NEW VERTICAL BLOCK EXEMPTIONS AND GUIDELINES IN EUROPE: KEY CHANGES AND EMERGING QUESTIONS

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By Charlotte Colin-Dubuisson & Sima Ostrovsky

With the revised European vertical rules in effect since June 1, 2022, businesses are grappling with the meaning and implications of certain new additions to the vertical regime as they have a one-year transitionary period to bring their distribution arrangements in line with the new order. While the aim of the amendments has been to simplify and clarify the rules, they have not managed to escape complexity and ambiguity despite the extensive consultation with stakeholders. Businesses are no doubt analyzing with interest the additional flexibility presented by the amendments relating to shared exclusivity and dual pricing while trying to make sense of the new guidance on information exchange in the context of dual distribution and the new hardcore restriction involving minimum advertised prices ("MAPs"). Intermediaries (physical or online) also have much food for thought with the new rules on online platforms and agency. In this article, we zoom in on a few of these developments, including information exchange, MAPs, shared exclusivity and dual pricing, to assess the flexibility and the uncertainty that they present.

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I. INTRODUCTION

Summer 2022 has been marked by the back-to-back adoption of the refreshed EU Vertical Block Exemption Regulation ("EU VBER"),[2] the UK Vertical Agreements Block Exemption Order ("UK VABEO"),[3] and their respective Vertical Guidelines.[4]

There are now two distinct sets of rules in Europe that companies must get to grips with when assessing the restrictions included in their supply or distribution arrangements. This, of course, serves to complicate the legal environment rather than simplifying it, contrary to what was expected and advocated for when the revision processes where launched.

In terms of timing, both texts provide for a one-year transitionary period for pre-existing vertical agreements (i.e. agreements entered into force before the adoption of the revised VBER and VABEO). In practice, this means that (i) all new agreements entered into after May 31, 2022 at the EU level and June 1, 2022 for the UK, must comply with the revised rules; and (ii) all pre-existing agreements have until May 31, 2023 in the EU and June 1, 2023 in the UK to be brought into line with the new rules.

The overall exemption mechanism remains the same in both jurisdictions i.e. the exemption will apply provided the 30 percent market share threshold is not exceeded by the supplier and the reseller, and the agreement does not contain hardcore restrictions. However, the exemption renewal process has introduced a few notable changes, which might be seen either as opportunities or risks, depending on where the businesses operate in the supply chain. These changes, however, are already raising questions as to their application, which somewhat thwart the simplification aims of the consultation process.

Against this backdrop, in this article we focus on the following four notable additions to the new vertical rules: hybrid platforms and information exchanges in the context of dual distribution; minimum advertised prices ("MAPs") and the treatment of intermediaries (agency and fulfilment contracts) in the context of resale price maintenance ("RPM"); shared exclusivity; and dual pricing.

II. DUAL DISTRIBUTION: A NEW ERA ?

Dual distribution (where the supplier competes with its resellers at the downstream level) is an exception to the requirement, under the vertical rules, that the supplier and reseller must not be competitors. The focus of the European Commission ("Commission") on this form of distribution, which was hotly debated during the revision process, has been largely due to the significantly increased uptake in dual distribution since 2010 when the previous VBER was adopted in Europe. In its 2017 e-commerce report, the Commission indicated that 64 percent of respondent manufacturers had launched their own direct-to-consumer websites within the last 10 years.[5]

While the relationship between suppliers and resellers in a dual distribution set-up remains vertical, since they also compete at the downstream level, this raises some antitrust concerns. In particular, the authorities are focused on information exchange,[6] which is thought to raise the risk of collusion at the retail level or as restricting the distributors' ability to compete effectively at the retail level, thereby reducing intra-brand competition. Some concerns were also raised in relation to online platforms selling online intermediation services ("OIS") competing with their buyers.

A. So, What's New?

The real novelty of the revised EU rules is that OIS providers competing with their buyers at retail level (i.e. hybrid platforms) are now excluded from the benefit of the dual distribution exception. In practice, this means that hybrid platforms cannot benefit from the VBER exemption, and their arrangements must be assessed under the horizontal rather than vertical rules. In this respect the UK VABEO is more lenient as hybrid platforms are still covered by the dual distribution exception.

2 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022R0720&qid=1652368074897.

