COMPETITION newsletter

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European Commission Staff Working Document on VBER evaluation indicates EU rules on vertical restraints set for digitalisation update

On 8 September 2020, the European Commission ("Commission") published its Staff Working Document ("SWD") in the context of the ongoing evaluation of Regulation (EU) No 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union ("TFEU") to categories of vertical agreements and concerted practices ("Vertical Block Exemption Regulation" or "VBER").[1] The publication of the SWD is the last step in the evaluation process, which centres on the five "Better Regulation" criteria of the Commission, namely effectiveness, efficiency, relevance, coherence, and EU added value.

Scope of evaluation

The current VBER, which entered into force on 1 June 2010, is due to expire on 31 May 2022. The purpose of the Commission's review of the VBER and the accompanying Guidelines on Vertical Restraints ("Vertical Guidelines") is to determine whether it should let the VBER lapse, prolong its duration or revise it, and in the latter case, what changes should be implemented in both VBER and the Vertical Guidelines.

The Commission's review process has focused heavily on bringing the rules on vertical restraints up to speed with the digital era, since the VBER's last update took place in 2010, when features such as e-commerce and online platforms were not as widespread and integral to the global economy as they are today. The rise of e-commerce in the past decade has been accompanied by the proliferation of new business practices, some of which the Commission and national competition authorities ("NCAs") have identified as concerning and have taken rigorous enforcement action against. The Commission has imposed considerable fines on several household names such as Coty, GUESS, Nike and Sanrio (Hello Kitty), in connection to practices relating to the distribution of their products. Enforcement

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1 *Vertical agreements are agreements entered into between two or more parties where each party operates at a different level of the production or supply chain, for example agreements between a manufacturer of goods and its wholesalers and retailers. Article 101 TFEU prohibits agreements which prevent, restrict or distort competition. However, such agreements may escape the prohibition of Article 101 TFEU if they contribute to the production or distribution of goods or to the promotion of technical progress, while bestowing consumers a fair share of the benefits accrued. The VBER creates a safe harbour for vertical agreements, excluding them from the general prohibition if certain conditions are met, notably in relation to the market share of all parties to the agreement in the relevant market (which must fall below 30%) and the types of restrictions included in the agreement.*

against vertical restraints on competition has also picked up at the national level; for example, the Hellenic Competition Commission has dealt with nine vertical restraint cases since 2010 and has imposed considerable fines in this respect.

The SWD reflects the information drawn from the preceding public consultation, the stakeholder workshop that was organized by the Commission's Directorate-General for Competition in Brussels in November 2019, consultations between the Commission and Member States' national competition authorities, and externally commissioned support studies. The review process has also taken into account information gathered by the Commission during its E-Commerce sector inquiry, the results of which are summarised in the final report of 10 May 2017, as well as the Commission's recent case practice with regard to vertical restraints.

The two-year evaluation process has led the Commission to conclude that the VBER remains a useful tool providing much needed legal certainty, and should thus be prolonged. However, the Commission acknowledges the need to review the rules and provide clarity on certain key dimensions, as well as to bring them in line with recent case law and decision-making practice.

Key issues identified during the evaluation process

The SWD reveals a number of issues identified by stakeholders as (at least to some extent) problematic in the interpretation and application of the current rules. We highlight here some of the most topical for businesses' current day-to-day implementation of vertical agreements:

- *Agency*: Agency agreements generally fall outside the scope of Article 101 TFEU, as long as the agent does not bear notable risks beyond the confines of its role as an intermediary. The evaluation highlights a lack of clarity concerning the level and type of risks that are relevant to determine whether a vertical agreement can be considered a "genuine" agency agreement. Questions have also been raised on how the agency exception is to be applied to online platforms. Stakeholders have indicated that it is difficult to ascertain whether online platforms fulfil the criteria to fall under the agency definition (e.g. whether certain types of investments realised by them can be considered market-specific and thus deprive them of the "agent" qualification). This uncertainty has resulted in the adoption of divergent approaches among NCAs and national courts. Furthermore, stakeholders point out the need for guidance on the possibility of applying the agency exception to tripartite relationships between suppliers, intermediaries and final customers in the execution of fulfilment contracts.

- *Resale Price Maintenance (RPM)*: The imposition by a supplier of minimum pricing obligations on retailers is considered by the current VBER as a "hardcore" restriction of competition, which cannot benefit from the VBER safe harbour regardless of the parties' market shares. Notably, the majority of cases on vertical restrictions pursued at the national level concern RPM, so clarity in what actually constitutes RPM is vital for businesses. Overall, the evaluation has revealed a high level of legal certainty regarding RPM under the current regime. However, several stakeholders call for additional guidance regarding the circumstances under which recommended resale prices (i.e. suggestions without the presence of an enforcement mechanism) or maximum resale prices could amount to RPM, and thus to a hardcore restriction under the VBER.

