RESPONSE OF CLIFFORD CHANCE LLP TO THE EUROPEAN COMMISSION'S PUBLIC CONSULTATION ON THE DRAFT REVISED REGULATION ON VERTICAL AGREEMENTS AND VERTICAL GUIDELINES

Clifford Chance welcomes the opportunity to respond to the consultation of the European Commission (**Commission**) on the draft revised regulation on vertical agreements (**Draft VBER**) and vertical guidelines (**Draft Guidelines**). Our observations below are based on the substantial experience of our antitrust lawyers of advising on vertical agreements under EU competition law, and in a large number of other jurisdictions. However, the comments in this response do not necessarily represent the views of every Clifford Chance lawyer, nor do they purport to represent the views of our clients.

1. AGENCY

Temporary ownership

1.1 We welcome the new guidance in paragraph 31(a) of the Draft Guidelines that "*[t]he fact that the agent may temporarily, for a very brief period of time, acquire the property of the contract goods while selling them on behalf of the principal does not preclude an agency agreement, provided the agent does not incur any costs or risks related to that transfer of property"*. We suggest clarifying that the "very brief" period should be assessed by reference to standard industry practice for the sector in question and, in particular, the typical period for which stocks are held by a distributor before being sold. The Draft Guidelines will otherwise create uncertainty as to whether agreements between principals and intermediaries, which might involve temporary transfers of ownership to the intermediary in fulfilling or negotiating contracts on behalf of the principal (but which otherwise satisfy the agency criteria set out in the Draft Guidelines), can qualify as agency agreements for the purposes of the Draft Guidelines.

Dual distributor / agency role

1.2 We consider that the approach to assessing agency in cases where the agent also acts as a distributor for other products of the principal, as set out in paragraphs 35-38 of the Draft Guidelines, is unnecessarily complex and is likely to make the implementation of such dual agency / distributor systems unviable in most cases. Even if a supplier were prepared to carry out the complex assessment of which costs are specific to the distribution of the agency products, coverage of those costs will effectively create an ex-post imbalance in the pre-existing distribution arrangements (in relation to the non-agency products) that have previously been entered into between the supplier and the agent/distributor.

1.3 For instance, if a supplier enters into a distribution agreement for the sales of Product A, it will be for the distributor to cover market-specific costs relating to those products out of its sales margins. If a supplier subsequently enters into an agency agreement with the same party for the sale of Product B, which is in the same product market as Product A, many of those costs would, under the approach set out in the Draft Guidelines, now have to be covered by the supplier. Consequently, the supplier must either renegotiate the terms and pricing under the previous distribution arrangement (which may not be possible), or face being party to a distribution arrangement that no

longer reflects the commercial balance of risk and reward between itself and the distributor. The greater the proportion of products sold under the distribution arrangement, the greater this imbalance will be. In our view, this, in conjunction with the complexity and uncertainty associated with calculating the relevant costs, is likely to make the use of dual agent/distributor models unworkable in practice.

1.4 In our view, a preferable approach would be to assess such arrangements as analogous to those where a party acts as agent for multiple different suppliers. For instance, if a party acts as agent for two different suppliers, with respective Products A and B that are both in the same product market, it cannot be the case that both suppliers must cover 100% of the agent's relevant market-specific investments, as in that case the agent would be compensated twice for the same costs. Instead, the suppliers will each assume a share of those costs, likely as a proportion of the agent's total sales in the market that are accounted for by their products (this point is not covered in the Draft Guidelines, but we consider that it should be). This same proportionate allocation of costs should be applied in dual agency/distributorship systems (i.e. with the principal covering an appropriate proportion of market-specific costs that are common to other products of the supplier). Otherwise, distributors that accept an agency role in respect of some products will be placed at a competitive disadvantage (because significantly more costly for suppliers) to agents that act as agents for multiple suppliers.

Online intermediaries and agency

1.5 Paragraph 44 of the Draft Guidelines states that online intermediaries "*are categorised as suppliers under the VBER […] and can therefore in principle not qualify as agents for the purpose of applying Article 101(1)*."

1.6 While this clarifies that, online intermediaries, when acting as such, are not acting as agents, it could also be interpreted as implying that providers of online intermediation services can never act as agents, even when they act in other roles that do not "*allow business users to offer goods or services to consumers, with a view to facilitating the initiating of direct transactions between those business users and consumers*" (as per the definition of online intermediation services in Article 1(d) of the Draft VBER). For instance, a provider of online intermediary services may use the same online platform to both provide online intermediation services to third party resellers, and also to sell other products on an agency basis with no "direct transaction" between the principal and consumer. We consider that the Draft Guidelines should clarify that an online intermediary may act as an agent in respect of other products for which it does not facilitate direct transactions.

