European Commission publishes long-awaited updated regulation and guidelines on vertical agreements

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In July 2021, the European Commission (Commission) published its proposed revised Vertical Block Exemption Regulation (Draft VBER) and Draft Vertical Guidelines (Draft Guidelines). The new Regulation and guidelines are being brought in to replace the current Regulation which came into force in 2010 and is due to expire on 31 May 2022.

The Vertical Block Exemption Regulation (VBER) concerns vertical agreements (i.e. agreements between businesses operating at different levels of the supply chain, for example a producer and a distributor). VBER provides a safe harbour from the competition rules if the parties' respective market shares do not exceed 30% on the market(s) affected by the agreement in question and the agreement does not contain any hardcore restrictions (such as resale price maintenance or bans on passive sales). The VBER and accompanying guidelines aim to provide certainty for businesses on the application of Article 101 of the Treaty on the Functioning of the European Union (TFEU) to such agreements and to help companies conduct their own competition assessment.

The current rules have been subject to a lengthy review and consultation process which started in October 2018. The VBER is thought to be outdated and poorly adapted to the growth of online sales and the emergence of new market players such as online platforms. The changes in the Draft VBER and Draft Guidelines are designed to address areas where the current rules are uncertain or where there are gaps, as well as addressing those areas where the current rules are no longer suitable for the digital economy. Some tighten the rules, such as regards dual distribution and parity clauses, other relax them, such as around exclusivity, price discrimination for online sales and non-compete clauses.

We explore some of the key changes in the Draft VBER and Draft Guidelines in this update.

Dual Distribution

One of the most significant changes in the Draft VBER and Draft Guidelines is the change made to the treatment of dual distribution which introduces more restrictions on the safe harbour available for such agreements.

Dual distribution exists where a supplier sells its goods and services through independent distributors and also directly to end customers in direct competition with its distributors. Dual distribution used to be relatively rare but has become increasingly prevalent due in particular to the growing practice of suppliers selling directly to customers through their own website.

The VBER currently provides a safe harbour for dual distribution agreements even though the supplier and distributor are directly competing. The Commission wishes to narrow the scope of the exemption, which currently covers agreements...
with potential competition concerns.

The Draft VBER limits the safe harbour for dual distribution to instances where the parties’ aggregate market share in the retail market does not exceed 10%. There is an additional but more limited safe harbour for dual distribution agreements where the parties’ aggregate market share is above 10% but does not exceed 30%. In this scenario all elements of the agreement can benefit from the safe harbour except for information exchanges between the parties (such as customer lists and actual sales prices).

The current VBER does not extend to dual distribution by wholesalers and importers who often fulfil a similar role as suppliers. The Draft VBER expands the scope of dual distribution to include wholesalers and importers.

Online intermediation services are excluded from the safe harbour if they have a hybrid function, namely where they sell goods or services in competition with businesses to which they also provide online intermediation services.

**Parity Obligations**

Parity obligations, often referred to as Most Favoured Nation clauses (MFN), have come under a lot of scrutiny from national competition authorities in recent years. An MFN is an obligation to offer a contract party the same or better conditions as those offered to other customers or on other sales channels.

The rise of online sales platforms, such as booking portals or price comparison tools, which often use MFNs has caused suppliers of goods or services using such platforms to not sell or resell their goods or services to end users under more favourable conditions. In the UK the CMA recently fined ComparetheMarket GBP17.9 million for the inclusion of wide MFN clauses in contracts with home insurance providers which were selling on its platform.

The Draft VBER aims to harmonise the treatment of MFNs after a number of inconsistent enforcement actions by European courts and national competition authorities. The Draft VBER differentiates between direct sales channels and indirect sales channels:

- **Indirect sales:** MFNs which apply across platforms imposed by providers of online intermediation services (often known as wide MFNs) will no longer benefit from the block exemption and will need to be assessed individually under Article 101 TFEU. Guidance on how to conduct that assessment can be found in the Draft Guidelines.
- **Direct sales:** MFNs which apply to sales made directly by the supplier of goods or services (known as narrow MFNs) can benefit from the block exemption so long as the other general conditions of VBER apply.

**More permitted sales restrictions**

The Draft VBER and Draft Guidelines provide more flexibility to suppliers to control active sales by a distributor. An active sales restriction is a restriction on the ability to directly approach customers. Currently the VBER only allows a supplier to restrict a distributor from actively approaching customers in very limited circumstances, such as a restriction that an exclusive distributor is not allowed to actively approach customers outside of its appointed territory where that territory has been exclusively allocated to another distributor or reserved to the supplier.

The consultation on the VBER found that the current rules are unclear.

