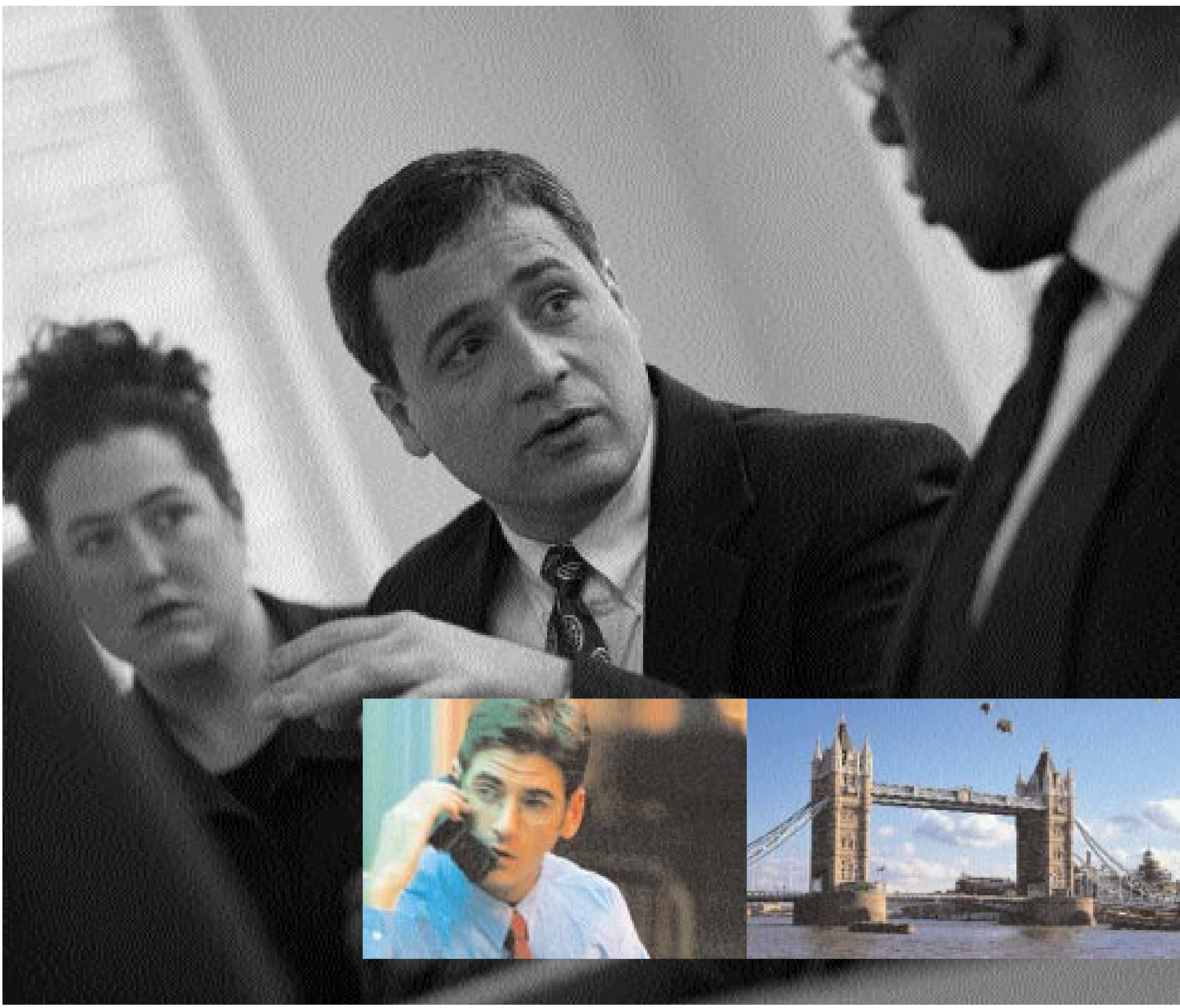
By Billie Munro Audia,

Philipp Tamussino,

and David W. Hull

RECENT DEVELOPMENTS IN EUROPEAN COMPETITION LAW:



Billie Munro Audia, Philipp Tamussino, and David W. Hull, "Recent Developments in European Competition Law: Vertical and Horizontal Agreements," *ACCA Docket* 19, no. 7 (2001): 52–72.

VERTICAL AND HORIZONTAL AGREEMENTS

If your company is doing business in Europe, as corporate counsel you will need to know about European Union ("EU") competition law basics, as well as recent changes to EU competition law that affect a large number of commercial agreements. Specifically, you need to be familiar with the new rules on vertical and horizontal agreements, whether they apply to your company, and how they might affect your commercial contracts and your structuring of deals. This article reviews some EU competition law basics, discusses the new rules and provides you checklists and analytical criteria to help you assess your company's commercial deals in light of EU competition law requirements.

EU competition law has become a standard component of day-to-day legal practice for many corporate counsel handling European-related transactions. It has broad territorial scope, often reaching beyond the borders of the EU and European Economic Area ("EEA") Member States.[1] In addition to having a broad territorial reach, EU competition law may apply to seemingly innocuous contract terms. The consequences of infringing these rules can be serious, including the invalidity of an entire agreement, exposure to fines, and deal postponements or prohibitions. These consequences are all risks that corporate counsel will want to assess and strive to avoid. Therefore, an understanding of EU competition law and the new rules is important.

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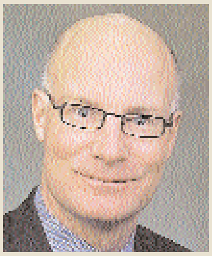

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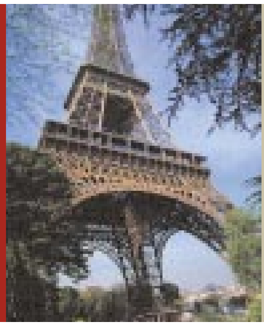
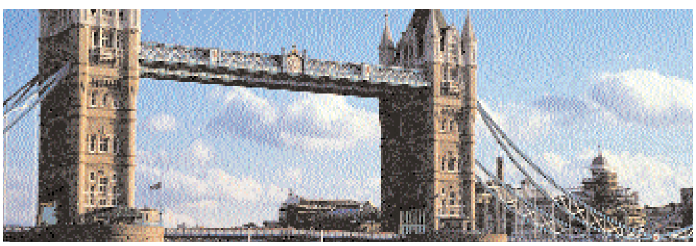


Lately, the European Commission ("EC" or "Commission") has become more aggressive about competition enforcement, honing in on the activities of technology companies. In fact, Mario Monte, the chief EU competition commissioner and an Italian economist, has specifically rejected the idea that the so-called new economy should operate by different competition rules from those under which the old economy had operated. This renewed enforcement emphasis is yet another reason that EU competition law should be prominent on the radar screen of in-house counsel at technology companies.



