Eversheds Sutherland (International) LLP

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

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1. Introduction

1.1 Eversheds Sutherland welcomes the European Commission's consultation document on the draft revised Block Exemption Regulation on vertical agreements ('**draft VBER**') and vertical guidelines ('**draft Guidelines**'). Overall, Eversheds Sutherland supports the Commission's approach in considering the actions it should take in respect of the draft VBER and draft guidelines, which aims to gather stakeholder feedback on the changes it proposes to address the issues identified in the evaluation of the current rules.

1.2 Since the current VBER and current Guidelines[1] entered into force, the business environment has changed significantly, in particular with the growth of e-commerce and the development of the platform economy. As the Commission has acknowledged, there is a need to address these developments and to update the rules relating to vertical agreements, which are heavily relied upon by a wide range of businesses and their advisors to provide certainty and legal clarity. Whilst the draft VBER and draft Guidelines go some way towards addressing the deficiencies in the current VBER and current Guidelines, there remain areas of the drafts where the proposed changes create significant legal uncertainty, are unduly restrictive or are unclear in their intent or scope, and this is of serious concern.

1.3 In particular, we urge the Commission to reconsider its position on:

1.3.1 the proposal in respect of dual distribution at Article 2(4) draft VBER, to block exempt all aspects of non-reciprocal vertical agreements between competitors only up to a market share threshold of 10%, and where market share is between 10% and 30%, to treat information exchange between the parties as horizontal. We consider that the overall certainty and usefulness of the VBER will be significantly reduced by the introduction of market share thresholds other than the 30% safe harbour, and that this is unnecessary, and will cause considerable uncertainty and complexity for business. We consider that in a dual distribution relationship, the centre of gravity of the agreement is vertical and information exchange between the parties should be assessed in this context;

1.3.2 the proposals in respect of dual role agents in paragraphs 35-37 of the draft Guidelines, to attribute all the common costs incurred for both the agency and the independent distribution of the differentiated products to the agency function if it is to fall outside Article 101(1). We consider that this will render the dual role model practically unworkable in this situation and is not justified; and

1.3.3 the overall approach to agency agreements, set out in section 3.2 of the draft Guidelines, which is unclear and creates a high degree of uncertainty.

1.4 In addition, once the substance of the draft Guidelines is finalised, we consider that it would be helpful for the Commission to go further in improving and simplifying the structure of the draft Guidelines. For example, it is sometimes difficult to find guidance on certain specific topics, such as dual pricing and the equivalence principle, in particular given the length of the draft Guidelines and the fact that the relevant paragraphs are not headed. We note the improvement in respect of RPM, which combines the previously scattered guidance into one section, but in certain cases, aspects of the same issue continue to be addressed in different places, e.g. for agency in the draft Guidelines paragraphs 27 onwards and 177 onwards, without clear signposting or cross referencing.

1.5 We have commented below in more detail on these points and other areas where we consider that the Commission could go further than it proposes in introducing changes to facilitate the assessment of vertical agreements and help reduce compliance costs for businesses.

Response to the consultation

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[1] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices; Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, p. 1–46.

2. Dual distribution

2.1 We note the Commission's proposal in the draft VBER and draft Guidelines to include a 10% aggregate market share threshold for the exemption to apply to dual distribution; and where market share is between 10% and 30%, to treat information exchanges between the parties as horizontal. We have serious concerns about this proposal, which is unhelpful and will add unnecessary complexity and uncertainty for businesses.

2.2 Firstly, we consider that the introduction of a market share threshold lower than the current 30% safe harbour, applicable to dual distribution only, is unnecessary. Dual distribution is increasingly common, particularly, but not exclusively in the consumer goods sector, where suppliers primarily active on the upstream market make direct sales to consumers online through a branded website, while continuing to operate their main distribution network through third party distributors. An "omni-channel" strategy is now a key feature of distribution and, absent market power, is likely to generate efficiencies which outweigh any possible restriction of (intra-brand) competition or theoretical horizontal concerns. As the Commission notes in para 17(c) of the draft Guidelines, a reduction of intra-brand competition is by itself unlikely to lead to negative effects for consumers if inter-brand competition is strong.

