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The Block Exemption of Vertical Agreements and Online Sales: Some Critical Remarks

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Distribution in the Digital Era (1)

- The growth of e-commerce, digital platforms and online intermediaries has **reshaped market dynamics** in the distribution sector
  - Emergence of **new players and tools** (e.g., online marketplaces, app stores, price comparison systems)
  - Possibility to operate online through **different business models** (traditional reseller or agency model; intermediaries that operate a multisided platform to facilitate interactions between different groups; direct distribution)
  - More **market transparency** (for both sellers and customers)
  - **Lower transaction costs** (for both sellers and customers)
  - Possibility to use **sophisticated tools** (algorithmic pricing, AI) to monitor market conditions, track competitors' prices and other terms, and adjust commercial policies

Distribution in the Digital Era (2)

- E-commerce and digital platforms have **intensified competition** at the distribution level
  - **Increased price transparency** and **lower search costs** for customers (*e.g.*, direct access to manufacturers and distributors' websites; marketplaces; price comparison tools)
  - Increased competitive pressure exerted by **firms located in other areas** → possible definition of **broader geographical markets** at the distribution level
  - Facilitation of **direct sales by manufacturers**, resulting in lower distribution margins

- At the same time, there are significant **risks to competition** (especially at the horizontal level)
  - More transparency (for sellers) and circulation of information facilitate **collusion**
  - The use of AI tools and algorithmic pricing may create a grey zone between explicit and tacit collusion: there is no meeting of the minds in the traditional sense, but **super-fast and super-rational autonomous adjustment**
  - Algorithms and AI tools may also be used to implement aggressive and extremely effective **price discrimination** strategies

Changes in Manufacturers' Distribution Strategies

- Many manufacturers have **integrated vertically** into online distribution by launching their own websites
- Suppliers have increasingly pursued an **omni or multi-channel strategy**, directly and/or through independent distributors and agents
- Suppliers have also tried to **tighten their control over the online distribution** of their products, by integrating vertically into online sales and/or using vertical restraints
  - Use of restraints that allow to **control online distribution** (price restrictions, marketplace bans, restrictions on the use of price comparison tools, exclusion of pure online players, etc.), in order to protect brand reputation and ensure the provision of information and promotional services, both in brick-and-mortar and online shops
  - Use of **selective distribution** to maintain a coherent brand image across offline and online sales, avoid free riding between different channels and prevent the sale of counterfeit products

Online Sales and Free-riding (1)

- The growth and widespread use of e-commerce has had an **ambiguous impact on the risk of free-riding**
  - The ease of internet searches and low prices offered by many online distributors may **increase the risk** of free-riding on the services provided by traditional distributors
  - However, the use of the internet may also **mitigate the risk** of free-riding, as information and other pre-sale services can be (i) provided online at a relatively low cost, and (ii) easily monitored by the supplier

- Certain factors may **reduce the need to protect brick-and-mortar stores** from online distribution
  - Free-riding on the efforts of brick-and-mortar stores is **more likely** for products that depend on **sensory experience** for sales, **less for others**
  - Free-riding may also occur in the **opposite direction** (customers browse internet retailers' websites to quickly gather information, and then purchase the selected product at brick-and-mortar stores)

Online Sales and Free-riding (2)

- Nonetheless, suppliers may need to **grant traditional distributors some degree of protection** from free-riding by online sellers

  - Many consumers **continue to rely on in-store retail services** in some situations, such as the purchase of complex products, experience goods or durable goods

  - Free-riding by internet retailers is generally a **greater problem** than free-riding in the reverse direction, also considering that

    (i) much of the effort of brick-and-mortar distributors takes the form of a **per customer cost**, while online retailers are more likely to incur fixed costs in providing support

    (ii) promotional efforts of brick-and-mortar distributors are **more difficult to verify** (need to preserve incentives)

Regulation No. 720/2022

- The **2022 review** of the rules on vertical restraints aimed, *inter alia*, at:
  - **(i) readjusting the safe harbor** provided by the block in connection with online sales and digital platforms, so as to reduce the risk of false positives and false negatives
  - **(ii) updating the relevant rules and guidelines** in light of the significant changes in the business environment, reshaped by the growth of e-commerce and the rise of online platforms

