European
Cultural
and Creative
Industries
Alliance

POSITION PAPER ON THE VERTICAL BLOCK EXEMPTION REGULATION DRAFT

The ECCIA members welcome the European Commission's draft proposal for a revised Vertical Block Exemption Regulation (VBER) and its associated Guidelines on Vertical Restraints (VGL) published on 9 July 2021 and is thankful for the opportunity to share its views on it.

We believe the new proposal globally reflects the issues raised by various stakeholders throughout the evaluation and impact assessment phases.

While it brings several positive adjustments of the applicable framework which usefully address the evolution of distribution and consumption patterns since 2010 (*section 1)*, we consider that some improvements in the draft proposal are needed in order to make it more efficient and increase legal certainty for our members (*section 2*).

First among them are the new provisions regarding **dual distribution**, which would, in our view, unnecessarily increase the complexity of the self-assessment required by the businesses - thus having a negative impact on the third objective pursued by the Commission in this revision, aka "*reducing compliance costs for businesses by simplifying complex areas of the current rules and streamlining the existing guidance*". The proposed changes are not supported by data or any theory of harm put forward by stakeholders or in the Commission's impact assessment study. We would therefore strongly recommend that the Commission keeps the status quo option of the impact assessment and refrains from implementing the new provisions of Articles 2(4) (a) and (b).

Secondly, further guidance is also necessary regarding the definition of **agents** and the risks associated to their dual role. The Commission should clarify (i) the definition of online intermediation services providers notably in comparison to online marketplaces (as defined in paragraph 313 of the VGL) as well as (ii) their status, notably set out in Article 2(7) and paragraph 44 of the VGL.

Thirdly, the Commission shall clearly confirm that the **combination of selective and exclusive distribution at different levels of trade in the same territory**, both separately permitted by Article 4(c) (i) and Article 4(c) (iii) of the VBER, does not raise any specific competition concerns. Indeed, brands have been relying on this mechanism for decades and we believe it is a coherent system ensuring the protection of the image of the brand and benefits local consumers access to the products.

Fourth, **the lack of enforcement tools allowing the protection of selective distribution networks** remains extremely problematic. If the Commission considers that the VBER is not the right vehicle for the implementation of this enforcement tool, it should at least highlight officially its crucial importance for suppliers and authorized selective distributors in the EU and call for the creation of a dedicated regulation dealing, for instance, with unfair commercial practices between businesses.

Finally, although we welcome the Commission's greater willingness to accept potential **pro-competitive effects arising from Resale Price Maintenance (RPM)**, we would welcome some clarifications regarding the definition of "experience" and "complex" products as well as the way to assess RPM in the context of selective distribution networks.

You will please find below the details of our analysis.

SECTION 1: POSITIVE ADJUSTMENTS

ECCIA welcomes the orientations taken by the European Commission (the Commission) regarding the specificities of the distribution of luxury products and the benefits that exclusive and selective distribution systems offer to both consumers and businesses.

A. Reconfirmation of the essential provisions of the VBER with the integration of recent Case Law

Paragraphs 135 and 194 of the VGL provide a useful reconfirmation of some of the most essential provisions of the existing framework, the requirement to operate one or more brick and mortar shops, as well as the requirement of an absolute amount of required offline sales.
Most importantly, we welcome the transposition of the CJEU's Coty case into the legal framework, confirming that a marketplace ban shall be block exempted if it meets certain criteria (e.g., the market shares of each of the supplier and the buyer do not exceed 30%, other online channels remain are available etc.).
Finally, the examples provided by the Commission on individual exemption vis a vis online marketplace bans (e.g. paragraph 322 of the VGL), while useful to a certain extent, shall not be exhaustive nor peremptory. Such examples shall indeed not prevent an individual qualitative assessment of the online marketplace ban at stake to be undergone on a case-by-case basis as the Commission indeed needs to keep in mind that the protection of the aura of a luxury brand is a constant challenge in the permanently evolving digital landscape.

These very important clarifications are welcome as they recognize the fact that although online and offline sales channels are complementary in an omnichannel distribution, they are different in terms of characteristics, costs structures and investments.

