Competition and European Union Law

European Commission adopts new Vertical Block Exemption Regulation and Guidelines

The European Commission adopted on 10 May 2022 the Block Exemption Regulation for vertical agreements, as well as the Guidelines on Vertical Restraints. The new legislation modernises commercial distribution and seeks to adapt to new online marketing models.

COMPETITION PRACTICE[1]
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Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) prohibits agreements or concerted practices between undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition. However, Article 101(3) TFEU provides for an exception to the general rule: such agreements or concerted practices are allowed if their benefits outweigh the harmful effects they create.

Regulation 330/2010 laid down the conditions that vertical agreements (i.e. agreements concluded between economic operators that are active at different levels of the production or marketing chain of a product or service) must fulfil in order to benefit from the exemption of Article 101(3) TFEU. The regulation has been under review for a period of over three and a half years, during which the European Commission (the "Commission") has gathered evidence on the functioning of the regulation and analysed whether to (i) let it expire or (ii) amend it.

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The Commission has chosen the second option, and adopted on 10 May 2022 Regulation 2022/720 (the" VBER", available **here**), as well as the Guidelines on Vertical Restraints (the "Guidelines", available **here**). The VBER entered into force on 1 June 2022; however, it establishes a transitional period from its entry into force until 31 May 2023. The transitional period aims at allowing vertical agreements in force as of 31 May 2022 that qualified for the exemption to adapt to the new rules and requirements under the VBER.

The VBER maintains the same structure as Regulation 330/2010: it provides in Article 2 for a general exemption from the prohibition of anti-competitive agreements for vertical agreements that fulfil a number of conditions. More precisely, the supplier and the buyer must not exceed a market share of 30% in their respective markets (Article 3 VBER) and the agreement concerned must not contain a restriction that removes the benefit of the block exemption, a "hardcore restriction" (Article 4 VBER).

The purpose of this paper is to analyse the main changes brought by the VBER in the following areas: (i) dual distribution, (ii) restrictions on online sales, (iii) parity obligations, (iv) selective and exclusive distribution systems and (v) agency agreements.

1. Dual distribution

Article 2(4) VBER exempts from the application of Article 101(1) TFEU situations of "dual distribution". That is the practice where a manufacturer distributes its products directly on the market and sells them to other distributors; so that the manufacturer competes with its own distributors on the market. The exemption applies if two conditionsare met:

- the agreement is reciprocal;
- the supplier operates upstream as a manufacturer, importer or wholesaler, and downstream as an importer, wholesaler or retailer of goods; and the buyer operates downstream as an importer, wholesaler or retailer, and is not a competing undertaking at the upstream level where it buys the contract goods.

1.1 *Dual distribution and exchanges of information*

Article 2(5) VBER clarifies that the exemption in Article 2(4) does not apply to exchanges of information between supplier and buyer which (i) are not directly related to the implementation of the vertical agreement or (ii) are not necessary to improve the production or distribution of the contract goods or services. While the first circumstance of exclusion is self-evident, being a consequence of the very scope of application of the VBER - which applies to vertical agreements -, the second circumstance (non-necessity) has to be interpreted and analysed on a case-by-case basis.

In this respect, the Guidelines include in their paragraphs (99) and (100) non-exhaustive lists of examples of exchanges of information that meet the requirements of Article 2(4) VBER.

The following exchanges of information would be exempted from the application of Article 101(1) TFEU:

- Information relating to the marketing of the contract products, including information on promotional campaigns and on new products to be supplied under the vertical agreement.

- Information concerning the supplier's recommended resale prices and the prices at which the buyer resells the goods, provided that this information is not used to restrict the buyer's ability to determine its sale prices.

- Aggregated information on the marketing and sales activities of other buyers of the contract goods, provided that this does not enable the buyer to identify the activities of particular competing buyers.Information on the volume or value of the buyer's sales of the contract goods relative to its sales of competing products.

On the other hand, the following exchanges of information would not be exempted:

- Information relating to the future prices at which the supplier and the buyer intend to sell the contract goods or services downstream.

- Information relating to end-users of the contract goods, except where this is necessary (i) to meet the requirements of certain end-users or (ii) to monitor compliance with a selective or exclusive distribution system under which particular end-users are allocated to the supplier or buyer.

