

New competition rules regarding distribution



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Companies must ensure that their contracts and policies applicable to their distribution network comply with the new European competition rules and take advantage of their opportunities.

On 10 May, the European Commission approved the final versions of the new competition rules applicable to distribution agreements. These rules shape the contractual clauses of a myriad of “vertical” agreements between suppliers and distributors, a category which includes contracts on distribution (selective or exclusive), franchising, dealership, resale, marketing, procurement, supply, agency, etc.

As of 1 June this year, if a company will need full legal certainty on the compatibility with competition rules of its new distribution contracts, they will have to be drafted in accordance with the new regulation. For distribution contracts and policies currently in force, a period of one year (until 31 May 2023) is granted for companies to adapt these agreements to the new competition rules.

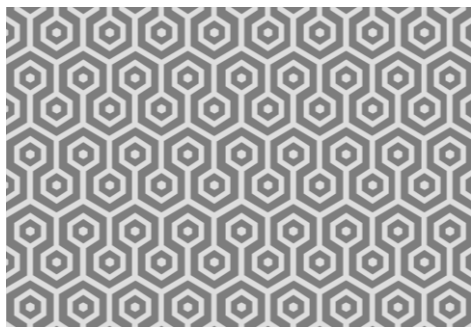
The new rules are therefore an invitation to companies to (i) review if their commercial agreements and policies applied to their distribution networks are competition law compliant; (ii) update their competition compliance programmes to factor in the new rules; and (iii) train their employees to raise

awareness of the new rules of the game in this field.

The new rules do not entail a revolutionary departure from previous regulations, but they do raise some new infringement risks for companies, while also creating opportunities to increase the efficiency and competitiveness of their distribution networks.

1. Opportunities Objectives pursued by the new competition rules on distribution

The new rules adopted by the European Commission are: (i) Regulation (EU) 2022/720 of 10 May on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (the “Regulation”, see link) which replaces Regulation (EU) 330/2010; and (ii) European Commission Guidelines on Vertical Restraints (the “Guidelines”, see link) which replace the 2010 Guidelines. They were submitted for public consultation as draft rules in July 2021 and February 2022. They are expected to remain in force until 2034.



The objectives pursued by the new European competition rules on distribution are: (i) stricter enforcement of competition rules in some areas (such as in relation to parity clauses; or exchanges of information in dual distribution systems); (ii) introduction of a more detailed regulation of e-commerce and internet platforms; (iii) relaxation of competition rules in other areas (wholesale prices for on-line resale; or renewal of single-branding obligations); and (iv) clarification of the rules, so that they can be applied more uniformly across the European Union (“EU”).

Under both the current and future regulatory framework, distribution contracts that fulfil the conditions set out in the Vertical Block Exemption Regulation are ensured to be compatible with the competition rules. Otherwise, they may still be compatible, if companies prove that their vertical agreements generate sufficient consumer benefits and efficiencies to compensate for their restrictive effects on competition. The Guidelines accompanying the Regulation serve as a guide for this self-assessment on benefits, efficiencies and compensation for restrictive effects.

The European Commission is very busy preparing new competition rules this year, as it is simultaneously undertaking a reform of the pieces of legislation applicable to horizontal agreements between competitors, having published draft rules on the subject a few weeks ago.

2. Infringement risks arising from the new European competition rules on distribution

The new Regulation and Guidelines introduce some new prohibitions, listed below. These are the issues that

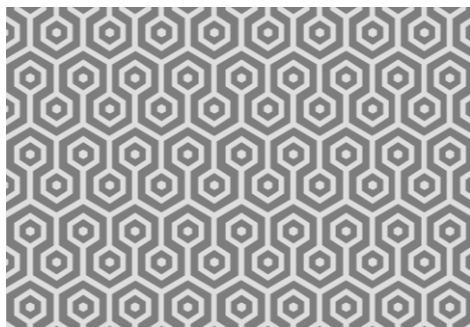
companies will need to review with particular care. If this review is overlooked, there is a risk that the company will commit infringements, as the previously existing regulatory framework was more lenient.

2.1. Dual distribution

A dual distribution system is one in which the supplier competes at the retail level with its distributors. This is a practice that has proliferated recently, especially as manufacturers have started to sell on-line directly to consumers. This situation is also common in franchise networks, as the franchisor usually has its own outlets that compete with franchisees’.

