

The Commission for Protection of Competition according to article 28 paragraph (3), regarding article 7 of the Law on Protection of Competition (official gazette no. 145/10, 136/11 and 41/14) and the Regulation on the detailed conditions for block exemption of certain types of vertical agreements (official gazette no. 42/12), on the session held on 28.12.2015 has enacted the following

Guidelines on Vertical Restraints¹

¹ This Guidelines are harmonized with the Commission Notice on vertical restraints Official Journal C 130,19.05.2010 p.1

- (1) These Guidelines set out the principles for the assessment of vertical agreements under Article 7 of the Law on Protection of Competition (Official Gazette no. 145/10, 136/11 and 41/14) (hereinafter the Law). Article 5 paragraph 1 indent 14 of the Law defines the term "vertical agreement". These Guidelines are without prejudice to the possible parallel application of Article 11 of the Law to vertical agreements. These Guidelines are structured in the following way:
- Section II (paragraphs (7) to (19)) describes vertical agreements which generally fall outside Article 7 paragraph (1) of the Law;
 - Section III (paragraphs (21) to (70)) clarifies the conditions for the application of the Regulation on the detailed conditions for block exemption of certain types of vertical agreements (Official Gazette no. 42/12) (hereinafter Regulation);
 - Section IV (paragraphs (71) to (74)) describes the principles concerning the withdrawal of the block exemption and the disapplication of the Regulation;
 - Section V (paragraphs (74) to (84)) provides guidance on how to define the relevant market and calculate market shares;
 - Section VI (paragraphs (85) to (216)) describes the general framework of analysis and the enforcement policy of the Commission for Protection of Competition (hereinafter 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 these Guidelines apply to all types of goods and services and to all levels of trade. Thus, the term "products" includes both goods and services. The terms "supplier" and "buyer" are used for all levels of trade. Because article 7 of the Law is applied only for the agreements between the undertakings, the Regulation and this Guidelines do not apply to agreements with final consumers where the latter are not undertakings.
- (3) By issuing these Guidelines, the Commission aims to help companies conduct their own assessment of vertical agreements under the Law and the Regulation. The standards set forth in these Guidelines cannot be applied mechanically, but must be applied with due consideration for the specific circumstances of each case. Each case must be evaluated in the light of its own facts.

2. Applicability of Article 7 of the Law to vertical agreements

- (4) Article 7 of the Law applies to vertical agreements that prevent, restrict or distort competition ("vertical restraints"). Article 7 of the Law provides a legal framework for the assessment of vertical restraints, which takes into consideration the distinction between anti-competitive and pro-competitive effects. Article 7 paragraph (1) prohibits those agreements which appreciably restrict or distort competition, while Article 7 paragraph (3) exempts those agreements which confer sufficient benefits to outweigh the anti-competitive effects.

- (5) For most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, that is, if there is some degree of market power at the level of the supplier or the buyer or at both levels. Vertical restraints are generally less harmful than horizontal restraints and may provide substantial scope for efficiencies.
- (6) The objective of Article 7 of the Law is to ensure that undertakings do not use agreements – in this context, vertical agreements – to restrict competition on the market to the detriment of consumers.

II. VERTICAL AGREEMENTS WHICH GENERALLY FALL OUTSIDE THE SCOPE OF ARTICLE 7 PARAGRAPH (1) OF THE LAW

1. Agreements of minor importance and SMEs

- (7) Agreements that are not capable of appreciably restricting competition by object or effect do not fall within the scope of Article 7 paragraph (1) of the Law. The Regulation applies only to agreements falling within the scope of application of Article 7 paragraph (1) of the Law. These Guidelines are without prejudice to the application of Regulation on certain conditions for agreements of minor importance (Official Gazette no. 44/12).
- (8) Subject to the conditions set out in the Regulation on certain conditions for agreements of minor importance concerning hardcore restrictions and cumulative effect issues, vertical agreements entered into by non-competing undertakings whose individual market share on the relevant market does not exceed 15 % are generally considered to fall outside the scope of Article 7 paragraph (1) of the Law². There is no presumption that vertical agreements concluded by undertakings having more than 15 % market share automatically infringe Article 7 paragraph (1) of the Law. Agreements between undertakings whose market share exceeds the 15 % threshold may not constitute an appreciable restriction of competition. 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 (85) to (216).
- (9) As regards hardcore restrictions (restrictions that must not be putted in the agreements) referred to in the Regulation on certain conditions for agreements of minor importance, Article 7 paragraph (1) of the Law, may apply below the 15 % threshold, provided that there is an appreciable effect on competition. Reference is also made to the possible need to assess positive and negative effects of hardcore restrictions as described in particular in paragraph (44) of these Guidelines.

² According to article 3 paragraph 1 point a) of the Decree on certain conditions for agreements of minor importance, for agreements between competing undertakings the *de minimis* market share threshold is 10 % for their collective market share on each affected relevant market.

2. Agency agreements

2.1 Definition of agency agreements

- (10) An agent is a legal or physical person 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.
- (11) The determining factor in defining an agency agreement for the application of Article 7 paragraph (1) of the Law is the financial or commercial risk borne by the agent in relation to the activities for which it 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. Neither is material for this assessment the qualification given to their agreement by the parties or national legislation.
- (12) There are three types of financial or commercial risk that are material to the definition of an agency agreement for the application of Article 7 paragraph (1) of the Law. First, there are the contract-specific 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, that is, which are required to enable the agent to conclude and/or negotiate this type of contract. Such investments are usually sunk, which means that upon leaving that particular field of activity the investment cannot be used for other activities or sold other than at a significant loss. Thirdly, there are the risks related to other activities undertaken on the same product market, to the extent that the principal requires the agent to undertake such activities, but not as an agent on behalf of the principal but for its own risk.
- (13) For the purposes of applying Article 7 paragraph (1) of the Law, the agreement will be qualified as an agency agreement 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, in relation to market-specific investments for that field of activity, and in relation to other activities required by the principal to be undertaken on the same product market. However, 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 its success as an agent or general investments in for instance premises or personnel, are not material to this assessment.
- (14) For the purpose of applying Article 7 paragraph (1) of the Law, an agreement will thus generally be considered an agency agreement 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:
- (a) 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;

- (b) does not maintain at its 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);
 - (c) does not undertake responsibility towards third parties for damage caused by the product sold (product liability), unless, as agent, it is liable for fault in this respect;
 - (d) 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);
 - (e) is not, directly or indirectly, obliged to invest in sales promotion, such as contributions to the advertising budgets of the principal;
 - (f) 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, unless these costs are fully reimbursed by the principal;
 - (g) does not undertake other activities within the same product market required by the principal, unless these activities are fully reimbursed by the principal.
- (15) This list is not exhaustive. However, where the agent incurs one or more of the risks or costs mentioned in paragraphs (12), (13) and (14), the agreement between agent and principal will not be qualified as an agency agreement. 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. For practical reasons, the risk analysis may start with the assessment of the contract-specific risks. If contract-specific risks are incurred by the agent, it will be enough to conclude that the agent is an independent distributor. On the contrary, if the agent does not incur contract-specific risks, then it will be necessary to continue further the analysis by assessing the risks related to market-specific investments. Finally, if the agent does not incur any contract-specific risks and risks related to market-specific investments, the risks related to other required activities within the same product market may have to be considered.
- 2.2 *The application of Article 7 paragraph (1) of the Law to agency agreements***
- (16) In the case of agency agreements as defined in section 2.1, the selling or purchasing function of the agent forms part of the principal's activities. Since the principal bears the commercial and financial risks related to the selling and purchasing of the contract goods and services all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 7 paragraph (1) of the Law. The following obligations on the agent's part will 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:

- (a) limitations on the territory in which the agent may sell these goods or services;
 - (b) limitations on the customers to whom the agent may sell these goods or services;
 - (c) the prices and conditions at which the agent must sell or purchase these goods or services.
- (17) 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 (single branding provisions). Since the agent is a separate undertaking from the principal, the provisions which concern the relationship between the agent and the principal may infringe Article 7 paragraph (1) of the Law. Exclusive agency provisions will in general not lead to anti-competitive effects. However, single branding provisions and post-term non-compete provisions, which concern inter-brand competition, may infringe Article 7 paragraph (1) of the Law if they lead to or contribute to a (cumulative) foreclosure effect on the relevant market where the contract goods or services are sold or purchased (see in particular Section VI.2.1). Such provisions may benefit from the Regulation, in particular when the conditions provided in Article 6 of that Decree are fulfilled. They can also be individually justified by efficiencies under Article 7 paragraph (3) of the Law as for instance described in paragraphs (133) to (137).
- (18) An agency agreement may also fall within the scope of Article 7 paragraph (1) of the Law, even if the principal bears all the relevant financial and commercial risks, where it facilitates collusion. That 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.
- (19) Where the agent bears one or more of the relevant risks as described in paragraph (14), the agreement between agent and principal does not constitute an agency agreement for the purpose of applying Article 7 paragraph (1) of the Law. In that situation, the agent will be treated as an independent undertaking and the agreement between agent and principal will be subject to Article 7 paragraph (1) of the Law as any other vertical agreement.

3. Subcontracting agreements

- (20) Subcontracting concerns a contractor providing technology or equipment to a subcontractor that undertakes to produce certain products on the basis thereof (exclusively) for the contractor. Subcontracting agreements whereby the subcontractor undertakes to produce certain products exclusively for the contractor generally fall outside the scope of Article 7 paragraph (1) of the Law, provided that the technology or equipment is necessary to enable the subcontractor to produce the products. However, other restrictions imposed on the subcontractor such as the

obligation not to conduct or exploit its own research and development or not to produce for third parties in general may fall within the scope of Article 7 of the Law.

III. APPLICATION OF THE REGULATION

1. Safe harbour created by the Regulation

- (21) For most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, that is, if there is some degree of market power at the level of the supplier or the buyer or at both levels. Provided that they do not contain hardcore restrictions of competition, which are restrictions of competition by object³, the Regulation creates a presumption of legality for vertical agreements depending on the market share of the supplier and the buyer. Pursuant to Article 4 of the Regulation, it is the supplier's market share on the market where it sells the contract goods or services and the buyer's market share on the market where it purchases the contract goods or services which determine the applicability of the block exemption. In order for the block exemption to apply, the supplier's and the buyer's market share must each be 30 % or less. Section V of these Guidelines provides guidance on how to define the relevant market and calculate the market shares. Above the market share threshold of 30 %, there is no presumption that vertical agreements fall within the scope of Article 7 paragraph (1) of the Law or fail to satisfy the conditions of Article 7 paragraph (3) of the Law but there is also no presumption that vertical agreements falling within the scope of Article 7 paragraph (1) of the Law will usually satisfy the conditions of Article 7 paragraph (3) of the Law.

2. Scope of the application of the Regulation

2.1 *Definition of vertical agreements*

- (22) Article 5 paragraph 1) point 14 of the Law defines a "vertical agreement" as "agreement between undertakings, decisions of associations of undertakings or concerted practices among entities operating at different levels of production or distribution on the market. ".

