Kluwer Competition Law Blog

New EU competition rules for distribution agreements

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On 10 May 2022, the European Commission ("EC") published a new Vertical Block Exemption Regulation ("VBER") and guidelines on vertical restraints ("Vertical Guidelines") that will enter into force on 1 June 2022. The package introduces important changes for the treatment of distribution agreements under EU competition law, in particular to the rules governing the combination of several different distribution systems, dual distribution, dual pricing and parity obligations.

What are the VBER and Vertical Guidelines?

The VBER provides parties to vertical agreements (i.e. agreements entered into between businesses operating at different levels of the supply chain) with increased certainty about the compatibility of their agreements with Article 101(1) of the Treaty on the Functioning of the European Union ("TFEU"), by creating a safe harbour exemption.

If neither party's market share exceeds 30% on the relevant sales and purchasing markets, vertical agreements, which do not contain any so-called "hardcore restrictions" (including, for example, resale price maintenance or certain territorial/customer restrictions), automatically benefit from an exemption. Agreements that do not satisfy the VBER conditions may still be compatible with Article 101(1) TFEU, but these agreements require individual assessment pursuant to Article 101(3) TFEU.

The Vertical Guidelines aim to help companies to self-assess whether their agreements are covered by the VBER or may qualify for an individual exemption pursuant to Article 101(3) TFEU.

The new VBER will enter into force on 1 June 2022, and will be valid for 12 years (with an evaluation report after eight years). There is a one-year transitional period for agreements already in force on 31 May 2022 that satisfy the conditions for exemption under the current VBER, but do not satisfy the conditions under the new VBER.

The new VBER and Vertical Guidelines follow an extensive evaluation exercise that the

EC undertook over the last three and a half years. The EC's evaluation has, in particular, focused on the changes that seemed appropriate as a result of the further growth of online sales and increasing emergence of new market players (such as online platforms). Like the rules governing horizontal relationships between competitors recently reviewed by the EC, the new vertical rules also account for economic and social developments, in particular digital transition and the European Green Deal.

Key revisions

Set out below is a snapshot overview of the key revisions.

Dual distribution	Dual distribution covers situations where a supplier is active both upstream and downstream, and hence may be regarded as competing with its downstream customers (e.g. where a manufacturer does not only sell its goods or services through independent retailers but also directly to end customers). The rise of online sales – in particular, through suppliers' own online shops – has resulted in a significant increase in dual distribution. The current VBER excludes vertical agreements between competitors from the block exemption, but specifically provides that dual distribution is covered by the safe harbour for vertical agreements. Accordingly, under the current VBER, dual distribution was effectively treated in the same way as other types of vertical agreements. The new VBER and Vertical Guidelines amends the safe harbour for dual distribution agreements in the following ways: **Expansion** o The scope of the dual distribution safe harbour covers also wholesalers and importers. **Limitations** o Vertical agreements relating to the provision of online intermediation services ("OIS"), where the OIS provider (e.g. e-commerce marketplaces, app stores, price comparison tools and social media services) also sells goods or services in competition with the companies to which it provides OIS, are excluded from the benefit of the safe harbour. o Information exchange between the supplier and its distributors is covered by the safe harbour only as long as (1) it is directly related to the implementation of the vertical agreement, or (2) it is necessary to improve the production or distribution of the contract goods or services. o The new Vertical Guidelines provide a "white" list, namely a "non-exhaustive" list of information that may be exchanged and typically benefit from the block exemption, and a "black" list that is "generally" unlikely to benefit from the exemption. o The EC dropped its proposed limitation to the safe harbour published for consultation in July 2021, whereby information exchanges could not benefit from the safe harbour unless the parties' aggregated market share in the retail market did not exceed 10% (see here our previous alert).

