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A NEW DAWN FOR VERTICAL AGREEMENTS IN THE EU AND UK?

Introduction

A decade is a long time in the fast-moving world of e-commerce and online trade. Ten years after the European Commission introduced the first Vertical Block Exemption Regulation (“**VBER**”), it was faced with assessing whether this tool was still fit for purpose in a business environment transformed by the growth in online sales and the rise of online platforms - and whether its safe harbour continued to protect agreements that were on balance efficiency-enhancing, while excluding those for which the efficiency defence could not be assumed with sufficient certainty. The new VBER, which came into effect on 1 June 2022, is the result of extensive evaluation and consultation with stakeholders across the EU and introduces some material changes to the scope of the safe harbour.

And what of the UK? Much has been made of the potential for divergence in the field of competition law in the UK post-Brexit. With the retained VBER in UK law expiring at the same time, the CMA was keen to put its own stamp on a UK-specific regime, also effective as of 1 June 2022 (although both regimes have a one-year transition period).

This briefing explores what’s new in the EU VBER, how the new UK framework compares, and what businesses can expect when navigating the two regimes now and in the future.

EU VBER: What’s changed?

In short, this is an evolution rather than a revolution. The VBER’s central framework remains the same: certain restrictions in ‘vertical’ agreements, between businesses operating at different levels in the supply chain (like manufacturers, distributors and retailers), are assumed to benefit from an efficiency defence under Article 101(3) TFEU as long as the parties’ market shares are below 30%, they are not competitors (with some exceptions) and the agreement does not contain ‘hardcore’ restrictions. There is also still a separate list of so-called ‘excluded’ restrictions which are not automatically block-exempted, and which require case-by-case assessment.

However, the perimeter of the safe harbour has been partially redrawn with a view, according to the Commission, to ‘eliminating false positives and reducing false negatives’. The Commission has also updated the associated vertical guidelines (the “**Guidelines**”), with the stated aim of providing more certainty to businesses navigating these tricky waters. We focus here on five key areas of change.

Dual distribution

The Commission’s evaluation indicated that the dual distribution model - where a supplier sells directly to end customers as well as via independent distributors, with whom the supplier therefore competes downstream - is more prevalent today than when the original VBER was introduced, and that it may raise non-negligible horizontal competition concerns. Nonetheless, the dual distribution exemption (an exception to the general rule that vertical agreements between competitors cannot be block-exempted) has been retained, and has in fact been extended to more levels of the supply chain to cover importers and wholesalers as well.

Two key changes relate to (i) information exchange and (ii) hybrid platforms. Information exchange in a dual distribution context will now only be exempted where it 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. Helpfully, the revised Guidelines provide examples of information exchange that are likely to be exempted, such as technical, logistical or performance-related information, and information which is likely to fall outside the exemption, such as information relating to future pricing, identified end users and goods sold by a buyer under its own brand. Additionally, ‘hybrid’ platforms - those which also compete on the downstream market for the goods or services - have been excluded from the dual distribution exemption, on the basis that they may have an incentive to favour their own sales and the ability to influence the outcome of competition on those markets.

Parity obligations

Parity obligations require an undertaking to offer the same or better conditions to its counterparty as those offered on other sales/marketing channels (e.g. on other platforms or the undertaking’s direct sales channels). Previously, all types of parity provisions were exempted. However, retail parity provisions (relating to the conditions under which products are offered to end users) have been subject to extensive enforcement action by a range of regulators in recent years. The new VBER removes the exemption for cross-platform retail parity obligations, adding them to the list of excluded restrictions. Conversely, other types of parity obligations (including so-called ‘narrow’ parity provisions, relating to

conditions on direct sales channels, and wholesale parity obligations) are still block-exempted. However, a new Article 6 warns that the benefit of the exemption may be withdrawn in certain circumstances, and refers explicitly to the use of narrow retail parity provisions in concentrated platform markets where there is no evidence of efficiencies.

Online sales restrictions

The previous VBER was drawn up at a time when e-commerce was thought to require special protection. The Commission's evaluation showed - unsurprisingly - that this is no longer the case. As a result, dual pricing - where suppliers can charge different wholesale prices to the same buyer depending on the sales channel - is no longer a hardcore restriction, subject to certain limiting principles. Moreover, criteria imposed by suppliers for online/offline sales in selective distribution systems no longer need to be equivalent, provided the online sales criteria do not have the object of preventing the effective use of the internet.

A new Article 4(e) codifies the development of recent EU case law (in particular *Pierre Fabre and Coty*) by stipulating that restrictions on the use of the online channel will be hardcore where they have the object of preventing buyers or their customers from effectively using the internet to sell the goods or services, including restrictions preventing the use of one or more entire online advertising channels. Recital 15 clarifies that a restriction will be hardcore if its object is to significantly diminish the aggregate volume of online sales of the goods/services or the possibility for consumers to buy them online.

