K&L GATES RESPONSE AND COMMENTS ON
EUROPEAN COMMISSION'S DRAFT REVISED VBER AND VERTICAL GUIDELINES

17 September 2021

1. INTRODUCTION AND SUMMARY

1.1 K&L Gates welcomes this opportunity to comment on the European Commission's proposed draft Vertical Agreement Block Exemption Regulation (VBER) and Vertical Guidelines (VGL).

1.2 We commend the Commission for an impressive and thorough Consultation exercise and for the clear and advanced drafts. We are grateful for the Commission's significant efforts to properly understand, and to create a pragmatic legal framework that supports, the fast-moving commercial realities and challenges faced by market participants today.

1.3 We are supportive of the vast majority of clarifications and updates in the proposed drafts, which in our view will help to enhance consumer welfare, provide legal certainty, and allow the necessary flexibility as the market evolves over the coming decade.

1.4 Nevertheless, we wish to express our serious concerns with two areas in the drafts:

- First, we consider the proposed approach to treat the combination of exclusive distribution at the wholesale level and selective distribution at the retail level in the same territory as a hardcore restriction is mistaken and could lead to a major loss in customer efficiencies. This is dealt with in Part 2 of this submission.

- Second, as regards the strict proposed approach to information exchange in the context of dual distribution, we believe the Commission (correctly) appreciates that some discussion is necessary and legitimate between a supplier and its customers that would not be permitted at all under the Horizontal Guidelines, and that horizontal risk can be managed with appropriate protocols. However, this should be clearer in the revised rules to avoid significant uncertainty. Please see Part 3 of this submission.

1.5 We have suggested amendments to the VBER and/or VGL accordingly.

1.6 Finally, Part 4 of this submission suggests a small number of clarifications to the draft texts, which may limit unintended misinterpretation by companies and legal practitioners in future.

2. COMBINATION OF EXCLUSIVE AND SELECTIVE DISTRIBUTION AT DIFFERENT LEVELS IN SAME TERRITORY

2.1 For the following reasons, we strongly oppose the Commission's draft proposal to treat as a hardcore restriction the combination of exclusive distribution at the wholesale level and selective distribution at the retail level within the same territory (para 222 of the draft VGL):

a) This approach overestimates the restrictive effects on competition.

b) This approach fails to recognise the very significant financial and non-financial investments often required by a wholesale distributor to support the implementation and operation of a retail selective distribution system. Such investments are in fact greater than those required under any other distribution system.

c) We have direct experience of wholesale distributors refusing to make the necessary investments to support a retail selective distribution system. As a result, we have seen systems significantly impaired or even abandoned because the wholesale distributor could not be sufficiently incentivised.

d) The Commission's proposed alternative of quantitative selective distribution at the wholesale level (Draft VGL, para 222) is not an option for suppliers whose market shares exceed 30-35%.

e) Irrespective of a supplier's market share, in our experience a selective distribution model at the wholesale level is not reflective of most direct wholesale relationships and generally not an efficient model for this level of trade. As noted by the Commission, the Respondents to the Commission's e-commerce sector inquiry indicated that "*exclusive distribution at the wholesale level and selective distribution at the retail level is commonly used as it reflects the most efficient way of putting certain types of goods on the market.*"[1]

f) There is insufficient history and evidence of significant negative effects for treating this combination as a hardcore restriction; and

g) The suggestion that individual exemption under Article 101(3) TFEU may be available (Draft VGL, para 168) will be of limited comfort and use to market participants, given the risk, legal uncertainty and legal costs this carries.

2.2 For these reasons, treating a hybrid distribution system with exclusivity at the wholesale level and selective distribution at the lower levels as a hardcore restriction is at odds with the Commission's stance of supporting flexibility for companies, and more importantly is likely to mean selective distribution will be unavailable in practice to a number of brands and that many others will be unable to effectively roll out or administer their systems, with the resultant loss in efficiencies.

[1] Commission Staff Working Document on the Evaluation of the VBER, page 191.

2.3 These points are addressed in further detail below.

(a) Overestimation of potential restrictive effects

2.4 The proposed approach appears to be based on a concern that this combination entails a "*restriction of active or passive sales to end users by the authorised distributors pursuant to Article 4(c)(i) VBER*" (para 222, draft VGL).

2.5 This understanding is incorrect. Any restrictions are in fact much more limited than this.

2.6 Based on our experience of seeing this two-tier combined model in the market:

- The exclusivity and any accompanying active sales restriction only applies to wholesalers at the 'top of the chain' – i.e. direct wholesale distributors are restricted from actively targeting authorised retailers in a territory where another direct wholesale distributor has been appointed as the exclusive wholesaler.

