repair or replacement costs⁽¹⁾.

(95) Where the vertical agreement, in addition to the supply of the contract goods, also contains IPR provisions — such as a provision concerning the use of the supplier's trademark — which help the buyer to market the contract goods, the supplier's market share

on the market where he sells the contract goods is decisive for the application of the Block Exemption Regulation. Where a franchisor does not supply goods to be resold but provides a bundle of services combined with IPR provisions which together form the business method being franchised, the franchisor needs to take account of his market share as a provider of a business method. For that purpose, the franchisor needs to calculate his market share on the market where the business method is exploited, which is the market where the franchisees exploit the business method to provide goods or services to end users. The franchisor must base his market share on the value of the goods or services supplied by his franchisees on this market. On such a market the competitors may be providers of other franchised business methods but also suppliers of substitutable goods or services not applying franchising. For instance, without prejudice to the definition of such market, if there was a market for fast-food services, a franchisor operating on such a market would need to calculate his market share on the basis of the relevant sales figures of his franchisees on this market. If the franchisor, in addition to the business method, also supplies certain inputs, such as meat and spices, then the franchisor also needs to calculate his market share on the market where these goods are sold.

3. The relevant market for individual assessment

⁽¹⁾ See for example Pelikan/Kyocera in XXV Report on Competition Policy, point 87, and Commission Decision 91/595/EEC in Case No IV/M.12 — Varta/Bosch, OJ L 320, 22.11.1991, p. 26, Commission Decision in Case No IV/M.1094 — Caterpillar/Perkins Engines, OJ C 94, 28.3.1998, p. 23, and Commission Decision in Case No IV/M.768 — Lucas/Varity, OJ C 266, 13.9.1996, p. 6. See also Eastman Kodak Co v Image Technical Services, Inc et al, Supreme Court of the United States, No 90 1029. See also point 56 of the Commission Notice on the definition of relevant market for the purposes of Community competition law.

(96) For individual assessment of vertical agreements not covered by the Block Exemption Regulation, additional markets may need to be investigated besides the relevant market defined for the application of the Block Exemption Regulation. A vertical agreement may not only have effects on the market between supplier and buyer but may also have effects on downstream markets. For an individual assessment of a vertical agreement the relevant markets at each level of trade affected by restraints contained in the agreement will be examined:

- (i) For 'intermediate goods or services' that are incorporated by the buyer into his own goods or services, vertical restraints generally have effects only on the market between supplier and buyer. A non-compete obligation imposed on the buyer for instance may foreclose other suppliers but will not lead to reduced in-store competition downstream. However, in cases of exclusive supply the position of the buyer on his downstream market is also relevant because the buyer's foreclosing behaviour may only have appreciable negative effects if he has market power on the downstream market.
- (ii) For 'final products' an analysis limited to the market between supplier and buyer is less likely to be sufficient since vertical restraints may have negative effects of reduced inter-brand and/or intra-brand competition on the resale market, that is on the market downstream of the buyer. For instance, exclusive distribution may not only lead to foreclosure effects on the market between the supplier and the buyer, but may above all lead to less intra-brand competition in the resale territories of the distributors. The resale market is in particular important if the buyer is a retailer selling to final consumers. A non-compete obligation agreed between a manufacturer and a wholesaler may foreclose this wholesaler to other manufacturers but a loss of in-store competition is not very likely at the wholesale level. The same agreement concluded with a retailer may however cause this added loss of in-store inter-brand competition on the resale market.
- (iii) In cases of individual assessment of an 'after-market', the relevant market may be the original equipment market or the after-market depending on the circumstances of the case. In any event, the situation on a separate after-market will be evaluated taking account of the situation on the original equipment market. A less significant position on the original equipment market will normally reduce possible anti-competitive effects on the after-market.

4. Calculation of the market share under the Block Exemption Regulation

- (97) The calculation of the market share needs to be based in principle on value figures. Where value figures are not available substantiated estimates can be made. Such estimates may be based on other reliable market information such as volume figures (see Article 9(1) of the Block Exemption Regulation).

(98) In-house production, that is production of an intermediate product for own use, may be very important in a competition analysis as one of the competitive constraints or to accentuate the market position of a company. However, for the purpose of market definition and the calculation of market share for intermediate goods and services, in-house production will not be taken into account.

(99) However, in the case of dual distribution of final goods, i.e. where a producer of final goods also acts as a distributor on the market, the market definition and market share calculation need to include the goods sold by the producer and competing producers through their integrated distributors and agents (see - Article 9(2)(b) of the Block Exemption Regulation). 'Integrated distributors' are connected undertakings within the meaning of Article 11 of the Block Exemption Regulation.

VI. ENFORCEMENT POLICY IN INDIVIDUAL CASES

(100) Vertical restraints are generally less harmful than horizontal restraints. The main reason for treating a vertical restraint more leniently than a horizontal restraint lies in the fact that the latter may concern an agreement between competitors producing identical or substitutable goods or services. In such horizontal relationships the exercise of market power by one company (higher price of its product) may benefit its competitors. This may provide an incentive to competitors to induce each other to behave anti-competitively. In vertical relationships the product of the one is the input for the other. This means that the exercise of market power by either the upstream or downstream company would normally hurt the demand for the product of the other. The companies involved in the agreement therefore usually have an incentive to prevent the exercise of market power by the other.

(101) However, this self-restraining character should not be over-estimated. When a company has no market power it can only try to increase its profits by optimising its manufacturing and distribution processes, with or without the help of vertical restraints. However, when it does have market power it can also try to increase its profits at the expense of its direct competitors by raising their costs and at the expense of its buyers and ultimately consumers by trying to appropriate some of their surplus. This can happen when the upstream and downstream company share the extra profits or when one of the two uses vertical restraints to appropriate all the extra profits.

(102) In the assessment of individual cases, the Commission will adopt an economic approach in the application of Article 81 to vertical restraints. This will limit the scope of application of Article 81 to undertakings holding a certain degree of market power where inter-brand competition may be insufficient. In those cases, the protection of inter-brand and intra-brand competition is important to ensure efficiencies and benefits for consumers.

1. The framework of analysis

1.1. Negative effects of vertical restraints

(103) The negative effects on the market that may result from vertical restraints which EC competition law aims at preventing are the following:

- (i) foreclosure of other suppliers or other buyers by raising barriers to entry;
- (ii) reduction of inter-brand competition between the companies operating on a market, including facilitation of collusion amongst suppliers or buyers; by collusion is meant both explicit collusion and tacit collusion (conscious parallel behaviour);
- (iii) reduction of intra-brand competition between distributors of the same brand;
- (iv) the creation of obstacles to market integration, including, above all, limitations on the freedom of consumers to purchase goods or services in any Member State they may choose.

(104) Such negative effects may result from various vertical restraints. Agreements which are different in form may have the same substantive impact on competition. To analyse these possible negative effects, it is appropriate to divide vertical restraints into four groups: a single branding group, a limited distribution group, a resale price maintenance group and a market partitioning group. The vertical restraints within each group have largely similar negative effects on competition.

(105) The classification into four groups is based upon what can be described as the basic components of vertical restraints. In paragraphs 103 to 136, the four different groups are analysed. In 137 to 229, vertical agreements are analysed as they are used in practice because many vertical agreements make use of more than one of these components.

Single branding group

(106) Under the heading of 'single branding' come those agreements which have as their main element that the buyer is induced to concentrate his orders for a particular type of product with one supplier. This component can be found amongst others in non-compete and quantity-forcing on the buyer, where an obligation or incentive scheme agreed between the supplier and the buyer makes the latter purchase his requirements for a particular product and its substitutes only, or mainly, from one supplier. The same component can be found in tying, where the obligation or incentive scheme relates to a product that the buyer is required to purchase as a condition of purchasing another distinct product. The first product is referred to as the 'tied' product and the second is referred to as the 'tying' product.

(107) There are four main negative effects on competition: (1) other suppliers in that market cannot sell to the particular buyers and this may lead to foreclosure of the market or, in the case of tying, to foreclosure of the market for the tied product; (2) it makes market shares more rigid and this may help collusion when applied by several suppliers; (3) as far as the distribution of final goods is concerned, the particular retailers will only sell one brand and there will therefore be no inter-brand competition in their shops (no in-store competition); and (4) in the case of tying, the buyer may pay a higher price for the tied product than he would otherwise do. All these effects may lead to a reduction in inter-brand competition.

(108) The reduction in inter-brand competition may be mitigated by strong initial competition between suppliers to obtain the single branding contracts, but the longer the duration of the non-compete obligation, the more likely it will be that this effect will not be strong enough to compensate for the reduction in inter-brand competition.

Limited distribution group

(109) Under the heading of 'limited distribution' come those agreements which have as their main element that the manufacturer sells to only one or a limited number of buyers. This may be to restrict the number of buyers for a particular territory or group of customers, or to select a particular kind of buyers. This component can be found amongst others in:

- exclusive distribution and exclusive customer allocation, where the supplier limits his sales to only one buyer for a certain territory or class of customers;

- exclusive supply and quantity-forcing on the supplier, where an obligation or incentive scheme agreed between the supplier and the buyer makes the former sell only or mainly to one buyer;
- selective distribution, where the conditions imposed on or agreed with the selected dealers usually limit their number;
- after-market sales restrictions which limit the component supplier's sales possibilities.

(110) There are three main negative effects on competition: (1) certain buyers within that market can no longer buy from that particular supplier, and this may lead in particular in the case of exclusive supply, to foreclosure of the purchase market, (2) when most or all of the competing suppliers limit the number of retailers, this may facilitate collusion, either at the distributor's level or at the supplier's level, and (3) since fewer distributors will offer the product it will also lead to a reduction of intra-brand competition. In the case of wide exclusive territories or exclusive customer allocation the result may be total elimination of intra-brand competition. This reduction of intra-brand competition can in turn lead to a weakening of inter-brand competition.

Resale price maintenance group

- (111) Under the heading of 'resale price maintenance' (RPM) come those agreements whose main element is that the buyer is obliged or induced to resell not below a certain price, at a certain price or not above a certain price. This group comprises minimum, fixed, maximum and recommended resale prices. Maximum and recommended resale prices, which are not hardcore restrictions, may still lead to a restriction of competition by effect.
- (112) There are two main negative effects of RPM on competition: (1) a reduction in intra-brand price competition, and (2) increased transparency on prices. In the case of fixed or minimum RPM, distributors can no longer compete on price for that brand, leading to a total elimination of intra-brand price competition. A maximum or recommended price may work as a focal point for resellers, leading to a more or less uniform application of that price level. Increased transparency on price and responsibility for price changes makes

horizontal collusion between manufacturers or distributors easier, at least in concentrated markets. The reduction in intra-brand competition may, as it leads to less downward pressure on the price for the particular goods, have as an indirect effect a reduction of inter-brand competition.

