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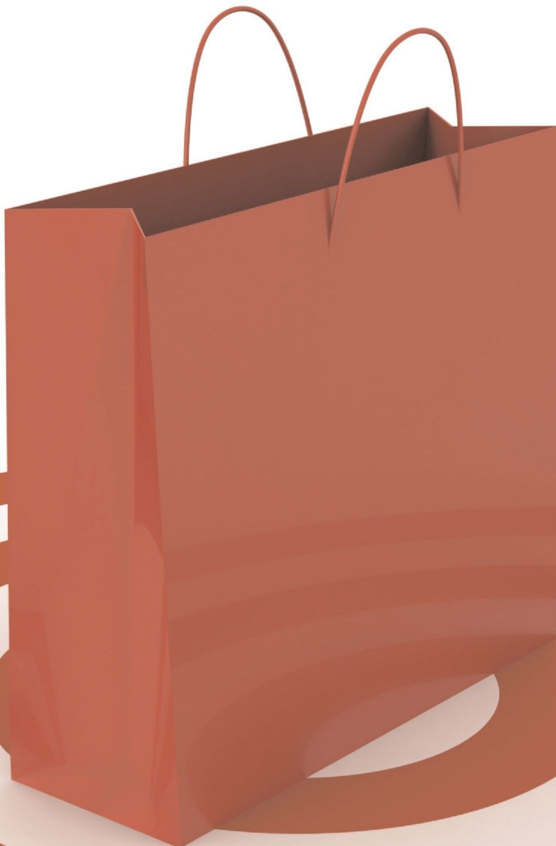
Consuming ISSUES

Current topics in the consumer products industry



CVAs - A new face for restructurings in the sector

Online Behavioural Advertising - Targeting your consumers

Packaging - Tentative steps: low carbon, low resource economy

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Consuming issues is prepared by the Consumer Products group of CMS Cameron McKenna. It should not be treated as a comprehensive review of all developments in this area of law nor of the topics it covers. Also, while we aim for it to be as up-to-date as possible, some recent developments may miss our printing deadline.

This newsletter is intended for clients and professional contacts of CMS Cameron McKenna LLP. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The newsletter is intended to simplify and summarise the issues which it covers.

Welcome

Welcome to the Autumn 2009 edition of our Consumer Products Bulletin, where we take a look at some of the legal issues affecting the industry.

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The anniversary of Lehman Brothers' demise reminds us, as if we needed reminding, that the last twelve months have been unlike any other in recent history for many sectors including the consumer products sector. Although the UK economy has suffered as much as any of the developed economies, there are signs that the sector may have weathered the worst of the storm. In this bulletin, we focus on some areas of law which will impact as the recovery begins. Areas of law such as competition, environmental and food safety are progressing, recession or no recession – and will change the way that consumer products companies do business.

Our first article, however, highlights one of the realities of life in a downturn: how to restructure ailing businesses. Twelve months ago, the "pre-pack" administration route was the flavour of the month, although many felt that unsecured creditors were always the loser through this method. The high profile restructuring of JJB Sports through a CVA showed that there was a different way of restructuring, and one which may be a better option where there is a large leasehold portfolio of non trading stores.

We then turn to OBA or Online Behavioural Advertising, which is the new big brother way of suppliers and manufacturers targeting online consumers. This network-based targeting has proved controversial and there are significant concerns about privacy and data protection. Companies will have to balance the effectiveness of OBA against a consumer backlash if the process becomes discredited.

We have heard much talk that the Great Depression proved a catalyst for accelerating progressive developments in technology during the 1930s. Will the 2008/2009 worldwide recession accelerate our move to a low carbon, low resource economy? Our next article looks at the recently published DEFRA strategic review of packaging policy. This is aimed at optimal use of resources and maximising recycling of waste packaging. This may prove to be one of the key stepping stones towards that low carbon and low resource economy – and all suppliers and packagers will need to adapt their policies, production and buying methods accordingly.

Competition law waits for no man. Back in July, the EC published its proposal for a revised block exemption for vertical agreements. The basic elements of the existing regime remain but the key changes relate to the increased buying power of retailers and the evolution of online trade. The revised block exemption is likely to be with us until 2020. Powerful retailers and distributors with a 30% market share may have to consider their arrangements.

The final article looks at an area which affects every single one of us: food safety. We consider the UK and Chinese food safety regimes, how they responded to the Irish pork and Chinese infant formula food scares recently, what steps they have taken since those scares, and the areas which remain a concern.

I do hope you enjoy this bulletin. Please call or drop me a line if you would like to discuss any of the issues raised.

CVAs

A new face for restructurings in the sector

"Several high profile consumer product companies have put forward proposals for a CVA as a reliable alternative to administration whilst ensuring business continuity."

There have been numerous instances over the last twelve months where consumer products businesses, particularly retailers, facing difficult times have carried out restructurings, either by means of a pre-packaged administration (pre-pack) or a company voluntary arrangement (CVA). Pre-packs had become the regular mode for rescuing businesses that are simply too debt laden to be rescued outside of insolvency but where a formal process would damage the business and its value for stakeholders. Meanwhile CVAs have come back into the spotlight as a potential lifeline for distressed companies and a credible alternative to a pre-pack.

This article examines why, in a market where the playing field for all stakeholders has become increasingly unpredictable, the choice and transparency offered by CVAs instead of the "clean slate" alternative (albeit a somewhat controversial alternative) offered by pre-packs should be part of any contingency planning by the management of distressed companies.

Company Voluntary Arrangements

A CVA is a procedure rather than a formal insolvency process that allows a company to agree a compromise in satisfaction of its debts and/or some other arrangement of its affairs that will enable the company to pay part of its debts and continue to trade its business. Any company can make a proposal to its creditors and it will be approved (and bind every creditor of the company) if 75% or more (by value) of the creditors voting on the resolution vote in favour of it – which they could be expected to do on the basis that they would receive more under the CVA than under an administration.

