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CLIENT ALERT

New European Commission's Vertical Block Exemption Regulation: Amended Rules for (Online) Distribution

June 8, 2022

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On 1 June 2022, after a four-year consultation and evaluation process, the European Commission's ("**EC**") new Vertical Block Exemption Regulation ("**VBER**")[1] entered into force. The new set of rules is required as the previous block exemption expired on 31 May 2022 after having been in force for 12 years. Supplementary to the new VBER, the EC adopted new guidelines on the assessment of vertical restraints ("**Guidelines**") that provide guidance on how to interpret and apply the VBER and how to assess vertical agreements that fall outside the safe harbor of the VBER.[2]

Background: The VBER concept

Article 101(1) Treaty on the Functioning of the European Union ("**TFEU**") prohibits agreements between undertakings that restrict competition. The provision captures horizontal agreements between competitors as well as vertical agreements between two or more undertakings operating at different levels of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services. Under Article 101(3) TFEU, however, agreements that restrict competition are compatible with the Single Market, provided that they contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing

1 Commission Regulation (EU) 2022/720 of 10 May 2022 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices; OJ L 134, 11.5.2022, pp. 4–13.

2 The final English text (C(2022) 3006 final) is available on the EC's website here.

consumers a fair share of the resulting benefits, and without eliminating competition. This assessment can be rather complex, and this is where the VBER comes into play.

Based on the assumption that many vertical agreements improve economic efficiency within the chain of production or distribution by facilitating better coordination between the participating companies, and lead to a reduction in the transaction and distribution costs and to an optimization of companies' sales and investment levels, the VBER generally block-exempts vertical agreements between non-competitors[3] from the prohibition in Article 101(1) TFEU, thus creating a safe harbor for those agreements.

The EC is of the view that the likelihood that such efficiency-enhancing effects will outweigh the anti-competitive effects depends on the degree of market power of the parties to the vertical agreement and, in particular, on the extent to which they face competition. The EC is furthermore of the view that the block exemption shall not be available for agreements which are likely to restrict competition and harm consumers or which are not indispensable to the attainment of the efficiency-enhancing effects, or which it cannot be assumed with sufficient certainty that they satisfy the conditions of Article 101(3) TFEU.

Therefore, a block exemption is subject to the prerequisite that each party to the agreement does not exceed the market share threshold of 30% and that the agreement does not contain clauses resulting in the entire agreement being excluded from the safe harbor ("**Hardcore Restrictions**" such as, amongst others, minimum and fixed resale prices) or other excluded restrictions which cannot be exempt themselves, but where the rest of the agreement can still benefit from the safe harbor. This general concept remains the same under the new VBER.

The new VBER Framework

However, the new set of rules introduces some clarifications and changes with significant practical relevance. One main driver for the changes is the online platform economy, which plays an increasingly important role in the distribution of goods and services. According to the EC, the online platform economy makes it possible to do business in new ways, some of which were not easy to categorize using concepts associated with vertical agreements in the traditional economy.

The following outline summarizes the key changes, where the EC either introduced new categories and clarifications, or narrowed down or widened the scope of safe harbor.

[3] Vertical agreements between competitors may be exempted if (i) the parties only compete on a downstream distribution level but only the supplier and not the buyer is active on the upstream level as manufacturer, importer, or wholesaler or (ii) the supplier is a provider of services at several levels of trade, while the buyer provides its services at the retail level and does not compete at the level of trade where it purchases the contract services.

Dual Distribution
The new VBER covers dual distribution scenarios in which a supplier sells goods or services at the upstream and at the downstream levels, e.g., where the supplier sells goods or services to independent distributors and also directly to end customers. Although the supplier competes with its distributor customer on the downstream level, vertical agreements in dual distribution scenarios are in principle exempt from the prohibition in Article 101(1) TFEU. However, the new VBER specifically excludes providers of online intermediation services ("**OIS**") (which are defined by reference to pre-existing EU regulations) from this privilege. The safe harbor does not apply to OIS providers that compete downstream with the undertakings to which they provide intermediation services. With respect to information exchanges between the supplier and the buyer in a dual distribution scenario, the safe harbor only applies to such exchanges if they are: - directly related to the implementation of the vertical agreement; and - necessary to improve the production or distribution of the contract goods or services. The Guidelines set out examples to illustrate which information may, depending on the particular circumstances, meet these conditions (e.g., technical information about the contract goods or services, or certain information to implement and monitor compliance with selective and exclusive distribution systems) and which information exchange is excluded from the safe harbor (e.g., future prices; information relating to identified end users; or exchange of information between a distributor and a manufacturer of competing branded goods, if the information relates to goods sold by the distributor under its own brand name).
Agency Agreements
The general exemption from the antitrust rules for genuine agency agreements (i.e., where a person entrusted with the power to negotiate and/or to conclude contracts for another person does not bear any financial or commercial risk in relation to the contracts) remains in place. However, dual role agency arrangements, in which an agent acts at the same time also as a distributor for the same supplier and within the same relevant market, should be assessed with caution. In particular, the new Guidelines indicate the risk that the supplier's pricing policy under the agency agreement may affect the agent/distributor's incentives with respect to the pricing of goods or services it sells as an independent distributor.