Market partitioning group

- (113) Under the heading of 'market partitioning' come agreements whose main element is that the buyer is restricted in where he either sources or resells a particular product. This component can be found in exclusive purchasing, where an obligation or incentive scheme agreed between the supplier and the buyer makes the latter purchase his requirements for a particular product, for instance beer of brand X, exclusively from the designated supplier, but leaving the buyer free to buy and sell competing products, for instance competing brands of beer. It also includes territorial resale restrictions, the allocation of an area of primary responsibility, restrictions on the location of a distributor and customer resale restrictions.
- (114) The main negative effect on competition is a reduction of intra-brand competition that may help the supplier to partition the market and thus hinder market integration. This may facilitate price discrimination. When most or all of the competing suppliers limit the sourcing or resale possibilities of their buyers this may facilitate collusion, either at the distributors' level or at the suppliers' level.

1.2. *Positive effects of vertical restraints*

- (115) It is important to recognise that vertical restraints often have positive effects by, in particular, promoting non-price competition and improved quality of services. When a company has no market power, it can only try to increase its profits by optimising its manufacturing or distribution processes. In a number of situations vertical restraints may be helpful in this respect since the usual arm's length dealings between supplier and buyer, determining only price and quantity of a certain transaction, can lead to a sub-optimal level of investments and sales.

(116) While trying to give a fair overview of the various justifications for vertical restraints, these Guidelines do not claim to be complete or exhaustive. The following reasons may justify the application of certain vertical restraints:

- (1) To 'solve a "free-rider" problem'. One distributor may free-ride on the promotion efforts of another distributor. This type of problem is most common at the wholesale and retail level. Exclusive distribution or similar restrictions may be helpful in avoiding such free-riding. Free-riding can also occur between suppliers, for instance where one invests in promotion at the buyer's premises, in general at the retail level, that may also attract customers for its competitors. Non-compete type restraints can help to overcome this situation of free-riding.

For there to be a problem, there needs to be a real free-rider issue. Free-riding between buyers can only occur on pre-sales services and not on after-sales services. The product will usually need to be relatively new or technically complex as the customer may otherwise very well know what he or she wants, based on past purchases. And the product must be of a reasonably high value as it is otherwise not attractive for a customer to go to one shop for information and to another to buy. Lastly, it must not be practical for the supplier to impose on all buyers, by contract, effective service requirements concerning pre-sales services.

Free-riding between suppliers is also restricted to specific situations, namely in cases where the promotion takes place at the buyer's premises and is generic, not brand specific.

- (2) To 'open up or enter new markets'. Where a manufacturer wants to enter a new geographic market, for instance by exporting to another country for the first time, this may involve special 'first time investments' by the distributor to establish the brand in the market. In order to persuade a local distributor to make these investments it may be necessary to provide territorial protection to the distributor so that he can recoup these investments by temporarily charging a higher price. Distributors based in

other markets should then be restrained for a limited period from selling in the new market. This is a special case of the free-rider problem described under point (1).

- (3) The 'certification free-rider issue'. In some sectors, certain retailers have a reputation for stocking only 'quality' products. In such a case, selling through these retailers may be vital for the introduction of a new product. If the manufacturer cannot initially limit his sales to the premium stores, he runs the risk of being de-listed and the product introduction may fail. This means that there may be a reason for allowing for a limited duration a restriction such as exclusive distribution or selective distribution. It must be enough to guarantee introduction of the new product but not so long as to hinder large-scale dissemination. Such benefits are more likely with 'experience' goods or complex goods that represent a relatively large purchase for the final consumer.
- (4) The so-called 'hold-up problem'. Sometimes there are client-specific investments to be made by either the supplier or the buyer, such as in special equipment or training. For instance, a component manufacturer that has to build new machines and tools in order to satisfy a particular requirement of one of his customers. The investor may not commit the necessary investments before particular supply arrangements are fixed.

However, as in the other free-riding examples, there are a number of conditions that have to be met before the risk of under-investment is real or significant. Firstly, the investment must be relationship-specific. An investment made by the supplier is considered to be relationship-specific when, after termination of the contract, it cannot be used by the supplier to supply other customers and can only be sold at a significant loss. An investment made by the buyer is considered to be relationship-specific when, after termination of the contract, it cannot be used by the buyer to purchase and/or use products supplied by other suppliers and can only be sold at a significant loss. An investment is thus relationship-specific because for instance it can only be used to produce a brand-specific component or to store a particular brand and thus cannot be used profitably to produce or resell alternatives. Secondly, it must be a long-term investment that is not recouped in the short run. And thirdly, the investment must be asymmetric; i.e. one party to

- the contract invests more than the other party. When these conditions are met, there is usually a good reason to have a vertical restraint for the duration it takes to depreciate the investment. The appropriate vertical restraint will be of the non-compete type or quantity-forcing type when the investment is made by the supplier and of the exclusive distribution, exclusive customer-allocation or exclusive supply type when the investment is made by the buyer.
- (5) The 'specific hold-up problem that may arise in the case of transfer of substantial know-how'. The know-how, once provided, cannot be taken back and the provider of the know-how may not want it to be used for or by his competitors. In as far as the know-how was not readily available to the buyer, is substantial and indispensable for the operation of the agreement, such a transfer may justify a non-compete type of restriction. This would normally fall outside Article 81(1).
- (6) 'Economies of scale in distribution'. In order to have scale economies exploited and thereby see a lower retail price for his product, the manufacturer may want to concentrate the resale of his products on a limited number of distributors. For this he could use exclusive distribution, quantity forcing in the form of a minimum purchasing requirement, selective distribution containing such a requirement or exclusive purchasing.
- (7) 'Capital market imperfections'. The usual providers of capital (banks, equity markets) may provide capital sub-optimally when they have imperfect information on the quality of the borrower or there is an inadequate basis to secure the loan. The buyer or supplier may have better information and be able, through an exclusive relationship, to obtain extra security for his investment. Where the supplier provides the loan to the buyer this may lead to non-compete or quantity forcing on the buyer. Where the buyer provides the loan to the supplier this may be the reason for having exclusive supply or quantity forcing on the supplier.
- (8) 'Uniformity and quality standardisation'. A vertical restraint may help to increase sales by creating a brand image and thereby increasing the attractiveness of a product to the final consumer by imposing a certain measure of uniformity and quality standardisation on the distributors. This can for instance be found in selective distribution and franchising.
- (117) The eight situations mentioned in paragraph 116 make clear that under certain conditions vertical agreements are likely to help realise efficiencies and the development of new markets and that this may offset possible negative effects. The case is in general strongest for vertical restraints of a limited duration which help the introduction of new complex products or protect relationship-specific investments. A vertical restraint is sometimes necessary for as long as the supplier sells his product to the buyer (see in particular the situations described in paragraph 116, points (1), (5), (6) and (8).
- (118) There is a large measure of substitutability between the different vertical restraints. This means that the same inefficiency problem can be solved by different vertical restraints. For instance, economies of scale in distribution may possibly be achieved by using exclusive distribution, selective distribution, quantity forcing or exclusive purchasing. This is important as the negative effects on competition may differ between the various vertical restraints. This plays a role when indispensability is discussed under Article 81(3).
- 1.3. **General rules for the evaluation of vertical restraints**
- (119) In evaluating vertical restraints from a competition policy perspective, some general rules can be formulated:
- (1) For most vertical restraints competition concerns can only arise if there is insufficient inter-brand competition, i.e. if there exists a certain degree of market power at the level of the supplier or the buyer or both. Conceptually, market power is the power to raise price above the competitive level and, at least in the short term, to obtain supra-normal profits. Companies may have market power below the level of market dominance, which is the threshold for the application of Article 82. Where there are many firms competing in an unconcentrated market, it can be assumed that non-hardcore vertical restraints will not have appreciable negative effects. A market is deemed unconcentrated when the HHI index, i.e. the sum of the squares of the individual market shares of all companies in the relevant market, is below 1 000.

- (2) Vertical restraints which reduce inter-brand competition are generally more harmful than vertical restraints that reduce intra-brand competition. For instance, non-compete obligations are likely to have more net negative effects than exclusive distribution. The former, by possibly foreclosing the market to other brands, may prevent those brands from reaching the market. The latter, while limiting intra-brand competition, does not prevent goods from reaching the final consumer.
- (3) Vertical restraints from the limited distribution group, in the absence of sufficient inter-brand competition, may significantly restrict the choices available to consumers. They are particularly harmful when more efficient distributors or distributors with a different distribution format are foreclosed. This can reduce innovation in distribution and denies consumers the particular service or price-service combination of these distributors.
- (4) Exclusive dealing arrangements are generally worse for competition than non-exclusive arrangements. Exclusive dealing makes, by the express language of the contract or its practical effects, one party fulfil all or practically all its requirements from another party. For instance, under a non-compete obligation the buyer purchases only one brand. Quantity forcing, on the other hand, leaves the buyer some scope to purchase competing goods. The degree of foreclosure may therefore be less with quantity forcing.
- (5) Vertical restraints agreed for non-branded goods and services are in general less harmful than restraints affecting the distribution of branded goods and services. Branding tends to increase product differentiation and reduce substitutability of the product, leading to a reduced elasticity of demand and an increased possibility to raise price. The distinction between branded and non-branded goods or services will often coincide with the distinction between intermediate goods and services and final goods and services.

Intermediate goods and services are sold to undertakings for use as an input to produce other goods or services and are generally not recognisable in the final goods or services. The buyers of intermediate products are usually well-informed customers, able to assess quality and therefore less reliant on brand and image. Final goods are, directly or indirectly, sold to final consumers who often rely more on brand and image. As distributors (retailers, wholesalers)

have to respond to the demand of final consumers, competition may suffer more when distributors are foreclosed from selling one or a number of brands than when buyers of intermediate products are prevented from buying competing products from certain sources of supply.

The undertakings buying intermediate goods or services normally have specialist departments or advisers who monitor developments in the supply market. Because they effect sizeable transactions, search costs are in general not prohibitive. A loss of intra-brand competition is therefore less important at the intermediate level.

- (6) In general, a combination of vertical restraints aggravates their negative effects. However, certain combinations of vertical restraints are better for competition than their use in isolation from each other. For instance, in an exclusive distribution system, the distributor may be tempted to increase the price of the products as intra-brand competition has been reduced. The use of quantity forcing or the setting of a maximum resale price may limit such price increases.
- (7) Possible negative effects of vertical restraints are reinforced when several suppliers and their buyers organise their trade in a similar way. These so-called cumulative effects may be a problem in a number of sectors.
- (8) The more the vertical restraint is linked to the transfer of know-how, the more reason there may be to expect efficiencies to arise and the more a vertical restraint may be necessary to protect the know-how transferred or the investment costs incurred.
- (9) The more the vertical restraint is linked to investments which are relationship-specific, the more justification there is for certain vertical restraints. The justified duration will depend on the time necessary to depreciate the investment.
- (10) In the case of a new product, or where an existing product is sold for the first time on a different geographic market, it may be difficult for the company to define the market or its market share may be very high. However, this should not be considered a major problem, as vertical restraints linked to opening up new product or geographic markets in general do not restrict competition.

This rule holds, irrespective of the market share of the company, for two years after the first putting on the market of the product. It applies to all non-hardcore vertical restraints and, in the case of a new geographic market, to restrictions on active and passive sales imposed on the direct buyers of the supplier located in other markets to intermediaries in the new market. In the case of genuine testing of a new product in a limited territory or with a limited customer group, the distributors appointed to sell the new product on the test market can be restricted in their active selling outside the test market for a maximum period of 1 year without being caught by Article 81(1).