Further guidance has been provided for assessing online sales restrictions. Quality requirements, marketplace bans, online advertising restrictions (except those relating to the most widely-used providers if they de facto ban the use of that advertising channel) and requirements to operate offline stores or make a minimum absolute volume of sales offline will be block-exempted. However, provisions amounting to a de facto prohibition on internet sales are excluded - including requirements to only sell in physical stores, banning the use of a supplier's brand online, requiring a buyer to block website access to customers outside the territory or the use of foreign credit cards or requiring a buyer to make a certain share of their total sales offline. Additionally, bans on price comparison websites and keyword bidding restrictions in search engine advertising are confirmed to be hardcore restrictions as they prohibit the use of entire online advertising channels (codifying the Commission's decision in Guess).

Active sales restrictions

The scope of the block exemption has been broadened in respect of active sales restrictions, which limit a buyer's ability to proactively approach customers and generally constitute hardcore restrictions. The Commission's evaluation found that these rules were unclear, and hampered suppliers in designing their distribution systems.

A new and more flexible concept of 'shared exclusivity' has been introduced: a supplier can now appoint a maximum of five distributors per exclusive territory or customer group. Moreover, suppliers can oblige distributors to 'pass on' restrictions of active sales to their immediate customers - which was not previously possible. Selective distribution systems have also received enhanced protection - suppliers can now prevent buyers and their customers from selling to unauthorised distributors in a territory where the supplier operates a selective distribution system, regardless of whether those buyers and customers are located in or outside the territory. However, the combination of exclusive and selective distribution in the same territory (i.e. appointing an exclusive wholesaler plus selected retailers) is still excluded from the block exemption.

Online platforms

Additional guidance has been provided on the rules relating to online platforms. Online platforms that meet the definition of 'online intermediation services' - those which facilitate direct transactions between two other parties - are categorised as suppliers, and cannot be categorised as a buyer in respect of the intermediated goods or services. The list of hardcore restrictions therefore applies to restrictions imposed <u>by</u> the platform, but not to restrictions imposed <u>on</u> the platform by sellers. Online platforms outside that definition have to self-assess whether they would be categorised as a buyer or a seller in respect of their vertical agreements. The Guidelines also clarify that online platforms generally aren't considered genuine agents as they deal with too many sellers, there is a material imbalance in bargaining power and they bear significant market-specific risks.

UK VABEO: To what extent is there divergence?

The new UK Vertical Agreements Block Exemption Order (**"VABEO"**) is more closely aligned with the new EU VBER than might have been expected - and that might perhaps have been the case if the revisions had been made with more water under the bridge post-Brexit. That said, there are some differences. For example:

- ***Wide retail parity provisions***: The VABEO is more restrictive than the VBER, including wide retail parity clauses in its list of <u>hardcore</u> restrictions presumed to be illegal as opposed to simply excluding it from the benefit of the exemption. Additionally, unlike the VBER which refers only to 'other online intermediation services', the VABEO prohibition on wide parity also applies to offline channels.

- ***Dual distribution***: While the VABEO includes similar provisions around information exchange, hybrid platforms are currently not excluded from the dual distribution exemption. The CMA noted in its recommendations to the Secretary of State that,

while it understood the competition concerns regarding hybrid platforms, it did not currently believe that there was sufficient evidence to warrant treating them differently to other platforms. However, it will keep this under review so while there is increased flexibility in the UK for now, this may change.

- ***Distribution networks***: The CMA has also introduced a principle of shared exclusivity (capped at a 'limited number' of distributors rather than five), whilst it will also now allow active sales restrictions to be passed on in exclusive and selective distribution networks. Unlike in the EU, however, it will allow suppliers to combine selective and exclusive distribution in the same territory as long as they are established at different levels of the value chain and the exclusive wholesaler is not also a member of the selective distribution system.

- ***Online sales restrictions***: Unlike the VBER, the CMA has not included a specific reference to online sales restrictions amounting to a hardcore or excluded restriction in the VABEO. However, the CMA's draft accompanying guidance (which we expect will be published in final form imminently) and existing case law in the UK makes clear that, in practice, the UK regime is aligned with the EU - restrictions that prevent the effective use of the internet essentially amount to restrictions on the territories into which or the customers to whom a distributor can sell, and will be considered a hardcore restriction.

Practical considerations

While the two regimes are broadly aligned, there are some material divergences. In practice, pan-European businesses may be unlikely to want to take different approaches between the EU and UK in respect of their distribution networks and may be more likely to comply with whichever regime is more restrictive, meaning that the more lenient aspects of each could have limited effect in reality - although it may at least be of comfort for businesses to know the scope is there.

It is also worth noting that while the EU VBER will be valid for the next 12 years, the UK VABEO will only be valid initially for six. In light of the fast pace of market developments, the CMA considered that the block exemption would need reviewing again at this point to ensure it remains relevant. That means businesses should be prepared to see greater divergence between the two regimes during the life of the VBER.

CONTACT

WILLIAM TURTLE
PARTNER
T: +44 (0)20 7090 3990
E: William.Turtle@slaughterandmay.com

KATIE HUDSON
ASSOCIATE
T: +32 (0)2 737 9433
E: Katie.Hudson@Slaughterandmay.com

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

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