- There is no restriction of sales (whether active or passive) at the retail level where selective distribution operates, whether to end customers or other authorised resellers. In other words, manufacturers permit authorised retailers at the retail level (i.e. selective distribution members) to passively and actively sell to end users as well as other authorised retailers in any territory/ies where the selective distribution system has been implemented. As such, there is no additional lessening of intra-brand competition at the retail level. In practice, this means that the top-level wholesaler's exclusivity is only partial (involves protection against active sales in its territory from other top-level wholesalers, but not from authorised retailers).

- Authorised retailers remain free to source their supplies from any of the manufacturer's wholesalers (although not through active marketing) or from other authorised resellers in any territory.

- Consumers remain free to purchase from authorised resellers in any territory (and to be actively marketed to by them).

- For completeness, we note that in our experience we have seen a small number of 'three tier' systems with selective distribution also applicable at the second tier to indirect wholesale sub-distributors – i.e. intermediary wholesalers who do not purchase directly from the brand. However, there is no restriction on active sales at this intermediary tier to potentially relevant customers. Authorised sub-distributors remain free to sell actively or passively to any authorised retailers or other authorised sub-distributors in the selective distribution territories. The only active sales restriction remains at the top (direct wholesale) level.

2.7 It is also notable that the draft revised verticals rules in principle permit much more restrictive models, such as exclusivity for a small number of distributors/resellers with active sales restrictions passed down through the chain. Disallowing a combined model with a limited active sales restriction only at the top

level could drive companies to adopt models that are more restrictive and deliver far fewer consumer efficiencies.

2.8 Finally, the active sales restriction on other top-level wholesalers is limited to intra-brand competition. It is well-established, and the proposed VGL correctly reiterate, that any reduction of intra-brand competition is by itself unlikely to lead to negative effects for consumers if inter-brand competition is strong.

(b) Failure to recognise major wholesaler investments which may necessitate protection

2.9 The Commission's proposed stance on two-tier combined models underestimates the very significant time, cost and business investments typically required from a wholesale distributor to implement and operate a selective distribution system.

2.10 The Commission clearly and correctly already recognises (more generally) that:

- "*Suppliers often use [exclusive distribution] to incentivise distributors to make the financial and non-financial investments needed to develop their brand in a territory where it is not well-known or to sell a new product in a particular territory or to a particular customer group or to increase the focus of the distributors' activities on a particular product (e.g. special marketing or display efforts).*" (Draft VGL, para 101.)

- "*Exclusive distribution may lead to efficiencies, especially where investments by the distributors are required to protect or build up the brand image and to provide demand enhancing services. In general, the case for efficiencies is strongest for new products, complex products and products whose qualities are difficult to judge before consumption (so-called experience products) or even after consumption (so-called credence products).*" (Draft VGL, para 124.)

- *"Exclusive customer allocation may lead to efficiencies where the investments of the distributors are necessary to build the brand image or where the distributors are required to invest in, for instance, specific equipment, skills or know-how to adapt to the requirements of the exclusive customer group…"* (Draft VGL, para 126.)

2.11 The Commission further recognises (for non-selective distribution contexts) that distributors *"may expect the protection provided by exclusivity to secure a certain volume of business and a margin that justifies their investment efforts"* (Draft VGL, para 101).

2.12 However, when it comes to territories where selective distribution applies at the retail level, these key points seem to be forgotten. This does not make sense since, if anything, the efficiencies noted in the proposed Guidelines as justifying exclusivity (investments for brand protection or elevation, launch of new products, enhanced marketing or display requirements, demand enhancing services, sale of complex goods, and so on) are most typically achieved using selective distribution among retailers.

2.13 Indeed, the investments required of a distributor in the set-up and administration of a retailer selective distribution system will often far exceed those expected where no selective distribution for retailers applies (and yet where exclusivity would be permitted under the proposed rules).

2.14 We appreciate that the Commission might be concerned that selective distribution in itself already entails a limitation on the number of resellers permitted to sell a product, and therefore that adding an active sales restriction at the level above this is an excessive restriction of competition. However, it is important to remember that the active sales restriction at the top level is limited for the reasons discussed above, and moreover that it may be necessary to achieve the full efficiencies at the retail level. In other words, the qualitative criteria for resellers alone will not suffice to deliver the quality efficiencies of selective distribution if they remain hypothetical and cannot be implemented or applied in practice; for these to be achieved, a distributor or distributors' substantial support is often required and may need to be incentivised with protection from active sales by other top-level direct wholesale distributors.

