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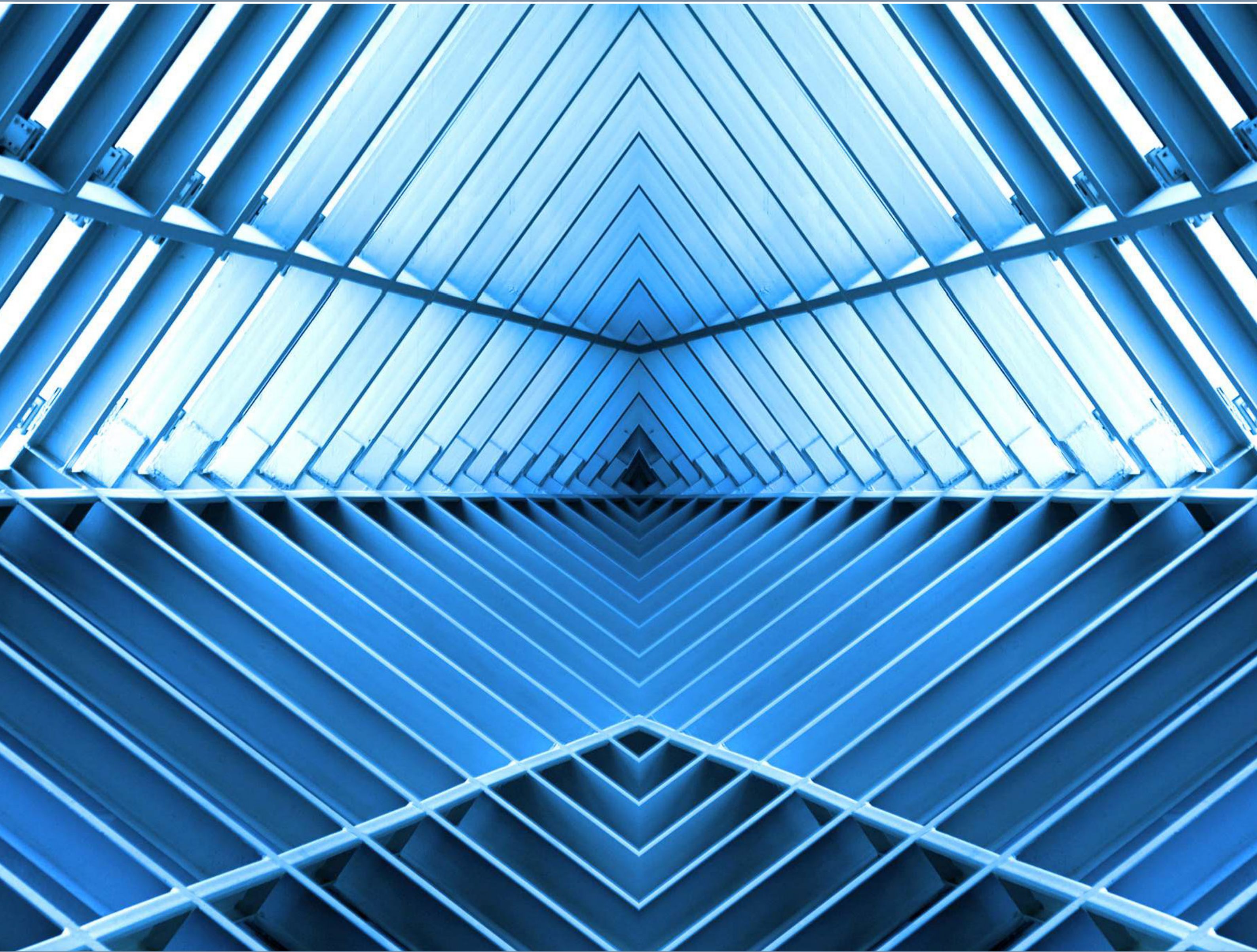

ANTITRUST CLIENT BRIEFING

Vertical Block Exemption Regulation and Guidelines

New EU distribution rules published and ready to enter into force on 1 June 2022

27 May 2022

At a Glance

On 10 May 2022, the European Commission (EC) adopted the [new Vertical Block Exemption Regulation] (VBER), accompanied by the [new Guidelines on Vertical Restraints] (Vertical Guidelines). The new rules are the result of a lengthy review process that was launched in 2018. While the overall assessment framework remains the same, the EC has introduced important changes, with the aim of clarifying how the established framework governing vertical agreements will be applied and interpreted in light of the growth of e-commerce and the evolution of the platform economy.