2.3 Secondly, the introduction of market share thresholds lower than the 30% safe harbour will cause significant complexity and uncertainty. The VBER will no longer be a clear safe harbour, and we consider this a retrograde step. Given the increasing prevalence of dual distribution, the Commission's proposals are likely to have a wide impact, subjecting many businesses to the additional burden of detailed market definition exercises.

2.4 In particular, the 10% market share threshold proposed in Article 2(4) of the draft VBER is extremely unhelpful, as to be confident of falling within this threshold any market definition exercise will have to be extremely precise, tested and thorough, given that the margin for error is so small. The effort of consistently monitoring, during the lifetime of a dual distribution agreement, whether the 10% market share threshold is exceeded or not will be significantly more burdensome compared to monitoring the 30% threshold. The transaction costs for parties engaging in dual distribution are likely to increase significantly. In addition, the threshold of 10% is surprising given that the Horizontal Guidelines set out clearly that it is unlikely that the competing parties to a commercialisation agreement will have market power if their combined market share does not exceed 15% (Horizontal Guidelines, paragraph 240).

2.5 Thirdly, to the extent that the Commission has concerns about information exchange in a dual distribution context, guidance on these concerns should properly be set out in the draft Guidelines, not treated and assessed under the rules applicable to horizontal agreements as proposed in Article 2(5). We acknowledge that dual distribution may raise theoretical horizontal concerns, primarily around information exchange and the extent to which the supplier/ brand owner may share information on pricing and promotional plans for its own direct channel with its distributors and vice versa. However, the centre of gravity of a dual distribution relationship is the vertical element. It is inherent to any vertical agreement, including dual distribution agreements, that the parties to the agreement exchange information. This fundamentally distinguishes information exchanged between competitors in a purely horizontal setting, and information exchanged in a dual distribution context. It is, therefore, in the vertical Guidelines that any concerns should be addressed.

2.6 We consider that in the context of dual distribution, it is unreasonable for a supplier to have to treat information from its distributors as equivalent to true third party competitor information, as information sharing across the whole (dual) network could improve consumer insight, respond to changes in consumer demand, and drive innovation, resulting in stronger, more effective inter-brand competition, even if some intra-brand competition is reduced.

2.7 In addition, the need to pursue a further analysis on the basis of the Horizontal Guidelines (which are also under review by the Commission with uncertain timing) will add to the complexity for businesses. We consider that any concerns should be addressed uniformly and coherently in a single document, that being the draft Guidelines.

2.8 Paragraph 90 of the draft Guidelines also seems to indicate that a dual distribution agreement between parties exceeding the 10% threshold will benefit from the block exemption only if the information exchange is compatible with the Horizontal Guidelines. The assessment of the information exchange under the Horizontal Guidelines becomes a condition for the exemption of the entire agreement. The VBER aims at providing a safe harbour and legal certainty, and in that context it is not helpful to make the application of the VBER conditional on an assessment under guidelines (whether vertical or horizontal). In addition, para. 90 of the draft Guidelines is not in line with Art. 2(5) draft VBER. The provision states that, if the 10% threshold is exceeded, the exemption applies to the dual distribution agreement, and that only the information exchange needs to be assessed separately.

2.9 We urge the Commission to address information exchange in the context of a dual distribution agreement within the draft Guidelines and it would be helpful to see commentary setting out:

2.9.1 the types of information a distributor may continue to freely share with the supplier and the supplier may freely use internally, as legitimate in the context of the (vertical) distribution relationship, for example, historic, current and forecast volume and sales figures, (including potentially costs, quantities and capacities) notwithstanding the dual relationship;

2.9.2 specific guidance on promotional calendars and marketing plans and the extent to which these may be coordinated between the supplier and the distributors in a dual distribution context to generate strong inter-brand competition; and

2.9.3 examples of the types of information barriers, and the degree and nature of the separation of information required for the protection of competitively sensitive information received from the distributor that should not be shared with the supplier's direct sales channel; and confirmation that any information barriers should be proportionate to the size of the relevant supplier's business.