Examples of distributor investments

2.15 The launch of a selective distribution system means that distributors go from selling products to whomever they want to needing to ensure before each sale that the purchaser meets the applicable criteria, has been authorised, and is contractually committed not to sell to unauthorised dealers. Every sale the distributor makes now has several layers of administration. Additionally, the introduction or revision of a selective distribution system can involve many months of preparation and typically requires extensive and often complex communications with customers in the market.

2.16 Examples of the typical efforts and investments required from a wholesale distributor in setting-up and running a selective distribution system are listed below, based on our experience of working with many manufacturers on their systems. These investments are often borne or shared by a wholesale distributor because many suppliers still do not market or sell directly to retailers in a territory, or only to a limited extent, and the retailer relationships and knowledge will lie with the wholesale distributor(s) tasked with promoting the brand in the territory:

- **Communicating the system** to their retail customers (often in the hundreds), including relaying market announcements and more significantly explaining (often unfamiliar or complex) legal terms and criteria to retail customers. The distributor will often 'bear the brunt' of this exercise and the uncertainty and questions from the market should not be underestimated; in practice these can be highly disruptive to the distributor's day-to-day business and of an ongoing nature.

- Taking an **active part in training** arranged by the manufacturer regarding how a selective distribution system works, what the system is intended to achieve, the contractual documentation, the practical mechanics of reseller authorisation, and the applicable competition law principles to ensure legal compliance. If the distributor is to be involved in communicating the programme to resellers, making recommendations for authorisation, or directly authorising resellers (all of which are commonplace as further addressed below), it needs to be familiar with and commit to the *Metro* principles requiring objectivity, uniformity and consistency of criteria application (and we have seen

this obligation built into distribution agreements). Based on our experience of delivering such training to wholesalers on behalf of several brands, this can include the cost of international travel and several days' commitment for distributors. It is also not uncommon for a distributor to engage its own specialist competition law counsel to review terms and risk, with the accompanying costs.

- Handling the **administration of applications and authorisations**, which can be significant and very off-putting for distributors. Even where a manufacturer operates an electronic sign-up portal, the distributor is likely to be involved in discussions and take on extensive paperwork (e.g. evaluation forms and approval forms). This is exacerbated in a manual system.

- **Reviewing retailers' applications and identifying and recommending retailers for authorisation** in a territory, which can involve time-consuming and resource-intensive evaluations of retailers' businesses to ensure compliance with the selective distribution criteria. This exercise, which involves gathering, processing and evaluating large amounts of information, is often delegated to or shared with the local wholesale distributor given its closer knowledge of, and direct relationships with, retailers and the local market.

- **Working with retailers to ensure criteria compliance**, for instance, where authorisation is conditional on certain improvements, or requires retailers to undergo training on new or complex products, customer demonstrations, enhanced pre-or after-sales / warranty support, and so on.

- Given the distributor's local presence and closer market knowledge, **monitoring** authorised retailers' ongoing compliance with the criteria and terms, as well as monitoring the local market for unauthorised resale activities. Informal inspections, audits, mystery shopper exercises and other local investigations may not be feasible or economical for the brand itself to carry out, especially where it does not have a local presence (which is common in hybrid models). In some instances, we have also seen suppliers request assistance from their distributors with issuing enforcement letters to non-compliant authorised resellers or unauthorised third parties.

- **Ensuring network updates are captured, processed and reflected**, for example, the opening of an authorised customer's new locations or websites (or closure of locations), a change in the product mix of the products sold by a partner, and so on.

- **Ongoing communications to the network on the supplier's behalf**, such as circulating up-to-date display or marketing materials, point of sale materials, digital content, product lists and updates, announcements, and so on.

- **Terminating supply relationships** with retail customers who are not eligible for authorisation or who breach selective distribution terms and handling consequent complaints. This can have major relationship implications for a wholesale distributor which may require independent legal advice and risk considerations for the distributor.

- The additional day-to-day hurdle of **verifying customers are authorised before selling** to them (e.g. checking manufacturer lists). Additionally, in our experience, the manufacturer may require

the distributor to ensure its sales system (e.g. online sales portal) only permits a sale following verification of approved status – this can require investments in modifying password controls and so on; and

- Of course, coupled with the above, the **risk and concern of direct immediate sales losses** for a distributor of not being permitted to sell to certain retail customers once a selective distribution system comes into force (i.e. if such customers are not authorised).

2.17 We also have experience of manufacturers asking a distributor to assist in the design of detailed retailer criteria, to ensure these are achievable and realistic for market participants in the territory as well as understandable. At the very least, most manufacturers will consult with key partners on aspects of advanced drafts before they are finalised. We have additionally seen distributors tasked with or charged for translations of reseller documentation for their local territory.

