Distribution Law Center

DRIVEN BY CONTRAST

Public Consultation on the Draft Revised Vertical Block Exemption Regulation and Vertical Guidelines

observations submitted by

Distribution Law Center

17 September 2021

1. Introduction

The Distribution Law Center is a recent initiative of the Brussels-based law firm **contrast** to create a one-stop platform for information related to the various legal aspects of distribution relationships. Competition law occupies a central position in this respect. The timing of the initiative is closely linked to the revision of Regulation 330/2010.

The Distribution Law Center groups specialized teams of law firms representing no less than 27 European jurisdictions (including the UK). These teams provide the relevant input to ensure that the platform meets the expectations of users from the legal, business and academic world.

The contributors of the Distribution Law Center that have assisted with respect to the present observations are the following: Banning (The Netherlands), Horten (Denmark), Modzelewska & Pásnik (Poland), E+H Eisenberger + Herzog (Austria), Arbtzen De Besche (Norway), Delchev & Partners (Bulgaria), Havel & Partners (Czech Republic and Slovakia), Chrysses Demetriades & Co (Cyprus), Kyriakides Georgopoulos (Greece), TGS Baltic (Estonia), CMS (France), Divjak, Topić, Bahtijarević & Krka (Croatia), Mușat & Asociații (Romania), Cederquist (Sweden), Šelih & partnerji (Slovenia) and Dittmar & Indrenius (Finland). Several of these contributors provided also input for the preparation of the Expert Report submitted by contrast at the request of DG Competition (link).

The Distribution Law Center will go live on 4 October 2021 (link). Access to the platform will be free of charge.

The Distribution Law Center is grateful for the opportunity offered to comment on the draft Vertical Block Exemption Regulation (C(2021)5026 final) ("draft VBER") and the draft Vertical Guidelines (C(2021) 5038 final) ("draft VGL").

The approach adopted by the Distribution Law Center is purely technical and its comments are not intended to influence the policy choices to be made.

The major aim of the Distribution Law Center at the present stage is for the future block exemption regime to be an efficient tool to ensure compliance with EU competition law. The Distribution Law Center reminds in this respect that the VBER is the most commonly used competition law instrument by a very wide range of businesses and that the external and in-house legal advisors of such businesses are not necessarily competition law specialists. Clarity and legal certainty are therefore key parameters for the success of the future regime.

The Distribution Law Center believes that this is all the more the case because, for most practitioners, reliance on the VBER is the most common practice. Experience teaches us indeed that individual assessments to determine whether a practice may be compatible with Article 101(3) TFEU are rare. In view hereof, the Distribution Law Center calls upon DG Competition to expand the sections in the draft VGL addressing the application of the VBER so that the objectives of legal certainty and ease of application are served and promoted.

When presenting its comments, the Distribution Law Center follows the order of the draft VGL.

2. <u>Agency</u>

Section 3.2 of the draft VGL addresses agency relationships. In this respect, the following technical points may be helpful for the review process:

- In para 28 of the draft VGL it has been added that the conditions for categorizing agreements as agency should be interpreted narrowly. The test covering this issue is already formulated in a very strict manner (*"does not bear any or only insignificant financial or commercial risk"*). The addition of this new language regarding narrow interpretation (which is not present in the current Vertical Guidelines) creates legal uncertainty and may cause unnecessary legal disputes. If it is decided to keep the additional language, it is advisable to add (e.g. by means of a footnote) a clarification as to why it is added and which particular situation it is trying to address.

- Para 30 of the draft VGL adds a new test for measuring the significance of the risks undertaken. Reference is made to the revenues generated by the agent from the relevant agency services. There is no explicit support for this approach in the caselaw of the Court. While it may be accurate that the turnover generated with the sale of the goods and services may not necessarily be the right parameter for assessing the level of the risk, it would seem to make economic sense to take into account the overall profile of the agent (including any other activities in which he is engaged). Not only does such a broader perspective present a more realistic perception of the level of risk effectively borne, it also avoids that the assessment may fluctuate based on temporary developments in the business success of the agent for a given principal.