2.10 Finally, the treatment of "hybrid platforms" in Article 2(7) and paragraph 91 of the draft Guidelines is complex and unclear, and will cause significant uncertainty, increasing the compliance burden on businesses, particularly smaller suppliers relying on platforms (where, as the Commission notes in para 44 of the draft Guidelines, there is already a significant imbalance of power).

2.11 We acknowledge that the risk of real competitive harm arising from dual distribution by an online platform with significant market power may be non-negligible, because the interests of those platforms and those of the suppliers using the platform may diverge significantly (unlike in the case of dual distribution between a supplier and its own distributors). However, this risk should only arise where the online platform has significant market power (which is sufficiently reflected by the 30% market share threshold, and even more so by – if introduced – the 10% market share threshold). To remove the benefit of the block exemption from all agreements with "hybrid platforms", including agreements regarding only the "purchase of goods or services sold by the provider of online intermediation services that has a hybrid function" (para 91), places an unnecessary burden of detailed self-assessment on suppliers, without justification. In addition, it may disincentivise potential competitors of existing online platforms from entering the online platform market(s).

3. Agency and online intermediation services

3.1 Whilst the inclusion of further examples and case studies in respect of agency is helpful, overall, the agency section of the draft Guidelines is confusing due to a failure to clearly distinguish agency agreements falling outside the scope of Article 101(1) and agency agreements subject to Article 101(1), leading to several unclear references to "agency agreements" without specifying which category.

3.2 What is and is not an agency agreement is defined by national contract laws, not competition laws, but we understand that section 3.2.1 of the draft Guidelines seeks to refer to agency agreements falling outside Article 101(1) - albeit that, notwithstanding the

heading of section 3.2.1, this term is not actually defined. Such agency agreements do not of course need to rely on the block exemption at all, but the Commission's extensive guidance about these types of agency agreements is already being widely misunderstood as setting the conditions for other agency relationships that do fall within Article 101(1) to benefit from the VBER.

3.3 We urge the Commission to clarify explicitly that the guidance set out in section 3.2.1 of the draft Guidelines applies to agency agreements falling outside Article 101(1) only, save that there are a number of paragraphs where the phrase "agency agreement" is used where that paragraph is equally applicable to both agency agreements falling outside Article 101(1) and those within Article 101(1). These are line 6 of paragraph 30; line 5 of paragraph 35; and line 10 of paragraph 36. In addition, line 1 of paragraph 177 should refer to both types of agency agreement; and the references to "agency concept" in paragraph 43 should be to an "agency agreement outside Art 101(1) concept" rather than to the use of agency in a situation that is subject to Article 101(1).

3.4 In general, the Commission should revisit how the phrase "agency agreement" is used throughout the whole of section 3.2 to ensure it refers properly to agency agreements falling outside Article 101(1) or agency agreements within Article 101(1); or, in some cases, to make clear that it is equally applicable to both types of agency relationship.

3.5 We also have concerns that the Commission's approach to agency is too restrictive, particularly in respect of dual role agents, and this is unjustified.

3.6 Firstly, the draft Guidelines set out at paragraph 28 that the conditions for categorising an agreement as an agency agreement falling outside Article 101(1) "should be interpreted narrowly". We consider this is unduly restrictive, given the already very restrictively formulated test for an agent as being one who "does not bear any or only insignificant financial or commercial risk". Limiting this test still further by this additional language in the draft Guidelines is not helpful and will create legal uncertainty.