2.18 These various examples of distributor support not only involve significant investments in the form of business time, effort and attention (which would otherwise be spent on selling goods), but can require investing in additional staff and upgraded systems.

(c) Protection of exclusivity may be necessary to achieve efficiencies

2.19 In view of the significant (actual and perceived) costs, effort, investments and business disruption for a wholesale distributor, we have direct experience of distributors resisting the introduction of a retail selective distribution system, refusing to assist the supplier, or limiting their support. If the distributor is also threatened with removal of their protection from active sales at the top wholesale level, we have no doubt that many partners will refuse to implement the system and that brands will be prevented from pursuing these strategies.

2.20 In these cases, exclusivity can act as a strong and necessary incentive for distributors to support a well-functioning selective distribution system, and thus be essential to achieve the intended consumer efficiencies in terms of enhanced quality, retailer sales efforts, and production innovation.

(d) A quantitative restriction at the wholesale level is not an option for suppliers whose market shares exceed 30-35%.

2.21 The draft VGL provide that whilst a selective distribution system cannot be combined with an exclusive system, "*the supplier may commit to supplying only one or a limited number of authorised distributors in a specific part of the territory where the selective distribution system is operated*" (Draft VGL, para 222).

2.22 However, this solution – whilst available to many market participants – is not a realistic option for suppliers with market shares exceeding the levels required to benefit from the VBER. These will often be brands with a strong reputation for quality and/or a prestigious brand status (explaining their market shares) which are in higher demand by consumers and thus more liable to poor sales practices by resellers.

2.23 In our experience, there will be a higher number of unauthorised resellers for major in-demand branded items. Accordingly, to compete for customers and market share, they will be strongly incentivised to offer the lowest possible price and thus will find it more challenging to make the investments in quality necessary to uphold the product's strong brand image. It is also very common to see consumer law violations in relation to strong brands, such as bait and switch practices (i.e. where the brand is used to attract traffic to the reseller's page, and the customer thinks it is buying one thing but receives a different product), failure to allow returns within statutory periods or to reimburse consumers for valid returns, misleading product information, misleading reference pricing, and so on. These brands therefore especially require the additional tool of selective distribution to protect consumers and thus their reputations.

2.24 However, in view of their market shares, under the revised rules they would be forced to set purely qualitative criteria for wholesalers and more importantly apply these uniformly and consistently to all applicant wholesalers to ensure *Metro* compliance. Indeed, given that the primary purpose of appointing a wholesale distributor is usually to help a supplier grow its brand and retail network, the very criteria brands do look for when selecting wholesale partners are quantitative in nature - e.g. does the wholesaler have sufficient depots or warehouse facilities, is it prepared to commit to a minimum purchase or sales target, can it invest a certain minimum in brand promotion in the territory, does it have a sufficiently large high quality retail customer network, etc.

2.25 In other words, brands would be forced to appoint any compliant wholesaler regardless of its size, financial commitments, or reach. This is simply not reflective of trade at the wholesale level for the reasons discussed above and further below. It seems unrealistic to expect, where a supplier has been forced to appoint numerous direct wholesaler distributors (because it cannot cap their number), that any of them will be sufficiently incentivised to grow the brand or network when their investments cannot be protected from active selling from the others. As would be the case in any distribution system, this proposition undermines the primary goal of having wholesale partners.

(e) A selective distribution model is not reflective of direct wholesale relationships

2.26 Fourthly, irrespective of a supplier's market share (i.e. even where wholesale quantitative selective distribution may be block exempted), a selective distribution model is not reflective of a typical direct wholesale relationship.

2.27 Selective distribution in the sense of *Metro* and even as outlined in the Draft VGL is concerned with elevating the consumer experience. As wholesalers typically do not sell to consumers, the usual criteria such as an appealing shop or website, skilled customer-facing staff, fast delivery, free returns, and so on, will not be relevant. As explained above, the priorities for deciding on the correct direct top-level wholesale partner(s) generally concern maximising sales, leveraging a distributor's customer network and relationships, and managing supplies to retailers in a particular territory, taking into account its local features. Direct partner selection is also typically based on extensive and lengthy negotiation as opposed to a standardised set of criteria.

2.28 Thus even where a quantitative cap on top direct wholesale partners could in principle be imposed because the supplier's market share is under 30%, it is likely to be applied purely for technical legal compliance and not as a reflection of how that relationship works. In other words, restructuring the top direct wholesale level so that it is based on (qualitative or qualitative) criteria is artificial; it would require introducing unnecessary legal and business costs and complexities for little efficiency gain (if anything, for possibly reduced efficiencies).