If the exchanges of information do not meet the conditions of Article 2(4) VBER, this does not necessarily mean that they are anti-competitive, but that they should be subject to individual analysis outside the VBER. For such cases, the Guidelines indicate that the presence of such exchanges does not prevent the other provisions of the vertical agreement from benefiting from the exemption provided for by the VBER Guidelines, paragraph (102). The Guidelines add that companies may take precautions in such scenarios to minimise risks, such as aggregating the information exchanged, delaying its provision or selecting the persons within the supplier's organisation who will receive such information (Guidelines, paragraph (103)).

1.2. *Dual distribution and providers of online intermediation services*

The VBER distinguishes those situations that are properly dual distribution from providers of online intermediary services (the term by which the VBER refers to platforms that facilitate transactions between businesses, 'B2B', or between businesses and final consumers, 'B2C'). Such platforms often act in two different roles: on the one hand, they act as buyers and distributors of the products of the manufacturer/supplier in question and, on the other hand, as intermediaries in the sale of products by third parties to whom they provide the online platform or intermediary service. The Guidelines describe this dual role of platforms as a "hybrid function".

However, according to Article 2(6) VBER, the dual distribution exemption does not apply to vertical agreements relating to the provision of online intermediation services where the provider of such services is a competing undertaking on the relevant market for the sale of the intermediated goods or services.

In any event, for the assessment of such agreements, the Guidelines stress that it is important to take into consideration that they may be "de minimis" agreements in cases where the parties have a low market share. For this purpose, account should be taken of the Commission's De Minimis Notice and the relevant provisions of the Spanish Competition Act. The Commission adds that market power in this sector can be measured by metrics that are not necessarily the platform's revenues (for instance, the number of intermediated transactions or the number of users). The Commission also indicates that, unless such agreements contain restrictions by object or the parties have significant market power, it is unlikely that it will prioritise the enforcement action in respect of online intermediation service agreements with hybrid providers.

2. Treatment of online sales restrictions

Under the VBER, the supplier may impose certain online sales restrictions (*section 2.1* below) or restrictions relating to online advertising (*section 2.2* below) on the buyer, provided that they do not have the direct or indirect effect of preventing the effective use of the internet by the buyer or its customers to sell the contract goods or services (which is considered a hardcore restriction of competition).

2.1. *Restrictions of online sales*

Under the Guidelines, the supplier may impose the following online sales restrictions:

- prohibiting the use of online marketplaces;
- setting quality requirements for the buyer's online store;
- requiring the distributor to have a physical store;
- implementing a dual pricing system for physical and online sales;
- obliging the buyer to sell a minimum amount of the contract goods or services offline.

Regarding the possibility to impose a direct or indirect ban of sales on online marketplaces, the Guidelines provide guidance for assessing those cases where the 30% market share threshold is exceeded. In particular, this restriction should be proportionate and not go beyond what is necessary to preserve the quality and ensure the proper use of the contract goods or services. In this respect, the Guidelines note that the following conducts are likely to fall outside the exemption provided for by the VBER: the supplier (i) has appointed the online marketplace as an authorised member of its selective distribution system, (ii) restricts the use of online marketplaces by certain authorised distributors, but not others or (iii) restricts the use of online marketplaces to its distributors, but uses such online marketplaces itself to distribute the contract goods or services.

Furthermore, the VBER has introduced the possibility of implementing a dual pricing system for offline and online sales. This is the practice whereby a manufacturer applies a different wholesale price for the same product, depending on whether the buyer will sell it online

or offline. Under the previous regulation, the same product could not be sold at a different price to the same buyer.

Now, the VBER does not qualify this practice as a hardcore restriction of competition. Therefore, manufacturers may set different prices for online and offline sales, as long as such dual pricing (i) incentivises or rewards an appropriate level of investments, (ii) is related to the costs incurred for each channel, and (iii) does not have the object of preventing buyers or their customers from using the internet to sell their goods or services online. This would be the case, if (i) the difference in the wholesale price makes selling online unprofitable or financially unsustainable or (ii) it is used to limit the quantity of products made available to the buyer for sale online.