- (23) The definition of "vertical agreement" referred to in paragraph (22) has four main elements:

- (a) The Regulation applies to agreements and concerted practices. The Regulation does not apply to unilateral conduct of the undertakings concerned. Such unilateral conduct can fall within the scope of Article 11 of the Law which prohibits abuses of a dominant position. For there to be an agreement within the meaning of Article 7 of the Law it is sufficient that the parties have expressed their joint intention to conduct themselves on the market in a specific way. The form in which that intention is expressed is irrelevant as long as it constitutes a faithful expression of the parties' intention. In case there is no explicit agreement expressing the concurrence of wills, the Commission will have to prove that the unilateral policy of one party receives the acquiescence of the other party. For vertical agreements, there are two ways in which

³ The restrictions that must not be put in the vertical agreements, restrictions listed in article 5 of the Decree

acquiescence with a particular unilateral policy can be established. First, the acquiescence can be deduced from the powers conferred upon the parties in a general agreement drawn up in advance. If the clauses of the agreement drawn up in advance provide for or authorise a party to adopt subsequently a specific unilateral policy which will be binding on the other party, the acquiescence of that policy by the other party can be established on the basis thereof. Secondly, in the absence of such an explicit acquiescence, the Commission can show the existence of tacit acquiescence. For that it is necessary to show first that one party requires explicitly or implicitly the cooperation of the other party for the implementation of its unilateral policy and second that the other party complied with that requirement by implementing that unilateral policy in practice. For instance, if after a supplier's announcement of a unilateral reduction of supplies in order to prevent parallel trade, distributors reduce immediately their orders and stop engaging in parallel trade, then those distributors tacitly acquiesce to the supplier's unilateral policy. This can however not be concluded if the distributors continue to engage in parallel trade or try to find new ways to engage in parallel trade. Similarly, for vertical agreements, tacit acquiescence may be deduced from the level of coercion exerted by a party to impose its unilateral policy on the other party or parties to the agreement in combination with the number of distributors that are actually implementing in practice the unilateral policy of the supplier. For instance, a system of monitoring and penalties, set up by a supplier to penalise those distributors that do not comply with its unilateral policy, points to tacit acquiescence with the supplier's unilateral policy if this system allows the supplier to implement in practice its policy. The two ways of establishing acquiescence described in this paragraph can be used jointly;

- (b) The agreement or concerted practice is between two or more undertakings. Vertical agreements with final consumers not operating as an undertaking are not covered by the Regulation. More generally, agreements with final consumers do not fall under Article 7 paragraph (1) of the Law, as that article applies only to agreements between undertakings, decisions by associations of undertakings and concerted practices of undertakings. This is without prejudice to the possible application of Article 11 of the Law.
- (c) 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;
- (D) 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 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. THE GOODS OR SERVICES SUPPLIED BY THE SUPPLIER AND THE RESULTING GOODS OR SERVICES ARE CONSIDERED TO BE CONTRACT GOODS OR SERVICES UNDER THE REGULATION. 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 REGULATION ON

BLOCK EXEMPTION OF CERTAIN CATEGORIES OF AGREEMENTS ON DISTRIBUTION AND SERVICING OF MOTOR VEHICLES (OFFICIAL GAZETTE NO. 41/12). 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 ITS OWN GOODS OR SERVICES.

- (24) The 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 sold by the supplier to the buyer. More generally, the 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, Article 3 paragraph (3) to (5) of the Regulation directly or indirectly excludes certain vertical agreements from the application of that Regulation.

2.2 *Vertical agreements between competitors*

- (25) Article 3 paragraph (5) of the Regulation explicitly excludes "vertical agreements entered into between competing undertakings" from its application. However, the vertical aspects of such agreements need to be assessed under these Guidelines. Article 2 paragraph (1) point (c) of the Regulation defines a competing undertaking as "an actual or potential competitor". Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, absent the agreement, in case of a small but permanent increase in relative prices it is likely that this first company, within a short period of time normally not longer than one year, would undertake the necessary additional investments or other necessary switching costs to enter the relevant market on which the other company is active. That assessment must be based on realistic grounds; the mere theoretical possibility of entering a market is not sufficient. A distributor that 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.
- (26) Article 3 paragraph (5) of the Regulation contains two exceptions to the general exclusion of vertical agreements between competitors. These exceptions concern non-reciprocal agreements. Non-reciprocal agreements between competitors are covered by the Regulation where (a) the supplier is a manufacturer and distributor of goods, while the buyer is only a distributor and not also a competing undertaking at the manufacturing level, or (b) the supplier is a provider of services operating at several levels of trade, while the buyer operates at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services. The first exception covers situations of dual distribution, that is, the manufacturer of particular goods also acts as a distributor of the goods in competition with independent distributors of its goods. In case of dual distribution it is considered that in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing or retail level. The second exception covers similar situations of dual distribution, but in this case for services, when the supplier is also a provider of products at the retail level where the buyer operates.

2.3 *Associations of retailers*

- (27) Article 3 paragraph (3) of the Regulation includes in its application vertical agreements entered into by an association of undertakings which fulfils certain conditions and thereby excludes from the 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 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 2 million in denar counter value. Retailers are distributors reselling goods to final consumers. Where only a limited number of the members of the association have a turnover exceeding the EUR 2 million threshold and where these members together represent less than 15 % of the collective turnover of all the members combined, the assessment under Article 7 paragraph (1) of the Law will normally not be affected.
- (28) An association of undertakings may involve both horizontal and vertical agreements. If that 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 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 must first be assessed as a horizontal agreement. Once that assessment leads to the conclusion that the horizontal agreement is not anticompetitive, an assessment of the vertical agreements between the association and individual members or between the association and suppliers is necessary.

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

- (29) Article 3 paragraph (4) of the Regulation includes vertical agreements containing certain provisions relating to the assignment to the buyer or use by the buyer of IPRs, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers. The exemption applies on condition that, in relation to the contract goods or services, those provisions do not contain restrictions of competition having the same object as vertical restraints which are not exempted under the Regulation and therefore exempt from the Regulation all other vertical agreements that contain IPR provisions. The Regulation applies to vertical agreements containing IPR provisions where five conditions are fulfilled:
- (a) The IPR provisions must be part of a vertical agreement, that is, an agreement with conditions under which the parties may purchase, sell or resell certain goods or services;
 - (b) The IPRs must be assigned to, or licensed for use by, the buyer;
 - (c) The IPR provisions must not constitute the primary object of the agreement;
 - (d) The IPR provisions must be directly related to the use, sale or resale of goods or services by the buyer or its 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;
- (e) The IPR provisions, in relation to the contract goods or services, must not contain restrictions of competition having the same object as vertical restraints which are not exempted under the Regulation.
- (30) Such conditions ensure that the 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 licensed 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.
- (31) 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 Regulation does not cover for instance:
- (a) agreements where a party provides another party with a recipe and licenses the other party to produce a drink with this recipe;
 - (b) agreements under which one party provides another party with a mould or master copy and licenses the other party to produce and distribute copies;
 - (c) the pure licence of a trade mark or sign for the purposes of merchandising;
 - (d) sponsorship contracts concerning the right to advertise oneself as being an official sponsor of an event;
 - (e) copyright licensing such as broadcasting contracts concerning the right to record and/or broadcast an event.
- (32) The second condition makes clear that the 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 Regulation. That means, in particular, that subcontracting involving the transfer of know-how to a subcontractor⁴ does not fall within the scope of application of the Regulation (see also paragraph (20)). However, vertical agreements under which the buyer provides only specifications to the supplier which describe the goods or services to be supplied fall within the scope of application of the Regulation.
- (33) The third condition makes clear that in order to be covered by the Regulation, the primary object of the agreement must not be the assignment or licensing of IPRs. The primary object must be the purchase, sale or resale of goods or services and the IPR provisions must serve the implementation of the vertical agreement.

⁴ See the subcontracting notice (referred to in paragraph (20)).

- (34) The fourth condition requires that the IPR provisions facilitate the use, sale or resale of goods or services by the buyer or its users. 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. An example would be a franchise agreement where the franchisor sells goods for resale to the franchisee and licenses the franchisee to use its trade mark and know-how to market the goods or where the supplier of a concentrated extract licenses the buyer to dilute and bottle the extract before selling it as a drink.
- (35) The fifth condition highlights the fact that the IPR provisions should not have the same object as any of the hardcore restrictions listed in Article 5 of the Regulation or any of the restrictions excluded from the coverage by Article 6 of that Regulation (see paragraphs (44) to (66) of these Guidelines).
- (36) Intellectual property rights relevant to the implementation of vertical agreements within the meaning of Article 3 paragraph (4) of the Regulation generally concern three main areas: trade marks, copyright and know-how.

Trade mark

- (37) 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

- (38) 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 7 paragraph (1) of the Law at all, are covered by the Regulation.
- (39) 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 Regulation. Under that form of distribution, licensing the software only occurs between the copyright owner and the user of the software. It may take the form of a "shrink wrap" licence, that is, a set of conditions included in the package of the hard copy which the end user is deemed to accept by opening the package.
- (40) Buyers of hardware incorporating software protected by copyright may be obliged by the copyright holder not to infringe the copyright, and must therefore not make copies and resell the software or make copies and use the software in combination with other hardware. Such use-restrictions, to the extent that they fall within Article 7 paragraph (1) of the Law at all, are covered by the Regulation.

Know-how

- (41) Franchise agreements, with the exception of industrial franchise agreements, are the most obvious example of where know-how for marketing purposes is communicated

to the buyer⁵. 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.

- (42) Licensing contained in franchise agreements is covered by the Regulation where all five conditions listed in paragraph (29) are fulfilled. Those conditions are usually fulfilled 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, it is not covered by the Regulation, but the Commission will, as a general rule, apply the principles set out in the Regulation and these Guidelines to such an agreement.
- (43) The following IPR-related obligations are generally considered necessary to protect the franchisor's intellectual property rights and are, where these obligations fall under Article 7 paragraph (1) of the Law, also covered by the 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 the franchisor, 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.

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Paragraphs 41-43 apply by analogy to other types of distribution agreements which involve the transfer of substantial know-how from supplier to buyer.

3. Hardcore restrictions under the Regulation

- (44) Article 5 of the Regulation contains a list of hardcore restrictions which lead to the exclusion of the whole vertical agreement from the scope of application of the Regulation. Where such a hardcore restriction is included in an agreement, that agreement is presumed to fall within Article 7 paragraph (1) of the Law. It is also presumed that the agreement is unlikely to fulfil the conditions of Article 7 paragraph (3) of the Law, for which reason the block exemption does not apply. However, undertakings may demonstrate pro-competitive effects under Article 7 paragraph (3) of the Law in an individual case⁶. Where the undertakings substantiate that likely efficiencies result from including the hardcore restriction in the agreement and demonstrate that in general all the conditions of Article 7 paragraph (3) of the Law are fulfilled, the Commission will be required to effectively assess the likely negative impact on competition before making an ultimate assessment of whether the conditions of Article 7 paragraph (3) of the Law are fulfilled⁷.
- (45) The hardcore restriction set out in Article 5 paragraph (1) point (a) of the 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 that 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 use of a particular supportive measure or 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.
- (46) 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 such an agreement cannot be qualified as an agency agreement for the purposes of applying Article 7 paragraph (1) of the Law (see paragraphs (10) to (19)) an obligation preventing or restricting the agent from sharing its commission, fixed or variable,

⁶ See in particular paragraphs 95 to 98 describing in general possible efficiencies related to vertical restraints and Section VI.2.10 on resale price restrictions.

⁷ Although, in legal terms, these are two distinct steps, they may in practice be an iterative process where the parties and the Commission in several steps, enhance and improve their respective arguments.

with the customer would be a hardcore restriction under Article 5 paragraph 1 point (a) of the Regulation. In order to avoid including such a hardcore restriction in the agreement, the agent should thus be left free to lower the effective price paid by the customer without reducing the income for the principal.