(f) There is insufficient history and evidence for treating the combination as hardcore

2.29 The Commission accepts that "*combining exclusive distribution at the wholesale level and selective distribution at the retail level is a common practice*". [2] It was also told by Respondents in its e-commerce sector inquiry that this model "*is commonly used as it reflects the most efficient way of putting certain types of goods on the market*." [3]

2.30 Accordingly, if the draft VBER and VGL are implemented in their current form, significant and expensive changes to distribution systems by a large number of brands will be required. We would query whether the Commission has sufficient experience of hybrid systems to effectively mandate such a change.

2.31 As recognised in para 163 of the Draft VGL, the other hardcore restrictions identified in the VBER (notably RPM and passive sales restrictions) are broadly aligned with the 'by object' restrictions identified by the CJEU's case law. The latter are restrictions which, by their very nature, have the potential to restrict competition. These have been developed based on case-law showing that certain types of coordination between undertakings reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects. Hardcore restrictions correspond to a category of restrictions under the VBER for which it is presumed that they generally result in harm to competition so that a vertical agreement containing such a hardcore restriction cannot be block exempted pursuant to Article 2(1) VBER.

2.32 However, simply put, this kind of evidence of harm seems to be lacking in the case of a hybrid combination of systems in the same territory.

2.33 It should not be underestimated that many market participants may have implemented or at least retained this model based on the fact that, unlike hardcore restrictions such as RPM and passive sales restrictions, the law is unclear. Indeed, the current wording of para 176 of the VGL can be interpreted as *allowing* the combination with a limited active sales restriction in a non-selective level.[4] In the absence of any underlying case law, decisional practice, or other discussion on this restriction - as would typically

[2] Commission Staff Working Document on the Evaluation of the VBER, page 191.

[3] Commission Staff Working Document on the Evaluation of the VBER, page 191.

[4] "*(176) Qualitative and quantitative selective distribution is exempted by the Block Exemption Regulation as long as the market share of both supplier and buyer each do not exceed 30 %, even if combined with other non-hardcore vertical restraints, such as non-compete or exclusive distribution, provided active selling by the authorised distributors to each other and to end users is not restricted.*"

be required for a hardcore restriction- coupled with the fact that this is considered by market participants to be one of the "the most efficient" models, it is not surprising that this model is widely adopted.

2.34 Therefore, the Commission should not adopt the proposed hardcore restriction without carefully assessing whether the model indeed "*reveals a sufficient degree of harm to competition that it may be found that there is no need to examine their effects*". This is particularly the case where:

- The potential harm seems to be unclear and untested (in our view, the restriction has limited additional effects); and
- By contrast, the Commission has received extensive evidence that these models are overall (highly) efficiency generating.

2.35 In particular, we note the following:

2.36 First, we have not identified any case law or even Commission cases examining the actual or potential harm of the combination which confirms it can be presumed to be material and justify such harsh treatment. Indeed, the few past Commission cases seem to have dealt with the combination of (at least) non-selective and selective distribution as a complete "non-issue". In *Villeroy and Boch*[5], the Commission expressly accepted that selective distribution did not have to apply at every level but that some restriction on non-selective wholesale partners was permitted to reflect the selectivity of the retail level.[6]

2.37 Second, the Expert Report on Active Sales Restrictions identifies this combination as an area where policy change "*can usefully be considered*" by the Commission, and that (whilst for them) "*such a change is less fundamental than the recommended key changes, [it] could be considered a tool to promote investments in the deployment and maintenance of selective distribution systems at the retail level in a given market*." The Report explains that the authors have, based on their conservative interpretation of the VBER, "*steered businesses away systematically from such a hybrid set-up*" specifically because of the legal uncertainty around triggering a potential hardcore restriction under VBER. They also cite this legal risk and uncertainty as the main reason why, at least in their experience, companies may avoid this model:

"*We are aware that stakeholders refer to combinations of exclusivity in certain territories and selectivity in other territories, or exclusivity at the wholesale level and selectivity at the retail level. Clients occasionally raised these scenarios with us, but, once the constraints presented by the VBER were*

[5] Case IV/30.665, Villeroy & Boch, Commission decision of 16 December 1985.

[6] "*As the objective qualitative selection criteria and the sales promotion obligations [applicable at the retail level] are considered compatible with Article [101(1)], the said commitment does not itself appreciably restrict competition in the present case. If the obligation on authorized retailers not to sell to retailers is recognized as being lawful, the same must be true of the obligation on wholesalers and central purchasing agencies to supply only Villeroy & Boch retailers, inasmuch as it constitutes at the wholesale level the reflection of the selectivity of the retail distribution system*" (paragraphs 34-35).

