DISTRIBUTION AND FRANCHISING
NEW VERTICAL BLOCK EXEMPTION REGULATION AND GUIDELINES

The European Commission has adopted a new Vertical Block Exemption Regulation ("VBER") which replaces the previous one approved in 2010. The new VBER updates the principles for a general exemption from competition rules for vertical agreements (including distribution and franchise agreements) in view of the recent market developments such as the growth of e-commerce and other new forms of distribution. The new VBER entered into force on 1 June 2022 and will expire after 12 years.

The Vertical Block Exemption

The objective of Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) is to ensure that companies do not use agreements to restrict competition on the market to the detriment of consumers and thus prohibits agreements and practices that restrict such competition. However, article 101(3) TFEU sets out the exception to this prohibition for agreements which contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits outweighing any anti-competitive effects.

The VBER, along with its Guidelines, help identifying admissible practices under Article 101(3) TFEU and provide for a safe harbor for vertical agreements. We summarize the most relevant ones in this article. It is important to no note that the market share thresholds of 30% have finally remained unchanged.

Exclusive distribution agreements

Exclusive distribution means that a supplier allocates a territory or a group of customers exclusively to an appointed distributor.

The number of distributors per exclusive territory or group of customers cannot exceed five. When a supplier appoints more than one distributor for an exclusive territory or customer group, these distributors can be protected from active sales into the exclusive territory or to the exclusive customer group from other supplier's buyers, but active and passive sales by these distributors within the exclusive territory or customer group cannot be restricted.

A supplier that operates an exclusive distribution system in a certain territory and a selective distribution system in another territory can restrict its exclusive distributors and their customers from selling actively or passively to unauthorized distributors located in the territory where the supplier already operates a selective distribution system or which it has reserved for the operation of such a system. The ability to pass on active and passive sales restrictions further down the distribution chain in this scenario is intended to protect the closed nature of selective distribution systems.

Selective distribution agreements

Selective distribution entitles a supplier to sell goods or services only to distributors selected based on specified criteria and where these distributors undertake not to sell such goods or services to unauthorized distributors within the territory reserved by the supplier to operate the selective system.

The main difference between exclusive distribution and selective distribution is that in the exclusive distribution system, the distributor is protected against active selling from outside its exclusive territory, whereas in a selective distribution system, the distributor is protected against active and passive sales by unauthorized distributors.

Free distribution agreements

Where there is no exclusive or selective distribution system, the VBER allows suppliers to protect their selective or exclusive territories or customer groups by restricting:

- Active sales by the buyer or its direct customers into a territory or customer group reserved to the supplier or allocated to a maximum of five exclusive distributors; and
- Active and passive sales by the buyer or its customers to unauthorized distributors located within a selective distribution system.

Active and passive sales

Active sales occur when the seller actively approaches individual customers while passive sales occur when a seller answers unsolicited requests from individual customers.

Offering a language option in an online store that is different from the languages commonly used in the territory in which the distributor is established generally indicates that the distributor is targeting the territory in which the language is commonly used and thus amounts to active selling. However, offering an English language option in an online store does not as such indicate that the seller is targeting English-speaking territories, as English is widely understood and used throughout the European Union.

Establishing an online store with a top-level domain corresponding to a territory other than the one in which the distributor is established is a form of active selling into that territory, whereas offering an online store with a generic and non-country specific domain name is a form of passive selling.

Participation in public procurement, or responding to invitations to tender issued by non-public entities are forms of passive selling.

Franchise agreements

Franchising has some specific characteristics, such as the use of a uniform business name, uniform business methods (including the licensing of the franchisor's intellectual property) and the payment of royalties in return for the benefits granted by the franchisor. Provisions that are strictly necessary for the functioning of a franchising system can be considered as falling outside the scope of Article 101(1) TFEU. This concerns, for instance, restrictions that prevent the franchisee from using the know-how of the franchisor for the benefit of any competitors, or the non-compete obligations that are necessary to maintain the common identity and reputation of the franchise network.