- (47) The hardcore restriction set out in Article 5 paragraph 1 point (b) of the Regulation concerns agreements or concerted practices that have as their direct or indirect object the restriction of sales by a buyer party to the agreement or its customers, in as far as those restrictions relate to the territory into which or the customers to whom the buyer or its customers may sell the contract goods or services. This hardcore restriction relates to market partitioning by territory or by customer group. 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, termination of supply, reduction of supplied volumes or limitation of supplied volumes to the demand within the allocated territory or customer group, threat of contract termination, requiring a higher price for products to be exported, limiting the proportion of sales that can be exported or profit pass-over obligations. Such 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, such as the use of differentiated labels or serial numbers. However, obligations on the reseller relating to the display of the supplier's brand name are not classified as hardcore. As Article 5 paragraph 1 point (b) only concerns restrictions of sales by the buyer or its customers, this implies that restrictions of the supplier's sales are also not a hardcore restriction, subject to what is stated in paragraph (56) regarding sales of spare parts in the context of Article 4 paragraph 1 point (e) of the Regulation. Article 4 paragraph 1 point (b) of the Regulation applies without prejudice to a restriction on the buyer's place of establishment. Thus, the benefit of the Regulation is not lost if it is agreed that the buyer will restrict its distribution outlet(s) and warehouse(s) to a particular address, place or territory.
- (48) There are four exceptions to the hardcore restriction in Article 4 paragraph 1 point (b) of the Regulation. The first exception in Article 4 paragraph 1 item (b) indent (i) of the Regulation allows a supplier to restrict active sales by a buyer party to the agreement 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 its 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 its territory or to its customer group by all the other buyers of the supplier on the territory of the Republic of North Macedonia, irrespective of sales by the supplier. 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. Such 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 paragraph 1 item (b) of the Regulation, the Commission interprets "active" and "passive" sales as follows:
- "Active" sales mean actively approaching individual customers by for instance direct mail, including the sending e-mails, or visits; or actively approaching a

specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory.

- “Passive” sales mean responding to unsolicited requests from individual customers including delivery of goods or services , especially general advertising or promotion 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. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' (exclusive) territories or customer groups.

(49) The internet is a powerful tool to reach a greater number and variety of customers than by more traditional sales methods, which explains why certain restrictions on the use of the internet are dealt with as (re)sales restrictions. In principle, every distributor must be allowed to use the internet to sell its products. In general, where a distributor uses a website to sell products that is considered a form of passive selling, since it is a reasonable way to allow customers to reach the distributor. The use of a website may have effects that extend beyond the distributor's own territory and customer group; however, such effects result from the technology allowing 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 same is true if a customer opts to be kept (automatically) informed by the distributor and it leads to a sale. Offering different language options on the website does not, of itself, change the passive character of such selling. The Commission thus regards the following as examples of hardcore restrictions of passive selling given the capability of these restrictions to limit the distributor's access to a greater number and variety of customers:

- (a) an agreement that the (exclusive) distributor shall prevent customers located in another (exclusive) territory from viewing its website or shall automatically rerout its customers to the manufacturer's or other (exclusive) distributors' websites. This does not exclude an agreement that the distributor's website shall also offer a number of links to websites of other distributors and/or the supplier;
- (b) an agreement that the (exclusive) distributor shall terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's (exclusive) territory;
- (c) an agreement that the distributor shall limit its proportion of overall sales made over the internet. This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products offline to ensure an efficient operation of its brick and mortar shop (physical point of sales), nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model (see

paragraphs (51) and (53)). This absolute amount of required offline sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location;

- (d) an agreement that the distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold offline. This does not exclude the supplier agreeing with the buyer a fixed fee (that is, not a variable fee where the sum increases with the realised offline turnover as this would amount indirectly to dual pricing) to support the latter's offline or online sales efforts.
- (50) A restriction on the use of the internet by distributors that are party to the agreement is compatible with the Regulation to the extent that promotion on the internet or use of the internet would lead to active selling into, for instance, other distributors' exclusive territories or customer groups. The Commission considers online advertisement specifically addressed to certain customers as a form of active selling to those customers. For instance, territory-based banners on third party websites are a form of active sales into the territory where these banners are shown. In general, efforts to be found specifically in a certain territory or by a certain customer group is active selling into that territory or to that customer group. For instance, paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory is active selling into that territory.
- (51) However, under the Regulation the supplier may require quality standards for the use of the internet site to resell its goods, just as the supplier may require quality standards for a shop or for selling by catalogue or for advertising and promotion in general. This may be relevant in particular for selective distribution. Under the Regulation, the supplier may, for example, require that its distributors have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system. Subsequent changes to such a condition are also possible under the Regulation, except where those changes have as their object to directly or indirectly limit the online sales by the distributors. Similarly, a supplier may require that its distributors use third party platforms to distribute the contract products only in accordance with the standards and conditions agreed between the supplier and its distributors for the distributors' use of the internet. For instance, where the distributor's website is hosted by a third party platform, the supplier may require that customers do not visit the distributor's website through a site carrying the name or logo of the third party platform.
- (52) There are three further exceptions to the hardcore restriction set out in Article 5 paragraph 1 item (b) of the Regulation. All three exceptions allow for the restriction of both active and passive sales. Under the first exception, it is permissible to restrict a wholesaler from selling to end users, which allows a supplier to keep the wholesale and retail level of trade separate. However, that exception does not exclude the possibility that the wholesaler can sell to certain end users, such as bigger end users, while not allowing sales to (all) other end users. The second exception allows a supplier to restrict an appointed distributor in a selective distribution system from selling, at any level of trade, to unauthorised distributors located in any territory where the system is currently operated or where the supplier does not yet sell the contract products (referred to as "the territory reserved by the supplier to operate that system" in Article 5 paragraph 1 point (b) of the Regulation). The third exception

allows a supplier to restrict a buyer of components, to whom the components are 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 5 paragraph 1 point (c) of the Regulation excludes the restriction of active or passive sales to end users, whether professional end users or final consumers, by members of a selective distribution network, without prejudice to the possibility of prohibiting a member of the network from operating out of an unauthorised place of establishment. Accordingly, dealers in a selective distribution system, as defined in Article 2 paragraph (1) point (e) of the Regulation, cannot be restricted in the choice of users to whom they may sell, or purchasing agents acting on behalf of those users except to protect an exclusive distribution system operated elsewhere (see paragraph (48)). Within a selective distribution system the dealers should be free to sell, both actively and passively, to all end users, also with the help of the internet. Therefore, the Commission considers any obligations which dissuade appointed dealers from using the internet to reach a greater number and variety of customers by imposing criteria for online sales which are not overall equivalent to the criteria imposed for the sales from the brick and mortar shop as a hardcore restriction. This does not mean that the criteria imposed for online sales must be identical to those imposed for offline sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes. For example, in order to prevent sales to unauthorised dealers, a supplier can restrict its selected dealers from selling more than a given quantity of contract products to an individual end user. Such a requirement may have to be stricter for online sales if it is easier for an unauthorised dealer to obtain those products by using the internet. Similarly, it may have to be stricter for offline sales if it is easier to obtain them from a brick and mortar shop. In order to ensure timely delivery of contract products, a supplier may impose that the products be delivered instantly in the case of offline sales. Whereas an identical requirement cannot be imposed for online sales, the supplier may specify certain practicable delivery times for such sales. Specific requirements may have to be formulated for an online after-sales help desk, so as to cover the costs of customers returning the product and for applying secure payment systems.
- (54) Within the territory where the supplier operates selective distribution, this system may not be combined with exclusive distribution as that would lead to a hardcore restriction of active or passive selling by the dealers under Article 5 paragraph 1 point (c) of the Regulation, with the exception that restrictions can be imposed on the dealer's ability to determine the location of its business premises. Selected dealers may be prevented from operating their business from different premises or from opening a new outlet in a different location. In that context, the use by a distributor of its own website cannot be considered to be the same thing as the opening of a new outlet in a different location. If the dealer's outlet is mobile, an area may be defined outside which the mobile outlet cannot be operated. In addition, the supplier may commit itself to supplying only one dealer or a limited number of dealers in a particular part of the territory where the selective distribution system is applied.
- (55) The hardcore restriction set out in Article 5 paragraph 1 point (d) of the Regulation concerns the restriction of cross-supplies between appointed distributors within a selective distribution system. Accordingly, 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. Consequently, selective distribution cannot be combined with vertical restraints aimed at forcing distributors to purchase the contract products exclusively from a given source. 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 5 paragraph 1 point (e) of the Regulation concerns agreements that prevent or restrict end-users, independent repairers and service providers from obtaining spare parts directly from the manufacturer of those spare parts. An agreement between a manufacturer of spare parts and a buyer that incorporates those parts into its own products (original equipment manufacturer (OEM)), may not, either directly or indirectly, prevent or restrict sales by the manufacturer of those spare parts to end users, independent repairers or service providers. Indirect restrictions may arise particularly 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 its own goods. In other words, the original equipment manufacturer may require its own repair and service network to buy spare parts from it.

4. Individual cases of hardcore sales restrictions that may fall outside the scope of Article 7 paragraph 1 of the Law or may fulfil the conditions of Article 7 paragraph (3) of the Law

- (57) Hardcore restrictions may be objectively necessary in exceptional cases for an agreement of a particular type or nature⁸ and therefore fall outside Article 7 paragraph (1) of the Law. For example, a hardcore restriction may be objectively necessary to ensure that a public ban on selling dangerous substances to certain customers for reasons of safety or health is respected. In addition, undertakings may plead an efficiency defence under Article 7 paragraph (3) of the Law in an individual case. This section provides some examples for (re)sales restrictions, whereas for RPM this is dealt with in section VI.2.10.
- (58) A distributor which will be the first to sell a new brand or the first to sell an existing brand on a new market, thereby ensuring a genuine entry on the relevant market, may have to commit substantial investments where there was previously no demand for that type of product in general or for that type of product from that producer. Such expenses may often be sunk and in such circumstances the distributor may not enter into the distribution agreement without protection for a certain period of time against (active and) passive sales into its territory or to its customer group by other distributors. For example such a situation may occur where a manufacturer established in a particular national market enters another national market and introduces its products with the help of an exclusive distributor and where this

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See paragraph 15 of Guidelines on the application of Article 7 paragraph (3) of the Law on protection of competition of 29.03.2012

distributor needs to invest in launching and establishing the brand on this new market. Where substantial investments by the distributor to start up and/or develop the new market are necessary, restrictions of passive sales by other distributors into such a territory or to such a customer group which are necessary for the distributor to recoup those investments generally fall outside the scope of Article 7 paragraph (1) of the Law during the first two years that the distributor is selling the contract goods or services in that territory or to that customer group, even though such hardcore restrictions are in general presumed to fall within the scope of Article 7 paragraph (1) of the Law.

- (59) In the case of genuine testing of a new product in a limited territory or with a limited customer group and in the case of a staggered introduction of a new product, the distributors appointed to sell the new product on the test market or to participate in the first round(s) of the staggered introduction may be restricted in their active selling outside the test market or the market(s) where the product is first introduced without falling within the scope of Article 7 paragraph (1) of the Law for the period necessary for the testing or introduction of the product.
- (60) In the case of a selective distribution system, cross supplies between appointed distributors must normally remain free (see paragraph (55)). However, if appointed wholesalers located in different territories are obliged to invest in promotional activities in 'their' territories to support the sales by appointed retailers and it is not practical to specify in a contract the required promotional activities, restrictions on active sales by the wholesalers to appointed retailers in other wholesalers' territories to overcome possible free riding may, in an individual case, fulfil the conditions of Article 7 paragraph (3) of the Law.
- (61) In general, an agreement that a distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold offline ("dual pricing") is a hardcore restriction (see paragraph (49)). However, in some specific circumstances, such an agreement may fulfil the conditions of Article 7 paragraph (3) of the Law. Such circumstances may be present where a manufacturer agrees such dual pricing with its distributors, because selling online leads to substantially higher costs for the manufacturer than offline sales. For example, where offline sales include home installation by the distributor but online sales do not, the latter may lead to more customer complaints and warranty claims for the manufacturer. In that context, the Commission will also consider to what extent the restriction is likely to limit internet sales and hinder the distributor to reach more and different customers.