"*The network of notified distribution agreements [i.e. including both those at the retail and the wholesale level] does not contain any obligation on the part of Villeroy & Boch resellers having as its object or effect any appreciable prevention, restriction or distortion of competition within the common market within the meaning of Article [101(1)]…*" (paragraph 39).

properly understood, they were in most cases abandoned…When confronted with questions in this respect, we tend to steer the business away from them given their intrinsic difficulties under the VBER."[7]

2.38 However, for this very reason, the authors expressly concede that they "*lack practical experience with [this] specific area and recommend that a further assessment is made by the European Commission before deciding on [this] policy option*". [8] In other words, the particular authors were unable to comment on the actual likelihood of harm and urged a more detailed assessment before a decision is taken.

2.39 Conversely, the authors also flag an example where this conservative interpretation of the VBER led to a manufacturer only partially implementing its business strategy, which from our reading would have created significant customer efficiencies which were accordingly lost or reduced.

2.40 Third, it should be noted that in the context of the review of the UK vertical rules, the UK's Competition and Markets Authority (CMA) has adopted the opposite view, namely that the combination of exclusive and selective distribution at different levels of the supply chain should be confirmed as permissible.[9] Specifically, the CMA proposes that the list of exceptions to the hardcore restriction in Article 4(b) of the retained VABER should be revised in the UK VABEO and clarified in the CMA VABEO Guidance to permit the following: "*(a) the combination of exclusive and selective distribution in the same or different territories;…*"

2.41 The CMA has noted as drivers for this proposed position:

- "*4.23 More generally, a significant number of participants expressed support for solutions which give them more flexibility to design their systems according to brand objectives and appetite for risk, rather than being driven to the stark and somewhat limiting choice between exclusive and selective distribution models.*"

- Fn 48: "*Some respondents to the [Commission's] Evaluation noted that exclusive distribution at the wholesale level and selective distribution at the retail level was considered one of the most efficient models for distributing certain goods and therefore should be unequivocally allowed. The [Commission's] Evaluation confirmed that this combination was common practice and that there was lack of clarity around the circumstances under which the combination of exclusive and selective distribution was block exempted.*"

[7] Expert report on the review of the Vertical Block Exemption Regulation Active sales restrictions in different distribution models and combinations of distribution models, page 10.

[8] Expert report on the review of the Vertical Block Exemption Regulation Active sales restrictions in different distribution models and combinations of distribution models, page 4.

[9] CMA, The retained Vertical Agreements Block Exemption Regulation - Consultation document, 17 June 2021, paras 4.41-4.42.

2.42 It should be stressed that the starting position for both the EU review and the UK review is the same law: the current VBER and the EU case law, coupled with the Commission's own findings in its e-commerce sector inquiry.

2.43 Therefore, we are concerned that the Commission appears to be introducing or crystallising a hardcore restriction in circumstances where the evidence does not support a presumption of serious harm, many expensive and unnecessary changes will be required, and significant consumer efficiencies could be lost.

(g) The possibility of individual exemption under Article 101(3) TFEU is of limited utility

2.44 We note that the Draft VGL (para 168) contain a narrow potential possibility for 101(3) exemption:

"*In the case of a selective distribution system, cross-supplies between authorised distributors must normally remain free …. However, if authorised wholesalers located in different territories are obliged to invest in promotional activities in the territory in which they distribute the goods or services concerned in order to support the sales by authorised distributors and it is not practical to specify in a contract the required promotional activities, restrictions on active sales by these wholesalers to authorised distributors in other wholesalers' territories to overcome possible free-riding may, in an individual case, fulfil the conditions of Article 101(3).*"

2.45 However, realistically we cannot see many companies relying on this given the complexity and uncertainty of an Article 101(3) analysis and the high risk of a hardcore infringement attached. This view is mirrored by the authors of the Expert Report on Active Sales Restrictions prepared for the Commission:

- "*In our experience, the hypothesis described in this specific paragraph of the Vertical Guidelines is mainly theoretical and lacks practical relevance.*" [10]

- "*We nor the Contributing Practitioners have come across an example, where a business felt sufficiently comfortable that its distribution set-up fell within the scope of paragraph 63 and could therefore benefit from an individual exemption. Even if that were the case, the consequences of applying paragraph 63 are unhelpful. There are multiple reasons that may explain why the exception contained in paragraph 63 does not work in practice…*"[11]

2.46 Accordingly, for suppliers with a market share of over 30%, the alternative proposed does not seem feasible.

2.47 For completeness, we also note that the draft VGL provide that "*the combination of selective distribution with a location clause, to protect an authorised distributor against competition from other authorised*

[10] Expert report on the review of the Vertical Block Exemption Regulation Active sales restrictions in different distribution models and combinations of distribution models, page 43.

