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Distributorship Agreements in the EU

technicalguide

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Contents

This booklet has been prepared for general information. It is not an exhaustive statement of the law. For advice in applying this general information to your specific circumstances, and details of the specialist e-commerce law services Fox Williams provides, please contact Stephen Sidkin or Nigel Miller at Fox Williams.

1. Introduction

This booklet summarizes the main points to consider when negotiating a distributorship agreement under EU law. Close attention must be given to European competition rules when considering an arrangement that covers all or any part of the common market.

This booklet is not a substitute for specialist legal advice on a specific transaction or on the drafting of the agreement itself.

2. Article 81(1)

Article 81(1) of the Treaty of Rome is one of the principal sources of EC competition law. It prohibits agreements and concerted practices 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.

Specifically, Article 81(1) relates to agreements and practices which:

- directly or indirectly fix purchase or selling prices or any trading conditions;
- limit or control production, markets, technical development or investment;
- share markets or sources of supply;
- apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; or
- make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Generally, an exclusive distributorship agreement (where the manufacturer undertakes to supply goods for resale within a particular geographical area only to the distributor) will be subject to the prohibition in Article 81(1).

3. Infringement of Article 85(1)

If an agreement or practice infringes Article 81(1), then:

- by virtue of Article 81(2), it is automatically void and unenforceable;

- the European Commission may impose fines upon each of the parties;
- third parties may be able to sue for damages or obtain an injunction where Article 81(1) has been infringed.

4. Agreements of “minor importance”

Agreements whose effect on trade between member states or on competition are negligible are not regarded as falling under the ban contained in Article 85(1). Only agreements which have an “appreciable impact” on market conditions are prohibited.

In its Notice on Agreements of Minor Importance of 3 September 1986, the Commission defined “appreciable” by indicating that agreements do not fall under the ban contained in Article 81(1) if:

- the goods or services which are the subject of the agreement do not represent more than 5 per cent. of the total market for such goods or services in the area of the common market affected by the agreement; or
- 10 per cent. of the total market in relation to a vertical agreement.

In these circumstances the agreements do not have to be notified to the Commission. This definition of “appreciable” is not, however, an absolute yardstick. Agreements which fall within the limits may still infringe Article 81(1) and agreements which fall outside the limits will not always infringe Article 81(1) if they still have a negligible effect on trade between member states or on competition.

However, the Commission has drawn up a blacklist of the types of agreement which are contrary to EU competition law and so must be notified to the Commission. This includes

- Horizontal agreements which set prices or quotas or fix market shares or sources of supply.
- Vertical agreements which set resale prices or which provide for territorial protection.

If such agreements fall below the market share thresholds above, it is for the national competition authorities to take action in the first instance unless the Commission receives a complaint.

5. Exemptions under Article 81(3)

Article 81(3) provides for an exemption from Article 85(1) where the agreement satisfies the following four conditions:

- it contributes to improving the production or distribution of goods or to promoting technical or economic progress; and
- it allows consumers a fair share of the resulting benefits; and
- it imposes on the parties only restrictions which are indispensable to the attainment of these objectives; and
- it does not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

6. Individual Exemptions

The Commission may grant an individual exemption under Article 81(3) in respect of a particular agreement. Such an exemption will be for a specified period, there may be conditions and obligations attached and the Commission has power to revoke it.

Normally, to enable the Commission to grant an individual exemption, the agreement must be notified formally for that purpose.

If the Commission considers that the agreement satisfies the conditions of Article 81(3), it will grant a formal exemption with the effect that the agreement will be fully valid under community law for the period of the exemption (typically ranging between 5 and 20 years). The Commission may impose conditions on the grant of an exemption requiring modification of particular provisions. Unfortunately, because of the Commission's lack of resources and because each decision must be fully reasoned, the average period for obtaining a formal exemption is two to three years!

Alternatively, an application may be made for negative clearance in order to obtain a declaration from the Commission that, in the light of the information available to it, the agreement falls outside Article 81(1) altogether. Unlike a notification, an application for negative clearance gives no interim protection from fines. Moreover, a decision granting negative clearance may be revised later in the light of a change of circumstances.

In practice, it is generally desirable to make a combined application, both for negative clearance and, in the alternative, for exemption under Article 81(3).

Instead of proceeding to a formal decision of exemption, the Commission may write the parties a comfort letter. This will indicate that the Commission sees no need to take action. The letter may be formal, in which case the Commission must first invite comments from third parties by publishing a notice in the Official Journal, or informal, stating that in the Commission's view it has no reason to intervene. The effect of a comfort letter, whether formal or otherwise, is that the agreement remains notified so that it will be protected from fines. National courts are not precluded from applying Article 81(1) to the agreement and they are not bound by the contents of such a letter, but they are likely to be influenced by it. The Commission itself cannot later renege on the position taken in the comfort letter, unless there has been a material change of circumstances, or the letter was written on the basis of incorrect information. One advantage of this procedure is that it is much quicker than obtaining a formal exemption or negative clearance; a comfort letter can normally be obtained within a few months.

7. Distributorship Agreements

Under European competition rules, exclusive distribution is regarded as an efficient form of selling, leading to a concentration in the sales activities of the distributor. Accordingly, provided they meet certain clearly defined criteria laid down by the European Commission, exclusive distribution agreements will be automatically exempt from the prohibition in Article 81(1) of the Treaty of Rome; it is then not necessary to notify the agreement in order to obtain an individual exemption.