The new VBER will enter into force on 1 June 2022 and will expire on 31 May 2034. Agreements already in force on 31 May 2022 are subject to a transitional period of one year; they must be compliant with the new rules by 31 May 2023.

What Is the VBER?

The VBER aims to give any business involved in the distribution of goods and services increased legal 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.

Vertical agreements are agreements entered into between businesses operating at different levels of the production or distribution chain. Vertical agreements without any "hardcore restrictions" (e.g., resale price maintenance (RPM) or certain territorial and customer restrictions) are presumed to benefit from an exemption if neither party's market share exceeds 30%. Vertical agreements above the market share threshold require individual assessment.

The VBER is accompanied by a set of guidelines (Vertical Guidelines) designed to help companies self-assess their vertical agreements.

Key Points

Dual Distribution

- Dual distribution remains block exempted. The scope of exemption is extended to cover importers and wholesalers but excludes providers of online intermediation services (OIS) such as online marketplaces that also act as resellers (referred to as with a "hybrid function").

- Information exchange in the context of dual distribution is exempted only when it is (i) directly related to the implementation of the vertical agreement and (ii) necessary to improve the production or distribution of the contract goods or services.

Parity Obligations / Most Favoured Nation Clauses

- Across-platform (or "wide") retail parity obligations are excluded from the exemption under the VBER.

- Narrow parity obligations remain block exempted.

Shared Exclusivity and Pass-On Active Sales Restrictions

- A supplier may appoint up to five exclusive distributors per exclusive territory or customer group and can require its distributors to pass on active sales restrictions to their immediate customers.

Dual Pricing and Equivalence Principle

- Suppliers are allowed to set different wholesale prices for online and offline sales by the same distributor.
- For selective distribution, the criteria imposed in relation to online sales no longer have to be overall equivalent to the criteria imposed on brick-and-mortar shops/offline sales.

Online Platforms

- The new VBER and the new Vertical Guidelines clarify the rules applicable to the online platform economy and provide updated guidance in related areas, such as online sales restrictions (including online advertising and marketplace bans), OIS, and RPM.

Non-Competes

- The benefit of the exemption is extended to non-competes that are tacitly renewable after five years if the buyer can give notice and terminate the agreement.

Key Changes in the VBER and Vertical Guidelines

I. Dual Distribution

Dual distribution refers to the scenario where a supplier sells goods or services not only at the upstream level, but also at the downstream level, thereby competing with its independent distributors. Dual distribution has become more prominent in the recent past, as online sales facilitate direct sales by suppliers, either through their own websites or through marketplaces.

Dual distribution was exempted under the previous VBER. However, the EC's review of the previous VBER revealed horizontal concerns when the supplier offers goods and services in direct competition with its own distributors.

Information Exchange: The new VBER introduces in Article 2(5) a two-limb test, according to which the exchange of information in dual distribution is exempted only when it is both (i) directly related to the implementation of the vertical agreement and (ii) necessary to improve the production or distribution of the contract goods or services. To provide guidance on how this test will apply in practice, the EC included in the new Vertical Guidelines a non-exhaustive list of examples of information that either may fulfil or are unlikely to fulfil the two conditions set out in Article 2(5) of the new VBER. The new Vertical Guidelines also provide examples of precautionary measures that parties can take to minimise the risk that the information exchange will raise competition concerns.

Hybrid OIS: The dual distribution exemption does not apply to vertical agreements if a provider of OIS (e.g., an online market place) offers goods and services in competition with other companies using its online platform and therefore has a hybrid function (Article 2(6) VBER; see V below).

Extension of the Scope of Exemption: The new VBER expands the scope of the exemption for dual distribution to cover not only manufacturers but also importers and wholesalers.

II. Parity Obligations / Most Favoured Nation Clauses

Parity clauses (or most favoured nation clauses) require a seller of goods or services to offer these goods or services to another party on conditions that are no less favourable than the conditions offered by the seller either (i) on any other sales/marketing channel (e.g., other platforms) — known as across-platform or "wide" parity clauses or (ii) on the company's direct sales channel (e.g., own website(s)) — known as "narrow" parity clauses.