5. Obligations that vertical agreements shall not contain

- (62) Article 6 of the Regulation excludes certain obligations from the coverage of the Regulation even though the market share threshold is not exceeded. However, the Regulation continues to apply to the remaining part of the vertical agreement if that part is severable from the non-exempted obligations according to the Regulation.
- (63) The first exclusion is provided for in Article 6 paragraph (1) point (a) of the Regulation and concerns non-compete obligations. Non-compete obligations are arrangements that result in the buyer purchasing from the supplier or from another undertaking designated by the supplier more than 80 % of the buyer's total purchases of the contract goods and services and their substitutes during the preceding calendar

year (as defined by Article 2 paragraph (1) point (d) of the Regulation), thereby preventing the buyer from purchasing competing goods or services or limiting such purchases to less than 20 % of total purchases. Where, in the first year after entering in the agreement, for the year preceding the conclusion of the contract no relevant purchasing data for the buyer are available, the buyer's best estimate of its annual total requirements may be used. Such non-compete obligations are not covered by the Regulation where the 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 Regulation. In general, non-compete obligations are exempted under that Regulation where their duration is limited to five years or less 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. 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 once the non-compete obligation expires.

- (64) 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 6 paragraph (1) point a) of the 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 its permission. By analogy, the same principles apply where the buyer operates from a mobile outlet owned by the supplier or leased by the supplier from third parties not connected with the buyer. Artificial ownership constructions, such as a transfer by the distributor of its proprietary rights over the land and premises to the supplier for only a limited period, intended to avoid the five-year limit cannot benefit from this exception.
- (65) The second exclusion from the block exemption is provided for in Article 6 paragraph (1) point (b) of the Regulation and concerns post term non-compete obligations on the buyer. Such obligations are normally not covered by the 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 2 paragraph (1) point (g) of the Regulation the know-how needs to be "substantial", meaning that the know-how includes information which is significant and useful to the buyer for the use, sale or resale of the contract goods or services.
- (66) The third exclusion from the block exemption is provided for in Article 6 paragraph (1) point (c) of the Regulation and concerns any direct or indirect obligation causing the members of the selective distribution system not to sell the brands of particular competing suppliers. However, if the supplier prevents its appointed dealers, either directly or indirectly, from buying products for resale from specific competing suppliers, such an obligation cannot enjoy the benefit of the Regulation. The objective of the exclusion of such an obligation is to avoid a situation whereby a certain number of suppliers using the same selective distribution outlets prevent one

specific competitor 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).

6. Severability

- (67) The Regulation exempts vertical agreements on condition that no hardcore restriction, as set out in Article 5 of that Regulation, is contained in or practised with the vertical agreement. If there are one or more hardcore restrictions, the benefit of the Regulation is lost for the entire vertical agreement. There is no severability for hardcore restrictions.
- (68) The rule of severability does apply, however, to the excluded restrictions set out in Article 6 of the 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 6.

7. Portfolio of products distributed through the same distribution system

- (69) 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 Regulation while others may not. In that case, the Regulation applies to those goods and services for which the conditions of application are fulfilled.
- (70) In respect of the goods or services which are not covered by the Regulation, the ordinary rules of competition apply, which means:
 - (a) there is no block exemption but also no presumption of illegality;
 - (b) if there is an infringement of Article 7 paragraph (1) of the Law which is not exemptible, consideration may be given to whether there are appropriate remedies to solve the competition problem within the existing distribution system;
 - (c) if there are no such appropriate remedies, the supplier concerned will have to make other distribution arrangements.

Such a situation can also arise where Article 11 of the Law applies in respect of some products but not in respect of others.

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

1. Withdrawal procedure

- (71) The block exemption may be withdrawn where a certain vertical agreement, considered either in isolation or in conjunction with similar agreements enforced by competing suppliers or buyers, comes within the scope of Article 7 paragraph (1) of the Law and does not fulfil all the conditions of Article 7 paragraph (3) of the Law.
- (72) The conditions of Article 7 paragraph (3) of the Law 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. 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. Such a situation may also arise when, on a given market, the cumulative use of qualitative criteria forecloses more efficient distributors. 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 a particular qualitative criterion or only the quantitative limitations imposed on the number of authorised distributors.

- (73) 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 7 paragraph (1) of the Law 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 (117) to (216).
- (74) Where the withdrawal procedure is applied, the Commission bears the burden of proof that the agreement falls within the scope of Article 7 paragraph (1) of the Law and that the agreement does not fulfil one or several of the conditions of Article 7 paragraph (3) of the Law. 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.

2. Detailed conditions for withdrawal of the block exemption

As referred to in Article 7 of the Regulation, the Commission may withdraw the benefit of the Regulation if in the misdemeanour procedure initiated *ex officio* or by request of a party, determine that the vertical agreement which is subject to the exemption in article 3 of the Regulation, have consequences that are not in accordance with the conditions laid down in article 7 paragraph 3 of the Law, and particularly if it determines the existence of particularly significant anticompetitive effects that may arise from the existence of parallel networks of vertical agreements having similar effects which significantly restrict access to the relevant market or competition therein (such as cumulative impacts may arise in the case of selective distribution or non-compete obligations).

V. MARKET DEFINITION AND MARKET SHARE CALCULATION

1. Commission Notice on definition of the relevant market

- (75) The Commission Notice on definition of the relevant market for the purposes of the Law on Protection of Competition (May 2011) 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 that notice.

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

- (76) Under Article 4 paragraph 1 of the Regulation, the market share of both the supplier and the buyer are decisive to determine if the block exemption applies. In order for the block exemption to apply, the market share of the supplier on the market where it sells the contract products to the buyer, and the market share of the buyer on the market where it purchases the contract products, does not each exceed 30 %. For agreements between small and medium-sized undertakings it is in general not necessary to calculate market shares (see paragraph (11)).
- (77) In order to calculate an undertaking's market share, it is necessary to determine the relevant market where that undertaking sells and purchases, respectively, the contract products. Accordingly, 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 buyers 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.
- (78) The product market definition primarily depends 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, 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 it 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 distributors are professional buyers, the geographic wholesale market is usually wider than the retail market, where the product is resold to final consumers. Often, this will lead to the definition of national or wider wholesale markets. But retail markets may also be wider than the final consumers' search area where homogeneous market conditions and overlapping local or regional catchment areas exist.
- (79) Where a vertical agreement involves three parties, each operating at a different level of trade, each party's market share must be 30 % or less in order for the block exemption to apply. As specified in Article 4 paragraph 2 of the Regulation, where in a multi party agreement an undertaking buys the contract goods or services from one undertaking party to the agreement and sells the contract goods or services to another undertaking party to the agreement, the block exemption applies only if its market

share does not exceed the 30 % threshold both as a buyer and a supplier. 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 shares of the manufacturer and the wholesaler (or association of retailers) on their respective downstream markets must not exceed 30 % and the market share of the wholesaler (or association of retailers) and the retailer must not exceed 30 % on their respective purchase markets in order to benefit from the block exemption.

- (80) Where a supplier produces both original equipment and the repair or replacement parts for that 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 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. In practice, the issue is whether a significant proportion of buyers make their choice taking into account the lifetime costs of the product. If so, it indicates there is one market for the original equipment and spare parts combined.
- (81) 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 it sells the contract goods is relevant for the application of the Regulation. Where a franchisor does not supply goods to be resold but provides a bundle of services and goods combined with IPR provisions which together form the business method being franchised, the franchisor needs to take account of its market share as a provider of a business method. For that purpose, the franchisor needs to calculate its 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 its market share on the value of the goods or services supplied by its 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 its market share on the basis of the relevant sales figures of its franchisees on this market.

3. Calculation of market shares under the Regulation

- (82) The calculation of market shares needs to be based in principle on sales value figures and the market share of the buyer is calculated upon the market purchase value data. 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 4 paragraph 3 point (a) of the Regulation).
- (83) 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.

(84) However, in the case of dual distribution of final goods, that is, where a producer of final goods also acts as a distributor on the market, the market definition and market share calculation need to include sales of their own goods made by the producers through their vertically integrated distributors and agents (see Article 4 paragraph 3 point (c) of the Regulation). "Integrated distributors" are connected undertakings within the meaning of Article 5 paragraph 1 indent 3 of the Law⁹.

VI. ENFORCEMENT POLICY IN INDIVIDUAL CASES

1. The framework of analysis

(85) Outside the scope of the block exemption, it is relevant to examine whether in the individual case the agreement falls within the scope of Article 7 paragraph 1 of the Law and if so whether the conditions of Article 7 paragraph (3) of the Law are satisfied. Provided that they do not contain restrictions of competition by object and in particular hardcore restrictions of competition, there is no presumption that vertical agreements falling outside the block exemption because the market share threshold is exceeded fall within the scope of Article 7 paragraph (1) of the Law or fail to satisfy the conditions of Article 7 paragraph (3) of the Law. Individual assessment of the likely effects of the agreement is required. Companies are encouraged to do their own assessment. Agreements that either do not restrict competition within the meaning of Article 7 paragraph (1) of the Law or which fulfil the conditions of Article 7 paragraph (3) of the Law are valid and enforceable. 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 7 paragraph (1) of the Law. The undertakings claiming the benefit of Article 7 paragraph (3) of the Law bear the burden of proving that the conditions of that paragraph are fulfilled. When likely anti-competitive effects are demonstrated, undertakings may substantiate efficiency claims and explain why a certain distribution system is indispensable to bring likely benefits to consumers without eliminating competition, before the Commission decides whether the agreement satisfies the conditions of Article 7 paragraph (3) of the Law.

(86) The assessment of whether a vertical agreement has the effect of restricting competition will be made by comparing the actual or likely future situation on the relevant market with the vertical restraints in place with the situation that would prevail in the absence of the vertical restraints in the agreement. In the assessment of individual cases, the Commission will take, as appropriate, both actual and likely effects into account. For vertical agreements to be restrictive of competition by effect they must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation, or the variety or quality of goods and services can be expected with a reasonable degree of probability. The likely negative effects on competition must be appreciable¹⁰. Appreciable anticompetitive effects are likely to occur when at least one of the parties has or obtains some degree of market power and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power. Market power is the ability to maintain prices above competitive

⁹ For these market definition and market share calculation purposes, it is not relevant whether the integrated distributor sells in addition products of competitors.

¹⁰ See Section II.1.

levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time. The degree of market power normally required for a finding of an misdemeanour under Article 7 paragraph (1) of the Law is less than the degree of market power required for a finding of dominance under Article 11 of the Law.

- (87) Vertical restraints are generally less harmful than horizontal restraints. The main reason for the greater focus on horizontal restraints is that such restraints 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, in other words, the activities of the parties to the agreement are complementary to each other. The exercise of market power by either the upstream or downstream company would therefore 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.
- (88) Such self-restraining character should not, however, 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. More generally, because of the complementary role of the parties to a vertical agreement in getting a product on the market, vertical restraints may provide substantial scope for efficiencies. However, when an undertaking 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.

1.1 Negative effects of vertical restraints

- (89) The negative effects on the market that may result from vertical restraints which the Law aims at preventing are the following:
- (a) anticompetitive foreclosure of other suppliers or other buyers by raising barriers to entry or expansion;
 - (b) softening of competition between the supplier and its competitors and/or facilitation of collusion amongst these suppliers, often referred to as reduction of inter-brand competition¹¹;
 - (c) softening of competition between the buyer and its competitors and/or facilitation of collusion amongst these competitors, often referred to as reduction of intra-brand competition if it concerns distributors' competition on the basis of the brand or product of the same supplier;

¹¹ By collusion is meant both explicit collusion and tacit collusion (conscious parallel behaviour).

