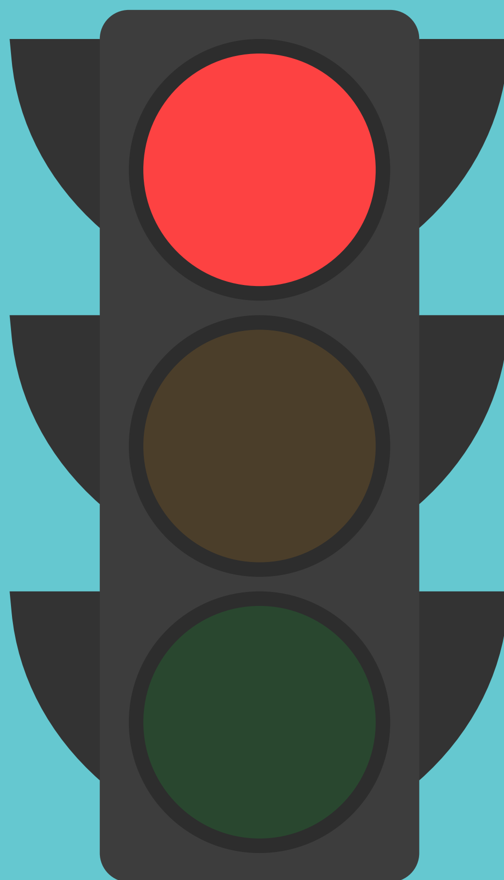
HARDCORE RESTRICTIONS IN REGULATION 2022/720 ON VERTICAL RESTRICTIONS



BY KASSIANI CHRISTODOULOU & MARION CARBO[1]

1 Kassiani Christodoulou, DG COMP, European Commission and Marion Carbo, DG COMP, European Commission. The information and views set out in this article are those of the authors and do not necessarily reflect the official opinion of the European Commission.

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HARDCORE RESTRICTIONS IN REGULATION 2022/720 ON VERTICAL RESTRICTIONS

By Kassiani Christodoulou & Marion Carbo

The Vertical Block Exemption Regulation is a valuable tool, helping businesses to self-assess the compliance of their sale and distribution agreements with EU competition rules and facilitating the work of European enforcement authorities, as it exempts vertical agreements falling within its scope from Article 101(1) of the Treaty. Ensuring that the scope of the VBER is appropriately defined is therefore crucial for reducing businesses' compliance costs and granting them flexibility in the design of their distribution systems, while ensuring the effective enforcement of the competition rules. Ensuring that hardcore restrictions are defined with sufficient clarity is key to the effectiveness of the rules. Following the adoption of the new VBER in May 2022, this article focuses on the changes made to the provisions concerning hardcore restrictions and the additional guidance provided in the accompanying Vertical Guidelines.

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I. INTRODUCTION

On May 10, 2022, the Commission adopted a revised Vertical Block Exemption Regulation ("VBER"),[2] followed by revised Vertical Guidelines.[3]

Like previous Block Exemption Regulations for vertical agreements, the new VBER aims to provide businesses with guidance that can help them self-assess the compliance of their supply and distribution agreements with Article 101 of the Treaty on the Functioning of the European Union ("the Treaty") and to facilitate the enforcement work of the Commission, national competition authorities and national courts.[4] It does so by creating legal certainty (a so-called "safe harbor"), whereby vertical agreements that meet the conditions of the VBER are exempted from the prohibition of Article 101(1) of the Treaty, as they are regarded as normally satisfying the conditions of Article 101(3) of the Treaty.[5] As a result, businesses no longer need to self-assess the compatibility of their vertical agreements with Article 101 of the Treaty, but may only assess whether their agreements fall within the scope of the VBER.

The new VBER and Vertical Guidelines follow the economic, effects-based approach introduced in the 1999 version of the VBER.[6] They acknowledge that vertical agreements are generally less harmful to competition than horizontal agreements. In particular, the complementary nature of the activities of the parties to a vertical agreement generally implies that the parties will have the incentive to increase their competitiveness through the vertical agreement and that vertical restraints provide greater scope for efficiencies by optimizing manufacturing and distribution.

