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Revised EU rules for vertical agreements unveiled

On 9 July 2021, the European Commission (the '**Commission'**) published its draft texts for the new Vertical Agreements Block Exemption Regulation ('**VBER'**) and Guidelines on Vertical Restraints ('**Guidelines**') for public consultation. These are the result of an evaluation process, which started in 2018, of the current competition law rules for vertical agreements. Those rules entered into force in January 2010 and are due to expire at the end of May 2022.

The Commission had a number of objectives for the EU's new vertical agreements regime, including updating it to take account of case law and market developments, while at the same time making the regime clearer, simpler and more tailored to protect benign agreements, without protecting anticompetitive agreements. The new draft texts, which reflect a more substantial rewrite than many expected, suggest that the Commission has been only partially successful in reconciling these often conflicting objectives. While some changes are cosmetic, for example reflecting a significant reordering of the Guidelines, others will have a significant practical impact.

One area that has not changed is the attitude taken to price restrictions. Despite intense lobbying, the new VBER retains the current approach in classifying resale price maintenance ('**RPM**') as a hardcore restriction of competition that is presumptively unlawful and can be justified only in exceptional circumstances.

The single key theme that emerges most strongly from the new texts is that the Commission agrees with those who have argued that the 2010 regime was unduly favourable to online retailers and marketplaces (principally Amazon). While the 2010 changes were motivated by a desire to encourage online retail, as a means of developing the single market and improving consumer access to products on a cross-border basis, brands objected that the regime made it too difficult for brands to control online retail. Should they be retained in the final texts, the proposed changes will make life harder and less certain for online retailers (especially those, such as Amazon, that operate third party marketplaces in parallel) and those doing business with them. While some of the changes will be welcomed by brands, others introduce additional complexity and uncertainty that are likely to make it harder to apply the VBER in

practice. As a result, it cannot be said that, taken in the round, the new texts mark a distinct improvement on the 2010 regime.

Background

The VBER creates a safe harbour, known as a 'block exemption', which protects common forms of distribution agreements from legal challenge under Article 101 of the Treaty on the Functioning of the European Union ('**TFEU**'), which prohibits anticompetitive agreements, and national equivalent rules. In principle, any agreement between parties operating at different levels of the supply chain (for example, a brand and a distributor) can benefit from the block exemption, provided that the parties' market shares do not exceed 30% of the relevant markets and the agreement does not contain any 'hardcore' restrictions of competition.

Hardcore restrictions (e.g., RPM, absolute territorial protection, customer allocation), which are set out in Article 4 of the VBER, are presumed to be so harmful to competition that they render an entire agreement ineligible for protection and presumptively unlawful. If an agreement contains a less serious 'excluded restriction', the specific restriction will be unenforceable, but the rest of the agreement will be protected.

The Guidelines set out extensive guidance concerning application of the VBER and for assessing the legality of agreements outside of its protective scope. Taken together, the VBER and Guidelines effectively create a code for the application of EU competition law (and, by extension, national competition laws) to vertical agreements.

Main changes in the draft revised VBER and Guidelines

Territorial and customer restrictions

Although the current VBER explicitly specifies the extent to which suppliers may impose restrictions on where and to whom their buyers may sell contract products, experience suggests that businesses found these rules difficult to apply in practice. For example, many businesses fail to appreciate that it is only possible to prohibit a buyer from making active sales into territories exclusive allocated to other buyers or reserved by the supplier, rather than prohibiting all active sales outside of the buyer's home territory. The rules can also be unduly rigid, making it difficult to operate an effective exclusive distribution regime or to operate exclusive and selective distribution systems in parallel.

The proposed new VBER makes some significant improvements in this area, partly by redrafting the list of hardcore restrictions to improve clarity and partly by revising the Guidelines. In particular, Article 4 of VBER has been extensively redrafted to make it clearer what restrictions are permitted under exclusive, selective and free distribution, respectively.

In addition, the new Article 4 text confirms that a brand can ban buyers located outside of a territory in which it operates selective distribution from selling to unauthorised distributors within that territory. While the imposition of such a restriction appears entirely reasonable, since otherwise the integrity of such a system could be materially impaired, it is not permitted under the current rules, creating in practice a major impediment to operating selective and exclusive distribution in different parts of the EU. This change therefore represents a small but significant improvement.

Additionally, Article 4(b) of the revised draft VBER introduces the possibility for a supplier to impose resale restrictions on the customers of its direct buyers, as well as on the buyers themselves. Under the current rules, the express prohibition on such 'pass on' of restrictions has been a key weakness of the regime for exclusive agreements. The new text makes this possible, as long as indirect buyers have either entered into a distribution agreement with the supplier or with a party that was given distribution rights by the supplier (in practice, the supplier's exclusive distributor or wholesaler).

Finally, the new VBER text will make it possible for suppliers to grant shared exclusivity, by appointing more than one exclusive distributor in a specific territory or for a particular customer group. However, the new text specifies that this will be possible only if the number of distributors appointed to a territory or customer group is proportionally related to the allocated territory or customer group, in such a way as to secure a certain volume of business that preserves their investment efforts. The inherent subjectivity and uncertainty of this test, combined with the fact that the burden will fall on the parties to prove that it is met, will make it hard to apply in practice. Since the consequences of getting it wrong mean that the underlying agreements are presumptively unlawful, suppliers are likely to stick to the well-established model of allocating exclusive territories or customer groups to a single buyer, undermining the rationale for the change.

Online and marketplace sales restrictions

Another area where the new texts mark a clear improvement over the current regime is the clarification of which forms of online sales restriction will be viewed as hardcore restrictions. This is achieved, for example, by updating the Guidelines to reflect recent case law developments with respect to restrictions on the use of price comparison sites and search advertising. The VBER itself has also been amended so that it expressly deals with online sales restrictions for the first time.