The most important point to bear in mind is that exclusive distribution agreements must not be used to divide up the common market along national boundaries, or to prevent parallel imports. Thus, whilst it is normally possible to prevent an exclusive distributor from selling *competing* products and from *actively* soliciting customers outside his territory, the distributor must be free to respond to *unsolicited* requests for products for delivery outside his territory.

Attempts by manufacturers of goods to protect their distributors against competition from parallel imports have been repeatedly condemned by the European Commission and can lead to the imposition of heavy fines.

Special rules apply where a manufacturer proposes to set up a network of distributors.

8. Block Exemptions - General

The Commission has power to grant block exemptions by regulation, using the experience it has gained in taking individual decisions. An agreement which benefits from a block exemption does not need to be notified.

The relevant block exemption for certain categories of vertical agreements (agreements between two parties operating at different levels of the supply chain) and concerted practices is Regulation 2790/1999.

9. Regulation 2790/1999

The Regulation applies to agreements to which only two undertakings are party.

The new EC Regulation fundamentally alters the criteria for exemption. Previously, agreements were exempt from Article 81 due solely to the existence of various clauses. Now, the market share of the parties needs to be considered. To be exempt by virtue of the new Regulation, the supplier must not have more than 30 per cent. of the relevant market on which it sells the goods or services. For exclusive supply agreements, the 30 per cent. limit relates to the relevant market of the purchaser. The relevant market is determined by reference to the relevant product and geographic markets.

Even when an agreement satisfies the market share criteria, the exemption may be lost in respect of the whole agreement where the agreement has one of the following types of offending restrictions:

- a restriction on the purchaser's ability to determine its sale price. However, a supplier can impose a maximum sale price or recommended sale price, provided this does not operate in practice as a fixed or minimum sale price.

- a restriction on the customers to whom or the territories where the purchaser may resell the goods or services. This restriction is acceptable, however, if it is in respect of active sales into the exclusive territory or to an exclusive customer group reserved by the supplier or to another purchaser. It is also acceptable if the ban is on wholesalers selling to consumers or on sales to unauthorised members of a selective distributorship system.

- a supplier cannot impose a restriction on selective distributors selling to consumers (other than in respect of the premises for the sales).

- a restriction on cross-supplies within a selective distribution system.

- a supplier of spare parts cannot be restricted from supplying to consumers or repairers not authorised by the purchaser of the spare parts.

Certain obligations will also be denied the benefit of the exemption without preventing the rest of the agreement from benefiting. The exemption does not apply to a non-compete obligation which lasts indefinitely or for more than five years (unless the goods or services are sold by the purchaser from premises and land owned or leased by the supplier and the restriction does not exceed the period of occupancy). For this purpose a non-compete obligation is one where the purchaser agrees to buy at least 80 per cent. of its purchases from the seller or agrees not to manufacture, buy or sell goods or services which compete with the contract goods or services. Equally post-termination non-compete obligations will be outside the exemption unless they are limited to one year, relate only to competing goods, and come within certain criteria set out in the Regulation.

If the relevant market share on entering into the agreement is less than 30 per cent. but subsequently rises above that level, then the agreement may lose the benefit of the exemption. The exemption continues to apply for two consecutive calendar years following the year in which the 30 per cent. threshold was first exceeded. However, if the market share exceeds 35 per cent., the exemption continues for only one calendar year following the year in which the 35 per cent. level was first exceeded.

Agreements complying with the old block exemption Regulations but which do not come within the new Regulation will continue to be exempted from Article 81 but only until 31 December 2001.

If an agreement benefits from the exempting Regulation or it would have done had the agreement had an effect on trade between member states of the EU, it will automatically be exempt from the Chapter I prohibition of the UK Competition Act 1998, which came into force on 1 March 2000. In addition, under an Exclusion Order, an agreement will not offend the Chapter I prohibition irrespective of market share where two or more firms operate at a different level of production or distribution and where the parties buy, sell or re-sell goods or services. This is provided that the agreement does not restrict the purchaser's ability to determine its sale price.

If an agreement does not benefit from the Exclusion Order, then the parties may be fined up to 30 per cent. of their turnover in the United Kingdom, although the fine will be reduced to take account of a fine already imposed by the European Commission or another member state in respect of the same agreement. In addition, as with infringements of Article 81, third parties can sue for damages.

Many companies may wish to exploit new opportunities created by the introduction of the new Regulation. Agreements that did not previously come within the exemption from Article 81 may now do so. The exemption will also automatically mean exemption from the Chapter I prohibition. Agreements which benefit from transitional relief may need to have their terms renegotiated by 31 December 2001. If the parties fail to do so, attacks could be made on the validity of their agreements. This may be by other contracting parties or the European Commission. Furthermore, the parties could face substantial fines and competitors may sue for damages.

10. Fox Williams

Fox Williams is a firm of solicitors practising in the City of London dealing with all aspects of commercial law, commercial litigation, commercial property law, corporate law and employment and partnership law. We are dedicated to providing clients with the highest quality of legal service.

The commercial law partners in Fox Williams have advised many clients on the negotiation of distributorship agreements.

Please contact any of the partners if you would like to know more about any of the matters mentioned in this guide or simply to discuss our particular approach to your legal needs.

Our expertise is at your disposal.

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Fox Williams LLP
Ten Dominion Street
London EC2M 2EE
T: +44 (0)20 7628 2000
F: +44 (0)20 7628 2100
mail@foxwilliams.com
www.foxwilliams.com