- Para 31(a) of the draft VGL usefully adds that the temporary and brief acquisition of the contract goods does not necessarily alter the analysis. Such acquisition is often due to considerations unrelated to competition law. This is a welcome addition.

- Para 33 of the draft VGL provides that "*it may also be necessary for the principal to systematically monitor* ...". This sentence follows a sentence in which reference is made to the possibility for the agent to declare by way of a simple method any additional costs. The formulation of these sentences (and in particular the language "*it may be necessary*") triggers legal uncertainty. If the agent can declare additional costs in a flexible manner, why would it then still be necessary to set up a monitoring process? Such a formulation risks to fuel unnecessary legal disputes. The replacement of the word "necessary" by "useful" conveys (almost the same message without attracting the legal uncertainty of the current formulation.

- Para 34 of the draft VGL provides that the "*independent distributor must be genuinely free to enter into the agency agreement*". It is unclear (also considering the caselaw of the Court) why this condition is added if the relevant test necessarily implies that all the relevant risks are to be borne by the principal. Furthermore, the example provided is fairly extreme. More relevant seems to be the question whether there is a risk that the distributor is not genuinely free if the principal provides that the relevant goods (e.g. a brand-new model) are only available through an agency set-up? This is in practice a much more common scenario than those presented in para 34. Hence, if the "genuine freedom" test is maintained, it should be clarified that this scenario (relevant products only available through agency) does not present a problem.

- Paras 35 – 37 of the draft VGL deal with the scenario where the same undertaking acts as both independent distributor and agent for the same supplier/principal. If the position reflected in the draft VGL is well understood, a scenario (which is quite common in practice) to launch a new and spectacularly improved model first through genuine agency, while continuing to sell the other models via independent distribution, becomes completely unworkable. It is unclear why the draft VGL do not apply a simple "but for" or counterfactual assessment to assess the risk level associated with the agency: think the agency away and define on that basis the costs that disappear; it are these costs in relation to which the agent should bear no or only a de minimis risk. The draft VGL seem to adopt the opposite approach for which we can see no basis in the caselaw of the Court. The reference to the Daimler judgment (T-325/01) would not seem to be particularly helpful in respect of this specific issue as conclusions are drawn from a line of argumentation where the Commission was relying on the position in different markets to undermine a finding of genuine agency. If the counterfactual approach is not followed, it seems reasonable that costs relevant to both activities are spread over these activities on the basis of a logical parameter (such as, e.g., turnover generated) in order to assess the level of risk assumed by the agent. The failure to adopt such a more moderate approach towards the allocation of costs threatens otherwise to render in many scenarios the combination of independent distribution and agency impossible.

- In the same context, there seems to be clear tension between the treatment of (genuine) agents that act as independent distributor for competing suppliers and those that combine the two functions for the same supplier. The risks for competition that are put forward with regard to the latter scenario seem to apply also in the former. Nevertheless, the attribution of costs in order to assess the level of the risks borne is entirely different. The logical explanation for such a radically different approach seems difficult to identify.

3. <u>Definition of Vertical Agreement</u>

Para 59 of the draft VGL reflects the standard position (see also, Vertical Guidelines, para 26) that rent and lease agreements are not covered by the block exemption. Both rental and lease would seem to qualify as services (which is the case in other areas of the law) so that it is not clear why it is stated that "*no good or service is being sold by the supplier to the buyer*".

4. <u>Vertical Agreements between competitors</u>

The issue of dual distribution reflects in the opinion of the Distribution Law Center one of the most important changes to the current regime. There is a genuine concern that the overall usefulness of the block exemption regime will be affected by the proposed new rules and furthermore that there is considerable legal uncertainty accompanying the new regime.

The current regime has attracted positive feedback from various circles and there is a demonstrable risk that its relevance is undermined. This will result in compliance risks and related business uncertainty. The cost of compliance will go up and the risk of unnecessary legal disputes will likewise increase. The Distribution Law Center would therefore be most grateful if the following points are taken into consideration when finalizing the new rules:

- The Distribution Law Center welcomes the extension of the exception included in Article 2.4 of the draft VBER to wholesalers and importers. This approach is consistent with the exception included in Article 4 (b) (iv), 4 (c) (i) and 4(d) (iv) of the draft VBER and, in particular, the final sentence of para 211 of the draft VGL.