COMPETITION LAW, THE EUROPEAN TERM FOR ANTITRUST, IS ONE OF THE RELATIVELY FEW AREAS IN WHICH EU LAW APPLIES DIRECTLY, WITH THE EUROPEAN COMMISSION ITSELF EXERCISING ENFORCEMENT POWERS.

Recent reform efforts are changing the effects of European competition law on what companies can do and how they can do it. After providing a brief introduction to some basic features of EU competition law, this article focuses on two areas in which the European Commission has recently introduced major changes. The first concerns "vertical agreements," which are distribution agreements and other kinds of agreements between companies operating at different levels of trade. The second concerns "horizontal agreements," which are agreements between competitors covering various activities from joint research and development ("R&D") to joint sales. Because they cover a broad range of commercial agreements, these changes are of relevance to many U.S. companies doing business in Europe. Note that the recent changes affect not only new agreements, but also existing agreements, as well, with companies having specific deadlines by which existing agreements must be brought into line with the new rules.

Many companies are welcoming the recent changes to EU competition rules on vertical and horizontal agreements. They remove the burden of overly detailed rules, thus giving many companies greater freedom to structure their deals in a way that makes the most commercial sense. For companies with insignificant market share, the analysis of an agreement under the new rules should be relatively easy. For companies with larger market shares, however, the new rules may make things more challenging, because they may require a more in-depth economic analysis of agreements.

Although a comprehensive discussion of the new rules is beyond the scope of this article, we hope to give you a basic understanding of the key changes and some analytical tools to help you assess your next deal in Europe in light of these rules. As we explain below, many deals will fall outside the scope of these rules either because the companies involved are small or because their market shares are small. This article aims at giving you a do-it-yourself kit for determining whether the rules apply to a given deal that your company may be considering or whether your deal may qualify for an exemption under the rules. In cases in which the rules apply, our aim is to give you an understanding of the issues that you will need to consider in order to structure your deals in a way that minimizes your company's exposure under the competition rules.

SOME BASIC CONCEPTS

Articles 81 and 82 of the EC Treaty

Competition law, the European term for antitrust, is one of the relatively few areas in which EU law applies directly, with the European Commission itself exercising enforcement powers. The basic provisions are Articles 81 and 82 (formerly Articles 85 and 86) of the EC Treaty. Article 82 prohibits abuses of dominant positions in a manner somewhat analogous to § 2 of the Sherman Act in the United States regarding monopolization. This article, however, focuses on Article 81, which is analogous to § 1 of the Sherman Act regarding agreements in restraint of trade and deals with restrictive agreements between companies, whether or not the companies occupy a dominant market position.[2]

Article 81 of the EC Treaty has three basic parts. First, Article 81(1) imposes a broad prohibition on agreements "which may affect trade between member states and which have as their object or effect the prevention, restriction, or distortion of competition within the common market." Article 81(2) then provides that any such agreement is automatically void. Finally, Article 81(3) allows the European Commission to exempt agreements from the broad prohibition if those agreements are found to have certain procompetitive effects.

You should be aware that your competitors may file complaints with the Commission concerning your company's European business practices and trigger an investigation to determine whether those practices infringe EU competition law. For example, Sun Microsystems filed a complaint with the Commission concerning Microsoft's efforts to leverage the Windows operating system to gain control over the server market. That complaint was the genesis of the European Commission's well-publicized case against Microsoft in Europe.

Broad Scope of Prohibition

Early on in its enforcement practice, the European Commission pushed for a broad interpretation of the prohibition in Article 81(1), with the consequence that a broad variety of agreements and many seemingly harmless clauses in those agreements are caught. This interpretation is important in day-to-day practice not only because of the possibility of fines, which may reach 10 percent of a company's worldwide turnover ("revenue" in American parlance), but also because offending contract clauses may be deemed void, and when the clause is central to the purpose of the agreement, the entire agreement may be struck down.

This possibility is crucial for in-house counsel because the invalidity of an agreement or a specific clause can be and often is asserted as a defense to enforcement of the contract's terms. Generally, the clauses that are business-critical, such as terms that protect distribution networks or intellectual property rights, are precisely the ones that will be most suspect under the competition rules and thus potentially most vulnerable. Consider a deal in which important technology is being shared in connection with an R&D arrangement and the agreement contains restrictions on the uses to which the technology may be put or how products made using the technology may be sold. Restrictions of this kind may be key to the business rationale for entering the deal. When assessed under the competition rules, however, questions may arise surrounding the enforceability of those restrictive terms, which most likely would undermine the basis for doing the deal. These questions underscore the importance of why counsel to technology companies need to consider—and earlier rather than later—the competition law aspects of European deals.

Broad Territorial Reach

Even an agreement entered into by two U.S. companies may be subject to the EU competition rules if the companies have operations in the EU. Similar to the approach to the extraterritorial application of U.S. antitrust law taken by some American courts, the European Commission and the European courts have taken a broad view of the territorial scope of EU competition law. Articles 81 and 82 of the EC Treaty apply to conduct that "affects trade between [the EU] Member States." From an international perspective, this reach may capture conduct that occurs outside the EU, but has foreseeable and direct effects inside it. After initial hesitation, the EU has embraced the "effects doctrine" in more recent decisions. For example, this doctrine extends EU competition law's reach to agreements concluded outside Europe that affect prices charged within the EU, as well as to agreements that limit imports from non-EU countries into Europe. Thus, the Commission casts a wide net as concerns jurisdiction, requiring in-house counsel to add EU competition to their basic checklist for most commercial deals.

Notifications, Individual Exemptions, and Block Exemptions

The broad interpretation of Article 81(1) led many companies to "notify" their agreements to the European Commission. Notification allows companies to request exemption from the prohibition in Article 81(1) and affords protection from the imposition of fines. In cases in which an agreement is found to have sufficient procompetitive effects (notwithstanding individual provisions that might be deemed restrictive of competition), the Commission may issue an individual exemption under Article 81(3). The flood of notifications, however, has made a detailed review of all agreements impossible. The result has been that most notifications result in the European Commission giving only limited assurances that the deal likely will not infringe Article 81. Such assurances generally take the form of "negative clearances" or "comfort letters."

To limit the need for such notifications, the European Commission has issued a series of "block exemptions" that provide a safe harbor by exempting whole categories of agreements from the application of the competition rules under specified conditions. The block exemptions generally set forth a "black list" of hard-core restrictions that remain prohibited.[3] The Commission's block exemptions have proven very important in the day-to-day practice of EU competition law. This article focuses on the block exemptions for vertical restraints and certain kinds of horizontal agreements recently issued by the Commission, together with interpretative guidelines.

