

THE NEW EU AND UK COMPETITION REGIMES FOR DISTRIBUTION ARRANGEMENTS

The European Commission (the **Commission**) has published the final revised texts of its Vertical Guidelines (the **Guidelines**) and Vertical Block Exemption Regulation (the **VBER**), which provide a widely-applicable safe harbour for distribution arrangements from the EU prohibition on anticompetitive agreements. The new rules enter into force on 1 June 2022, with a one-year transition period for existing arrangements. They will be valid for a maximum of twelve years and will be evaluated by the Commission after eight years in place.

The Commission's changes, made after an extensive public consultation process throughout 2021 and 2022, reflect the significant changes in market dynamics since the VBER was last updated in 2010. For example, the increased use of "dual distribution" models - where suppliers compete with their distributors in certain sales channels - has prompted changes to the treatment of such arrangements, and the growth of online sales in recent years has resulted in giving suppliers more freedom to support physical sales channels. Various other changes will allow suppliers more flexibility to restrict their distributors from selling to certain territories or customer groups.

Following the UK's departure from the EU, the UK Government recently announced the final version of its "Vertical Agreements Block Exemption Order", which differs from the equivalent EU VBER in certain material respects.

THE CHANGES TO THE EU REGIME

The VBER exempts a broad range of distribution arrangements from the EU prohibition on anticompetitive agreements, provided the parties have market shares of less than 30% on their respective markets (for the buyer, the relevant market is the purchasing market) and the agreement does not contain any "hardcore" restrictions of competition law.

Key issues

- Why has the Commission amended the EU competition regime for distribution arrangements?
- What new freedoms will suppliers have to restrict distributors' sales to certain territories or customers, and to support physical sales channels?
- What are the new rules and guidance in relation to online platforms?
- How does the new UK regime for distribution arrangements differ from the EU regime?

The Guidelines explain how the VBER applies, and also set out how the Commission assesses various types of vertical arrangements that fall outside the scope of the VBER.

The main changes to the VBER and Guidelines are as follows.

Updated definitions of active and passive sales

A fundamental principle of the EU competition regime for distribution agreements is that suppliers can, in certain circumstances, prevent their distributors from making "active" sales (*e.g.*, through targeted advertising) to customers in territories or groups allocated to other distributors, but cannot, as a rule, prevent passive (*i.e.*, unsolicited) sales. The revised VBER and Guidelines now contain more detail on what these terms mean in an online context.

One significant change is that offering a website in the language that is not commonly used in the distributor's home country is now accepted as being a form of active selling, although the Commission takes the view that English is commonly used in all EU countries. In a similar vein, the Commission clarifies that setting up an online store with a country-specific top-level domain for a territory different to the one where the seller is established also amounts to active selling into that territory. The VBER and Guidelines also clarify that responding to a tender (public or private) is a form of passive selling.

Dual distribution

Dual distribution (see box to the right) has become increasingly common since the current VBER was enacted, as suppliers often maintain a presence in certain online sales channels, *e.g.*, selling through their own website. The previous VBER exempted dual distribution – despite it involving a horizontal agreement between competitors at the retail level rather than a purely vertical agreement – but only if the supplier is a manufacturer (and the distributor is not). The new VBER extends the benefit of the exemption to suppliers that are wholesalers or importers too.

However, the new VBER also clarifies that exchanges of information between the competing distributors will only be covered by the exemption if they are both: (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. The revised Guidelines contain guidance on the types of information that will typically be considered to meet this test. This is a welcome change to the Commission's previous proposal to implement a 10% market share threshold above which such information exchanges would not be covered at all.

Exclusive distribution

The previous VBER allowed a supplier to restrict active sales by a buyer into a territory or customer group for which it has appointed a single exclusive distributor (see box to the right), but not if two or more distributors are appointed. This somewhat counterintuitive rule (more distributors should mean more competition) has been scrapped under the new VBER. Instead,

Distribution models

- **Exclusive distribution** means a system where the supplier allocates a territory or customer group exclusively to itself or to a maximum of five buyers and restricts all its other buyers from actively selling into the exclusive territory or to the exclusive customer group
- **Selective distribution** means a system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors within the selective distribution territory.
- **Dual distribution** means a system in which the supplier competes with its distributor(s) on the downstream (*e.g.*, retail) market. Can be combined with exclusive or selective distribution.

suppliers can appoint a maximum of five exclusive distributors for a given territory or customer group.