- Article 2.4 (a) and (b) and Article 2.5 of the draft VBER rely on a market share threshold consisting of the aggregate market share in the relevant market at the retail level and whether such market share does or does not exceed 10%. The choice of this threshold is somewhat surprising in many respects.

  First, the choice of a limit of 10% with reference to the De Minimis Notice is remarkable in a block exemption context. One would have expected to find here at least the 15% safe harbor threshold of the Horizontal Guidelines (see, paras 240-241).

  Second, following consultations, the initial approach for calculating the 30% market share limit in Regulation 2790/99 was changed to the regime currently in place, where the buyer's market share is measured on the purchasing market and not on his downstream market. The legitimate concerns that have caused this switch in approach are equally applicable here. This is even more so than was the case at the time, as the local market definitions (see the merger control cases handled at the NCA level) have become inherently more difficult to apply. Reference can be made to the 80% footprint rule that is now frequently applied in mergers to define the geographic delimitation of markets at retail level and that requires considerable fact finding and is subject to considerable fluctuations that are outside the control of the parties concerned (the opening or closure of one additional competing retail store may bring the parties above or below the threshold overnight).

  Third, in order to measure the retail market share correctly, it is necessary to include not only the supplier's products, but also all of the competing products. In order to assess its legal position under the block exemption, the supplier will therefore need to have access to up-to-date and detailed information on the performance of its buyers in terms of competing products. It is a question whether this will not trigger information exchange needs that the current drafts seem to consider potentially problematic.

  The Distribution Law Center strongly supports the position that the dual distribution regime is not rendered dependent on any market share threshold and in any event not on a market share threshold that is so difficult to define as that pertaining to the retail market.

- Para 87 of the draft VGL provides that Article 2.4 "*should be interpreted narrowly due to the exceptional nature of this provision*". Language of this nature injects legal uncertainty and will stimulate legal disputes. Either this language should be deleted so that Article 2.4 can be interpreted on its own merits or, if it is decided to keep it in, it should be clarified so that it is clear what the language is intended to catch and no abuse can be made of it in legal proceedings.

- Article 2.5 of the draft VBER refers to the need to assess the exchange of information based on the rules applicable to horizontal agreements. The current Horizontal Guidelines do contain certain principles governing horizontal information exchanges, but these principles are not tailored towards dual distribution scenarios where there may be both horizontal and vertical information streams. Furthermore, the object restrictions contained in the Horizontal Guidelines are in any event covered by Article 2.6 of the draft VBER.

  It is therefore important that the Horizontal Guidelines are amended by the time of the entry into force of the new VBER. Furthermore, the relevant principles should provide more guidance than is currently the case in the Horizontal Guidelines. With the exception of the object restrictions, the Horizontal Guidelines offer a framework of analysis, but not very much in terms of precise guidance. Economic literature strongly suggests that the marketing of the future will be essentially data-driven. In view hereof, it would be inefficient if legal uncertainty is created as to the data that can be exchanged in a dual distribution scenario.

- There is inconsistency between Article 2.5 of the draft VBER and para 90 of the draft VGL[1]. Article 2.5 excludes information exchanges that are not compatible with the rules applicable to horizontal agreements from the block exemption, but leaves the application of the block exemption intact for the remainder of the vertical agreement ("*the exemption provided for in paragraph 1 shall apply, except for …*"). Para 90 of the draft VGL makes it a condition for the applicability of the block exemption that the information exchange rules are complied with ("*if the following conditions are fulfilled*"). This inconsistency needs to be resolved. Furthermore, if the para 90 approach were to be maintained (which is not what the Distribution Law Center advocates) the relevant information exchange rules will have to be defined with absolute precision (similar to the level of precision of the hardcore restrictions). Otherwise, these rules in combination with Article 2.5 (which will operate in practice as an additional hardcore restriction) are bound to become a source of considerable legal uncertainty.