3.7 Secondly, we welcome the clarification in the draft Guidelines at paragraph 31(a) that the fact that an agent temporarily and briefly acquires title in the goods (a "flash transfer"), does not preclude the existence of an agency agreement falling outside Article 101(1) (it should not preclude the existence of an agency agreement falling within Article 101(1) either, and this should be clarified). However, we consider the Commission should go further in respect of fulfilment contracts and similar models, such as drop shipping models, and explicitly state that qualification as an agency agreement should not be put in doubt where the agent provides logistical services to the supplier for the delivery of the products, the price of which has been negotiated and agreed directly between the supplier and the end user.

3.8 Related to this, the draft Guidelines do not adequately explain why "online intermediation services" providers (i.e. platforms) can no longer act as agents for suppliers as set out in paragraph 44 of the draft Guidelines. Their designation as "suppliers" is not sufficient in itself to explain this, as agents themselves are suppliers of intermediation services. A platform may provide the same services to manufacturers as are provided by non-platform agents, in terms of connecting them to customers, delivery and logistics in respect of the goods etc. and be fully reimbursed for all these services; the draft Guidelines also make clear at paragraph 179 that the supplier of goods, rather than the platform, must set the price. In these circumstances, the position in paragraph 44 of the draft Guidelines creates confusion and uncertainty.

3.9 Thirdly, in respect of dual-role agents (where an independent distributor of a supplier also acts as an agent for that supplier), the Commission's approach lacks clarity and is unduly restrictive. In particular:

3.9.1 Our reading of paragraphs 35-37 of the draft Guidelines (which is in accordance with the Commission's Dual Role Agent Working Paper) indicates that it is the Commission's intention that all the common costs incurred for both the agency and the independent distribution of the differentiated products should be allocated to the agency function if it is to fall outside Article 101(1). This approach is not justified, and in many instances (e.g. where the agency role is

limited in terms of volume or value of sales) such cost allocation will makes the hybrid role completely unworkable in practice and would prevent the efficient development of such a hybrid model. We respectfully suggest that the Commission should instead allow a pro-rata allocation of common costs to the two functions.

3.9.2 In respect of the position in paragraph 34 of the draft Guidelines that the independent distributor must be "genuinely free" to enter into the agency agreement, it is unclear if the Commission intends to capture the scenario where the supplier makes particular products available only under the agency route. This is in practice a common position and it should be clarified that it does not present a problem.

3.9.3 Paragraph 43 of the draft Guidelines states that compliance with paragraphs 34-37 "has to be assessed strictly", and this is unhelpful given the already highly restrictive approach to dual distribution which runs the risk of rendering this common model wholly unworkable in practice.

3.10 Fourthly, in respect of agency agreements falling within Article 101(1), paragraph 40 of the draft Guidelines and Article 1(1)(j) of the draft VBER indicate that the agent is to be considered a "buyer" for the purposes of the draft VBER. This leaves open the possibility that it will be a hardcore restriction under Article 4(d) of the draft VBER for the principal to restrict the territory into which or the customers to whom the agent/buyer may sell the contract goods or services, notwithstanding that the agent is selling the contract goods on behalf of the principal. We note that paragraph 39 of the draft Guidelines describes the ability of the principal to determine the scope of the agent's activities as an "inherent part of an agency agreement." We respectfully request that the Commission clarify this point, and make clear whether a principal in an agency relationship falling within Article 101(1) (for example because it has not be possible to conclude with sufficient certainty that all relevant risks are being fully borne by the principal) can direct the customers to whom and territory in which the agent makes sales on its behalf.

3.11 Finally, we would welcome some further clarity and clear examples in respect of distribution models which take effect as variants on agency, in particular concession agreements, and fulfilment contracts.

4. Indirect measures restricting online sales

Dual pricing

4.1 We are supportive of the Commission's approach in the draft Guidelines to no longer classify dual pricing as a hardcore restriction.

4.2 We welcome that the draft Guidelines make clear that different prices for goods/services which are intended to be resold online are permitted provided that the price differential:

4.2.1 is intended to incentivise or reward the level of investment made online/offline; and

4.2.2 reflects the differences in the costs incurred in each of the different distribution channels at the retail level.

