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European Commission
Directorate-General for Competition – Unit A1
1049 Bruxelles / Brussel
Belgique / België

Ref HT.6179

Budapest, 17 September 2021

Response to the European Commission's public consultation on the draft revised regulation on vertical agreements and vertical guidelines

Dear Ladies and Gentlemen,

The LIDC Hungarian Competition Law Association welcomes the opportunity to provide its views to the European Commission on the draft revised regulation on vertical agreements (the **VBER**) and vertical guidelines (the **VGL**).

We believe that the drafts are well suited to achieving the Commission's key objectives of eliminating false positives and reducing false negatives, updating the guidance on vertical agreements and on reducing compliance costs. We particularly welcome that the drafts reflect some of the key comments made by the stakeholders during the review process, including those expressed by the LIDC Hungarian Competition Law Association in our submission of 27 May 2019.

Below we provide limited comments on a few points that might still benefit from further improvement before the drafts are finalised.

1. DUAL PRICING – COST ANALYSIS REQUIREMENT IS TOO BURDENSOME

In paragraph 195 of the VGL, the Commission says that dual pricing can now be block exempted:

> *"A requirement that the same buyer pays a different price for products intended to be resold online than for products intended to be resold offline can benefit from the safe harbour of the VBER, in so far as it has as its object to incentivise or reward the appropriate level of investments respectively made online and offline."*

The Commission then explains the test to be applied for block exemption:

> *"Such difference in price should be related to the differences in the costs incurred in each channel by the distributors at retail level. To that end, the wholesale price difference should take into account the different investments and costs incurred by a hybrid distributor so as to incentivise or reward that hybrid distributor for the appropriate level of investments respectively made online and offline, as where the wholesale price difference is entirely unrelated to the difference in costs incurred in each channel, such price difference is unlikely to bring about efficiency-enhancing effects. Therefore, where the wholesale price difference has as its object to prevent the effective use of the internet for the purposes of selling online it amounts to a hardcore restriction, as set out in paragraph (188) of these Guidelines. This*

would, in particular, be the case where the price difference makes the effective use of the internet for the purposes of selling online unprofitable or financially not sustainable."

While we appreciate and agree that dual pricing should be able to benefit from the block exemption, the analysis that the Commission describes in paragraph 195 is more or less equivalent to an individual assessment under Article 101(3). The test appears to be too vague and open-ended to serve as helpful guidance for a block exemption. For example, a requirement to allocate the differences in *'costs incurred in each channel'* would mean analysis of fixed and variable costs and distribution of those costs based on various allocation keys. Requiring such analysis is not in the spirit of operational self-assessment under the block exemption. Even if the Commission's description remains in place, we would suggest to add a more operational safe harbour rule that a price difference of, for instance, 10% between products for online/offline distribution enjoys block exemption without the need for a detailed cost analysis.

2. INFORMATION EXCHANGE IN DUAL DISTRIBUTION BETWEEN THE 10% AND 30% MARKET SHARE THRESHOLDS

Under Article 2(5) of the new draft VBER, "exchange of information" in the context of dual distribution does not fall within the VBER to the extent the parties' aggregate market share exceeds 10% at a retail level. This presumably includes any reporting by the buyer to the supplier on realized resales prices. However, it is less clear whether the supplier remains in the safe harbour if it issues to the buyer recommended resale prices that fall within scope of the VBER under Article 4(a).

Moreover, we do not think that block exempting recommended resale prices and other information exchange based on a (low) market share threshold of 10% serves the interest of competition authorities in terms of prioritizing limited resources. This is because it would likely result in all such cases becoming an economics heavy 'market definition battle' with undertakings seeking to establish relevant markets in which they can get below 10%.

As a general point, we note that a certain level of information exchange is necessary for any distribution relationship to be operated efficiently, and this is also true for dual distribution. Information exchange elements of a dual distribution relationship, which relate only to the vertical context of such relationship (i.e. sales of the supplier directly to the distributor), and which are inherent in these kind of relationships (i.e. in the cooperation of a supplier and a buyer) should not be assessed separately from other elements and conditions of the same relationship, and under a different legal regime.

Exchange of information between a distributor and a supplier that are related to and necessary for efficient management and development of the supply chain by the supplier - e.g. forecasting consumer needs and analyzing consumer profiles and trends; performing effective stock management and production volumes; preparing and organizing joint promotions or campaigns; discussing about recommended or maximum retail prices for reaching optimal sales volumes; effectively reacting to seasonal changes in demand, etc. -, should not be generally treated as horizontal information exchange. Requiring that exchanges of information relating to the context of dual distribution relationships be entirely assessed under the Horizontal Guidelines would unnecessarily remove the efficiencies and legal certainty provided by the vertical block exemption, while it would add unnecessary complexity to the assessment of these vertical relationships. This may also hinder the legitimate business incentives of suppliers to build and develop dual-channel distribution systems, by forcing them to implement an overly cautious approach when dealing with their distributors, and when collecting or exchanging information even only in a vertical context. Further, this could also mean a competitive disadvantage for suppliers engaged in dual-channel distribution, as compared to suppliers not selling directly to end customers.

Thus, in our view, information exchange in a dual distribution relationship that is ancillary to the vertical context of the relationship should also be covered by the VBER, while any potentially problematic horizontal context of such relationship should be excluded from the VBER and should be addressed under the Horizontal Guidelines. It would be disproportionate to treat each and every aspect of a supplier-buyer communication in a dual distribution scenario as a horizontal arrangement.