Pre-Packaged Administrations

In contrast, a pre-pack is a formal process where an administrator sells a company's business (as a going concern) or assets (on a break-up basis) and uses the proceeds of sale to pay creditors a pro rata proportion of their claims in the administration. There is no continuation of the body corporate as with a CVA. The differences between this type of sale and a standard sale out of administration are that it is done much quicker and an insolvency process commences immediately before the sale contract is completed (although the vast majority of administrators will have put a lot of effort into ensuring they are signing the right deal well before that stage is reached). Unlike conventional administrations which risk uncertainty and a real prospect that the business will close thereby lessening creditor returns

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even further, an accelerated disposal process could ensure enhanced realisations for creditors in the administration for past debts by preserving the value of a business' goodwill and brands.

CVAs: Just how successful are they?

Several high profile consumer product companies have put forward proposals for a CVA as a reliable alternative to administration whilst ensuring business continuity. Focus DIY has become the latest retailer to avoid administration and restructure its business through a CVA. Its creditors (institutional landlords of non-trading premises) agreed to forego rents, service charges and insurance on their stores in return sharing in a £3.7 million compensation fund. Before that, Discover Leisure, an AIM listed caravan retailer, secured 99.7% support of creditors voting in favour of the proposal, with creditors agreeing to accept 22p for every £1 they were owed.

Both Focus DIY and Discover Leisure's CVA followed the high profile CVA in respect of JJB Sports earlier this year. Landlords of non-trading stores accepted a compromise of their claims in return for claiming against a fund of £10 million. When landlords of trading premises also accepted a proposal for monthly, rather than quarterly rents, the obvious benefits of a CVA as a restructuring tool came to the fore.

However, not all recent attempts to secure a CVA have been successful. The need for such a high majority of creditor support, which often requires creditors to be offered a greater return than in a formal insolvency, means that in many cases CVAs are not commercially viable. Stylo, the AIM listed footwear retailer which owned Barratt and PriceLess shoes, failed to get the 75% majority vote in favour of its proposal when it sought to make its landlords accept, amongst other terms, turnover based rent. It was thought that with landlords facing their own constraints, the terms of the Stylo proposal were not sufficiently attractive to the majority of landlords to justify acceptance. Stylo was placed into administration and the administrators announced the sale of 160 stores (70 fewer than would have remained trading under the CVA). Cobra also failed to secure a CVA, which would have given all creditors some money back, after a major creditor, Wells & Young which brews Cobra beer under licence, vetoed the proposal forcing the company into administration.

There are challenges to securing a successful CVA. Particular difficulties are:

> "CVAs have come back into the spotlight as a potential lifeline for distressed companies and a credible alternative to a pre-pack."

the absence of a moratorium (a period during which creditors cannot bring claims against the company) unless the company qualifies as a small company; obtaining secured creditor support (as they are not bound by a CVA); and having sufficient resources to trade through the CVA process, as well as the fact that after the approval of the CVA the supervisor remains in situ for 28 days making it challenging for the directors to revert to business as usual at a time when creditors are needing reassurance that the restructuring will go through as planned. CVAs are therefore often time consuming, complex and expensive to implement with no definite prospect of success. There is also the tension between offering creditors enough in a CVA to gain their approval for it and keeping enough cash in the business to ensure its viability as a going concern for the foreseeable future. So there is much upfront planning and agreement with creditors to avert enforcement

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proceedings and enable the company to continue trading during the CVA process, whilst at the same time ensuring that the necessary level of support from creditors will be given on the day.

Recent Budget announcements on insolvency reform, on which the Insolvency Service, on 15 June 2009, has launched a consultation paper, look to address some of the issues. The Insolvency Service will consult on extending the moratorium in CVAs to medium and large sized companies and introducing priority funding during the CVA period. This should overcome some of the obstacles currently facing management when considering a CVA.

Pre-packs: an acceptable alternative or a tool of last resort?

Lombok, the furniture retailer, entered into a pre-pack administration with a consortium led by Privet Capital and Paradigm in which 14 stores out of 19 were bought. High & Mighty was sold in early September to JD Williams & Company, part of the N Brown Group, as part of a pre-pack administration. These follow the high profile case in March 2009, when Mosaic Fashions was put into pre-pack administration, with most of the group being sold to Icelandic bank Kaupthing and Mosaic's management. The UK businesses and assets of Warehouse, Oasis, Coast, Karen Millen and Anoushka G were each run under a newly formed group called Aurora Fashions.

In each case, the administrators believed that this would achieve the best outcome for creditors. However, in each case, there had been no attempt at proposing a CVA, which would have given creditors choice and transparency over the process. This lack of transparency and choice have given pre-packs something of a bad reputation because they are concluded in a hurry and without the market being thoroughly tested. It can often appear that a failing business is moved into a new company leaving the liabilities behind in the old company. Stakeholders will often question whether the administrator and management (who often end up in control of the new company) have pushed through a quick deal for their own benefit and to the detriment of creditors. Pre-packs are often seen as a means of disposing of unwanted obligations to suppliers, staff and landlords, while at the same time allowing management to buy back the decent stores and take control of inventory.

It is often forgotten that an administrator is under an obligation to creditors and not to management and that an administrator's obligation is to achieve the best return on any sale of business or assets. Nonetheless, because the administrators are largely dependent on the company's management for information, where the managers are potential purchasers an obvious conflict arises – management will have an inherent interest in ensuring that the price is as low as possible and so it is unavoidable that eyebrows will often be raised.

There have been recent initiatives to address the concerns with pre-packs and ensure that administrators keep a detailed record of the reasons for the pre-pack and be able to explain and justify the pre-pack to withstand creditor scrutiny over the usual perceived lack of transparency. On 1 January 2009, insolvency regulatory authorities agreed to issue Statement of Insolvency Practice 16 (SIP 16). SIP 16 requires administrators to explain to creditors the reasons behind their appointment and, critically, the reasons for the administrator concluding that a pre-pack would be the best outcome for creditors. Among other things, this requires administrators to disclose any valuations obtained by them, any alternative courses of action considered and whether major creditors were consulted.

