



**EUROPEAN COMMISSION CONSULTATION ON THE DRAFT REVISED REGULATION ON
VERTICAL AGREEMENTS AND VERTICAL GUIDELINES**

HERBERT SMITH FREEHILLS LLP RESPONSE

1. INTRODUCTION

- 1.1 Herbert Smith Freehills LLP welcomes the opportunity to provide comments to the European Commission in relation to its consultation on the draft revised Regulation on vertical agreements (draft VBER) and the draft vertical guidelines. The comments set out below are those of Herbert Smith Freehills LLP and do not represent the views of our individual clients.
- 1.2 We support the Commission's objectives of the review, in particular those to readjust the safe harbour of the VBER in order to eliminate false negatives, to provide updated guidance which takes into account developments in e-commerce and to simplify complex areas of the current rules in order to reduce compliance costs for businesses.
- 1.3 In some respects we believe that the draft VBER and the draft vertical guidelines achieve these objectives. We do however have concerns that some of the proposed changes also create some uncertainty, requiring the parties to make difficult assessments. The purpose of block exemption Regulations is to provide clarity and bright-line exemptions, without the need for further assessment by the parties. The additional risk and burden this creates for the parties may ultimately prevent them from entering into what are otherwise efficiency inducing agreements.
- 1.4 We have set out our comments relating to each of the key areas covered in the draft VBER and draft vertical guidelines. We have also flagged some further topics covered in the draft vertical guidelines where we consider that more detailed guidance would be helpful.

2. DUAL DISTRIBUTION

- 2.1 The draft VBER proposes both an extension and a reduction of the safe harbour under the block exemption. We welcome the extension of the safe harbour to wholesalers and importers active in the downstream market (Article 2(4)(a) draft VBER). These relationships have the same characteristics as dual distribution by a supplier and should not be treated differently.
- 2.2 We regret the inclusion of the additional 10% threshold under Article 2(4)(a) and (b) draft VBER which will cause significant complexity and uncertainty, as a result of which the VBER will no longer provide a clear safe harbour below the 30% threshold. The Commission's De Minimis Notice already provides comfort for horizontal aspects of



agreements below the 10% threshold and the draft VBER therefore does not add any further safe harbour.

- 2.3 Where parties exceed the new 10% threshold difficult issues will arise on permitted information exchanges relating to resale pricing and other sales information which can be reported back to the supplier, and the need for information barriers within vertically integrated businesses. This can create a significant burden on businesses as such requirements can be costly and complex, and may act as a disincentive for suppliers to supply directly to consumers, thereby depriving consumers of an extra sales channel.
- 2.4 If businesses will be left to self-assess the issue of information exchange, the Commission should provide additional guidance on information exchange in the context of dual distribution. Such guidance will need to recognise that the exchange of certain information between a supplier and its distributors is essential in order to operate an effective distribution system. The Commission has indicated that it intends to include further guidance on information exchange in the context of dual distribution in its revised guidance on horizontal cooperation agreements. In our view this should also be addressed in the vertical guidelines. One of the stated aims of the revised VBER and guidelines is a simplification and streamlining of the rules, and this will not be achieved where there is a need to cross refer to a different set of guidelines on such a crucial issue.
- 2.5 It would also be helpful if the Commission would provide more detailed guidance on horizontal concerns above the 30% market share. Such guidance should recognise that coordination on conduct or pricing are harder to achieve where online markets are very competitive and price information is available to consumers.
- 2.6 Under article 2(7) draft VBER the dual distribution exemption will not apply to dual distribution by providers of online intermediation services with a hybrid function (selling goods or services in competition with undertakings to which they provide online intermediation services). Any arrangement between an online intermediary active at retail level and a retailer will therefore have to be assessed as a horizontal agreement. The draft VBER introduces a blanket exclusion for all hybrid providers of online intermediation services regardless of size, which is very broad and will disadvantage smaller providers which may otherwise have a pro-competitive impact on the market.
- 2.7 Finally, we would also welcome some guidance on agency issues under dual distribution, where a supplier uses agents who also act as distributors (dual role agents). As a minimum we would expect the Commission to integrate the conclusions of its working



paper on 'Distributors that also act as agents for certain products for the same supplier' in the vertical guidelines.