[11] Expert report on the review of the Vertical Block Exemption Regulation Active sales restrictions in different distribution models and combinations of distribution models, page 44.

distributors opening a shop in its vicinity, may in particular fulfil the conditions of Article 101(3) if the combination is indispensable to protect substantial and relationship-specific investments made by the authorised distributor" (Draft VGL, para 146). However, again given the uncertainty, this remains highly theoretical and unlikely to be relied upon in practice. As a wholesale business is often also carried out by staff 'in the field' or by phone, email or online, a location clause may be of limited utility in any event.

Proposed amendments to VBER and the VGL

2.48 For the above reasons we urge the Commission to permit a narrow possibility for a hybrid system with exclusivity at the top tier and selective distribution at one or more lower tiers, where these respective models are eminently more suitable and efficiency-producing.

2.49 To avoid adding an overcomplicated or potentially confusing new exception to Article 4(c)(i) of the VBER, we suggest a small amendment to the wording of the Article 4(c)(ii) hardcore restriction as shown below.

"*(c) where the supplier operates a selective distribution system,*

…(ii) the restriction of cross-supplies between the members of the ~~selective~~ distribution system operating at any tiers where selective distribution is in place ~~the same or different levels of trade~~;"

2.50 Paragraph 222 of the Draft VGL would need to be revised to reflect this. Our suggested approach serves to stress that no active sales restriction is possible at any selective distribution level; i.e. any active sales restriction must be limited to the top tier only in circumstances where the top-level distributor has been granted exclusivity to incentivise support for a lower tier selective distribution system.

3. CLARITY ON INFORMATION EXCHANGES IN DUAL DISTRIBUTION

3.1 We support the continuation of VBER coverage for dual distribution where the parties' market shares fall within the VBER thresholds. Removal of the VBER for the construct of dual distribution would have resulted in significant market uncertainty and disruption, since many if not most consumer brands we deal with have begun or have plans in place to start selling directly to consumers. This pre-existing trend was accelerated by the Covid-19 pandemic and will only grow.

3.2 Further, we note VBER exemption for information exchanges between parties with a combined 10% market shareholding. Whilst we consider this construct in the VBER might give rise to confusion among market participants, we understand the Commission's rationale on the substance (on the basis that any horizontal restrictive effects are likely to be *de minimis*).

3.3 *However*, we disagree with the proposal to apply the Horizontal Guidelines (at least in their present form) to discussions between suppliers and their customers where the parties' market shares exceed the new 10% threshold. As explained in our firm's submissions to the Commission dated 20 November 2020 and 26 March 2021, the effect of this will be to remove many market participants' ability to discuss topics which are entirely legitimate and indeed necessary for efficient vertical (supply and distribution) relationships but which would be inappropriate in a purely horizontal context under the current Horizontal

Guidelines, such as: proposed sales targets, marketing strategies and budgets (including for particular territories or customers), recommend resale prices, maximum resale prices, future network-wide promotions funded by the supplier, exclusivity, customer lists, and so on.

3.4 We do not believe it can be the Commission's intention to remove supply partners' ability to discuss these topics provided that appropriate measures are in place to manage horizontal risk. Prohibiting these topics altogether (as would be required under the current Horizontal Guidelines) would lead to far less efficient distribution structures as well as create major practical confusion in the market. It would essentially render much of the rest of the VBER irrelevant where a supplier competes with its customers (which is often).

3.5 Accordingly, the new rules should expressly acknowledge that dual distribution setups are different from purely horizontal competitive relationships, that the risk is limited to intra-brand as opposed to inter-brand competition, and that the risk can be managed with protocols. These may include separations and information exchange limitations between the sales team and the competitive direct-to-consumer team in an organisation, coupled with training for the sales team on how to handle sensitive topics to avoid inappropriate disclosures.

3.6 We understand the Commission is envisaging some sort of "interim guidance" on this subject. To our mind, since the "centre of gravity" of most dual distribution relationships is the vertical supply aspects, the VGL seem like the more natural fit for this subject. As an alternative, we would suggest (permanent) standalone guidance. This would avoid the need for replacement or duplicated guidance in the Horizontal Guidelines, as well as address the risk of uncertainty in the gap before the revised Horizontal Guidelines come into effect.

4. OTHER CLARIFICATIONS

Possible alternative status for online intermediation service providers in some instances

4.1 We note that the draft revised rules categorise undertakings providing online intermediation services as "suppliers".

4.2 In our experience, they do indeed often sell goods independently of the supplier or other market participants, where this designation (for competition purposes) would be accurate.