- Article 2.7 of the draft VBER is truly problematic for the overall usefulness of the block exemption. As defined (see, draft VBER, Article 1.1 (d)), "*suppliers of online intermediation services*" seems to cover also producers and importers that offer a platform to their dealer network on which the latter can offer their products and services. This will often be the case for dealers that lack the resources to invest in a professional platform or web shop themselves. From the moment that such a supplier or importer engages in direct selling, the hypothesis covered by Article 2.7 seems to enter into play. It is unclear to the Distribution Law Center whether it is truly the intention to capture

[1] There is a possible further inconsistency with para 93 (final sentence).

also such cases. If that is the case, it would be helpful to have explained why that is so. If such is not the intention, the text should be amended accordingly.

- The importance of this issue is reinforced by the fact that the legal consequence of the application of Article 2.7 of the draft VBER is not entirely clear. Contrary to Article 2.6 (which refers to both Article 2.4 and Article 2.5), Article 2.7 refers only to the inapplicability of Article 2.4. This would seem to suggest that providers of online intermediation services can still benefit from the block exemption provided that they comply with the information exchange rules referred to in Article 2.5. Para 92 of the draft VGL points however in a different direction and suggests that in any event a case-by-case assessment is needed. This possible inconsistency should be ironed out in the definitive texts. The Distribution Law Center submits that, in order to safeguard the usefulness of the block exemption in more than just a limited number of cases, it is preferable not to follow the para 92 route and to interpret Article 2.7 as stated above in full consistency with Article 2.6.

- As a more general observation, the Distribution Law Center is concerned that the proposed regime is based on the position that dual distribution has undergone a major shift since the adoption of Regulation 330/2010. The idea is that at such time dual distribution was limited to occasional flagship stores and that in the meantime internet selling has caused a major change in this respect. This viewpoint has been tested by many of the contributing teams of the Distribution Law Center and is not confirmed and presents therefore in our opinion an inaccurate justification for the proposed change. Furthermore, the Distribution Law Center wishes to emphasize that dual distribution is the norm and that producers, importers and wholesalers do typically engage in some form of direct selling. Any legal uncertainty created under the new regime with regard to dual distribution affects therefore the vast majority of distribution agreements that are concluded at present and reduces the relevance and usefulness of the block exemption regime.

5. Market shares and market definition

The Distribution Law Center welcomes the simplified regime covering cases temporarily exceeding the 30% market share limit (see, draft VBER, Article 3 juncto 7).

At the same time, the Distribution Law Center would invite the Commission to provide further explanations on the treatment of "in-house supply" (see, draft VGL, para 160). At this point, the Commission explains on the one hand that such sales taking place within vertically integrated economic entities would not be taken into account when calculating the relevant market share, and – on the other hand – suggests that in-house supply would somehow be taken into account when making the assessment of the impact of the agreement on competition. This approach does not necessarily contribute to providing businesses with legal certainty. Logically, the mechanism in place actually forbids an NCA to engage in an effects-based analysis once the agreement is clearly qualified as benefiting from the block exemption. In view hereof, it would be helpful if the Commission were to provide more guidance as to how "in-house supply" needs to be dealt with.

6. Main types of distribution agreements

The draft VBER (see, Article 4(b), (c) and (d)) distinguishes between exclusive distribution, selective distribution and "free" distribution (see also, draft VGL, para 187). This renders matters unnecessarily complex. The Distribution Law Center submits that the only relevant distinction is that between selective distribution agreements (i.e. agreements meeting the conditions of Article 1(1)(f)) and non-selective distribution agreements (i.e. agreements not meeting one or more of these conditions). For the treatment of territorial and customer restrictions the characteristics of the target (that is protected by the relevant territorial or customer restrictions) are then decisive. In this sense, the introductory sentence of para 187 draft VGL is not entirely accurate. This is proven by the fact that the list of Article 4(b) and Article 4(d) is identical.

In view hereof, the Distribution Law Center proposes to facilitate matters by deleting Article 4(d) and by stating that Article 4(b) is applicable to all agreements not meeting one or more of the requirements of Article 1(1)(f) of the draft VBER.