3 https://www.legislation.gov.uk/uksi/2022/516/contents/made.

4 Vertical agreements block exemption order guidance (publishing.service.gov.uk) EUR-Lex - 52022XC0630(01) - EN - EUR-Lex (europa.eu).

5 See para. 179 of the Commission's Final report on the E-commerce Sector Inquiry of 2017 (available here: https://ec.europa.eu/competition/antitrust/sector_inquiry_swd_en.pdf) and its Impact assessment report on the new VBER (here) p. 13, available here: 20220510_revised_VBER_and_vertical_guidelines_impact_assessment_report.pdf (europa.eu).

6 See impact assessment report on the new VBER (here) p. 13.

The second change concerns information exchange in a dual distribution scenario but is much less fundamental. Indeed, the revised rules both in the EU and the UK clarified (albeit with a slightly different test) that information exchange must be specifically assessed in a dual distribution scenario. In its initial proposal, the Commission had proposed to establish a new market share threshold of 10 percent above which information exchange within dual distribution systems would need to be self-assessed. Following quasi-unanimous criticism, this proposal was abandoned in the EU and was not seriously entertained in the UK.

Rather, the VBER establishes a (new) test under which companies operating in a dual distribution system must satisfy two conditions when exchanging information to ensure that it is exempt. Suppliers and resellers need to ensure that the information they exchange is (i) directly related to the implementation of the vertical agreement; and (ii) necessary to improve the production or distribution of the contract goods or services.[7] The test in the UK VABEO is narrower and only requires the information sharing to be *"required to implement that vertical agreement"* (and generally not to restrict competition by object).[8]

B. What Does This Mean in Practice?

What these two EU conditions mean exactly is not entirely clear, especially the second limb, and one can expect that it will be challenging to come to a clear-cut conclusion in the short term. If the conditions are not met, the exchange of information needs to be self-assessed, but the safe harbor continues to apply to the rest of the agreement. There is no guidance for the actual self-assessment, except for a few suggested risk mitigating measures.

Both the EU and the UK guidelines contain a (near identical) whitelist and a blacklist for information that will generally meet the exemption test. While some consider the examples as useful, others (including the authors) believe that these lists, albeit not exhaustive, are too rigid and may even serve as a deterrent for legitimate information sharing.

The other quirk with this new approach to information sharing is the burden of proof. The wording of Article 2(5) VBER seems to suggest that both conditions for permissibility of information sharing are presumed to be met as a matter of principle (the UK appears to have a similar presumption). This means that the Commission or a claimant would need to demonstrate that this information was in fact illegitimate. But, in practice, businesses will most likely always need to conduct some form of self-assessment to ensure that they have the requisite evidence to demonstrate the legitimacy of the information exchange.

All in all, this is not a revolutionary change in the vertical regime. It was never clear under the old rules whether information exchange within a dual distribution was exempted. A footnote in the 2010 Vertical Guidelines specifically stated that *"[d]irect information exchange between competitors is not covered by the Block Exemption Regulation,"* albeit in the context of category management.[9] And, in practice, many suppliers already had safeguards for the information exchanged with their competing resellers downstream (and vice versa). The revised VBER and VABEO and accompanying guidelines, while clarifying the framework of analysis, are therefore not game changers.

III. RESALE PRICE MAINTENANCE – REIMAGINED?

Both in the VABEO and VBER, the authorities' approach to RPM, and more generally price restrictions, remained largely unchanged. These restrictions continue to fall in the hardcore bucket despite concerted attempts by various stakeholders to argue in favor of a much more lenient (effects-based) approach, in line with the US doctrine. However, there are a number of interesting changes on the fringes.

A. Minimum Advertised Price – The Last-minute Change

The first interesting change in the RPM space is that both the EU and UK rules now expressly list MAPs as an indirect means of imposing RPM.[10] This was not an express restriction in the versions of the EU and UK Guidelines that were subject to consultation. The last minute "clarification" in the final published versions suggests a tightening of the approach to RPM both in the UK and the EU.

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7 See para. 96 of the new EU Vertical Guidelines.