In dual distribution systems, safeguards will have to be put in place with regard to exchanges of information between the supplier and its distributors. From now on, the Regulation does not guarantee the compatibility with the competition rules of exchanges which are not directly related to the implementation of the agreement or which are not necessary to improve the production or distribution of the contract products.

The Guidelines state that the supplier may legitimately have access to information from its distributors concerning the following matters: (i) technical information; (ii) logistics; (iii) customer feedback; (iv) resale prices of its distributors; (v) marketing; (vi) promotional campaigns; and (vii) the percentage of sales achieved by the distributor of the products provided by the supplier, out of the distributor's total sales of that type of products (including those purchased from other suppliers). The supplier may also provide the distributor with aggregated information on the performance of other distributors in its network (marketing and sales activities).



By contrast, access by the supplier to the following types of information from its distributors could from now on be considered anti-competitive, where the supplier has not established competition compliance mechanisms: (i) future resale prices; (ii) information on sales to individual customers (although this is allowed in certain circumstances); and (iii) information exchanged on private label products between a supermarket chain and manufacturers producing competing products under their own brand.

That said, the Guidelines open the possibility that the exchange of information between a manufacturer and its distributors in relation to the categories of information identified in the previous paragraph may still be compatible with competition rules, if the supplier implements competition compliance protocols. In particular, this internal compliance control may consist in preventing, by means of firewalls, distributor's information that is considered problematic from reaching the supplier's business unit that competes at the retail level with the distributors. Once this firewall is in place, the Guidelines suggest that the supplier could be entitled to access also to the information from the distributor mentioned in the previous paragraph.

2.2 Internet sales by distributors

The previous regulatory framework already provided that suppliers could not impose an absolute prohibition on their distributors to resell over the internet. The Guidelines state that a supplier shall not require its distributors to resell only in physical shops. Nor may the supplier prevent distributors from (i) using the supplier's brand name on the distributors' websites (although in relation to the distributor's website domain the regulation is different); (ii) doing any type

of advertising on the internet, for instance, via search engines; (iii) never bidding with the supplier's brand or name, in order to obtain a higher visibility of their own websites in search engines; (iv) using the services of any price comparison websites.

2.3. E-commerce platforms selling directly to consumers

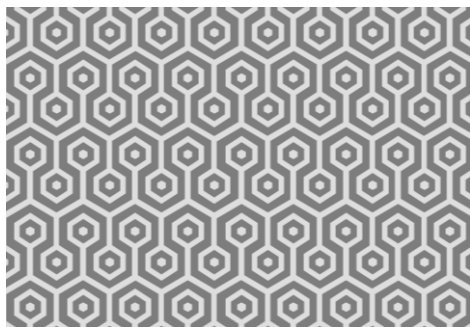
The block exemption granted by the Regulation will not cover dual distribution relationships of operators of online intermediation services (e-commerce platforms) which, in addition to selling directly to consumers, also intermediate sales between retailers and consumers (hybrid platforms). However, the Guidelines clarify that the competition rules will apply more flexibly to hybrid platforms with smaller market shares.

2.4. Restrictions on parity obligations by online intermediation platforms

Parity obligation (or most favoured nation / customer clause) means the prohibition imposed on the other party to offer third parties lower prices or better trading conditions.

The Regulation does not protect parity obligations imposed on companies by online intermediation platforms where they directly or indirectly prevent the companies from offering consumers lower prices or better terms through competing platforms (wide parity clause). The Guidelines clarify that better terms mean higher inventory, availability or capacity.

However, the Regulation block-exempts the prohibition imposed by the platform on companies to make better offers through the companies' own direct sales channels (narrow parity clause).



2.5. Public procurement and private tenders

The Guidelines state that bidding in public procurement and private tenders will be considered passive selling, thus limiting the role of suppliers in organising their network's participation in them.

2.6. Agency agreements

In relation to agency agreements, the new rules regulate in more detail issues such as: (i) operators who, in relation to the same supplier, act both as resellers (for some products) and agents (for other products); (ii) agents acting for several principals who compete with each other; and (iii) e-commerce platforms.

3. Opportunities created by the new rules to make distribution networks more efficient and competitive

The change in the regulatory regime also opens up the possibility for companies to reformulate and modernise some aspects of their distribution networks in order to provide a better service to customers and to become more competitive. Some possibilities in this regard are listed below.