APPRECIABLE EFFECT ON COMPETITION?

Before looking at the new rules on vertical and horizontal agreements, we first examine a threshold requirement for the application of Article 81(1) to an agreement: that it has an "appreciable" effect on competition. If an agreement has no appreciable effect on competition, the prohibition in Article 81(1) does not apply. This requirement has enormous practical effect because it represents by far the most significant "out" from the EU competition rules. If your company is small or has a small share of the market affected by the agreement, it is unlikely that the agreement will be considered to have an appreciable effect on competition, in which case your agreement will fall outside the scope of the EU competition rules.

The European Commission has issued a notice called the *De Minimis* Notice[4] that explains what is meant by "appreciable." To determine whether your agreement has an appreciable effect, you need to answer the questions in the sidebar called "Appreciable Effect under EU Competition Law."

APPRECIABLE EFFECT UNDER EU COMPETITION LAW

To determine whether your agreement has an appreciable effect under EU competition law, answer the following four questions:

1 DO THE PARTIES HAVE SMALL MARKET SHARE?

If the combined market share of the parties does not exceed 5 percent in the case of a horizontal agreement or 10 percent in the case of a vertical agreement, the agreement is considered not to have an appreciable effect on competition and thus is deemed to fall outside of Article 81(1), unless the agreement contains certain hardcore restrictions or the effect of the agreement, when taken together with other similar agreements, is to foreclose competition in the market. You should note that the Commission is currently considering raising these thresholds to 10 percent and 15 percent, respectively.

2 ARE THE COMPANIES SMALL?

As a general rule, agreements between small- and medium-sized companies ("SMEs") do not fall within the scope of the Article 81(1) prohibition. An SME is a company that, taken together with the members of its corporate group, has annual revenue of less than EUR 40 million (about $35 million) or whose balance sheet is below EUR 27 million (that is, whose total assets do not exceed this amount) and that does not employ a worldwide total of more than 250 people.

3 DOES THE AGREEMENT CONTAIN HARDCORE RESTRICTIONS?

Even if the parties' combined market share does not exceed the relevant threshold, an agreement will be caught by the Article 81(1) prohibition if the agreement contains resale price maintenance or market-sharing provisions or purports to confer territorial protection (exclusive or otherwise) on the parties to the agreement or on third parties.

4 DOES THE AGREEMENT HAVE A CUMULATIVE EFFECT?

Even if the parties' combined market share does not exceed the applicable threshold or the parties are SMEs, the agreement may fall within the scope of Article 81(1) if the agreement is part of a network of similar agreements that cumulatively have the effect of foreclosing competition on the market. In judging whether such a cumulative effect exists, it is necessary to examine a range of economic factors, such as the structure of the market and whether the agreement would raise barriers to entry and remove opportunities for new entrants.

THE AIMS OF THE CURRENT REFORMS

Before looking at the new rules on vertical and horizontal agreements, it is useful to understand what the European Commission is trying to achieve by changing the rules. In essence, the Commission has two broad goals:

- **Focus on the Real-World Economic Effect of the Agreement**

The first main goal of the Commission in the current reforms is to focus on the real-world economic effects of agreements. Under the old rules, agreements between companies with a combined market share of 80 percent were treated in much the same way as an agreement between two companies with a combined market share of 15 percent. From the standpoint of antitrust policy, this approach was not satisfactory. Depending on the situation, either it allowed large players in the market to enter into agreements that raised significant antitrust concerns, or it subjected smaller players to an onerous regulatory burden that was unnecessary given their lack of market power.

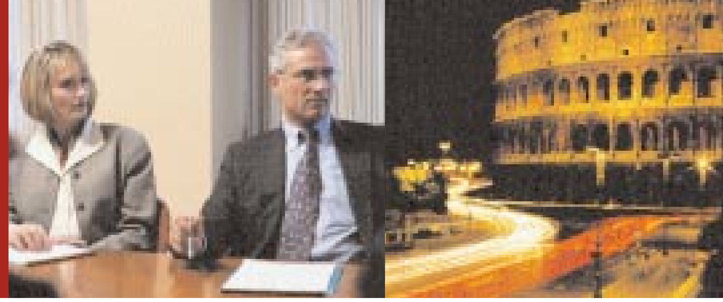
The new rules reflect an attempt to focus on the actual economic effect of agreements in the market rather than a mechanical application of detailed rules. To this end, the European Commission introduced market share thresholds that are designed to be a rough measure of market power and that are used to weed out agreements that are unlikely to pose competition law concerns. Below the applicable threshold, no market power is deemed to exist, and either the agreement is considered to fall outside the scope of Article 81(1) altogether, or it is eligible for exemption under the applicable block exemption regulation. Although market share above the applicable threshold does not lead to a presumption of illegality, high market shares make the safe harbors unavailable, forcing affected companies to make case-by-case analyses of whether a given agreement might violate the law.

As discussed in greater detail below, the applicable market share threshold depends on the type of agreement involved. The thresholds tend to be lower for agreements between competitors, particularly those involving activity in the market, such as production or sales (as opposed to, for instance, R&D), than for vertical agreements, because agreements between competitors are seen as being more likely to generate antitrust concerns. To assist companies in making the required analysis, the Commission has issued two sets of guidelines, one for vertical agreements ("Vertical Restraints Guidelines")[5] and the other for horizontal agreements ("Horizontal Guidelines").[6]

For the practitioner analyzing a given agreement, the new approach both simplifies matters and complicates matters. It simplifies matters in the sense that, if a company's market share is less than the applicable market share threshold, the agreement will either fall outside the scope of the competition rules or be eligible for exemption as long as it does not contain a limited number of so-called "hardcore" restrictions. This new approach gives the parties substantially more flexibility in structuring their agreements in a way that makes the most commercial sense. The new approach can, however, also complicate matters. In each case, the parties' market share needs to be determined. This determination may not be particularly difficult in the case of well-defined markets with readily available statistics, but it may be very difficult in other cases, such as those involving new markets. As antitrust lawyers are painfully aware, market definition is more an art than a science and may involve a complex analysis of how an industry operates.

Although a discussion of all the factors that may be relevant to the definition of the relevant market is beyond the scope of this article,[7] it is worth noting that the definition of the relevant market has two essential elements: (1) the definition of the relevant product market and (2) the definition of the relevant geographic market. In defining the relevant product market, the focus of the analysis is generally on identifying which products customers regard as effective substitutes for those under consideration, taking into account their prices, characteristics, and intended uses. In defining the relevant geographic market, the focus is generally on identifying the geographic area where conditions of competition are the same.

