ALLEN & OVERY

European Commission publishes revised antitrust rules on vertical agreements

New post-Brexit UK regime will have limited divergences

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On 10 May 2022, the European Commission (EC) published the **revised Vertical Block Exemption Regulation** (VBER), together with the accompanying **revised Guidelines on Vertical Restraints** (Vertical Guidelines), which will replace the existing rules upon their expiry on 31 May 2022 (subject to the applicable transitional arrangements). The VBER exempts certain categories of agreements between businesses at different levels of the supply chain, so-called vertical agreements, from the prohibition on anti-competitive agreements, on the basis that their restrictive effects are counterbalanced by pro-competitive effects.

The VBER is intended to provide legal certainty to stakeholders as to which vertical agreements can be considered compliant with EU antitrust rules, and which agreements require an extended individual assessment. It also aims to serve as a common framework of assessment for national competition authorities (NCAs) and national courts, in order to ensure consistency in the application of the relevant rules and, therefore, a level playing field for businesses operating across the EU.

The UK has also published its new vertical rules. The VBER was retained in UK law post-Brexit and is also due to expire on 31 May 2022. It will be replaced by the **Vertical Agreements Block Exemption Order** (VABEO)

and will be accompanied by guidance issued by the Competition and Markets Authority (CMA), which is **currently in draft form** and due to be finalised shortly (Draft UK Guidance).

The VBER and Vertical Guidelines, as well as the VABEO and Draft UK Guidance, contain important updates to the rules on vertical agreements. In both the EU and the UK, some changes mean that the rules have been relaxed, with the block exemption extended to cover a larger number of agreements. In other areas, the rules have been tightened. Importantly, the EU and UK rules are broadly in line with each other. However, there are some key differences in approach, which will be crucial for businesses with operations in both jurisdictions.

In this alert, we highlight the key changes and comment on the extent to which the new UK rules are consistent with, or diverge from, the revised EU rules.

Adapting the rules to the changed market landscape

One of the aims of the EC in revising the vertical rules was to provide guidance on new market developments. In particular, the growth of e-commerce has led to new types of vertical agreement and made other, previously less common arrangements, more prevalent.

Dual distribution exemption extended, except (in the EU) in the case of online platforms

Under the old VBER, the block exemption was not available for agreements between competitors except for non-reciprocal agreements between a supplier of goods or services and a distributor, where the parties did not compete upstream, but only at the downstream level (known as 'dual distribution' arrangements).

The VBER and Vertical Guidelines extend this dual distribution exemption to also cover agreements where the parties' activities overlap at the wholesaler or importer level.

However, the EU rules provide for one important new exclusion for online platforms that have a hybrid function, ie that supply online intermediation services while at the same time selling goods or services downstream in competition with their online intermediation service customers. Vertical agreements between hybrid platforms and such sellers do not benefit from the dual distribution exemption and must, therefore, be individually assessed. But the dual distribution exemption still applies to vertical agreements where a hybrid platform does not compete with a commercial user of its platform, eg because it does not sell substitutable products or services, or does not compete in the same geographic market.

The Vertical Guidelines provide some helpful guidance on how to assess vertical agreements involving 'hybrid platforms' – in the absence of restrictions by object or significant market power, it is unlikely that the EC will prioritise enforcement action in respect of such agreements. This is particularly the case where a supplier allows buyers of its goods or services to use its website to distribute those goods/services, but no competing brands of goods or services are sold on that website and the supplier is not otherwise providing online intermediation services in respect of such goods or services.

Importantly, while the UK rules also extend the scope of the dual distribution exemption, they do not contain the 'hybrid platforms' exclusion – the VABEO opts instead for a less restrictive approach where these types of arrangement can benefit from the UK block exemption.

A new approach to information exchange in dual distribution scenarios

In the draft revised VBER and revised Vertical Guidelines, published in July 2021, the EC proposed an exclusion from the block exemption for any information exchange in dual distribution scenarios when the combined market share of supplier and buyer at the retail level exceeded a 10% threshold. The EC assumed at the time that, in such circumstances, "possible horizontal concerns were no longer negligible". This triggered significant criticism from interested parties and, ultimately, led the EC to change course.