Advertising costs

1.7 Paragraph 38, states that investments in "*advertising for the agent's shop as such (instead of advertising specific to* [the product to be sold under the agency]*)*" would be "*partly relevant for the assessment of the agency agreement to the extent they relate to the sale of product A*". This appears to be inconsistent with the statement in paragraph 31(g) of the Draft Guidelines that advertising costs do not need to be covered by the principal unless they are "*specific to the contract goods or services*".

2. DUAL DISTRIBUTION

Imposition of a market share threshold for information exchanges

2.1 As we indicated in our response to the initial VBER consultation, we consider that it is inconsistent with commercial reality to expect a supplier to compete with its distributor in the same way as distributors compete with each other, as suppliers do not have incentives to engage in fierce competition with their own distributors. Their relationship is fundamentally that of business partners, not rivals. Consequently, we consider that the proposal to remove information exchanges between suppliers and their distributors (in a dual distribution model) from the scope of the VBER is unlikely to have any significant beneficial impact in terms of stimulating greater intra-brand competition. In this respect, we disagree with the Commission's assertion that "*the effects that dual distribution agreements have on the market and the possible competition concerns can be similar to horizontal agreements*", and note that it is not supported by any evidence, examples, published decisions or case law. The fact that increased e-commerce means that dual distribution is more prevalent does not alter the fundamental point, as expressed in the current vertical guidelines, that "*in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing or retail level*".

2.2 It contrast, requiring information exchanges to be subject to individual assessment is likely to have very significant detrimental effects:

2.2.1 The natural tendency of businesses towards cautious over-compliance is likely to mean that they abstain from information exchanges that have significant benefits for the efficiency of the distribution system. For instance, sales forecasts and information on distributors' planned promotional activities can substantially improve the supplier's efficient management of its production schedules and stocking, as well as enhance its understanding of (and therefore responsiveness to) consumer demand. Suppliers that conclude that they are unable to receive this information are likely to find themselves at a disadvantage to those of their rivals that do not pursue dual distribution strategies. We note, in this respect, that the Draft Guidelines do not seek to offer any new guidance on the types of information exchange which may be problematic when implemented by competitors that are not in a vertical relationship, but which may be justified by the distributional efficiencies that they generate in a dual distribution system. While we understand that the Commission intends to include such guidance in the forthcoming revision of the Horizontal Guidelines, we consider that it would be more appropriate to include guidance on information exchanges in the context of distribution arrangements in the Vertical Guidelines.

2.2.2 Where a distributor has a share of over 10% of the retail market, even the smallest suppliers will become subject to requirements to assess the compliance of their information exchanges with the distributor. The associated compliance costs are likely to be disproportionate. For instance, where, as is often the case, a supplier has one account manager for a particular product (responsible for both direct sales and sales to distributors), it cannot implement an information barrier between its direct sales function and its wholesale sales function, so must choose

to either split them between different employees, or forego the receipt of information that enhances its supply-chain efficiencies; options that both create disproportionate costs.

2.2.3 Even for larger suppliers, a requirement to implement firewalls would create considerable inefficiencies, as they would be required to split out functions that are currently tightly integrated and would be unable to assess and use information across all their sales channels in a holistic and coherent way.

2.2.4 Already under the current VBER, parties are required to apply different approaches where a party exceeds one of the 30% VBER thresholds, and may even need to have different agreements between the same parties where the thresholds are exceed for some of the contract products, but not for others. Introducing an additional 10% threshold would considerably exacerbate this complexity and make it excessively difficult to maintain and operate a coherent overall distribution system.

2.3 These detrimental effects are likely, in our view, to deter many suppliers from engaging in direct supply, even when dual distribution is their favoured distribution model due to the very significant benefits that it can have in terms of brand development, meeting consumer demand and reaching different categories of consumers.

2.4 Consequently, we favour retaining the benefit of the VBER for information exchanges within dual distribution arrangements, combined with better guidance within the Guidelines on the types of information exchange that are not (even under the present VBER) covered, such as disclosures by a retailer of information relating to the products of competing suppliers, or disclosures by a supplier of information relating to its sales to other distributors, both of which are unrelated to the vertical agreement between the parties, and therefore would not be covered by the VBER in any event. If the Commission decides to retain the approach set out in the draft VBER, we submit that the relevant threshold should be set at 20%, not 10%, reflecting the fact competition between a supplier and its distributor cannot be equated to the competition between "full" competitors that is addressed by the Commission's *De Minimis* Notice.