7. Exclusive distribution agreements

The Distribution Law Center welcomes the amendments to the regime of exclusive distribution which may assist to increase the attractiveness of this distribution formula. By the same token, the Distribution Law Center regrets that both legal uncertainty and inconsistencies may contaminate the usefulness of the improvements:

- The draft VBER opens up the possibility to impose active sales restrictions in scenarios of shared exclusivity. The definition included in Article 1(1)(g) of the draft VBER and the draft VGL (see, e.g., paras 102, 107 and 125) add that the number of appointed distributors should be determined in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts. The exact legal consequences of this addition are unclear.

  Article 1(1) (g) of the draft VBER and para 102 of the draft VGL could be read as adding a condition that must be read into Article 4(b). Para 107 of the draft VGL refers to a possibility of withdrawal. Since we find ourselves in a hardcore environment, there is at least a double problem. The first is that hardcore restrictions, given their important legal consequences, must be defined with the utmost precision and should leave as little room as possible for interpretation. This requirement is clearly not met here and the condition leaves ample room for varying interpretations and unnecessary disputes. The second is that it is undesirable that there are uncertainties about the precise legal consequences, particularly in a hardcore environment. As stated, para 107 of the draft VGL does not refer to the inapplicability of the block exemption, but to the likelihood of withdrawal. Furthermore, Article 4(d) of the draft VBER does not refer to the defined term "exclusive distribution system" so that it is unclear on what legal basis this condition can be read into Article 4(d)(i) of the draft VBER.

  The Distribution Law Center submits that legal certainty would be served by eliminating this additional condition and by having the normal operation of the market decide the number of exclusive distributors to be appointed in a shared exclusivity scenario. If an additional condition is intended to apply in relation to shared exclusivity, the Distribution Law Center recommends that it is reflected in clear terms so that legal certainty is preserved and that the future Vertical Guidelines offer explicit guidance as to how undertakings can ensure and demonstrate their compliance with the condition.

- No explicit reference is contained in the draft VBER towards the parallel imposition requirement. The draft VGL do not state explicitly that this condition is abandoned. The draft VBER (Article 1(1)(g)) refers to "*restricts other buyers*" which would not seem to cover all other buyers in the EEA. The language of the draft VGL is however less clear in this respect. Para 100 refers to "*restricting its other buyers*", which could still be read as referring to the parallel imposition requirement. The same wording is not used in para 103 of the draft VGL, which refers to "by other buyers". Para 205 refers to "*by the other buyers of the supplier within the Union, including buyers to which other territories or customer groups have been exclusively allocated by the supplier*", which again suggests that the EEA-wide parallel imposition requirement may remain in place.

  The Distribution Law Center would therefore be grateful that the future Vertical Guidelines make the position in respect of the parallel imposition requirement explicit. If the requirement were to be maintained (which the Distribution Law Center does not advocate), it would be desirable that it is explicitly reflected in the future block exemption.

- The ability to pass on the active sales restriction is a major novelty of the draft VBER. Very little explanation is provided in this respect (see, draft VGL, para 206 and footnote 94). The Distribution Law Center submits that, since this is a major novelty of the new regime (compared to 20 years of the opposite practice), it is highly desirable that the future Vertical Guidelines explain very concretely what the pass on (or roll-over) possibility entails. The average practitioner that applies the block exemption regime is bound either not to spot the change or not to appreciate its precise implications.

8. Selective distribution agreements

The Distribution Law Center welcomes the addition of Article 4(b)(ii) and 4(d)(ii) of the draft VBER. The approach adopted in these provisions is consistent with the reverse protection reflected in Article 4(c)(i). Both systems of reverse protection ensure that choices lawfully made under the block exemption are not undermined as a consequence of the fact that such choices are not implemented across the whole of the EEA.

In this respect, we would like to raise one specific drafting point. The draft VBER prohibits the restriction of active or passive sales to end users by members of the selective distribution system operating at the retail level, except in the situation set out in the first hyphen of Article 4(c)(i). The first hyphen concerns the possibility to restrict the active sales by members of the selective distribution system into an exclusively reserved territory or to an exclusively reserved customer group. In accordance with the current VBER the exception should also refer to the third hyphen of Article 4(c)(i), namely the possibility to restrict the place of establishment of the members of the selective distribution system.