Other vertical restraints contained in franchise agreements will be assessed using the principles applicable to the distribution system that most closely corresponds to each franchise agreement. For instance, if franchisees are prohibited from selling to non-franchisees, it must be assessed under the principles applicable to selective distribution. If a franchise agreement only grants territorial exclusivity and protection from active sales by other franchisees, it must be assessed under the principles applicable to exclusive distribution.

Dual Distribution

Dual distribution concerns situations where a supplier not only sells its goods or services through independent distributors but also sells directly to end consumers on their websites in parallel, thereby competing with its distributors at retail level.

Dual distribution is permitted and extended to wholesalers and importers, covering scenarios where the two parties compete either on an upstream or on a downstream retail level. Suppliers of online intermediation services that have a hybrid function (they provide online intermediation services to companies and sell the same products/services as these companies) are carved out from this exemption.

Exchange of information between supplier and distributor is allowed only if it is related to the implementation of the vertical agreement or is necessary to improve the distribution of the goods or services. It will be important for suppliers and distributors implementing dual distribution to review whether the level of information exchanged is compliant with the new BVER framework.

Online sales

Preventing the effective use of the internet by the distributor or its customers is a hardcore restriction. This would be the case for vertical agreements which significantly diminish the aggregate volume of online sales, limit the possibility for end users to buy the goods or services online, or prevent the use of one or more entire online advertising channels by the distributor.

The supplier may impose, however, certain requirements on the distributor relating to the manner in which the goods or services are to be sold online provided that they do not indirectly have the object of preventing the effective use of the internet by the distributor.

Restrictions imposed by a supplier to a distributor on marketplace sales are not hardcore restrictions, since they only limit the way the distributor may sell online and does not restrict sales to a specific territory or customer group. However, a platform ban that prevents the effective use of the internet to a distributor for online sales will constitute a hardcore restriction.

Imposing certain online advertising restrictions (requirement that online advertising meets certain quality standards or includes specific content or information) is allowed provided that they do not have the object of preventing the use of an entire advertising channel by the distributor. Prohibitions on the use of online advertising channels are hardcore restrictions. Comparison websites are regarded as online advertising channels since they re-direct customers to the website of a retailer.

Requirements that a distributor prevents customers located in another territory from viewing its website or automatically re-routing its customers will also be considered hardcore restrictions.

Dual pricing

Dual pricing is permitted, which means that supplier may apply a different wholesale price for products intended to be sold online than for products to be sold offline.

However, the difference in the wholesale prices must be reasonably and the pricing system should not restrict cross-border sales or prevent the effective use of the internet as a sales channel, and must has as its object to incentivize or reward the appropriate level of investments respectively made in online channels and in brick-and-mortar channels.

Dual pricing provides businesses with more flexibility to apply different prices but careful drafting of agreements will be important to capture the purpose of the dual pricing.

Resale price

Agreements which have the object of restricting the distributor's ability to determine its sale price (establish a fixed or minimum sale price, or set the sale price within a certain range) are considered hardcore restrictions. Fixing prices can also be applied through indirect means, including incentives to observe a minimum price or disincentives to deviate from a minimum price.

The imposition by the supplier of a maximum resale price or the recommendation of a resale price is not a hardcore restriction. However, if the supplier combines such a maximum price or resale price recommendation with incentives to apply a certain price level or disincentives to lower the sale price, this can amount to fixing prices.

Note that price monitoring and price reporting are not considered, on their own, fixing prices.

Non-compete obligations

Non-compete obligations that are tacitly renewable beyond a period of five years are possible provided that the distributor can effectively renegotiate or terminate the 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.

Post termination non-compete obligations imposed on the distributor are possible only if the non-compete obligation is indispensable to protect the know-how transferred by the supplier, it is limited to the point of sale from which the supplier operated during the contract period and is limited to a maximum period of 1 year.

The new VBER establishes a <u>one-year transition period which will end on 31 May 2023</u>. This means that any new distribution and franchise agreements entered on or after 1 June 2022 will have to comply with the new BVER, while distribution and franchise agreement already in force will have until 31 May 2023 to adapt, giving companies a window period to review their agreements and make sure they remain compliant with the new BVER.