- (a) market position of the supplier;
- (b) market position of competitors;
- (c) market position of the buyer;
- (d) entry barriers;
- (e) maturity of the market;
- (f) level of trade;
- (g) nature of the product;
- (h) other factors.

1.4. Methodology of analysis

(120) The assessment of a vertical restraint involves in general the following four steps:

- (1) First, the undertakings involved need to define the relevant market in order to establish the market share of the supplier or the buyer, depending on the vertical restraint involved (see paragraphs 88 to 99, in particular 89 to 95).
- (2) If the relevant market share does not exceed the 30 % threshold, the vertical agreement is covered by the Block Exemption Regulation, subject to the hardcore restrictions and conditions set out in that regulation.
- (3) If the relevant market share is above the 30 % threshold, it is necessary to assess whether the vertical agreement falls within Article 81(1).
- (4) If the vertical agreement falls within Article 81(1), it is necessary to examine whether it fulfils the conditions for exemption under Article 81(3).

1.4.1. Relevant factors for the assessment under Article 81(1)

(121) In assessing cases above the market share threshold of 30 %, the Commission will make a full competition analysis. The following factors are the most important to establish whether a vertical agreement brings about an appreciable restriction of competition under Article 81(1):

- (122) The importance of individual factors may vary from case to case and depends on all other factors. For instance, a high market share of the supplier is usually a good indicator of market power, but in the case of low entry barriers it may not indicate market power. It is therefore not possible to provide strict rules on the importance of the individual factors. However the following can be said:

Market position of the supplier

- (123) The market position of the supplier is established first and foremost by his market share on the relevant product and geographic market. The higher his market share, the greater his market power is likely to be. The market position of the supplier is further strengthened if he has certain cost advantages over his competitors. These competitive advantages may result from a first mover advantage (having the best site, etc.), holding essential patents, having superior technology, being the brand leader or having a superior portfolio.

Market position of competitors

- (124) The same indicators, that is market share and possible competitive advantages, are used to describe the market position of competitors. The stronger the established competitors are and the greater their number, the less risk there is that the supplier or buyer in question will be able to foreclose the market individually and the less there is a risk of a reduction of inter-brand competition. However, if the number of competitors becomes rather small and their market position (size, costs, R&D potential, etc.) is rather similar, this market structure may increase the risk of collusion. Fluctuating or rapidly changing market shares are in general an indication of intense competition.

Market position of the buyer

(125) Buying power derives from the market position of the buyer. The first indicator of buying power is the market share of the buyer on the purchase market. This share reflects the importance of his demand for his possible suppliers. Other indicators focus on the market position of the buyer on his resale market including characteristics such as a wide geographic spread of his outlets, own brands of the buyer/distributor and his image amongst final consumers. The effect of buying power on the likelihood of anti-competitive effects is not the same for the different vertical restraints. Buying power may in particular increase the negative effects in case of restraints from the limited distribution and market partitioning groups such as exclusive supply, exclusive distribution and quantitative selective distribution.

Entry barriers

(126) Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level, usually above minimum average total cost, and make supra-normal profits without attracting entry. Without any entry barriers, easy and quick entry would eliminate such profits. In as far as effective entry, which would prevent or erode the supra-normal profits, is likely to occur within one or two years, entry barriers can be said to be low.

(127) Entry barriers may result from a wide variety of factors such as economies of scale and scope, government regulations, especially where they establish exclusive rights, state aid, import tariffs, intellectual property rights, ownership of resources where the supply is limited due to for instance natural limitations⁽¹⁾, essential facilities, a first mover advantage and brand loyalty of consumers created by strong advertising. Vertical restraints and vertical integration may also work as an entry barrier by making access more difficult and foreclosing (potential) competitors. Entry barriers may be present at only the supplier or buyer level or at both levels.

(128) The question whether certain of these factors should be described as entry barriers depends on whether they are related to sunk costs. Sunk costs are those costs that have to be incurred to enter or be active on a market but that are lost when the market is

exited. Advertising costs to build consumer loyalty are normally sunk costs, unless an exiting firm could either sell its brand name or use it somewhere else without a loss. The more costs are sunk, the more potential entrants have to weigh the risks of entering the market and the more credibly incumbents can threaten that they will match new competition, as sunk costs make it costly for incumbents to leave the market. If, for instance, distributors are tied to a manufacturer via a non-compete obligation, the foreclosing effect will be more significant if setting up its own distributors will impose sunk costs on the potential entrant.

(129) In general, entry requires sunk costs, sometimes minor and sometimes major. Therefore, actual competition is in general more effective and will weigh more in the assessment of a case than potential competition.

Maturity of the market

(130) A mature market is a market that has existed for some time, where the technology used is well known and widespread and not changing very much, where there are no major brand innovations and in which demand is relatively stable or declining. In such a market negative effects are more likely than in more dynamic markets.

Level of trade

(131) The level of trade is linked to the distinction between intermediate and final goods and services. As indicated earlier, negative effects are in general less likely at the level of intermediate goods and services.

Nature of the product

(132) The nature of the product plays a role in particular for final products in assessing both the likely negative and the likely positive effects. When assessing the likely negative effects, it is important whether the products on the market are more homogeneous or heterogeneous, whether the product is expensive, taking up a large part of the consumer's budget, or is inexpensive and whether the product is a one-off purchase or repeatedly purchased. In general, when the product is more heterogeneous, less expensive and resembles more a one-off purchase, vertical restraints are more likely to have negative effects.

⁽¹⁾ See Commission Decision 97/26/EC (Case No IV/M.619 — Gencor/Lonrho), (O) L 11, 14.1.1997, p. 30.

Other factors

(133) In the assessment of particular restraints other factors may have to be taken into account. Among these factors can be the cumulative effect, i.e. the coverage of the market by similar agreements, the duration of the agreements, whether the agreement is 'imposed' (mainly one party is subject to the restrictions or obligations) or 'agreed' (both parties accept restrictions or obligations), the regulatory environment and behaviour that may indicate or facilitate collusion like price leadership, pre-announced price changes and discussions on the 'right' price, price rigidity in response to excess capacity, price discrimination and past collusive behaviour.

1.4.2. *Relevant factors for the assessment under Article 81(3)*

(134) There are four cumulative conditions for the application of Article 81(3):

- the vertical agreement must contribute to improving production or distribution or to promoting technical or economic progress;
- the vertical agreement must allow consumers a fair share of these benefits;
- the vertical agreement must not impose on the undertakings concerned vertical restraints which are not indispensable to the attainment of these benefits;
- the vertical agreement must not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

(135) The last criterion of elimination of competition for a substantial part of the products in question is related to the question of dominance. Where an undertaking is dominant or becoming dominant as a consequence of the vertical agreement, a vertical restraint that has appreciable anti-competitive effects can in principle not be exempted. The vertical agreement may however fall outside Article 81(1) if there is an objective justification, for instance if it is necessary for the protection of relationship-specific investments or for the transfer of substantial know-how without which the supply or purchase of certain goods or services would not take place.

(136) Where the supplier and the buyer are not dominant, the other three criteria become important. The first, concerning the improvement of production or distribution and the promotion of technical or economic progress, refers to the type of efficiencies described in paragraphs 115 to 118. These efficiencies have to

be substantiated and must produce a net positive effect. Speculative claims on avoidance of free-riding or general statements on cost savings will not be accepted. Cost savings that arise from the mere exercise of market power or from anti-competitive conduct cannot be accepted. Secondly, economic benefits have to favour not only the parties to the agreement, but also the consumer. Generally the transmission of the benefits to consumers will depend on the intensity of competition on the relevant market. Competitive pressures will normally ensure that cost-savings are passed on by way of lower prices or that companies have an incentive to bring new products to the market as quickly as possible. Therefore, if sufficient competition which effectively constrains the parties to the agreement is maintained on the market, the competitive process will normally ensure that consumers receive a fair share of the economic benefits. The third criterion will play a role in ensuring that the least anti-competitive restraint is chosen to obtain certain positive effects.

2. **Analysis of specific vertical restraints**

(137) Vertical agreements may contain a combination of two or more of the components of vertical restraints described in paragraphs 103 to 114. The most common vertical restraints and combinations of vertical restraints are analysed below following the methodology of analysis developed in paragraphs 120 to 136.

2.1. **Single branding**

(138) A non-compete arrangement is based on an obligation or incentive scheme which makes the buyer purchase practically all his requirements on a particular market from only one supplier. It does not mean that the buyer can only buy directly from the supplier, but that the buyer will not buy and resell or incorporate competing goods or services. The possible competition risks are foreclosure of the market to competing suppliers and potential suppliers, facilitation of collusion between suppliers in case of cumulative use and, where the buyer is a retailer selling to final consumers, a loss of in-store inter-brand competition. All three restrictive effects have a direct impact on inter-brand competition.

(139) Single branding is exempted by the Block Exemption Regulation when the supplier's market share does not exceed 30 % and subject to a limitation in time of five years for the non-compete obligation. Above the market share threshold or beyond the time limit of five years, the following guidance is provided for the assessment of individual cases.

