"EXTRA, EXTRA, READ ALL ABOUT IT"—FINAL EUROPEAN AND UK BRAND DISTRIBUTION RULES PUBLISHED

Date: 13 May 2022

Antitrust, Competition, and Trade Regulation Alert

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On 10 May 2022, the European Commission (the Commission) finally published the official final version of the European Vertical Block Exemption Regulation (VBER) and guidelines (Vertical Guidelines). The new rules will come into effect on 1 June 2022 and govern how brands can design their European go-to-market strategies and control the sale of their products for the next decade. The United Kingdom's new rules, contained in the Vertical Agreements Block Exemption Order, are now also final.

So what does this mean for consumer brands?

In this alert, we provide quick-fire responses to the top five questions that have been on everyone's lips.

> 1. “Let’s get straight to the point—I want to ask you about prices. I saw something online about MAP possibly being allowed in Europe—is that right?”

- The short answer is “no”—as a general rule, it remains illegal and very high risk in the European Union and United Kingdom to agree a minimum or fixed resale price with customers, and this also includes prescribing a minimum advertised price. All of these are treated as unlawful “resale price maintenance” (RPM).
- While recommended or maximum resale prices are acceptable, sales teams should also be trained that putting any direct or indirect pressure on customers to “adhere to RRP/MSRP” counts as unlawful RPM. This includes using price-monitoring tools to flag and enforce “price deviations” by retailers, so make sure you are using software in a legally compliant way.
- That being said the Commission has expressed clear willingness to countenance RPM in exceptional circumstances where its effect would be overall pro-competitive, such as:
  - As part of a temporary pricing campaign to support a new product launch where there are no realistic and less restrictive alternative means of incentivizing the resellers to promote the product.
  - As part of a coordinated short-term low-price campaign, in particular, where the supplier applies a uniform distribution format across its retailer network.

- To protect retailers that make investments in additional pre-sales services (e.g., for complex products) from free-riding by others.
- Very interestingly, to prevent a particular distributor from using a brand's product as a loss leader, specifically when it resells below the wholesale price. The Commission correctly concedes that "this can damage the brand image of the product and, over time, reduce overall demand for the product and undermine the supplier's incentives to invest in quality and brand image."

The thresholds for these potential exemptions are high, and it still carries significant uncertainty and potentially high risk if an authority or court disagrees that the RPM is necessary in the circumstances. However, the Commission's more pragmatic stance is encouraging, and as the scope of these potential exemptions (and national competition authorities' attitudes towards them) become clearer, we can expect to see more companies pursuing these options.

Another concession: The new rules also now state that where a supplier concludes a supply agreement with a specific customer, and then enters into an agreement with a reseller that it has chosen for the purpose of executing ("fulfilling") that supply agreement, imposing on the reseller the resale price agreed with the customer will not constitute RPM.

> 2. "That's interesting—a lot more to think about in that area now. The real trouble is simply that our brick and mortar partners just can't compete with the prices of their online competitors, because of their higher overheads. This has been worsened by the lockdowns and we have a lot of partners planning to shut their offline stores. This is terrible for our brand."

This is one area where the new rules introduce a major change and a clear recognition that the high street does need some protection.

- It will no longer be a hardcore restriction of competition to charge a hybrid seller different wholesale prices for the products it sells in brick and mortar stores compared with those it sells online.
- We see many brands taking advantage of this to introduce meaningful performance pricing policies, which reward or incentivize partners for their investments in the brand and consumer experience.
- The key is to make sure a price difference is not arbitrary and is reasonably related to differences in the investments and costs incurred by the buyer to make sales in each channel. A price difference that has the object of preventing the effective use of the Internet to sell to particular territories or customers will still be regarded as a very serious competition law violation.
- We also suggest "watching this space" for Germany and France—their attitude to dual pricing has historically been more conservative (see our article here), so particular care needs to be taken on pricing policies affecting these territories.
- Another positive development in the new rules is that selective distribution criteria for brick and mortar partners no longer have to be 100% equivalent to the online retailer criteria. This relaxation of the rules

will allow brands to apply standards for partners that are more relevant and appropriate to the channel in which they operate, which could help to ease the burden on offline network partners.

> 3. “You mentioned selective distribution. Remind me what that is again please? I seem to recall we thought about it but not every country was ready for that—or we couldn’t protect selective distribution territories—so we abandoned the idea.”

Selective distribution is a system where (i) distributors/sellers are authorized based on their compliance with certain qualitative criteria, and (ii) they agree not to sell outside the authorized network.

A properly designed selective distribution system is a necessary precondition for a brand to be able to stop someone from purchasing and reselling their product (often called grey market selling)—without a legally valid system in place, grey market enforcement carries serious antitrust risk.

In this area, the new rules are mostly helpful in clarifying or confirming some important points.