The Draft VBER and Draft Guidelines therefore aim to clarify the rules and include a definition of active and passive sales. This includes guidance on what are considered active sales in relation to e-commerce such as:

- Translating a website into a language which is not commonly used in the distributor’s allocated territory.
- Targeted online advertising or promotions, such as online advertising allowing the distributor to target a particular customer or geographic market.

In addition the Draft VBER and Draft Guidelines include the following proposed changes:

- **Shared Exclusivity:** A supplier can appoint more than one exclusive distributor for a particular territory or a particular category of customers. The number of distributors should however be proportionate to the territory or category of customers to secure a certain volume of business that preserves the distributor’s investments.
- **Pass on:** Another change for exclusive distribution is the possibility for a supplier to oblige its buyers to pass on to customers any active sales restrictions. This is possible only if the customer has entered into a distribution agreement
with the supplier or with a party that received distribution rights from the supplier. This is intended to extend the protection of the investments made by exclusive distributors.

- **Enhanced protection for unauthorised sales:** A supplier can restrict all sales (active or passive) to any unauthorised distributors by customers of authorized distributors as well as by the distributors themselves in a territory where a supplier operates a selective distribution system.

### Online Sales

One of the objectives of the Draft VBER and Draft Guidelines is to update the rules in light of the growth of e-commerce and online platforms. The new rules have incorporated the principles which have been established by the European Courts in recent years.

The Draft Guidelines clarify what constitutes a hardcore restriction. For example, the following will be hardcore online sales restrictions:

- a supplier, directly or indirectly, implementing a restriction which has its object or effect the prevention of buyers or its customers from using the internet for the purpose of selling goods or services or from using online advertising tools.
- preventing a distributor from using price comparison websites or paid referencing in search engines.

For restrictions on the use of online marketplaces, the Commission proposes that such a prohibition is in principle able to benefit from the block exemption so long as a distributor can still sell via other online sales channels (such as via its own website).

In addition, a restriction on online advertising can benefit from the block exemption so long as it does not exclude a specific online channel. The restriction must therefore be linked to the content of online advertising or set quality standards.

In relation to indirect measures aimed at restricting online sales:

- **Dual pricing** (charging a different wholesale price for distributors selling online compared to those selling via a bricks and mortar store) will no longer be classified as a hardcore restriction. The price difference charged must reflect the different costs and investments incurred by the distributors in the specific distribution channel and it must not make online sales unprofitable.

- **No need for equivalence:** Criteria for selective distribution systems for online sales no longer need to be equivalent to those applied to distributors selling in physical stores given the inherent differences in each sales channels. As above, the different criteria must not be aimed at restricting online sales.

### Non-compete obligations

Under the current VBER non-compete obligations which have a duration which exceeds five years do not benefit from the block exemption. Non-compete obligations which are tacitly renewable beyond 5 years are deemed to have an indefinite duration and therefore also don’t benefit from the block exemption.

Under the Draft VBER and Draft Guidelines tacitly renewable non-compete obligations can continue to benefit from the block exemption, so long as the buyer can effectively terminate the agreement or renegotiate the terms on reasonable notice and at reasonable cost after the expiry of five years.

### Additional clarity

The Draft VBER and Draft Guidelines aim to reduce compliance costs for businesses by simplifying and setting out in more detail the application of the VBER to vertical agreements. In particular the provisions on territorial and customer protections have been replaced by three distinct sections on each of the main distribution systems (exclusive distribution, selective distribution and free distribution).

Each of these types of distribution system is explained in detail in the Draft Guidelines and information is provided on the hardcore restrictions and exceptions which will apply to them in Article 4.

The Draft Guidelines also include all the guidance on RPM in one section. Guidance was previously scattered across
various sections in the guidelines making it hard for businesses to clearly follow. RPM will however continue to be a hardcore restriction despite lobbying from some market participants for this to be dropped as a hardcore restriction.

Genuine agency agreements will continue to fall outside of Article 101(1) TFEU. The Draft Guidelines contain a new section covering agency which clarifies the definition of agency. Significantly, if an “agent” takes title over goods while selling them on behalf of the principal, so long as they do not insure any costs or risk relating to the transfer of the goods, they can continue to be classified as an agent. Note however that online intermediation services will be classified as suppliers for the purpose of VBER and will not therefore qualify as agents for Article 101 TFEU.

Next Steps

The Commission is consulting on the Draft VBER and Draft Guidelines and accepting comments by 17 September 2021 on its website. The Commission will then finalise the Draft VBER and Draft Guidelines.

The new rules are expected to enter into force on 1 June 2022.

Separately, the UK is expected to publish its own, post-Brexit, vertical agreements block exemption order later in 2021. Divergence from the Commission’s proposals is expected, in particular around dual distribution, where the UK is expected to introduce a more permissive set of rules, and online intermediation services.

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