Under the previous VBER, both wide and narrow parity clauses benefitted from the block exemption. However, national competition authorities and courts have identified anti-competitive effects stemming mainly from wide parity clauses.

Wide and Narrow Retail Parity Obligations: The new VBER adopts a tougher stance in relation to across-platform (wide) retail parity clauses which are now excluded from the scope of the VBER (Article 5(1)(d)). All other types of parity obligations (including narrow parity obligations) continue to benefit from the exemption provided by the VBER. However, the scope of that benefit may in practice be limited due to the introduction of an Article in the new VBER on "Withdrawal". Article 6 of the new VBER mentions as a specific case of withdrawal, instances where the relevant market for the supply of OIS is highly concentrated and a cumulative effect of parallel networks of similar agreements that provide for narrow retail parity clauses restricts competition between OIS providers. In the past, withdrawal has been very rare. The new Vertical Guidelines offer detailed guidance on the assessment of parity obligations in a new chapter.

III. Distribution Systems and Active Sales Restrictions

The new VBER distinguishes exclusive distribution, selective distribution, and free distribution. In addition, Section 4.6 of the new Vertical Guidelines provides a detailed explanation of the characteristics of each of these distribution systems. Significant changes have been made in exclusive and selective distribution systems.

The distinction between active and passive sales is retained. The new VBER introduces a definition of active sales (i.e., actively targeting customers) and passive sales (i.e., sales made in response to unsolicited requests from individual customers) in Article 1(1)(l) and (m). The definition of these principles has been expanded to cover digital economy scenarios.

Exclusive Distribution: In an exclusive distribution system, the supplier allocates a territory or a group of customers exclusively to one or a limited number of buyers, while restricting all its other buyers within the EU from actively selling into the exclusive territory or to the exclusive customer group allocated to the exclusive distributor(s). Any restrictions on passive sales in an exclusive distribution system remain a hardcore restriction.

The new VBER introduces the concept of "shared exclusivity" in Article 4(b)(i) with a direct limit on the number of appointed distributors to a maximum of five. The EC justifies the introduction of this maximum number to allow for greater legal certainty. The new Vertical Guidelines specify that the scope of the territory or customer group should be defined in the agreement and can correspond to an area larger or smaller than a Member State or even be limited to a single customer.

Moreover, a supplier may now require buyers to pass on restrictions of active sales to their direct customers, giving enhanced protection in respect of exclusively allocated customer groups or territories. However, such pass-on is not block-exempted further down the distribution chain.

Selective Distribution: In a selective distribution system, the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria. Those distributors undertake not to sell such goods or services to unauthorised distributors within the territory reserved by the supplier to operate the system.

The distributor is protected against active and passive sales by unauthorised distributors. The new Vertical Guidelines grant selective distribution systems enhanced protection: suppliers may now prohibit buyers and their customers from selling to unauthorised distributors located in a territory where the supplier operates a selective distribution system, regardless of whether those buyers and customers are themselves located inside or outside that territory.

The equivalence principle is no longer applicable within selective distribution, which gives more flexibility to the supplier within a selective distribution network (see VI below).

Finally, the new Vertical Guidelines maintain the current approach of prohibiting the combination of selective and exclusive distribution systems within the same territory. However, the combination of selective and exclusive distribution systems is now explicitly allowed across different territories.

IV. Agency

An agent is a legal or natural person entrusted with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the purchase of goods or services by the principal, or the sale of goods or services supplied by the principal. An agent is considered as genuine when it bears no significant financial or commercial risks. In such cases, the agent does not act as an independent economic operator, and therefore the agency agreement falls outside the scope of Article 101(1) TFEU.

Genuine Agency: The new Vertical Guidelines clarify that an agency agreement is less likely to be categorised as falling outside the scope of Article 101(1) TFEU if the agent negotiates and/or concludes contracts on behalf of a large number of principals. This element is taken into account particularly in the assessment of whether the OIS can qualify as agents (see V below).

Reimbursement Method: The new Vertical Guidelines provide flexibility as regards the methods used to cover the risks and costs relevant to the agency activity, which may, for example, include a fixed lump sum or a fixed percentage of the revenues generated from the sale of goods or services under the agency agreement. However, the method used by the principal should allow the agent to easily distinguish between the amount(s) intended to cover the relevant risks and costs and any other amount(s) paid to the agent, for example intended to remunerate the agent for providing the agency services.