They also set out that the likelihood that the efficiency-enhancing effects of a vertical agreement will outweigh any anti-competitive effects resulting from the restrictions it contains depends on the degree of market power of the parties to the vertical agreement and, therefore, on the extent to which they face competition from other suppliers of interchangeable goods or services. This is because undertakings with market power may, in certain cases, use vertical restraints to pursue anti-competitive purposes that ultimately harm consumers.[7]

However, the rules also provide that agreements which contain certain severely anti-competitive restrictions, so-called "hardcore restrictions" are unlikely to result in such efficiency-enhancing effects, as they do not create objective economic benefits, do not benefit consumers or are not indispensable to the attainment of such pro-competitive effects. Hardcore restrictions are generally restrictions of competition by object and unlikely to fulfil the conditions of Article 101(3) of the Treaty.

Against that background, the VBER sets out a clear framework for establishing whether a vertical agreement can benefit from the safe harbor.

First, it can be presumed that vertical agreements generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits, where the market share of the supplier (on the market where it sells the contract products) and of the buyer (on the market where it buys the contract products) do not exceed 30 percent. Above this threshold, there can be no such presumption, and therefore the VBER does not apply. Businesses would have to make an individual assessment as to the compliance of their vertical agreements with competition rules in those cases.

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2 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, C/2022/3015, OJ L 134, 11.5.2022, p. 4-13.

3 Communication from the Commission Guidelines on vertical restraints ("Vertical Guidelines"), 2022/C 248/01, OJ C 248, 30.6.2022, p. 1-85.

4 Commission Staff Working Document, Impact Assessment Report accompanying the documents 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 and Communication from the Commission, Approval of the content of a draft for a Communication from the Commission, Guidelines on vertical restraints, SWD(2022)139 ("VBER Impact Assessment SWD"), p. 25.

5 Regulation No 19/65/EEC of 2 March of the Council on application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ 36, 6.3.1965, p. 35, as amended by Council Regulation (EC) No 1215/1999 of 10 June 1999, OJ L 148, 15.6.1999, p. 1.

6 Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336, 29.12.1999, p. 21-25.

7 Section 2 of the Vertical Guidelines.

Second, vertical agreements containing hardcore restrictions cannot benefit from the safe harbor created by the VBER, irrespective of the market share of the parties. Where a vertical agreement contains a hardcore restriction, the whole agreement is excluded from the scope of the VBER and has to be individually assessed.[8]

The hardcore restrictions are listed in Article 4 of the VBER. This article focuses on the changes made that Article in the new VBER, for which further guidance is provided in the corresponding sections of the new Vertical Guidelines.

In line with the overall objectives of the review of the VBER, the changes made in Article 4 sought to ensure that the VBER does not exempt agreements for which there is no certainty that they meet the conditions of Article 101(3) of the Treaty, and that it does not exclude from the block exemption agreements for which such certainty exists. The structure of Article 4 has also been simplified and clarifications and updates have been added to reflect market and case law developments.[9]

II. ARTICLE 4(A) – PRICING RESTRICTIONS

The first type of hardcore restrictions identified in Article 4 concerns restrictions on the buyer's ability to determine its sale price and, in particular, resale price maintenance obligations ("RPM"), namely the imposition of a fixed or minimum resale price by the supplier on the distributor. Given that RPM eliminates price competition between distributors, it is considered a by object restriction under Article 101 of the Treaty[10] and a hardcore restriction under Article 4(a) of the VBER.

RPM was already a hardcore restriction under the previous VBER. During the review, some stakeholders questioned the categorization of RPM as a hardcore restriction.[11] As there was no clear evidence that RPM is on balance efficiency-enhancing and, thus, fulfils the conditions of Article 101(3) of the Treaty, the Commission did not make substantive changes to Article 4(a) in the new VBER. As a result, RPM remains a hardcore restriction and agreements that involve RPM cannot benefit from the block exemption. However, the hardcore categorization does not exclude the possibility that parties may be able to justify the use of RPM in individual cases if the conditions of Article 101(3) are met.

