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EUROPEAN COMMISSION LAUNCHES IMPACT ASSESSMENT PHASE IN ITS REVIEW OF THE VERTICAL BLOCK EXEMPTION REGULATION AND VERTICAL GUIDELINES

BACKGROUND

Article 101(1) of the Treaty on the Functioning of the European Union (**TFEU**) prohibits agreements between undertakings that restrict competition unless they contribute to improving the production or distribution of goods or services or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits.

The Vertical Block Exemption Regulation (**VBER**) (and its accompanying Vertical Guidelines (**VGLs**)) provides automatic exemption from the prohibition in Article 101(1) for vertical agreements that meet certain criteria. These criteria include that the market share of each of the parties to the agreement does not exceed 30% and there are no "hardcore" or "excluded" restrictions in the agreement such as resale price maintenance obligations. Vertical agreements are agreements entered into between two or more undertakings operating at different levels of the production or distribution chain – for example, between a manufacturer and a wholesaler.

COMMISSION'S REVIEW OF THE VBER AND VGLS

The VBER (and accompanying VGLs) were adopted in 2010 and will expire on 31 May 2022. The Commission is carrying out a review of the VBER to determine whether it should let it lapse, prolong its duration in its current form or revise it. It launched the evaluation phase of its review on 3 October 2018, during which it gathered evidence on the functioning of the VBER and VGLs. It published a Staff Working Document summarising its findings on 8 September 2020. In summary, the Commission found that:.

- Overall, the VBER is a useful instrument that increases legal certainty and facilitates self-assessment of vertical agreements – but there are provisions that lack clarity, are difficult to apply or are no longer adapted to the market developments that occurred since its adoption in 2010, in particular as regards the online environment.
- However, the market has changed significantly since the adoption of the VBER and VGLs in 2010. In particular, the growth of online sales has had a significant impact on distribution models, including an increase in the use of vertical agreements and an increase in the number of distribution or sales channels used by suppliers. The use of selective distribution has increased, and the use of exclusive distribution has decreased. New types

Key issues

- The Commission is carrying out a review of the VBER (and the accompanying VGLs). The VBER expires on 31 May 2022 and the purpose of the review is to determine whether the Commission should let the VBER lapse, prolong its duration or revise it.
- On 23 October 2020, the Commission published its inception impact assessment, that outlines the potential changes to the VBER that the Commission is exploring. The deadline for stakeholders' feedback on this assessment is 20 November 2020.
- This followed the publication of a Staff Working Document summarising its findings from the evaluation stage of the review on 8 September 2020.
- The Commission is considering possible changes to the rules in relation to resale price maintenance, non-compete obligations, dual distribution, active sales restrictions, restrictions on online sales and parity obligations.

of restrictions that are not covered by the VBER and VGLs have become more prevalent, including restrictions regarding sales through online marketplaces, on online advertising and retail parity clauses.

- There is significant room for simplification of the rules so as to reduce the cost to businesses of assessing the application of the VBER and VGLs, by reducing the complexity of the wording and structure of the rules and by updating the rules in order to bring them in line with current needs (in particular, ensuring the rules are sufficiently well adapted to recent market developments).

Executive Vice-President of the Commission Margrethe Vestager, who is in charge of EU competition policy, said: "*The evaluation has shown that the VBER and the Vertical Guidelines are useful tools that significantly facilitate the self-assessment by businesses of their vertical agreements. At the same time, the market has significantly changed and the evaluation has identified a number of issues that need to be addressed. The Commission will therefore reflect on how to address these issues to ensure that the rules remain fit for a world that is increasingly digital and changing at a fast pace*."