In cases in which the applicable market share threshold is exceeded, matters become even more complicated because the new approach in effect requires a detailed evaluation of the agreement to determine whether it would restrict competition within the meaning of Article 81(1) and, if so, whether it would qualify for an exemption under



Article 81(3). This complication requires the parties to determine the economic effect of certain restrictions by assessing how they would operate in the specific product market involved. The key elements of this analysis are discussed in greater detail below.

As a practical matter, the new approach basically means that companies with small market shares are given much more freedom to structure their deals and will not need to undertake a detailed antitrust review of their transactions. In contrast, companies with large market shares may have to devote considerable time and resources to evaluating their deals from an antitrust perspective.

AS A PRACTICAL MATTER, THE NEW APPROACH BASICALLY MEANS THAT COMPANIES WITH SMALL MARKET SHARES ARE GIVEN MUCH MORE FREEDOM TO STRUCTURE THEIR DEALS AND WILL NOT NEED TO UNDERTAKE A DETAILED ANTITRUST REVIEW OF THEIR TRANSACTIONS.

- **Move Away from Excessive Detail**

The European Commission's second main goal in the current reforms is to move away from excessive detail in its regulation of vertical and horizontal agreements. Under the old approach, a block exemption regulation would list all the clauses that were permitted, as well as those that were prohibited, so that each regulation became a sort of form contract that placed severe restraints on the parties in structuring their deals. The new regulations remove this straightjacket by listing only the prohibited clauses. Not only does this change make the regulations much easier to understand and apply, but also it gives counsel much more flexibility in structuring agreements because, as a general rule, a clause is permissible as long it is not expressly prohibited.

VERTICAL AGREEMENTS

Key Features

The new rules on vertical agreements are contained in a block exemption regulation, Regulation 2790/1999 ("Vertical Restraints Block Exemption").[8] In addition, the accompanying Vertical Restraints Guidelines offer guidance in applying the regulation and in analyzing agreements that fall outside the scope of the regulation. The Vertical Restraints Block Exemption became effective June 1, 2000, and gives companies until the end of 2001 to bring existing agreements into line with the new regime.

Broad Scope

The Vertical Restraints Block Exemption replaced a series of separate exemptions (for exclusive distribution, exclusive purchasing, and franchising) with a unified block exemption framework. It also broadened the scope of the existing exemptions to include the distribution of services, as well as goods, to cover multiparty agreements, and to apply to both intermediate and final goods and services.

No Precautionary Notification

The new regulation also introduced a major procedural change with which many in-house lawyers are pleased. In the past, if an agreement did not qualify for a block exemption, the parties often notified the agreement to the European Commission to request an individual exemption under Article 81(3). One of the advantages of making such a notification was that it protected the parties against fines as of the date of notification. Under the new system, an agreement may benefit from this immunity from fines as of the date the agreement takes effect, even if notification occurs later. As a practical matter, this change means that there is no longer any need to make a precautionary notification to the Commission in order to receive immunity from fines. If a question later arises as to whether the agreement restricts competition under Article 81(1) or whether it is eligible for exemption under Article 81(3), the parties may then notify the agreement to the Commission, and the Commission may issue an exemption having retroactive effect as of the date the agreement took effect. If the Commission does not issue an exemption, it is highly unlikely that the parties would be subject to a fine as long as they are able to make good faith arguments as to why they believed the agreement was eligible for exemption.

The main purpose of this change was to reduce the number of notifications and thus allow the European Commission to devote its scarce resources to more important enforcement priorities, such as cartels. Although companies may still notify vertical agreements, the Commission has discouraged such notifications by making it clear that they will not receive priority review. In practical terms, it could be months or even years before the Commission gets around to looking at a notified agreement. This change is consistent with the broad procedural reforms currently being advanced by the Commission aimed at decentralizing the enforcement of the competition rules by putting an end to the Commission's exclusive right to grant exemptions under Article 81(3).[9] Dan Fitz, general counsel for Cable and Wireless plc, has observed, "The new vertical restraints rules are to be welcomed because they relieve companies of the burden of notifying their agreements, thus saving them from having to pay unnecessary legal fees."

An Example

To take a concrete example of how the new system is intended to work, suppose that the parties to a distribution agreement determine that they are not eligible for an automatic exemption under the Vertical Restraints Block Exemption because the supplier's market share exceeds the 30 percent threshold. In such a case, the parties must undertake their own analysis of the distribution agreement to determine whether it restricts competition within the meaning of Article 81(1) and, if so, to ensure that it is drafted in such a way that it would be eligible for exemption under Article 81(3). The broad outlines of this analysis are discussed below. Suppose that a dispute later arises between the parties in a national court concerning the validity of a provision in the agreement. For example, the distributor may argue that the provision is unenforceable because it restricts competition within the meaning of Article 81(1) and has not received an exemption under Article 81(3). At that point, the supplier may ask the national court to stay the proceedings and notify the agreement to the European Commission. If the Commission then determines that the agreement qualifies for an exemption under Article 81(3), the exemption will have retroactive effect back to the date of the agreement's effec-

Checklist for Reviewing Vertical Agreements under EU Competition Law

Use this checklist to analyze your current and future vertical agreements to make sure that they do not run afoul of EU competition law:

- ❏ Does the agreement have an appreciable effect on competition?
- ❏ Does the agreement fall within the Article 81(1) prohibition?
- ❏ Is the agreement eligible for exemption under the new Vertical Restraints Block Exemption?
- ❏ Is the agreement the type of vertical agreement covered by the Vertical Restraints Block Exemption?
- ❏ Is the agreement between competitors such that it would be subject to the rules on horizontal agreements?
- ❏ Does the supplier's market share exceed 30 percent?
- ❏ Does the agreement contain hardcore restrictions, such as resale price maintenance provisions or territorial restrictions?
- ❏ Does the agreement contain certain other restrictions, such as noncompete obligations that extend for more than five years?
- ❏ Does the agreement when considered with other similar agreements have the effect of foreclosing the market to competition?
- ❏ Is the agreement eligible for individual exemption?

From this point on . . .
Explore information related to this topic.

ONLINE:

- Most legislation and cases are available on the website of the European Commission's Competition Directorate at www.europa.eu.int/comm./competition.
- ACCA's Virtual Library contains about 50 items on European competition law at www.acca.com/vl.

ON PAPER:

- *Competition Manual*, PLC Publications, a very practical manual designed for in-house lawyers.
- *Butterworth's Competition Law*, a comprehensive loose-leaf treatise.
- Ritter, Braun, and Rawlinson, *European Competition Law: A Practitioner's Guide*, Kluwer Law International (2000), a good one-volume treatise.

tive date, with the result that the national court should throw out the distributor's competition law defense. If your deal does not qualify for an exemption in this case, you run the risk of the national court declaring void the questionable provision or the entire agreement.