Dual Role Agents: The new Vertical Guidelines incorporate the EC's Working Paper of 5 February 2021 and clarify that an undertaking active on a downstream market may act as both a genuine agent and an independent distributor for different products of the same supplier, as long as the agency relationship is not (de facto) imposed by the principal. However, this "dual role" creates difficulties in distinguishing between investments and costs that relate to the agency function, including market-specific investments, and those that relate solely to the independent activity, in particular when both activities are undertaken in the same relevant market. To identify the market-specific investments to be reimbursed in such cases, the new Vertical Guidelines establish that the principal should consider the hypothetical situation of an agent that is not yet active in the relevant market in order to assess which investments are relevant to the type of activity for which the agent is appointed.

V. OIS

Application of the VBER is based on whether undertakings active in the supply and distribution chain qualify as suppliers or buyers. Since the adoption of the previous VBER various new players in the online world emerged which could not easily be categorised under its provisions that were tailored to the traditional economy. To align the application of the vertical rules across the EU, the EC has introduced provisions in the new VBER that clarify the treatment of vertical agreements entered into by undertakings active in the online platform economy.

Definition of OIS: The new VBER defines OIS as information society services that allow undertakings to offer goods or services to other undertakings or to final consumers, to facilitate the initiation of direct transactions between undertakings or between an undertaking and a final consumer, irrespective of whether and where the transactions are ultimately concluded. The new Vertical Guidelines provide examples of such services, which may include e-commerce marketplaces, app stores, price comparison tools, and social media services used by undertakings.

Multiple Functions and Ancillary Services: When an undertaking active in the online platform economy performs multiple functions, the new Vertical Guidelines clarify that these functions must be assessed separately for each vertical agreement that the undertaking enters into, notably because these often relate to different business models applied in different sectors or even within the same sector. This applies, for instance, if an undertaking, in addition to providing OIS, also buys and resells goods or services. The fact that an undertaking offers ancillary services in addition to its intermediation services — such as advertising services, rating services, insurance or guarantee against damage, or the collection of payments — does not preclude it from qualifying as a provider of OIS.

OIS and Agency: The new Vertical Guidelines provide that undertakings active in the online platform economy generally do not qualify as genuine agents due to their particular characteristics. Such undertakings (i) often serve a very large number of sellers, (ii) take advantage of strong network effects contributing to imbalance in size and bargaining power, and (iii) make significant market-specific investments, such as software, advertising, and after-sales services.

Qualification of OIS as a Supplier: Article 1(1)(d) of the new VBER provides that OIS providers are categorised as suppliers under the VBER. The new Vertical Guidelines clarify the consequences of that categorisation. Notably, an OIS provider (i) cannot be categorised as a buyer in respect of goods or services offered by third parties using those OIS and (ii) cannot impose any hardcore restrictions on buyers of those services.

Market Definition and Market Share Calculation: For the purpose of applying the market share thresholds provided in the VBER, the new Vertical Guidelines clarify that the market share of the OIS provider is calculated on the relevant market for the supply of those services. For the definition of relevant markets, the new Vertical Guidelines suggest a case-by-case approach based on the assessment of the degree of substitutability between (i) online and offline intermediation services, (ii) intermediation services used for different categories of goods or services, and (iii) intermediation services and direct sales channels.

Hybrid OIS: The dual distribution exemption does not apply to vertical agreements relating to the provision of OIS if the OIS provider is also a competing undertaking on the relevant market for the sale of the intermediated goods or services and therefore has a hybrid function (see I above). The new Vertical Guidelines clarify that the application of Article 2(6) presupposes that the vertical agreement entered into by the provider of OIS with a hybrid function does not qualify as an agency agreement.

VI. Online Sales

Under the previous Vertical Guidelines, restrictions that intended to treat online and offline sales differently were considered hardcore. This policy choice was based on the fact that in 2010, when the previous VBER was adopted, online sales were not developed on an equal level with offline sales and therefore required special protection. Based on the evidence gathered during the review process, the EC concluded that online sales have developed into a well-functioning sales channel that no longer requires special protection relative to offline sales channels.