- (140) The 'market position of the supplier' is of main importance to assess possible anti-competitive effects of non-compete obligations. In general, this type of obligation is imposed by the supplier and the supplier has similar agreements with other buyers.
- (141) It is not only the market position of the supplier that is of importance but also the extent to and the duration for which he applies a non-compete obligation. The higher his tied market share, i.e. the part of his market share sold under a single branding obligation, the more significant foreclosure is likely to be. Similarly, the longer the duration of the non-compete obligations, the more significant foreclosure is likely to be. Non-compete obligations shorter than one year entered into by non-dominant companies are in general not considered to give rise to appreciable anti-competitive effects or net negative effects. Non-compete obligations between one and five years entered into by non-dominant companies usually require a proper balancing of pro- and anti-competitive effects, while non-compete obligations exceeding five years are for most types of investments not considered necessary to achieve the claimed efficiencies or the efficiencies are not sufficient to outweigh their foreclosure effect. Dominant companies may not impose non-compete obligations on their buyers unless they can objectively justify such commercial practice within the context of Article 82.
- (142) In assessing the supplier's market power, the 'market position of his competitors' is important. As long as the competitors are sufficiently numerous and strong, no appreciable anti-competitive effects can be expected. It is only likely that competing suppliers will be foreclosed if they are significantly smaller than the supplier applying the non-compete obligation. Foreclosure of competitors is not very likely where they have similar market positions and can offer similarly attractive products. In such a case foreclosure may however occur for potential entrants when a number of major suppliers enter into non-compete contracts with a significant number of buyers on the relevant market (cumulative effect situation). This is also a situation where non-compete agreements may facilitate collusion between competing suppliers. If individually these suppliers are covered by the Block Exemption Regulation, a withdrawal of the block exemption may be necessary to deal with such a negative cumulative effect. A tied market share of less than 5 % is not considered in general to contribute significantly to a cumulative foreclosure effect.
- (143) In cases where the market share of the largest supplier is below 30 % and the market share of the five largest suppliers (concentration rate (CR) 5) is below 50 %, there is unlikely to be a single or a cumulative anti-competitive effect situation. If a potential entrant cannot penetrate the market profitably, this is likely to be due to factors other than non-compete obligations, such as consumer preferences. A competition problem is unlikely to arise when, for instance, 50 companies, of which none has an important market share, compete fiercely on a particular market.
- (144) 'Entry barriers' are important to establish whether there is real foreclosure. Wherever it is relatively easy for competing suppliers to create new buyers or find alternative buyers for the product, foreclosure is unlikely to be a real problem. However, there are often entry barriers, both at the manufacturing and at the distribution level.
- (145) 'Countervailing power' is relevant, as powerful buyers will not easily allow themselves to be cut off from the supply of competing goods or services. Foreclosure which is not based on efficiency and which has harmful effects on ultimate consumers is therefore mainly a risk in the case of dispersed buyers. However, where non-compete agreements are concluded with major buyers this may have a strong foreclosure effect.
- (146) Lastly, 'the level of trade' is relevant for foreclosure. Foreclosure is less likely in case of an intermediate product. When the supplier of an intermediate product is not dominant, the competing suppliers still have a substantial part of demand that is 'free'. Below the level of dominance a serious foreclosure effect may however arise for actual or potential competitors where there is a cumulative effect. A serious cumulative effect is unlikely to arise as long as less than 50 % of the market is tied. When the supplier is dominant, any obligation to buy the products only or mainly from the dominant supplier may easily lead to significant foreclosure effects on the market. The stronger his dominance, the higher the risk of foreclosure of other competitors.
- (147) Where the agreement concerns supply of a final product at the wholesale level, the question whether a competition problem is likely to arise below the level of dominance depends in large part on the type of wholesaling and the entry barriers at the wholesale level. There is no real risk of foreclosure if competing manufacturers can easily establish their own wholesaling operation. Whether entry barriers are low depends in part on the type of wholesaling, i.e. whether or not wholesalers can operate efficiently with only the product concerned by the agreement (for example ice cream) or whether it is more efficient to trade in a

- whole range of products (for example frozen food-stuffs). In the latter case, it is not efficient for a manufacturer selling only one product to set up his own wholesaling operation. In that case anti-competitive effects may arise below the level of dominance. In addition, cumulative effect problems may arise if several suppliers tie most of the available wholesalers.
- (148) For final products, foreclosure is in general more likely to occur at the retail level, given the significant entry barriers for most manufacturers to start retail outlets just for their own products. In addition, it is at the retail level that non-compete agreements may lead to reduced in-store inter-brand competition. It is for these reasons that for final products at the retail level, significant anti-competitive effects may start to arise, taking into account all other relevant factors, if a non-dominant supplier ties 30 % or more of the relevant market. For a dominant company, even a modest tied market share may already lead to significant anti-competitive effects. The stronger its dominance, the higher the risk of foreclosure of other competitors.
- (149) At the retail level a cumulative foreclosure effect may also arise. When all companies have market shares below 30 % a cumulative foreclosure effect is unlikely if the total tied market share is less than 40 % and withdrawal of the block exemption is therefore unlikely. This figure may be higher when other factors like the number of competitors, entry barriers etc. are taken into account. When not all companies have market shares below the threshold of the Block Exemption Regulation but none is dominant, a cumulative foreclosure effect is unlikely if the total tied market share is below 30 %.
- (150) Where the buyer operates from premises and land owned by the supplier or leased by the supplier from a third party not connected with the buyer, the possibility of imposing effective remedies for a possible foreclosure effect will be limited. In that case intervention by the Commission below the level of dominance is unlikely.
- (151) In certain sectors the selling of more than one brand from a single site may be difficult, in which case a foreclosure problem can better be remedied by limiting the effective duration of contracts.
- (152) A so-called 'English clause', requiring the buyer to report any better offer and allowing him only to accept such an offer when the supplier does not match it, can be expected to have the same effect as a non-compete obligation, especially when the buyer has to reveal who makes the better offer. In addition, by increasing the transparency of the market it may facilitate collusion between the suppliers. An English clause may also work as quantity-forcing. Quantity-forcing on the buyer is a weaker form of non-compete, where incentives or obligations agreed between the supplier and the buyer make the latter concentrate his purchases to a large extent with one supplier. Quantity-forcing may for example take the form of minimum purchase requirements or non-linear pricing, such as quantity rebate schemes, loyalty rebate schemes or a two-part tariff (fixed fee plus a price per unit). Quantity-forcing on the buyer will have similar but weaker foreclosure effects than a non-compete obligation. The assessment of all these different forms will depend on their effect on the market. In addition, Article 82 specifically prevents dominant companies from applying English clauses or fidelity rebate schemes.
- (153) Where appreciable anti-competitive effects are established, the question of a possible exemption under Article 81(3) arises as long as the supplier is not dominant. For non-compete obligations, the efficiencies described in paragraph 116, points 1 (free riding between suppliers), 4, 5 (hold-up problems) and 7 (capital market imperfections) may be particularly relevant.
- (154) In the case of an efficiency as described in paragraph 116, points 1, 4 and 7, quantity forcing on the buyer could possibly be a less restrictive alternative. A non-compete obligation may be the only viable way to achieve an efficiency as described in paragraph 116, point 5 (hold-up problem related to the transfer of know-how).
- (155) In the case of a relationship-specific investment made by the supplier (see efficiency 4 in paragraph 116), a non-compete or quantity forcing agreement for the period of depreciation of the investment will in general fulfil the conditions of Article 81(3). In the case of high relationship-specific investments, a non-compete obligation exceeding five years may be justified. A relationship-specific investment could, for instance, be the installation or adaptation of equipment by the supplier when this equipment can be used afterwards only to produce components for a particular buyer. General or market-specific investments in (extra) capacity

are normally not relationship-specific investments. However, where a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, this new capacity may only be economically viable when producing for this particular customer, in which case the investment would be considered to be relationship-specific.

- (156) Where the supplier provides the buyer with a loan or provides the buyer with equipment which is not relationship-specific, this in itself is normally not sufficient to justify the exemption of a foreclosure effect on the market. The instances of capital market imperfection, whereby it is more efficient for the supplier of a product than for a bank to provide a loan, will be limited (see efficiency 7 in paragraph 116). Even if the supplier of the product were to be the more efficient provider of capital, a loan could only justify a non-compete obligation if the buyer is not prevented from terminating the non-compete obligation and repaying the outstanding part of the loan at any point in time and without payment of any penalty. This means that the repayment of the loan should be structured in equal or decreasing instalments and should not increase over time and that the buyer should have the possibility to take over the equipment provided by the supplier at its market asset value. This is without prejudice to the possibility, in case for example of a new point of distribution, to delay repayment for the first one or two years until sales have reached a certain level.

- (157) The transfer of substantial know-how (efficiency 5 in paragraph 116) usually justifies a non-compete obligation for the whole duration of the supply agreement, as for example in the context of franchising.

- (158) Below the level of dominance the combination of non-compete with exclusive distribution may also justify the non-compete obligation lasting the full length of the agreement. In the latter case, the non-compete obligation is likely to improve the distribution efforts of the exclusive distributor in his territory (see paragraphs 161 to 177).

- (159) Example of non-compete

The market leader in a national market for an impulse consumer product, with a market share of 40 %, sells

most of its products (90 %) through tied retailers (tied market share 36 %). The agreements oblige the retailers to purchase only from the market leader for at least four years. The market leader is especially strongly represented in the more densely populated areas like the capital. Its competitors, 10 in number, of which some are only locally available, all have much smaller market shares, the biggest having 12 %. These 10 competitors together supply another 10 % of the market via tied outlets. There is strong brand and product differentiation in the market. The market leader has the strongest brands. It is the only one with regular national advertising campaigns. It provides its tied retailers with special stocking cabinets for its product.

The result on the market is that in total 46 % (36 % + 10 %) of the market is foreclosed to potential entrants and to incumbents not having tied outlets. Potential entrants find entry even more difficult in the densely populated areas where foreclosure is even higher, although it is there that they would prefer to enter the market. In addition, owing to the strong brand and product differentiation and the high search costs relative to the price of the product, the absence of in-store inter-brand competition leads to an extra welfare loss for consumers. The possible efficiencies of the outlet exclusivity, which the market leader claims result from reduced transport costs and a possible hold-up problem concerning the stocking cabinets, are limited and do not outweigh the negative effects on competition. The efficiencies are limited, as the transport costs are linked to quantity and not exclusivity and the stocking cabinets do not contain special know-how and are not brand specific. Accordingly, it is unlikely that the conditions for exemption are fulfilled.

- (160) Example of quantity forcing

A producer X with a 40 % market share sells 80 % of its products through contracts which specify that the reseller is required to purchase at least 75 % of its requirements for that type of product from X. In return X is offering financing and equipment at favourable rates. The contracts have a duration of five years in which repayment of the loan is foreseen in equal instalments. However, after the first two years buyers have the possibility to terminate the contract with a six-month notice period if they repay the outstanding loan and take over the equipment at its market asset value. At the end of the five-year period the equipment becomes the property of the buyer. Most of the competing producers are small, twelve in total with the biggest having a market share of 20 %, and engage in similar contracts with different

durations. The producers with market shares below 10 % often have contracts with longer durations and with less generous termination clauses. The contracts of producer X leave 25 % of requirements free to be supplied by competitors. In the last three years, two new producers have entered the market and gained a combined market share of around 8 %, partly by taking over the loans of a number of resellers in return for contracts with these resellers.

Producer X's tied market share is 24 % ($0,75 \times 0,80 \times 40$ %). The other producers' tied market share is around 25 %. Therefore, in total around 49 % of the market is foreclosed to potential entrants and to incumbents not having tied outlets for at least the first two years of the supply contracts. The market shows that the resellers often have difficulty in obtaining loans from banks and are too small in general to obtain capital through other means like the issuing of shares. In addition, producer X is able to demonstrate that concentrating his sales on a limited number of resellers allows him to plan his sales better and to save transport costs. In the light of the 25 % non-tied part in the contracts of producer X, the real possibility for early termination of the contract, the recent entry of new producers and the fact that around half the resellers are not tied, the quantity forcing of 75 % applied by producer X is likely to fulfil the conditions for exemption.

2.2. *Exclusive distribution*

(161) In an exclusive distribution agreement the supplier agrees to sell his products only to one distributor for resale in a particular territory. At the same time the distributor is usually limited in his active selling into other exclusively allocated territories. The possible competition risks are mainly reduced intra-brand competition and market partitioning, which may in particular facilitate price discrimination. When most or all of the suppliers apply exclusive distribution this may facilitate collusion, both at the suppliers' and distributors' level.

(162) Exclusive distribution is exempted by the Block Exemption Regulation when the supplier's market share does not exceed 30 %, even if combined with

other non-hardcore vertical restraints, such as a non-compete obligation limited to five years, quantity forcing or exclusive purchasing. A combination of exclusive distribution and selective distribution is only exempted by the Block Exemption Regulation if active selling in other territories is not restricted. Above the 30 % market share threshold, the following guidance is provided for the assessment of exclusive distribution in individual cases.

