LVMH

September 2021

LVMH contribution to the European Commission's public consultation on the draft revised Regulation on vertical agreements and guidelines

On 9 July, the European Commission published its highly anticipated proposal for a revised Vertical Block Exemption Regulation (VBER) and its accompanying Vertical Guidelines (VGL) and invited all interested parties to submit comments on the draft texts.

LVMH welcomed the publication of the draft VBER and VGL, as they globally reflect the issues raised by various stakeholders throughout the evaluation and impact assessment phases and lay the ground for the modernisation of the framework that the Commission hinted at.

However, we are strongly concerned by the proposed modification of the rules relating to dual distribution, which we believe could single-handedly offset the benefits of the VBER and VGL. In particular, we believe that the introduction of a new combined threshold to qualify for the dual distribution exemption would generate a lot of legal uncertainty, which would seriously undermine the benefits of the exemption (see section 2).

1) Positive provisions of the VBER and VGL

Protection of the acquis – §194 of the VGL provides a useful reconfirmation of some of the most essential provisions of the existing framework, such as the brick and mortar clause, a direct or indirect ban on sales on online marketplaces (codification of the Coty jurisprudence), as well as "*a requirement that the buyer sells at least a certain absolute amount (in value or volume, but not in proportion of its total sales) of the contract goods or services offline to ensure an efficient operation of its brick and mortar shop*". In particular, we welcome the brick and mortar requirement proportional to our distributors' effective customer reach.

More flexibility under 30% – the VGL state that qualitative and/or quantitative selective distribution systems can benefit from the safe harbour "even if they do not meet the Metro criteria" (§136). Read in combination with the removal of §56 of the existing framework (see below), we welcome these new developments as a move towards the original spirit of a block exemption.

Equivalence principle – the deletion of §56 VGL and addition of §221 VGL, which allows our brands to "*impose on its authorised distributors criteria for online sales that are not identical to those imposed for sales in brick and mortar shops"* offers a welcome opportunity for our brands to adapt their qualitative criteria to the specificities of each sales channel.

Active sales restrictions – the new definition of active sales offers a useful clarification that will allow our brands to better protect the exclusivities allocated to our distributors in certain territories of the EU. This addition will be particularly welcome in the digital world, where the qualification of all online sales as passive sales made it virtually impossible to enforce our exclusive distribution contracts online.

Dual pricing – §195 VGL offers an opportunity for brands who wish to use dual pricing to ensure a fairer repartition of costs within their omnichannel networks that reflects the difference in their distributors' cost structures, and to reward investments into the quality of the sale environment and customer experience.

Coherence of the qualitative criteria throughout the customer experience – our customers' digital experience is no longer linear. Therefore, we welcome the possibility to determine qualitative criteria for our authorised distributors when they advertise our products, either directly (such as through online platforms) or indirectly (via price comparison tools). This will allow our brands to consolidate the consistency of the experience that our customers are offered and to align our distributors' practices with our own.

2) Areas for improvement

❖ **Dual distribution**

In our contribution to the previous consultation, LVMH – together with a vast majority of manufacturers and their trade associations – have called for the maintenance of the current framework for dual distribution. Indeed, we are convinced that dual distribution increases both intra- and inter-brand competition, as it increases both the availability of our products, and consumer choice. Dual distribution also enabled the creation of multi-brand stores, where consumers can compare and choose between competing products in a single retail space. This increases inter-brand competition because without the existence of multi-brand stores, competition would likely stop at the shop's entrance door.

The Commission's decision to introduce new safeguards to determine our brands' ability to fully benefit from the dual distribution exemption is in our opinion misguided and risks severely undermining legal certainty and – ultimately – competition. Please see below some of the arguments against the introduction of these new safeguards:

It is not supported by data – 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 22% of respondents advocated for a change in dual distribution rules[1]. In addition, 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*". Finally, 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 were therefore very surprised to see that the Commission decided to include such a mechanism without any kind of testing or based on any theory of harm.

The Horizontal Block Exemption Regulation (HBER) and Horizontal Guidelines (HGL) are not suited for dual distribution – the horizontal framework covers exchanges of information in cases of undertakings competing primarily on different products. In the case of dual distribution, the undertakings are selling the same product. This is an important distinction, because there is a mutual interest for both undertakings to sell as much products as possible.

While the HBER and HGL are currently under revision, the latest public consultation only 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.

Selective distribution, by nature, requires a minimum level of information exchange – 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. In order to maintain the luxury image of its products and to provide customers with a coherent retail experience across the 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,

[1] It should be noted that given the way the question was framed, that figure does not necessarily mean that respondents who argued for a change in the dual distribution rules where necessarily in favour of restricting those rules, rather than loosening the rules.

suppliers and distributors also need to exchange (anonymised) data about, for example, past product performance and upcoming promotion campaigns.

The new threshold will be virtually impossible to calculate and is 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 HBER and HGL, they are not supposed to directly share any data about their respective market shares (since it is not public data).

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 for businesses 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 our 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.