- The Commission acknowledged that online sales have developed into a **well-functioning and established sale channel**, which no longer needs special protection → removal of certain hardcore restrictions

- However, the Commission confirmed the **strict treatment of certain provisions** that may prevent the effective use of the internet, and introduced **some additional limits** on manufacturers' ability to control online distribution

The Restriction of Active and Passive Sales in Exclusive Distribution Systems (1)

- Regulation No. 720/2022 (VBER) confirms the **traditional distinction between active and passive sales**
  - ➢ The supplier **may restrict active sales** by the exclusive distributor into a territory or to a customer group reserved to the supplier or exclusively allocated to a maximum of five buyers → justified by the need to grant exclusive distributors a certain degree of protection to preserve their incentive to invest and provide information and promotional services
  - ➢ However, to benefit from the block exemption, the supplier **cannot restrict passive sales** into such territories or to such customer groups → restriction considered particularly harmful, also because it results in market partitioning

- The **Vertical Guidelines** provide indications on active and passive sales
  - ➢ **Targeted efforts** to sell in exclusive territories/customer groups allocated to other distributors result in active selling
  - ➢ However, the fact that the use of a website may have **effects beyond the distributor's territory or customer group** is not considered an indication of active selling, but a **consequence of the technology used**, which allows easy access from everywhere

The Restriction of Active and Passive Sales in Exclusive Distribution Systems (2)

- In practice, the distinction between active and passive selling may be uncertain and, in any case, is **much less significant** in the online world

- Distributors **do not need to engage in active selling** to realize a large portion (even the majority) of their sales in territories, or to customer groups, allocated to other distributors
  - Sellers' websites are **easily accessible** from everywhere
  - Consumers are increasingly willing to invest time on-line to learn about products and **search for the best alternatives**. They play an **active role** in searching available options, and this reduces the need for active selling by distributors
  - **Price comparison systems, comparison shopping services, marketplaces** and similar tools further facilitate customers' searches
  - In most cases, the **location of the distributor is irrelevant** for customers' purchasing decisions (no travel costs or additional transport costs)

- **Does it make sense to distinguish** between active and passive online sales?

The Restriction of Active or Passive Sales in Selective Distribution Systems (1)

- Online sales benefit from **strong protection** also in **selective distribution systems**

  - The **restriction of active or passive sales to end users by retailers** (also with the help of the internet) constitutes a hardcore restriction under Article 4(c)(iii) of the VBER

  - A contractual clause **prohibiting *de facto* the use of the internet** as a method of marketing

    (i) amounts, in principle, to a restriction by object, and

    (ii) cannot benefit from the block exemption, as it constitutes a hardcore restriction under Article 4(c)(iii) of the VBER (ECJ, *Pierre Fabre Dermo-Cosmétique*)

The Restriction of Active or Passive Sales in Selective Distribution Systems (2)

- The VBER introduced a **more flexible approach** to the definition of **selection criteria and quality standards** in selective distribution systems
  - Under Regulation No. 330/2010 and the related guidelines, obligations imposing on appointed distributors **criteria for online sales that were not overall equivalent** to those imposed for sales from brick-and-mortar stores were considered **hardcore restrictions**
  - The Vertical Guidelines currently in force **no longer qualify lack of equivalence as hardcore restriction**. The Commission acknowledged that the offline and online channels are inherently different in nature and may require different criteria

- However, the possibility to impose non-equivalent criteria is subject to the **general limiting principle** provided for by Article 4(e) of the VBER: it must not **prevent** buyers or their customers from **effectively using the internet** to sell their goods or services

The Prevention of the Effective Use of the Internet (1)

- The block exemption does not apply to agreements that, directly or indirectly, have as their object the **prevention of the effective use of the internet** by the buyer or its customers to sell the contract products (Article 4(e) VBER)

- Preventing the effective use of the internet is a hardcore restriction "**as it restricts the territory into which or the customers to whom** the contract goods or services may be sold **within the meaning of points (b), (c) or (d)**" of the same Article
  - This raises the question of whether point (e) reflects prohibitions that are already inherent in other provisions of the same Article, and thus is ultimately **redundant**, or introduces **further cases** of hardcore restrictions
  - In practice, Article 4(e) of the VBER, read in conjunction with the Vertical Guidelines, allowed the Commission to **list a (significant) number of hardcore restrictions** specifically regarding online sales