(163) The market position of the supplier and his competitors is of major importance, as the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the 'position of the supplier', the more serious is the loss of intra-brand competition. Above the 30 % market share threshold there may be a risk of a significant reduction of intra-brand competition. In order to be exemptable, the loss of intra-brand competition needs to be balanced with real efficiencies.

(164) The 'position of the competitors' can have a dual significance. Strong competitors will generally mean that the reduction in intra-brand competition is outweighed by sufficient inter-brand competition. However, if the number of competitors becomes rather small and their market position is rather similar in terms of market share, capacity and distribution network, there is a risk of collusion. The loss of intra-brand competition can increase this risk, especially when several suppliers operate similar distribution systems. Multiple exclusive dealerships, i.e. when different suppliers appoint the same exclusive distributor in a given territory, may further increase the risk of collusion. If a dealer is granted the exclusive right to distribute two or more important competing products in the same territory, inter-brand competition is likely to be substantially restricted for those brands. The higher the cumulative market share of the brands distributed by the multiple dealer, the higher the risk of collusion and the more inter-brand competition will be reduced. Such cumulative effect situations may be a reason to withdraw the benefit of the Block Exemption Regulation when the market shares of the suppliers are below the threshold of the Block Exemption Regulation.

(165) 'Entry barriers' that may hinder suppliers from creating new distributors or finding alternative distributors are less important in assessing the possible anti-competitive effects of exclusive distribution. Foreclosure of other suppliers does not arise as long as exclusive distribution is not combined with single branding.

- (166) Foreclosure of other distributors is not a problem if the supplier which operates the exclusive distribution system appoints a high number of exclusive distributors in the same market and these exclusive distributors are not restricted in selling to other non-appointed distributors. Foreclosure of other distributors may however become a problem where there is 'buying power' and market power downstream, in particular in the case of very large territories where the exclusive distributor becomes the exclusive buyer for a whole market. An example would be a supermarket chain which becomes the only distributor of a leading brand on a national food retail market. The foreclosure of other distributors may be aggravated in the case of multiple exclusive dealership. Such a case, covered by the Block Exemption Regulation when the market share of each supplier is below 30 %, may give reason for withdrawal of the block exemption.
- (167) 'Buying power' may also increase the risk of collusion on the buyers' side when the exclusive distribution arrangements are imposed by important buyers, possibly located in different territories, on one or several suppliers.
- (168) 'Maturity of the market' is important, as loss of intra-brand competition and price discrimination may be a serious problem in a mature market but may be less relevant in a market with growing demand, changing technologies and changing market positions.
- (169) 'The level of trade' is important as the possible negative effects may differ between the wholesale and retail level. Exclusive distribution is mainly applied in the distribution of final goods and services. A loss of intra-brand competition is especially likely at the retail level if coupled with large territories, since final consumers may be confronted with little possibility of choosing between a high price/high service and a low price/low service distributor for an important brand.
- (170) A manufacturer which chooses a wholesaler to be his exclusive distributor will normally do so for a larger territory, such as a whole Member State. As long as the wholesaler can sell the products without limitation to downstream retailers there are not likely to be appreciable anti-competitive effects if the manufacturer is not dominant. A possible loss of intra-brand competition at the wholesale level may be easily outweighed by efficiencies obtained in logistics, promotion etc, especially when the manufacturer is based in a different country. Foreclosure of other wholesalers within that territory is not likely as a supplier with a market share above 30 % usually has enough bargaining power not to choose a less efficient wholesaler. The possible risks for inter-brand competition of multiple exclusive dealerships are however higher at the wholesale than at the retail level.
- (171) The combination of exclusive distribution with single branding may add the problem of foreclosure of the market to other suppliers, especially in case of a dense network of exclusive distributors with small territories or in case of a cumulative effect. This may necessitate application of the principles set out above on single branding. However, when the combination does not lead to significant foreclosure, the combination of exclusive distribution and single branding may be pro-competitive by increasing the incentive for the exclusive distributor to focus his efforts on the particular brand. Therefore, in the absence of such a foreclosure effect, the combination of exclusive distribution with non-compete is exemptable for the whole duration of the agreement, particularly at the wholesale level.
- (172) The combination of exclusive distribution with exclusive purchasing increases the possible competition risks of reduced intra-brand competition and market partitioning which may in particular facilitate price discrimination. Exclusive distribution already limits arbitrage by customers, as it limits the number of distributors and usually also restricts the distributors in their freedom of active selling. Exclusive purchasing, requiring the exclusive distributors to buy their supplies for the particular brand directly from the manufacturer, eliminates in addition possible arbitrage by the exclusive distributors, who are prevented from buying from other distributors in the system. This enhances the possibilities for the supplier to limit intra-brand competition while applying dissimilar conditions of sale. The combination of exclusive distribution and exclusive purchasing is therefore unlikely to be exempted for suppliers with a market share above 30 % unless there are very clear and substantial efficiencies leading to lower prices to all final consumers. Lack of such efficiencies may also lead to withdrawal of the block exemption where the market share of the supplier is below 30 %.
- (173) The 'nature of the product' is not very relevant to assessing the possible anti-competitive effects of exclusive distribution. It is, however, relevant when the issue of possible efficiencies is discussed, that is after an appreciable anti-competitive effect is established.
- (174) Exclusive distribution may lead to efficiencies, especially where investments by the distributors are required to protect or build up the brand image. In

general, the case for efficiencies is strongest for new products, for complex products, for products whose qualities are difficult to judge before consumption (so-called experience products) or of which the qualities are difficult to judge even after consumption (so-called credence products). In addition, exclusive distribution may lead to savings in logistic costs due to economies of scale in transport and distribution.

(175) Example of exclusive distribution at the wholesale level

In the market for a consumer durable, A is the market leader. A sells its product through exclusive wholesalers. Territories for the wholesalers correspond to the entire Member State for small Member States, and to a region for larger Member States. These exclusive distributors take care of sales to all the retailers in their territories. They do not sell to final consumers. The wholesalers are in charge of promotion in their markets. This includes sponsoring of local events, but also explaining and promoting the new products to the retailers in their territories. Technology and product innovation are evolving fairly quickly on this market, and pre-sale service to retailers and to final consumers plays an important role. The wholesalers are not required to purchase all their requirements of the brand of supplier A from the producer himself, and arbitrage by wholesalers or retailers is practicable because the transport costs are relatively low compared to the value of the product. The wholesalers are not under a non-compete obligation. Retailers also sell a number of brands of competing suppliers, and there are no exclusive or selective distribution agreements at the retail level. On the European market of sales to wholesalers A has around 50 % market share. Its market share on the various national retail markets varies between 40 % and 60 %. A has between 6 and 10 competitors on every national market: B, C and D are its biggest competitors and are also present on each national market, with market shares varying between 20 % and 5 %. The remaining producers are national producers, with smaller market shares. B, C and D have similar distribution networks, whereas the local producers tend to sell their products directly to retailers.

On the wholesale market described above, the risk of reduced intra-brand competition and price discrimination is low. Arbitrage is not hindered, and the absence of intra-brand competition is not very relevant at the wholesale level. At the retail level neither intra- nor inter-brand competition are hindered. Moreover, inter-brand competition is largely unaffected by the exclusive arrangements at the wholesale level. This

makes it likely, if anti-competitive effects exist, that the conditions for exemption are fulfilled.

(176) Example of multiple exclusive dealerships in an oligopolistic market

In a national market for a final product, there are four market leaders, who each have a market share of around 20 %. These four market leaders sell their product through exclusive distributors at the retail level. Retailers are given an exclusive territory which corresponds to the town in which they are located or a district of the town for large towns. In most territories, the four market leaders happen to appoint the same exclusive retailer ('multiple dealership'), often centrally located and rather specialised in the product. The remaining 20 % of the national market is composed of small local producers, the largest of these producers having a market share of 5 % on the national market. These local producers sell their products in general through other retailers, in particular because the exclusive distributors of the four largest suppliers show in general little interest in selling less well-known and cheaper brands. There is strong brand and product differentiation on the market. The four market leaders have large national advertising campaigns and strong brand images, whereas the fringe producers do not advertise their products at the national level. The market is rather mature, with stable demand and no major product and technological innovation. The product is relatively simple.

In such an oligopolistic market, there is a risk of collusion between the four market leaders. This risk is increased through multiple dealerships. Intra-brand competition is limited by the territorial exclusivity. Competition between the four leading brands is reduced at the retail level, since one retailer fixes the price of all four brands in each territory. The multiple dealership implies that, if one producer cuts the price for its brand, the retailer will not be eager to transmit this price cut to the final consumer as it would reduce its sales and profits made with the other brands. Hence, producers have a reduced interest in entering into price competition with one another. Inter-brand price competition exists mainly with the low brand image goods of the fringe producers. The possible efficiency arguments for (joint) exclusive distributors are limited, as the product is relatively simple, the resale does not require any specific investments or training and advertising is mainly carried out at the level of the producers.

Even though each of the market leaders has a market share below the threshold, exemption under Article 81(3) may not be justified and withdrawal of the block exemption may be necessary.

(177) Example of exclusive distribution combined with exclusive purchasing

Manufacturer A is the European market leader for a bulky consumer durable, with a market share of between 40 % and 60 % in most national retail markets. In every Member State, it has about seven competitors with much smaller market shares, the largest of these competitors having a market share of 10 %. These competitors are present on only one or two national markets. A sells its product through its national subsidiaries to exclusive distributors at the retail level, which are not allowed to sell actively into each other's territories. In addition, the retailers are obliged to purchase manufacturer A's products exclusively from the national subsidiary of manufacturer A in their own country. The retailers selling the brand of manufacturer A are the main resellers of that type of product in their territory. They handle competing brands, but with varying degrees of success and enthusiasm. A applies price differences of 10 % to 15 % between markets and smaller differences within markets. This is translated into smaller price differences at the retail level. The market is relatively stable on the demand and the supply side, and there are no significant technological changes.

In these markets, the loss of intra-brand competition results not only from the territorial exclusivity at the retail level but is aggravated by the exclusive purchasing obligation imposed on the retailers. The exclusive purchase obligation helps to keep markets and territories separate by making arbitrage between the exclusive retailers impossible. The exclusive retailers also cannot sell actively into each other's territory and in practice tend to avoid delivering outside their own territory. This renders price discrimination possible. Arbitrage by consumers or independent traders is limited due to the bulkiness of the product.

The possible efficiency arguments of this system, linked to economies of scale in transport and promotion efforts at the retailers' level, are unlikely to outweigh the negative effect of price discrimination and reduced intra-brand competition. Consequently, it is unlikely that the conditions for exemption are fulfilled.

2.3. *Exclusive customer allocation*

(178) In an exclusive customer allocation agreement, the supplier agrees to sell his products only to one distributor for resale to a particular class of customers. At the same time, the distributor is usually limited in his active selling to other exclusively allocated classes of customers. The possible competition risks are

mainly reduced intra-brand competition and market partitioning, which may in particular facilitate price discrimination. When most or all of the suppliers apply exclusive customer allocation, this may facilitate collusion, both at the suppliers' and the distributors' level.