Issues Checklist for Vertical Restraints

This section describes the issues that you will need to examine when analyzing a vertical agreement under the Vertical Restraints Block Exemption. This process has essentially three steps. First, ask whether the agreement restricts competition within the meaning of Article 81(1). If not, no further review is required. Second, if the agreement may be deemed to restrict competition, ask whether the agreement is eligible for exemption under the Vertical Restraints Block Exemption. Third, if not, the agreement must then be analyzed using the principles set forth in the Vertical Restraints Guidelines to determine whether it would be eligible for an individual exemption under Article 81(3). These analytical steps are explained in more detail below and are summarized in the sidebar "Checklist for Reviewing Vertical Agreements under EU Competition Law" on page 61.

Does the Agreement Fall within Article 81(1)?

The first issue is whether the agreement restricts competition within the meaning of Article 81(1). If the agreement in question has an "appreciable" effect on competition—that is, if it is not saved by the European Commission's *De Minimis* Notice as described above—you will need to consider whether the agreement concerns a new market or a new territory and whether it might qualify as an agency agreement.

- *Does the Agreement Concern a New Product or a New Territory?*

Even if the market share of the parties exceeds the 10 percent threshold set forth in the *De Minimis* Notice, the agreement will generally fall outside the scope of Article 81(1) if the product is new or if an existing product is being sold for the first time in a different geographic market. According to the Vertical Restraints Guidelines, for the first two years after the product has been put on the market, the Commission will treat the agreement as falling outside the scope of Article 81(1), regardless of the parties' market shares.

- *Is the Agreement an Agency Agreement?*

Genuine agency agreements fall outside the scope of Article 81(1). Whether an agreement is an agency agreement rather than a distribution agreement depends primarily on the degree of financial or commercial risk borne by the agent. If the agent bears no or only insignificant risks in relation to the contracts concluded on behalf of the principal and in relation to investments related to the agreement, it is likely that the agent will be considered a genuine agent. Although the degree of risk borne by the parties must be assessed on a case-by-case basis, the Commission considers that an agreement is an agency agreement in a case in which the agent does not own the contract goods and does not incur any cost or risk relating to (1) market specific investments, (2) the supply/purchase of the contract goods, (3) sales promotion, (4) maintaining a stock of the contract goods, (5) after-sales service, (6) product liability, and (7) customers' nonperformance of the contract. Finally, even genuine agency agreements may fall within the scope of Article 81(1) in cases in which the agent is prevented from acting as the agent of other competitors and this limitation results in a foreclosure of competition on the relevant market and in which the same agent is used to facilitate collusion on the market, such as cases in which several competitors use the same agent.

Is the Agreement Eligible for Exemption under the Vertical Restraints Block Exemption?

If you determine that the agreement falls within the scope of Article 81(1), you will then need to check whether it is covered by the safe harbor under the Vertical Restraints Block Exemption.

• *Is the Agreement a Vertical Agreement?*

The Vertical Restraints Block Exemption is directed at vertical agreements for the purchase or sale of goods or services. Although it also covers vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights, you should note that true technology transfer agreements are covered by a separate block exemption.[10] Moreover, the Vertical Restraints Block Exemption does not apply to motor vehicle distribution agreements, which are also covered by a separate block exemption regulation.[11]

• *Is the Agreement between Competitors?*

The Vertical Restraints Block Exemption does not cover vertical agreements that are concluded on a reciprocal basis between competitors. This exclusion may be very broad because it includes both actual and potential competitors, with the latter being defined as companies that would be able and likely to enter the market within one year.

Agreements between competitors may, however, benefit from the block exemption if they are nonrecip-

rocal. A distribution agreement is deemed nonreciprocal if, for example, Company A becomes a distributor of Company B without Company B receiving any reciprocal rights from Company A. Nonreciprocal agreements of this kind between competitors may benefit from the Vertical Restraints Block Exemption if (1) the buyer's total annual worldwide revenue does not exceed EUR 100 million, (2) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor that does not manufacture competing goods, or (3) the supplier is a provider of services at several levels of trade and the buyer does not provide services at the level of trade at which it purchases the services.

• *Is the Supplier's Market Share Greater than 30 Percent?*

The Vertical Restraints Block Exemption applies only if the supplier's market share does not exceed 30 percent of the relevant market in which he sells.[12] This calculation, of course, requires a definition of the relevant product and geographic markets. In some cases, the determination of the relevant market may be relatively easy, such as, for example, in cases in which the markets have been defined in European Commission precedent and there are published industry statistics. In other cases, determining market share can be difficult, making it necessary to consult specialized counsel and perhaps an economist. John DeGregorio, European counsel for consumer goods manufacturer Kimberly-Clark Corporation, has noted,

> With the introduction of market share thresholds to the block exemption analysis, it's more important than ever for in-house counsel to know how the Commission and European courts may define the "relevant market" for the goods that your company manufactures and sells—and to be comfortable with the definition your company adopts.

• *Does the Agreement Contain Hardcore Restrictions?*

The Vertical Restraints Block Exemption lists a number of so-called "hardcore" restrictions that, if included in the agreement, prevent the safe harbor from applying. Unlike the restrictions discussed in the following section, hardcore restrictions are not severable, which means that, if any of them is included in an agreement, the entire agreement loses the benefit of the Vertical Restraints Block Exemption. These restrictions are as follows:

- **Resale Price Maintenance.** Restrictions placed on the buyer's ability to determine its sale price are generally prohibited. The seller may, however, impose a maximum price and issue pricing recommendations, provided that no pressure is placed on the buyer to comply with such recommendations by, for example, making discounts contingent on the buyer's complying with a pricing recommendation.
- **Territorial or Customer Restrictions.** Any restriction placed on the territories into which, or the customers to whom, the buyer may sell are prohibited, with the following exceptions:
  - An agreement may restrict active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer. Moreover, no limitation may be placed on passive sales. "Active" sales means actively approaching customers, while "passive" sales means responding to unsolicited requests from individual customers.
  - Restrictions placed on a wholesaler's ability to sell to end users are permissible.
  - An agreement may place restrictions on the members of a so-called "selective" distribution system that prevent them from selling to unauthorized distributors. Under a selective distribution system, the supplier selects a limited number of distributors on the basis of specified criteria, and these distributors are prohibited from selling to unauthorized distributors.
  - In cases in which a buyer is supplied components for the purposes of his own manufacturing/assembly operations, the agreement may limit the buyer's ability to sell components to customers who would use the components to manufacture goods competing with those manufactured by the supplier.
- **Sales to End Users by Retailers in a Selective Distribution System.** No restriction may be placed on active or passive sales to end users by retailers who belong to a selective distribution system. In a distribution system of this kind, no

restrictions may be placed on a retailer's ability to sell outside of his territory or on the customers to whom he may sell.

