
A first look at the revised Vertical Restraints Block Exemption Regulation – old wine in new skins?

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I. Introduction

Following an intense public consultation period, the European Commission on 20 April 2010 adopted its revised Vertical Restraints Block Exemption Regulation (the “new VRBER”),¹ and the accompanying guidelines (the “new Guidelines”).² The provisions came into force on 1 June 2010, thus replacing the previous block exemption regulation (the “old VRBER”), which expired on 31 May 2010,³ and the related guidelines (the “old Guidelines”).⁴

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¹ Regulation (EU) No 330/2010 of 20/4/2010 on the application of Art. 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L 102 of 23/4/2010, p. 1.

² Commission Notice, Guidelines on Vertical Restraints, OJ C 130 of 19/5/2010, p. 1. The guidelines do not constitute secondary EU law and as such are not binding on the Member States or National Competition Authorities (NCAs) but serve as standing rules for the Commission.

³ Regulation (EC) No 2790/1999 of 22/12/1999 on the application of Art. 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336 of 29/12/1999, p. 21.

⁴ Commission Notice, Guidelines on Vertical Restraints, OJ C 291 of 13/10/2000, p. 1.

Given that a one year grace period (ending 31 May 2011) is currently applicable to agreements that were in force prior to 1 June 2010 and met the exemption criteria under the previous regime, it is too early to comment on the practical implementation of the new VRBER. However, it appears useful to highlight the changes at this early stage in order to assess to what extent contracting practices, and consequently legal advice, will have to be adapted. In particular, it will be necessary to adjust agreements currently in force to the new rules while the transition period is running.

In this context it may also be mentioned that the Commission is currently conducting a revision of the likewise important Horizontal Restraints Block Exemption Regulation (the “new HRBER”). The public consultation with view to the new HRBER ended on 25 June 2010. The Commission intends to adopt a final text as well as new guidelines by the end of 2010.⁵

II. Scope of the new VRBER

As with the old VRBER,⁶ the purpose of the new VRBER is to exclude vertical agreements from the general prohibition of cartels and concerted practices as laid down in Art. 101(1) Treaty on the Functioning of the European Union.⁷ The conditions that have to be met in order to benefit from the VRBER (the “safe harbour”) are that certain market share thresholds are not exceeded by the contracting undertakings and that specific “hardcore” restrictions are not contained in the agreement itself. The VRBERs as “umbrella regulations” historically have their roots in recent insights and paradigm shifts in competition economics suggesting that vertical agreements are only detrimental to competition in the presence of significant market power or when particularly restrictive provisions are used.⁸

⁵ See the Commission’s press release IP/10/489, Competition: Commission consults on review of rules applicable to horizontal co-operation agreements.

⁶ *Wish*, Regulation 2790/99: The Commission’s “new style” block exemption for vertical agreements, CMLR 2000, p. 887.

⁷ Consolidated Version of the Treaty on the Functioning of the European Union, OJ C 83 of 30/3/2010, p. 47, “TFEU”.

⁸ Before the VRBERs came into existence, the approach to vertical restraints was one of the most criticized aspects of EU competition policy. The Commission distinguished vertical agreements based on their legal form rather than their economic effect, thus producing significant type 1 errors (competition law mistakenly prohibits pro-competitive conduct) and type 2 errors (competition law mistakenly approves anti-competitive conduct). One of the most vocal critics of this policy was *Neven* (who later went on to become the Commission’s first Chief Competition Economist); see the seminal *Neven et al.*, *Trawling for Minnows: European Competition Policy and Agreements between Firms*, 1998.

Although this objective of the old VRBER remains largely unchanged in the new VRBER, the main modifications to the block exemption reflect two major economic developments which the Commission expressly sought to address: (i) The increasing amount of large distributors with market power in certain industries, who just like large suppliers can put in place vertical restraints that harm competition (e.g. supermarket chains), and (ii) the growing importance of the Internet as a medium for online sales and cross-border commerce, which can be hampered if suppliers can restrict online sales by not equally supplying online-only distributors (e.g. limit the quantity for products sold via online-shops or charge higher prices for products to be sold online).⁹