- (d) the creation of obstacles to market integration, including, above all, limitations on the possibilities for consumers to purchase goods or services in any Member State they may choose.
- (90) Foreclosure, softening of competition and collusion at the manufacturers' level may harm consumers in particular by increasing the wholesale prices of the products, limiting the choice of products, lowering their quality or reducing the level of product innovation. Foreclosure, softening of competition and collusion at the distributors' level may harm consumers in particular by increasing the retail prices of the products, limiting the choice of price-service combinations and distribution formats, lowering the availability and quality of retail services and reducing the level of innovation of distribution.
- (91) On a market where individual distributors distribute the brand(s) of only one supplier, a reduction of competition between the distributors of the same brand will lead to a reduction of intra-brand competition between these distributors, but may not have a negative effect on competition between distributors in general. In such a case, if inter-brand competition is fierce, it is unlikely that a reduction of intra-brand competition will have negative effects for consumers.
- (92) Exclusive arrangements are generally more anti-competitive than non-exclusive arrangements. Exclusive arrangements, whether by means of express contractual language or their practical effects, result in one party sourcing all or practically all of its demand 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.
- (93) 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.
- (94) In general, a combination of vertical restraints aggravates their individual negative effects. However, certain combinations of vertical restraints are less anti-competitive than their use in isolation. 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. Possible negative effects of vertical restraints are reinforced when several suppliers and their buyers organise their trade in a similar way, leading to so-called cumulative effects.

1.2. Positive effects of vertical restraints

- (95) It is important to recognise that vertical restraints may 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.

- (96) 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:

- (a) To solve a "free-rider" problem. One distributor may free-ride on the promotion efforts of another distributor. That 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 free-riding¹².

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 other promotional activities, but not on after-sales services for which the distributor can charge its customers individually. The product will usually need to be relatively new or technically complex or the reputation of the product must be a major determinant of its demand, as the customer may otherwise very well know what it 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 promotion or service requirements.

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

- (b) 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 on 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 it 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 on the new market (see also paragraph (58) in Section III.4). This is a special case of the free-rider problem described under point (a).
- (c) The "certification free-rider issue". In some sectors, certain retailers have a reputation for stocking only "quality" products. In such a case, selling through those retailers may be vital for the introduction of a new product. If the manufacturer cannot initially limit its sales to the premium stores, it runs the risk of being de-listed and the product introduction may fail. There may,

¹² Whether consumers actually benefit overall from extra promotional efforts depends on whether the extra promotion informs and convinces and thus benefits many new customers or mainly reaches customers who already know what they want to buy and for whom the extra promotion only or mainly implies a price increase.

therefore, 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.

- (d) 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 its 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 it can only, for instance, 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, that is, one party to the contract invests more than the other party. Where 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.

- (e) 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 its 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, which would normally fall outside Article 7 paragraph (1) of the Law.
- (f) The "vertical externality issue". A retailer may not gain all the benefits of its action taken to improve sales; some may go to the manufacturer. For every extra unit a retailer sells by lowering its resale price or by increasing its sales effort, the manufacturer benefits if its wholesale price exceeds its marginal production costs. Thus, there may be a positive externality bestowed on the manufacturer by such retailer's actions and from the manufacturer's perspective the retailer may be pricing too high and/or making too little sales efforts. The negative externality of too high pricing by the retailer is sometimes called the "double marginalisation problem" and it can be avoided by imposing a maximum resale price on the retailer. To increase the retailer's sales efforts

selective distribution, exclusive distribution or similar restrictions may be helpful¹³.

- (g) "Economies of scale in distribution". In order to have scale economies exploited and thereby see a lower retail price for its product, the manufacturer may want to concentrate the resale of its products on a limited number of distributors. To do so, it could use exclusive distribution, quantity forcing in the form of a minimum purchasing requirement, selective distribution containing such a requirement or exclusive sourcing.
 - (h) "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 its 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.
 - (i) "Uniformity and quality standardisation". A vertical restraint may help to create a brand image by imposing a certain measure of uniformity and quality standardisation on the distributors, thereby increasing the attractiveness of the product to the final consumer and increasing its sales. This can for instance be found in selective distribution and franchising.
- (97) The nine situations listed in paragraph (96) 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 its product to the buyer (see in particular the situations described in paragraph (96)(a), (e), (f), (g) and (i)).
- (98) A large measure of substitutability exists between the different vertical restraints. As a result, 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 sourcing. However, the negative effects on competition may differ between the various vertical restraints, which plays a role when indispensability is discussed under Article 7 paragraph (3) of the Law.
- 1.3. *Methodology of analysis*
- (99) The assessment of a vertical restraint generally involves the following four steps¹⁴:

¹³ See however the previous footnote.

¹⁴ These steps are not intended to present a legal reasoning that the Commission should follow in this order to take a decision.

- (a) First, the undertakings involved need to establish the market shares of the supplier and the buyer on the market where they respectively sell and purchase the contract products.
- (b) If the relevant market share of the supplier and the buyer each do not exceed the 30 % threshold of the relevant market where they sale products or services subject of the agreement, the vertical agreement is covered by the Regulation, subject to the hardcore restrictions and excluded restrictions set out in that Regulation.
- (c) If the relevant market share is above the 30 % threshold for supplier and/or buyer, it is necessary to assess whether the vertical agreement falls within Article 7 paragraph (1) of the Law.
- (d) If the vertical agreement falls within Article 7 paragraph (1) of the Law, it is necessary to examine whether it fulfils the conditions for exemption under Article 7 paragraph (3) of the Law.

1.3.1. Relevant factors for the assessment under Article 7 paragraph (1) of the Law

- (100) In assessing cases above the market share threshold of 30 % of the relevant market, the Commission will undertake a full competition analysis. The following factors are particularly relevant to establish whether a vertical agreement brings about an appreciable restriction of competition under Article 7 paragraph (1) of the Law:
 - (a) nature of the agreement;
 - (b) market position of the parties;
 - (c) market position of competitors;
 - (d) market position of buyers of the contract products;
 - (e) entry barriers;
 - (f) maturity of the market;
 - (g) level of trade;
 - (h) nature of the product;
 - (i) other factors.
- (101) 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 parties is usually a good indicator of market power, but in the case of low entry barriers it may not be indicative of market power. It is therefore not possible to provide firm rules on the importance of the individual factors.
- (102) Vertical agreements can take many shapes and forms. It is therefore important to analyse the nature of the agreement in terms of the restraints that it contains, the duration of those restraints and the percentage of total sales on the market affected by those restraints. It may be necessary to go beyond the express terms of the

agreement. The existence of implicit restraints may be derived from the way in which the agreement is implemented by the parties and the incentives that they face.

- (103) The market position of the parties provides an indication of the degree of market power, if any, possessed by the supplier, the buyer or both. The higher their market share, the greater their market power is likely to be. This is particularly so where the market share reflects cost advantages or other competitive advantages vis-à-vis competitors. Such competitive advantages may, for instance, result from being a first mover on the market (having the best site, etc.), from holding essential patents or having superior technology, from being the brand leader or having a superior portfolio.
- (104) Such indicators, namely market share and possible competitive advantages, are used to assess the market position of competitors. The stronger the competitors are and the greater their number, the less risk there is that the parties will be able to individually exercise market power and foreclose the market or soften competition. It is also relevant to consider whether there are effective and timely counterstrategies that competitors would be likely to deploy. However, if the number of competitors becomes rather small and their market position (size, costs, R&D potential, etc.) is rather similar, such a market structure may increase the risk of collusion. Fluctuating or rapidly changing market shares are in general an indication of intense competition.
- (105) The market position of the parties' customers provides an indication of whether or not one or more of those customers possess buyer power. The first indicator of buyer power is the market share of the customer on the purchase market. That share reflects the importance of its demand for possible suppliers. Other indicators focus on the position of the customer on its resale market, including characteristics such as a wide geographic spread of its outlets, own brands including private labels and its brand image amongst final consumers. In some circumstances, buyer power may prevent the parties from exercising market power and thereby solve a competition problem that would otherwise have existed. This is particularly so when strong customers have the capacity and incentive to bring new sources of supply on to the market in the case of a small but permanent increase in relative prices. Where strong customers merely extract favourable terms for themselves or simply pass on any price increase to their customers, their position does not prevent the parties from exercising market power.
- (106) Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level without attracting new entry. In the absence of entry barriers, easy and quick entry would render price increases unprofitable. When effective entry, preventing or eroding the exercise of market power, is likely to occur within one or two years, entry barriers can, as a general rule, be said to be low. 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, essential facilities, a first mover advantage and brand loyalty of consumers created by strong advertising over a period of time. 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. The question whether certain of those factors should be described as entry barriers depends particularly on whether

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

- (107) 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.
- (108) The level of trade is linked to the distinction between intermediate 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 that often rely more on brand and image. As distributors 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.
- (109) 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.
- (110) In the assessment of particular restraints other factors may have to be taken into account. Among these factors can be the cumulative effect, that is, the coverage of the market by similar agreements of others, 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.

1.3.2. Relevant factors for the assessment under Article 7 paragraph (3) of the Law

- (111) Restrictive vertical agreements may also produce pro-competitive effects in the form of efficiencies, which may outweigh their anti-competitive effects. Such an assessment takes place within the framework of Article 7 paragraph (3) of the Law,

which contains an exception from the prohibition rule of Article 7 paragraph (1) of the Law. For that exception to be applicable, the vertical agreement must produce objective economic benefits, the restrictions on competition must be indispensable to attain the efficiencies, consumers must receive a fair share of the efficiency gains, and the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned.

- (112) The assessment of restrictive agreements under Article 7 paragraph (3) of the Law is made within the actual context in which they occur and on the basis of the facts existing at any given point in time. The assessment is sensitive to material changes in the facts. The exception rule of Article 7 paragraph (3) of the Law applies as long as the four conditions are fulfilled and ceases to apply when that is no longer the case¹⁵. When applying Article 7 paragraph (3) of the Law in accordance with these principles it is necessary to take into account the investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment.
- (113) The first condition of Article 7 paragraph (3) of the Law requires an assessment of what are the objective benefits in terms of efficiencies produced by the agreement. In this respect, vertical agreements often have the potential to help realise efficiencies, as explained in section 1.2, by improving the way in which the parties conduct their complementary activities.
- (114) In the application of the indispensability test contained in Article 7 paragraph (3) of the Law, the Commission will in particular examine whether individual restrictions make it possible to perform the production, purchase and/or (re)sale of the contract products more efficiently than would have been the case in the absence of the restriction concerned. In making such an assessment, the market conditions and the realities facing the parties must be taken into account. Undertakings invoking the benefit of Article 7 paragraph (3) of the Law are not required to consider hypothetical and theoretical alternatives. They must, however, explain and demonstrate why seemingly realistic and significantly less restrictive alternatives would be significantly less efficient. If the application of what appears to be a commercially realistic and less restrictive alternative would lead to a significant loss of efficiencies, the restriction in question is treated as indispensable.
- (115) The condition that consumers must receive a fair share of the benefits implies that consumers of the products purchased and/or (re)sold under the vertical agreement must at least be compensated for the negative effects of the agreement. In other words, the efficiency gains must fully off-set the likely negative impact on prices, output and other relevant factors caused by the agreement.
- (116) The last condition of Article 7 paragraph (3) of the Law, according to which the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned, presupposes an analysis of remaining competitive pressures on the market and the impact of the agreement on such sources of competition. In the application of the last condition of Article 7 paragraph (3) of the Law, the relationship between Article 7 paragraph (3) of the Law and Article 11 of the Law must be taken into account. According to settled case

¹⁵ Similarly, the prohibition of Article 7 paragraph (1) of the Law also only applies as long as the agreement has a restrictive object or restrictive effects.

law, the application of Article 7 paragraph (3) of the Law cannot prevent the application of Article 11 of the Law. Moreover, since Articles 7 and 11 of the Law both pursue the aim of maintaining effective competition on the market, consistency requires that Article 7 paragraph (3) of the Law be interpreted as precluding any application of the exception rule to restrictive agreements that constitute an abuse of a dominant position. The vertical agreement may not eliminate effective competition, by removing all or most existing sources of actual or potential competition. Rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the form of innovation. In its absence, the dominant undertaking will lack adequate incentives to continue to create and pass on efficiency gains. Where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains. A restrictive agreement which maintains, creates or strengthens a market position approaching that of a monopoly can normally not be justified on the grounds that it also creates efficiency gains.