(179) Exclusive customer allocation is exempted by the Block Exemption Regulation when the supplier's market share does not exceed the 30 % market share threshold, even if combined with other non-hardcore vertical restraints such as non-compete, quantity-forcing or exclusive purchasing. A combination of exclusive customer allocation and selective distribution is normally hardcore, as active selling to end-users by the appointed distributors is usually not left free. Above the 30 % market share threshold, the guidance provided in paragraphs 161 to 177 applies *mutatis mutandis* to the assessment of exclusive customer allocation, subject to the following specific remarks.

(180) The allocation of customers normally makes arbitrage by the customers more difficult. In addition, as each appointed distributor has his own class of customers, non-appointed distributors not falling within such a class may find it difficult to obtain the product. This will reduce possible arbitrage by non-appointed distributors. Therefore, above the 30 % market share threshold of the Block Exemption Regulation exclusive customer allocation is unlikely to be exemptable unless there are clear and substantial efficiency effects.

(181) Exclusive customer allocation is mainly applied to intermediate products and at the wholesale level when it concerns final products, where customer groups with different specific requirements concerning the product can be distinguished.

(182) Exclusive customer allocation may lead to efficiencies, especially when the distributors are required to make investments in for instance specific equipment, skills or know-how to adapt to the requirements of their class of customers. The depreciation period of these investments indicates the justified duration of an exclusive customer allocation system. In general the case is strongest for new or complex products and for products requiring adaptation to the needs of the individual customer. Identifiable differentiated needs are more likely for intermediate products, that is products sold to different types of professional buyers. Allocation of final consumers is unlikely to lead to any efficiencies and is therefore unlikely to be exempted.

(183) Example of exclusive customer allocation

A company has developed a sophisticated sprinkler installation. The company has currently a market share of 40 % on the market for sprinkler installations. When it started selling the sophisticated sprinkler it had a market share of 20 % with an older product. The installation of the new type of sprinkler depends on the type of building that it is installed in and on the use of the building (office, chemical plant, hospital etc.). The company has appointed a number of distributors to sell and install the sprinkler installation. Each distributor needed to train its employees for the general and specific requirements of installing the sprinkler installation for a particular class of customers. To ensure that distributors would specialise the company assigned to each distributor an exclusive class of customers and prohibited active sales to each others' exclusive customer classes. After five years, all the exclusive distributors will be allowed to sell actively to all classes of customers, thereby ending the system of exclusive customer allocation. The supplier may then also start selling to new distributors. The market is quite dynamic, with two recent entries and a number of technological developments. Competitors, with market shares between 25 % and 5 %, are also upgrading their products.

As the exclusivity is of limited duration and helps to ensure that the distributors may recoup their investments and concentrate their sales efforts first on a certain class of customers in order to learn the trade, and as the possible anti-competitive effects seem limited in a dynamic market, the conditions for exemption are likely to be fulfilled.

2.4. *Selective distribution*

(184) Selective distribution agreements, like exclusive distribution agreements, restrict on the one hand the number of authorised distributors and on the other the possibilities of resale. The difference with exclusive distribution is that the restriction of the number of dealers does not depend on the number of territories but on selection criteria linked in the first place to the nature of the product. Another difference with exclusive distribution is that the restriction on resale is not a restriction on active selling to a territory but a restriction on any sales to non-authorised distributors, leaving only appointed dealers and final customers as possible buyers. Selective distribution is almost always used to distribute branded final products.

(185) The possible competition risks are a reduction in intra-brand competition and, especially in case of cumulative effect, foreclosure of certain type(s) of distributors and facilitation of collusion between suppliers or buyers. To assess the possible anti-competitive effects of selective distribution under Article 81(1), a distinction needs to be made between purely qualitative selective distribution and quantitative selective distribution. Purely qualitative selective distribution selects dealers 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, a certain range of the products being sold etc⁽¹⁾. The application of such criteria does not put a direct limit on the number of dealers. Purely qualitative selective distribution is in general considered to fall outside Article 81(1) for lack of anti-competitive effects, provided that three conditions are satisfied. First, the nature of the product in question must necessitate a selective distribution system, in the sense that such a system must constitute a legitimate requirement, having regard to the nature of the product concerned, to preserve its quality and ensure its proper use. Secondly, resellers must be chosen on the basis of objective criteria of a qualitative nature which are laid down uniformly for all potential resellers and are not applied in a discriminatory manner. Thirdly, the criteria laid down must not go beyond what is necessary⁽²⁾. Quantitative selective distribution adds further criteria for selection that more directly limit the potential number of dealers by, for instance, requiring minimum or maximum sales, by fixing the number of dealers, etc.

(186) Qualitative and quantitative selective distribution is exempted by the Block Exemption Regulation up to 30 % market share, even if combined with other non-hardcore vertical restraints, such as non-compete or exclusive distribution, provided active selling by the authorised distributors to each other and to end users is not restricted. The Block Exemption Regulation exempts selective distribution regardless of the nature of the product concerned. However, where the nature of the product does not require selective distribution, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in intra-brand competition. If appreciable anti-competitive effects

⁽¹⁾ See for example judgment of the Court of First Instance in Case T-88/92 *Groupeement d'achat Édouard Leclerc v Commission* [1996] ECR II-1961.

⁽²⁾ See judgments of the Court of Justice in Case 31/80 *L'Oréal v PVBA* [1980] ECR 3775, paragraphs 15 and 16; Case 26/76 *Metro I* [1977] ECR 1875, paragraphs 20 and 21; Case 107/82 *AEG* [1983] ECR 3151, paragraph 35; and of the Court of First Instance in Case T-19/91 *Vichy v Commission* [1992] ECR II-415, paragraph 65.

occur, the benefit of the Block Exemption Regulation is likely to be withdrawn. In addition, the following guidance is provided for the assessment of selective distribution in individual cases which are not covered by the Block Exemption Regulation or in the case of cumulative effects resulting from parallel networks of selective distribution.

- (187) The market position of the supplier and his competitors is of central importance in assessing possible anti-competitive effects, as the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the position of the supplier, the more problematic is the loss of intra-brand competition. Another important factor is the number of selective distribution networks present in the same market. Where selective distribution is applied by only one supplier in the market which is not a dominant undertaking, quantitative selective distribution does not normally create net negative effects provided that the contract goods, having regard to their nature, require the use of a selective distribution system and on condition that the selection criteria applied are necessary to ensure efficient distribution of the goods in question. The reality, however, seems to be that selective distribution is often applied by a number of the suppliers in a given market.
- (188) The position of competitors can have a dual significance and plays in particular a role in case of a cumulative effect. Strong competitors will mean in general that the reduction in intra-brand competition is easily outweighed by sufficient inter-brand competition. However, when a majority of the main suppliers apply selective distribution there will be a significant loss of intra-brand competition and possible foreclosure of certain types of distributors as well as an increased risk of collusion between those major suppliers. The risk of foreclosure of more efficient distributors has always been greater with selective distribution than with exclusive distribution, given the restriction on sales to non-authorized dealers in selective distribution. This is designed to give selective distribution systems a closed character, making it impossible for non-authorized dealers to obtain supplies. This makes selective distribution particularly well suited to avoid pressure by price discounters on the margins of the manufacturer, as well as on the margins of the authorized dealers.
- (189) Where the Block Exemption Regulation applies to individual networks of selective distribution, withdrawal of the block exemption or disapplication of the Block Exemption Regulation may be considered in case of cumulative effects. However, a cumulative effect problem is unlikely to arise when the share of the market covered by selective distribution is below 50 %. Also, no problem is likely to arise where the market coverage ratio exceeds 50 %, but the aggregate market share of the five largest suppliers (CR5) is below 50 %. Where both the CR5 and the share of the market covered by selective distribution exceed 50 %, the assessment may vary depending on whether or not all five largest suppliers apply selective distribution. The stronger the position of the competitors not applying selective distribution, the less likely the foreclosure of other distributors. If all five largest suppliers apply selective distribution, competition concerns may in particular arise with respect to those agreements that apply quantitative selection criteria by directly limiting the number of authorized dealers. The conditions of Article 81(3) are in general unlikely to be fulfilled if the selective distribution systems at issue prevent access to the market by new distributors capable of adequately selling the products in question, especially price discounters, thereby limiting distribution to the advantage of certain existing channels and to the detriment of final consumers. More indirect forms of quantitative selective distribution, resulting for instance from the combination of purely qualitative selection criteria with the requirement imposed on the dealers to achieve a minimum amount of annual purchases, are less likely to produce net negative effects, if such an amount does not represent a significant proportion of the dealer's total turnover achieved with the type of products in question and it does not go beyond what is necessary for the supplier to recoup his relationship-specific investment and/or realise economies of scale in distribution. As regards individual contributions, a supplier with a market share of less than 5 % is in general not considered to contribute significantly to a cumulative effect.
- (190) 'Entry barriers' are mainly of interest in the case of foreclosure of the market to non-authorized dealers. In general entry barriers will be considerable as selective distribution is usually applied by manufacturers of branded products. It will in general take time and considerable investment for excluded retailers to launch their own brands or obtain competitive supplies elsewhere.
- (191) 'Buying power' may increase the risk of collusion between dealers and thus appreciably change the analysis of possible anti-competitive effects of selective distribution. Foreclosure of the market to more efficient retailers may especially result where a strong dealer organisation imposes selection criteria on the supplier aimed at limiting distribution to the advantage of its members.