- **Sales among Members of a Selective Distribution System.** An agreement may not limit sales among members of a selective distribution network, even if one is a wholesaler and the other a retailer. This prohibition means that the distributors may not be required to purchase products only from the supplier; distributors must be able to purchase from other authorized distributors.
- **Spare Parts.** In the context of an agreement between a components supplier and a buyer who uses these components in his own manufacturing operations, no restriction may be placed on the supplier's ability to sell these components to end users, to independent repairers, or to other service providers for use as spare parts.

• *Does the Agreement Contain Other Restrictions?*

In addition to the hardcore restrictions noted above, the Vertical Restraints Block Exemption lists three other types of contract clauses that are not eligible for exemption. Unlike hardcore restrictions, these additional restrictions are severable, which means that their inclusion does not cause the entire agreement to lose the benefit of the block exemption, but only that portion of the agreement containing the offending restriction. These three additional restrictions are as follows:

- **Noncompete Obligations Exceeding Five Years.** Any direct or indirect noncompete obligation that is indefinite in duration or that exceeds five years is prohibited. Any noncompete obligation that is automatically renewable falls within this prohibition. As a result, a noncompete obligation included in a distribution agreement concluded for an initial period of one year but with automatic renewal is void, unless the agreement expressly states that the noncompete clause will not be renewed after five years. Note that exclusive purchase obligations under which the buyer must buy more than 80 percent of the buyer's total purchases of the contract goods or services from a given source are considered to be noncompete obligations under the Vertical Restraints Block Exemption. The five-year limit does not apply in cases in which the buyer sells the goods or services from premises owned or leased by the supplier, which is often the case with gas stations and pubs, for example. In these cases, the noncompete obligation may apply for as long as the buyer occupies the premises.
- **Postterm Noncompete Obligation.** Any postterm noncompete obligation is prohibited, unless it is (1) limited to the land and premises from which the buyer has operated during the contract period (thus allowing circumvention by selling competing goods from another outlet), (2) necessary to protect the know-how transmitted by the buyer during the agreement, and (3) limited to one year after the termination of the contract. Restrictions on the use and disclosure of know-how that has not fallen into the public domain, however, may be unlimited in time.
- **Noncompete Obligations on Members of Selective Distribution Systems.** Direct or indirect restrictions on the ability of the members of a selective distribution system to sell the goods or services of particular competing suppliers are prohibited. Note, however, that this prohibition applies only when the restriction refers to the goods of a particular competitor. As a result, a total ban of sales of competing goods is permitted. The aim of this provision is to prevent collective boycotts that would prevent a particular competitor from entering the market.

• *Are There Parallel Networks of Similar Agreements?*

Even in cases in which the 30 percent market share is not exceeded, the European Commission may withdraw the benefit of the Vertical Restraints Block Exemption if the Commission believes that a particular agreement has effects that are not compatible with the conditions for exemption laid down in Article 81(3). This situation could happen, for example, in cases in which there are parallel networks of similar agreements that limit access to or competition in a particular market. For a given agreement to be subject to this withdrawal mechanism, the Commission must be able to demonstrate that that particular agreement's contribution to the cumulative effect of all of the agreements is not insignificant.

Is the Agreement Eligible for Individual Exemption?

As discussed, if the supplier's market share exceeds 30 percent, the agreement will not be eligible for

Checklist for Reviewing Horizontal Agreements under EU Competition Law

Use this checklist to analyze your current and future horizontal agreements to make sure that they do not run afoul of EU competition law:

❏ **Does the agreement have an appreciable effect on competition?**

If your company is small or the parties' combined market share is low, it is unlikely that the agreement will be considered to have an appreciable effect on competition, in which case your agreement will fall outside the scope of the EU competition rules.

❏ **Do the new rules on horizontal agreements apply?**

If the parties are not competitors, the agreement will most likely be viewed as a "vertical" agreement subject to the vertical rules described in the accompanying article. In addition, if the agreement involves the creation of a stand-alone joint venture company, it may be covered by the EU merger rules, in which case a notification to the European Commission may be needed. Note also that separate, specific rules apply to certain industry sectors, such as insurance, transportation, and agriculture.

❏ **Does the agreement fall within the Article 81(1) prohibition?**

For certain kinds of agreements, the new rules provide market share thresholds under which an agreement will not, or at least will be unlikely to, violate the Article 81(1) prohibition. The thresholds are tied to the parties' combined market share and vary according to the kind of agreement concerned: 25 percent for R&D agreements; 20 percent for production agreements; and 15 percent for commercialization and joint purchasing agreements.

❏ **Is the agreement eligible under one of the new horizontal block exemptions?**

If your agreement is not saved under the three steps above, it may benefit from the safe harbor under the Specialization Block Exemption or the R&D Block Exemption. You will need to review the block exemptions carefully, in particular because they contain blacklists of provisions that make the exemptions unavailable.

❏ **Is the agreement eligible for individual exemption?**

If your agreement raises concerns under EU competition law and is not saved by one of the new horizontal block exemptions, you may need to consider whether it would be eligible for individual exemption. Much as is the case with vertical agreements, examining an agreement's eligibility for individual exemption generally requires careful consideration of a complex series of factors, and you would be well advised to consult specialized EU competition counsel.

automatic exemption under the Vertical Restraints Block Exemption, and the parties will then have to make their own assessment of the distribution agreement under Article 81. To assist the parties in this exercise, the Commission published the Vertical Restraints Guidelines, in which it describes both broad analytical principles and how these principles apply to specific kinds of restrictions.

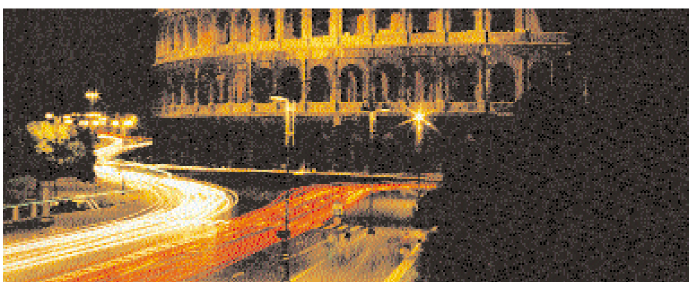
Although a detailed discussion of these principles is beyond the scope of this article, the main factors that the Commission will take into account in its analysis of a given restriction under Article 81(1) include the following:

- **Supplier's position on the market.** The higher the market share, the greater the concern.
- **Position of competitors on the market.** In cases in which there are strong competitors, the risk of market foreclosure is less strong.
- **Entry barriers to the market.** Substantial barriers to entry will heighten competition law concerns.
- **Maturity of the market.** Vertical agreements are more likely to give rise to competition concerns in mature markets than in markets that are rapidly developing.
- **Level of trade.** Vertical agreements for intermediate goods and services are considered to be less likely to give rise to competition concerns than agreements for goods and services in finished form.
- **Nature of the product.** Agreements involving products that are not homogeneous, are expensive, and are purchased only occasionally are more likely to give rise to competition concerns.