B. Definition of active sales

The new definition of active sales as provided in Article 1(1) of the VBER offers a useful clarification that will allow brand owners to better protect the exclusivities allocated to their distributors in certain territories of the EU.

This addition will be particularly welcome in the digital world, where the current qualification of all online sales as passive sales made it virtually impossible for brands to enforce their exclusive distribution contracts online.

C. Indirect restrictions on online sales

The clarifications provided by the Commission are very helpful as they reflect the evolution of the markets and the current business environment.

The use of dual pricing represents an effective compensation tool for the higher costs incurred by physical stores retailers. Brands also have thus the opportunity to reward the

retailers who invest the most to improve the sales environment and customer experience associated with the sale of their products.
We thus welcome the fact that the VGL no longer qualifies dual pricing as a hardcore restriction.

We also welcome the Commission's clarification that the criteria imposed in relation to online sales no longer have to be equivalent to those imposed on brick & mortar shops, since these two channels are "*intrinsically different in nature*". Paragraph 221 of the VGL, allowing brands to "*impose on its authorized distributors criteria for online sales that are not identical to those imposed for sales in brick-and-mortar shops"* will help brand owners to adapt their qualitative criteria according to the specificities of each sales channel.

The Commission recently mentioned that these evolutions derived from a clear consensus between suppliers and retailers. We are therefore confident that this will incentivize or reward the appropriate level of investments and relates to the costs incurred in relation to each channel.

D. Specific vertical restrictions

Paragraphs 193 and 328 of the VGL produce welcome clarifications regarding the possibility to determine qualitative criteria for authorized distributors when they advertise brands' products, either directly (such as through online platforms) or indirectly (via price comparison tools). This will allow brands to consolidate the coherence of the experience they offer to their customers and preserve their luxury image and positioning.

SECTION 2: AREAS FOR IMPROVEMENT

A. Dual distribution

To the best of our knowledge, dual distribution has not led to any specific concerns at the European level and indeed it was not a major item of concern raised by the stakeholders throughout the consultation process. The ECCIA members were surprised by the deep changes proposed in the draft.

<u>The changes are not supported by any data</u>

The Commission's rationale by which "possible horizontal concerns are no longer negligible" owing to the growth of online sales and direct sales to consumers is both surprising and dubitable, while the suggested approach to tackle such "possible concerns" appears disproportionate and formalistic, especially as the Commission has neither articulated a clear theory of harm or illustrated the reasons for proposing such a disruptive change with examples of false positive outcomes from the past decades.

The often-cited Hugo Boss case[1] contains little to no legal reasoning, and it addresses behavior that could have been addressed perfectly well under the existing vertical framework. Also, this case was atypical since it did not concern normal contact between a supplier and a retailer but two retailers that did not want price promotions. Beyond this precedent of limited relevance, we are not aware of any other case or situation that would demonstrate and legitimize the need for the proposed reform.

Since the end of 2018, stakeholders have been given several opportunities to have their say in the revision process of the VBER and VGL. The alleged issue of dual distribution only came up during the final public consultation of the impact assessment phase, where only

[1] Danish competition authority, 24 June 2020, Case 19/04380, Hugo Boss

22% of respondents advocated for a change in dual distribution rules. In its summary report, the Commission also concluded that "respondents provided mixed feedback on whether they have experience/knowledge of situations of dual distribution currently covered by the exception that may raise horizontal competition concerns". In addition, neither the Commission's economic study nor the expert report address the issue of dual distribution or present any evidence of horizontal issues raised by dual distribution.

We understand that the Commission does not consider dual distribution as a concern in itself but wishes to be able to apprehend abusive situations by exception. **However, the restrictions on dual distribution propounded in the draft would immediately trigger a massive disruption of distribution networks across the continent, greatly slowing down brand manufacturers' capacities to invest, innovate, create consumer efficiencies, and make the economy greener and more digital. It would create uncertainty that would severely undermine the benefit of having a block exemption.**

<u>The benefits of dual distribution</u>

Currently exempted under the VBER, dual distribution relationships correspond to situations where a manufacturer distributes its goods directly to consumers as well as via independent retailers. Brands may distribute their products either 100% directly, 100% multi-brand or through a dual distribution combination. Dual distribution is today a reality for the vast majority – if not all – of the brands in most retail sectors. Entirely integrated or entirely externalized distribution are extremely rare. Introducing restrictions to capture potential future, exceptional situations, seems disproportionate to the objective, due to the complexity and uncertainty of assessment of market shares it would create.