In the final VBER and Vertical Guidelines, the EC drops the proposed market share-based safe harbour and instead provides additional guidance on the circumstances in which information exchange in a dual distribution context may raise concerns. The EC's revised approach is in line with the recommendations made by the authors of the **expert report** it commissioned on information exchange in dual distribution scenarios.

The VBER applies to the exchange of information between a supplier and buyer that is directly related to the implementation of the relevant vertical agreement and is necessary to improve the production or distribution of the contract goods or services by the parties. The new rules, therefore, acknowledge that dual distribution scenarios are different from purely horizontal competitive relationships and that the exchange of certain potentially sensitive information is often necessary and efficiency enhancing.

The Vertical Guidelines set out non-exhaustive examples of information that are likely to be deemed directly related to the implementation of the relevant agreement and necessary to improve the production or distribution of the contract goods or services. This includes, for example, certain technical, logistical and marketing information and recommended prices. Examples are also given of information that is unlikely to meet the relevant criteria, such as that relating to future prices. However, the EC stresses that, ultimately, the assessment will be individual and facts-specific.

Helpfully, the Vertical Guidelines give examples of precautions that will minimise the risk of competition concerns where parties to a vertical agreement in a 'dual distribution' scenario wish to exchange information that does not fulfil the relevance to the agreement and the efficiency enhancing conditions. These include aggregating information, ensuring an appropriate delay between the generation of the information and the exchange or restricting access, through firewalls, by downstream sales personnel to the information.

The UK looks as if it will adopt a similar approach to information exchange in dual distribution. While not specified in the VABEO itself, the Draft UK Guidance broadly mirrors the Vertical Guidelines, setting out similar lists of examples and precautionary measures. It is to be hoped that this consistency remains in the final guidance when published.

Agency agreements: clarity on online intermediation services and dual role agents

Genuine agency agreements fall outside the scope of the prohibition on anti-competitive agreements. An agreement will be categorised as such a genuine agency agreement if the agent bears no, or only insignificant, financial or commercial risk as regards the contracts entered into with the principal.

In their guidance, both the EC and the CMA clarify how the agency concept should be applied to digital markets. The authorities note in particular that undertakings active in the online platform economy cannot in principle be categorised as agents since they: (i) generally act as independent economic operators (often serving a very large number of sellers) and not as part of the undertakings for which they provide services; (ii) often have significant market power which drives commercial decision-making in their relationship with sellers; and (iii) typically make significant market-specific investments, for example, in software, advertising and after-sales services, indicating that those undertakings bear significant financial or commercial risks associated with the transactions that they intermediate.

Dual role agency arrangements raise specific assessment challenges and call for additional caution.

A dual role agent is a company that acts at the same time as an agent and a distributor for a supplier within the same relevant market. Such arrangements have become more prevalent over time, justifying the inclusion of specific EC and CMA guidance on how to assess them under antitrust rules. The EC has previously issued guidance through a **working paper**.

In particular, the combination of agency and independent distribution for the same supplier creates difficulties in distinguishing between investments and costs that relate to the agency function, including market-specific investments, and those that relate solely to the independent activity.

The Vertical Guidelines and the Draft UK Guidance provide some clarifications in this respect. To identify the market-specific investments to be reimbursed when entering into an agency agreement with an independent distributor that is already active on the relevant market, the principal should consider the hypothetical situation of an agent that is not yet active in the relevant market in order to assess which investments are relevant to the type of activity for which the agent is appointed. This means, in practice, that the principal would have to cover market-specific investments that are required in order to operate in the relevant market, including where those investments also concern differentiated products distributed outside the scope of the agency agreement but are not exclusively related to the sale of such differentiated products. It would seem that the EC and CMA do not consider it sufficient for the principal to cover the relevant proportion of such costs that relates to the agency products.