Suppliers of luxury goods would likely exceed the threshold because of retailers' market share – in the luxury sector, the supply market is usually very competitive, with a lot of actors, and no dominant player. For example, in perfumes and cosmetics, the top 10 players of the market in 2017 only made up a combined market share of 26%[2]. This number is down from 30,7% in 2010, which shows that competition in the sector has increased since the adoption of the VBER and VGL in 2010.

However, on the retail side, the market for perfumes and cosmetics (P&C) is usually more consolidated, with a more limited number of actors. This can be explained by the market structure and the usually higher entry costs. Many P&C retailers have a market share that exceeds 10% in their relevant markets.

As a result, suppliers operating under dual distribution would automatically be above the 10% threshold of articles 2(4)(a) and (b), regardless of their own market share at retail level. The new threshold would therefore disproportionately affect suppliers, whose market share at retail level is usual minimal.

The solution does not solve the alleged problem – in a retail environment as dynamic as the luxury market, where brands produce a minimum of two collections per year, in addition to several collaborations and capsule collections, brands welcome and need the predictability and certainty offered by the existing VBER. The new thresholds of article 2(4)(a) and (b) will undoubtedly slow down the collaborative process and create unnecessary barriers to the optimisation of the partnership. Brands will decide that it is more convenient to launch these collections/collaborations via their own retail network. The result would be a further integration of brands' distribution networks, which would ultimately lead to less competition and less consumer choice.

The problem is the threshold itself – it should be clarified that all of the above-mentioned concerns are linked to the creation of a new threshold in itself, not to the fact that it is too low. 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[3], the main concern we are raising is linked to the creation of any new threshold that would constitute an unnecessary barrier to our brands' eligibility for a dual

[2] RBB Economics (2019) The effects of vertical restraints and online sales in the cosmetics industry - A report for Cosmetics Europe, p. 55

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

distribution exemption. As previously argued, we believe that dual distribution is pro-competitive and leads more intra- and inter-brand competition, more consumer choice, and also more investment and jobs.

Conclusion – for all of the above-mentioned reasons, our recommendation is that the Commission refrains from introducing the new provisions of articles 2(4) and (b) and leaves the existing provisions relating to dual distribution untouched (Option 1 of the impact assessment: status quo).

❖ Online intermediation services

It is unclear why providers of online intermediation services should be considered as suppliers, since in most cases they do not produce or sell products – in their own name or through brands that they own. Therefore, we believe providers of online intermediary services should only be considered as suppliers when they produce and sell products on their platform that directly compete with their suppliers'.

It should also be clarified that hybrid platforms which act both as providers of online intermediation services and as retailers shall not be qualified as "supplier" when acting as retailers. For instance, where a platform would enter into a distribution agreement with a brand-owner, according to which the platform will purchase and resell the brand-owner's products, how would such a platform be qualified vis-a-vis the brand-owner?

In addition, paragraph 44 of the Guidelines 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 not correlated with today's digital business models. We believe that providers of online intermediation services should not be able to qualify as an agent only in the exceptional cases when they are also suppliers, as defined in the above paragraph..

Finally, we believe article 2(7) should clarify that undertakings providing online intermediation services should only be considered as being "in competition with undertakings" when they both produce and sell competing products on their platform.

If not, none of the agreements with providers of online intermediation services (including potentially with marketplaces) selling a supplier's products on the platform would benefit from the exemption, since the platforms will almost always be selling products that compete with their suppliers' products (as it is the business model of any multibrand store, and it is also considered a hardcore restriction for a supplier to request that its retailer does not sell products from its competitors).

Excluding *de facto* all agreements between brands and providers of online intermediation services would generate a lot of legal uncertainty, which would seriously undermine the benefits of the exemption as brands will decide that it is more convenient to use their own web site or retail network, and will ultimately lead to less competition and less consumer choice.

❖ Resale Price Maintenance (RPM)

We welcome the clarification brought by §182 VGL of the exceptional circumstances under which RPM may be exempted, especially with regards to new products. We are of the understanding that RPM for seasonal products, which require substantial investments by retailers and offer a short period of time to recover them, would fall under the scope of the exemptions laid down in §182. In such cases, all customers would benefit from the additional services without distinction, and RPM can be justified by the need to avoid free riding to secure our retailers' ability to recover their investments.

We would, however, welcome the introduction of a specific mention of seasonal products in §182 in order to maximise legal certainty. Indeed, as is the case for new products, seasonal products will require substantial investments that can only be recovered over a limited period of time. It should therefore be possible to use RPM in order to enable our distributors to recover such investments.

In addition, we would also welcome additional clarifications as to what the Commission considers falls under the definition of "experience" and "complex" products. Finally, we understand from the Guidelines and welcome that Minimum Advertised Pricing (MAP) in line with a brand's qualitative requirements remains exempted as long as it does not lead to RPM.

❖ **Fight against unauthorised sales**

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

While this new provision might strengthen brands' ability to contractually restrict unauthorized sales, we remain convinced that this provision will remain toothless without an enforcement mechanism allowing brands to oppose their selective distribution networks vis-à-vis third parties.

We would therefore still advocate for the creation of such an enforcement mechanism, as we have consistently called for throughout the VBER and VGL's revision process.