In addition, suppliers can, in certain circumstances, require distributors to impose restrictions on active sales on their own customers; something which was not permitted under the previous regime.

Selective distribution

Suppliers operating a selective distribution system (see box on the previous page) can, under the new VBER, prevent all distributors from making sales to unauthorised distributors located within the selective distribution territories, not just (as was the case under the previous regime) distributors that are also located in that territory. There is also an unqualified right to require such restrictions to flow down to customers of its distributors.

However, contrary to the wishes of many suppliers, the Commission has not softened the rule that prevents suppliers from operating exclusive distribution at the wholesale level combined with selective distribution at the retail level.

Evergreen clauses

Exclusivity (or "single branding") requirements preventing the distributor from selling goods or services that compete with those of the supplier are not block exempted if their duration exceeds five years or is indefinite. While this will not change, the final VBER scraps the rule that treats tacitly renewable restrictions as being indefinite. This will allow parties to implement distribution arrangements with single branding requirements that do not need to be renegotiated every five years provided that the distributor can effectively renegotiate or terminate the vertical agreement with a reasonable period of notice and at a reasonable cost, thus allowing the distributor to effectively switch its supplier after the expiry of the 5-year period.

Dual pricing and criteria for online sales

Under the previous regime, a supplier usually would be committing a hardcore antitrust infringement if it charged a higher wholesale price for products that a distributor resells online, and a lower price for products that are resold in physical stores. Under the new VBER, this will be permissible, provided the difference in the wholesale price takes into account the different investments and costs incurred by the distributor in the two channels.

Similarly, suppliers operating a selective distribution system are no longer required to impose on their authorised distributors criteria for online sales that are "overall equivalent" to those applicable for offline sales.

Online platforms

Recognising the growth of sales through online platforms (or "online intermediation services" in the jargon of the new VBER), there are provisions in the new VBER and Guidelines that are expressly aimed at such platforms. In particular:

- online platforms that sell on their own behalf, as well as hosting the sales of third-party sellers, cannot benefit from the dual distribution exception described above in respect of agreements that relate to their supply of online intermediation services. However, online platforms' distribution agreements that do not relate to their online intermediation services (e.g., agreements to buy and resell products on their platform

on their own behalf) will remain covered, provided the other conditions of the VBER are met;

- "wide" across-platform parity clauses – requiring a party that sells through an online platform not to sell its products on better terms on any competing platform – are excluded from the scope of the new VBER and will therefore need to be assessed for compliance separately. Narrow parity clauses – requiring a party not to sell on more favourable terms through a specific sales channel (such as its own website) than on an online platform - continue to be block exempted, and the revised Guidelines contain new guidance on how the Commission will assess both wide and narrow parity clauses that fall outside the scope of the VBER;
- the revised Guidelines now reflect the case law of the EU Courts (in particular the *Coty* judgment of the EU Court of Justice), stating that a ban on distributors using online platforms is acceptable under the VBER, and explaining the circumstances in which such a ban will not be acceptable if the VBER is not applicable;
- the Guidelines express the Commission's view that online platforms will not generally meet the conditions for being "genuine agents" in respect of products that they resell on behalf of suppliers, such that suppliers cannot rely on the agency exception to control the resale prices charged by the online platform. However, suppliers remain free to set prices when using a platform as an online intermediary for their own direct sales to customers; and
- the revised Guidelines also contain a new section explaining when restrictions on the use of price comparison tools fall within the VBER, and how the Commission will assess the compliance of those that do not.

Resale price maintenance and minimum advertised price restrictions

While the Commission has not fundamentally changed its negative attitude towards resale price maintenance (RPM) and minimum advertised price (MAP) restrictions, the revised Guidelines do contain some important revisions. In particular, they now clarify that:

- there is no RPM if a supplier imposes, in a fulfilment contract, the prices that a distributor will charge to specific customers that have prior agreements with the supplier; and
- while RPM and MAP restrictions remain hardcore restrictions for the purposes of the VBER, it may be possible to justify them under the "efficiency" exception of Article 101(3) TFEU, if used to prevent a particular distributor from using the supplier's product as a loss leader, *e.g.*, where the supplier regularly resells a product below the wholesale price in a way that damages the brand image of the product, reduces overall demand for it and undermines the supplier's incentives to invest in quality and brand image. Suppliers wishing to rely on this possibility will need to take particular care to develop strong evidence for their justifications and to ensure that they correctly calculate the net wholesale price that is used as a basis for the restriction.