8 See para. 6.22 of the UK Guidance.

9 See footnote 55 of the EU Vertical Guidelines.

10 See para. 187 of the new EU Vertical Guidelines and para. 8.12 of the UK Guidance.

An MAP is the lowest price at which resellers can advertise a supplier's products either offline or online. This concept is not new, but MAP policies had not been under the spotlight until recently in Europe. In the US, the Federal Trade Commission has provided some guidance on the topic[11] and has been actively challenging MAP policies since 2000, for example in relation to advertising restrictions in the pre-recorded music space.[12]

In practice, this means that suppliers and resellers have an additional area of caution to observe in their distribution policies. MAPs aimed at protecting a certain price positioning or luxury brand image, even if, in practice, resellers are able to discount from prices at the point of sale, are generally no longer acceptable.

The only exception to this comes in the form of an additional efficiency defense included in the EU and UK guidance where suppliers could technically use an MAP *"to prevent a **particular distributor** from using the product of a supplier as **a loss leader.**"*[13] However, this "exception" comes with a number of conditions: (i) the product concerned must be resold below wholesale price; and (ii) the specific distributor's loss-leading behavior must be regular; and (iii) capable of damaging the brand image of the supplier.

Suppliers will certainly see this new exception as a positive development. But given the risks attached to an RPM infringement (i.e. the loss of the exemption for the entire vertical agreement), we are likely to see this exception getting the same treatment as the other RPM exceptions in the past (e.g. short-term price campaigns), which remained only "theoretical" possibilities. While there may be a lot of short-term interest in applying the new exception, in-house legal may be reticent in recommending this route for fear of opening a pandora's box (i.e. allowing legitimate pricing intervention to embolden sales teams to intervene in non-exceptional cases). What seems more likely is that the new MAP exception may encourage suppliers to query with resellers any pricing below the wholesale level.

Whichever way they choose to deal with a loss leader situation, suppliers will need to have solid evidence to demonstrate that their reaction was legitimate and meets the conditions laid down in the Vertical Guidelines.

B. Intermediaries: Some Limited Concessions?

While MAPs represent an additional restriction in the hardcore bucket, the EU Commission and the Competition and Markets Authority ("CMA") have tried to show some flexibility in other RPM-related areas. During the consultation process, stakeholders rallied for a more lenient approach in scenarios where suppliers negotiate the commercial conditions and the wholesale price for their products with end-customers but involve intermediaries to handle the logistical support (i.e. invoicing, delivery, orders etc.). In a number of sectors, these intermediaries take the title for the products (i.e. briefly become the owners of the goods before delivering them), which has previously disqualified them from being classed as an "agent" under the old vertical rules. As a result, suppliers could not impose on these intermediaries the prices and conditions pre-negotiated with the end-customer, often on a multi-national basis,[14] despite obvious economies of scale and even if this was imposed by the end-customer. In response to these concerns, the EU and UK authorities have proposed two changes with new guidance on temporary transfer of title and fulfilment contracts.

Firstly, in the section dedicated to **agency** agreements allowing to fall outside the scope of Article 101 TFEU, the Commission has specified that, despite the principle (which remains) that the agent does not acquire the title to the goods bought or sold under the agency agreement, *"the fact that the agent may temporarily, for a very brief period of time, acquire the property in the contract goods while selling them on behalf of the principal, does not preclude the existence of an agency agreement that falls outside the scope of Article 101(1) of the Treaty, provided that the agent does not incur any costs or risks in relation to the transfer of property."*[15] The UK adopted a similar formulation, hidden away in a footnote of the Guidance.[16]

In practice, this means that suppliers operating their business through intermediaries (whether chosen or not by the end-customer), acting as real agents from a competition law perceptive, can negotiate prices directly with end-customers and impose these resale prices on

11 https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/dealings-supply-chain/manufacturer-imposed-requirements.

12 https://www.ftc.gov/legal-library/browse/cases-proceedings/9710070-universal-music-video-distribution-corpand-umg-recordings-inc.

13 See para. 197 of the new EU Guidelines and para. 8.21 (c) of the UK guidance.

14 See Concurrences N°1-2021 I On-Topic I The VBER and Vertical Guidelines: Revision or Reform? Reflection on critical issues, p. 16 on this specific question.

15 See paras. 33 a) and 192-193 of the new EU Vertical Guidelines.

16 See footnote 22 of the UK Guidance.

intermediaries, even if the intermediaries take ownership of these products for a brief period of time. While suppliers no doubt welcome this clarification, the conditions to benefit from this exception are very strict as the intermediaries must still qualify as a "genuine" agent for the purpose of competition law, by taking no costs or risk in relation to the supply of the product and transfer of title.