In addition, the Vertical Guidelines and Draft UK Guidance raise the concern that the obligations imposed on a dual role agent in relation to its agency activity may influence its incentives and limit its decision-making independence when undertaking other activities for the same supplier as a distributor. They note in particular that there is a possibility that the pricing policy of the principal for the products sold under the agency agreement will influence the incentives of the agent/distributor to price independently the products that it sells as an independent distributor, thus potentially raising resale price maintenance (RPM) concerns. However, the Vertical Guidelines and Draft UK Guidance state that the less interchangeable the products sold under the agency agreement and the products sold independently by the agent are, the less likely it is that those concerns will arise.

Online sales and advertising restrictions clarified

The VBER and VABEO provide that restrictions having as their object the prevention of buyers or their customers from effectively using the internet to sell their products online are hardcore. This principle covers direct and indirect restrictions, as well as restrictions in relation to both online sales channels and online advertising channels, such as search engines or price comparison services. This approach reflects established EU case law.

Both the EC and the CMA clarify that some partial restrictions may be legitimate. For instance, it could be possible to place restrictions on specific search engines or price comparison services, or on a specific online sales channel (such as online marketplaces) while retaining the benefit of the block exemption, provided there are sufficient other options available to allow effective online selling. It could also be possible to place quality standards for online selling and advertising activity (particularly, but not only, in selective distribution systems), provided these quality standards do not prevent the effective use of the internet by the buyer to sell the contract goods or services to particular territories or customers. Online sales restrictions generally do not have such an object where the buyer remains free to operate its own online store and to advertise online.

Updating existing rules

Not all of the changes are linked to new market developments. Rather, they serve to clarify or update existing rules, or to address divergent enforcement action by NCAs.

Rules on parity obligations tightened

The assessment of parity obligations attracted considerable debate during the consultation process as, historically, NCAs and courts have taken divergent approaches in this area, leading to significant legal uncertainty for businesses. While the new VBER and the Vertical Guidelines introduce new provisions and

guidance on parity obligations (also known as “most favoured nation” (MFN) clauses), it will not directly resolve such national divergences.

The key substantive change to the EU rules is that the new VBER excludes across-platform retail parity obligations from the block exemption. Under an across-platform parity obligation, a buyer of an online intermediation service (such as a seller on an online marketplace) must not offer, sell or resell goods or services to end users under more favourable conditions through another online intermediation service (such as through another online marketplace).

With the exception of such across-platform parity obligations, the VBER continues to cover all other types of parity clauses. This includes any other “wide” retail parity obligations, ie which relate to indirect sales channels other than online platforms. Still, this is a significant change compared to the previous rules, under which all kinds of parity obligations were block exempted.

The Vertical Guidelines also offer guidance on other types of parity obligations that are covered by the block exemption. For example, they discuss ‘narrow’ parity obligations, whereby platforms restrict sellers from offering more favourable conditions through their direct distribution channels than through the relevant platform. The Vertical Guidelines recognise that such parity obligations can result in significant efficiencies as they can reduce free-riding by sellers on investments made by a platform. The Vertical Guidelines also provide guidance on ‘upstream’ parity obligations, which relate to conditions offered by the seller to non-end users such as other retailers.

In relation to parity obligations covered by the block exemption, the Vertical Guidelines advocate a case-by-case approach. This is reflected not only in the guidance, but also in the VBER itself, which expressly provides that the benefit of the block exemption can be withdrawn from any ‘narrow’ parity obligation, 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 such narrow parity obligations. In fact, parity obligations are the only type of restrictions for which the VBER specifically sets out the pre-conditions for the withdrawal of the benefit of the block exemption. Given this case-by-case approach, we can expect to see continued divergence of outcomes in NCA investigations in relation to retail parity obligations. It remains, therefore, important for businesses to be aware of differences in approach and enforcement priorities by NCAs.