3.1. Dual wholesale pricing for on-line / off-line resale

Probably the most relevant change in the new rules is that suppliers are allowed, in certain circumstances, to agree different wholesale prices with distributors, depending on whether the distributors will resell the products on-line or off-line. This opens up the possibility for the wholesale price to be higher if the distributor will resell the product on-line, and for the supplier to make appropriate checks in this respect to ensure that it is charging its wholesale prices correctly. This change applies to all distribution systems.

However, dual pricing should not become a de facto ban on on-line sales imposed on distributors, nor on parallel trade within the EU. Moreover, it should not

lead to resale price fixing conduct by the supplier to the detriment of its distributors.

3.2. Limitations in relation to e-commerce platforms

In relation to online sales by distributors, the Guidelines clarify that a supplier may prohibit its distributors from reselling via e-commerce platforms. This provision applies to all distribution systems.

3.3. Allocation of territories in favour of up to five distributors

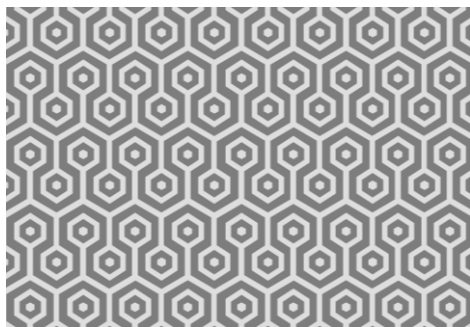
Exclusive distribution is defined in competition law as a system in which the supplier allocates territories or customer groups to distributors. Distributors are prohibited from making active sales into the territories/customers of other distributors. Active selling occurs when, without a prior request from the customer, the distributor addresses the customer by means of a visit, call, e-mail, direct commercial action, etc.

The Regulation allows the supplier to appoint up to five distributors in exclusive distribution systems. The existing regulatory framework only provided guarantees of compatibility with the competition rules for exclusive distribution systems in which only one distributor per territory was appointed.

In exclusive distribution systems, the Regulation allows the supplier to oblige its distributors to prohibit the distributors' customers from making active sales in the territory/customer group allocated to other distributors.

3.4. Possibility to impose new obligations on distributors in selective distribution systems

A selective distribution system is one in which the supplier undertakes to sell its products only to distributors selected on the basis of specific criteria and the network members undertake not to resell to unauthorised distributors. Franchises are often integrated into selective distribution systems.



In order to ensure a better sealing of the selective distribution network, the Regulation allows the supplier to impose on authorised distributors an obligation to prohibit the distributors' customers from reselling to unauthorised operators.

The Regulation continues to allow the supplier to set quality standards for distributors' online sales. The Guidelines give greater freedom to suppliers to define these standards for online sales, which no longer have to be "globally equivalent" to the criteria set for physical sales by distributors.

3.5. Resale prices of distributors

Like under the previous framework, a supplier may recommend resale prices or set maximum resale prices to its distributors. But it may not fix resale prices nor minimum resale prices on its distributors. However, the Guidelines allow the supplier and the distributors to use IT tools to monitor the online retail price of the network.

The Guidelines make it clear that a supplier cannot, as a general rule, prohibit its distributors from advertising prices lower than those recommended by the supplier. However, the Guidelines make an effort to reconcile this provision with the unfair competition law's prohibition on selling at a loss (in particular to avoid damage to brand image).

In a scenario where the supplier agrees on a selling price with a client and the sale is made by an operator appointed by the supplier, it is not considered an infringement for the supplier to instruct the operator in question at what price to resell the product to the client.

3.6. Resale prices of distributors

Non-compete obligations are those which requires the distributor (i) to concentrate its orders for a particular type of product with one supplier; or (ii) to purchase more than 80% of its requirements on a particular market from only one supplier. The Regulation continues to consider these clauses compatible if they last up to five years. However, it will no longer require that, after the fifth year, they must be expressly renewed, and tacit renewal is permitted in certain circumstances.

3.7. Sustainability

As in the area of horizontal agreements, the new competition rules on vertical agreements emphasise the importance of assessing sustainable development objectives in determining whether an agreement is compatible with the competition rules. The Guidelines open up, for example, the possibility of considering that single-branding clauses (whereby the customer commits to purchase only from a particular supplier) are compliant even if they last longer than five years, if such a restriction helps to achieve sustainable development objectives.