Parity obligations/MFNs	Parity obligations (referred also as Most Favoured Nation Clauses, or MFNs) require a company to offer its contracting party the same or better conditions as on other outlets (be it other platforms or any other sales channel). While all parity obligations are fully exempted by the current VBER, the new VBER narrowed the scope of the safe harbour for MFN clauses as follows: o Across-platform retail parity obligations, whereby an online platform restricts a supplier from offering its product on other retail platforms/channels at a lower price/better terms ("wide parity clauses"), do not benefit from the block exemption and will have to be assessed individually under Article 101 TFEU (as an "excluded restriction" under Article 5(1)(d) of the new VBER); and o The new VBER continues to exempt all other parity obligations, including retail parity obligations relating to direct sales or marketing channels (so-called "narrow" parity clauses). For example, clauses that restrict suppliers from offering better terms on their own websites are still exempted. However, the new rules state that where narrow retail parity obligations are imposed by online platforms covering a significant share of users (cumulative effects) and there is no evidence of efficiencies, the benefit of the block exemption is likely to be withdrawn.
Dual pricing	Dual pricing means charging the same distributor different prices for products intended to be sold online and products sold offline. While the current Vertical Guidelines treated dual pricing as a form of hardcore restriction on online sales, the new rules adopt a more flexible approach: o Under the new Vertical Guidelines, dual pricing is no longer treated as a hardcore restriction, as it may incentivise or reward an appropriate level of investments. This applies to all suppliers irrespective of their distribution model. The parties may set up a system to implement dual pricing effectively (e.g. monitoring items that are sold online); o The price difference must be reasonably related to the cost and investment differences between the online and offline channels, but the parties are not required to carry out complex cost calculations; o However, to fall within the safe harbour, the difference in the wholesale price must not have the object of restricting sales to particular territories/customers or preventing the effective use of the internet, and the supplier must not cap the amount of products that may be sold online; and o The supplier may not require that the retail prices be higher or lower depending on the sales channel.

Online sales restrictions (including online advertising)	A hardcore restriction, and thus not covered by the block exemption, is the prevention of the effective use of the internet by buyers or their customers to sell goods or services, as it restricts the territory into which or the customers to whom the sales are made. Other restrictions of online sales or restrictions of online advertising may fall within the safe harbour. The following examples are in principle covered by the block exemption, irrespective of the type of distribution system operated: o Restrictions intended to ensure the quality or a particular appearance of the buyer’s online store; o Requirements regarding the display of the goods or services in the online store, such as the minimum number of items displayed or the way the trademarks or brands are presented; o Restrictions relating to the use of particular online sales channels (e.g. direct or indirect bans of the use of online marketplaces); o Restrictions of online advertising (providing that they do not have the object of preventing the use of an entire advertising channel by the buyer), e.g.: o online advertising meets certain quality standards or includes specific content or information; o the buyer does not use the services of particular online advertising providers that do not meet certain quality standards; o the buyer does not use the brand name of the supplier in the domain name of its online store; and o Requirements that the buyer operates one or more brick and mortar shops and makes a minimum absolute volume of sales offline. In contrast, the following examples are considered as hardcore restrictions removing the benefit of the block exemption: o Restrictions of the use of entire online advertising channels, such as price comparison websites or paid referencing in search engines (but fully banning online marketplaces as a *sales* channel is not a hardcore restriction); o Requirements to prevent access of customers located in other territories to the buyer’s website or reroute them; o Requirements to reject payments with foreign credit cards; o Requirements that sales may only take place in a physical space or in the physical presence of specialised personnel; o Prohibiting the buyer to use the supplier’s trademarks or brand names on its website; and o Requirements that the buyer makes a certain share of total sales offline.

Exclusive Distribution	o In the new VBER, the block exemption is extended to systems of shared exclusivity, allowing a supplier to appoint up to a maximum of five distributors in a particular territory or for a particular customer group (the current rules, by contrast, seem to allow for the appointment of one exclusive distributor per territory/ customer group). However, restrictions of active or passive sales within the exclusive territory or customer group are not covered by the block exemption. o Active sales restrictions are limitations of the buyer's ability to actively approach customers in a specific territory or customer groups defined by other criteria. Conversely, passive sales restrictions refer to sales made in response to unsolicited requests from individual customers. Preventing passive sales is and will remain a hardcore restriction of competition and is thus prohibited. The new VBER provides a definition of active and passive sales, clarifying their scope with regard to operating websites. Whereas the operation of a website is in principle a form of passive selling, it constitutes active selling if the website has a top-level domain corresponding to particular territories or it offers languages that are not commonly used in the territory where the distributor is established. o The new rules explicitly allow to combine selective and exclusive distribution in different territories within the EU, and provide additional protection for such a set-up. Accordingly, members of a selective distribution system set up in one territory could be prevented from actively selling into a territory or to a customer group exclusively allocated to a maximum of five distributors, or reserved to the supplier. Conversely, a supplier is also able to prevent its exclusive distributors from selling actively or passively to unauthorised distributors located in the territory where the supplier operates a selective distribution system or which it has reserved for the operation of such a system. o As with the previous rules, combining an exclusive and selective distribution system in the same territory is still not covered by the block exemption. For example, a supplier cannot apply exclusive distribution at the wholesale level and selective distribution at the retail level. o In order to protect investment incentives, suppliers may oblige their distributors to pass on their respective sales restrictions "down the chain". With respect to protecting an exclusive distribution system, such pass-on is only exempted vis-à-vis the direct customers of the distributor, whereas in selective distribution systems, the supplier may require a pass-on throughout the entire distribution chain.