Which is better?

There is no definitive answer – in some cases a CVA will prove to have been the best tool for the job and in others, such as in the case of Cobra beer, only a pre-pack will do. Each tool is not without its shortcomings but the number of large companies proposing CVAs is certainly on the rise.

It is already clear that management are increasingly factoring in the attractiveness of CVAs as part of their contingency planning. The extension of the moratorium and introduction of priority funding can only serve to make CVAs more attractive to management and thereby to increase their prominence as a rescue tool.

Online Behavioural Advertising

Targeting your consumers

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What is Online Behavioural Advertising?

Online Behavioural Advertising (OBA) or 'interest-based advertising' is designed to target advertisements to individual internet user's interests. Examples of common user interests are food and drink, luxury goods or eco-friendly products. OBA works by tracking online activity including the searches that individual users have conducted, the websites they have visited and the content they have viewed, via the use of cookies. The objective of OBA is to drive targeted advertising which increases the 'conversion rate' – the number of users who see the ad and then subsequently make a purchase.

An example might be that an ad for premium pasta would be sent to users whose profile shows that they have accessed Italian cookery or restaurant websites twice in the last week. This kind of profiling technology has been adopted by many brands as a highly effective marketing tool.

There are two main types of OBA: site-based targeting and, much more recently, network-based targeting.

Site-based targeting has been used by online sellers for a number of years. This involves the use of cookies but uses browser information from a single site only. The function of the cookie is to allow a website to recognise a user's previously selected preferences when the user returns to the site. Usually, the cookie will be linked to the IP address of the user's computer, which identifies that computer but not a specific user.

Although site-based targeting has been used for some time now, network-based targeting, such as Phorm, has emerged much more recently and has proved to be much more controversial. The difference is that user browser information, which forms the user's 'profile', is collected from all sites accessed by the user, not just a single site. Advertisements are then targeted based on this user profile.

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Network-based targeting has resulted in OBA being the subject of a backlash by campaigners and consumers concerned about privacy, some of whom have branded it as ‘spyware’. There have also been potentially more significant challenges to this form of targeting. Earlier this year the European Commission launched an investigation into the UK government’s failure to take any enforcement action over BT’s testing of Phorm’s services on its broadband network without users’ consent in 2006 to 2007. Reputation and consumer trust is key for big brands, particularly in the current market, and so negative publicity regarding use of such services should be borne in mind by companies that are considering network-based targeting.

Is it regulated?

Online behavioural advertisers who collect and use consumers’ personal data must comply with the Data Protection Act 1998 and the Privacy and Electronic Communications (EC Directive) Regulations 2003, which govern marketing via email or other electronic means of communications, and the use of cookies to gather information on visitors to a website.

The trade association for online advertising, the Internet Advertising Bureau (IAB), has produced a set of guidelines for OBA. The self-regulatory Good Practice Principles aim to prevent behavioural advertising from infringing consumers’ privacy. Signatories must comply with the new Principles, which, according to an IAB statement, “set out commitments to transparency, user choice and education”. These commitments will be represented by a statement of adherence on each signatory’s website or in its privacy policy.

The Principles were published in response to consumer concerns over OBA and were developed in collaboration with the ten current signatories: Google, AOL, Microsoft Advertising, Yahoo!, Phorm, AudienceScience, NebuAd, Platform A, Specific Media and Wunderloop. There are three main Principles:

- Notice - companies must provide clear and unambiguous notice to users that it collects data.
- Choice - companies must provide an approved means for consumers to opt-out.
- Education - companies must make information available to educate users and ensure that this information is easily accessible.

The Principles came into effect on 4 September 2009. Each signatory must inform internet users that it collects data for OBA purposes, provide a mechanism for users and educate them about the collection and use of data as well as how to decline OBA. The signatories also agree not to use OBA specifically to target children under 13 and also commit to exercising their judgement in relation to other sensitive groups. Supporting the Principles is a portal aimed at consumers - www.youronlinechoices.co.uk - helping them to understand how behavioural advertising works, its benefits and how privacy is protected.

One significant issue with OBA is whether the intended opt-out system on its own can satisfy data protection laws. Opt-out systems require individuals to state positively, for

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example by ticking a box, that they do not want a company to use his/her data for marketing purposes. Unless the box is ticked by the individual, the default is that their data will be used for marketing purposes.

Data protection laws require that individuals must actively opt-in, rather than opt-out, to such marketing except where: (i) their details have been collected in the course of a sale or negotiations for a sale (ii) the products being marketed are similar to those relating to that sale and (iii) they were given the opportunity to opt out at the stage their details were collected. Whether the OBA envisaged by the Principles will meet these conditions, allowing the opt-out rather than the opt-in system to apply, will therefore depend on the circumstances of the data collection for each individual.

The Information Commissioner's Office, the independent data protection regulator, has supported the Principles. However, privacy rights groups have criticised the Principles for providing insufficient protection for consumers. The digital rights body Open Rights Group (ORG) sees the inconvenience of the user opt-out system as particularly flawed because it claims that this "pesters users" in "an illegitimate attempt to substitute acquiescence for consent".

The Principles only apply to signatories, although it should be noted that most of the industry key players are members. Signatories must institute a complaints-handling process for users. Should a complaint be resolved unsatisfactorily, the user will have the right to refer the matter to an OBA Board. It is unclear what degree of independent review will be applied and, in any event, the self-regulatory nature of the Principles will be unsatisfactory to some, and public pressure for more rigorous controls is unlikely to relent.

The Principles should also provide some comfort to advertisers as this should reduce the likelihood of negative responses from consumers that receive advertisements.