On the other hand, the supplier cannot:

- require the buyer to prevent customers located in another territory from viewing its website or to terminate consumers' online transactions when their credit card data reveal an address that is not within the buyer's territory;
- oblige the buyer to seek prior authorisation before making individual online sales transactions;
- require the buyer to sell only on in a physical space or in the presence of specialised personnel;
- prohibit the buyer from using the supplier's trademarks on its website or online store.

2.2. *Restrictions relating to online advertising*

First, the supplier can require that online advertising meets certain quality standards or includes specific content or information.

Second, it is not possible to completely prohibit the use of price comparison tools or search engine advertising or to impose indirect obligations leading to the same result, such as (i) the obligation on the distributor not to use the suppliers' trademarks or brand names for bidding to be referenced in search engines, or (ii) the prohibition to provide price-related information to price comparison tools (Guidelines, paragraph (206)). However, the Guidelines allow for restrictions on the use of *certain* price comparison tools (i) that do not meet certain quality standards (Guidelines, paragraph (349)), and (ii) that are not used by the majority of the public.

Finally, the Guidelines list in paragraph (353) a number of criteria for assessing the compatibility of restrictions on price comparison tools in agreements that may not benefit of the VBER (e.g. the parties have a market share above 30%): (i) the market position of the supplier and its competitors, (ii) the importance of price comparison tools as an advertising channel in the product and geographic markets and (iii) the scope of the restrictions.

3. Parity obligations

Parity obligations, also known as Most Favoured Nation (MFN) or customer clauses, are obligations that prohibit a company from offering third parties better prices or contractual conditions.

A distinction can be made between wide MFN and narrow MFN obligations. Wide MFNs are those which prohibit a company from offering better terms in any other sales or marketing channel; narrow MFNs limit the offering of better terms only in the company's own websites.

From another point of view, a distinction can also be made between wholesale and retail parity obligations. In the first case, these are limitations on the sale or marketing in the wholesale channel; retail parity obligations prevent the good or service from being sold to the end user at a lower price or on better terms.

Under the VBER, all parity obligations are exempted from the application of Article 101(1) TFEU, except for the specific case of retail parity obligations that prevent a company from selling on competing online intermediation services under more favourable conditions.

This is set out in Article 5(1)(d) VBER when it states that "[t]he exemption provided for in Article 2 shall not apply to the following obligations contained in vertical agreements: (...) (d) any direct or indirect obligation causing a buyer of online intermediation services not to offer, sell or resell goods or services to end users under more favourable conditions via competing online intermediation services".

The parity obligation may derive not only from a contractual clause, but also from other direct or indirect measures, such as differential pricing or incentives whose application depends on the conditions under which the buyer of online intermediation services offers goods or services to end users through competing online intermediation services.

In any event, section 8.2.5.1 of the Guidelines sets our criteria to be taken into account in assessing whether an across-platform retail parity obligation that is not exempted by the VBER fulfils the conditions of Article 101(3) TFEU:

- the market position of the provider of online intermediation services that imposes the obligation and of its competitors;
- the share of buyers of the relevant online intermediation services that are covered by the obligations;
- the homing behaviour of buyers of the online intermediation services and of end users (how many competing online intermediation services they use);
- the existence of barriers to entry to the relevant market for the supply of online intermediation services;
- the significance of the direct sales channels of buyers of the online intermediation services and the extent to which those buyers are able to remove their products from the platforms of the providers of online intermediation services (de-listing).

Moreover, the Guidelines also provide criteria to be taken into account for the self-assessment of the remaining parity obligations in those cases where the VBER does not apply, mainly because one of the parties exceeds the 30% market share threshold in the relevant market (sections 8.2.5.2 to 8.2.5.5 of the Guidelines).

Finally, competition authorities may decide to apply Article 101(1) TFEU to parity obli-

gations which, despite in principle fulfilling the conditions of the VBER, entail effects incompatible with Article 101(3) TFEU. In particular, Article 6(1) VBER mentions that such effects may arise, for example, where the relevant market for the supply of online intermediation services is highly concentrated and competition between the providers of such services is restricted by the cumulative effect of parallel networks of similar agreements that restrict buyers of the online intermediation services from offering, selling or reselling goods or services to end users under more favourable conditions on their direct sales channels.