Online Intermediation Services
The new VBER establishes that providers of OIS (which can include e-commerce platforms, social media providers, app stores etc. which allow other businesses to offer goods or services to end customers) are categorized as 'suppliers', whereas the vendors offering or selling goods or services via OIS are categorized as 'buyers'. The guidelines also clarify that an OIS provider is in principle not an 'agent', and thus not generally exempt from Article 101(1) TFEU. While OIS are defined by reference to pre-existing EU law, the application of the OIS definition to specific online economy business models and agreements remains underdeveloped. This leads to a degree of uncertainty as to the application of the new OIS-based VBER rules to individual agreements. OIS providers can still benefit from the safe harbor framework as a 'supplier' of services, although the dual distribution privileges (see above) do not apply to them. Vertical agreements relating to the provision of OIS are not covered by the safe harbor, if a hybrid provider of OIS also competes with the buyer of such services on the downstream level, e.g., if the OIS provider also acts a retailer. The EC's rationale is that OIS providers may have the ability and incentive to distort competition on the downstream market for the intermediated goods and services.
Restrictions of Online Sales
Vertical agreements which have the objective to prevent effective use of the internet as a sales or advertising channel are generally categorized as Hardcore Restrictions. However, the new Guidelines set out a list of examples, which are not considered Hardcore Restrictions and thus generally covered by the safe harbor. For example, suppliers may: - impose restrictions on buyers relating to the use of particular online sales channels, such as certain online marketplaces; - impose quality standards for online sales; - require that buyers operate at least one brick and mortar store; and - require that buyers sell a minimum absolute amount of products (in value or volume, but not in proportion of its sales) offline. It should be noted, however, that the above rules, as drafted, do not expressly apply to restrictions imposed on OIS, as these rules are drafted to protect the freedom of 'buyers' to use the internet and not the freedom of OIS 'suppliers' to use the internet.

Parity Clauses
So-called wide most-favored-nation ("**MFN**") clauses that restrict a seller from offering more favorable conditions across all retail platforms are excluded from the safe harbor. OIS providers may not prevent their users from offering and (re-)selling goods or services under more favorable conditions on other competing platforms. Narrow MFNs, e.g., restrictions that prevent a business from offering more favorable conditions in their own online store, and other types of parity clauses may still fall within the safe harbor.
Dual Pricing
Dual pricing is no longer *per se* a Hardcore Restriction. Suppliers may charge the same distributor different prices for products to be sold online or offline. The EC states that this may incentivize or reward an appropriate level of investments in online or offline sales channels. However, the Guidelines clarify that the new safe harbor does not apply if dual pricing has the object of restricting sales to particular territories or customers or of preventing the effective use of the internet (in which case the dual pricing system would be considered an unlawful Hardcore Restriction).
Greater Protection and More Flexibility for Exclusive and Selective Systems
Suppliers are allowed to restrict their distributors outside of a selective distribution system from actively or passively selling to unauthorized distributors within the territories where the supplier operates a selective distribution system. Furthermore, suppliers no longer have to apply the same selection criteria for offline and online authorized distributors within a selective distribution network, as long as the criteria for online sales do not have as their object to prevent buyers/customers from effectively using the internet for selling their goods or services online (in which case the criteria would be seen as a Hardcore Restriction). In addition, the new VBER introduces a new shared exclusivity, i.e. the safe harbor for exclusive distribution systems applies if the supplier appoints up to five exclusive distributors for the same territory or customer group. The safe harbor previously only covered a situation in which a supplier had appointed one single distributor for a territory or customer group. In an exclusive distribution system, suppliers may protect their distributors against active sales into the distributors' respective territory or their assigned customer group. The concepts of active and passive sales are now more clearly defined and better reflect the important role of e-commerce.

The combination of selective and exclusive distribution systems in adjacent territories is now covered by the safe harbor. The following two set-ups are generally exempt: - suppliers may restrict their distributors in an exclusive distribution system from active or passive sales into territories where the supplier operates a selective distribution system; and - suppliers may restrict their distributors in a selective distribution system from active sales to territories where the supplier operates an exclusive distribution system.
Resale Price Maintenance
Resale price maintenance (i.e. agreements which have the object of restricting the buyer's ability to determine its sale price) is still treated as Hardcore Restriction. In particular, fixed and minimum resale prices are maintained as Hardcore Restrictions. However, the new Guidelines provide for additional guidance on efficiency grounds that may lead to an exception in individual cases (e.g., in connection with the introduction of new products; short-term price campaigns; preventing loss leader strategies; and offering additional pre-sales services for complex products).
Non-Compete Covenants
Non-compete obligations of the buyer are now also covered if they are tacitly renewable beyond the duration of five years, provided that the distributor can terminate and renegotiate the agreement after five years.

Conclusion and Outlook

Overall, the new set of rules provides more clarity and legal certainty to businesses in relation to a number of important aspects of modern supply chains. It is welcomed that the EC has comprehensively addressed stakeholder's feedback in the consultation and evaluation process. The new rules introduce greater protection for selective and exclusive distribution systems and enlarge the safe harbor to certain practices relating to online sales, such as dual pricing. That said, the practical application of the new OIS/supplier concept and related provisions in the new rules remains subject to a degree of uncertainty.

It is crucial that businesses whose vertical agreements are covered by the current VBER analyze whether any changes have to be made, in order to comply with the new set of rules once the transition period ends. All new vertical agreements that enter into force as of 1 June 2022 have to take the new rules into account. A new review process will likely kick off in eight years and the new VBER will expire in twelve years (2034).

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