Furthermore, the review identified difficulties with applying the VBER to atypical price restrictions[12] and a lack of clarity as regards the conditions under which RPM can benefit from the exception provided by Article 101(3) of the Treaty.[13] To improve legal certainty, the Commission made structural changes to the Vertical Guidelines, by consolidating the previously scattered guidance on RPM in Section 6.1.1. of the new Vertical Guidelines. It also provided additional guidance to further clarify the rules on pricing restrictions and facilitate businesses' self-assessment.

In particular, Section 6.1.1 of the Vertical Guidelines provides examples of efficiencies that may result from RPM, and which may fulfil the conditions of Article 101(3) of the Treaty in individual cases outside the scope of the block exemption. These include the use of RPM to achieve an expansion of demand during the launch of a new product or to avoid the undercutting of a coordinated short-term low price campaign in a franchising system.

The Vertical Guidelines also include guidance on other types of pricing restrictions, such as a prohibition on a distributor to advertise prices for the contract products below a level set by the supplier (minimum advertised prices restrictions or ("MAPs")). Although in principle MAPs leave the distributor free to sell at a price that is lower than the advertised price, de facto they disincentivize the distributor from setting a lower sale price by restricting its ability to inform potential customers accordingly and, in that way, remove a key parameter of competition between

8 Article 5 of the VBER also excludes certain restrictions from the benefit of the safe harbor, irrespective of whether the market shares of the parties exceed 30 percent. These are restrictions for which it cannot be assumed with sufficient certainty that they fulfil the conditions of Article 101(3) of the Treaty. However, contrary to hardcore restrictions, these restrictions are not generally regarded as falling within the scope of Article 101(1) of the Treaty or failing to satisfy the conditions of Article 101(3) of the Treaty. They are subject to an individual assessment. Moreover, unlike vertical agreements containing hardcore restrictions, which fall entirely outside the scope of the VBER, vertical agreements containing excluded restrictions can still benefit from the safe harbor, if the excluded restriction in question can be severed from the rest of the vertical agreement.

9 VBER Impact Assessment SWD, p. 25-26.

10 Judgments of 3 July 1985, in Case C-243/83, EU:C:1985:284, *Binon v. AMP*; 1 October 1987 in Case C-311/85, EU:C:1987:418, *VVR v. Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten*; 19 April 1988, in Case C-27/87, EU:C:1988:183, *Erauw-Jacquery v. La Hesbignonne*.

11 Commission staff working document, Evaluation of the Vertical Block Exemption Regulation ("VBER Evaluation SWD"), Brussels, 8 September 2020, SWD(2020) 172 final, p. 171-174.

12 VBER Evaluation SWD, p. 169.

13 VBER Evaluation SWD, p. 170.

retailers. Therefore, the Vertical Guidelines state that, for the application of Article 4(a) of the VBER, MAPs will be treated as an indirect form of RPM, but also provide guidance on circumstances under which MAPs may fulfil the conditions of Article 101(3) of the Treaty in individual cases outside the scope of the block exemption.

Another area where Section 6.1.1 of the new Vertical Guidelines provides additional clarifications concerns certain types of fulfilment contracts, namely instances where a supplier enters into a vertical agreement with a buyer for the execution of a supply agreement concluded directly between the supplier and a specific customer. Such contracts will not be regarded as RPM, on condition that the sale price has been pre-agreed between the supplier and the customer and that the buyer fulfilling the contract is selected by the supplier. This is, for example, the case where customers purchase goods from an undertaking active in the online platform economy which is operated by a group of independent retailers under a common brand and where that undertaking determines the price of the goods and forwards the orders to the retailers for fulfilment.[14] By contrast, where the undertaking that provides the fulfilment services is selected by the customer, the imposition of a resale price by the supplier may restrict competition at the level of the provision of the fulfilment services and may amount to RPM.