PROPOSED REVISIONS TO THE VBER AND VGLS THAT THE COMMISSION IS EXPLORING

On 23 October 2020, the Commission published its inception impact assessment, that outlines the potential changes to the VBER that the Commission is exploring. The deadline for stakeholders' feedback on this assessment is 20 November 2020. In addition to clarifying and simplifying the rules, including incorporating recent case law and filling in gaps, the Commission identified several areas in which the evaluation showed that a revision of the scope of the VBER may be warranted. Overall, the Commission is proposing to relax some of the rules on vertical distribution, except in relation to parity clauses where it proposes limiting the scope of application of the VBER.

The Commission has identified potential changes to the rules it is exploring, in the following areas:

- **Resale price maintenance** (i.e. an agreement to establish a fixed or minimum price to be observed by the buyer): improving clarity in relation to the treatment of possible efficiencies resulting from resale price maintenance, which is currently a hardcore restriction and therefore cannot be exempted under the VBER.
- **Non-compete obligations** (i.e. arrangements that result in the buyer purchasing from the supplier more than 80% of the buyer's total purchases of the contract goods and services and their substitutes): reducing costs and administrative burden by not excluding tacitly renewable non-compete obligations from the benefit of the VBER to the extent that the buyer can periodically terminate or renegotiate the agreement.
- **Dual distribution** (i.e. situations in which a supplier sells its goods or services directly to end customers competing with its distributors at the retail level): under the current rules dual distribution is generally covered by the block exemption, as it constitutes an exception to the general rule that agreements between competitors are not vertical but horizontal in nature. However, the Commission's review found that dual distribution has

increased significantly in line with the growth of online sales and that accordingly there is a risk of the VBER exempting vertical agreements where horizontal concerns are no longer negligible. Accordingly, the Commission is considering:

- Limiting the scope of the exception to instances unlikely to raise horizontal concerns by, for example, introducing a threshold based on the parties' market shares in the retail market and/or aligning the coverage of the exception with the horizontal rules.
- Extending the exception to dual distribution by wholesalers and/or importers.
- Removing the exception from the VBER altogether, thus requiring an individual assessment of likely anti-competitive effects in all dual distribution cases.

- **Active sales restrictions**: the current rules do not allow passive sales (i.e. responding to unsolicited requests or orders) restrictions, but they do allow active sales (i.e. actively approaching customers) restrictions in limited cases. The Commission found that some suppliers consider the current rules to be complex and unclear, preventing them from designing their distribution systems according to business needs; and also that they prevent the effective protection of the territory in which a selective distribution system is operated against sales from outside that territory to unauthorised distributors inside the selective distribution territory. Accordingly, the Commission is considering:
  - Expanding the exceptions for active sales restrictions.
  - Allowing restrictions on sales from outside the territory to unauthorised distributors inside the territory.
- **Online sales restrictions**: online sales are generally considered a form of passive sales and accordingly restrictions that make it more difficult to sell online are currently hardcore restrictions that cannot benefit from the automatic exemption under the VBER. The Commission found that online sales have developed into a well-functioning sales channel over the last decade, whereas physical stores are facing increased pressure; and that accordingly free-riding can happen in both directions, including free-riding on the investments of online distributors by offline distributors. Accordingly, the Commission is considering allowing certain types of online sales restrictions to benefit from the VBER that are currently excluded:
  - Permitting dual pricing (i.e. charging the same distributor different wholesale prices depending on whether the product is to be sold online or offline) in certain circumstances.
  - Allowing suppliers, in certain circumstances, to impose selection criteria for online sales that are not equivalent to the criteria imposed for offline sales as part of a selective distribution system.
- **Parity obligations**: currently, the Commission considers that all types of parity obligations can be block exempted under the VBER - although this position has been challenged by certain national competition authorities, most notably the Federal Cartel Office in Germany. The Commission's review revealed an increase in the use of parity obligations across sectors, and that national competition authorities have identified anti-competitive

effects of obligations that require parity with other indirect sales or marketing channels (so-called 'wide' parity obligations, as opposed to 'narrow' parity obligations that require parity only with the supplier's direct sales channel). The Commission is considering:

- Removing the benefit of the VBER for parity obligations that require parity relative to specific types of sales channels i.e. 'wide' parity obligations. This would require an individual assessment of likely anti-competitive effects in respect of such obligations.
- Removing the benefit of the block exemption for all types of parity obligations. This would require an individual assessment of likely anti-competitive effects in all cases.