However, the new VRBER deliberately does not follow one other recent groundbreaking economic and judicial development in the field of vertical agreements: The 2007 United States Supreme Court ruling in *Leegin Creative Leather Products v. PSKS Inc.* which declared that resale price maintenance (RPM) is not per se unlawful but must be judged under “the rule of reason”.¹⁰ Although the Supreme Court judgement had sparked a lively debate in Europe as to whether or not EU competition policy should follow suit and remove RPM from the list of hardcore restrictions,¹¹ the Commission chose not to do so primarily because there had been no case in the Member States or the EU that had convincingly demonstrated the pro-competitive advantages of RMP.¹²

Of the changes that were adopted the most significant is the two-limbed market share threshold. This means that both the supplier’s market share and the distributor’s market share must now not exceed 30 percent, thereby further limiting the availability of the exemption (Art. 3). This modification was heavily criticized prior to the adoption of the new VRBER, notably by competition authorities and professional associations in the Member States¹³ and remains controversial after the

⁹ Press release IP/10/445, Antitrust: Commission adopts revised competition rules of distribution of goods and services.

¹⁰ *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

¹¹ *Jones*, RPM: A Debate About Competition Policy in Europe?, ECJ 2009, pp. 479-514; *Kneepkens*, RPM: Economics Call for a More Balanced Approach, ECLR 2007, pp. 656-664; *Peepkorn*, RPM and its Alleged Efficiencies, ECJ 2008, pp. 201-212; *Vickers*, Competition Law and Economics: A Mid-Atlantic Viewpoint, ECJ 2007, pp. 1-55.

¹² *Simon*, Vertical Restraints: New BER and Guidelines Adopted, JECL & Pract 2010, p. 311 et seq.

¹³ From the German perspective: Bundesministerium für Wirtschaft und Technologie und Bundeskartellamt, Stellungnahme zum Entwurf einer Verordnung der Europäischen Kommission über die Anwendung von Artikel 81 Abs. 3 EG-Vertrag auf Gruppen von vertikalen Vereinbarungen und aufeinander abgestimmten Verhaltensweisen (Vertikal-GVO), 2009, p. 2 et seq.; *Kunz-Hallstein/Loschelder*, Stellungnahme der GRUR durch den Fachausschuss für Kartellrecht zu dem Entwurf einer Verordnung über die Anwendung von Art. 81 III EG auf Gruppen von vertikalen Vereinbarungen und aufeinander abgestimmte Verhaltensweisen, GRUR 2010, p. 38.

adoption.¹⁴ While the Commission argues that SMEs as suppliers needed additional protection from distributors with significant market power, the critics invoke the argument of legal uncertainty for suppliers with regard to the market shares of the distributors. This issue will be discussed in detail under III.

Simultaneously, the definition of what constitutes a vertical agreement has been widened. The new Guidelines now expressly state that for there to be an agreement within the meaning of Art. 101 TFEU, it is sufficient for the parties to have expressed their joint intention to conduct themselves on the market in a specific way (para. 25 lit. a)). The new quality lies in the fact that in the absence of an explicit acquiescence, an agreement or concerted practice can take the form of a mere tacit acquiescence where one party explicitly or implicitly requires an action from the other party for the implementation of a unilateral policy and the other party complies by carrying it out (para. 25 lit. a)). This new stipulation may pose a risk for suppliers who for example prompt distributors to adhere to particular resale prices.

One modification that initially sparked some confusion in the German-speaking Member States concerned the definition of “vertical” in the authentic German versions of the old vis-a-vis the new VRBER.¹⁵ While the old regulation, literally translated, defined “vertical” as relating to “a different production or distribution level” (“*eine unterschiedliche Produktions- oder Vertriebsstufe*“, Art. 2(1)), the new regulation now uses the phrase “a different level of the production or distribution chain” (“*auf einer anderen Ebene der Produktions- oder Vertriebskette*“, Art. 1 lit. a)). The new word “chain” instead of “level” led some to believe that now more than two undertakings would have to be involved to form the “chain”. However, this was soon revealed to be merely a translation rather than a legal issue.¹⁶