3. **ACTIVE SALES RESTRICTIONS**

- 3.1 Under the current regime there are very few exceptions under which active sales restrictions are permitted. The rules are complex and limit suppliers in designing distribution systems according to their business needs. We welcome the Commission's approach to increase flexibility but in our view the Commission could go further.
- 3.2 Shared exclusivity is now permitted (Article 4(b) draft VBER), allowing a supplier to appoint more than one exclusive distributor for a particular territory or customer group. This provides added flexibility for suppliers. The draft vertical guidelines (para 102) however specify that the number of exclusive distributors should be limited, and 'should be determined in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts'. This requirement is vague and we believe that there needs to be greater flexibility for the supplier to determine the appropriate number. It raises difficult issues for the supplier as it involves a forecast under dynamic market conditions. It is unclear what the appropriate relevant timeframe should be for this analysis: does the volume of business need to be sufficient for each distributor at the start of the agreement or can the supplier assume that sales will increase and that the generated business will end up being sufficient. If so, what is the relevant timeframe? If the Commission decides to uphold this requirement it should include more detailed guidance on these issues in its vertical guidelines.
- 3.3 Also, active or passive sales between the shared exclusivity distributors cannot be restricted (para 103 draft vertical guidelines). Given that shared exclusive distributors will compete with each other, there should therefore be no real concern over the number of shared exclusive distributors.
- 3.4 We welcome the revised approach under the new regime which now provides greater scope for flexibility in designing distribution systems, in particular the possibility to combine exclusive and selective distribution systems, but not for the same territory. In our view this should go further and it should be possible for a supplier to combine both regimes in the same territory. This approach is currently proposed by the CMA in its draft Vertical Agreements Block Exemption Order.

4. **TREATMENT OF ONLINE INTERMEDIATION SERVICES**

- 4.1 An undertaking that provides online intermediation services, irrespective of whether it is a party to the transaction it facilitates, is now defined as a supplier. The seller who uses the



platform is defined as a 'buyer' of the intermediation services. The platform is said to be independent, as opposed to being an agent of the 'buyer'.

- 4.2 It is helpful that the Commission has attempted to provide clarity by providing definitions of supplier and buyer. However these markets are complex and the definitions can be counter-intuitive. Online intermediation services providers captures a large number of undertakings with very different business models which do not necessarily fit within the definitions of "supplier". This catch-all definition may have unintended or adverse consequences for providers of online intermediation services and their customers, including consumers using these intermediation services.
- 4.3 Paragraph 179 of the draft vertical guidelines indicates that the online service provider is treated as a supplier with regard to the actual products. Paragraph 63 of the draft vertical guidelines however refers to the online service provider as a supplier in relation to the online intermediation services provided. This is an inconsistency that requires further clarification. In addition, it is not clear which market will be relevant in order to calculate the 30% market share threshold. Is the relevant market here the market for online intermediation services or is it the actual product market? On the whole the concept and status of online intermediation services are confusing and require greater clarification in a more detailed stand-alone section of the vertical guidelines.

5. **RESALE PRICE MAINTENANCE**

- 5.1 The Commission is not prepared to abandon its strict and formal approach to RPM which remains a hardcore restriction. Clarification on so-called 'fulfilment contracts' (recognising that the fixing of the resale price between a supplier and a buyer that executes a prior agreement between supplier and a specific end-user does not constitute RPM where the end-user has waived its right to choose the undertaking that should execute the agreement) is welcome. However, the requirement that the end-user has waived its right may raise a number of practical issues if it is not clarified in the final version of the guidelines. To cite a few: What form should this waiver take? Should it be included in the sales agreement or be a separate document? Does it need to include certain mandatory provisions to be valid?
- 5.2 The draft guidelines unfortunately do also not expand on the potential efficiencies of RPM but simply reproduce the current guidelines, which is disappointing and can be expected to deter businesses from engaging in potentially efficiency enhancing RPM.
- 5.3 As RPM is listed as a hardcore restriction, businesses will require a greater degree of certainty on the circumstances under which RPM would be permitted. As a minimum guidance on these examples should be expanded. For example a short-term low price campaign is described as being of two to six weeks in most cases. There is no further



guidance as to what would justify a longer period, such as seasonality of the product, or purchasing cycles.