Consumer concerns about privacy have led many ISPs to decide not to use services such as Phorm at the current time. However, it would seem that much of the consumer concern arises from a lack of knowledge or understanding about this type of targeted advertising. There is a question as to whether or not any of the information processed through OBA would amount to personal data. In addition, the information which is stored is often only stored for limited periods of time. Indeed, much more information, including sensitive personal data, is regularly made available by individuals on online social networking sites, which might suggest that the concern is due to a lack of information about OBA, rather than its actual processes. Further, OBA also offers some clear benefits to consumers - they get advertising which is interesting and

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relevant to them and the revenue created by advertising keeps internet costs low for consumers.

The OFT is currently looking to clarify and update the understanding of any potential consumer harm that arises from misleading advertising and misleading pricing generally. As part of its research it will be considering OBA, including the use of opt-ins and opt-outs.

There are of course other, more practical, issues for companies in the consumer products sector to be aware of. For example, computers are often shared by several individuals, particularly in a family home. What is deemed suitable for one person may not be for the other user(s) in a household, for example, advertisements for alcohol. As another example, one user may not want another user to see advertising for products connected to products which they were looking at online if, for example, they were searching for a surprise gift.

Conclusion

OBA is undoubtedly a highly valuable service for most if not all consumer products companies as it is a particularly effective way of reaching key target audiences and, thereby, ensuring that marketing spend is used most effectively by targeting those most likely to buy.

Consumers will, however, always be concerned about privacy, which is a hurdle that advertisers must overcome. However, consumer knowledge and choice will be key. Any company seeking to take advantage of this method of advertising must therefore be confident that consumers are fully informed and are given a choice. In this way, the prospect of receiving advertising which they are interested in, rather than advertising which they are not, is likely to produce positive results.

Tentative steps: low carbon, low resource economy

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Introduction – the new ingredient

Many readers will be aware that the Climate Change Act 2008 (the Act) became law on 26 November 2008. This Act applies to the UK and sets a legally binding target for reducing UK greenhouse gas emissions (GHG), namely a reduction of at least 34% of emissions by 2020 and at least 80% by 2050 (compared with baseline levels for CO2 and other GHG). The Act is the first of its kind in the world and many other countries are watching its progress with keen interest. The Act contains many provisions which are aimed at facilitating achievement of the GHG targets. In essence it is an enabling Act. For instance, the Act contains powers to introduce further legislation by statutory instruments, requires the Government to publish five yearly carbon budgets from 2008 and in respect of England and Wales confers powers to create waste reduction pilot schemes. We think that it is not unreasonable to suggest that this Act, and its subsequent secondary legislation, could become very pervasive, impacting on the workings of virtually all commercial sectors in time to come.

Scotland is aiming higher than the rest of the UK. The Climate Change (Scotland) Act 2009 (the Scotland Act), passed on 4 August 2009, supplements the Act introducing an interim target of at least 42% reduction by 2020 (the 2050 target remains the same, 80%). Further, the Scotland Act provides that regulations may be introduced to require specified persons to prepare plans for the prevention, reduction, management, recycling, use and disposal of waste produced by or otherwise associated with their activities. Both the Act and the Scotland Act (together the Climate Change Legislation) will have major implications for the consumer products sector.

The impact of the new legislation

In order to devise programmes and implement action under the Climate Change Legislation all of the UK administrations have been preparing various strategies for some time. The Scottish Government has launched a consultation - open until 13 November 2009 - on a new Scottish Zero Waste Plan (due to be finalised in Spring 2010). The Welsh Assembly has recently launched a consultation on the programme of action for its Climate Change Strategy. The consultation was open until 2 October 2009 with the Welsh Climate Change Strategy due to be published by the end of 2009. The Welsh consultation proposes two key objectives in respect of recycling waste, namely (i) a rate of 70% recycling across all sectors by 2025 and (ii) by 2050 'an aspiration to produce no waste in the long term, by designing products and services with waste prevention in mind'.

On 9 June 2009, the Department for Environment Food and Rural Affairs (Defra) published a strategic review of packaging policy in conjunction with the Department for Business Innovation & Skills (BIS), the Devolved Administrations, and with input from stakeholders. 'Making the most of packaging: A strategy for a low-carbon economy' (the Strategy) sets the direction for packaging policy for the next ten years. (http://www.defra.gov.uk/environment/waste/topics/packaging/pdf/full-packaging-strategy.pdf). This Strategy is set in the context of a resource efficient and low carbon economy and generally extends to the whole of the UK.

Trigger for the review

Two triggers are identified for the policy review: addressing consumer concern over packaging levels and the requirement for policy to contribute to greater resource efficiency and reduce the environment impact of the packaging supply chain.

The vision

The Strategy outlines a packaging policy vision: to encourage optimal use of resources across the whole packaging supply chain and to maximise the recycling of waste packaging.

Optimising packaging

Minimisation of the environment impact of packaging over its whole lifecycle, without compromising the ability to protect products, is to be achieved by:

- designing packaging in line with sustainability principles - with re-usability, recyclability or recovery in mind (as a standard)
- potential Government promotion of refillable and re-usable packaging
- promotion of best practice in packaging recyclability and suitability for specific forms of recovery where appropriate e.g. anaerobic digestion
- delivering real reductions in packaging, under existing and new voluntary agreements
- marketing innovation and development to meet the growing demand for re-usable and recycled packaging, across all types of packaging.

Implementation will be effected by (amongst other examples):

- Government working with other bodies to raise the profile of eco-design and increase its uptake by business
- Government, the Devolved Administrations and their agencies providing a lead through public procurement
- raising consumer awareness
- Waste & Resources Action Programme (WRAP) developing a successor to the current Courtauld Commitment
- for the period 2010 – 2015, identifying priority sectors for packaging reductions and voluntary agreements across the UK on packaging minimisation. The first wave of priority sector requirements is timetabled for 2011.

