EU brings regime for vertical agreements into the digital age

The review of the regulatory regime for vertical agreements in the EU has finally come to an end. On 10 May 2022, the European Commission (the Commission) published the revised Vertical Block Exemption Regulation and the accompanying Vertical Guidelines. Below we summarize the key changes.

New challenges for distribution systems in a new market reality

Having a grip on the competition rules applying to vertical relationships – that is, restrictions on what companies can agree with their suppliers and customers – is essential for almost all businesses. And it is not getting any easier. Over the past decade, the market has evolved in particular through the growth of e-commerce, expanding the routes to market and causing suppliers to increasingly adopt mixed or "dual" distribution systems, i.e. selling in parallel directly to consumers and via distributors. This development has brought challenges that the previous EU vertical regime was unable to tackle efficiently.

The revised Vertical Block Exemption Regulation (the VBER, Regulation (EU) 2022/720) and the Guidelines on Vertical Restraints (the Vertical Guidelines) attempt to tackle these challenges from a regulatory perspective, and to better address how suppliers and distributors should deal with, for example, information flows when suppliers compete with their own distributors, the balance of traditional and online trade, the protection of the integrity and value of distribution systems across the common market, as well as agency set-ups. They replace the previous regime, which entered into force in 2010 and was due to expire at the beginning of June this year.

The revised VBER and the Vertical Guidelines enter into force on 1 June 2022. However, there is a 12-month transitional period for agreements that are already in force on 31 May 2022 and satisfy the block exemption conditions under the previous regime, meaning that companies have until 31 May 2023 to ensure their agreements in force on 31 May 2022 comply with the new rules.

The main changes to the VBER and the Vertical Guidelines focus on making the regime fit for the digital age by adjusting the safe harbors and introducing specific rules and guidance regarding the assessment of online sales restrictions.

Narrower safe harbor for dual distribution

Dual distribution, i.e. the practice whereby a supplier sells its goods or services both (i) through independent distributors; and (ii) directly to end customers, e.g. through its own website, continues to be block exempted to the extent the parties' market shares do not exceed 30% and the agreements do not include certain identified hardcore restrictions of competition. The revised VBER, however, takes a stricter approach to information exchange in dual distribution, as the block exemption only applies to an exchange of information between the supplier and the buyer that is directly related to the implementation of the vertical agreement and necessary to improve the production or distribution of the contract goods or services by the parties.

To facilitate the assessment of information exchange in dual distribution, the Vertical Guidelines provide non-exhaustive lists of information that generally is likely or unlikely to benefit from the block exemption. While these lists provide guidance to assist in self-assessment, the Vertical Guidelines emphasize that inclusion of a particular type of information in the lists does not imply that such information will benefit from or fall outside the safe harbor in all cases, as different types of information may be needed, e.g. to operate different distribution models. Further, the lists are quite limited, thus leaving a wide grey area. However, where information exchange falls outside the block exemption, it is not automatically prohibited, but must be assessed on a case-by-case basis under Article 101(3) TFEU.

In addition, the revised VBER adjusts the scope of the parties covered by the block exemption for dual distribution. On the one hand, the scope of suppliers included in the safe harbor is expanded to cover wholesalers and importers in addition to manufacturers. On the other hand, the revised VBER provides that the safe harbor does not apply to vertical agreements with hybrid online intermediation service providers, such as online marketplaces like Amazon, which sell goods and services in competition with the undertakings to which they provide online intermediation services. Such vertical agreements are to be assessed on a case-by-case basis.

Narrower safe harbor for parity obligations

Parity obligations (sometimes called Most Favored Nation clauses) require a supplier to offer the same or better conditions to its contracting party as those offered to certain other parties or via certain other sales channels. Under the previous VBER, all types of parity obligations were block exempted. The revised VBER, however, takes a stricter approach to certain types of parity obligations.

