

COSMETICS EUROPE, FEBEA AND COSMETICA ITALIA'S CONTRIBUTION ON THE DRAFT NEW SECTION OF THE VERTICAL GUIDELINES REGARDING EXCHANGES OF INFORMATION IN THE CONTEXT OF DUAL DISTRIBUTION

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On July 9th, 2020, the Commission published drafts of the revised Vertical Block Exemption Regulation (“**VBER**”) and Vertical Guidelines (“**VGL**”). One of the most questionable points of the draft VBER was the proposed new version of Article 2 on the conditions for benefiting from an exemption in the case of dual distribution scenarios and, more specifically, the issue of exchanges of information in dual distribution situations.

To address this item, the Commission organized a new stakeholders workshop and opened a specific consultation. The Commission also ordered a specific expert report on the matter (the “**Expert Report**”).

Based on these additional elements, the Commission published, on February 4th, 2022, a draft new section of the VGL which aims at providing guidance on the conditions of application of Article 2 (the “**Draft New Section**”) and opened the present consultation phase until February 18th.

As a preliminary remark, Cosmetics Europe, the Fédération des Entreprises de la Beauté (FEBEA) and Cosmetica Italia (“the **Cosmetic Industry**”) would like to welcome the different initiatives taken by the Commission to address the issue of exchanges of information in the context of dual distribution and would like to thank the Commission for paying thorough attention to the stakeholders' views, which are, for the most part, reflected in this Draft New Section.

Nonetheless, the Cosmetics Industry considers that the current version of the Draft New Section raises a certain number of questions that deserve to be substantiated and clarified to ensure the level of legal certainty required by the revision process. These issues of clarity mainly concern, on the one hand, the articulation between the Draft New Section and the VBER (1.) and, on the other hand, the specific provisions of the Draft New Section (2.).

1. Remarks on the articulation of the Draft New Section and Article 2 of the VBER

1.1 Paragraphs 6 to 9 of the Draft New Section and Article 2(4) of the draft VBER

Paragraphs 6 to 9 of the Draft New Section largely refer to Article 2(4)(a) and 2(4)(b) of the draft VBER and do not refer to the 10% retail level market share threshold initially provided in the draft VBER, meaning that such exemption mechanism no longer applies.

If the removal of such market share threshold - which was qualified as irrelevant by the conclusions of the Expert Report¹ - appears, at a first glance, as leading to a simplification of the exemption mechanism for stakeholders, the Cosmetics Industry regrets that the Commission did not use the consultation as an opportunity to submit to comments an updated version of Article 2 of the VBER.

Stakeholders cannot fully appreciate the scope and implications of the Draft New Section without precisely knowing the content of the legal text it intends to apply to. In the present case, the Cosmetics Industry can only assume that the 10% market share threshold has been removed, without however being certain of this and without knowing what the modified rule entails.

This situation necessarily creates considerable legal uncertainty for stakeholders regarding one of the most important and questionable points addressed in the new VBER and VGL, which impacts virtually all vertical relationships.

2. Paragraphs 9 and 10 of the Draft New Section and Article 2(5) VBER

Paragraph 9 of the Draft New Section provides that, if the conditions of Articles 2(4) are fulfilled, the block exemption will apply to all aspects of the vertical agreement, including exchanges of information that is “*necessary to improve the production or distribution of the contract goods or services by the parties*”.

Conversely, paragraph 10 specifies that the latest version of Article 2(5) of the VBER will provide that exchanges of information in a dual distribution scenario shall not benefit from the block exemption “*where the information exchange is not necessary to improve the production or distribution of the contract goods or services by the parties*”².

These two paragraphs are difficult to reconcile, because it seems that they do not impose the same burden of proof. By reading Paragraph 9, it seems that exchanges of information can only be exempted if the information is proven to be necessary (*i.e.* no automatic exemption). However, Paragraph 10 seems to indicate that exchanges of information will generally benefit from the exemption **unless** it is proven that they are in fact not necessary.

The Cosmetics Industry believes that it should be clarified in Paragraph 9 that, under the Regulation, provided that the conditions of Article 2(4) are fulfilled, exchanges of information will automatically benefit from the exemption **unless** it is proven that they do not comply with Article 2(5) VBER.

A proposal for drafting is provided in **Appendix 1**.

¹ Expert Report, page 47: “*The authors of this Expert Report therefore believe that an additional market share threshold in the VBER for information exchange in dual distribution scenarios would not help to distinguish such situations from pro-competitive practices and/or conduct.*”

² The initial version of Article 2(5) proposed in the draft VBER published in July stated that “*If the competing supplier and buyer referred to in Article 2(4)(a) or (b) have an aggregate market share that exceeds [10]% in the relevant market at retail level but that does not exceed the market share thresholds of Article 3, the exemption provided for in paragraph 1 shall apply, except for any exchange of information between the parties, which has to be assessed under the rules applicable to horizontal agreements*”

In addition, the “test” applied to verify if an exchange of information in a dual distribution scenario should benefit from the exemption is therefore whether the information is “necessary” to improve the production or distribution of the contract goods or services.

The Cosmetics Industry finds such a test to be unrealistically severe. The expression “necessary to improve the production or distribution of the contract goods or services” and especially the use of the word “necessary” appears to be excessively broad insofar as it could lead to removing the exemption for exchanges of information which, although they are not strictly “necessary” to improve the production or distribution of products, do not raise any issue in terms of competition law.

The Cosmetics Industry considers that the exchanges of such information, which are not likely to raise a competition concern, should not be excluded from the exemption just because there are not “strictly necessary”. Practically speaking, the “necessity test” may be uncertain and be subject to divergent approaches from NCAs. As a consequence, for stakeholders to benefit from a sufficient level of legal certainty, the benefit of the block exemption should only be removed for information exchanges that may hurt competition, *i.e.* exchanges of so-called “disproportionate information”, defined in the Expert Report as information that “*goes beyond the level of Information required for the procompetitive elements of a vertical agreement*”³.