Overall, the changes make it easier for brands to restrict online sales by clarifying which forms of online sales and promotion amount to active selling and by tightly specifying the forms of online selling that will be viewed as passive selling. This is important, since brands have significantly more ability to limit active sales.

In another win for brands, the new draft Guidelines make it clear that direct or indirect bans on the use of third party online marketplaces are to be treated as block-exempted restrictions under VBER, and hence lawful in all circumstances. Although the

Commission appears to remain sceptical about certain marketplace restrictions, for example if a brand supplies or sells through a hybrid marketplace such as Amazon while simultaneously restricting sellers' access to it, the new Guidelines make it clear that these are factors only when deciding whether an agreement is caught by Article 101(1) TFEU or is exempt under Article 101(3). The nature of the restriction does *not* affect the analysis of whether VBER is available, since all forms of marketplace restriction are in principle block-exempted.

While the principle that marketplace bans are a legitimate means of controlling the way in which products are sold online was already established in the landmark 2017 *Coty* judgment of the European Court of Justice, and the Commission had made its position clear in a 2018 policy brief, there was some residual uncertainty over the extent to which it applied to non-luxury goods or whether it depended on local market conditions. The fact that the Commission has now confirmed this in the new Guidelines will make it much more difficult for national courts or competition authorities to take a different approach.

The new texts also contain some helpful clarification of how 'online intermediation services providers' such as Amazon, eBay or Booking.com are to be treated under VBER. This was needed, since such operators do not fall neatly into the traditional framework, under which a supplier provides contract products to a buyer. Correctly, in the authors' view, the new VBER text confirm that online intermediation services providers should be treated as *suppliers*, on the basis that they are supplying sales intermediation services to sellers, who in turn supply contract products to customers under separate agreements. The Guidelines expand on this point, including by confirming that the role of such intermediaries makes it difficult to characterise them as agents in competition law terms, even if this is the express intention of an agreement.

The new texts contain two more wins for brands. First, they will have greater freedom to set different wholesale prices for products, depending on whether they are sold on- or offline (known as 'dual pricing') without this being viewed as a hardcore restriction of online sales. Second, brands that operate selective distribution systems will have greater freedom to set criteria for online sales, without having to prove that they are equivalent to the criteria they apply to brick-and-mortar sales.

Dual distribution

Unfortunately, the benefits listed above are partly undermined by the Commission's proposed approach on dual distribution. This covers situations in which a manufacturer simultaneously sells through independent distributors and direct to end customers. Since the manufacturer competes with its distributors in such circumstances, agreements between it and its distributors would in principle not be protected by VBER, since the block exemption does not apply to agreements between competitors.

The current VBER regime contains a specific exception to permit such cases of dual distribution but only where the supplier is the manufacturer of the products

concerned. Since the growth of online retail has made it much easier for brands to sell direct to customers, whether on their own websites or on third party marketplaces, dual distribution has become much more common. This has, in turn, raised concerns that the sharing of information in such scenarios may lead to restrictions of competition and a blurring of the nature of the relationship between a brand and its resellers.

Conversely, some had argued that it did not make sense to permit dual distribution by brands but not distributors or importers. Under the current rules, if a distributor chooses to sell direct to end customers alongside resellers that it supplies, its agreements with those resellers are no longer protected by VBER. This is hard to justify, especially as it may act as a disincentive to distributors selling direct, which would be expected to increase competition.

The Commission has evidently decided to address these conflicting demands by adopting a compromise that, if retained in the final texts, may end up pleasing nobody.

On the one hand, Article 2 of the revised draft VBER expands the scope of the dual distribution exception by extending it to wholesalers and importers, in addition to manufacturers. This is welcome. On the other, it significantly limits its application by introducing new, more complex, market share thresholds for parties engaging in dual distribution, and introducing additional hurdles that must be met, including that the agreements do not contain any 'by object' restrictions. The new Article 2 text also specifies that hybrid online marketplaces may not rely on the exception if they sell goods or services in competition with undertakings to which they provide online intermediation services. The justification for this provided by the Guidelines states that the retail activities of such platforms "typically raise non-negligible horizontal concerns". The result of this and related change is that most agreements with hybrid online platforms will be removed from the protection of the VBER safe harbour and will thus need to be assessed on a case-by-case basis. This appears to be a deliberate attempt to make selling to or through platforms such as Amazon less attractive and is thus a direct challenge to their business model.

In a further (albeit more limited) challenge to the business model of hybrid platforms, retail parity obligations that require users of an online platform not to offer their products on more favourable terms on other platforms have been defined as excluded restrictions in the new Article 5. This is unlikely to have a significant impact in practice, however, as increased scrutiny of such 'wide MFN' clauses has led to them being dropped by many large platforms. So called 'narrow' parity clauses, under which the parity restriction applies only to a seller's sales on its own website, as well as other forms of MFN, will continue to benefit from the block exemption.

Next steps

The public consultation on the draft revised VBER and Guidelines will be open until 17 September 2021 and interested stakeholders are invited to submit their comments.

Based on these comments, as well as further non-public engagement with Member States and National Competition Authorities, the Commission will revise the drafts before confirming the final texts. The new VBER and Guidelines will enter into force on 1 June 2022 and are set to remain in force until 31 May 2034. Whether the market context will have changed sufficiently by then to require another significant rewrite remains to be seen.

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Meet the Authors

Becket McGrath is a partner in the London and Brussels office of Euclid Law. Before joining Euclid in June 2020, Becket was a partner at a US firm.

Becket advises clients on all aspects of EU and UK competition law, with an emphasis on online distribution, defending companies against antitrust investigations and merger control. He is qualified as a solicitor in England & Wales and as a Belgian advocaat.

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