The revised VBER excludes from the block exemption across-platform retail parity obligations. These are obligations imposed by online intermediation service providers, such as online marketplaces, which, directly or indirectly, cause suppliers not to offer the contract goods or services to end users under more favorable conditions via competing online intermediation services. The conditions may concern prices, inventory, availability or any other terms or conditions of offer or sale. Across-platform retail parity obligations may still be lawful but need to be assessed on a case-by-case basis under Article 101(3) of the Treaty on the Functioning of the European Union (the TFEU).

All other types of parity obligations continue to be covered by the block exemption under the revised VBER. Thus, in cases where the parties' respective market shares do not exceed 30%, the block exemption covers narrow retail parity obligations, which prevent retailers from offering better prices or conditions on their direct sales channels (such as their own website) than they offer on an online marketplace, for example. The block exemption also covers all parity obligations imposed on upstream levels of the market. It should, however, be noted that, under the revised VBER, the Commission may withdraw the benefit of the block exemption in highly concentrated platform markets where the cumulative use of narrow retail parity obligations may restrict competition.

More flexibility and clarity for active sales restrictions

Restriction of active sales (i.e. sales actively targeting customers) and passive sales (i.e. sales made in response to unsolicited requests from individual customers) are both considered as hardcore restrictions of competition. Restrictions of passive sales are exempted only in very limited circumstances, such as in the context of selective distribution systems, whereas restrictions of active sales are also allowed in the context of exclusive distribution. This premise remains unchanged in the revised VBER. However, in the review process, the Commission recognized the need to provide greater flexibility for suppliers to design their distribution systems and to protect their distributors against active or passive sales by unauthorized distributors.

First, the revised VBER introduces the concept of shared exclusivity, meaning that the supplier is allowed to appoint a maximum of five exclusive distributors for a given territory or customer group. For shared exclusivity to be block exempted, both the supplier's and the distributors' respective market shares must not exceed 30% and the shared exclusive territory or customer group must be protected from active sales by all the supplier's other buyers. However, active and passive sales within the shared exclusive territory or customer group cannot be restricted. The limitation to a maximum of five exclusive distributors per territory or customer group seeks to strike a balance between providing suppliers with sufficient flexibility to organize their distribution systems and preserving the distributors' incentive to invest in promoting and selling the supplier's goods or services.

Further, to protect the investment incentives of exclusively appointed distributors, the revised VBER allows suppliers to require that the restriction of active sales into an exclusive territory or to an exclusive customer group be passed on to the direct customers of all its other buyers.

The revised VBER also provides enhanced protection for selective distribution systems against active and passive sales to unauthorized distributors. Where a supplier operates different distribution systems in different areas or for different customer groups, the revised VBER provides that the supplier may prohibit its other distributors – whether exclusive, selective, or free distributors – and their customers from selling actively or passively to unauthorized distributors within an area where the supplier operates a selective distribution system.In addition, the revised VBER and Vertical Guidelines provide more clarity, in particular, on when certain online sales practices amount to active sales. Definitions of active and passive sales, which have been added to the VBER, provide that, in addition to price comparison websites and search engine advertising targeting customers in particular territories, operating a website with a country-specific top-level domain or offering language options that are different from those commonly used in the territory where the distributor is established amount to active sales. However, offering an English language option in an online store does not as such amount to active selling to English-speaking territories. The revised Vertical Guidelines also contain further guidance, e.g. on when online advertising amounts to active sales.

More flexibility and up-to-date guidance on online sales restrictions

Due to the significant growth of e-commerce over the past decade, the revised VBER and Vertical Guidelines also clarify how the Commission will evaluate certain online practices. The revised VBER defines the prevention of the effective use of the internet by the buyer or its customers to sell the contract goods or services as a hardcore restriction. In addition to direct bans on online sales, any restrictions which have the object of significantly diminishing the overall volume of online sales or the possibility for end users to buy the goods or services online are treated as hardcore restrictions. For example, preventing the use of an entire online advertising channel, such as search engines or price comparison services, qualifies as a hardcore restriction.