2. Analysis of specific vertical restraints

- (117) The most common vertical restraints and combinations of vertical restraints are analysed in the remainder of these Guidelines following the framework of analysis developed in paragraphs (85) to (116). Other restraints and combinations exist for which no direct guidance is provided in these Guidelines. They will, however, be treated according to the same principles and with the same emphasis on the effect on the market.

2.1. *Single branding provisions*

- (118) Under the heading of "single branding provisions" fall those agreements which have as their main element the fact that the buyer is obliged or induced to concentrate its orders for a particular type of product with one supplier. That component can be found amongst others in non-compete and quantity-forcing on the buyer. A non-compete arrangement is based on an obligation or incentive scheme which makes the buyer purchase more than 80% of its 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. 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 its purchases to a large extent with one supplier. Quantity-forcing may for example take the form of minimum purchase requirements, stocking requirements or non-linear pricing, such as conditional rebate schemes or a two-part tariff (fixed fee plus a price per unit). 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 single branding obligation, especially when the buyer has to reveal who makes the better offer.
- (119) The possible competition risks of single branding are foreclosure of the market to competing suppliers and potential suppliers, softening of competition and 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. Such restrictive effects have a direct impact on inter-brand competition.

- (120) Single branding is exempted by the Regulation where the supplier's and buyer's market share each do not exceed 30 % and are subject to a limitation in time of five years for the non-compete obligation. The remainder of this section provides guidance for the assessment of individual cases above the market share threshold or beyond the time limit of five years.
- (121) The capacity for single branding obligations of one specific supplier to result in anticompetitive foreclosure arises in particular where, without the obligations, an important competitive constraint is exercised by competitors that either are not yet present on the market at the time the obligations are concluded, or that are not in a position to compete for the full supply of the customers. Competitors may not be able to compete for an individual customer's entire demand because the supplier in question is an unavoidable trading partner at least for part of the demand on the market, for instance because its brand is a 'must stock item' preferred by many final consumers or because the capacity constraints on the other suppliers are such that a part of demand can only be provided for by the supplier in question. The market position of the supplier is thus of main importance to assess possible anti-competitive effects of single branding obligations.
- (122) If competitors can compete on equal terms for each individual customer's entire demand, single branding obligations of one specific supplier are generally unlikely to hamper effective competition unless the switching of supplier by customers is rendered difficult due to the duration and market coverage of the single branding obligations. The higher its tied market share, that is, the part of its market share sold under a single branding obligation, the more significant foreclosure is likely to be. Similarly, the longer the duration of the single branding obligations, the more significant foreclosure is likely to be. Single branding obligations shorter than one year entered into by non-dominant companies are generally not considered to give rise to appreciable anti-competitive effects or net negative effects. Single branding obligations between one and five years entered into by non-dominant companies usually require a proper balancing of pro- and anti-competitive effects, while single branding 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. Single branding obligations are more likely to result in anti-competitive foreclosure when entered into by dominant companies.
- (123) When assessing the supplier's market power, the market position of its competitors is important. As long as the competitors are sufficiently numerous and strong, no appreciable anti-competitive effects can be expected. Foreclosure of competitors is not very likely where they have similar market positions and can offer similarly attractive products (products with similar characteristics, price and usage). In such a case, foreclosure may, however, occur for potential entrants when a number of major suppliers enter into single branding contracts with a significant number of buyers on the relevant market (cumulative effect situation). This is also a situation where single branding agreements may facilitate collusion between competing suppliers. If, individually, those suppliers are covered by the 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.

- (124) In cases where the market share of the largest supplier is below 30 % and the market share of the five largest suppliers is below 50 %, there is unlikely to be a single or a cumulative anti-competitive effect situation. Where a potential entrant cannot penetrate the market profitably, it is likely to be due to factors other than single branding obligations, such as consumer preferences.
- (125) Entry barriers are important to establish whether there is anticompetitive foreclosure. Wherever it is relatively easy for competing suppliers to create new buyers or find alternative buyers for their product, foreclosure is unlikely to be a real problem. However, there are often entry barriers, both at the manufacturing and at the distribution level.
- (126) Countervailing power is relevant, as powerful buyers will not easily allow themselves to be cut off from the supply of competing goods or services. More generally, in order to convince customers to accept single branding, the supplier may have to compensate them, in whole or in part, for the loss in competition resulting from the exclusivity. Where such compensation is given, it may be in the individual interest of a customer to enter into a single branding obligation with the supplier. But it would be wrong to conclude automatically from this that all single branding obligations, taken together, are overall beneficial for customers on that market and for the final consumers. It is in particular unlikely that consumers as a whole will benefit if there are many customers and the single branding obligations, taken together, have the effect of preventing the entry or expansion of competing undertakings.
- (127) Lastly, "the level of trade" is relevant. Anticompetitive 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 an anticompetitive foreclosure effect may however arise in a cumulative effect situation. A cumulative anticompetitive effect is unlikely to arise as long as less than 50 % of the market is tied.
- (128) Where the agreement concerns the supply of a final product at the wholesale level, the question whether a competition problem is likely to arise depends in large part on the type of wholesaling and the entry barriers at the wholesale level. There is no real risk of anticompetitive foreclosure if competing manufacturers can easily establish their own wholesaling operation. Whether entry barriers are low depends in part on the type of wholesaling, that is, 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 foodstuffs). In the latter case, it is not efficient for a manufacturer selling only one product to set up its own wholesaling operation. In that case, anti-competitive effects may arise. In addition, cumulative effect problems may arise if several suppliers tie most of the available wholesalers.
- (129) 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 single branding 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.

- (130) At the retail level, a cumulative foreclosure effect may also arise. Where all suppliers have market shares below 30 %, a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is less than 40 % and withdrawal of the block exemption is therefore unlikely. That figure may be higher when other factors like the number of competitors, entry barriers etc. are taken into account. Where not all companies have market shares below the threshold of the Regulation but none is dominant, a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is below 30 %.
- (131) 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.
- (132) 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.
- (133) Where appreciable anti-competitive effects are established, the question of a possible exemption under Article 7 paragraph (3) of the Law arises. For non-compete obligations, the efficiencies described in points (a) (free riding between suppliers), (d), (e) (hold-up problems) and (h) (capital market imperfections) of paragraph (96), may be particularly relevant.
- (134) In the case of an efficiency as described in paragraph (96) (a), (d) and (h), 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 (96)(e), (hold-up problem related to the transfer of know-how).
- (135) In the case of a relationship-specific investment made by the supplier (see paragraph (96)(d)), a non-compete or quantity forcing agreement for the period of depreciation of the investment will in general fulfil the conditions of Article 7 paragraph (3) of the Law. 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.
- (136) 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 an anticompetitive foreclosure effect on the market. In case of capital market imperfection, it may be more efficient for the supplier of a

product than for a bank to provide a loan (see paragraph (96)(h)). However, in such a case the loan should be provided in the least restrictive way and the buyer should thus in general not be prevented from terminating the obligation and repaying the outstanding part of the loan at any point in time and without payment of any penalty.

- (137) The transfer of substantial know-how (paragraph (96)(e)) usually justifies a non-compete obligation for the whole duration of the supply agreement, as for example in the context of franchising.

(138) *Example of non-compete obligation*

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 %. Those 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 of Article 7 paragraph (3) of the Law are fulfilled.

(139) *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 its sales on a limited number of resellers allows him to plan its sales better and to save transport costs. In the light of the efficiencies on the one hand and 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 on the other hand, the quantity forcing of 75 % applied by producer X is likely to fulfil the conditions of Article 7 paragraph (3) of the Law.

2.2 *Exclusive distribution*

- (140) In an exclusive distribution agreement, the supplier agrees to sell its products to only one distributor for resale in a particular territory. At the same time, the distributor is usually limited in its active selling into other (exclusively allocated) territories. The possible competition risks are mainly reduced intra-brand competition and market partitioning, which may facilitate price discrimination in particular. When most or all of the suppliers apply exclusive distribution, it may soften competition and facilitate collusion, both at the suppliers' and distributors' level. Lastly, exclusive distribution may lead to foreclosure of other distributors and therewith reduce competition at that level.
- (141) Exclusive distribution is exempted by the Regulation where both the supplier's and buyer's market share each do 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 Regulation if active selling in other territories is not restricted. The remainder of this section provides guidance for the assessment of exclusive distribution in individual cases above the 30 % market share threshold.
- (142) The market position of the supplier and its 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 fulfil the conditions of Article 7 paragraph (3) of the Law, the loss of intra-brand competition may need to be balanced with real efficiencies.
- (143) 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 and/or softening of competition. The loss of intra-brand competition can increase that risk, especially when several suppliers operate similar distribution systems. Multiple exclusive dealerships, that is, when different suppliers appoint the same exclusive distributor in a given territory, may further increase the risk of collusion and/or softening of competition. If a dealer is granted the exclusive right to distribute two or more important competing products in the same territory, inter-brand competition may be substantially restricted for those brands. The higher the cumulative market share of the brands distributed by the exclusive multiple brand dealers, the higher the risk of collusion and/or softening of competition and the more inter-brand competition will be reduced. If a retailer is the exclusive distributor for a number of brands this may have as result that if one producer cuts the wholesale price for its brand, the exclusive 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, compared to the situation without multiple exclusive dealerships, producers have a reduced interest in entering into price competition with one another. Such cumulative effect situations may be a reason to withdraw the benefit of the Regulation where the market shares of the suppliers and buyers are below the threshold of the Regulation.

- (144) 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.
- (145) Foreclosure of other distributors is not an issue where the supplier which operates the exclusive distribution system appoints a high number of exclusive distributors on the same market and those exclusive distributors are not restricted in selling to other non-appointed distributors. Foreclosure of other distributors may however become an issue 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.
- (146) 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.
- (147) 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 on a market with growing demand, changing technologies and changing market positions.
- (148) 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.