Dual distribution brings significant pro-competitive benefits through consumer efficiencies. By providing them with complementary channels, more points of sales, experiences, and product value, dual distribution empowers consumers, whose direct feedback enables brand owners to understand and serve them better and to innovate more, better, and faster. As the Covid-19 pandemic has increased direct-to-consumer and e-commerce sales, brand owners and retailers have cooperated to implement omnichannel capabilities such as click-and-collect or call-and-collect. Without the current block exemption on dual distribution, such cooperation would have simply been impossible – to the detriment of brands, retailers and consumers alike. The reasoning is applicable in similar terms to franchising: the position on dual distribution would restrict brand owners' capabilities to efficiently test, improve and evolve their franchising model and its components, to the detriment of their franchisees, and by ricochet, the consumers. Typically, franchising is a concept, or a recipe, that is developed by the brand owner and reproduced by franchisees benefiting both from the brand image and the mix of factors that have brought the brand to a certain level of success. On the ground, evolution and improvement of the franchise concept is most often the result of the brand owner's own retail experience and – not least importantly – larger financial capacity to "test" new ideas before implementing them on a larger scale, including through franchisees. Restricting dual distribution would therefore hamper such evolution.

Alongside many sectors and industries across Europe, we are therefore deeply concerned by the following elements of the draft:

- the withdrawal of the currently existing exemption for dual distribution;
- the introduction of an additional combined market share threshold for dual distribution of 10% (at retail level);

- the need to assess under the Guidelines on "horizontal co-operation agreements" ("Horizontal Guidelines") any information exchanged in the framework of a dual distribution relationship.

These changes would impair the omnichannel reality and ultimately reduce consumers' purchasing power and the competitiveness of European markets: dual distribution lies at the heart of the omnichannel reality, which increases competition among market players and consumer satisfaction.

Focus on the proposal to introduce a new threshold

Notwithstanding our concerns deriving from the potential withdrawal of the currently existing exemption for dual distribution, **we consider that the new threshold will be virtually impossible to calculate and incoherent** – it is very difficult to imagine how brands and their distributors will be able to assess whether or not they are below the proposed 10% combined market shares threshold when, under the Horizontal Block Exemption Regulation and related Guidelines, they are not supposed to directly share any data about their respective market shares.
In addition, the second situation where the supplier and distributor do not fulfil the conditions of Articles 2(4) (a) or (b) but fulfil the conditions of Article 3 will also create a lot of legal uncertainty. Indeed, while the threshold of Articles 2(4) (a) and (b) is based on the retail market share, the second threshold of Article 3 is based on the supply market share, which is inconsistent and confusing at best.
Consequently, the introduction of this new threshold would create an obstacle to benefit from the exemption, which undermines the rationale for the exemption in itself. Indeed, the main added value of the VBER is that it gives brands the security that they can benefit from an exemption as long as they remain under the existing 30% threshold. The Commission itself after the evaluation phase decided that the threshold was appropriate and did not need to be modified. **Therefore, we strongly advise against the creation of this new mechanism which would make access to the VBER more difficult, and consequently undermine its rationale**.

We would also emphasize that the **problem is the creation of a new threshold per se** – not the level of the threshold itself. While there is undoubtedly a concern with the fact that the threshold is set at 10% of combined market share, which is considerably lower than today's 30% threshold[2], our main concern is linked to the creation of any new threshold that would constitute an unnecessary barrier to brands' eligibility for a dual distribution exemption. As previously argued, we believe that dual distribution is pro-competitive and leads to more intra- and inter-brand competition, more consumer choice, and also more investment and jobs.

Exchange of information

Manufacturers and their retail partners have a legitimate need to discuss and share information concerning market opportunities, marketing strategies and the sales and performances of the manufacturer's goods or services.