In addition, businesses will need to take into account that the new UK rules take a different approach to wide retail parity obligations. Under the VABEO, wide retail parity obligations are a hardcore restriction. This means that, where such clauses are included, the entire agreement falls outside the block exemption. By contrast, the EU approach means that the benefit of the block exemption is only lost for the clause itself – the rest of the agreement can remain exempt.

Another important difference between the EU and UK rules is that, under the VABEO, all wide retail parity obligations fall outside the scope of the block exemption, whether they are imposed by an online platform or any other supplier. As discussed above, the EU only excludes wide retail parity clauses that are ‘across-platform’. The UK is, therefore, taking a more restrictive approach to such provisions.

Updated active and passive sales restrictions allow more flexibility to design distribution systems

Crucially, the EC extended the block exemption to cover the combination of exclusive and selective distribution systems in adjacent territories. Such combination was not prohibited outright under the previous rules. However, in practice, to make such a combination work, suppliers had to impose various sales restrictions on the distributors within the two systems, which in turn were not all covered by the block exemption. Businesses, therefore, had to self-assess whether such cross-sales restrictions were compatible with EU antitrust rules.

Now, the new rules offer greater legal certainty, covering the most important cross-restrictions. In particular, the VBER now covers situations in which a supplier restricts:

- its exclusive distributors from selling both actively and passively to unauthorised distributors in the territory where the supplier operates a selective distribution system
- its selective distributors from actively selling to end-customers into a territory or to a customer group where it operates an exclusive distribution system.

In the UK, the VABEO is broadly aligned with the VBER on these issues, with one key difference – exclusive and selective distribution systems can be combined in the same territory.

The new VBER broadens the safe harbour significantly for exclusive distribution systems, introducing shared exclusivity. Under the previous rules, if a supplier wanted to offer protection to a distributor against active sales into its territory or customer group, such protection was covered by the block exemption only where the supplier appointed a single distributor for such territory or customer group. Under the new rules, the block exemption covers such protection against active sales even where a supplier appoints up to five such "exclusive" distributors for the same territory or customer group. The UK has also broadened the safe harbour, although using a slightly different formulation, ie where the supplier appoints "one or a limited number of other buyers".

In addition, the VBER has been extended to cover situations in which a distributor "passes-on" the relevant restrictions to its own customers. For example, if a supplier restricts its distributor from actively selling into a territory in which the supplier operates an exclusive distribution system, and the distributor, in turn, requires its own direct customer to comply with this restriction, then this latter restriction is also covered by the block exemption. The UK rules adopt the same approach.

RPM remains problematic but additional guidance given

The EU and UK rules continue to treat RPM as a hardcore competition law infringement.

For the EU, this is consistent with the apparent enforcement priorities of NCAs. According to the evaluation carried out by the EC during the review of the vertical rules, out of a total of 391 vertical cases dealt with by NCAs over the past ten years, as many as 210 (that is, more than half) concerned RPM.

Without introducing any dramatic changes, the Vertical Guidelines provide additional guidance in a number of areas. For example, they discuss the circumstances in which recommended prices can be considered as RPM (ie when they are combined with disincentives for price reductions). While minimum advertised price policies (MAPs) are generally considered hardcore, the Vertical Guidelines note that they can be used to address loss leading, and therefore in certain circumstances they may qualify for an individual exemption. Price monitoring and fulfilment contracts do not necessarily amount to RPM, but can be problematic depending on how they are implemented or when combined with other factors. The Draft UK Guidance contains guidelines on many of the same points.

However, despite multiple calls for change during the consultation phase, the new Vertical Guidelines did not significantly expand the situations in which RPM may be legitimate. MAPs used to address loss leading is the only new addition, together with the examples given in the old Vertical Guidelines: (i) when introducing completely new products; (ii) short-term (2-6 weeks) low price campaigns; and (iii) when it is indispensable to finance pre-sales services relating to complex products. The Draft UK Guidance is even more limited – just (i) and (ii) are included.

Relaxation of dual pricing arrangements for online and offline sales

The revised EU and UK rules relax the current requirement for wholesale price parity between goods intended to be resold online and those intended to be resold offline.