This is a particularly serious issue in the case of franchise systems where stores operated by the franchisor and independent franchisees are both present in the market. The proposal to assess information exchange in the context of dual distribution under the horizontal rules would undermine the very concept of franchising. Information exchange between a franchisor and a franchisee is vital and indispensable to: (i) carry out the business in an efficient, standardized manner; (ii) meet the customer's expectation to receive an optimal and uniform experience at all times, regardless of the location and regardless of whether it is owned and operated by the franchisor or an SME franchisee; and (iii) capitalize on the efficiencies of scale generated by the brand uniformity that are then passed on to consumers. Therefore, the current rules on information exchange between a franchisor and a franchisee should not be changed.

In addition to the above, for the sake of predictability and legal certainty, the VBER should contain a transitional grace period where the parties initially meet the market share thresholds set out in Article 2(4) and (5), but in subsequent years, their market share grows and surpasses the thresholds. Such grace period is already in place in relation to the 30% threshold, in Article 7(d) of the VBER, and should equally be available for the thresholds set out in Articles 2(4) and (5).

We would ask for further consideration of the above points, and would welcome additional clarification from the Commission on dual distribution as it seems to be one of the most problematic part of the draft VBER.

3. THE DEFINITION OF "SUPPLIER" NEEDS TO BE CLARIFIED

The definition of "supplier" under Article 4(1)(d) should be clarified to ensure that it covers manufacturers and (online as well as offline) service providers, and not only online intermediary service providers. We identified issues with the definition in both the English and the Hungarian language versions.

The only category of suppliers described in the definition are online intermediation services. In the English version, the only term which hints that the definition might cover other categories of suppliers is the term *"includes"*:

> *" 'supplier'* ***includes*** *an undertaking that provides online intermediation services ..."* [emphasis added]

This definition however lacks clarity as to what else (if anything) is included in this definition. This can give rise to incorrect interpretations, under which only online intermediation service providers would qualify as suppliers. One example of such incorrect interpretation is the Hungarian language version of the VBER, which also needs to be rectified:

Hungarian language version	Translation back to English
" "szállító": online közvetítő szolgáltatásokat nyújtó vállalkozás..."	*" 'supplier': ~~includes~~ an undertaking that provides online intermediation services ..."*

4. SINGLE BRANDING OBLIGATIONS LONGER THAN FIVE YEARS

We welcome the additional flexibility provided in the VBER and the VGL in relation to single branding arrangements that are tacitly renewable beyond five years.[1] However, we suggest that the Commission also have such flexibility be reflected in paragraphs 283 and 285 of the VGL. In addition, we suggest simplifying the structure of Article 5(a) which now creates confusion as to whether it excludes from the block exemption any agreements that are concluded for an indefinite term from a commercial perspective, but structured as tacitly renewable agreements (i.e., from a civil law perspective).

Paragraph 283 of the VGL should be adjusted to avoid contradicting such paragraph 234 of the VGL. Paragraph 283 currently provides that *"Above the market share threshold or beyond the time limit of five years, single branding agreements are no longer covered by the block exemption and therefore must be individually assessed"*. Such unequivocal language is clearly inconsistent with the guidance in the second sentence of paragraph 234 of the VGL, which provides that non-compete agreements that are tacitly renewable beyond five years can benefit from the block exemption (i.e., if they meet other conditions).). Likewise, the guidance provided in paragraph 285 of the VBER in relation to single branding obligations exceeding five years needs to be updated. The current language of this paragraph 285 effectively creates a presumption of anti-competitive effects, and implies that an exemption under Article 101(3) is unlikely, whenever a single branding obligation exceeds five years. This is not consistent with paragraph 234 of the VGL which provides that non-compete agreements which can be tacitly renewed after five years can be covered by the block exemption (i.e., if they are subject to effective and reasonable renegotiation or termination rights).

In addition, we suggest that the Commission considers simplifying the language of Article 5(a) of the VBER. We believe that no clear distinction can be made, from a commercial perspective, between an agreement that is (i) concluded for an indefinite term, and one that is (ii) concluded for a definite term but is tacitly renewable for consecutive periods. In contractual practice, any contract that is concluded for an indefinite period will contain termination provisions. Therefore, from a commercial perspective, such agreements are equivalent to contracts that are concluded for a fixed period, but can be tacitly renewed beyond such period. Both cases share the key characteristic that the contractual relationship remains in place indefinitely, unless one of the parties unilaterally signals to the other that it no longer wishes to continue the contract. The only difference is the form in which such signalling takes place: a termination notice (in the case of an indefinite term contract), or an objection against renewal (in the case of a tacitly renewable contract).

It is therefore artificial to distinguish between the two forms of contracts in Article 5(a) of the VBER and paragraph 234 of the VGL.

Such an artificial distinction would result in confusion, increased compliance costs and possible false negatives. In particular, the term *"indefinite"* in Article 5 of the VBER creates the misleading impression that the block exemption does not cover *any* contracts at all that are (from a commercial perspective) concluded for an indefinite term. However, as explained above, contracts that are tacitly renewable are in fact covered by the block exemption (as per paragraph 234 of the VGL).

Therefore, we suggest that the term *"indefinite"* is deleted from Article (5)(a) of the VBER, and that the rest of the provision should be amended to exclude only those non-compete agreements from the benefit of the block exemption, that are concluded for a fixed term that is longer than 5 years (i.e., without the possibility for termination).

1 The new flexibility is a result of the deletion of the last sub-paragraph of (current) Article 5 of the VBER, and as a result of the additional guidance in paragraph 234 of the VGL. As a result, non-compete obligations that are tacitly renewable for more than five years will be able to benefit from the block exemption, if the buyer can effectively renegotiate or terminate them on reasonable conditions.

We trust that you find the above comments useful. Please let us know if you have any questions regarding these points.

Sincerely yours,

Zoltán Hegymegi-Barakonyi

President

LIDC Hungarian Competition Law Association