Selective distribution	The new Vertical Guidelines involve a relaxation of the so-called "equivalence principle" between offline and online sales from selective distribution systems, because evidence showed that online sales have developed into a well-functioning sales channel that no longer requires special protection relative to offline sales channels. o In *Coty*, the EU Courts held that luxury goods suppliers may prohibit members of their selective distribution network from selling the contract goods through third-party platforms without infringing EU competition law. The new Vertical Guidelines codify the *Coty* judgment in that they explicitly state that banning sales though online marketplaces altogether, as a sales channel, is not a hardcore restriction. Conversely, banning the use of entire advertising channels, such as search engines (including through keyword bidding/paid-reference service restrictions) or price comparison websites, will be viewed as a hardcore restriction pursuant to Article 4(e) (and even banning only certain search engines or price comparison websites may be viewed as a hardcore restriction if it has as its object the prevention of the effective use of the internet, notably if the remaining services in that advertising channel are de facto not capable of attracting customers to the buyer's online store). o The new Vertical Guidelines clarify that a supplier may impose criteria for online/offline sales in a selective distribution system that are not equivalent, provided that the online sales criteria do not have the object of preventing the effective use of the internet. o By way of example, the new Vertical Guidelines state that a supplier may impose requirements to ensure quality standards for online sales, such as a requirement to set up and operate an online after-sales helpdesk, a requirement to cover the customers' costs of returning purchased products, or the use of secure payment systems. The new VBER grants stronger protection to selective distribution systems. o Exclusive distributors appointed in a territory not covered by the selective distribution system can be restricted from active and passive selling to unauthorised distributors in the territory where the selective distribution system is operated. The supplier can also require the distributor to pass on this obligation to its customers. o The new Vertical Guidelines explain that a selective distribution system may benefit from the block exemption regardless of the nature of the product concerned, the nature of the selection criteria, and whether these are published.

RPM **(including minimum advertised prices ("MAPs") and fulfilment contracts)**	Resale price maintenance ("RPM"), including fixing margins, remains a hardcore restriction. It is likely that RPM will continue to be the target of aggressive enforcement by the EC and national competition authorities. The new Vertical Guidelines provide expanded guidance on RPM, including in relation to price monitoring and providing specific guidance on Minimum advertised prices ("MAPs") and fulfilment contracts. MAPs prohibit the distributor from advertising prices below a level set by the supplier. o Imposing MAPs will be treated as a form of resale price maintenance ("RPM"), and thus as a hardcore restriction of competition. o MAPs might be justified under Article 101 (3) TFEU to prevent a particular distributor from using the product of a supplier as a loss leader, if it is possible to demonstrate that the distributor regularly resells a product below the wholesale price and the MAP is aimed at preventing the distributor from selling below the wholesale price. Fulfilment contracts are agreements where a supplier enters into a vertical agreement with an intermediary purchaser for the purposes of executing a supply agreement concluded previously between the supplier and a specific customer (e.g. where a supplier has a framework contract with a customer in which the price is already agreed, but for some – e.g. logistical – reasons needs to execute the contract "through" an independent distributor). The new Vertical Guidelines revises the previous fulfilment contract exception to RPM contained in the previous Vertical Guidelines (which considered that the fixing of a resale price in a fulfilment contract does not constitute RPM where the end user has waived its right to choose the undertaking that should execute the agreement), as follows: o The imposition of a resale price by the supplier on the intermediary buyer for fulfilling the contract with the supplier's customer is not RPM, where the supplier selects the enterprise that will provide the fulfilment services; and o The imposition of a resale price by the supplier may amount to RPM where the undertaking that will provide the fulfilment services is selected by the customer.
Agency	o Genuine agency agreements continue to fall outside the scope of Article 101 (1) TFEU. o The new Vertical Guidelines provide expanded guidance on what constitutes a genuine agency agreement: · The fact that the agent may temporarily acquire the property in the contract goods while selling them on behalf of the principal does not preclude the existence of a genuine agency agreement that falls outside the scope of Article 101 (1) TFEU. Crucial is that the agent does not incur costs or risks in relation to the property transfer; · It is less likely that an agency agreement will be categorised as falling outside the scope of Article 101 (1) TFEU where the agent negotiates and/or concludes contracts on behalf of a large number of principals; · Agreements entered into by undertakings active in the online platform economy generally do not meet the conditions to be categorised as agency agreements that fall outside the scope of Article 101 (1) TFEU. Such undertakings generally act as independent economic operators and not as part of the undertakings for which they provide services; and · Dual role agents (where an independent distributor of some goods/services of a supplier also acts as an agent for other goods/services of the same supplier): for the agreement to be classified as a genuine agency agreement falling outside Article 101 (1) TFEU, the independent distributor must be genuinely free to enter into the agency agreement, e.g. the agency relationship must not be de facto imposed by the principal through a threat to terminate or worsen the terms of the distribution relationship. Similarly, the principal must not directly or indirectly impose on the agent an activity as an independent distributor, unless such activity is fully reimbursed by the principal.