9. Hardcore restrictions under the VBER

Para 164 of the draft VGL provides that hardcore restrictions do not necessarily fall within the scope of Article 101(1) TFEU. The example is provided of a sales ban regarding certain dangerous products to certain categories of customers. Such a ban is objectively justified on account of the nature of the product. The open question is whether restrictions that thus escape Article 101(1) TFEU remain hardcore restrictions that render the block exemption inapplicable to the vertical agreement as a whole. The same question applies to the examples provided in this section of the draft VGL (see, paras 167 and ff.). As an extension of the same question, it seems that the RPM cases that qualify for an individual exemption based on the considerations reflected in the draft VGL trigger the need to assess the whole of the vertical agreement on an individual basis.

If that is the intended approach, it would be helpful to have it explained explicitly in the draft VGL. The price paid for having such valid restrictions (falling outside Art. 101(1) TFEU altogether or covered individually by Art. 101(3) TFEU) is indeed high given the loss of the benefit of the block exemption.

10. Hardcore restrictions pursuant to article 4(b) to (d) VBER

The Distribution Law Center welcomes the abolition of the hardcore treatment of dual pricing in hybrid distribution scenarios (see, draft VGL, para 195). The policy objective of avoiding that the effective use of the internet is prevented remains safeguarded, while additional flexibility is being offered to the business. This approach seems more proportionate to the policy concerns expressed by the Commission and serves legal certainty.

Likewise, the Distribution Law Center welcomes the abolition of the equivalence test in hybrid distribution scenarios. Again, the closer link to the prevention of the effective use of the internet is more consistent with the policy choice made by the Commission and avoids issues of interpretation and legal uncertainty (see, draft VGL, para 221).

11. Restrictions that are excluded from the VBER

There is some tension between the unchanged formulation of Article 5(1)(a) of the draft VBER and the opening created by the second sentence of para 234 of the draft VGL. Given that the unchanged formulation has been in place for decades, legal certainty would be served by having the idea underlying said second sentence expressed in the block exemption itself.

12. Withdrawal and non-application

Given the virtually inexistent experience under the current and the previous block exemption regimes, it is somewhat surprising that on several occasions it is stipulated that the benefit of the block exemption is likely to be withdrawn (see, e.g., draft VGL, paras 107 and 205). On other occasions, more cautious language is used, such as "*may be a reason to withdraw*" (see, draft VGL, para 111) or "may be considered" (see, draft VGL, para 140).

The stronger formulation ("*it is likely that the block exemption will have to be withdrawn*") is also used when presenting certain examples (see, e.g., draft VGL, para 148). The "*example of selective distribution with cumulative effects*" is copied from the current Vertical Guidelines (see, para 188). Notwithstanding the strong formulation, the Distribution Law Center is not aware of any such withdrawal over the past decade. Furthermore, one would expect in the para 188 example a more sophisticated assessment of the factual and economic position before no less than 7 distribution set-ups that are below (and sometimes even well below) the market share limit are threatened with withdrawal. For instance, why would it be likely that the block exemption is withdrawn if there is ample proof of in-store inter-brand competition (even though the product is not terribly complex and the service requirements may not be particularly high). Also, the suggestion (draft VGL, para 148, final para) that the Commission can reverse the burden of proof so easily would not seem to be warranted and risks in fact to be misleading.

The Distribution Law Center submits that it is essential that the safe harbor that is created with the block exemption is not put into doubt by strong language regarding a possible withdrawal and a suggestion that, with a limited number of rather general factual statements, the Commission is entitled to reverse the burden of proof. The Distribution Law Center would welcome more careful language in relation to a possible withdrawal, such as e.g. "*There may be a need to assess the position in more detail in order to determine whether it might be necessary to withdraw the benefit of the block exemption*". Such more careful formulation is consistent with the safe harbor approach that underpins the block exemption regime.

Brussels, 17 September 2021