Moreover, several changes were made to the scope of the VRBER in regard to agreements between competitors. The old Guidelines defined a competing undertaking as “an actual or potential supplier in the same product market” (Art. 1 lit. a)). The new Guidelines now define an actual competitor as “an undertaking active on the same relevant market” (Art. 1 lit. c)). Since “relevant market” in this context means both, the product and the geographical market, undertakings are now only considered as competitors if they offer competing products in the same geographical area.¹⁷ Since undertakings are now less likely to be considered competitors, it can

¹⁴ *Funke/Just*, Neue Wettbewerbsregeln für den Vertrieb: Die Verordnung (EU) Nr. 330/2010 für Vertikalverträge, DB 2010, p. 1392; *Lettl*, Die neue Vertikal-GVO (EU Nr. 330/2010) – Unter Einbeziehung der Änderungen der Vertikal-Leitlinien im Hinblick auf den Internetvertrieb insbesondere in selektiven Vertriebssystemen, WRP 2010, p. 812.

¹⁵ From the German perspective: Bundesministerium für Wirtschaft und Technologie und Bundeskartellamt, (fn. 13), pp. 2 et seq.; *Kunz-Hallstein/Loschelder*, (fn. 13), p. 38.

¹⁶ *Funke/Just*, (fn. 14), p. 1390.

¹⁷ *Lettl*, (fn. 14), p. 810.

be said that the scope of the VRBER has been somewhat expanded to agreements between competitors.

However, the old Guidelines made an exception for non-reciprocal agreements between competitors where the buyer had a turnover of less than € 100 million in the previous fiscal year to be considered for the safe harbour (Art. 2(4)). The new Guidelines do not contain this turnover-based exception any more, thus again limiting the scope of the VRBER to agreements between competitors. This seems prudent, since the absolute turnover says little about the actual position of an undertaking in the market.¹⁸ This now defunct exception used to be beneficial for agreements between small suppliers and large manufacturers who could also have produced the supplied parts in question themselves; the parties to such an agreement will now have to consider applying for an individual exemption.¹⁹

The generally more comprehensive approach of the new Guidelines is further marked by the express confirmation that the new VRBER does not preclude the application of the special provisions for subcontracting agreements contained in the Subcontracting Agreements Notice.²⁰ In accordance with this notice, subcontracting agreements whereby the subcontractor undertakes to produce products exclusively for the contractor on the basis of technology and equipment provided by him generally fall outside the scope of Art. 101(1) TFEU, provided that the technology or equipment in question is necessary to enable the subcontractor to produce the products. This provision provides useful elbow room to suppliers and the clarification of its applicability may prove useful for certainty purposes.

In addition, the new Guidelines indicate the circumstances in which the Commission might withdraw the benefit of the block exemption in individual cases under Art. 29(1) of Regulation 1/2003²¹ (para. 69). The Guidelines state that the Commission bears the burden of proof that the agreement infringes Art. 101(1) TFEU, while the undertaking claiming exemption under Art. 101(3) TFEU bears the burden of proof for the exculpatory conditions. Furthermore, paragraph 69 also contains an efficiency defence in that when the Commission demonstrates likely anti-competitive effects of the distribution system, the undertaking can substantiate welfare-enhancing effects. Under Art. 29(2), national authorities also have powers to withdraw the benefit of the VRBER in a particular Member State.

¹⁸ *Funke/Just*, (fn. 14), fn. 21.

¹⁹ *Ibid.*

²⁰ Commission Notice, Assessment of certain subcontracting agreements in relation to Art. 85(1) of the EEC Treaty, OJ C 1 of 03/01/1979, p. 2.

²¹ Regulation (EC) No 1/2003 – Implementation of the rules on competition laid down in Art. 81 and 82 of the Treaty of 16/12/2002, OJ L 1 of 4/1/2003, p. 1; for more details see *van der Hout*, in: Mäsch (Hrsg.), *Praxiskommentar zum deutschen und europäischen Kartellrecht*, 2010, Art. 29, para. 5 et seq.

III. Market share thresholds

The first condition that has to be met in order for agreements to benefit from the safe harbour of the VRBER is that the market share threshold of the contracting undertakings is not exceeded. For vertical agreements between non-competitors where the parties have individual market shares of 15 percent or less, the *de minimis* criterion is met so that such agreements always fall outside the scope of Art. 101(1) TFEU. For agreements where the parties have market shares of more than 15 percent the rules of the VRBER apply. Under the old VRBER, the safe harbour was only applicable if the supplier held less than 30 percent of the supply market. Under the new VRBER the additional condition is now that the distributor must also not hold more than 30 percent of the purchasing market (Art. 3(1)).

