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SAFETY OUTSIDE THE SAFE HARBOUR?

**EXEMPTION OF VERTICAL AGREEMENTS FALLING OUTSIDE THE HUNGARIAN VERTICAL
BLOCK EXEMPTION DECREE¹**

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Individual exemption of vertical agreements often causes practical problems. If an agreement does not fall within any of the block exemption regulations, it is not easy to decide whether it will nevertheless be exempted from the prohibition of restrictive agreements nevertheless. The same problem arises if the agreement contains one or more black-listed provisions that render the respective block exemption regulation inapplicable. For example, a distribution agreement may provide for the one year non-compete obligation of the distributor and may also contain a resale price maintenance (RPM) clause. The one year non-compete obligation is automatically block exempted, however as a result of the RPM, the whole agreement loses the benefit of block exemption. As a result, the validity of the non-compete clause will be assessed on an individual basis, which leaves space for uncertainty.

This legal uncertainty may be reduced to a certain extent on the basis of the recent *Castrol* case (case no. Vj-7/2008) decided upon by the Hungarian Competition Office ("**HCO**"). In this article, we summarise the findings of the HCO and its import in connection with the exemption of vertical agreements under Hungarian law.

The competition law of (vertical) agreements in Hungary is in fact a reflection of EU competition law at the national level. Section 11 of the Hungarian Competition Act ("**Competition Act**") lays down the general prohibition of restrictive agreements (Art. 101 (1) of the FEU Treaty, former Art. 81(1) of the EC Treaty). Agreements that fulfil certain preconditions gain automatic exemption (Section 17 of the Competition Act / Art. 101 (3) of the FEU Treaty, former Art. 81(3) of the EC Treaty). Vertical agreements

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between parties with a market share not exceeding a certain threshold (30% in Hungary) may gain exemption by Government Decree 55/2002 (III. 26.) on the exemption from the prohibition on restriction of competition of certain groups of vertical agreements ("**Vertical Block Exemption Decree**"), which can be described as the national equivalent of Commission Regulation 2790/1999/EC.

Similarly to Commission Regulation 2790/1999/EC, the Vertical Block Exemption Decree contains a list of hard-core restrictions. In case of certain hardcore restrictions, the particular obligation (e.g. non-compete obligation exceeding five years) falls outside the Vertical Block Exemption Decree. However, in case of other hard-core restrictions (e.g. RPM), the whole agreement falls outside the scope of the Vertical Block Exemption Decree. The *Castrol* case might cast doubt on this differentiation.

The case can be summarized as follows: Castrol is a Hungarian company manufacturing motor oils and lubricants. Castrol sells its products to motor vehicle service stations ("**Partners**"), which are mainly small and medium enterprises. Between 1997 and 2007, the terms of the agreement between Castrol and a Partner contained a non-compete clause prohibiting the Partner from selling, advertising and using other suppliers' products. In several cases the term of this clause exceeded five years. The agreements also contained a clause setting a minimum resale price for the Partners; however, Castrol did not monitor the compliance with this latter clause.

The HCO found that the agreements restricted competition, but they could have benefited from the block exemption granted by the Vertical Block Exemption Decree. However, the resale price maintenance clause (as a hard-core restriction) excluded the agreements from the ambit of the Vertical Block Exemption Decree, leaving only the possibility of an individual exemption based on Section 17 of the Competition Act, on the same conditions as set out in Article 101 (3) of the FEU Treaty. Agreements with a non-compete obligation longer than five years were still found to be anti-competitive. However, the HCO decided that agreements that prohibit using the products of competing suppliers for a period less than five years can be exempted individually, despite the setting of a minimum resale price. The HCO's main reason for this was brief: such agreements would have automatically benefited from the block exemption in the absence of the fixing of minimum resale price.

This reasoning may lead to the argument that in cases where certain clauses of an agreement are allowed under the Vertical Block Exemption Decree but the whole agreement falls outside of it, individual exemption can still be based on the fact that the other clauses would fall under the block exemption in the absence of the hard-core restriction. This means that the interpretation of the four (fairly vague) conditions in Section 17 of the Competition Act (or Article 101 (3) of the FEU Treaty) may be simplified by a reference to the Vertical Block Exemption Decree, just as if it was a "legislative interpretation" of Section 17 (Article 101 (3) FEU Treaty).

This interpretation is far from the intent of the Hungarian and European legislator. According to recital 5 of Regulation 2790/1999 EC: "The benefit of the block exemption

should be limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 81(3)." Moreover, the European Commission's Guidelines on Vertical Restraints state that "If there are one or more hardcore restrictions, the benefit of the Block Exemption Regulation is lost for the entire vertical agreement. There is no severability for hard-core restrictions."

The interpretation of the preconditions of individual exemption in light of the Vertical Block Exemption Decree means conferring an "indirect effect" on the later. This however was clearly not intended by the legislator. Nevertheless, the interpretation adopted by the HCO in the *Castrol* case contributes to legal certainty outside the scope of application of the Vertical Block Exemption Decree, which is a very positive consequence of the decision.

Due to the fact that the relevant rules of Hungarian legislation are very similar to those of the EU law, the *Castrol* case might influence the application of EU competition law by the HCO in the future.