4.3 We would, however, welcome guidance on the evidence that would be required to demonstrate the differences in costs for sales offline and online.

Equivalence principle

4.4 Similarly, we support the Commission's proposal to allow a supplier operating a selective distribution system to impose on its authorised distributors criteria for online sales that are not identical to those imposed for sales in brick and mortar shops, in as far as the criteria imposed for online sales do not prevent online sales.

4.5 However, we would welcome some further clarity and examples of instances where the imposition of such conditions will be acceptable.

Marketplaces

4.6 We also welcome the clarity that the draft Guidelines provide on the restrictions that can be imposed on sales through online marketplaces, and in particular the confirmation that such a ban on the use of marketplaces can fall within the VBER even outside the context of a selective distribution system.

4.7 We also note that, in accordance with preamble para 12 of the draft Guidelines, any restriction on online sales can only benefit from the block exemption where it does not have as its object to directly or indirectly prevent the effective use of the internet. A supplier clearly cannot impose an outright ban on internet sales but some further guidance on whether a particular restriction would amount to a (prohibited) ban on online sales would be helpful for businesses.

5. Resale Price Maintenance

5.1 We note the Commission's proposal in the draft Guidelines to recognise the following examples of efficiencies:

5.1.1 when a manufacturer introduces a new product, particularly if it is a completely new product, and it is not possible to impose effective promotion requirements on all buyers by way of contract;

5.1.2 to organise a coordinated short term low price campaign (described as being of 2 to 6 weeks in most cases);

5.1.3 to allow retailers to provide (additional) pre-sales services, in particular in the case of experience or complex products, and avoid free-riding.

5.2 Whilst these are sensible examples, we consider they do not go far enough. In particular, no explanation for the limitation of a low price campaign to 2-6 weeks is given, or what would be required to justify a longer period, for example, seasonality of the product, or usual purchasing cycles, etc.

5.3 In our view, the Commission should include further case studies and examples to address the current lack of clarity and guidance.

5.4 We would also welcome more clarity on minimum advertised price policies, as the text at paragraph 174 of the draft Guidelines only indicates with MAPs "may" amount to RPM, without stating that absent the examples set out in that paragraph, a MAP would not amount to RPM.

6. Parity obligations (or 'most favoured nation' clauses)

6.1 We note the Commission's proposal in the draft VBER to include restrictions on indirect sales channel parity obligations (i.e., that a product or service may not be offered on better terms on any other channels whether a supplier's own or any intermediaries, i.e. a 'wide MFN') as excluded restrictions rather than hardcore, but we consider that a stricter approach is merited. The approach taken by competition authorities in a number of Member States also speaks in favour of a stricter treatment of wide MFNs, at least in respect of pricing MFNs.

6.2 We welcome the clarity provided by the Commission's explicit confirmation in paragraph 239 of the draft Guidelines that all other types of parity clause (i.e. direct or narrow parity clauses, parity obligations relating to the conditions under which goods or services are offered to customers who are not end users, and parity obligations relating to the conditions under which manufacturers, wholesalers or retailers purchase goods or services as inputs) are covered by the block exemption.

7. Territorial and customer restrictions

7.1 The Commission's additional flexibility in respect of territorial and customer restrictions is welcome. In particular, the concept of "shared exclusivity" will provide suppliers with greater flexibility to design their distribution systems efficiently. However, there is the potential for uncertainty in terms of how to assess (in accordance with para 102 of the draft Guidelines) whether the number of appointed distributors will secure the volume of business necessary to preserve their investment efforts. Any complexity in this assessment is likely to deter suppliers from using the "shared exclusivity" option and this would be a wasted opportunity. We would therefore welcome guidance on how this assessment should be conducted, and explicit confirmation that this need not be an exhaustive ongoing examination.

7.2 We also welcome the ability to pass on active sales restrictions to downstream distributors. These proposed reforms will provide businesses with more flexibility to structure their distribution networks and the necessary confidence that their investments will not be lost.