- *Selective distribution – online sales restrictions*: The evaluation makes clear that market developments have led to a significant increase in the use of selective distribution at different levels of the vertical supply chain. The establishment of a closed network of distributors allows brands to exercise greater control over their products' online presence. In light of this, stakeholders have signalled that the VBER needs to catch up with the recent case law and enforcement practice with regard to selective distribution, for example the judgments of the Court of Justice of the EU ("CJEU") in *Coty, Pierre Fabre, Auto24* and the Commission's decision in *GUESS*.

  The evidence gathered indicates a generally low level of legal certainty on how the rules on selective distribution are to be applied in the online context. Stakeholders raise concerns in respect of perceived inconsistencies between different NCAs' assessments of selective distribution systems under Article 101 TFEU and corresponding national provisions, and indicate that this confusion seems to be greatest in the area of restrictions on the use of online marketplaces. In this respect, stakeholders call for the CJEU *Coty* judgment to be referred to and reflected in the VBER and/or the Vertical Guidelines. *Coty* clarifies that a prohibition on the use of online marketplaces, unlike a horizontal online sales ban (i.e. a ban on all online sales, including sales on the retailer's own website) is compatible with competition law if it adheres to the so-called "*Metro* criteria", namely: (i) it is based on qualitative criteria, (ii) which are necessary to preserve the quality and ensure the proper use of the products, and (iii) which are applied uniformly and in a non-discriminatory manner.

  In addition, stakeholders have pointed to a lack of guidance on assessing the competition law compatibility of restrictions on using price comparison websites. Most notably, NCAs – some of which have had to deal with novel questions regarding restrictions on the use of such websites, e.g. the Bundeskartellamt in the *Asics* case – have generally noted that price comparison websites normally re-direct consumers to the website of the seller to complete the transaction. Thus, since final customers carry out the transaction on the website of the authorized distributor, which has – presumably – been accepted by the supplier as meeting the quality criteria required, a restriction on the use of price comparison websites by distributors in the context of a selective distribution system appears less justified than an online platform ban.

  Stakeholders also identify a need for additional legal certainty in the treatment of restrictions on the use of trademarks and brand names for online sales advertising. While many stakeholders consider that such restrictions make finding a specific retailer's website at the critical moment of the purchasing process more difficult and thus amount to a *de facto* prohibition of online sales, some stakeholders report insufficient clarity in the VBER and the Vertical Guidelines on the competition law compatibility of such restrictions, and call of explicit guidance in this regard.

  As is evident from the above, the feedback received indicates an overall lack of clarity and legal certainty in the assessment of online restrictions, as the VBER, along with the Vertical Guidelines, is not up to speed with recent market developments. Since the VBER in its current form was to an important extent crafted with offline sales in mind, the self-assessment of vertical practices in the online environment is often a difficult task for stakeholders. In this context, some respondents to the public consultation noted that the VBER should have a dedicated section dealing with online sales, to provide legal certainty on the subject in a comprehensive manner.

However, it is worth noting that, on certain online issues, wide divergences of opinion are noted between different stakeholders groups. For example, many stakeholders (notably manufacturers) consider the "brick-and-mortar requirement" exemption in the current Vertical Guidelines (which allows a supplier to require that its distributors operate at least one brick-and-mortar shop to enter the supplier's selective distribution network) necessary to provide offline distributors with incentives to invest in promoting a product by preventing free-riding by online distributors that focus mainly on price and do not offer comparable pre-sales services. On the contrary, other stakeholders (notably online platforms) have signalled that this requirement is a way to exclude pure online distributors, who have made substantial investments in their logistics to best serve end customers, from the distribution of certain products and services, regardless of the quality of the services they provide.

- *Parity (MFC) clauses*: Retail parity clauses, also referred to as "Most-Favoured-Customer – MFC" clauses, are contractual obligations whereby a retailer is entitled to receive from its upstream supplier (price and non-price) terms and conditions no less favourable than those that the supplier provides to any other retailer. The VBER evaluation has shown that the use of retail parity clauses has increased over the last ten years, especially in the e-commerce context. Stakeholders point out that the VBER and the Vertical Guidelines do not provide sufficient guidance on how to assess the compatibility of retail parity clauses with Article 101 TFEU. This lack of clarity might have led to divergent approaches being adopted in different Member States, notably in the hotel bookings saga of cases. Thus, the revamped VBER and Vertical Guidelines are expected to provide further clarity on the competition law assessment of such clauses.

Next Steps

According to its press release of 8 September 2020, the Commission is now launching the second phase of its review, i.e. an impact assessment to determine how the VBER could be revised in order to address the issues raised during the evaluation process. Third parties will be given the opportunity to comment at various stages throughout the impact assessment phase. The Commission plans to publish a draft revised VBER within 2021. It will be most interesting to see how the Commission will navigate the complexities of bringing the rules on vertical restraints up to speed with technological developments in a manner that is efficient and equitable for all stakeholders concerned.

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