- (192) Article 5(c) of the Block Exemption Regulation provides that the supplier may not impose an obligation causing the authorised dealers, either directly or indirectly, not to sell the brands of particular competing suppliers. This condition aims specifically at avoiding horizontal collusion to exclude particular brands through the creation of a selective club of brands by the leading suppliers. This kind of obligation is unlikely to be exemptable when the CR5 is equal to or above 50 %, unless none of the suppliers imposing such an obligation belongs to the five largest suppliers in the market.
- (193) Foreclosure of other suppliers is normally not a problem as long as other suppliers can use the same distributors, i.e. as long as the selective distribution system is not combined with single branding. In the case of a dense network of authorised distributors or in the case of a cumulative effect, the combination of selective distribution and a non-compete obligation may pose a risk of foreclosure to other suppliers. In that case the principles set out above on single branding apply. Where selective distribution is not combined with a non-compete obligation, foreclosure of the market to competing suppliers may still be a problem when the leading suppliers apply not only purely qualitative selection criteria, but impose on their dealers certain additional obligations such as the obligation to reserve a minimum shelf-space for their products or to ensure that the sales of their products by the dealer achieve a minimum percentage of the dealer's total turnover. Such a problem is unlikely to arise if the share of the market covered by selective distribution is below 50 % or, where this coverage ratio is exceeded, if the market share of the five largest suppliers is below 50 %.
- (194) Maturity of the market is important, as loss of intra-brand competition and possible foreclosure of suppliers or dealers may be a serious problem in a mature market but is less relevant in a market with growing demand, changing technologies and changing market positions.
- (195) Selective distribution may be efficient when it leads to savings in logistical costs due to economies of scale in transport and this may happen irrespective of the nature of the product (efficiency 6 in paragraph 116). However, this is usually only a marginal efficiency in selective distribution systems. To help solve a free-rider problem between the distributors (efficiency 1 in paragraph 116) or to help create a brand image (efficiency 8 in paragraph 116), the nature of the product is very relevant. In general the case is strongest for new products, for complex products, for products of which the qualities are difficult to judge before consumption (so-called experience products) or of which the qualities are difficult to judge even after consumption (so-called credence products). The combination of selective and exclusive distribution is likely to infringe Article 81 if it is applied by a supplier whose market share exceeds 30 % or in case of cumulative effects, even though active sales between the territories remain free. Such a combination may exceptionally fulfil the conditions of Article 81(3) if it is indispensable to protect substantial and relationship-specific investments made by the authorised dealers (efficiency 4 in paragraph 116).
- (196) To ensure that the least anti-competitive restraint is chosen, it is relevant to see whether the same efficiencies can be obtained at a comparable cost by for instance service requirements alone.
- (197) Example of quantitative selective distribution:
- In a market for consumer durables, the market leader (brand A), with a market share of 35 %, sells its product to final consumers through a selective distribution network. There are several criteria for admission to the network: the shop must employ trained staff and provide pre-sales services, there must be a specialised area in the shop devoted to the sales of the product and similar hi-tech products, and the shop is required to sell a wide range of models of the supplier and to display them in an attractive manner. Moreover, the number of admissible retailers in the network is directly limited through the establishment of a maximum number of retailers per number of inhabitants in each province or urban area. Manufacturer A has 6 competitors in this market. Its largest competitors, B, C and D, have market shares of respectively 25, 15 and 10 %, whilst the other producers have smaller market shares. A is the only manufacturer to use selective distribution. The selective distributors of brand A always handle a few competing brands. However, competing brands are also widely sold in shops which are not member of A's selective distribution network. Channels of distribution are various: for instance, brands B and C are sold in most of A's selected shops, but also in other shops providing a high quality service and in hypermarkets. Brand D is mainly sold in high service shops. Technology is evolving quite rapidly in this market, and the main suppliers maintain a strong quality image for their products through advertising.

In this market, the coverage ratio of selective distribution is 35 %. Inter-brand competition is not directly affected by the selective distribution system of A. Intra-brand competition for brand A may be reduced, but consumers have access to low service/low price retailers for brands B and C, which have a comparable quality image to brand A. Moreover, access to high service retailers for other brands is not foreclosed, since there is no limitation on the capacity of selected distributors to sell competing brands, and the quantitative limitation on the number of retailers for brand A leaves other high service retailers free to distribute competing brands. In this case, in view of the service requirements and the efficiencies these are likely to provide and the limited effect on intra-brand competition the conditions for exempting A's selective distribution network are likely to be fulfilled.

(198) Example of selective distribution with cumulative effects:

On a market for a particular sports article, there are seven manufacturers, whose respective market shares are: 25 %, 20 %, 15 %, 15 %, 10 %, 8 % and 7 %. The five largest manufacturers distribute their products through quantitative selective distribution, whilst the two smallest use different types of distribution systems, which results in a coverage ratio of selective distribution of 85 %. The criteria for access to the selective distribution networks are remarkably uniform amongst manufacturers: shops are required to have trained personnel and to provide pre-sale services, there must be a specialised area in the shop devoted to the sales of the article and a minimum size for this area is specified. The shop is required to sell a wide range of the brand in question and to display the article in an attractive manner, the shop must be located in a commercial street, and this type of article must represent at least 30 % of the total turnover of the shop. In general, the same dealer is appointed selective distributor for all five brands. The two brands which do not use selective distribution usually sell through less specialised retailers with lower service levels. The market is stable, both on the supply and on the demand side, and there is strong brand image and product differentiation. The five market leaders have strong brand images, acquired through advertising and sponsoring, whereas the two smaller manufacturers have a strategy of cheaper products, with no strong brand image.

In this market, access by general price discounters to the five leading brands is denied. Indeed, the requirement that this type of article represents at least 30 % of the activity of the dealers and the criteria on

presentation and pre-sales services rule out most price discounters from the network of authorised dealers. As a consequence, consumers have no choice but to buy the five leading brands in high service/high price shops. This leads to reduced inter-brand competition between the five leading brands. The fact that the two smallest brands can be bought in low service/low price shops does not compensate for this, because the brand image of the five market leaders is much better. Inter-brand competition is also limited through multiple dealership. Even though there exists some degree of intra-brand competition and the number of retailers is not directly limited, the criteria for admission are strict enough to lead to a small number of retailers for the five leading brands in each territory.

The efficiencies associated with these quantitative selective distribution systems are low: the product is not very complex and does not justify a particularly high service. Unless the manufacturers can prove that there are clear efficiencies linked to their network of selective distribution, it is probable that the block exemption will have to be withdrawn because of its cumulative effects resulting in less choice and higher prices for consumers.

2.5. **Franchising**

(199) Franchise agreements contain licences of intellectual property rights relating in particular to trade marks or signs and know-how for the use and distribution of goods or services. In addition to the licence of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance. The licence and the assistance are integral components of the business method being franchised. The franchisor is in general paid a franchise fee by the franchisee for the use of the particular business method. Franchising may enable the franchisor to establish, with limited investments, a uniform network for the distribution of his products. In addition to the provision of the business method, franchise agreements usually contain a combination of different vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.

(200) The coverage by the Block Exemption Regulation of the licensing of IPRs contained in franchise agreements is dealt with in paragraphs 23 to 45. As for the vertical restraints on the purchase, sale and resale of goods and services within a franchising arrangement, such as selective distribution, non-compete or exclusive distribution, the Block Exemption Regulation applies up to the 30 % market share threshold for the

franchisor or the supplier designated by the franchisor⁽¹⁾. The guidance provided earlier in respect of these types of restraints applies also to franchising, subject to the following specific remarks:

- 1) In line with general rule 8 (see paragraph 119), the more important the transfer of know-how, the more easily the vertical restraints fulfil the conditions for exemption.
- 2) A non-compete obligation on the goods or services purchased by the franchisee falls outside Article 81(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 81(1), as long as it does not exceed the duration of the franchise agreement itself.

(201) Example of franchising:

A manufacturer has developed a new format for selling sweets in so-called fun shops where the sweets can be coloured specially on demand from the consumer. The manufacturer of the sweets has also developed the machines to colour the sweets. The manufacturer also produces the colouring liquids. The quality and freshness of the liquid is of vital importance to producing good sweets. The manufacturer made a success of its sweets through a number of own retail outlets all operating under the same trade name and with the uniform fun image (style of lay-out of the shops, common advertising etc.). In order to expand sales the manufacturer started a franchising system. The franchisees are obliged to buy the sweets, liquid and colouring machine from the manufacturer, to have the same image and operate under the trade name, pay a franchise fee, contribute to common advertising and ensure the confidentiality of the operating manual prepared by the franchisor. In addition, the franchisees are only allowed to sell from the agreed premises, are only allowed to sell to end users or other franchisees and are not allowed to sell other sweets. The franchisor is obliged not to appoint another franchisee nor operate a retail outlet himself in a given contract territory. The franchisor is also under the obligation to update and further develop its products, the business outlook and the operating manual and make these improvements available to all retail franchisees. The franchise agreements are concluded for a duration of 10 years.

Sweet retailers buy their sweets on a national market from either national producers that cater for national tastes or from wholesalers which import sweets from foreign producers in addition to selling products from national producers. On this market the franchisor's products compete with other brands of sweets. The franchisor has a market share of 30 % on the market for sweets sold to retailers. Competition comes from a number of national and international brands, sometimes produced by large diversified food companies. There are many potential points of sale of sweets in the form of tobacconists, general food retailers, cafeterias and specialised sweet shops. On the market for machines for colouring food the franchisor's market share is below 10 %.

Most of the obligations contained in the franchise agreements can be assessed as being necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 81(1). The restrictions on selling (contract territory and selective distribution) provide an incentive to the franchisees to invest in the colouring machine and the franchise concept and, if not necessary for, at least help to maintain the common identity, thereby offsetting the loss of intra-brand competition. The non-compete clause excluding other brands of sweets from the shops for the full duration of the agreements does allow the franchisor to keep the outlets uniform and prevent competitors from benefiting from its trade name. It does not lead to any serious foreclosure in view of the great number of potential outlets available to other sweet producers. The franchise agreements of this franchisor are likely to fulfil the conditions for exemption under Article 81(3) in as far as the obligations contained therein fall under Article 81(1).

2.6. **Exclusive supply**

- (202) Exclusive supply as defined in Article 1(c) of the Block Exemption Regulation is the extreme form of limited distribution in as far as the limit on the number of buyers is concerned: in the agreement it is specified that there is only one buyer inside the Community to which the supplier may sell a particular final product. For intermediate goods or services, exclusive supply means that there is only one buyer inside the Community or that there is only one buyer inside the Community for the purposes of a specific use. For intermediate goods or services, exclusive supply is often referred to as industrial supply.

⁽¹⁾ See also paragraphs AEG [1983] ECR 3151, paragraph 35; and of the Court of First Instance in Case T-19/91 Vichy v Commission [1992] ECR II-415, paragraph 65. See also paragraphs 89 to 95, in particular paragraph 95.