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Maximising recycling

A premise of the Strategy is the common held view that recycling uses less energy than manufacturing from virgin materials, thus reducing GHG emissions. Consequently policy should work to maximise the recycling of waste packaging through:

- more recycling by householders - facilitated via recycling schemes that are easy to use and collect all of the main packaging materials
- local authorities and businesses treating waste packaging as a resource, leading to more recycling by businesses and an emphasis on quality in household collection and sorting
- improving the current UK recycling rates to those achieved by the best EU performers.

Implementation is to be by:

- instigating material-specific recycling strategies
- modifying and increasing the transparency of the current producer funding system so that revenues are more visible to local authorities and producers
- more investment by packaging producers including potential changes to existing producer responsibility laws
- improving the quality of recyclates via income sharing contracts and raising standards at material recoveries facilities
- incentivising closed loop uses in relation to plastics and glass
- encouraging more effective collection and sorting
- greater use of partnerships by local authorities
- review of tendering processes.

Measuring the impact of packaging: weight v carbon

The relevant EU legislation including the Packaging and Packaging Waste Directive (94/62/EC) (the Packaging Directive), sets out targets based on the weight of packaging. This approach was thought to be administratively efficient because it is relatively simple to understand and to measure against. However, the Strategy identifies that the current weight based methods of measurement are limited in their ability to address whole lifecycle and climate change impacts and do not fit neatly with wider carbon-based targets. Consequently the Government will consider and consult upon the best method for measuring the environment impact of packaging including evaluating a move from weight-based to carbon-based targets. This will require consistency in evaluating the carbon footprint of products. In order to avoid the burden of different reporting regimes there is a clear statement in the Strategy that there is no intention of moving to mandatory carbon-based targets for packaging before the Packaging Directive is reviewed (likely to start at the earliest in 2014). Nevertheless there is a clear appetite to consider fundamental change in assessment methods in ways which would align closer with the Climate Change Legislation.

Implementing the Strategy

The Strategy provides an outline implementation timetable of action points and responsibilities. As some of the proposals will require changes to legislation, appropriate consultation will be necessary. Those affected should keep abreast of proposals.

Broader implications beyond the packaging supply chain

The key aims of the Strategy are to overturn the historic trend of overall packaging growth, optimise the resource efficiency of packaging, and improve waste packaging recycling rates. The Strategy explores the whole lifecycle of products and identifies developments for the waste management sector and particular materials. It states that depending on the material involved, packaging waste should ideally be recycled or have energy recovered from it. The Strategy expressly acknowledges the potential need for a network of anaerobic digestion and other energy from waste plants to be developed. Otherwise it identifies that there is a need to upgrade the sophistication of existing waste collection and sorting facilities.

Action by the regulator

Our recent experience suggests that there is currently increased activity on the part of the regulators in respect of investigations under the Packaging (Essential Requirements) Regulations 2003. These regulations require packaging to be manufactured so that its volume and weight are limited to the minimum adequate amount to maintain the necessary level of safety, hygiene and acceptance for the packed product.

Conclusion

Fundamental changes across all sectors are likely to be required in order to attain the GHG reduction targets set out in the Climate Change Legislation. The above example of packaging waste should be viewed as only one example of potentially many more, where existing law and policy may have to be realigned to become fit for purpose in a low carbon, low resource and more efficient economy. Whilst changes in respect of the way in which targets are measured are expected in the long term, in the meantime the retail and packaging industry will face sustained scrutiny and calls for increased structured involvement in reducing packaging waste.

Supply chain

Revising European rules for distribution agreements

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On 28 July 2009 the European Commission published its proposal for a revised block exemption for 'vertical agreements' (covering distribution, supply and purchase agreements) as well as draft guidelines. A block exemption regulation sets out conditions according to which agreements benefit from an automatic exemption from the prohibition on anti-competitive agreements. The current regulation expires on 31 May 2010.

The proposed new text retains the basic elements of the outgoing regime. It does not contain any particularly radical new elements. However, it does suggest some significant amendments and clarifications to reflect both the Commission's enforcement experience over the last decade and market developments. The key changes take particular account of the increased buyer power of big retailers and the evolution of online trade. The proposed new guidelines also contain some new and useful commentary on particular types of commercial practice.

The Commission asked interested third parties to comment on its drafts of the revised block exemption regulation and accompanying guidelines by 28 September 2009. It is likely that the Commission will aim to adopt the new rules fairly soon, and not wait for the expiry of the current regulation.

Positive experience to date under the vertical agreements block exemption

The Commission has been keen to stress that its experience of the effects-based verticals regime introduced in 1999 has been positive, and that the approach has been generally well received by stakeholders.

The current block exemption was introduced to reduce the regulatory burden of an onerous, and now defunct, notification system. It also ushered in an effects-based analysis which assessed potential restrictions of competition according to their market circumstances and not according to rigid rules. It did this by implementing a regime based upon automatic exemption from the prohibition on anti-competitive agreements where (i) market share thresholds were not exceeded, and (ii) a limited black list of restrictions was not infringed. It also set out, in detailed guidelines, a flexible approach to assess restrictions for companies which fell outside the market share thresholds, but did not infringe the black list. The structure of this regime will be retained.

Over the last ten years, market circumstances have changed. The expansion of the internet as a distribution channel has brought significant developments. Consumer perception of the internet has changed and is still evolving. Further guidance is therefore considered necessary in this area. All competition authorities are concerned about the increasing buyer power of large retailers and other distribution chains. Finally, European case law has developed to some extent.

The Commission has suggested a small number of key amendments to the existing regime in order to take into account such changes in the marketplace, and to refine its approach in line with its experience.

New importance of purchaser's market share

The main change to the block exemption is to the market share threshold. Under the new proposals, for an agreement to benefit from automatic exemption, not only the supplier's but also the purchaser's market share must not exceed 30%. This means that agreements entered into by powerful distributors or retailers would no longer enjoy the benefit of the block exemption just because the supplier under the agreement had a market share below 30%. It appears that it will be the purchaser's market share downstream, that is, on its resale market, that will be relevant for these purposes.