Dual pricing arrangements will now benefit from the block exemption as they may incentivise or reward an appropriate level of investments in online or offline sales channels.

However, these dual pricing arrangements will not benefit from the block exemption if they effectively make it unviable to sell goods or services to particular customers or territories. This would, in particular, be the case where the difference in the wholesale price makes selling online unprofitable or financially unsustainable, or where dual pricing is used to limit the quantity of products made available to the buyer for sale online.

Extending the safe harbour for single branding and non-compete obligations

The VBER and the Vertical Guidelines largely maintain the existing rules applicable to non-compete obligations including single branding.

As before, non-compete obligations are excluded from the block exemption if their duration is indefinite or exceeds five years. However, in a key change, the new Vertical Guidelines state that if an agreement is tacitly renewable beyond a period of five years it can benefit from the block exemption, provided that there is nothing which “locks-in” the buyer for a longer period. In practice, parties may face challenges when seeking to apply this new guidance, given the difficulty of distinguishing between non-compete agreements that are indefinite and those that are tacitly renewable. However, regardless of such potential challenges, it is clear that the Vertical Guidelines are seeking to extend the block exemption to single branding arrangements that are potentially longer than five years.

By contrast, the UK rules do not contain a similar relaxation. The VABEO simply excludes from the block exemption non-compete clauses that are automatically renewable beyond a period of five years, which are deemed to be indefinite.

New guidance on sustainability

Similarly to the recently published **draft revised Guidelines on Horizontal Cooperation Agreements**, the Vertical Guidelines discuss sustainability issues.

They clarify that vertical agreements pursuing sustainability objectives (such as addressing climate change, limiting the use of natural resources, reducing waste or promoting animal welfare) are not a distinct category of vertical agreements. Therefore, they should follow the same assessment path as other vertical agreements and can be covered by the block exemption.

To the extent they are not covered by the block exemption, the Vertical Guidelines provide examples of efficiencies which may be recognised when considering whether a vertical agreement can benefit from an individual exemption. For example, they mention that non-compete obligations exceeding five years can benefit from an individual exemption, if they are necessary to enable green energy investments. They also state that in a selective distribution system, it would qualify as qualitative criteria if the supplier sets out sustainability-related conditions, such as a requirement to provide recharging services or recycling facilities in the distributors’ outlets.

Unlike the Vertical Guidelines, the Draft UK Guidance makes no reference to sustainability. It will be interesting to see whether the final version will include any guidelines on this topic.

Conclusion

In the EU and the UK, the new rules will take effect from 1 June 2022. The EU rules will be in force until 31 May 2034, whereas the UK rules will be subject to further revision earlier, as they expire on 1 June 2028.

Of crucial importance to businesses, there will be a 12 month transition period during which agreements affecting the EU or the UK that are currently block exempted under VBER, but which do not meet the requirements for block exemption under the new vertical rules, will retain the benefit of the block exemption.

Companies operating in the EU should also be aware that, ultimately, enforcement of the new VBER will be carried out through the EU's decentralised competition enforcement system by the EC as well as by NCAs. This will inevitably lead to some national differences in the application of the rules as well as in enforcement priorities (see, for example, our **overview** of how the previous VBER and Vertical Guidelines were applied by CEE competition authorities).

For companies that are currently relying on the VBER, it is important to now assess whether any amendments will be needed to their vertical agreements affecting the EU or the UK to ensure compliance with the applicable rules beyond the end of the transition period. Equally, any vertical agreements coming into force from 1 June 2022 need to take into account the new rules. It will also be crucial to ensure that relevant commercial and sales people are properly trained on the changes and how these affect their interactions with vertical business partners. The differences between the EU and UK approaches must be carefully considered.

Finally, the EC's review of its vertical rules is still not complete. The EC has indicated that it will soon open its stakeholder consultation on the Motor Vehicle Block Exemption Regulation and accompanying guidance, which apply to vertical agreements related to the distribution of motor vehicles, and which expire on 31 May 2023.

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