The significance of this change is clear, albeit it being even greater in multi-party agreements where one undertaking is both a supplier and a distributor, in which case the undertaking must meet the threshold in both the buying and selling markets. The debate in this regard centred on the question of whether or not the introduction of a buyer's market share threshold was a necessary step to take. The Commission argued that just like suppliers, distributors could use their market power to put in place vertical restraints and that the threshold would be beneficial for SMEs since they are more likely to be harmed by distributor-led vertical restraints.²² One example given by the Commission was that of large supermarket chains using vertical restraints on small producers.²³

One main concern raised against the introduction of the buyer's market threshold was that suppliers usually have little information about the market shares of the distributors so that they would now be forced to rely on potentially costly external expertise (e.g. market studies) in order to monitor the other contracting party's market and reduce their own legal uncertainty.²⁴ Another criticism is that reducing the scope of application of the safe harbour in general is disproportionate to the aim of protecting SMEs since market power on the distribution side is seen to be a rather uncommon phenomenon.²⁵ It indeed appears questionable if there would not have been a less intrusive way of approaching this issue, for example by withdrawing the exemption in individual cases. It remains to be seen how this aspect will be tackled in the Commission's practice.

²² Press release MEMO/10/138, Antitrust: Commission adopts revised competition rules for vertical agreements: frequently asked questions, question 5.

²³ Press release IP/10/445, (fn. 9); *Simon*, (fn. 12), p. 312.

²⁴ *Funke/Just*, (fn. 14), fn. 21.

²⁵ *Lettl*, (fn. 14), p. 811.

IV. Hardcore restrictions

The second condition that has to be met is that the agreement must not contain any “hardcore” restrictions, such as resale price maintenance (“RPM”) or bans on cross-border selling. This systematic has not been modified by the new provisions.

The list of restrictions which constitute hardcore measures has not been significantly modified by the VRBER. However, the new Guidelines do expressly provide that parties may rebut the presumption that hardcore restrictions infringe Art. 101(1) TFEU; particular examples of when otherwise hardcore restrictions may fall outside of the scope of or fulfil the conditions of Art. 101(3) TFEU are also listed, for example in the case of the restriction of passive sales by other distributors into a territory or customer group in order to recoup substantial investments of one distributor necessary to start-up and/or develop a new market, provided this occurs only during the first two years that the distributor is selling the contract goods or services in that territory or to that customer group.

As under the previous rules, a distinction is made between exclusive and selective distribution agreements. In exclusive distribution arrangements, the distributor is limited in choice in respect of territories, customer type, or both. In selective distribution arrangements on the other hand, the distributor’s choices are linked to criteria corresponding to the characteristics of the products in question and the related restrictions involve sales to unauthorised distributors rather than to end customers.²⁶

The distinction between active and passive sales has been retained and the definitions remain essentially the same, though they have been supplemented slightly for clarification. As was the case previously, suppliers employing exclusive distribution systems may restrict distributors from making active sales outside of their allocated areas (so that generally speaking only restrictions on passive sales are disallowed in such configurations), but suppliers employing selective distribution systems may not do so (so that generally speaking only restrictions regarding sales to unauthorised distributors are allowed in such instances).

However, unlike the old Guidelines, the new Guidelines stipulate that a territory or customer group may be considered as exclusively allocated to the buyer even if the supplier sells products in the same territory or to the same group of customers. A prohibition of active sales in another distributor’s territory or to another distributor’s customer group therefore no longer constitutes a hardcore restriction, even if the supplier itself sells products in that territory or to that customer group.

In respect of selective distribution, one of the previous hardcore restrictions was supplemented in such a way that a supplier may now only restrict sales by its distributors to unauthorised distributors in markets where such a system is operated.

²⁶ For an overview on the distinction between exclusive and selective distribution agreements see *Wish*, Competition Law, 6th ed. 2009, p. 628 et seq.