> "The key changes take particular account of the increased buyer power of big retailers and the evolution of online trade."

This contrasts with the current regime, where the relevant market share threshold (also 30%) is usually the supplier's. The purchaser's share is only relevant where provisions in the agreement restrict the supplier from selling to other EU-located purchasers. Reference to this type of restriction has been removed from the draft block exemption.

The Commission has stated that the introduction of a market share threshold for purchasers as well as suppliers is motivated by the market power of larger retailers and distributors. This development is likely to be controversial so it will be interesting to see the effect of third party comments on this point.

Permissive approach to restrictions of passive sales?

The majority of the more significant changes do not relate to the rules in the block exemption itself, but represent a fine tuning of the Commission's analytical approach and are found in the draft guidelines.

One point likely to be of interest to businesses generally is the proposed change to the Commission's general assessment of the restriction of so-called passive selling. A longstanding principle of EU competition law is that a supplier cannot prevent a distributor from responding to unsolicited business opportunities outside its designated territory or customer group – 'passive' selling. The current verticals regime prohibits all restrictions of passive selling.

The new draft guidelines suggest one exception to this rule. A supplier should be allowed to restrict passive sales for two years to a territory or customer group reserved for a new distributor where that new distributor has significant start-up costs.

It is interesting that this carve-out is not in the text of the block exemption but only in the guidelines, since an equivalent provision for technology licences is found

> "Resale price maintenance remains a hardcore restriction."

in the text of the technology transfer block exemption itself.

This point is nonetheless likely to be of considerable practical importance to suppliers who have a cross-border network of distributors.

Resale price restrictions - a more flexible approach?

There is a revised section in the guidelines analysing how the law should be applied to resale price restrictions, where the supplier in some way imposes a resale price on a distributor. In the past, it has appeared that the Commission considers resale price restraints to be almost per se illegal, taking a strict approach that they are prohibited. In the draft guidelines, the anti-competitive effects of resale price maintenance provisions are clearly enumerated, and their serious nature is reiterated. Resale price maintenance remains a hardcore restriction. An agreement containing an rpm provision cannot benefit from the block exemption at all.

However, the proposed guidelines also set out various economic benefits (efficiencies) that could potentially apply to the use of fixed or minimum resale price maintenance in certain circumstances. Such efficiencies will not be easy to demonstrate, but this change in the guidelines indicates that such arguments can be made and that the Commission would listen to them. This may be simply a clarification of the situation as it currently stands. Nevertheless, it is significant that the guidelines even hint at more flexibility in this area. The new guidance from the Commission could be of use to branded goods manufacturers, for example looking to stop 'loss leader' tactics by retailers, or when trying to introduce a new brand.

Updated explanation of points relating to online sales

The proposed guidelines update and amplify the guidance on a supplier's ability to restrict on-sales by its purchasers. This has been a contentious issue during the life of the current block exemption. The Commission's willingness to attempt further guidance in this area is therefore to be welcomed.

Internet selling receives more focus. In general the aim appears to be maximising use of the internet as a distribution channel, particularly across borders. This ties in with the Commission's more general interest in removing barriers to cross-border e-commerce (which were reported on in March 2009 by DG Consumer Affairs). The Commission indicates, for example, that suppliers should not:

- require an exclusive distributor to stop customers from another exclusively allocated territory viewing its website, or to re-route customers automatically to a website in another territory
- require an exclusive distributor to terminate consumers' transactions over the internet if their credit card data reveal that they are outside that distributor's territory
- require a distributor to limit the proportion of overall sales made over the internet
- require a distributor to pay more for products intended to be sold online rather than offline.

This is balanced against the Commission's aim to ensure that online distributors cannot 'free ride' on the hard work of other distributors to promote the product in question. The supplier is, therefore, able to require quality standards for the use of an internet site, as it could for a shop. An outright ban on internet selling will not be permitted unless clearly justified, which will only be possible in limited circumstances. In a selective distribution system, a supplier may require that a dealer has a bricks-and-mortar shop before he can sell online, although suppliers must not discourage dealers from selling online by imposing more onerous criteria than those for offline sales.

Issues around internet selling and selective distribution arrangements are likely to be particularly contentious during the Commission's consultation process. The views of business will be very important here.

New analysis of upfront access payments and category management

New sections in the proposed guidelines indicate how the Commission applies the law to two specific types of vertical restraint that are not expressly analysed in the existing guidelines. These are upfront access payments (the various fees that suppliers pay for example in order to get access to a distribution network and which remunerate services provided to the suppliers by the retailers) and category management agreements (where a supplier works with a retailer on the marketing of a whole category of products, rather than just its own products in that category). Although there is nothing novel in the law set out in those sections, the clarification of the Commission's thinking is useful. Their inclusion also emphasises that the Commission's appreciation of the commercial benefits of such practices does not entirely remove its concerns that they may be used for anti-competitive ends.

Conclusion

Suppliers and distributors in all industries, including online businesses, are affected by the verticals regime, and may have had particular experiences of the regime to date. Many companies may have chosen to express concerns to the Commission about elements of the regime retained in the draft block exemption and guidelines which they believe are not working, or pointed out problematic (or simply commercially unwelcome) aspects of the proposed changes. The Commission has in the past shown a willingness to take account of stakeholder comments in revising other block exemptions.

The implications for business will have significant longevity. The new rules and guidelines will remain in force for a ten year period, until the end of May 2020. Following the consultation phase, final versions of the block exemption and guidelines are due to be produced towards the end of 2009.

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A primary aim of most legal regimes across the world is the protection of public health and safety from threats posed by numerous factors, including – increasingly – food. This is especially visible in the context of recent scares and scandals connected with varying types of products, perhaps most notably Irish pork and Chinese infant formula.

In this context, this article aims to discuss the highlights of the EU and Chinese food safety legislation, the ways in which the pork and milk situations were handled and how they can be improved, the common characteristics and pitfalls of the food safety systems in the relevant territories.