4.3 However, in the last few years we have seen an emergence of new business models where a platform is only providing website hosting services (essentially a "rented online shop window" or "e-concession") to the product supplier, and the supplier is actually selling directly to the consumers (taking inventory and sales risk and covering the investments and costs, such as for marketing, storage and delivery). At most, to the extent the platform is handling the transactions on the supplier's behalf, it might also qualify as an agent.

4.4 These alternative models can be highly efficient and can be expected to grow as suppliers increase their direct to consumer businesses and seek to take advantage of existing platform technologies and reach.

From the platform / web host side, it offers a lower risk and lower investment proposition than purchasing and reselling stock.

4.5 However, the presumption in paragraph 44 of the draft revised VGL that providers of online intermediation services are to be categorised as suppliers could lead to unintended consequences that they can never qualify as 'genuine agents' even if they meet the conditions set out in paragraphs 30 to 32 of the draft revised VGL. This could cause difficulties and introduce significant uncertainty as companies explore new direct-to-consumer business models.

4.6 Accordingly, paragraph 44 of the draft revised VGL should be clarified to acknowledge this. An example is provided below:

"*(44) Undertakings providing online intermediation services are categorised as suppliers under the VBER (see also paragraphs (60) to (64) of these Guidelines) and can therefore in principle not qualify as agents for the purpose of applying Article 101(1) unless it is clear that they meet the conditions for agency set out in paragraph (31) of these Guidelines or otherwise act purely as website hosts or logistics service providers. Moreover, with some limited exceptions, providers of online intermediation services generally act as independent economic operators and not as part of the undertakings of the sellers to which they provide online intermediation services…*"

Selective distribution products

4.7 We agree with the definition in the Draft VGL of the products to which selective distribution may apply as comprising high quality, high-tech or luxury goods.

4.8 It should be noted, however, that typically all of these products will be final branded items (as recognised in the Commission's e-commerce sector report) so selective distribution does not simply ensure the preservation of their material quality and proper use, but also the preservation of the trademark's *reputation* and *brand image* even of non-luxury high quality or tech goods.

4.9 Additionally, the Commission may wish to consider noting sustainability requirements (such as a commitment to specific environmental, social or governance objectives) as possible justifications for selective distribution. Given the EU's Green Deal and proposed new Supply Chain Due Diligence initiatives, suppliers of a range of products will be required to ensure that resellers meet particular requirements (such as commitment to recycling schemes, decarbonisation objectives, anti-slavery commitments and so on). Placing more emphasis on environmental protection in the Commission's policies and activities would also be in compliance with Article 11 of the Treaty on the Functioning of the EU.

Enforcement of selective distribution

4.10 We entirely support the Commission's clear description of the principles for the assessment of selective distribution systems. We also consider that the proposed revisions correctly reflect current and expected market realities, for instance, the differences in sales channels and the need to support brick and mortar

network partners. It is clear that EU law permits selective distribution and recognises its significant benefits for consumers.

4.11 However, we note that in practice there are limited tools for the *enforcement* of selective distribution systems against unauthorised resellers, given that the supplier will typically not have any direct contractual link or relationship with such third parties, and they may deliberately evade the usual channels of supply.

4.12 Suppliers are thus obliged to devise novel enforcement tools before the national courts using intellectual property laws, unfair competition laws, or the rules on inducement of breach of contract. In the absence of well-known grounds for enforcement, suppliers also face the risk of counter-threats for sending cease and desist letters in some jurisdictions (even in circumstances where they clearly have a valid selective distribution system in place).

4.13 Accordingly, there are very few cases in practice and the uncertainty around valid enforcement can disincentive suppliers from using such a system or limit its effectiveness. In short, many suppliers feel their hands are tied and that a selective distribution system has little meaning in practice.

4.14 The only Member State we are aware of with useful and clear enforcement tools in this area is France, which has a statute in place. Under article L442-2 of the French Commercial Code, companies that sell or facilitate the sale of goods outside a selective distribution system without authorisation can be held liable for damages.

4.15 We urge the Commission to consider introducing, or to encourage Member States to consider introducing, legal tools that allow for more effective enforcement of a legally valid selective distribution system. This would enable such a model to progress from a limited concept to one delivering maximum consumer efficiencies and protecting consumers from harmful practices. As we advise regularly on the possibilities for selective distribution enforcement (including in the courts), we would be happy to discuss this further with the Commission.

5. CONCLUSION

5.1 In conclusion, once again we commend the Commission on an impressive consultation, revision and drafting exercise. There are numerous highly sensible revisions and clarifications in the draft texts which we believe will support the enhancement of consumer and economic welfare in Europe, and which offer sufficient flexibility to accommodate developments in the coming decade. We are grateful for the Commission's efforts and attention to this important exercise, and remain available for any discussions or further input as may assist.