Selective distribution and franchising, by nature, require a minimum level of exchange of information – in a selective distribution contract, the distributor agrees to invest resources in order to fulfil the supplier's qualitative criteria, mainly related to the quality of the retail environment and customer experience. To maintain the luxury image of its products and to provide customers with a coherent retail experience across the

[2] Looking at just the two parties' market share individually, namely the suppliers' market share and the retailer's market share.

suppliers' various sales channels and retailers, the supplier will generally train the distributor's retail staff and share all relevant information about the product needed in order to guarantee the excellence of the customer experience (both pre- and after-sale). In order to optimise the partnership, suppliers and distributors also need to exchange (anonymised) data about for example past product performance and upcoming promotion campaigns. The foregoing applies almost in identical terms to franchising, where the cooperation and interactions are often even deeper due to the mono-brand activity of the franchisee.

The Horizontal Block Exemption Regulation and related Guidelines are not suited for dual distribution – the horizontal framework covers exchanges of information in cases of undertakings competing on different products. In the case of dual distribution, the undertakings are selling the same product. This is a crucial distinction, because there is a mutual interest for both undertakings to sell as many products as possible. While the HBER and HGL are currently under revision, the latest public consultation barely contains a couple of questions relating to dual distribution. Therefore, it does not look like the Commission is seeking input from stakeholders to beef up its section on information exchanges in cases of dual distribution.

Conclusion

We consider that these proposals regarding dual distribution would have a negative impact on competition and therefore on the welfare of consumers and businesses in the EU. If manufacturers and distributors could no longer cooperate and create efficiencies, the ensuing reduction of product competition, innovation and choice would lead to an increase in retail prices.
For the businesses, they would have a serious adverse impact on legal certainty, market dynamics and business models, and it would create substantial new costs related to complex risk- and self-assessment (to determine the relevant retail market shares, overlaps and market definitions) and the management of information flows under the Horizontal Guidelines (distinguishing direct sales to consumers from B2B sales).

We would therefore strongly recommend that the Commission keeps the status quo option of the impact assessment and refrain from implementing the new provisions of Articles 2(4) (a) and (b).

B. Agents and risks associated to their dual role

Definition of agents

The ECCIA members welcome the clarification that a brief temporary passing of title will not in itself preclude an agency agreement.

Further clarification is although needed regarding the status of online intermediation services providers. Indeed, it remains unclear why providers of online intermediation services should be considered as suppliers since, in most cases, they do not produce or sell any products. Therefore, we believe providers of online intermediation services should only be considered as suppliers when they produce and sell products on their platform that directly compete with their suppliers'.

In addition, paragraph 44 of the VGL states that "*undertakings providing online intermediation services are categorised as suppliers under the VBER and can therefore in principle not qualify as agents for the purpose of applying Article 101(1)*". We believe this approach is too restrictive and would simply deprive suppliers and distributors in the

European Union from concluding partnerships with online players other than on a purchase-resale relationship basis. Not only would it create additional risks of free riding on "traditional" retailers but (ii) this would also deprive consumers from innovative/complementary customer experiences online.
Online intermediation services should only fail to qualify as an agent in the exceptional cases when they are also suppliers, as defined in the above paragraph.

Besides, the distinction between the definitions (i) of online intermediation services providers, notably in Article 2(7) notably and (ii) online marketplaces (in paragraph 313 of the VGL) is unclear and creates a great deal of confusion for stakeholders. The definition of providers of online intermediation services shall therefore be urgently clarified and narrowed down.

Finally, we believe Article 2(7) should clarify that providers of online intermediation services should only be considered as being "in competition with undertakings" when they produce and sell competing products on their platform. Indeed, we believe the concept of being "in competition" should be determined at the supply level rather than the retail level. If not, it will be basically impossible for providers of online intermediation services (including online marketplaces) to sell any products, because they will always be selling products that compete with their suppliers (it is the basic principle of any multibrand store, and it is also considered an excluded restriction in the context of a selective distribution system to request that your retailer does not sell products from specific competitors).

Alleged risks associated to the dual role of agents

On the one hand, we welcome the clarification made in paragraph 36 of the VGL that when an agent can undertake other activities as an independent distributor for the same principal but in different product markets. Indeed, it is standard practice that suppliers may want to use agency contracts with one of their independent distributors for certain products with a different positioning, such as Haute Parfumerie, Couture, or complication watches, in order to fully control the customer experience pre and after sales.