EU

The main European-level legal act relevant to the food sector is Regulation 178/2002 of the European Parliament and of the Council, which lays down the general principles and requirements of food law, establishing the European Food Safety Authority (EFSA) and laying down procedures in matters of food safety.

Pursuant to European food-related legislation, unsafe food products – i.e. products that are harmful or potentially dangerous from a health standpoint - must not be placed on the market, and must be recalled if they may already have reached consumers. In appraising whether a given foodstuff can be considered unsafe, such factors as the likely effect of the product on health, in the light of normal conditions of use and/or the particular health sensitivities of the group of consumers at which the product is aimed, are taken into account. If an unsafe foodstuff forms part of a batch or production consignment, the entire quantity is presumed to be unsafe.

Responsibility for ensuring that the requirements set out by the relevant legal regulations are observed at all stages of the food production chain lies with food business operators. A key element of this process is ensuring the traceability of food, feed, food-

"Responsibility for ensuring that the requirements set out by the relevant legal regulations are observed at all stages of the food production chain lies with food business operators."

Food crisis

EU and PRC food safety law: case studies

producing animals and all substances incorporated into foodstuffs at all times, by means of implementation of appropriate systems and procedures.

In turn, the EU member states are responsible for enforcement of these regulations, either directly in the case of regulations or following transposition into national law (in the case of directives and other legal acts), as well as for defining appropriate measures and penalties for infringements. Furthermore, in cases where a given product is considered to pose a threat to public health, the authorities of a given member state are obliged to immediately inform the general public of this fact and ensure that all necessary steps aimed at elimination of this threat are undertaken.

The EU food safety regime

An important feature of the EU food safety regime is the Rapid Alert System for Food and Feed (RASFF). This system is designed to encompass all foodstuffs and animal feed, and functions through a network composed of the EU member states, the Commission and EFSA.

Generally speaking, the purpose of RASFF is to distribute information about food-related risks to the Commission and the general public. Once the Commission receives notification about a risk from the RASFF, it disseminates information on (i) measures aimed at preventing or controlling the use of food or feed (e.g. restricting the placing on the market or forcing the withdrawal or recall of food or feed); and (ii) any rejection of a batch or consignment of food or feed by a competent authority at the EU border.

"The handling and effects of the situation under discussion exposed a number of weaknesses of the European food safety control system."

Crisis situations

The European Commission is responsible for preparing a general crisis management plan to be applied in cases where a given foodstuff is suspected to pose a threat to human health.

In addition, it can apply one or more of a number of measures should a given member state not be able to independently deal with a food-related threat. These measures include suspension of placement of a given product on the market, imposition of special requirements in respect of a given product, imposition of interim measures aimed at controlling the threat, and establishment of a crisis unit responsible for identifying all relevant information and options available in respect of preventing, eliminating or reducing the risk to human health.

The Irish pork scare

On 6 December 2008, the recall of all Irish pork placed on the market from 1 September onwards was ordered following discovery of the presence of up to 200 times the legal limit of dioxins in Irish pork products. It is suspected that the situation resulted from use of contaminated feed at nine Irish pork farms and up to 37 cattle farms.

Within hours of the outbreak of the crisis, the Food Safety Authority of Ireland (FSAI) informed the general public of the situation and reassured them that all necessary measures were being taken to prevent any threats to human health. These included a complete product recall, including disposal of pork products by restaurants, hotels and supermarket chains. In addition, the FSAI set up a helpline to

"The level of traceability afforded by the current systems in these countries is an issue that will need to be reviewed and amended going forward."

provide information and guidance to the public. EFSA also promptly issued a statement in this respect, stating scientific data in respect of the risk of negative effects on human health of pork consumption.

The handling and effects of the situation under discussion exposed a number of weaknesses of the European food safety control system. Firstly, national food safety authorities (in this case the FSAI) often do not monitor risk in relation to the entire food chain. Secondly, the food traceability system does not cover the entire production chain - when the dioxin situation was discovered, the pork could be traced back to the farms from which it originated, but this was not the case beyond slaughter (i.e. the pork products could not be traced back to a particular batch processed at a given slaughterhouse at a specific moment in time) as no such procedures are foreseen by Irish law.

The recall was carried out even though it was accepted by the FSAI that any possible risk to consumer health was extremely low. The estimated cost to the pork industry was €100,000,000, which is unlikely to be covered under recall insurance terms. However, public confidence in Irish pork does not appear to have been affected long term.

China

The current regime is governed by the Food Safety Law of the People's Republic of China, published on 28 February 2009 (the Law), which entered into force on 1 June 2009. This legal act applies to any kind of food products (any processed and unprocessed substances intended for consumption by human beings), food additives and other food-related products (including food packaging materials, containers, detergents, disinfectants and production equipment) imported or produced in China. All related producers, distributors and catering service providers must comply with the Law.

The Chinese food safety regime

A feature of the Chinese food safety regime is the streamlined regulatory framework which allocates regulatory responsibilities to five main authorities, being the Ministry of Health (MOH), the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), the State Administration for Industry and Commerce (SAIC), the State Food and Drug Administration (SFDA) and the Ministry of Agriculture (MOA).

Although a Food Safety Committee under the State Council has been established to coordinate any conflicts between the aforementioned authorities, it is as yet unclear whether it will be effective in this respect.

Risk monitoring and crisis management system

The Law also provides for general crisis management procedures. The state council and local governments should prepare crisis management plans for national and different local levels. If a food safety accident occurs, the food business operator should report the case to the local health department (at county level) within two hours. For a serious case, such local health department should also report the case to its upper level authorities. The relevant health department together with other departments, such as local counterparts of AQSIQ, SAIC and SFDA, have then the authority to adopt rescue measures to prevent and mitigate the harm of the food safety accident, such as requiring medical treatment of personal injuries, inspecting and

requesting recall of the contaminated food and raw materials and rapid information release of the accident.