However, the territory where a selective distribution system is operated is considered the territory reserved for the system and thus includes the possibility of reserving territory for a future expansion of the distribution network. As such, the supplier may in fact restrict sales by its distributors to unauthorised distributors in territories that the supplier reserved for itself, but where it does not yet sell products. This will enable suppliers to appoint selective distributors whilst nevertheless reserving key territories or a certain sale channel to themselves.

Some commentators have read this modification as meaning that the supplier can only restrict sales within territories reserved by the supplier for itself and that thus a member of such an arrangement is now free to make unfettered sales in territories where no selective distribution system has been implemented by the supplier itself. However, this view is negated by paragraph 55 of the Guidelines, which clearly defines “the territory reserved by the supplier to operate the system” widely, namely as “any territory where the system is currently operated or where the supplier does not yet sell the contract products”.

Given the intensely debated case law in respect of RPM which emerged from the other side of the Atlantic (United States Supreme Court judgement in *Leegin Creative Leather Products v. PSKS Inc.*²⁷), it was in particular much awaited to see whether the Commission would somewhat adjust its view on this traditionally hardcore restriction. The new provisions still very much uphold the view that RPM is a hardcore restriction, and thus presumptively in breach of Art. 101(1) TFEU.

The new Guidelines highlight that generally, the presumption that hardcore restrictions infringe Art. 101(1) TFEU is rebuttable. In express reference to RPM, the new Guidelines include (limited) examples of when RPM could lead to efficiencies that meet the criteria of Art. 101(3) TFEU. Examples include the introduction of a new product or RPMs in order to organise and maintain a short term (two to six week) low price campaign in a franchise or similar distribution system. A full rule of reason approach has however by no means been adopted and it is expected that given the traditional view of RPM practices, any allegedly resulting efficiencies are likely to be difficult to sustain.

V. Online sales

The VRBER itself does not in fact make any reference to online sales; however, the new Guidelines deal with the issue in detail and thus help to delineate the often murky lines between active and passive sales in the online world.²⁸

²⁷ *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

²⁸ The Commission as a general approach tries to promote online sales in order to increase consumer choice and price competition; see the Commission's press release IP/10/445, (fn. 9).

In general, the view has been retained that online sales are passive sales, meaning that the majority of restrictions on online sales in exclusive distribution systems, whether explicit or *de facto*, are classified as hardcore. However, certain methods of targeting customers via the Internet are considered active selling tactics and can thus be prohibited. Examples include online advertisements specifically addressed to certain customers, territory based banners on third party websites and the sending of unsolicited e-mails to customers. Websites are still considered a form of passive selling even where information is featured in multiple languages and thus may encourage sales to customers outside of the distributors' allocated territory, so that this is not a basis for restricting their use.

More specifically, the new provisions make it clear that practices such as the compulsory re-routing of customers outside of the distributor's territory to their national websites, or the termination of online transactions where credit cards issued outside of the distributor's territory are used, are hardcore restrictions. Even the receipt and processing of an order by a customer following a visit to the website comes under the umbrella of passive selling, as does a sale triggered by a customer opting to be kept automatically informed on products by the distributor.

The limiting of the proportion of overall sales that a distributor may make over the Internet is considered hardcore, although a requirement that the buyer has to sell at least a "certain absolute amount" of a product offline to ensure an efficient operation of its brick and mortar shop, whether in volume or value, is acceptable. The requirement that higher prices be paid for products intended to be resold online is also considered hardcore, though this does not exclude "the supplier agreeing with the buyer a fixed fee" to support its online or offline sales efforts.

On the other hand, the regulation of online sales in order to preserve the quality of a distribution network, particularly where selective distribution systems are concerned, is viewed more flexibly. Restrictions allowed in the offline world may be applied in the online world. Quality and service conditions may for example be imposed, provided that these are "overall equivalent to" the conditions applicable to offline sales. In addition however, distributors selling through the internet may be required to operate at least one "bricks and mortar" shop, provided the characteristics of the product being sold justify the imposition of such a requirement and that the object of that requirement is not in fact the direct or indirect limitation of online sales by distributors.