Secondly, the Commission and the CMA have also introduced (alleged) flexibility by allowing **fulfilment contracts** to escape RPM risk even if the intermediary is not a genuine agent. The EU and UK guidance specify that a fulfilment contract involves a supplier entering into a *"vertical agreement with a buyer for the purpose of executing (fulfilling) a supply agreement concluded previously between the supplier and a specific customer."*[17] In the context of such fulfilment contracts, a supplier can impose a resale price without it amounting to RPM but only if the supplier (and not the customer) *"selects the undertaking that will provide the fulfilment services."* In short, the RPM risk could be avoided if: (i) the supplier and end-customer enter a main supply agreement with a pre-agreed price; (ii) the supplier enters into a distinct fulfilment agreement with a "fulfilment intermediary" for the purpose of executing (fulfilling) the main agreement; and (ii) the supplier and not the end-customer chooses the fulfilment intermediary.

The third limb makes this additional flexibility somewhat less flexible. The stated reason for the additional requirement that the fulfilment intermediary must be chosen by the supplier is that in the case of a customer choosing the fulfilment agent, the imposition of a resale price may restrict competition for the provision of fulfilment services. Given that often the end-customer chooses the fulfilment agent, this exception may have limited application in many distribution arrangements.

Some uncertainty also arises due to the additional example provided by the Commission and the CMA relating to fulfilment contracts in the online environment, namely *"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 that undertaking determines the price for the sale of the goods and forwards orders to the retailers for fulfilment."* This scenario seems extremely specific and does not fully correspond to the pre-negotiation scenario between a supplier and end-customers described earlier in this section.

While the additional flexibility has been welcomed in the RPM space, where many are still disappointed that the European authorities are not taking a more enlightened (effects based) approach, the exceptions are quite narrow and will require careful execution to avoid falling on the wrong side of the ordinarily hardcore restriction.

IV. SHARED EXCLUSIVITY: ADDITIONAL FLEXIBILITY FLANKED BY NEW UNCERTAINTIES

The other notable change in the VBER and VABEO concerns exclusive distribution, which is an exception to the hardcore territorial and customer restrictions.

According to the previous EU Vertical Guidelines,[18] suppliers could implement an exclusive distribution by allocating an exclusive territory or customer group to itself or *"only to one distributor"* and protecting that exclusive distributor *"against active selling into its territory or to its customer group by all the other buyers of the supplier within the Union, irrespective of sales by the supplier."*

The three key changes in the new EU vertical rules are as follows:[19]

- the supplier can now appoint **up to five (exclusive) resellers** for the same territory or customer group;
- the supplier cannot restrict active or passive **cross-selling** among these exclusive distributors within the exclusive territory or customer group; and
- the supplier can require its buyers to **pass on** the restriction of active sales into exclusive territories or to exclusive customer groups to their **direct customers** (but not further down the chain).

While these changes have been presented by the Commission as additional flexibility for suppliers when operating their distribution network, these changes already raise a number of practical questions and difficulties.

17 See paras. 192 and 193 of the new Vertical Guidelines and para. 8.18 of the UK Guidance.

18 See para. 51.

19 See paras. 121-124 and 220 of the new EU Vertical Guidelines.

Firstly, the appointment of up to **five exclusive distributors** obviously raises the question of incentives. Indeed, from the reseller's perspective the real benefit of exclusive distribution was to benefit from an assured level of sales in compensation for the investments in the promotion of the supplier's brand. What will be the incentive of the so-called exclusive distributors to invest in the brand promotion if they are in fact not exclusive in markets where there is already a very limited number of retailers? This point will no doubt lead to some contentious negotiations between suppliers and retailers but at the heart of it, this amendment puts in question the very definition of "exclusive" distribution.

Interestingly, in the UK Guidance, the drafting is even more broad and allows suppliers to appoint "**a limited number**" **of exclusive distributors**," without specifying the number. But the UK Guidance expressly bakes in the incentives point by requiring that the number of appointed distributors should be determined "*in proportion to the allocated geographical area or customer group*" so as to incentivize investment by the distributors.[20] The proportionality calculation will not likely be straight forward, so it is arguable that the EU formulation at least provides a bit more certainty.