- (203) Exclusive supply as defined in Article 1(c) of the Block Exemption Regulation is exempted by Article 2(1) read in conjunction with Article 3(2) of the Block Exemption Regulation up to 30 % market share of the buyer, even if combined with other non-hardcore vertical restraints such as non-compete. Above the market share threshold the following guidance is provided for the assessment of exclusive supply in individual cases.
- (204) The main competition risk of exclusive supply is foreclosure of other buyers. The market share of the buyer on the upstream purchase market is obviously important for assessing the ability of the buyer to 'impose' exclusive supply which forecloses other buyers from access to supplies. The importance of the buyer on the downstream market is however the factor which determines whether a competition problem may arise. If the buyer has no market power downstream, then no appreciable negative effects for consumers can be expected. Negative effects can however be expected when the market share of the buyer on the downstream supply market as well as the upstream purchase market exceeds 30 %. Where the market share of the buyer on the upstream market does not exceed 30 %, significant foreclosure effects may still result, especially when the market share of the buyer on his downstream market exceeds 30 %. In such cases withdrawal of the block exemption may be required. Where a company is dominant on the downstream market, any obligation to supply the products only or mainly to the dominant buyer may easily have significant anti-competitive effects.
- (205) It is not only the market position of the buyer on the upstream and downstream market that is important but also the extent to and the duration for which he applies an exclusive supply obligation. The higher the tied supply share, and the longer the duration of the exclusive supply, the more significant the foreclosure is likely to be. Exclusive supply agreements shorter than five years entered into by non-dominant companies usually require a balancing of pro- and anti-competitive effects, while agreements lasting longer than five years are for most types of investments not considered necessary to achieve the claimed efficiencies or the efficiencies are not sufficient to outweigh the foreclosure effect of such long-term exclusive supply agreements.
- (206) The market position of the competing buyers on the upstream market is important as it is only likely that competing buyers will be foreclosed for anti-competitive reasons, i.e. to increase their costs, if they are significantly smaller than the foreclosing buyer.
- Foreclosure of competing buyers is not very likely where these competitors have similar buying power and can offer the suppliers similar sales possibilities. In such a case, foreclosure could only occur for potential entrants, who may not be able to secure supplies when a number of major buyers all enter into exclusive supply contracts with the majority of suppliers on the market. Such a cumulative effect may lead to withdrawal of the benefit of the Block Exemption Regulation.
- (207) Entry barriers at the supplier level are relevant to establishing whether there is real foreclosure. In as far as it is efficient for competing buyers to provide the goods or services themselves via upstream vertical integration, foreclosure is unlikely to be a real problem. However, often there are significant entry barriers.
- (208) Countervailing power of suppliers is relevant, as important suppliers will not easily allow themselves to be cut off from alternative buyers. Foreclosure is therefore mainly a risk in the case of weak suppliers and strong buyers. In the case of strong suppliers the exclusive supply may be found in combination with non-compete. The combination with non-compete brings in the rules developed for single branding. Where there are relationship-specific investments involved on both sides (hold-up problem) the combination of exclusive supply and non-compete i.e. reciprocal exclusivity in industrial supply agreements is usually justified below the level of dominance.
- (209) Lastly, the level of trade and the nature of the product are relevant for foreclosure. Foreclosure is less likely in the case of an intermediate product or where the product is homogeneous. Firstly, a foreclosed manufacturer that uses a certain input usually has more flexibility to respond to the demand of his customers than the wholesaler/retailer has in responding to the demand of the final consumer for whom brands may play an important role. Secondly, the loss of a possible source of supply matters less for the foreclosed buyers in the case of homogeneous products than in the case of a heterogeneous product with different grades and qualities.
- (210) For homogeneous intermediate products, anti-competitive effects are likely to be exemptable below the level of dominance. For final branded products or differentiated intermediate products where there are entry barriers, exclusive supply may have appreciable anti-competitive effects where the competing buyers are relatively small compared to the foreclosing buyer, even if the latter is not dominant on the downstream market.

(211) Where appreciable anti-competitive effects are established, an exemption under Article 81(3) is possible as long as the company is not dominant. Efficiencies can be expected in the case of a hold-up problem (paragraph 116, points 4 and 5), and this is more likely for intermediate products than for final products. Other efficiencies are less likely. Possible economies of scale in distribution (paragraph 116, point 6) do not seem likely to justify exclusive supply.

(212) In the case of a hold-up problem and even more so in the case of scale economies in distribution, quantity forcing on the supplier, such as minimum supply requirements, could well be a less restrictive alternative.

(213) Example of exclusive supply:

On a market for a certain type of components (intermediate product market) supplier A agrees with buyer B to develop, with his own know-how and considerable investment in new machines and with the help of specifications supplied by buyer B, a different version of the component. B will have to make considerable investments to incorporate the new component. It is agreed that A will supply the new product only to buyer B for a period of five years from the date of first entry on the market. B is obliged to buy the new product only from A for the same period of five years. Both A and B can continue to sell and buy respectively other versions of the component elsewhere. The market share of buyer B on the upstream component market and on the downstream final goods market is 40 %. The market share of the component supplier is 35 %. There are two other component suppliers with around 20-25 % market share and a number of small suppliers.

Given the considerable investments, the agreement is likely to fulfil the conditions for exemption in view of the efficiencies and the limited foreclosure effect. Other buyers are foreclosed from a particular version of a product of a supplier with 35 % market share and there are other component suppliers that could develop similar new products. The foreclosure of part of buyer B's demand to other suppliers is limited to maximum 40 % of the market.

(214) Exclusive supply is based on a direct or indirect obligation causing the supplier only to sell to one buyer. Quantity forcing on the supplier is based on incentives agreed between the supplier and the buyer that make the former concentrate his sales mainly

with one buyer. Quantity forcing on the supplier may have similar but more mitigated effects than exclusive supply. The assessment of quantity forcing will depend on the degree of foreclosure of other buyers on the upstream market.

2.7. **Tying**

(215) Tying exists when the supplier makes the sale of one product conditional upon the purchase of another distinct product from the supplier or someone designated by the latter. The first product is referred to as the tying product and the second is referred to as the tied product. If the tying is not objectively justified by the nature of the products or commercial usage, such practice may constitute an abuse within the meaning of Article 82⁽¹⁾. Article 81 may apply to horizontal agreements or concerted practices between competing suppliers which make the sale of one product conditional upon the purchase of another distinct product. Tying may also constitute a vertical restraint falling under Article 81 where it results in a single branding type of obligation (see paragraphs 138 to 160) for the tied product. Only the latter situation is dealt with in these Guidelines.

(216) What is to be considered as a distinct product is determined first of all by the demand of the buyers. Two products are distinct if, in the absence of tying, from the buyers' perspective, the products are purchased by them on two different markets. For instance, since customers want to buy shoes with laces, it has become commercial usage for shoe manufacturers to supply shoes with laces. Therefore, the sale of shoes with laces is not a tying practice. Often combinations have become accepted practice because the nature of the product makes it technically difficult to supply one product without the supply of another product.

(217) The main negative effect of tying on competition is possible foreclosure on the market of the tied product. Tying means that there is at least a form of quantity-forcing on the buyer in respect of the tied product. Where in addition a non-compete obligation is agreed in respect of the tied product, this increases the possible foreclosure effect on the market of the tied product. Tying may also lead to supra-competitive prices, especially in three situations. Firstly, when the tying and tied product are partly substitutable for the buyer. Secondly, when the tying allows price discrimination according to the use the customer

⁽¹⁾ Judgment of the Court of Justice in Case C-333/94 P Tetrapak v Commission [1996] ECR I-5951, paragraph 37.

makes of the tying product, for example the tying of ink cartridges to the sale of photocopying machines (metering). Thirdly, when in the case of long-term contracts or in the case of after-markets with original equipment with a long replacement time, it becomes difficult for the customers to calculate the consequences of the tying. Lastly, tying may also lead to higher entry barriers both on the market of the tying and on the market of the tied product.

(218) Tying is exempted by Article 2(1) read in conjunction with Article 3 of the Block Exemption Regulation when the market share of the supplier on both the market of the tied product and the market of the tying product does not exceed 30 %. It may be combined with other non-hardcore vertical restraints such as non-compete or quantity forcing in respect of the tying product, or exclusive purchasing. Above the market share threshold the following guidance is provided for the assessment of tying in individual cases.

(219) The market position of the supplier on the market of the tying product is obviously of main importance to assess possible anti-competitive effects. In general this type of agreement is imposed by the supplier. 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 a tying obligation.

(220) To assess the supplier's market power, the market position of his competitors on the market of the tying product is important. As long as his competitors are sufficiently numerous and strong, no anti-competitive effects can be expected, as buyers have sufficient alternatives to purchase the tying product without the tied product, unless other suppliers are applying similar tying. In addition, entry barriers on the market of the tying product are relevant to establish the market position of the supplier. When tying is combined with a non-compete obligation in respect of the tying product, this considerably strengthens the position of the supplier.

(221) Buying power is relevant, as important buyers will not easily be forced to accept tying without obtaining at least part of the possible efficiencies. Tying not based on efficiency is therefore mainly a risk where buyers do not have significant buying power.

(222) Where appreciable anti-competitive effects are established, the question of a possible exemption under

Article 81(3) arises as long as the company is not dominant. Tying obligations may help to produce efficiencies arising from joint production or joint distribution. Where the tied product is not produced by the supplier, an efficiency may also arise from the supplier buying large quantities of the tied product. For tying to be exemptable, it must, however, be shown that at least part of these cost reductions are passed on to the consumer. Tying is therefore normally not exemptable when the retailer is able to obtain, on a regular basis, supplies of the same or equivalent products on the same or better conditions than those offered by the supplier which applies the tying practice. Another efficiency may exist where tying helps to ensure a certain uniformity and quality standardisation (see efficiency 8 in paragraph 116). However, it needs to be demonstrated that the positive effects cannot be realised equally efficiently by requiring the buyer to use or resell products satisfying minimum quality standards, without requiring the buyer to purchase these from the supplier or someone designated by the latter. The requirements concerning minimum quality standards would not normally fall within Article 81(1). Where the supplier of the tying product imposes on the buyer the suppliers from which the buyer must purchase the tied product, for instance because the formulation of minimum quality standards is not possible, this may also fall outside Article 81(1), especially where the supplier of the tying product does not derive a direct (financial) benefit from designating the suppliers of the tied product.

(223) The effect of supra-competitive prices is considered anti-competitive in itself. The effect of foreclosure depends on the tied percentage of total sales on the market of the tied product. On the question of what can be considered appreciable foreclosure under Article 81(1), the analysis for single branding can be applied. Above the 30 % market share threshold exemption of tying is unlikely, unless there are clear efficiencies that are transmitted, at least in part, to consumers. Exemption is even less likely when tying is combined with non-compete, either in respect of the tied or in respect of the tying product.

(224) Withdrawal of the block exemption is likely where no efficiencies result from tying or where such efficiencies are not passed on to the consumer (see paragraph 222). Withdrawal is also likely in the case of a cumulative effect where a majority of the suppliers apply similar tying arrangements without the possible efficiencies being transmitted at least in part to consumers.

2.8. *Recommended and maximum resale prices*

- (225) The practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price is — subject to the comments in paragraphs 46 to 56 concerning RPM — covered by the Block Exemption Regulation when the market share of the supplier does not exceed the 30 % threshold. For cases above the market share threshold and for cases of withdrawal of the block exemption the following guidance is provided.
- (226) The possible competition risk of maximum and recommended prices is firstly that the maximum or recommended price will work as a focal point for the resellers and might be followed by most or all of them. A second competition risk is that maximum or recommended prices may facilitate collusion between suppliers.
- (227) The most important factor for assessing possible anti-competitive effects of maximum or recommended resale prices is the market position of the supplier. The stronger the market position of the supplier, the higher the risk that a maximum resale price or a recommended resale price leads to a more or less uniform application of that price level by the resellers, because they may use it as a focal point. They may

find it difficult to deviate from what they perceive to be the preferred resale price proposed by such an important supplier on the market. Under such circumstances the practice of imposing a maximum resale price or recommending a resale price may infringe Article 81(1) if it leads to a uniform price level.

- (228) The second most important factor for assessing possible anti-competitive effects of the practice of maximum and recommended prices is the market position of competitors. Especially in a narrow oligopoly, the practice of using or publishing maximum or recommended prices may facilitate collusion between the suppliers by exchanging information on the preferred price level and by reducing the likelihood of lower resale prices. The practice of imposing a maximum resale price or recommending resale prices leading to such effects may also infringe Article 81(1).

2.9. *Other vertical restraints*

- (229) The vertical restraints and combinations described above are only a selection. There are other restraints and combinations for which no direct guidance is provided here. They will however be treated according to the same principles, with the help of the same general rules and with the same emphasis on the effect on the market.