Non-compete obligations	Non-compete obligations are defined as obligations causing the buyer not to manufacture, purchase or sell goods that compete with the contract goods, or that oblige the buyer to purchase from the supplier more than 80% of the buyer's total purchases of the contract goods. o Non-compete (exclusivity) obligations cannot benefit from the new VBER if their duration exceeds five years. o Non-compete (exclusivity) obligations that are tacitly renewable beyond a period of five years can benefit from the new VBER; provided that the buyer can effectively renegotiate or terminate with a reasonable period of notice and at a reasonable cost. o Non-compete obligations imposed on members of a selective distribution system in respect of resales of specific competing suppliers' products do not benefit from the block exemption.
Sustainability	The new Vertical Guidelines explicitly recognise that the achievement of sustainability objectives is capable of constituting an efficiency under Article 101 (3) TFEU, including: o The use of sustainability-related criteria in a selective distribution system; and o The imposition of exclusivity obligations to incentivise investments in green energy plants.
Online intermediation service providers	o Providers of online intermediation services qualify as suppliers under the new VBER. o Restrictions imposed by the online intermediation service provider on buyers of those services relating to the price at which, the territories to which, or the customers to whom the intermediated goods or services may be sold, including restrictions relating to online advertising and online selling, are subject to the provisions of Article 4 of the new VBER (hardcore restrictions). For example, the block exemption does not apply to an agreement under which a provider of online intermediation services imposes a fixed or minimum sale price for a transaction that it facilitates. o Not all undertakings active in the online platform economy may qualify as a provider of online intermediation services. Those who do not qualify may be categorised as either suppliers or buyers for the purposes of applying the new VBER. This could affect the application of the 30% market share threshold and the applicability of Article 4 (hardcore restrictions) and Article 5 (excluded restrictions). o Hybrid platforms: The new VBER does not apply to vertical agreements relating to the provision of online intermediation services where the provider of the online intermediation services is a competing undertaking on the relevant market for the sale of the intermediated goods or services. These agreements must be assessed individually under Article 101 (1) TFEU. o However, the new Vertical Guidelines state that "in the absence of restrictions by object or significant market power, it is unlikely that the Commission will prioritise enforcement action in respect of vertical agreements relating to the provision of online intermediation services where the provider has a hybrid function."

Impact

While they maintain the overall analytical framework of the past, the new EC vertical rules introduce some important changes that business should consider now in a review of existing supply and distribution arrangements. Some of the changes offer new opportunities for restructuring distribution networks with, for example, a more lenient approach to active sales restrictions and certain practices related to online sales. Other changes present a stricter approach, for example in relation to safe harbours for dual distribution and parity obligations, which may necessitate changes to current commercial arrangements.

Going forward, there may be some uncertainty regarding the application of the rules in practice. For example, there is now a requirement to undertake a case-by-case assessment of whether a restriction has as its object the effective use of the internet (since restricting the effective use of the internet is now listed as a hardcore restriction under Article 4 (e) of the new VBER). This requirement somewhat defeats the purpose of a block exemption to provide a safe harbour that avoids the need of individual assessment.

Entering into force on 1 June 2022 (on the same day as the new EC rules) is the UK's Vertical Agreements Block Exemption Order, which set outs new UK rules regarding vertical agreements. There is, however, some divergence between the two systems, and business will need to consider two separate systems for the EU and UK.

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