2.5 As a separate point, Articles 2(4)(a) and 2(5) of the Draft VBER applies a market share threshold "at the retail level". It is unclear how this applies where neither party is active on the retail market (e.g. the supplier is a manufacturer and the distributor is a wholesaler). In particular, does it mean that: (i) the exemption in Article 2(4)(b) is applicable; or (ii) the parties must assess whether sales of the contract products that are made by third party downstream retailers account for more than 10% of the retail market?

<u>"Hybrid" online intermediaries that also sell products or services on their own behalf</u>

2.6 Paragraph 91 of the Draft Guidelines states that "*[a]s the retail activities of suppliers of online intermediation services that have such a hybrid function typically raise non-negligible horizontal concerns, they do not fulfil the rationale of the dual distribution exception , which in any case must be interpreted narrowly. For the same reason, any restriction regarding the extent to which or the conditions under which online intermediation services can be provided to third parties shall not be covered by the VBER. This does not only apply to restrictions that are stipulated in an agreement with*

a buyer of online intermediation services, but also to agreements regarding the purchase of the goods or services sold by the provider of online intermediation services that has a hybrid function."

2.7 This last sentence could be interpreted either as (i) applying only to the preceding sentence (i.e. that the VBER does not cover restrictions relating to the supply of online intermediations services to third parties, even if included in an agreement for the resale of products by the hybrid online intermediation service provider (**HOISP**); or (ii) as stating that all agreements entered into by HOISPs are excluded from the VBER, both when acting as a marketplace (service provider to sellers) and when acting as a retail business.

2.8 If the latter interpretation is intended by the Commission, our view is that this position goes too far, and will have detrimental effects on suppliers that sell their products to hybrid online intermediaries. As the VBER will no longer cover HOISPs' agreements to provide intermediation services, we consider there to be no grounds to also remove HOISPs' retail activities from the VBER in order to address potential horizontal inter-brand competition concerns.[1] Doing so would be both:

2.8.1 be unjustified, because any potential horizontal inter-brand competition issues that arise would be addressed by the individual assessment of the vertical agreements relating to the intermediation side of the business that would be required under the Draft VBER, and would necessarily need to take into account the HOISP's competing activities at the retail level. If those potential concerns are addressed, there are no grounds to treat HOISPs differently to other online or offline retailers; and

2.8.2 have disproportionate detrimental effects on both suppliers and HOISPs. Even the smallest suppliers would be required to incur the compliance costs of individually assessing their distribution agreements with HOISPs and potentially altering them, e.g. to eliminate any quantitative selective distribution, and applying those changes to all other authorised distributors in a non-discriminatory way, in order to comply with the *Metro* criteria. There are very large number of small suppliers that sell products through HOISPs in the EU. In addition, even the smallest of HOISPs would find themselves at a disadvantage to competing online retailers that do not provide intermediation services.

2.9 Consequently, we submit that the Draft VBER and paragraph 91 of the Draft Guidelines should be amended to clarify that (i) it is only vertical agreements concerning the online intermediation services of an HOISP that are excluded, not those relating to their retail activities; and that (ii) as an exception to this, vertical agreements entered into by HOISPs' retail functions are not covered by the VBER if they contain restrictions relating to the supply of online intermediations services to third parties.

[1] Recital 12 of the Draft VBER indicates that the Commission considers that "*the retail activities of providers of online intermediation services that have such a hybrid function typically affect inter-brand competition*".

3. EXCLUSIVE DISTRIBUTION

3.1 We have four comments on the proposed changes in respect of exclusive distribution.

3.2 First, the Draft VBER (Article 1(g)) would allow suppliers to appoint more than one exclusive distributor for a given territory or customer group, provided the number of distributors is determined "in such a way as to secure a certain volume of business that preserves their investment efforts". Given that suppliers will be imposing a hardcore restriction (which the Commission equates to an object infringement) if they determine this number incorrectly, we consider that the guidance should include an illustrative example of such a determination. This should address a scenario in which future sales volumes are particularly uncertain (e.g. because the supplier's products are not yet distributed in the territory in question).

3.3 Second, the Draft Guidelines (paragraph 222) reiterate that exclusive distribution and selective distribution cannot be combined in the same territory, as this would lead to a "restriction of active or passive sales to end users by authorised distributors" in breach of Article 4(c)(i) of the Draft VBER. In order to eliminate any residual doubt over this point, we suggest that it should be explicitly stated that it is not, therefore, possible to combine exclusive distribution at the wholesale level with selective distribution at the downstream/retail level.