III. ARTICLE 4(B) TO (D) – TERRITORIAL AND CUSTOMER RESTRICTIONS

The second type of hardcore restrictions identified in Article 4 relate to the territories in which and the customers to whom the buyer can sell the contract products. This type of restrictions is considered hardcore, as they are capable of partitioning the internal market and reducing competition across territories or customer groups. Therefore, the buyer in a vertical agreement should in principle be allowed to actively approach customers (active selling) as well as to respond to unsolicited customer requests (passive selling). The VBER only allows for restrictions of active and passive selling under very limited circumstances, notably when necessary to protect investments by exclusive distributors or to prevent sales to unauthorized distributors located in a selective distribution territory. In all other instances, restrictions of active or passive sales are by object restrictions under Article 101 of the Treaty[15] and hardcore under Article 4 of the VBER.

The review revealed that the rules setting out when restrictions of active and passive sales are hardcore under the previous VBER were perceived as unclear and complex.[16] Feedback from stakeholders also indicated that the rules were too rigid and, to some extent, prevented businesses from shaping their distribution systems according to their needs.[17] Other areas of the rules, such as the distinction between active and passive sales, were considered as no longer up to date.[18]

The new VBER and Vertical Guidelines implement structural and substantive changes that aim to address these issues, while maintaining the overall approach, in line with the requirement to only exempt vertical agreements for which there is sufficient certainty that the conditions of Article 101(3) of the Treaty are met.

First, Article 4 of the VBER has been re-structured, so that the hardcore restrictions relevant to the most common types of distribution system are grouped together. In particular, Article 4(b) covers territorial or customer restrictions in exclusive distribution systems; Article 4(c) covers selective distribution system, and Article 4(d) covers all other types of distribution agreements ("free distribution"), i.e. distribution under neither an exclusive nor a selective distribution system (Article 4(d)).

Second, to improve legal certainty and promote harmonized application throughout the EU, the definition of active and passive sales has been moved from the Vertical Guidelines to the new VBER and adapted to take account of new sales techniques that that have emerged or became more widely used with the growth of e-commerce. Article 1(l) of the new VBER defines active sales as actively targeting customers using all forms of direct communication or targeted advertising, whether offline or online. It specifies that the use of search engine advertising or price comparison services that target particular territories, the use of a website with a country-specific top-level domain or the use in an online store

14 This guidance is without prejudice to the assessment under Article 101 of the Treaty of the horizontal agreements between the retailers that set up and operate such a fulfilment model.

15 Judgments of 13 July 1966 in Joined Cases 56 and 58-64, ECLI:EU:C:1966:41, Établissements Consten *S.A.R.L. and Grundig-Verkaufs-GmbH v. Commission*; 6 October 2009 in Joined Cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P, ECLI:EU:C:2009:610, *GlaxoSmithKline Services Unlimited v. Commission.*

16 VBER Evaluation SWD, p. 176-177.

17 VBER Evaluation SWD, p. 190.

18 VBER Evaluation SWD, p. 216.

of languages that are not commonly used in the territories where the distributor is established[19] amount to active sales. Article 1(m) of the new VBER defines passive sales as sales made in response to unsolicited requests from individual customers that were not actively targeted by the distributor, and include sales resulting from participation in public procurement or responding to private invitations to tender. Additional guidance on active and passive selling is provided in Section 6.1.2.2 of the new Vertical Guidelines.

Third, the rules on exclusive and selective distribution have been revised to grant suppliers and distributors more flexibility in setting up their distribution systems, to the extent that this does not result in a severe restriction of competition.

As regards exclusive distribution, a definition has been included in Article 1(h) of the VBER to improve clarity, providing that the essence of exclusive distribution is that the supplier allocates a territory or customer group exclusively to certain buyers and restricts all its other buyers from selling actively into that territory or customer group. Moreover, the review introduced two additional exceptions, whereby certain restrictions of active sales are no longer considered hardcore. Those restrictions are considered on balance efficiency-enhancing, since they provide increased protection for the investments made by exclusive distributors.