NEXT STEPS

The deadline for stakeholders to provide their feedback to the Commission's inception impact assessment is 20 November 2020. In addition, an open public consultation is planned for the end of 2020. During the course of 2021, the Commission will publish a draft of the revised VBER and VGLs for comment. Consultation on the draft text and guidelines will follow before the new VBER and VGLs are adopted and entered into in after 31 May 2022.

APPLICABILITY IN THE UK FOLLOWING BREXIT

The United Kingdom left the European Union on 31 January 2020 (**Exit Day**) and entered a transition period which will end on 31 December 2020. During the transition period, the VBER continues to apply in the UK as it did before Exit Day. After the end of the transition period, the European Union (**Withdrawal**) Act 2018 (the Withdrawal Act) and the Competition (Amendment etc.) (EU Exit) Regulations 2019, made under the Withdrawal Act, preserve the VBER in the UK as a 'retained exemption'. This means it will operate as an exemption from Chapter I of the Competition Act 1998 (the UK equivalent of Article 101 TFEU).

The VBER could be varied and/or extended by the Secretary of State, acting in consultation with the CMA. There is no indication as to what is intended when the current VBER expires on 31 May 2022.

There are ongoing efforts to reform UK competition law – the CMA has been instructed by the UK Government to undertake a review of the state of competition in the UK, and John Penrose MP is leading a review of UK competition policy. It remains to be seen to what extent UK competition policy might evolve away from EU competition policy as a result of these reviews, including to what extent the UK may depart from the Commission's treatment of vertical restraints following these reviews.

C L I F F O R D
C H A N C E

CONTACTS

Belgium

Thomas Vinje
T +32 2 533 5929
E thomas.vinje
@cliffordchance.com

Dieter Paemen
T +32 2 533 5012
E dieter.paemen
@cliffordchance.com

Anastasios Tomtsis
T +32 2 533 5933
E anastasios.tomtsis
@cliffordchance.com

Czech Republic

Alex Cook
T +4 20 222 555 212
E alex.cook
@cliffordchance.com

France

Michel Petite
T +33 1 4405 5244
E michel.petite
@cliffordchance.com

Katrin Schallenberg
T +33 1 4405 2457
E katrin.schallenberg
@cliffordchance.com

David Tayar
T +33 1 4405 5422
E david.tayar
@cliffordchance.com

Germany

Michael Dietrich
T +49 211 4355 5542
E michael.dietrich
@cliffordchance.com

Joachim Schütze
T +49 211 4355 5547
E joachim.schutze
@cliffordchance.com

Marc Besen
T +49 211 4355 5312
E marc.besen
@cliffordchance.com

Italy

Luciano Di Via
T +39 064229 1265
E Luciano.divia
@cliffordchance.com

Poland

Iwona Teriecka
T +48 22 429 9410
E iwona.terlecka
@cliffordchance.com

Romania

Nadia Badea
T +40 21 66 66 100
E nadia.badea
@cliffordchance.com

Spain

Miguel Odriozola
T +34 91 590 9460
E miguel.odriozola
@cliffordchance.com

Miquel Montañá
T +34 93 344 2223
E miquel.montana
@cliffordchance.com

The Netherlands

Frans Muller
T +31 20711 9318
E frans.muller
@cliffordchance.com

United Kingdom

Alex Nourry
T +44 20 7006 8001
E alex.nourry
@cliffordchance.com

Jenine Hulsmann
T +44 20 7006 8216
E jenine.hulsmann
@cliffordchance.com

Nelson Jung
T +44 20 7006 6675
E nelson.jung
@cliffordchance.com