Product recall system

Food producers and suppliers should immediately cease production and/or distribution of unsafe food and should voluntarily recall the food from the market. AQSIQ, SAIC and SFDA are each empowered in this respect.

Increased sanctions

Companies responsible for producing or distributing substandard food now face severe administrative penalties (including confiscation of illegal income, revocation of licences and imposition of hefty fines), civil sanctions and in severe cases also criminal prosecution.

The Chinese infant formula scare

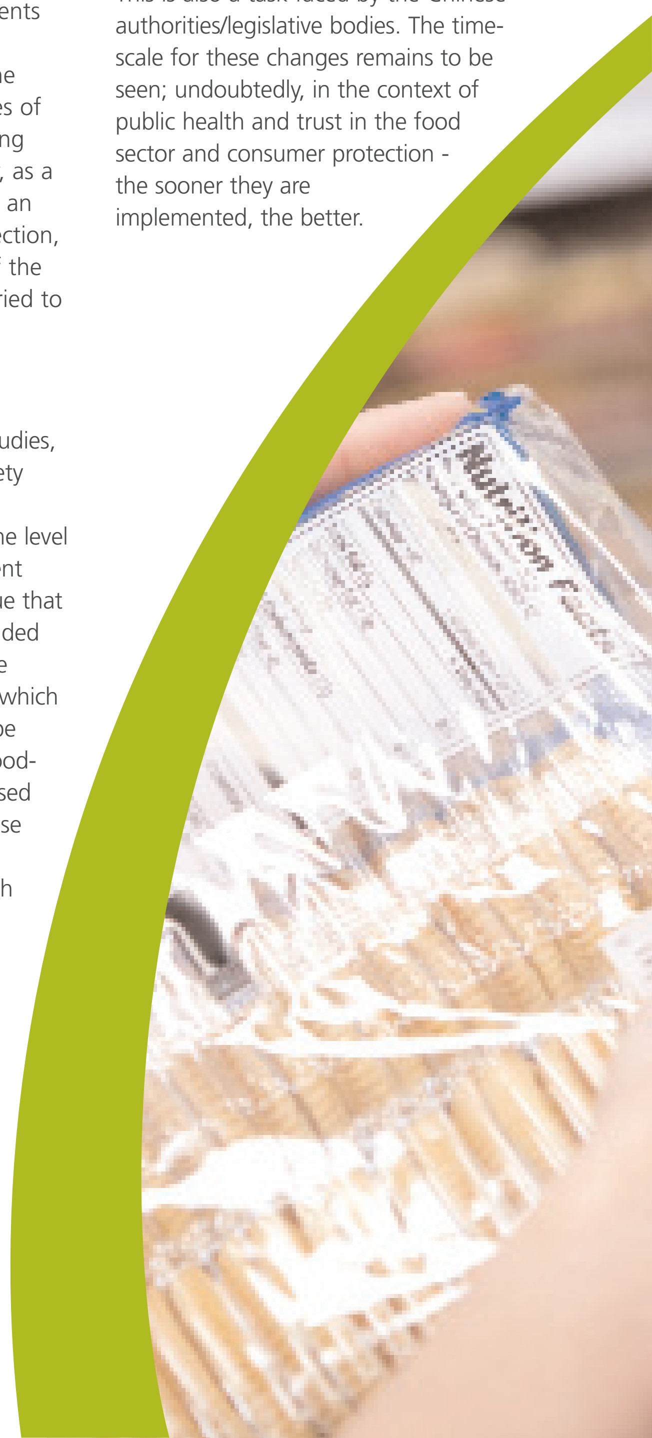
The melamine dairy scandal (autumn 2008) is one of the most severe food safety cases to have occurred in China to date, and relates to placement on the Chinese market of infant formula containing melamine, a toxic industrial chemical that artificially creates higher protein levels. According to media reports, six babies died and nearly 300,000 others became ill as a result of consumption of such products.

Sanlu, a major domestic manufacturer of dairy products, was found guilty of manufacturing and selling counterfeit and substandard products and was subjected to a fine of approx. RMB 50 million (€5 million). The personnel that added melamine to the company's infant formula, as well as Sanlu's chairman and other senior staff responsible for the production and sale of the contaminated products, were also subjected to severe criminal sanctions. All of the contaminated products were recalled and large sums of compensation were paid to victims; furthermore, all dairy products present on the Chinese market were placed under the strict scrutiny of the government.

The Sanlu case has highlighted several deficiencies in the Chinese food safety regulation system. Firstly, the case emphasizes the loose control of food additives. Secondly, local governments did not properly perform their monitoring duties, partly due to the overlapping scopes of competences of the relevant authorities and resulting gaps in allocation of duties. Finally, as a reputable company, Sanlu enjoyed an exemption from food quality inspection, which further delayed discovery of the source of the crisis. The Law has tried to address all of these issues.

Lessons learnt

As highlighted in the above case studies, both in the EU and China food safety regulations fail to fully ensure the maximum degree of food safety. The level of traceability afforded by the current systems in these countries is an issue that will need to be reviewed and amended going forward, in order to eliminate situations whereby the entity from which a given product originates cannot be identified. Similarly, it is vital that food-related scares and crises are addressed at an early stage, which was the case in the pork situation but not in respect of the Sanlu situation, which became apparent only after a number of fatalities had occurred. The new Chinese food safety law has responded to these critics in strengthening and reorganizing the distribution of powers among the various competent authorities and increasing the sanctions; however, there is still a long way to go in the process of building a fully reliable and comprehensive food safety system. In contrast, the European system seems stable and reasonably comprehensive, but must focus on adapting to the situations that now arise and methodologies that are effective in ensuring early diagnosis and immediate remedial action, so as to avoid total product recalls (as was the case in 2008). This is also a task faced by the Chinese authorities/legislative bodies. The time-scale for these changes remains to be seen; undoubtedly, in the context of public health and trust in the food sector and consumer protection - the sooner they are implemented, the better.



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