The Prevention of the Effective Use of the Internet (2)

- In general terms, the Vertical Guidelines suggest that a restriction may **prevent the effective use of the internet** if it has the object of

  (i) significantly diminishing the **aggregate volume of online sales** of the contract products or the possibility for end users to buy them online

  (ii) preventing the use of **one or more entire online advertising channels** by the buyer, or

  (iii) preventing the buyer from establishing or using its **own online store**

The Prevention of the Effective Use of the Internet (3)

- The first case (significant decrease in the volume of online sales) may be difficult to assess. It may require an **analysis not only of the content** of the provision, **but also of its likely impact** on the market
  - **Difficult to reconcile with the function of blacklists**, which should clearly identify hardcore restrictions based on their content, without requiring in-depth analysis of their market impact

- The Vertical Guidelines **list a number of obligations** considered capable of preventing the effective use of the internet, such as, *inter alia*
  - requiring the buyer to **prevent** customers located in another territory from **viewing its website or online store** or to **re-route customers** to the online store of the manufacturer or another seller
  - requiring the buyer to **terminate consumers' online transactions** where their credit card data reveal an address that is not within the buyer's territory
  - requiring the buyer to sell the contract products only in a **physical space** or in the physical presence of **specialized personnel**
  - requiring the buyer to seek the supplier's **prior authorization** before making an online sale
  - **prohibiting** the buyer from **using the supplier's trademarks** on its website or online store

The Prevention of the Effective Use of the Internet (4)

- The second case (**ban on the use of an entire online advertising channel**, such as search engines or price comparison services) reflects certain UE and national precedents. However, it is **debatable** whether such restriction should be considered hardcore
  - Different online advertising channels may **compete and represent valid alternatives** for the promotion of certain products
  - In the offline world, suppliers may **limit the use of certain forms of advertising**, *e.g.* if they are not consistent with the characteristics, image and reputation of certain products

- On the other hand, the supplier can impose requirements relating to the manner in which the contract products are to be sold online, such as a **ban on the use of online marketplaces**, or **quality standards** for online sales
  - However, even in this case, the restrictions must not indirectly have the object of **preventing the effective use** of the internet by the buyer to sell the contract products to particular territories or customers

The Prevention of the Effective Use of the Internet (5)

- The Vertical Guidelines introduced a more flexible approach to **dual pricing schemes** (agreements requiring the buyer to pay different wholesale prices for products sold online and offline)
  - Dual pricing can **benefit from the block exemption** where the difference in the wholesale price is **reasonably related to differences in investments or costs** relating to online and offline sales
  - However, it is considered a **hardcore restriction** if the difference in wholesale prices has the object of **preventing the effective use of the internet** by the buyer, in particular by making online sales unprofitable or financially unsustainable, or by limiting the quantity of products available for online sales

- Even in this case, it may be necessary to carry out a more **in-depth assessment of the likely impact** of the clause, which seems to go beyond the analysis traditionally conducted under BERs

Concluding Remarks (1)

- The adaptation of the traditional principles on territorial and customer restrictions to on-line sales has resulted in a **limitation of the protection** that suppliers can grant to their distributors. The internet has
  - **blurred the boundaries** between active and passive sales, by eliminating or significantly reducing search costs, and facilitating active searches by customers
  - **reduced the need to actively target customers** to sell products in territories or to customers allocated to other dealers (even for a large portion of distributors' turnover)

- Is the distinction between active and passive sales **still meaningful in the online scenario**? Should we remove certain online restrictions from the list of hardcore restrictions, or at least admit the possibility of applying the *de minimis* rule?

Concluding Remarks (2)

- Certain provisions of the VBER seem to require an **assessment not only of the content** of the restriction, **but also of its likely impact**, which goes beyond the analysis traditionally conducted under BERs
  - Sort of **intermediate approach** between the individual assessment under Article 101 TFEU and the analysis traditionally carried out under BERs
  - In principle, a **trend toward more open standards**, rather than rigid rules and presumptions, should be considered a welcome development under Article 101 TFEU (see, *e.g.*, ECJ, C-211/22, *Super Bock*, stating that hardcore restrictions cannot be presumed to be restrictions by object)
  - However, this approach seems difficult to reconcile with the **(legal certainty) function** of BERs