Agency

The Commission has resisted calls to relax its approach in relation to "genuine agency" agreements, which allow a supplier to control resale prices charged by an agent. In particular, the criteria for a genuine agent remain difficult to satisfy, and certain new clarifications in the revised Guidelines may exacerbate this in cases where a supplier uses a reseller as an agent for some products and independent distributor for others.

DIFFERENCES BETWEEN THE EU AND UK VBERS

Having left the EU, the UK now has its own, separate competition regime for distribution arrangements. The UK Government recently announced the final version of its "Vertical Agreements Block Exemption Order", which differs from the equivalent EU block exemption in certain material respects, as summarised in the table below.

Some of these differences are by design. For instance, the UK Competition and Markets Authority has concluded a number of investigations into parity clauses in the past, which have informed its stricter stance in this area. Many of the other differences appear to have arisen because the UK block exemption was initially based on the draft version that the Commission published for consultation and has not incorporated changes that the Commission made in its final version of the VBER.

	EU position	UK differences
Updated definitions of active and passive sales	See page 2 above. The Commission's guidance also states that if it is "not possible" to prevent online advertising from being seen by customers in another distributor's territory or customer group, it will be considered passive selling.	Same as for the EU VBER, but additionally clarifies that advertising/promotion that is only attractive for the distributor if it reaches customers in a specific group or territory will be considered active selling to that group/territory, even if it also reaches other customers. Conversely, if general advertising/promotion is directed generally at a territory/customer group, and is a "reasonable way" to reach them, it will be considered to be passive selling to any other territories or customer groups of other distributors that it happens to also catch.
Agreements below the market share threshold, but which subsequently exceed it	Exemption continues to apply for 2 calendar years after the year in which the 30% market share threshold is exceeded.	Same as for the EU VBER, except that if a market share exceeds 35%, exemption only applies for 1 calendar year after the year in which the threshold is exceeded.
Exclusive distribution	Suppliers can appoint up to 5 exclusive distributors for any given territory or customer group (see page 2 above).	The number of exclusive distributors appointed must be determined in proportion to the territory/customer group "in such a way as to secure certain volumes of business that preserves their investment efforts".
Evergreen exclusivity clauses	Restrictions that are tacitly renewable beyond 5 years are covered (see page 3 above).	Restrictions that are tacitly renewable beyond 5 years are excluded and must be assessed separately for compliance.

Flow down of restrictions to distributors' customers	Suppliers can require distributors to impose exempted restrictions on their own customers, e.g., (depending on the type of distribution system) restrictions on sales to certain territories, customer groups and unauthorised distributors.	Flow down of restrictions exempted only if to customers that have entered into a distribution agreement with the supplier or with a party that was given distribution rights by the supplier. It is not clear that this will be a significant difference in practice.
Parity clauses	Wide across-platform parity clauses entered into by online platforms are excluded from the exemption and must be assessed separately, but are not 'hardcore' restrictions (see page 3 above).	Wide across-retail channel parity obligations that are entered into by any supplier (not just online platforms) are 'hardcore' restrictions that bring the entire agreement outside the scope and are considered highly likely to infringe competition law.
Dual distribution	Online platforms' contracts relating to the supply of online intermediation services are not covered by the exemption if the platform is a dual distributor of the relevant products (see page 2 above). Information exchanges between competing dual distributors only exempted if certain conditions are met.	Online platforms' intermediation services are covered by the exemption (provided other criteria are met) irrespective of whether they are dual distributors. No conditions are imposed on exemption of information exchanges between dual distributors.
Duration	12 years, until 31 May 2034	6 years, until 1 June 2028

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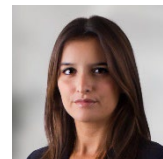
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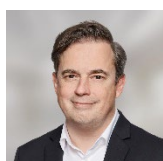
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