If it is determined that a vertical agreement restricts competition within the meaning of Article 81(1), the next step is to determine whether the agreement might be eligible for exemption under Article 81(3). This determination requires the parties to demonstrate that the agreement accomplishes all of the following goals:

- Contributes to improving distribution or to promoting technical or economic progress.
- Allows consumers a fair share of these benefits.
- Imposes on the companies concerned only restrictions that are indispensable to the attainment of these benefits.
- Does not afford such companies the possibility of eliminating competition in respect of a substantial part of the products in question.

In cases in which a vertical agreement is not clearly covered by the Vertical Restraints Block Exemption, the determination of whether it falls within the scope of Article 81(1) and, if so, whether it is eligible for individual exemption under Article 81(3) generally is a complex exercise. Accordingly, especially in cases in which an agreement exceeds the 30 percent market share threshold, you would be well advised to consult specialized EU competition counsel.



IF THE AGREEMENT INVOLVES THE ESTABLISHMENT OF A JOINT VENTURE THAT WILL OPERATE AS A STAND-ALONE COMPANY, IT MAY WELL BE COVERED BY THE EU MERGER RULES RATHER THAN THE RULES ON HORIZONTAL AGREEMENTS.

HORIZONTAL COOPERATION AGREEMENTS

Overview

In addition to the reform of its rules on vertical restraints, the EU has recently changed the rules governing cooperation agreements between competitors, so-called "horizontal" agreements. The rules are set forth in two new block exemptions, Regulation 2658/2000 on specialization agreements ("Specialization Block Exemption")[13] and Regulation 2659/2000 on R&D agreements ("R&D Block Exemption"),[14] and in the new Horizontal Guidelines, mentioned above. These new rules will be particularly important for the review of partnering and "co-opetition" agreements that are becoming increasingly common for technology companies.

The new block exemptions try to do for horizontal agreements what the rules described above have done for vertical agreements: introduce greater focus on the real-world effect of a specific agreement, avoid extensive lists of permitted and blacklisted contract clauses, and give parties greater flexibility, especially in cases in which the market shares in question are relatively low. The new block exemption regulations went into effect on January 1, 2001, and they give companies until June 30, 2002, to bring existing agreements into compliance with the new rules.

The European Commission issued the Horizontal Guidelines to provide guidance both for the review of specialization and R&D agreements that do not clearly fall within the safe harbors under the new regulations, as well as for other kinds of horizontal agreements. The Horizontal Guidelines specifically address the following areas:

- **Research and development agreements.** Ranges from R&D outsourcing to true cooperation agreements on the research, development, and marketing of new products.
- **Production agreements.** Includes joint production arrangements, unilateral or reciprocal specialization agreements in which companies combine commitments to cease or begin production of certain products with purchasing obligations, and subcontracting arrangements.
- **Joint purchasing agreements.** Includes arrangements whereby purchasing is conducted through an association.
- **Commercialization agreements.** Involves cooperation among competitors in selling, distributing, or promoting their products.
- **Standardization agreements.** Defines technical or quality requirements for present or future products.
- **Environmental agreements.** Includes those in which parties undertake to achieve certain kinds of pollution abatement or other environmental objectives.

The Analytical Framework

Again, a detailed review of how various kinds of horizontal cooperation agreements are treated under the new rules is beyond the scope of this article. Nevertheless, it is worth going through the main steps in the analysis, which are basically the same in the case of each of the various kinds of horizontal agreements. These analytical steps are explained in more detail below and are summarized in the sidebar “Checklist for Reviewing Horizontal Agreements under EU Competition Law” on page 66.

Do the New Rules Apply?

The first step in the analysis is determining whether the agreement is a horizontal cooperation agreement to which the rules we are concerned with here apply. To make this determination, you will need to consider the following questions:

ONCE YOU HAVE DETERMINED THE MARKET SHARE OF THE PARTIES, YOU WILL NEED TO CHECK WHETHER THE COMBINED SHARE OF THE PARTIES EXCEEDS THE MARKET SHARE THRESHOLD FOR THE SPECIFIC TYPE OF AGREEMENT INVOLVED.

• *Is the Agreement between Competitors?*

If the agreement is not between competitors—that is, companies operating at the same level of trade—it is not a horizontal agreement. Rather, it would be a vertical agreement reviewable under the rules discussed above. Of course, it is not always as easy as it sounds to distinguish between the two because the new rules define “competitors” to include potential competitors, as well as actual competitors. If you enter into an agreement with a company that is not in the same market, that company could still be considered a competitor if it operates in a closely related market and could easily enter your market.

• *Is the Agreement a Joint Venture Covered by the Merger Rules?*

If the agreement involves the establishment of a joint venture that will operate as a stand-alone company, it may well be covered by the EU merger rules rather than the rules on horizontal agreements. If you believe that your deal may fall into this category, you should check with EU competition counsel. If it turns out that the merger rules apply, your deal may need to be notified to the European Commission for clearance.

• *Are There Sector-Specific Rules that Apply?*

You should always consider whether sector-specific rules may govern the agreement. The EU has adopted specific rules that govern certain kinds of horizontal agreements in certain sectors, such as agriculture, transportation, and insurance.

Does the Agreement Fall within Article 81(1)?

Once you have determined that the rules on horizontal agreements are relevant, the next step in the analysis is to determine whether the agreement falls within the scope of Article 81. In this regard, the following questions are relevant:

• **Does the Agreement Have an Appreciable Effect on Competition?**

As is the case with vertical agreements, you should first determine whether the agreement would have an appreciable effect on competition (see the sidebar “Appreciable Effect under EU Competition Law” on page 57). If parties are small or their market shares are small, the agreement may fall outside the scope of the EU competition rules altogether.

• *What Kind of Agreement Is Involved?*

You must determine the kind of agreement involved for two reasons. First, certain kinds of horizontal cooperation agreements, such as those for cooperation on pure R&D projects, generally are viewed as not raising competition issues. The Horizontal Guidelines describe certain kinds of agreements that typically do not fall within the scope of Article 81(1): cooperation agreements between noncompetitors, cooperation on projects that companies cannot carry out independently, and agreements covering areas that do notinfluence price, output, or other parameters of competition.