The Vertical Guidelines provide further guidance on how various online sales restrictions are evaluated. For example, even though it is not possible to prevent the use of an entire online advertising channel, prohibiting the use of a particular search engine or price comparison service may be allowed under certain circumstances. Further, certain quality standards can be imposed on online advertising. In addition, restrictions relating to the use of particular online sales channels, such as online marketplaces, can also benefit from the block exemption.

The revised Vertical Guidelines also recognize that, over the past decade, online sales have developed into a well-functioning sales channel, which no longer needs special protection. Under the previous regime, setting different prices or conditions for online and offline sales amounted to a hardcore restriction. The revised Vertical Guidelines adopt a more relaxed approach to these practices to the extent they do not have as their object to prevent the effective use of the internet for the purposes of selling online.

- Dual pricing, i.e. a requirement that the same buyer pays a different price for products intended to be resold online than for products intended to be resold offline, can benefit from the block exemption where the difference in the wholesale price is reasonably related to differences in the investments and costs incurred by the buyer in each channel. In such circumstances, dual pricing may incentivize or reward an appropriate level of investments in the online and offline sales channels. However, if dual pricing makes selling online unprofitable or financially unsustainable, it would also amount to a hardcore restriction under the revised rules.

- In the context of selective distribution systems, suppliers are no longer required to impose the same qualitative criteria for online sales as they impose for sales in brick-and-mortar shops. Thus, in a selective distribution system, a supplier may, for example, establish specific requirements to ensure certain service quality standards for users purchasing online, such as a requirement to cover the costs of customer returns.

Other clarifications

The revised VBER maintains resale price maintenance (RPM) as a hardcore restriction. Thus, the imposition of fixed or minimum resale prices remains prohibited with very limited exceptions, whereas the imposition of maximum or recommended resale prices does not in itself amount to RPM, provided these prices are not combined with incentives to apply a certain price level or disincentives to lower the sales price. The revised Vertical Guidelines, however, provide additional guidance on how certain conduct is to be assessed under the RPM rules. For example, the Vertical Guidelines clarify that minimum advertised price (MAP) policies, which are typically treated as an indirect means of applying RPM, may also lead to efficiencies and thus be allowed in individual cases, e.g. where they are used to prevent a particular distributor from using the product of a supplier as a loss leader. The Vertical Guidelines also clarify that the RPM prohibition applies to online intermediation service providers, thus preventing online platforms from imposing fixed or minimum sales prices for the transactions they facilitate.

Non-compete obligations remain to be excluded from the scope of the VBER safe harbor when their duration is indefinite or exceeds five years. However, under the revised VBER, non-compete obligations that are tacitly renewable beyond a period of five years are now covered by the block exemption, provided that the buyer can renegotiate or terminate the agreement with a reasonable notice period and at reasonable cost, thus allowing the buyer to effectively switch its supplier after the expiry of the five-year period.

True agency agreements remain outside the scope of Article 101(1) TFEU in general, but the Vertical Guidelines provide more clarity on certain key concepts relating to, for example, the assessment of commercial risk taken by the agent. The Vertical Guidelines also contain new guidance on so-called dual role agents, that is, independent distributors of certain goods or services of a supplier who also act as an agent for other goods or services of the same supplier. Most importantly, the Vertical Guidelines clearly set out that undertakings active in the online platform economy generally do not meet the conditions to be considered true agents.

Final remarks

The revised VBER and Vertical Guidelines introduce much needed changes to make the EU regime for vertical agreements fit for the digital age. While reducing the scope of the safe harbors, the revised VBER provides more flexibility for suppliers to design both their online and offline distribution more efficiently and more clarity on the assessment of various online practices. However, online platforms, which the previous VBER did not address specifically, face stricter rules under the revised VBER.