3.4 Third, while it is implicit in the drafting of Article 1(b)(i) of the Draft VBER, we consider that the Draft Guidelines should explicitly confirm that "a party that was given distribution rights by the supplier" should be understood as including the exclusive distributor itself (even if that distributor had not, at the time of the agreement, previously been given distribution rights by the supplier).

3.5 Finally, we welcome the following clarifications, as previous uncertainty on these points has led to multiple diverging interpretations of the applicable requirements:

3.5.1 paragraph 105 of the Draft Guidelines that suppliers do not need to be economically active in territories or customer groups that they reserve to themselves; and

3.5.2 that participation in a public tender is considered to be a form of passive selling.

4. RESALE PRICE MAINTENANCE (RPM)

Fulfilment contracts

4.1 We welcome the clarification that the setting of a price in a fulfilment contract is not RPM. Our experience is that fulfilment contracts are clearly beneficial, as they allow buyers to negotiate better prices from an upstream supplier than would otherwise be available from distributors. Moreover, we are aware of a number of suppliers that are already relying on this interpretation of the law despite it being unclear in the current guidelines.

Maximum resale prices

4.2 The Revised Guidelines repeat the statements in the existing guidelines about the risk that a maximum resale price obligation "*leads to a more or less uniform application of*

that price level by the resellers, because they may use it as a focal point." However, price caps tend to be used where demand for the supplier's products is high, such that distributors have incentives to charge excessive prices (which would damage the supplier's brand), and in those circumstances it is natural that a price cap leads to uniform retail prices: no retailer has an incentive to offer a lower price as they know they will sell all their stock at the capped price. The guidelines should recognise that this is not indicative of competition concerns, even if the supplier has a high market share.

Minimum advertised price (MAP) obligations

4.3 Paragraph 174 of the Draft Guidelines states that MAP requirements "*may also amount to RPM for instance in cases where the supplier sanctions retailers for ultimately selling below the respective MAPs, require them not to offer discounts or prevent them from communicating that the final price could differ from the respective MAP*".

4.4 While we welcome this softening of the Commission's previously-stated position,[2] we consider that the statement ought to be made less ambiguous. In particular, it should clarify that MAP policies do not, on their own and in the absence of other factors, amount to RPM, and that this will be the case, in particular, if distributors are not subject to any threats or sanctions for selling below the MAP, are not prevented from offering discounts and are free to communicate that the final price may differ from the MAP.

RPM satisfying the Article 101(3) conditions

4.5 We suggest that the Commission includes an illustrative example of a case in which an RPM agreement is "necessary in order to overcome free riding between retailers", as per paragraph 182(c) of the Draft Guidelines. This could usefully set out an indicative scenario in which the Commission might accept that it is not possible for the supplier to impose effective promotion or service requirements on all buyers (as per paragraph 14(b) of the Draft Guidelines. This scenario could be based on the facts of the *Tooltechnics* decision of the Australian Competition and Consumer Commission.[3]

4.6 As a linked point, we question the continued reference to "high value products" as a an important factor to the assessment whether free riding is a legitimate concern. This appears to be based on paragraph 107 of the existing Guidelines, which states that "*the product must be of a reasonably high value as it is otherwise not attractive for a customer to go to one shop for information and to another to buy*." However, with the growth of online sales channels and smart phones this is no longer the case – even for relatively low value products consumers can, and frequently do, use the internet to

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[2] The Commission has previously stated that "*a]dvertising is an important element of the competitive process as it increases the information available for consumers. Retailers will frequently have no incentive to deviate from the minimum advertised price. Therefore, MAPs will likely amount to a restriction of competition within the meaning of Article 101(1) without any credible efficiency defense under Article 101(3)"* See the response of the Commission to Petition No 2383/2014 by Norbert Perstinger (Austrian), on the introduction of the Minimum Advertised Price (MAP) in the European Union, at https://www.europarl.europa.eu/doceo/document/PETI-CM-572975_EN.pdf

[3] For details, see https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2014/12/accc-authorises-resale-price-maintenance-for-the-first-time.pdf

check prices at competing outlets, and even submit orders, while still in the shop or website from which they have obtained the relevant information or pre-sales service.