Dual Pricing: Unlike in the previous Vertical Guidelines, dual pricing (i.e., the practice in which a supplier asks different wholesale prices for online and offline sales by the same distributor) is allowed under the new Vertical Guidelines, subject to several limiting principles. In particular, the difference in the wholesale price for online and offline sales must be reasonably related to differences in costs or investments between the online and offline sales channels and must not (i) aim to prevent the buyer's effective use of the internet by making selling online unprofitable or financially unsustainable, or (ii) limit the quantity of products made available to the buyer for sale online. As regards the method of implementation of dual pricing, the new Vertical Guidelines allow parties to agree to a system they deem appropriate and do not impose a requirement to carry out complex cost calculations.

Equivalence Principle: The new Vertical Guidelines take into account the inherently different nature of the online and offline channels. As a result, in the context of selective distribution, the criteria imposed by suppliers in relation to online sales are no longer required to be overall equivalent to the criteria imposed on brick-and-mortar shops, as long as they do not indirectly aim to prevent the buyer's effective use of the internet to sell the contract goods or services to particular territories or customers. Quality standards for online sales can, for example, relate to a requirement to set up and operate an online after-sales help desk; a requirement to cover the costs of customers returning purchased products, the use of secure payment systems, or the use of delivery services using green bicycles for the achievement of sustainability objectives.

Definition of Active and Passive Sales: The definition of active sales in Article 1(1)(l) and (m) of the new VBER provides updated guidance on practices related to online sales, such as the use of price comparison services, online advertising, and the use of local domains and local languages on websites. The new Vertical Guidelines introduce a distinction in the treatment of restrictions on the use of search engines based on their functionality: Search engine optimisation (SEO) related to tools or techniques intended to improve the visibility or ranking of the online store in search engine results, or offering an app in an app store, is treated as passive selling. Conversely, search engine advertising and other online advertising such as on websites, app stores, or social media that allow the advertiser to target customers according to their particular characteristics are treated as active selling.

The Limiting Principle of Effective Use of the Internet: The new VBER introduces a new hardcore restriction related to the use of the internet. Restrictions on online sales are hardcore when they, directly or indirectly, in isolation or in combination with other factors, aim to prevent buyers or their customers from effectively using the internet to sell the contract goods or services. Indirect measures that could prevent the effective use of the internet can be either measures aimed at significantly diminishing the aggregate volume of online sales, or measures that aim to prevent the use of specific online channels. The new Vertical Guidelines provide a list of examples of obligations that indirectly aim to prevent the effective use of the internet.

Online Advertising Restrictions: The new VBER provides for the possibility that restrictions of online advertising may not be considered hardcore. The scope of the restriction is the decisive factor when conducting the relevant assessment. In particular, prohibiting the use of specific price comparison services or search engines is generally not a hardcore restriction, as the buyer may use other online advertising services. However, the use of the most widely used advertising services may amount to a hardcore restriction if the remaining services in that advertising channel are de facto not capable of attracting customers to the buyer's online store. Imposing quality standards, or requiring the buyer not to use the brand name of the supplier in the domain name of its online store, are online advertising restrictions that can benefit from the exemption.

Marketplace Bans and Price Comparison Services: The new Vertical Guidelines introduce a definition of online marketplaces and price comparison services and provide specific guidance on the assessment of restrictions on their use. Online marketplaces are defined as a distinct online sales channel, while price comparison services, as well as search engines, are considered online advertising channels. Accordingly, a ban on the use of price comparison services constitutes a hardcore restriction, since it prevents the buyer from using an entire online advertising channel, which is prohibited under Article 4(e) of the new VBER. But restrictions that do not prevent the use of all price comparison services, such as imposing quality standards, can still benefit from the exemption according to the new Vertical Guidelines. Restrictions on the use of online marketplaces are exempted provided that they do not aim to prevent the effective use of the internet.

VII. Resale Price Maintenance (RPM)

RPM concerns agreements that, directly or indirectly, aim to restrict the buyer's ability to determine its resale price, by means of imposing a fixed or minimum sale price/price level on the buyer. These qualify as hardcore restrictions on competition. Irrespective of the distribution system in which it is implemented (exclusive, non-exclusive/selective), RPM is not exempted under the VBER; in most cases, it will also not pass the test for individual exemption under Article 101(3) TFEU. During the public consultation, stakeholders requested more guidance on which practices can amount to RPM. To provide more clarity in the treatment of RPM, the EC introduced additional guidance in relation to minimum advertised prices (MAPs) and fulfilment contracts.