On the other hand, we regret the Commission's narrow interpretation on distributors that also act as agents for the same products and the same supplier. In certain situations, stakeholders may therefore need time and flexibility to gradually convert their business models to their best interest without this being regarded as a misuse of the agency concept. In this scenario, a distributor would therefore need to act for a limited period of time as an agent in one city and as a distributor in another with complete separation of such activities. Individual assessments, further guidance and flexibility are therefore more than welcome on this matter (different business models in different cities/geographical markets, different business models between online/offline channels, different business models in limited periods, measures to preserve the partners' decision-making freedom or to reimburse the costs and risks incurred).

C. Organization of distribution networks and protection of selective distribution networks

Combination of selective and exclusive distribution

Brands which have not penetrated every European market may wish to set up exclusivity at the wholesale level for a distributor/wholesaler who then is responsible for running a selective distribution system at the retail level.

Such a combination of exclusive and selective distribution systems in the same territory tends to pursue a double legitimate objective.

On the one hand, the exclusivity granted to a distributor/wholesaler in a territory enables the latter, as a local expert, to make continuous investments and to dedicate time and efforts to maintain in-depth expertise in local consumers' preferences and specificities. Restrictions of active sales into this territory, from other wholesalers operating in other territories, enable this exclusive wholesaler to recoup its investments, without fear of free riding, it being understood that authorized distributors/wholesalers remain free to resell their products to other authorized distributors/wholesalers located in other territories. The possibility for the exclusive distributor/wholesaler to focus on the local wholesale market (e.g. by implementing local selective distribution via the selection of authorized retailers and ensuring that the latter comply at all times with predetermined qualitative criteria, enhancing logistics such as compliance with packaging and labelling requirements, etc.) enables a duplication of selective distribution benefits and facilitates local consumers' access to high-quality products and associated services. Having recourse to an exclusive distributor / wholesaler is therefore particularly important for high-end products to ensure the quality of their distribution.

On the other hand, the selective distribution system implemented at the retail level is a way to induce retailers to provide consumers with the specific services and advice necessary given the luxury nature and image of the products. In addition to consumer welfare (quality of points of sale, services, advice, etc.), it aims at protecting the image of the brand here also being understood that authorized retailers remain free to resell their products to other authorized retailers.

To sum up, selective distribution run by an exclusive distributor/wholesaler in a territory A simply mirrors selective distribution run by a brand owner in a territory B. Such coherent distribution system seeks to ensure that the products are displayed in a manner that enhances their value and reputation, and therefore contributes to sustaining the aura of luxury surrounding them. It also benefits the consumers who may not have been able to find the products in said territory otherwise.

We therefore strongly believe that the mere fact of combining these distribution models, both separately permitted by Article 4(c) (i) and Article 4(c) (iii) of the VBER, does not raise specific competition concerns and this should be strictly and clearly confirmed by the Commission.

<u>Protection of selective distribution networks</u>

Article 4(c) of the VBER allows brands to restrict "active or passive sales by the members of the selective distribution system or their customers to unauthorized distributors located within the territory where the selective distribution system is operated".

We don't see the added value of this update as there is currently no enforcement tool available. We are wondering how brand owners could rely on this disposition of the VBER before national and EU courts and we would welcome any corresponding guideline in the VGL.

Restricting sales from outside the territory in which a selective distribution system is operated to unauthorized distributors inside that territory is welcome. But restricting sales from inside the territory in which a selective distribution system is operated to unauthorized distributors inside and/or outside that territory is equivalently essential. Any member of an authorized network (exclusive and selective at wholesale and/or retail

level) set-up for certain products shall be clearly prevented from unduly supplying such products to any unauthorized entity (i.e., non-authorized member of the said network). Respectively, any unauthorized entity shall be legally prevented from soliciting, or acquiring from authorized members of the network, as well from offering for sale and/or selling such products. It is the natural counterpart of the responsibilities attached to selective distribution as well as the condition of this business model's survival.

We remain extremely concerned by the absence of a harmonized enforcement mechanism tool in the VBER to protect selective/exclusive distribution systems while it shall be their natural counterpart.