- (149) A manufacturer that chooses a wholesaler to be its exclusive distributor will normally do so for a larger territory, such as a whole country. As long as the wholesaler can sell the products without limitation to downstream retailers there are not likely to be appreciable anti-competitive effects. 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. The possible risks for inter-brand competition of multiple exclusive dealerships are however higher at the wholesale than at the retail level. Where one wholesaler becomes the exclusive distributor for a significant number of suppliers, not only is there a risk that competition between these brands is reduced, but also that there is foreclosure at the wholesale level of trade.
- (150) As stated in paragraph (144), foreclosure of other suppliers does not arise as long as exclusive distribution is not combined with single branding. But even when exclusive distribution is combined with single branding anticompetitive foreclosure of other suppliers is unlikely, except possibly when the single branding is applied to a dense network of exclusive distributors with small territories or in case of a cumulative effect. In such a case it may be necessary to apply the principles on single branding set out in section 2.1. 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 its efforts on the particular brand. Therefore, in the absence of such a foreclosure effect, the combination of exclusive distribution with non-compete may very well fulfil the conditions of Article 7 paragraph (3) of the Law for the whole duration of the agreement, particularly at the wholesale level.
- (151) The combination of exclusive distribution with exclusive sourcing increases the possible competition risks of reduced intra-brand competition and market partitioning which may facilitate price discrimination in particular. 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 sourcing, 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, which are prevented from buying from other distributors in the system. As a result, the supplier's possibilities to limit intra-brand competition by applying dissimilar conditions of sale to the detriment of consumers are enhanced, unless the combination allows the creation of efficiencies leading to lower prices to all final consumers.
- (152) The nature of the product is not particularly relevant to the assessment of possible anti-competitive effects of exclusive distribution. It is, however, relevant to an assessment of possible efficiencies, that is, after an appreciable anti-competitive effect is established.
- (153) 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, complex products, and products whose qualities are difficult to judge before consumption (so-called experience products) or whose 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.

(154) Example of exclusive distribution at the wholesale level

On 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 country, or to a region. Those exclusive distributors deal with 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, including 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 territory of the Republic of North Macedonia 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 in this example, 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. Therefore it is likely, even if anti-competitive effects exist, that also the conditions of Article 7 paragraph (3) of the Law are fulfilled.

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

On a national market for a final product, there are four market leaders, which each have a market share of around 20 %. Those 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. Those 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. That 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, the conditions of Article 7 paragraph (3) of the Law may not be fulfilled and withdrawal of the block exemption may be necessary for the agreements concluded with distributors whose market share is below 30 % of the procurement market.

2.3. *Exclusive customer allocation*

- (156) In an exclusive customer allocation agreement, the supplier agrees to sell its products to only one distributor for resale to a particular group of customers. At the same time, the distributor is usually limited in its active selling to other (exclusively allocated) groups of customers. The Regulation does not limit the way an exclusive customer group can be defined; it could for instance be a particular type of customers defined by their occupation but also a list of specific customers selected on the basis of one or more objective criteria. The possible competition risks are mainly reduced intra-brand competition and market partitioning, which may in particular facilitate price discrimination. Where most or all of the suppliers apply exclusive customer allocation, competition may be softened and collusion, both at the suppliers' and the distributors' level, may be facilitated. Lastly, exclusive customer allocation may lead to foreclosure of other distributors and therewith reduce competition at that level.
- (157) Exclusive customer allocation is exempted by the Regulation when both the supplier's and buyer'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 sourcing. A combination of exclusive customer allocation and selective distribution is normally a hardcore restriction, 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 (140) to (154) applies also to the assessment of exclusive customer allocation, subject to the specific remarks in the remainder of this section.
- (158) The allocation of customers normally makes arbitrage by the customers more difficult. In addition, as each appointed distributor has its own class of customers, non-appointed distributors not falling within such a class may find it difficult to obtain the product. Consequently, possible arbitrage by non-appointed distributors will be reduced.

- (159) 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.
- (160) 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 group 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 efficiencies.

(161) 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 other's 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 of Article 7 paragraph (3) of the Law are likely to be fulfilled.

2.4. *Selective distribution*

- (162) Selective distribution agreements, like exclusive distribution agreements, restrict the number of authorised distributors on the one hand and the possibilities of resale on the other. 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.

- (163) 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 softening of competition and facilitation of collusion between suppliers or buyers. To assess the possible anti-competitive effects of selective distribution under Article 7 paragraph (1) of the Law, 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. 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 7 paragraph (1) of the Law 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 and made available to all potential resellers and are not applied in a discriminatory manner. Thirdly, the criteria laid down must not go beyond what is necessary. 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.
- (164) Qualitative and quantitative selective distribution is exempted by the Regulation as long as the market share of both supplier and buyer each do not exceed 30 %, 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 Regulation exempts selective distribution regardless of the nature of the product concerned and regardless of the nature of the selection criteria. However, where the characteristics of the product do not require selective distribution or do not require the applied criteria, such as for instance the requirement for distributors to have one or more brick and mortar shops or to provide specific services, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in intra-brand competition. Where appreciable anti-competitive effects occur, the benefit of the Regulation is likely to be withdrawn. In addition, the remainder of this section provides guidance for the assessment of selective distribution in individual cases which are not covered by the Regulation or in the case of cumulative effects resulting from parallel networks of selective distribution.
- (165) The market position of the supplier and its 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 on the market, 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 on a given market.

- (166) 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-authorised dealers in selective distribution. That restriction is designed to give selective distribution systems a closed character, making it impossible for non-authorised dealers to obtain supplies. Accordingly, selective distribution is particularly well suited to avoid pressure by price discounters (whether offline or online-only distributors) on the margins of the manufacturer, as well as on the margins of the authorised dealers. Foreclosure of such distribution formats, whether resulting from the cumulative application of selective distribution or from the application by a single supplier with a market share exceeding 30 %, reduces the possibilities for consumers to take advantage of the specific benefits offered by these formats such as lower prices, more transparency and wider access.
- (167) Where the Regulation applies to individual networks of selective distribution, withdrawal of the block exemption or disapplication of the 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 which do not apply selective distribution, the less likely other distributors will be foreclosed. If all five largest suppliers apply selective distribution, competition concerns may arise with respect to those agreements in particular that apply quantitative selection criteria by directly limiting the number of authorised dealers or that apply qualitative criteria, such as a requirement to have one or more brick and mortar shops or to provide specific services, which forecloses certain distribution formats. The conditions of Article 7 paragraph (3) of the Law 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 or online-only distributors offering lower prices to consumers, 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 its 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.
- (168) Entry barriers are mainly of interest in the case of foreclosure of the market to non-authorised 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.

- (169) 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.
- (170) Article 6 paragraph (1) point (c) of the 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. Such a condition aims specifically at avoiding horizontal collusion to exclude particular brands through the creation of a selective club of brands by the leading suppliers. That kind of obligation is unlikely to be exemptible when the CR5 is equal to or above 50 %, unless none of the suppliers imposing such an obligation belongs to the five largest suppliers on the market.
- (171) Foreclosure of other suppliers is normally not a problem as long as other suppliers can use the same distributors, that is, 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 in section 2.1. 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 where 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 %.
- (172) Maturity of the market is important, as loss of intra-brand competition and possible foreclosure of suppliers or dealers may be a serious problem on a mature market but is less relevant on a market with growing demand, changing technologies and changing market positions.
- (173) Selective distribution may be efficient when it leads to savings in logistical costs due to economies of scale in transport and that may occur irrespective of the nature of the product (paragraph (96) (g)). However, such an efficiency is usually only marginal in selective distribution systems. To help solve a free-rider problem between the distributors (paragraph (96) (a)) or to help create a brand image (paragraph (96)(i)), the nature of the product is very relevant. In general, the case is strongest for new products, complex products, products whose qualities are difficult to judge before consumption (so-called experience products) or whose qualities are difficult to judge even after consumption (so-called credence products). The combination of selective distribution with a location clause, protecting an appointed dealer against other appointed dealers opening up a shop in its vicinity, may in particular fulfil the conditions of Article 7 paragraph (3) of the Law if the combination is indispensable

to protect substantial and relationship-specific investments made by the authorised dealer (paragraph (96)(d)).

- (174) 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.

- (175) Example of quantitative selective distribution

On 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 that 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.

On that 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 of Article 7 paragraph (3) of the Law are likely to be fulfilled.

- (176) 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: the distributors are required to have one or more brick and mortar shops, those 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 that 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.

On that market, access by general price discounters and online-only distributors 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. The requirement to have one or more brick and mortar shops excludes online-only distributors from the network. 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*

- (177) Franchise agreements contain licences of intellectual property rights relating in particular to trademarks 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 its 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.
- (178) The coverage by the Regulation of the licensing of IPRs contained in franchise agreements is dealt with in paragraphs (22) to (43). 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 obligations or exclusive distribution, the

Regulation applies up to the 30 % market share threshold¹⁶. The guidance provided in respect of those types of restraints applies also to franchising, subject to the following two specific remarks:

- (a) The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or are indispensable to protect the know-how and that the vertical restraints fulfil the conditions of Article 7 paragraph (3) of the Law;
- (b) A non-compete obligation on the goods or services purchased by the franchisee falls outside the scope of Article 7 paragraph (1) of the Law where 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 7 paragraph (1) of the Law, as long as it does not exceed the duration of the franchise agreement itself.

(179) 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, 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 that 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. The franchisor's market share of the market for machines for colouring food is below 10 %.

¹⁶

See also paragraphs (75) to (84), in particular paragraph (81).

Most of the obligations contained in the franchise agreements can be deemed necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 7 paragraph (3) of the Law. 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 to, at least help 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 7 paragraph (3) of the Law in as far as the obligations contained therein fall under Article 7 paragraph (1) of the Law.

2.6 *Exclusive supply*

- (180) Under the heading of exclusive supply fall those restrictions that have as their main element that the supplier is obliged or induced to sell the contract products only or mainly to one buyer, in general or for a particular use. Such restrictions may take the form of an exclusive supply obligation, restricting the supplier to sell to only one buyer for the purposes of resale or a particular use, but may for instance also take the form of quantity forcing on the supplier, where incentives are agreed between the supplier and buyer which make the former concentrate its sales mainly with one buyer. For intermediate goods or services, exclusive supply is often referred to as industrial supply. Exclusive supply is exempted by the Regulation where both the supplier's and buyer's market share does not exceed 30 %, even if combined with other non-hardcore vertical restraints such as non-compete. The remainder of this section provides guidance for the assessment of exclusive supply in individual cases above the market share threshold.
- (181) The main competition risk of exclusive supply is anticompetitive foreclosure of other buyers. There is a similarity with the possible effects of exclusive distribution, in particular when the exclusive distributor becomes the exclusive buyer for a whole market (see section 2.2, in particular paragraph (144)). 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 may arise 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 its downstream market exceeds 30 % and the exclusive supply relates to a particular use of the contract products. 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.
- (182) 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 it 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.

- (183) The market position of the competing buyers on the upstream market is important as it is likely that competing buyers will be foreclosed for anti-competitive reasons, that is, to increase their costs, if they are significantly smaller than the foreclosing buyer. Foreclosure of competing buyers is not very likely where those competitors have similar buying power and can offer the suppliers similar sales possibilities. In such a case, foreclosure could only occur for potential entrants, which 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 Regulation.
- (184) 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, there are often significant entry barriers.
- (185) 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 obligations. The combination with non-compete obligations 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 obligations that is, reciprocal exclusivity in industrial supply agreements may often be justified, in particular below the level of dominance.
- (186) Lastly, the level of trade and the nature of the product are relevant for foreclosure. Anticompetitive 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 its customers than the wholesaler or 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. 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.
- (187) Efficiencies can be expected in the case of a hold-up problem (paragraph (96)(d) and (96)(e)), and such efficiencies are more likely for intermediate products than for final products. Other efficiencies are less likely. Possible economies of scale in distribution (paragraph (96)(g)) do not seem likely to justify exclusive supply.

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

(189) 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 its 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 of Article 7 paragraph (3) of the Law 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.

2.7. *Upfront access payments*

(190) Upfront access payments are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. This category includes various practices such as slotting allowances¹⁷, the so called pay-to-stay fees¹⁸, payments to have access to a distributor's promotion campaigns etc. Upfront access payments are exempted under the Regulation when both the supplier's and buyer's market share does not exceed 30 %. The remainder of this section provides guidance for the assessment of upfront access payments in individual cases above the market share threshold.