MAPs: MAPs are minimum advertised prices that prohibit the distributor from advertising prices below a level set by the supplier. While in the draft revised Vertical Guidelines (published in 2021) the EC proposed to treat MAPs as a practice that may amount to RPM in certain instances, the new Vertical Guidelines adopt a stricter stance by treating MAPs as an indirect means to apply RPM.

Fulfilment Contracts: Under a fulfilment contract, the supplier enters into a vertical agreement with a buyer for the purpose of executing (fulfilling) a supply agreement concluded previously between the supplier and a specific customer. Under the new Vertical Guidelines, the treatment of fulfilment contracts depends on whether the undertaking that will provide the fulfilment services is selected by the supplier or the customer. If the supplier selects the undertaking that will provide the fulfilment services, the imposition of a resale price by the supplier is not considered RPM. By contrast, if that undertaking is selected by the customer, the imposition of a resale price by the supplier on the undertaking may amount to RPM. Horizontal agreements between retailers that set up and operate such a fulfilment model shall be assessed by taking into account the guidance in the EC's Horizontal Guidelines.

Agency and RPM: The new Vertical Guidelines clarify that, for non-genuine agency agreements, any direct or indirect obligation preventing or restricting the agent from sharing its remuneration with the customer, irrespective of whether the remuneration is fixed or variable, amounts to RPM. Therefore, the agent shall be free to reduce the effective price paid by the customer without reducing the income due to the principal.

OIS and RPM: Under the new Vertical Guidelines, the vertical agreements entered into by OIS providers are generally not considered as agency agreements. Where the agreement relates to the provision of online intermediation services, OIS providers are treated as suppliers in respect of those services. Therefore, restrictions imposed by OIS providers on buyers of those services relating to the resale price of goods or services that are sold via the OIS amount to RPM. Restrictions of the ability of OIS providers to share their remuneration relating to the provision of online intermediation services are not hardcore restrictions as they do not restrict the ability of a buyer to determine its resale price.

VIII. Other Areas

Non-Compete Obligations: The new Vertical Guidelines block exempt non-compete clauses that are tacitly renewable beyond a period of five years, provided that the buyer can effectively renegotiate or terminate the vertical agreement containing the non-compete obligation with a reasonable period of notice and at a reasonable cost, so that the buyer can effectively switch its supplier after the expiry of the five-year period. In certain instances, a non-compete obligation may be justified for the period of depreciation of an investment, which may be longer than five years. In particular, a long-term non-compete obligation may be necessary for relationship-specific investments made by the supplier, or for long-term investments pursuing sustainability objectives, where such investments can take place only if a sufficient number of buyers are willing to commit to purchase from the supplier for a longer period ("hold-up problem").

Sustainability: The new Vertical Guidelines clarify that the notion of sustainability is broad and includes, addressing climate change (e.g., through the reduction of greenhouse gas emissions), limiting the use of natural resources, reducing waste, and promoting animal welfare. For vertical agreements that pursue sustainability objectives, the new Vertical Guidelines clarify that these agreements are not a distinct category of vertical agreements and therefore any efficiencies stemming from agreements that restrict competition must be assessed under Article 101(3) TFEU. For selective distribution, the new Vertical Guidelines clarify that qualitative criteria for the selection of distributors may refer to sustainability objectives, such as addressing climate change, protecting the environment, or limiting the use of natural resources. As indicated above, investments pursuing sustainability objectives may justify non-compete obligations for a duration longer than five years.

Outlook

The new VBER will enter into force on 1 June 2022 with a transitional period of one year. A parallel reform of the UK VBER equivalent will enter into force on the same day. The final UK legislation and guidance are not yet published. Latham & Watkins will monitor and report on developments related to the UK VBER.

Sources

- Latham's Antitrust Client Briefing on dual roles in distribution
- 2020 Staff Working Document setting out the results of the evaluation (Evaluation SWD)
- 2020 VBER Inception Impact Assessment setting out the policy options for a potential revision of the previous VBER and Vertical Guidelines; see Latham's Antitrust Client Briefing on the EC's inception impact assessment
- 2021 Draft revised VBER (draft VBER)
- Latham's Antitrust Client Briefing on the draft Vertical Guidelines
- May 2022, additional public consultation on proposed guidance relating to information exchange in the context of dual distribution

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