6. **ONLINE SALES RESTRICTIONS**

- 6.1 The more relaxed treatment of online sales restrictions and recognition by the Commission that online sales have now developed into a well-functioning sales channel and therefore no longer require special protection are helpful. We welcome in particular the permissive approach to dual pricing and the removal of the equivalence principle for selective distribution as a hardcore restriction.
- 6.2 On dual pricing the draft guidelines note that differences in wholesale prices will be justified when this is intended to incentivise or reward the appropriate level of investments respectively made online and offline, and relates to the costs incurred for each channel, provided it does not make selling online unprofitable or financially not sustainable (draft guidelines paragraph 195). It will not always be easy for suppliers to determine where to draw the line between permitted dual pricing and an illegal online sales ban on that basis, which unfortunately reduces the benefit of the permissive approach to dual pricing.
- 6.3 The draft vertical guidelines contain more detailed guidance on a range of online sales restrictions and what is/is not permitted which is helpful. In our view however the approach to online/bricks and mortar is still skewed in favour of online. This is unnecessary, in particular in light of the impact of Covid-19 on the demise of bricks and mortar stores and the Commission should consider whether this can be recalibrated.
- 6.4 Under Article 1(1)(n) draft VBER and paragraph 188 of the draft guidelines, a restriction that directly or indirectly has as its object to prevent the buyers or their customers from effectively using the internet for selling their goods or services online or from effectively using one or more online advertising channels qualifies as a hardcore restriction. The key question will therefore be what "effectively using the internet" for selling or advertising exactly means and despite the additional guidance this may not always be clear. In addition, paragraph 188 also refers to measures that are "capable of significantly diminishing the overall amount of online sales", which requires a more effects based analysis and should therefore not automatically be treated as a by object restriction.

7. **MFNS**

- 7.1 Narrow and all wholesale MFNs remain block exempt which is welcome as it important to recognise (in line with the Commission's assessment) that these clauses generate efficiencies. Wide retail MFNs are now added as a new type of excluded restriction under



Article 5 draft VBER. Compared to the CMA's approach which proposes to make all wide MFNs a hardcore restriction the Commission's approach is welcome.

- 7.2 There is guidance on how to assess the effects of wide MFNs and how to assess MFNs that fall outside the block exemption (paragraphs 333 – 353 draft guidelines). In particular, it would be helpful to have more detailed guidance on the circumstances in which wholesale MFNs may raise competition concerns. As the Commission acknowledges, the guidance provided for the assessment of retail MFNs is less likely to be relevant but there has nonetheless been enforcement activity in this space (e.g. the 2017 Amazon e-books decision).

8. TOPICS REQUIRING FURTHER GUIDANCE

- 8.1 The following topics covered in the draft vertical guidelines would in our view benefit from further guidance.

8.1.1 Restrictions on sales inside/outside the EU

Article 4 draft VBER only applies to agreements concerning trade within the EU and such restrictions can therefore not qualify as by object restrictions. As with the current vertical guidelines, the draft vertical guidelines refer to *Javico v Yves Saint Laurent* (footnote 69). It is often the case that suppliers allocate exclusive territories to distributors outside of the EU and wish to impose restrictions on those distributors from selling outside those territories into territories reserved to another distributor, and we would welcome the Commission taking the opportunity to clarify how it would apply the principles in *Javico* to such an arrangement. This issue has become more relevant as a result of Brexit, which has resulted in an increase in trade outside the EU and many EU suppliers setting up distribution agreements for the EU and for the UK. More detailed guidance on how the Commission will assess restrictions on sales outside the EU will therefore be welcome. The CMA is proposing to adopt its own guidance on sales restrictions into and out of the UK.

8.1.2 Guidance on Upfront access payment

There is no change in the draft vertical guidelines from the current version. In our view the revised guidelines should reflect the Commission's experience over the last 11 years. It would be helpful to have more guidance on the factors that might help distinguish when up-front access payments could facilitate collusion and when they have beneficial effects.

8.1.3 Category management agreements

Again, the draft vertical guidelines are not really different from the current guidelines. It would be helpful to have more guidance on the issue of information



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exchange between suppliers via retailers, if not in the vertical guidelines at least in the revised horizontal guidelines.

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