(191) Upfront access payments may sometimes result in anticompetitive foreclosure of other distributors if such payments induce the supplier to channel its products through only one or a limited number of distributors. A high fee may make that a supplier wants to channel a substantial volume of its sales through this distributor in order to cover the costs of the fee. In such a case, upfront access payments may have the same downstream foreclosure effect as an exclusive supply type of obligation. The assessment of that negative effect is made by analogy to the assessment of exclusive supply obligations (in particular paragraphs (180) to (185)).

¹⁷ Fixed fees that manufacturers pay to retailers in order to get access to their shelf space.

¹⁸ Lump sum payments made to ensure the continued presence of an existing product on the shelf for some further period.

- (192) Exceptionally, upfront access payments may also result in anticompetitive foreclosure of other suppliers, where the widespread use of upfront access payments increases barriers to entry for small entrants. The assessment of that possible negative effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (121) to (130)).
- (193) In addition to possible foreclosure effects, upfront access payments may soften competition and facilitate collusion between distributors. Upfront access payments are likely to increase the price charged by the supplier for the contract products since the supplier must cover the expense of those payments. Higher supply prices may reduce the incentive of the retailers to compete on price on the downstream market, while the profits of distributors are increased as a result of the access payments. Such reduction of competition between distributors through the cumulative use of upfront access payments normally requires the distribution market to be highly concentrated.
- (194) However, the use of upfront access payments may in many cases contribute to an efficient allocation of shelf space for new products. Distributors often have less information than suppliers on the potential for success of new products to be introduced on the market and, as a result, the amount of products to be stocked may be sub-optimal. Upfront access payments may be used to reduce this asymmetry in information between suppliers and distributors by explicitly allowing suppliers to compete for shelf space. The distributor may thus receive a signal of which products are most likely to be successful since a supplier would normally agree to pay an upfront access fee if it estimates a low probability of failure of the product introduction.
- (195) Furthermore, due to the asymmetry in information mentioned in paragraph (194), suppliers may have incentives to free-ride on distributors' promotional efforts in order to introduce sub-optimal products. If a product is not successful, the distributors will pay part of the costs of the product failure. The use of upfront access fees may prevent such free riding by shifting the risk of product failure back to the suppliers, thereby contributing to an optimal rate of product introductions.

2.8. *Category Management Agreements*

- (196) Category management agreements are agreements by which, within a distribution agreement, the distributor entrusts the supplier (the "category captain") with the marketing of a category of products including in general not only the supplier's products, but also the products of its competitors. The category captain may thus have an influence on for instance the product placement and product promotion in the shop and product selection for the shop. Category management agreements are exempted under the Block Exemption Regulation when both the supplier's and buyer's market share does not exceed 30 %. The remainder of this section provides guidance for the assessment of category management agreements in individual cases above the market share threshold.
- (197) While in most cases category management agreements will not be problematic, they may sometimes distort competition between suppliers, and finally result in anticompetitive foreclosure of other suppliers, where the category captain is able, due to its influence over the marketing decisions of the distributor, to limit or disadvantage the distribution of products of competing suppliers. While in most cases the distributor may not have an interest in limiting its choice of products, when

the distributor also sells competing products under its own brand (private labels), the distributor may also have incentives to exclude certain suppliers, in particular intermediate range products. The assessment of such upstream foreclosure effect is made by analogy to the assessment of single branding obligations (in particular paragraphs (121) to (130) by addressing issues like the market coverage of these agreements, the market position of competing suppliers and the possible cumulative use of such agreements.

- (198) In addition, category management agreements may facilitate collusion between distributors when the same supplier serves as a category captain for all or most of the competing distributors on a market and provides these distributors with a common point of reference for their marketing decisions.
- (199) Category management may also facilitate collusion between suppliers through increased opportunities to exchange via retailers sensitive market information, such as for instance information related to future pricing, promotional plans or advertising campaigns¹⁹.
- (200) However, the use of category management agreements may also lead to efficiencies. Category management agreements may allow distributors to have access to the supplier's marketing expertise for a certain group of products and to achieve economies of scale as they ensure that the optimal quantity of products is presented timely and directly on the shelves. As category management is based on customers' habits, category management agreements may lead to higher customer satisfaction as they help to better meet demand expectations. In general, the higher the inter-brand competition and the lower consumers' switching costs, the greater the economic benefits achieved through category management.

2.9 *Tying*

- (201) Tying refers to situations where customers that purchase one product (the tying product) are required also to purchase another distinct product (the tied product) from the same supplier or someone designated by the latter. Tying may constitute an abuse within the meaning of Article 11 of the Law. Tying may also constitute a vertical restraint falling under Article 7 of the Law where it results in a single branding type of obligation (see paragraphs (118) to (139)) for the tied product. Only the latter situation is dealt with in these Guidelines.
- (202) Whether products will be considered as distinct depends on customer demand. Two products are distinct where, in the absence of the tying, a substantial number of customers would purchase or would have purchased the tying product without also buying the tied product from the same supplier, thereby allowing stand-alone production for both the tying and the tied product. Evidence that two products are distinct could include direct evidence that, when given a choice, customers purchase the tying and the tied products separately from different sources of supply, or indirect evidence, such as the presence on the market of undertakings specialised in the manufacture or sale of the tied product without the tying product, or evidence indicating that undertakings with little market power, particularly on competitive markets, tend not to tie or not to bundle such products. For instance, since customers

¹⁹ Direct information exchange between competitors is not covered by the Regulation, see Article 3(5) of that Regulation and paragraphs 25 and 26 of these Guidelines.

want to buy shoes with laces and it is not practicable for distributors to lace new shoes with the laces of their choice, 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.

- (203) Tying may lead to anticompetitive foreclosure effects on the tied market, the tying market, or both at the same time. The foreclosure effect 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 7 paragraph (1) of the Law, the analysis for single branding can be applied. 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. The tying may lead to less competition for customers interested in buying the tied product, but not the tying product. If there is not a sufficient number of customers that will buy the tied product alone to sustain competitors of the supplier on the tied market, the tying can lead to those customers facing higher prices. If the tied product is an important complementary product for customers of the tying product, a reduction of alternative suppliers of the tied product and hence a reduced availability of that product can make entry onto the tying market alone more difficult.
- (204) Tying may also directly lead to prices that are above the competitive level, especially in three situations. Firstly, if the tying and the tied product can be used in variable proportions as inputs to a production process, customers may react to an increase in price for the tying product by increasing their demand for the tied product while decreasing their demand for the tying product. By tying the two products the supplier may seek to avoid this substitution and as a result be able to raise its prices. Secondly, when the tying allows price discrimination according to the use the customer 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.
- (205) Tying is exempted under the Regulation when the market share of the supplier, on both the market of the tied product and the market of the tying product, and the market share of the buyer, on the relevant upstream markets, do not exceed 30 %. It may be combined with other vertical restraints, which are not hardcore restrictions under that Regulation, such as non-compete obligations or quantity forcing in respect of the tying product, or exclusive sourcing. The remainder of this section provides guidance for the assessment of tying in individual cases above the market share threshold.
- (206) The market position of the supplier on the market of the tying product is obviously of central 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.
- (207) The market position of the supplier's competitors on the market of the tying product is important in assessing the supplier's market power. As long as its 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.

- (208) 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.
- (209) Where appreciable anti-competitive effects are established, the question whether the conditions of Article 7 paragraph (3) of the Law are fulfilled arises. 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 fulfil the conditions of Article 7 paragraph (3) of the Law, it must, however, be shown that at least part of these cost reductions are passed on to the consumer, which is normally not the case 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 paragraph (96)(i)). 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 the scope of Article 7 paragraph (1) of the Law. 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 the scope of Article 7 paragraph (1) of the Law, especially where the supplier of the tying product does not derive a direct (financial) benefit from designating the suppliers of the tied product.

2.10 Resale price restrictions

- (210) As explained in section III.3, 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, are treated as a hardcore restriction. Where an agreement includes RPM, that agreement is presumed to restrict competition and thus to fall within Article 7 paragraph (1) of the Law. It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 7 paragraph (3) of the Law, for which reason the block exemption does not apply. However, undertakings have the possibility to plead an efficiency defence under Article 7 paragraph (3) of the Law in an individual case. It is incumbent on the parties to substantiate that likely efficiencies result from including RPM in their agreement and demonstrate that all the conditions of Article 7 paragraph (3) of the Law are fulfilled. It then falls to the Commission to effectively assess the likely negative effects on competition and consumers before deciding whether the conditions of Article 7 paragraph (3) of the Law are fulfilled.

- (211) RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency on the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. Such a negative effect is particularly plausible where the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly, and a significant part of the market is covered by RPM agreements. Second, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, that is, at the distribution level. Strong or well organised distributors may be able to force or convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilise a collusive equilibrium. The resulting loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers. Third, RPM may more generally soften competition between manufacturers and/or between retailers, in particular when manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them. Fourth, the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the direct effect of RPM is a price increase. Fifth, RPM may lower the pressure on the margin of the manufacturer, in particular where the manufacturer has a commitment problem, that is, where it has an interest in lowering the price charged to subsequent distributors. In such a situation, the manufacturer may prefer to agree to RPM, so as to help it to commit not to lower the price for subsequent distributors and to reduce the pressure on its own margin. Sixth, RPM may be implemented by a manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all. Lastly, RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.
- (212) However, RPM may not only restrict competition but may also, in particular where it is supplier driven, lead to efficiencies, which will be assessed under Article 7 paragraph (3) of the Law. Most notably, where a manufacturer introduces a new product, RPM may be helpful during the introductory period of expanding demand to induce distributors to better take into account the manufacturer's interest to promote the product. RPM may provide the distributors with the means to increase sales efforts and if the distributors on this market are under competitive pressure this may induce them to expand overall demand for the product and make the launch of the product a success, also for the benefit of consumers²⁰. Similarly, fixed resale prices, and not just maximum resale prices, may be necessary to organise in a franchise system or similar distribution system applying a uniform distribution format a coordinated short term low price campaign (2 to 6 weeks in most cases) which will also benefit the consumers. In some situations, the extra margin provided by RPM

²⁰ This assumes that it is not practical for the supplier to impose on all buyers by contract effective promotion requirements, see also paragraph 96 point (a).

may allow retailers to provide (additional) pre-sales services, in particular in case of experience or complex products. If enough customers take advantage from such services to make their choice but then purchase at a lower price with retailers that do not provide such services (and hence do not incur these costs), high-service retailers may reduce or eliminate these services that enhance the demand for the supplier's product. RPM may help to prevent such free-riding at the distribution level. The parties will have to convincingly demonstrate that the RPM agreement can be expected to not only provide the means but also the incentive to overcome possible free riding between retailers on these services and that the pre-sales services overall benefit consumers as part of the demonstration that all the conditions of Article 7 paragraph (3) of the Law are fulfilled.

- (213) The practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price is covered by the Regulation when the market share of each of the parties to the agreement does not exceed the 30 % threshold, provided it does not amount to a minimum or fixed sale price as a result of pressure from, or incentives offered by, any of the parties. The remainder of this section provides guidance for the assessment of maximum or recommended prices above the market share threshold and for cases of withdrawal of the block exemption.
- (214) The possible competition risk of maximum and recommended prices is that they will work as a focal point for the resellers and might be followed by most or all of them and/or that maximum or recommended prices may soften competition or facilitate collusion between suppliers.
- (215) An 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.
- (216) Where appreciable anti-competitive effects are established for maximum or recommended resale prices, the question of a possible exemption under Article 7 paragraph (3) of the Law arises. For maximum resale prices, the efficiency described in paragraph (96)(f) (avoiding double marginalisation), may be particularly relevant. A maximum resale price may also help to ensure that the brand in question competes more forcefully with other brands, including own label products, distributed by the same distributor.