Some countries, already aware of the risks to which brand owners are exposed, have been precursors and introduced specific legal mechanisms. For instance, France has been a pioneer in this area and introduced in 1996 within the French Commercial Code an article punishing the fact of contributing directly or indirectly to the violation of a selective distribution network (which is now the following: Article L.442-2 of the French Commercial Code). This Article provides a mechanism that is unique in Europe, including a presumption of irregular supply (and thus reversing the burden of proof, which is always extremely difficult for brand owners to provide), as soon as the violation, even an indirect one, of a selective/exclusive distribution network is established (i.e. complicity in a contractual infringement, disorganization of the network).

Since this mechanism directly deals with the contractual relationship between suppliers and retailers, we truly believe it should be introduced in the VBER. We therefore again call the Commission to include a similar or identical provision within the upcoming VBER. Such a tool would enable brand owners to properly rely, in practice, on the definition of selective distribution by the Commission in the current VBER: i.e. a "*distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorized distributors within the territory reserved by the supplier to operate that system*".

In the Coty judgment, the CJEU pointed out that "*the absence of a contractual relationship between the supplier and third-party platforms is (…) an obstacle which prevents that supplier from being able to require, from those third-party platforms, compliance with the quality conditions that it has imposed on its authorized distributors*" and highlighted a corresponding "*risk of deterioration of the online presentation of those goods which is liable to harm their luxury image and thus their very character*". Such reasoning is simply to be transposed to any unauthorized distribution channels.
Such a mechanism would also be in line with recent national case law emerging across Europe[3].

Finally, beyond the protection of brand owners and their selective distribution networks, the introduction of such a mechanism at EU level would position the EU as a very attractive region for many selective brand owners leading thus to positive impacts on economic efficiency, competition and consequently on the wellbeing of consumers.

If the Commission considers that the VBER is not the right vehicle for the implementation of this enforcement tool, it should at least highlight officially its crucial importance for suppliers and authorized distributors in the EU and call for

[3] Milan IP Court July 3, 2019 / R.G.50977 2018, Sisley Italia SRL v. Amazon Europe Core or Milan Tribunal Business Civil Section 10182/2020 Shiseido Europe S.A. and Shiseido Italy S.P.A. v. Amazon Europe Core S.A.R.L., Amazon EU S.A.R.L. and Amazon Services Europe S.A.R.L.

the creation of a dedicated regulation dealing, for instance, with unfair commercial practices between businesses.

D. Resale price maintenance (RPM)

In the last consultation, ECCIA supported the Commission's orientation in identifying the concrete instances regarding the conditions under which efficiencies for RPM can be claimed and the evidence that is required to satisfy the conditions of Article 101(3) TFEU.

We therefore welcome the Commission's greater willingness to accept potential pro-competitive effects arising from RPM.

The possibility to benefit from an individual exemption under certain circumstances, such as a temporary short-term pricing campaign for a new product launch as specified in paragraph 182 of the VGL is very much welcome. It is also justified by the need to avoid free-riding and therefore secure our retailers' ability to recover their substantial investments in the process. **In order to maximize legal certainty, the introduction of a specific mention of seasonal products in this paragraph would be helpful.**

The practical guidance provided on the possibility of exemption in the case of maximum or recommended RPM above the 30% threshold is also useful.

However, we would welcome additional clarifications from the Commission regarding:

- **what is considered to fall under the definition of "experience" and "complex" products.**
- **the assessment of RPM in the context of selective distribution networks (i.e., for products that require a high-level retail service as well as for products perceived by consumers via their allure and prestigious image which bestow on them an aura of luxury).** As requested by national competition authorities in the context of their common consultation on the reform of Regulation n°330/2010, the Commission should notably clarify the legitimate necessity for manufacturers to protect their brand image from devaluating promotional operations ("*the Exemption Regulation on vertical agreements and the Guidelines do not provide sufficient legal certainty on the assessment of resale price restrictions in the context of selective distribution networks. In this particular context, suppliers could indeed defend that the protection of their brand image or the characteristics of their products or services could justify practices that would restrict the ability of buyers to determine their resale price*".)