- They now explicitly recognize that selective distribution may be appropriate for many high-quality products (not just technical or luxury goods).
- It is also confirmed when and what types of restrictions on online marketplaces are likely to be accepted.
- The new rules expressly allow brands to combine different distribution systems within the European Union, for instance, exclusive or free distribution in one territory and selective distribution in another (where the local conditions might support this model better). More importantly, they clarify that it is legally permissible to prevent customers and indirect customers in a nonselective distribution territory from selling a brand's products to unauthorized dealers in a territory where selective distribution has been implemented. This means your business team has more flexibility to decide where selective distribution might work and the comfort that the system can be protected from outside leakage.

> 4. “We’ve always gone for exclusive relationships. Anything we should be aware of there?”

Yes. Two really interesting developments are the following:

- Brands will be able to grant “shared” exclusivity over particular territories or customers to up to five distributors (rather than only one distributor, as before). This presents some novel potential options for brands as they relook at their system designs, for instance, where selective distribution is not appropriate but a single distributor is not enough.
- It is also now possible to protect a distributor's exclusive territory or customer group from active sales both from the brand's other direct distributors, as is currently possible, as well as from indirect customers to whom the active sales restriction can be passed down. This enhances the possibilities for protecting the exclusivity granted to partners. However, remember that passive sales (i.e., sales following unsolicited

orders from customers, for instance, where the customer is browsing a foreign website but has not been targeted in any way) can never be restricted in the European Union.

One very puzzling area of the new EU rules to note is how they treat the situation where the brand has an exclusive distributor at the wholesale level (A), but applies selective distribution at the retail level (i.e., applies quality criteria for the selection of authorized retailers). This is a common model in the market given the very different roles played by wholesalers (trade-facing) and retailers (consumer-facing). Sometimes brands restrict their wholesalers in other territories from making active sales to authorized retailers in distributor A's exclusive territory.

Unfortunately, the new EU rules treat an active sales restriction in this scenario as a hardcore restriction of competition—which could void an agreement and expose the parties to large fines. However, they do allow for a possible individual exemption on a case-by-case basis—for instance, where the wholesale distributor would not be prepared to make the investments needed to support the implementation and maintenance of a retail selective distribution system in its territory unless it received some protection from active selling by other wholesalers. Alternatively, companies can still choose to only appoint one wholesale distributor per territory (there are different options for how this can be structured) but without restricting active selling by others into that distributor's territory.

Note that in the United Kingdom an active sales restriction in this scenario is not a problem.

> "That sounds… confusing."

It will be interesting to watch how this one plays out.

In the meantime, we suggest digging out your distributor contracts and having this aspect reviewed to make sure your terms are compliant.

> 5. "Ok, my last question for now… Like many others, our brand has been growing its D2C business, and this was accelerated by COVID-19. It's very exciting and great for customer engagement with the brand, but we're finding it quite tricky to know what we can and can't say to our network partners who are now also our competitors. Any tips?"

Yes, this situation—called "dual distribution"—is an important feature of the new rules.

We are pleased to report the Commission has not adopted the very conservative approach as proposed in its July 2021 draft of the rules and that the VBER will continue to exempt certain information exchanges between brands with market shares of under 30% and their competing customers. The Commission has also helpfully clarified that the exemption for dual distribution will apply to more levels of the supply chain, such as importers and wholesalers, and not just retailers.

However, brands should note that the scope of the old legal exemption has been narrowed in some respects—the information must now be "directly related to the implementation of the vertical agreement and necessary to improve the production or distribution of the contract goods or services" to be automatically exempted. The

Vertical Guidelines provide examples of what is or is not (usually) likely to meet this test, but as a rule of thumb obviously competitively sensitive exchanges (e.g., a brand's or customer's competitive strategy or future prices, where these are not part of a network-wide maximum price promotion) are likely to raise concerns. Certainly, sales teams should be appropriately trained and technical or administrative precautions considered to minimize the competition risk, especially as this area looks ripe for investigation.

Another thing to be aware of is that the legal exemption for dual distribution will not apply to an agreement between a brand and a provider of online intermediation services (e.g., e-commerce platform) where the platform also sells the product in competition with the brand. In these scenarios, the relationship needs to be individually assessed to ensure competition law compliance.

> "That's a lot to take in."

It is, and there is more where that came from. However, do not worry—sign up here if you are interested in being kept up to date on developments in this space, including other key areas to watch.

Our team is available to connect if you would like to discuss how the new laws will affect your company, to ensure it is not exposed to material new risk and, conversely, is aware of opportunities that may have opened up.

K&L Gates Invitation: Brand Distribution Strategies in Europe—What Are the New Opportunities?

You are invited to join us in-person on the evening of 21 June 2022 at our office in London for a panel discussion and summer networking event, bringing together dynamic thought leaders from consumer brands and our team to exchange ideas and demystify the new European and UK brand distribution regime. Details and a registration link are available here.

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