4. Distribution systems

The VBER distinguishes between three distribution systems: (i) exclusive distribution, (ii) selective distribution and (iii) other distribution. The VBER introduces amendments with respect to (i) the design of exclusive and selective distribution systems (*sections 4.1* and *4.2 below*) and (ii) the restrictions allowed under the different distribution systems (*section 4.3 below*).

4.1. *The design of exclusive distribution systems*

Article 1(1)(h) VBER defines exclusive distribution systems as those in which the supplier allocates exclusively for itself or for a maximum of five buyers a territory or a group of customers and restricts the active sales of the rest of its buyers in that territory or group of customers.

By doing so, the VBER introduces an important change with respect to the previous regulation by adopting, within the concept of exclusive distribution, what has been called “shared exclusivity”. In other words, the shared exclusivity refers to the possibility of allocating a territory or customer group for the supplier or for several buyers (maximum five) and not for a single buyer.

4.2. *The design of selective distribution systems*

Within a selective distribution system, the supplier can select his authorised distributors on the basis of quantitative and/or qualitative criteria, the latter being in principle to be established for online and offline sales. Until now, the qualitative criteria set for online and offline sales by selective distributors had to be “equivalent”. However, the Guidelines now indicate that, considering that the two sales channels have different characteristics, the criteria for online sales may not be equivalent to the criteria for offline sales, provided that the criteria imposed on online sales do not have the indirect object of preventing the effective use of the internet by the buyer to sell the contract goods or services to particular territories or customers.

4.3. *Restrictions permitted in the different distribution systems*

As in the previous regulation, Articles 4(b), 4(c)(1) and 4(d) VBER include as a hardcore restriction the restriction of the territory into which, or the customers to whom, the distributor may actively or passively sell the contract goods or services, and then establishes a series of exceptions, which can be summarised as follows:

- It is permissible for the supplier to prohibit active sales by the buyer

and its direct customers into a territory or to an exclusive customer group, irrespective of the distribution system in the territory of origin.

- The supplier operating a selective distribution system in a territory is allowed to restrict the active and passive sales of the buyer and its customers to unauthorised distributors located within the territory of the selective distribution system.

- The supplier is allowed to restrict the place of establishment of the members of the selective distribution system.

- The supplier is allowed to restrict the active or passive sales to end users by members of the selective distribution system operating at the wholesale level of trade.

- The supplier is allowed to restrict the ability to actively or passively sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier.

First, the VBER introduces the possibility of imposing certain restrictions on the resale of the contractual product or service not only on the buyer of the agreement, but also on the buyer's customers. In particular, the supplier of the agreement may limit (i) active sales to the exclusive territory or customer group and (ii) active and passive sales to unauthorised distributors in the territory where the supplier operates a selective distribution system.

Second, the concepts of active and passive sales have been updated and clarified. The VBER includes a definition of active and passive sales that is in line with the traditional understanding of these concepts: active sales are those that occur when the customer, territory or customer group in question has been actively approached; passive sales are those that occur without such an active approach. However, the Guidelines clarify these notions (especially in relation to online sales) and introduce some important changes.

On the one hand, as regards active sales, the Guidelines clarify that the use of a language option other than the languages commonly used in the distributor's territory is understood as active sales (except when the language is English, as it is generally used throughout the European Union). The same applies to online shops that use a domain corresponding to a territory other than that of the distributor[2]. Similarly, the use of online advertising media in languages other than those commonly used in the distributor's territory is considered a form of active sales.

In line with the above, the Guidelines specify that promotions and advertising targeted at a specific customer group are a form of active selling and refer, in particular, to online advertising services that allow the seller to select the territories or customers for which the online advertisement will be displayed. How-

[2] The use of a general domain name that is not country-specific, such as ".com", is not considered an active sale.

ever, in each case, the purpose of the advertising in question will have to be analysed to determine whether it results in active or passive sales: if the advertising is targeted at customers located in the distributor's territory and cannot be prevented from being seen by customers located in other territories or by different customer groups, then it will be considered passive sales. The use of search engine optimisation tools and techniques (dedicated to improving the visibility or ranking of the buyer's website in search engines) or the offer of an application in the app store are also, in principle, forms of passive sales, insofar as they are means by which potential customers can find the distributor.