Second, properly classifying the agreement in question enables you to determine which of the horizontal block exemptions or which section of the Horizontal Guidelines applies. Perhaps most importantly, different market share thresholds apply to different kinds of agreements. In cases in which an agreement involves more than one area, you will need to find the agreement's "center of gravity" in order to determine which section of the Horizontal Guidelines applies. Of course, although the Horizontal Guidelines offer some help on this issue, it remains one that may prove difficult in practice.

• *What Is the Parties' Market Share?*

You may have already determined the parties' market share in connection with your assessment of whether the agreement has an appreciable effect on competition. You should note that the Horizontal Guidelines offer some help in certain specific situations in which market definition may be difficult, such as in cases in which an R&D agreement is directed toward the development of a new product for which no "market" currently exists.

Once you have determined the market share of the parties, you will need to check whether the combined share of the parties exceeds the market share threshold for the specific type of agreement involved. The new block exemptions set forth a 25 percent threshold for R&D agreements and a 20 percent threshold for production agreements. In addition, the Horizontal Guidelines explain that joint purchasing agreements and commercialization agreements are unlikely to raise concerns in cases in which the parties' market share lies below 15 percent.

• **What Is the Structure of the Market?**

If the combined market share of the parties exceeds the relevant threshold, it is likely that the agreement will be deemed to fall within the scope of Article 81(1). The Horizontal Guidelines indicate, however, that other factors may be taken into account, which means that there may be cases in which the agreement will not fall within the scope of Article 81(1) even if the relevant market share threshold is exceeded if it can be shown that the market is competitive. Although the specific factors that should be taken into account and the weight attributed to them will vary according to the kind of horizontal agreement involved, the following factors are typically included in the analysis: the structure of the market, entry barriers and the likelihood of new entrants to the market, the countervailing power of buyers and suppliers, and the maturity of the market.

Does One of the New Block Exemptions Apply?

If your agreement is an R&D agreement or a specialization agreement, you should make sure that it complies with the applicable block exemption. Note in particular that both of the block exemptions contain blacklists of prohibited provisions that make the exemptions unavailable, including the following:

- **Specialization Block Exemption.** Will not apply to agreements containing provisions that fix prices for sales to third parties, limit output or sales, or allocate markets or customers. Certain provisions, however, on the agreed amount of product in specialization agreements and certain agreements on volume, capacity, and pricing for production joint ventures are permissible.
- **R&D Block Exemption.** Contains a longer list of prohibited provisions, including limitations on output and sales, agreements on pricing for sales to third parties, restrictions on research activities outside the scope of the joint R&D effort, no-challenge clauses in respect of intellectual property ("IP") rights relevant to the R&D effort, and certain other restrictions on sales or licensing activities. Note that restrictions on the customers that the parties to the agreement may serve are prohibited only after seven years from the time the contract products first appear on the market.

Is the Agreement Eligible for Exemption under Article 81(3)?

If the agreement falls within the scope of Article 81(1) and is not covered by the safe harbor under one of the new block exemption regulations, you will need to determine whether the agreement may be eligible for individual exemption under Article 81(3). As noted above, this determination generally requires a showing that the agreement contributes to improving distribution or to promoting technical or economic progress, allows consumers a fair share of these benefits, imposes only restrictions that are indispensable to the attainment of these benefits, and does not afford a possibility of eliminating competition in respect of a substantial part of the products in question. The Horizontal Guidelines provide further guidance on how the required analysis is to be conducted with respect to specific kinds of horizontal agreements. As a practical matter, however, the analysis frequently is quite complicated, and the involvement of specialized EU competition counsel is advisable.

CONCLUSION

Counsel doing deals in Europe ignore EU competition law at their peril. Because of the broad territorial and substantive scope of the EU competition rules, they catch agreements of all shapes and sizes. Failure to comply with these rules may result in an agreement being held unenforceable and, in some cases, fines being imposed on the parties.

In addition to providing a basic introduction to some of the EU competition rules, this article has given an overview of recent changes to the rules on vertical and horizontal agreements. These rules have enormous practical effect because they apply to a wide range of commercial agreements. The gist of the recent changes is to simplify the rules so that companies have more freedom to structure their deals in a way that makes the most commercial sense.

At a practical level, the new rules will make life easier for the vast majority of companies. Only large companies or companies with significant market shares will need to undertake an indepth analysis of their agreements from a competition law angle. All other companies will need to worry only about complying with minimum requirements. This article has attempted to provide the analytical tools to allow counsel to determine whether an indepth analysis is required and to identify clauses in agreements that could give rise to competition concerns.

Although the new rules will make life easier for most, they could mean that deals involving large companies with significant market shares will receive more scrutiny than in the past. Because these companies are no longer eligible for automatic exemption from the competition rules, they will need to undertake their own competition law review of their agreements.

NOTES

1. The 15 EU Member States are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom. By virtue of the European Economic Area ("EEA") Agreement, the EU competition rules also cover Norway, Liechtenstein, and Iceland. These countries, plus the 15 EU Member States, constitute the EEA.
2. One other well-publicized area of EU competition law is the control of mergers and other concentrations under the EU Merger Regulation 4064/89 (as amended).
3. Note that the European Commission has made a large number of relevant materials, including all of the materials cited in this article, available online at http://europa.eu.int/comm/competition/index_en.html.
4. Notice on Agreements of Minor Importance, OJ (1997) C 372/4. The Commission is currently in the process of revising this notice. The main effect of this revision is likely to be to bring more agreements within the scope of this notice.
5. Commission Notice, Guidelines on Vertical Restraints, OJ (2000) C 291/1.
6. Commission Notice, Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements, OJ (2001) C 3/2.
7. The Commission has issued a notice that gives guidance on the definition of the relevant market. *See* Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law, OJ (1997) C372/3.
8. Commission Regulation 2790/1999 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, OJ (1999) L 336/21.
9. These reforms are described in the Commission's Proposal for a Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty and amending Regulations (EEC) No 4056/86 and (EEC) No 3975/87, COM (2000) 582 final (September 27, 2000).
10. Commission Regulation 240/96 on the Application of Article 85(3) to Certain Categories of Technology Transfer Agreements, OJ (1996) L 31/2.
11. Commission Regulation 1475/1995 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements, OJ (1995) L 145/25.
12. The Vertical Restraints Block Exemption still applies if the 30 percent threshold is exceeded by no more than 5 percent during two consecutive years or in cases in which it is exceeded by no more than 35 percent during any one year.
13. Commission Regulation 2658/2000 on the Application of Article 81(3) of the Treaty to Categories of Specialisation Agreements, OJ (2000) L 304/3.
14. Commission Regulation 2659/2000 on the Application of Article 81(3) of the Treaty to Categories of Research and Development Agreements, OJ (2000) 304/7.