The fundamental idea is therefore that the possibility of online sales should be available to all distributors, but that a restriction on online sales is acceptable to the extent that such use would enable the distributor to make active sales into territories or to customer groups reserved exclusively. As such, an exclusive distributor will continue to be exposed to competition from online sales from outside its assigned

territory or customer group. However, the Guidelines, albeit no doubt to be very influential on questions of interpretation generally and to provide guidance for the Commission's decision making process, are not in fact legally binding in a strict sense. How the more borderline issues and activities are consequently dealt with in practice therefore remains to be seen.²⁹

VI. Other changes

The competitive effects of two altogether new areas relevant to mass retailing are covered in the new Guidelines, namely upfront access payments and category management.

- (i) Upfront access payments are fixed fees paid by suppliers to distributors in return for access to their distribution network. According to the Guidelines, these may lead to anticompetitive foreclosure of other distributors if they induce the supplier to channel its products through only that distributor or a limited number of distributors as a result, and to the foreclosure of other suppliers if the extensive use of those payments increases barriers to entry. Expressly mentioned potential efficiencies include the efficient allocation of shelf space or decreased incentives for suppliers to free-ride on the promotional efforts of distributors.
- (ii) Category management agreements involve the distributor designating the supplier to direct the marketing of a particular category of products, including the products of other suppliers. This is often practiced by retailers who collaborate with leading suppliers of a category of products. Although the new Guidelines consider that such arrangements may lead to anticompetitive foreclosure of other suppliers where the category manager is in a position to limit or disadvantage the distribution of products of competing suppliers, it is also stated that such agreements may allow distributors to achieve pro-competitive economies of scale and that, in general, category management agreements will not be considered problematic.

In addition, the new provisions have refined the distinction between agents and distributors by clarifying, in accordance with recent case law, that only risks taken by the agent in the same product market are relevant when assessing whether an agency is a true agency.

²⁹ According to the Commission online sales foster the single market as a whole, see *Monti*, A new strategy for the Single Market – at the service of Europe's economy and society, report, 9/5/2010, p. 45.

As commented above in relation to the clarification regarding online sales, how any of the potentially ambiguous notions of these guiding principles will be applied in practice by the Commission on the one side, and national competition authorities on the other, remains to be seen. The inclusion of practices not previously referred to in the guidelines is however in itself meaningful: The categories now take on a European scope, meaning that wider EU implications now have to be taken into account in addition to national approaches. This may for example pose a problem for Member States which traditionally apply a more restrictive approach to the practices in question, as is often the case in respect of upfront access payments.

VII. Conclusion

As has been seen, the principal changes brought about by the new provisions are (i) the limitation of the safe harbour by the extension of the market share threshold to the distributor too, and (ii) the clarification provided on the classification of passive and active online sales. According to the Commission, the narrower safe harbour is necessary in order to contain the power of large purchasers. On the other hand, the relative softening of the Commission's approach in respect of practices such as passive sales and RPM illustrates that the new Guidelines are structured on a clear rule-exception basis:

- (1) The VRBER exempts vertical agreements from the provisions of Art. 101(1) TFEU – unless the agreements contain “hardcore restrictions” or unless particular clauses are subject to individual exclusion due to their nature as “excluded restrictions”;
- (2) Clauses (in the case of excluded restrictions) or agreements (in the case of hardcore restrictions) not covered by the safe harbour offered by VRBER, must be shown to have an anticompetitive object or effect by those challenging them – if this is argued successfully, the burden is then on the undertakings concerned to prove that the restriction should be exempted on the ground of efficiencies as provided by Art. 101(3) TFEU;
- (3) It is assumed that hardcore and excluded provisions restrict competition – however, this assumption may still be rebutted in individual cases.

This approach, which allows for the weighing up of the commercial consequences of restrictions, is described by the Commission as its “more economic approach” which has been followed for a couple of years now. However, whether the slight shift in view on RPM is much more than formalistic will only be answered by the Commission's practice in time.

What is certain on a practical level is that as a consequence of the additional market share threshold, parties to an agreement now face an additional burden in determining the market position of the distributor and whether an agreement would fall under the block exemption. It is expected that transaction and compliance costs will increase as a result, particularly in scenarios where reliable external market shares of purchasing markets are not available, for example due to sector characteristics or geographical region. To what extent the increased independence of the parties, resulting from the significantly increased explanations and clarifications contained in the new Guidelines, will balance out this effect, remains to be seen.