On the other hand, the VBER indicates that sales resulting from participation in tendering procedures (public or private) are passive sales. The Commission considers that the organisation of the tenders is a form of unsolicited request addressed to multiple potential sellers and, therefore, the sale that may result from participation in the procedure will be considered a passive sale.

Third, the VBER introduces the possibility of prohibiting non-selective distributors from selling to unauthorised distributors in the territory in which the supplier operates a selective distribution system. This issue arises in situations where the supplier operates a mixed distribution system, whereby it combines, in the different territories comprising the European Economic Area, a selective distribution system with another type of distribution system, one exclusive system or the other.

5. Agency contracts

An agency contract is an agreement whereby one natural or legal person ("the agent") is entrusted to negotiate or conclude contracts on behalf of another person ("the principal") for the purchase of goods or services by the principal, or the sale of goods or services supplied by the principal. However, this kind of agreement is exempted from the application of Article 101(1) TFEU if it can be qualified as genuine, i.e. if the agent does not assume any financial or commercial risk in relation to the contracts concluded or negotiated on behalf of the principal.

5.1. *Types of risks*

According to the Guidelines, there are three types of risk: (i) risks directly related to the contracts concluded and/or negotiated on behalf of the principal, (ii) risks arising from or related to investments specifically intended for the type of activity for which the agent has been appointed and (iii) risks related to the need to undertake other activities in the same product market, provided that the principal requires, as part of the agency relationship, the agent to perform those activities on its own account, and not on behalf of the principal (Guidelines, paragraph (31)).

In this respect, paragraph (33) of the Guidelines describes the characteristics that genuine agency agreements usually have:

- The agent does not acquire the property in the goods bought or sold under the agency agreement). However, the fact that the agent temporarily acquires the property in

the contract goods does not exclude the existence of a genuine agency agreement.

- The agent does not contribute to the costs relating to the supply or purchase of the contract goods or services.

- The agent does not maintain, at his own cost or risk, stocks of the contract goods and may return the unsold goods to the principal without charge.

- The agent assumes no responsibility for customers' non-performance of the contract.

- The agent assumes no responsibility towards customers or third parties for loss or damage resulting from the contract goods or services.

- The agent is not obliged to invest in sales promotion.

- The agent does not make market-oriented investments in equipment, premises, training of personnel or advertising of contract goods or services.

Furthermore, paragraph (35) of the Guidelines describe that the principal may reimburse costs to the genuine agent in order to avoid the latter incurring risks, either (i) by repaying the exact costs incurred by the agent, (ii) by way of a fixed lump sum or (iii) by paying a fixed percentage of the revenue under the agency contract. The method chosen should ensure that amounts given by the principal to reimburse costs are clearly distinguishable from any other payments made by the principal to the agent (e.g. remuneration for the provision of agency services).

If the agency contract is genuine because it does not contain the financial or commercial risks described above, the prohibitions contained in Article 101(1) TFEU do not apply to it in respect of the obligations imposed on agents in relation to contracts concluded and/or negotiated on behalf of the principal (e.g. resale price maintenance). In addition, if the contract cannot be qualified as genuine, this does not automatically mean that it is contrary to Article 101(1) TFEU, but the clauses contained therein will have to be assessed under Article 101(3) TFEU.

5.2. *Dual agents*

A dual agent is an agent who is a distributor of some goods or services of one supplier and at the same time an agent for other goods or services of the same supplier (Guidelines, paragraph (36)). According to the Guidelines, dual agency agreements do not benefit from the exemption set out in Article 2 VBER, unless: (i) the activities and risks covered by the agency agreement can be delineated, (ii) the distributor is genuinely free to enter into the agency agreement and (iii) all risks linked to the sale of goods or services covered by the agency agreement are borne by the principal (Guidelines, paragraph (34)).

5.3. *Agency agreements and providers of online intermediation services*

Finally, companies providing online intermediation services cannot be considered as genuine agents (Guidelines,

paragraph (46)). Therefore, if they impose a minimum resale price for the transaction they facilitate, this is not automatically exempted under the VBER, but a more detailed examination will have to be carried out as to whether the conditions of Article 101(3) TFEU are fulfilled.

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