The first new exception concerns shared exclusivity, namely the possibility for the supplier to appoint more than one exclusive distributor. Under the new VBER, shared exclusivity is block-exempted up to a maximum of five distributors per exclusive territory or customer group. The setting of a maximum number of (shared) exclusive distributors is intended to provide legal certainty for suppliers that want to set up an exclusive distribution system and provide them with more flexibility to determine the appropriate number of exclusive distributors depending on the size of the particular territory or customer group and the type of products concerned. The (rather low) maximum number of (shared) exclusive distributors limits the risk that the exclusive distributors will free-ride on each other's investment efforts. As a result, the exclusive distributors can benefit from the protection resulting from the restriction of active sales by all non-exclusive distributors, but they remain free to make active and passive sales within the shared, exclusively allocated, territory or customer group.

The second new exception provides that the restriction of active sales into exclusive territories can now be "passed on" one level further down the distribution chain. Namely, a supplier can instruct its distributors to prohibit their direct customers from making active sales into territories or to customer groups for which the supplier operates an exclusive distribution system. This provides exclusive distribution with a higher level of protection by limiting active selling also by the direct customers of the buyer.

As regards selective distribution, the new VBER provides that a supplier may restrict any of its buyers from selling either actively or passively to unauthorized distributors located in a territory where the supplier operates a selective distribution system. Previously, the supplier could only impose this restriction on the appointed members of the selective distribution system. Consequently, the supplier could not, within the block exemption, prevent distributors located in a territory where the supplier operated a free distribution system from selling to unauthorized distributors in territories where the supplier operated a selective distribution system. This change is intended to give greater protection to selective distribution, with the aim of enabling suppliers to incentivize investments in brands and retail services.

Lastly, to improve clarity, the new Vertical Guidelines describe in Section 4.6.2 the different steps that should be followed to assess the compliance of selective distribution systems with Article 101 of the Treaty. They also clarify, as this appeared to have been not well understood under the previous rules, that selective distribution systems can benefit from the safe harbor of the VBER regardless of the nature of the product concerned, the nature of the selection criteria (qualitative or quantitative) imposed by the supplier, and whether or not the supplier discloses its selection criteria.

IV. ARTICLE 4(E) – ONLINE SALES AND ADVERTISING RESTRICTIONS

Beyond the changes made to the hardcore restrictions already included in the previous VBER, the new VBER introduces a new provision, Article 4(e), relating to restrictions of online sales and online advertising.

The previous VBER did not contain specific provisions for online sales and advertising restrictions, so these benefitted from the safe harbor, provided that they did not amount to hardcore restrictions under Article 4 (or excluded restrictions under Article 5). Similarly, the Vertical Guidelines only provided limited guidance on the assessment of online sales restrictions.

19 However, the Vertical Guidelines clarify that offering an English language option in an online store does not as such indicate that the seller is targeting English-speaking territories, as English is widely understood and used throughout the EU.

During the review, the digitalization of the market emerged as the most significant change since the adoption of the previous VBER.[20] Stakeholders noted that the rules were not well adapted to e-commerce, new market players' ways of doing business and new market behaviors, such as consumers' expectation for seamless switching between online and offline channels. Stakeholders also stressed that the new rules should reflect the case law adopted over the last decade in relation to online sales and advertising restrictions.

Article 4(e) does not introduce any substantive change to the assessment of online sales restrictions. Rather, it clarifies and consolidates how the rules relating to restrictions on the territories in which and the customers to whom the buyer can sell the contract products set out in Article 4(b) to 4(d) of the VBER are applied to online sales and advertising restrictions. It also seeks to improve legal certainty by providing for a single framework for the assessment of all types of online sales and advertising restrictions. More concretely, Article 4(e) provides that restrictions of online sales or online advertising are hardcore where they have the object, directly or indirectly, in isolation or in combination with other factors controlled by the parties, of preventing the effective use of the internet for selling the contract goods or services by the buyer in a vertical agreement. Other restrictions of online sales can thus benefit from the safe harbor of the VBER. Article 4(e) of the VBER applies irrespective of the distribution system used by the parties to the vertical agreement.