Secondly, unlike the previous rules, the updated Guidelines no longer expressly include the qualifications of "*irrespective of sales by the supplier.*" It is unclear from the revised formulation whether the supplier's sales should also be restricted into the exclusive territory or customer group (which was not the case previously). This is of course a very important point for suppliers operating dual distribution systems where they sell in competition with their distributors. To the extent the removal of the reference to the supplier's sales being permitted was intentional, this would mean that when operating an exclusive distribution system, suppliers will need to appoint themselves as one of the co-exclusive distributors to ensure they have the flexibility to sell into the exclusive territories / customer groups.

V. DUAL PRICING: IS THIS REALLY THE END OF THE HARDCORE RESTRICTION?

The last change worth commenting on is the removal of dual pricing from the list of hardcore restrictions from the VBER and VABEO. Dual pricing refers to a situation where a supplier imposes on a same reseller different wholesale prices depending on whether the products are intended to be resold online or offline. Under the previous EU Vertical Guidelines,[21] differential pricing for offline and online sales was prohibited because this was a "*restriction of passive selling*" which limited "*the distributor's access to a greater number and variety of customers.*"

The new EU Vertical Guidelines provide an exemption for dual pricing but under rather strict conditions (which are mirrored in the UK Guidance).[22] The rationale behind the relaxation of the rules is that this "*may incentivise or reward an appropriate level of investments in online or offline sales channels.*" The key limit is that this should not have "*the object of preventing the effective use of the internet by the buyer to sell the contract goods or services to particular territories or customers.*" Should this be the case, the restriction is then hardcore again.

To help navigating this qualification, the EU and UK guidelines specify that differential pricing is likely to be a hardcore restriction if:

- the difference in the wholesale price makes selling online unprofitable or financially unsustainable; or
- dual pricing is used to limit the quantity of products made available to the buyer for sale online.

Conversely, dual pricing is covered by the exemption if:

- the difference in the wholesale price is reasonably related to differences in the investments and costs incurred by the buyer to make sales in each channel; or
- when products are sold through a combination of offline and online channels, where the price difference takes into account investments or costs related to that type of distribution.

Finally, this section ends by suggesting that suppliers and resellers can agree on the appropriate method to implement dual pricing, including, for example, an ex-post balancing of accounts on the basis of actual sales.

The proposed formulation is a bit confusing. On the one hand, the EU and UK authorities state that dual pricing is in principle fine. On the other hand, they flag that if the suppliers are not careful this will be treated as hardcore. The risk to be taken by suppliers (and resellers?) so

20 See paras 10.57-10.59 of the UK Guidance.

21 See para. 52 of the EU Vertical Guidelines.

22 See para. 209 of the new EU Vertical Guidelines and para. 8.42 of the UK Guidance.

to benefit from this new exception seems quite high given the number of requirements to fall on the right side of the hardcore line.

In practice, suppliers and resellers do expect dual pricing to feature in the next round of distribution agreement negotiations. But this new approach to dual pricing raises a lot of practical questions. Just to highlight a few:

- Does the reference to "*wholesale prices*" include broader price-related terms, e.g. rebates?
- What information would the supplier need to access to ensure that the dual pricing mechanism does not make selling online unprofitable or financially unsustainable for the reseller. Similarly, what information would the reseller need to put forward to demonstrate that dual pricing prevents them from selling online or offline? More importantly, is it even acceptable to share this information in a dual distribution scenario given the new information exchange guidance?
- How are suppliers and distributors meant to assess the differences in investments and costs incurred by the resellers depending on the sales channel without sharing sensitive information in a dual distribution scenario?
- What level of cost differences justify a dual pricing mechanism? A mere difference, even if limited? A significant difference?
- What does the reference to suppliers and resellers being able to agree a "method to implement dual pricing" require? Is this an obligation to agree or can suppliers simply impose the method and the necessary information it should have access to through reporting obligations?

A lot of questions to be answered, which gives the overall impression that the Commission and the CMA are giving additional flexibility with one hand and taking it back with the other. The devil is in the detail and all these important changes will give rise to a lot of legal and operational discussions between suppliers and resellers during their commercial negotiations.

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