Distribution Law Center

DRIVEN BY CONTRAST

HORTEN

6

DLC COUNTDOWN

"VERTICAL" IN THE SPOTLIGHT: NON-COMPETE RESTRICTIONS

WHAT?

Distribution agreements often contain non-compete clauses. They impose restrictions on a distributor's ability to **manufacture or sell products competing with the products** covered by the distribution agreement, the so-called contract products.

Let us make things concrete. A distributor is appointed to sell **vacuum cleaners** of brand A (the contract products). The non-compete restriction determines whether the distributor is allowed (and, if so, to what extent) to manufacture or sell vacuum cleaners of competing brand B or any other competing brand for that matter.

Such a non-compete provision does not always qualify as a **restriction of competition**. The absence of a restriction is for instance accepted in a franchising context. In many instances, however, such an obligation will be deemed to restrict competition and, for that reason, will need an exemption. The application of a block exemption regulation is the most efficient way to secure such an exemption.

NOW?

The current vertical block exemption regulation applicable to distribution agreements is Commission Regulation 330/2010. It is often referred to as the VBER, which focuses on **two types** of non-compete clauses:

- First, an absolute prohibition for a distributor to manufacture, purchase, sell or resell competing products. In our case, only sales of brand A are allowed and no sales at all of any other competing vacuum cleaners. Such clauses are known as "**single branding**".

- Second, purchasing obligations requiring a distributor to purchase more than 80% of his requirements from a designated supplier. Hence, if the distributor is contractually prevented from purchasing competing vacuum cleaners in excess of 20% of his total purchases of vacuum cleaners during the preceding year, the block exemption applies only if the regime governing non-compete restrictions is adhered to. This is often referred to as the "**80%-rule**".

Non-compete obligations in distribution agreements benefit from an automatic exemption under the VBER if they comply with one important rule: their duration may **not exceed five years**. This time limit applies to both single branding and the 80%-rule. There are specific exceptions in cases where premises are made available by the supplier to the distributor. However, absent that exception, the general rule is that a limitation to five years must be respected.

The **consequences** of the rule are rather straightforward. The block exemption does not apply where the non-compete obligation:

- applies for an **indefinite period of time**, even if the distribution agreement provides for a termination possibility;
- is entered into for a **fixed term of more than five years**; or
- is **tacitly renewable** beyond a period of five years, meaning that the non-compete obligation is entered into for a fixed term of five years or less, but continues automatically beyond five years unless the parties terminate the agreement or the non-compete provision.

The logic underpinning the rule is that a distributor must be able to give his "fresh" consent to a non-compete obligation upon the expiry of each five-year period. Put differently, a competing supplier (for instance of brand B) must be in a position to convince the distributor, at least once every five years, to commence the distribution of brand B.

THE FUTURE AS OF 1 JUNE 2022?

The current proposals by the European Commission will leave the existing regime for non-compete obligations **largely unchanged** after 1 June 2022. They continue to cover both single branding and the 80%-rule. The five-year time limit also remains the norm to benefit from an automatic exemption.

However, the current proposals for the new Vertical Guidelines bring about **one important change** relating to **tacit renewals**.

Non-compete obligations may be tacitly renewable beyond five years on the condition that the distributor can effectively switch to a competing supplier after the expiry of the five-year period. This includes the possibility to terminate the cooperation with the supplier with a reasonable notice period and without incurring any unreasonable costs. With the reference to the absence of unreasonable costs, the draft Vertical Guidelines aim for instance at the burden presented by the need to repay a loan to the supplier.

IN PRACTICE?

- The current VBER regime on non-competition obligations remains **largely unchanged** after 1 June 2022. Non-compete obligations must be limited to five years in order to benefit from the block exemption.
- The strict application of that maximum period is made somewhat more flexible under the new proposals. **Tacit renewal beyond a period of five years will not automatically qualify as an excluded restriction**, i.e. a restriction not benefiting from the block exemption. The requirement is that the distributor should be able to avoid tacit renewal by effectively renegotiating or terminating the distribution agreement under reasonable conditions.

ASSESSMENT?

With this **additional flexibility** an artificial difference seems to be made between non-compete obligations of indefinite duration and fixed-term non-compete obligations that are tacitly renewable. The first category would still fall outside the VBER. The second category is now block exempted provided that the distribution agreement can be effectively renegotiated or terminated.

We **fail to see the logical difference** between a distribution agreement of indefinite duration that can be terminated with a reasonable notice period and at reasonable cost and the case where tacit renewal of a fixed-term non-compete obligation can be avoided under the same conditions. It is reasonable to expect that this apparent inconsistency will be remedied in the final texts. By the same token, it would be desirable that this new possibility is anchored in the VBER itself and not hidden somewhere in paragraph 234 of the draft Vertical Guidelines.

THE FINAL REVISED VBER IS PLANNED TO ENTER INTO FORCE ON 1 JUNE 2022.

WANT TO KNOW MORE? STAY TUNED…

Counting down towards 1 June 2022, we aim to provide you with regular updates and the necessary legal know-how in order to fully prepare your business for the future. Please also check out the Distribution Law Center platform (www.distributionlawcenter.com) and our LinkedIn page for much more information on the laws governing vertical agreements, covering both competition and commercial law. 27 specialized teams from all over the EEA are working hard to turn the platform into your favourite source of guidance and information.