5. PARITY OBLIGATIONS

5.1 As noted in our response to the initial VBER consultation, we continue to believe that parity obligations on buyers of online intermediation services should be treated in the same way as other vertical restrictions. In particular, parity obligations – both narrow and wide - are particularly important to allow new, innovative platforms to establish themselves (and so create competition) without free-riding from established/incumbent platforms. Moreover, without the legal certainty of cover under the VBER, such potential new entrants they may conclude that securing this protection carries too much antitrust risk. Consequently, we favour retaining parity obligations within the coverage of the VBER for the benefit of nascent online intermediation service providers.[4]

5.2 Our concern that the Commission's approach could deter some providers of innovative online intermediation services from entering the market is exacerbated by the vagueness of the associated guidance in the Draft Guidelines. In particular:

5.2.1 paragraph 345 refers to retailers imposing parity obligations on suppliers in relation to the conditions under which the suppliers goods or services are sold by other retailers, and notes that this will "generally" involve prohibited RPM. However, it also states that "*[i]n cases where undertakings are able to implement such retail parity obligations in compliance with the rules relating to minimum RPM, the obligations are covered by the block exemption*". This appears to suggest that parity obligations relating to non-price conditions of sale (e.g. levels of pre- or after-sales service) would be block exempted, but if so the Commission should make that clearer; and

5.2.2 the Draft Guidelines list various factors that are relevant to the assessment of whether various types of parity obligations breach Art 101(1) or satisfy Article 101(3), but provide no clear guidance on how to apply these factors. For example, at what level is the "market position" of an online intermediary problematic (para 346), or the share of sales through a direct channel considered "significant" (para 347), or buyers considered to represent a "considerable share of total demand"? Clearly the precise levels will vary depending on the other relevant factors identified, but this could be addressed with some illustrative examples.

6. OTHER POINTS

Definition of "competing" undertaking

6.1 Both the Draft VBER and current VBER define "competing undertaking" in a way that appears to exclude the benefit of the VBER even if the product markets in which the contracting parties compete are entirely unrelated to those of the contract products or services that are the subject of the vertical agreement. In our view, it should be amended

[4] If the Commission is not minded to retain cover of the VBER with the currently-applicable market share thresholds, we submit that it should consider retaining coverage with lower market share threshold of e.g. 20%.

to clarify that, for the purposes of the VBER, contracting parties will only be considered to be competing undertakings if they are actual or potential competitors in the markets that are the subject of the agreement.

Online intermediaries as suppliers

6.2 Article 1(d) of the Draft VBER states that online intermediaries are to be treated as suppliers for the purposes of the VBER. However, it is not clear whether they are to be treated as suppliers of online intermediation services only, or also (through a form of legal fiction) as also being suppliers of the products in respect of which the online intermediation services are supplied (notwithstanding that it is the buyer of the online intermediation services that will in fact supply those products). It is important to clarify this point, because an online intermediary may fall below the 30% market share threshold if only its online intermediation services are taken into account (e.g. because its fees, and therefore revenues, are lower than those of its competitors) but exceed the threshold if it is necessary to take into account the value of all sales of the relevant products that are made buyers of the online intermediation services using the online intermediary's platform.

6.3 We also consider that it would be helpful, for readers of the Draft Guidelines who are not familiar with the P2B Regulation,[5] for paragraph 64 of the Draft Guidelines to summarise the types of business that are considered to fall within the definition of suppliers of online intermediation services, e.g. e-commerce websites, price comparison websites, app stores, online search engines and social media services.

Restrictions on the use of online marketplaces

6.4 The new section of the Draft Guidelines that deals with restrictions on the use of online marketplaces and the *Coty* judgment does not address paragraphs 54 and 55 of that judgment, which indicated that a platform ban is reasonably necessary only to the extent that such platforms do not amount to the "main distribution channel" for the goods or services in question. While the CJEU, in reliance on the Commission's e-commerce sector inquiry report, concluded that this was not the case in 2017, the e-commerce sector report itself noted that the proportion of all online sales that are made through third party platforms varies greatly between member states, and that marketplaces are more important as a sales channel for smaller and medium-sized retailers that they are for larger retailers.[6]

6.5 Consequently, it seems to us to be possible that, if not now then at some point in the future, a platform ban could result in buyers or their customers being prevented from effectively using the internet to sell their goods in some EU member states where online market places are most widely used and/or for products that are sold primarily by smaller businesses. In those circumstances, a platform ban might therefore amount to

[5] Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services.

[6] See *Final report on the E-commerce Sector Inquiry*, paragraph 39, which notes that: (i) marketplaces play a more important role in some Member States, such as Germany (62% of the respondent retailers used marketplaces, at the time) than others (such as Belgium, where only 4% did); and (ii) marketplaces are more important as a sales channel for smaller and medium-sized retailers while they are of lesser importance for larger retailers.

a hardcore restriction of passive sales that is not covered by the VBER, in line with Article 1(n) of the Draft VBER and paragraph 188 of the Draft Guidelines. In our view, the Draft Guidelines should, in the interests of legal certainty, include some guidance on whether that might be the case and, if so, the circumstances in which the Commission might take that view.

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September 2021