The Cosmetics Industry thus provides an alternative wording in **Appendix 1** of this contribution.

3. Remarks on the Draft New Section

The Cosmetics Industry welcomes the initiative of the Commission to clarify, in paragraphs 13 and 14, the types of information that shall generally be considered as appropriate or inappropriate to exchange in dual distribution situations, by providing non-exhaustive lists of such information.

Nevertheless, the Cosmetics Industry regrets the lack of clarity of certain elements presented in these paragraphs, which calls for the following comments.

3.1 Articulation between paragraphs 12, 13 and 14

Paragraph 12 makes a general point that the specific characteristics of each distribution system should be taken into consideration when assessing the “necessity” of information exchanges. Within selective distribution systems, it notes that: “*it may be necessary for suppliers to obtain information from distributors relating to their compliance with the selection criteria*”.

This clarification is welcomed by the Cosmetics Industry.

Nonetheless, it believes that the Draft New Section should go one step further by actually including the examples provided in Paragraph 12 within the “white” list provided in Paragraph 13.

³ Expert Report, page 50

Regarding selective distribution more specifically, the Expert Report notes that suppliers are required “(i) *to verify the compliance of its distributors with the qualitative and/or quantitative selection criteria and (ii) to prevent distributors from selling outside of the system*” and that “**Information Exchange in a selective distribution system is to a large extent driven by these inherent elements of the distribution format**”.

For these reasons, the Cosmetics Industry considers that additional illustrations specific to selective distribution should be included in Paragraph 13 regarding information relevant for the supplier of a selective distribution system to verify that its distributors/retailers comply with the quantitative and/or qualitative selection criteria as well as any other contractual obligations of the selective distribution agreement, including and especially the obligation not to sell the contract goods or services to unauthorized distributors outside the selective distribution network, which is key for preserving the integrity of such a system.

The Cosmetics Industry e provides a suggestion of wording in **Appendix 1**.

3.2 Paragraph 14 (b)

Paragraph 14(b) of the Draft New Section targets “customer-specific data” and “information that identifies particular customers”. According to this paragraph, such type of information is generally considered as not necessary for the vertical relationship and, as such, the communication of such information would generally not benefit from the exemption.

Despite the importance of this paragraph, the central notion of “customer” is nowhere defined in the VBER nor the VGL. Yet, understanding what this notion covers is **fundamental** for the sake of clarity and ultimately for legal certainty because customer-specific data are central to any vertical relationship.

The notion of “customer” can cover not only end-customers purchasing goods for their own use but also operators who purchase goods to resell them (e.g. retailers or distributors acting as customers of wholesalers or importers).

If the notion of “customer” in Paragraph 14(b) also targets retailers/distributors as customers of wholesalers/importers, thus covering “B2B dual distribution” situations⁴, Paragraph 14(b) would have a **seriously harmful** impact on all vertical business models.

In this case, Paragraph 14(b) would indeed have the effect of preventing suppliers in B2B dual distribution situations from obtaining retailer-specific data or information which allows them to identify their wholesaler/importers’ clients, even when such “customers” are in fact retailers which purchase and resell the suppliers’ own branded goods.

In other words, Paragraph 14(b) would virtually mean that suppliers which resort to intermediaries for at least a part of their sales would be prevented from obtaining information on **their own distribution networks**.

Such a restrictive approach would be incredibly harmful to all vertical relationships.

⁴ i.e. where a supplier sells its goods/services through wholesalers and directly to some retailers

It would also have specifically harmful consequences for selective or exclusive distribution systems which require control from suppliers on the compliance of authorized members of their network with their quantitative and qualitative criteria.

In this regard, the Cosmetics Industry does not understand why the Commission would adopt such a restrictive approach: distributors/retailer-specific data are without a doubt at the core of the business model of any vertical relationship and are vital to improving the production or distribution of the contract goods or services (e.g. return on investments on media campaigns, reporting on allocation at the retail level of advertising budget allocated to the wholesaler by the supplier, inventory management, etc.).

In this regard, the main issue which was brought up on this topic concerns a purported risk that suppliers collecting information from their retailers could use this information to favor their own D2C sales, to the detriment of retailers. Yet, such hypothetical abusive use of information does not relate to the type of information that is usually communicated by the retailers to suppliers on a consensual basis, but to the use that is made of such information to the detriment of retailers. This would in any case not constitute a collusion issue but rather a risk of abuse or unfair competition. This topic is already apprehended by the ongoing Data Act consultation and the VBER is not appropriate to deal with such an issue.

If such exchanges of information were deemed to be generally anti-competitive, as suggested in Paragraph 14(b), suppliers would have no choice but to change their business models completely to avoid any situation of dual distribution. This would, in the end, have the effect of eliminating dual distribution and intra-brand competition altogether, which would seriously harm competition.

The Cosmetics Industry, therefore, recommends deleting Paragraph 14(b) from the New Section.

Should the Commission not be inclined to remove this paragraph, the Cosmetics Industry believes that it is essential to clarify in the Draft New Section that the word “customer” only covers **end customers** who purchase the products for their own use but does not cover operators which purchase the products in order to resell them (e.g. retailers or distributors acting as customers of wholesalers or importers).

This being clarified and assuming Article 14(b) only intends to target end-customers, the Cosmetics Industry notes that the exceptions listed in Paragraph 14(b) call for some clarifications in order to be suited to business constraints and dynamics. The Cosmetics Industry thus proposes a suggestion of modification in **Appendix 1**.