Article 4(e) reflects the case law of the Court of Justice of the European Union in this area, and in particular the judgments in the cases *Pierre Fabre* and *Coty*. In the *Pierre Fabre* case,[21] the Court found that a clause banning authorized distributors in a selective distribution system from selling *via* the internet had as its object the restriction of passive sales to end users wishing to purchase online and located outside the physical trading area of the relevant member of the selective distribution system. It also found that the clause amounted to a hardcore restriction under the VBER, as it prohibited *de facto* the internet as a method of marketing. In the Coty case,[22] the Court found that a clause banning the use of online marketplaces to sell the contract goods was not a hardcore restriction under the VBER. This was because it did not restrict the territories into which or the customers to whom the authorized distributors could sell, notably because the distributors remained free to sell online, e.g. through their own online stores, and could raise awareness of their online activities through online advertising.

Article 4(e) consolidates that case law, by setting out when online sales restrictions are hardcore by reference to the prevention of the effective use of the internet (in line with the findings in the *Pierre Fabre* case) and by clarifying that restrictions that do not prevent the effective use of the internet can benefit from the block exemption (in line with the judgment in Coty). It also takes into account the emphasis given by the Court to the ability of a distributor to raise awareness of its online activities, by taking a somewhat stricter stance regarding restrictions of online advertising and providing that prohibiting the use of an entire online advertising channel amounts to a hardcore restriction.

Additional guidance on the application of this rule is provided in recital 15 of the VBER and Section 6.1.2 of the Vertical Guidelines. For instance, the rules explain that a restriction of online sales that aims at significantly diminishing the aggregate volume of online sales of the contract products on the market or the possibility for consumers to buy the contract products online amounts to a hardcore restriction. The rules also recall that the categorization of a restriction as hardcore should not depend on market-specific circumstances or the individual characteristics of the parties. Article 4(e) must be applied to the vertical agreement as a whole, including for establishing whether the use of multiple online sales or advertising restrictions has the object of preventing the effective use of the internet.

Section 6.1.2 of the Vertical Guidelines also includes examples of types of restrictions that will generally benefit from the block exemption, such as a requirement to operate an offline store, a requirement that a minimum volume of sales is made offline, a ban on the use of online marketplaces or the imposition of quality requirements for online sales. It also includes examples of types of restrictions that will generally qualify as hardcore under Article 4 of the VBER, such as a requirement to make a certain share of total sales offline, a ban on the use of the supplier's brand on the distributor's website or a ban on the use of entire online advertising channels.

V. CONCLUSION

The VBER is a valuable tool, helping businesses to self-assess the compliance of their sale and distribution agreements with EU competition rules and facilitating the work of European enforcement authorities, as it exempts vertical agreements falling within its scope from Article 101(1) of the Treaty. Ensuring that the scope of the VBER is appropriately defined is therefore crucial for reducing businesses' compliance costs and granting them flexibility in the design of their distribution systems, while ensuring the effective enforcement of the competition rules. The scope

20 VBER Evaluation SWD, p. 30 and following.

21 Judgment of 13 October 2011 in Case C-439/09, EU:C:2011:649, *Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence and Ministre de l'Économie, de l'Industrie et de l'Emploi.*

22 Judgment of 6 December 2017 in Case C-230/16, EU:C:2017:941, *Coty Germany GmbH v. Parfümerie Akzente GmbH.*

of the block exemption is defined by means of the hardcore restrictions, together with the market share threshold; ensuring that the hardcore restrictions are defined with sufficient clarity is therefore key to the effectiveness of the rules.

On the basis of a thorough and interactive review process, during which the Commission invited comments from all types of stakeholders, sought the opinion of experts in the field and analyzed market trends and case law developments, the new VBER and Vertical Guidelines seek to provide a set of rules that are comprehensive, up-to-date and increase legal certainty.

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