ADDITIONAL SUPPORTING COMMENTS TO SPECIFIC QUESTIONS

IN RESPONSE TO THE EU COMMISSION'S PUBLIC QUESTIONNAIRE FOR THE 2018 EVALUATION OF THE VERTICAL BLOCK EXEMPTION REGULATION

COMMENTS BY

THE LIDC HUNGARIAN COMPETITION LAW ASSOCIATION

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1. AD QUESTIONS 1.5 AND 1.6

1.5 Please estimate the level of legal certainty provided by the VBER and the VGL for each of the following areas by providing a qualitative estimate using the following number coding: 1 (very low), 2 (slightly low), 3 (appropriate), or selecting "DN" if you do not know or "NA" if not applicable to your organisation

1.6 If you have rated one or several issues as "very low" or "slightly low", please explain the reasons for your rating. Please also explain whether the lack of legal certainty stems from (i) the definition of the particular area in the VBER or the related description in the VGL, (ii) their application in practice or (iii) the overall structure of the VBER and/or VGL.

1. Our general comment is that the VBER and the VGL provides a high level of legal certainty in many areas, but that there are some traditional and new areas (e.g. RPM, online sales) in which further guidance would be needed.

1.1 Lack of legal certainty in case of forward looking self-assessments

2. Although the VBER creates a safe harbour for agreements, and the VGL provides guidance on such safe harbour, undertakings still need to assess their agreements and practices, often on the basis of Article 101 (3), either due to their market share or the content of the agreement. As paragraph 123 of the VGL provides, such assessment is made *"on the basis of the facts existing at any given point in time"*. Subsequently, if the European Commission or an NCA investigates a vertical agreement, it does so retrospectively, on the basis of the actual facts. Moreover, competition authorities have the powers to collect market data from any and all market players. Therefore, they can form a clear and well-founded assessment of the effects of an agreement. Undertakings, however, must assess the future effect of, and efficiencies resulting from, their agreement on the basis of clearly insufficient data, which might, even with due care, lead to wrong conclusions, simply due to the inherent uncertainty of future and insufficient data. Despite this, undertakings bear all liability for concluding such agreements. This uncertainty and legal risk prevent innovative distribution structures and may reduce efficiency and consumer welfare, as they deter undertakings from arrangements outside of the safe harbour created by the VBER.

3. Our association would welcome a solution from the Commission to this problem. A possible solution could be to include a standard of care into the VGL, for example in paragraph 123. If undertakings comply during their self-assessment under Article 101 (3) with such standard of care, they avoid fines. This would not facilitate unlawful behaviour, because undertakings would still be obliged to conduct their self-assessment according to a high

standard and could also be required to re-assess the efficiencies on the basis of actual experience. However, such a solution could facilitate the development and introduction of creative and innovative, yet effective ways of distribution in the EU.

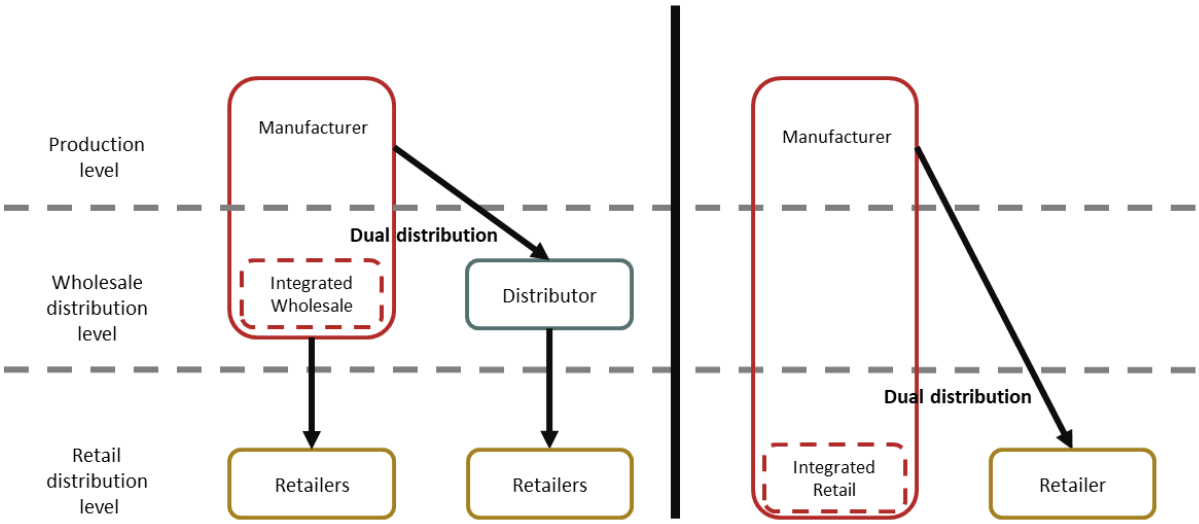
1.2 Article 2(4) of the VBER and dual distribution

4. Consider amending Article 2(4) so it allows for dual distribution throughout the supply chain.

(a) Clarifying that Article 2(4)(a) of the VBER also applies to dual distribution by a wholesaler

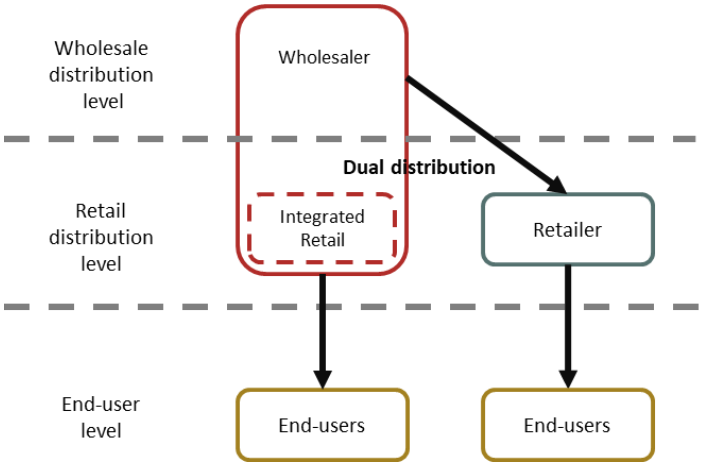
5. As Article 2(4)(a) is now written, it creates sufficient certainty that the VBER applies to dual distribution when an independent distributor is appointed by a manufacturer with vertically integrated distribution – as illustrated in the figure below.

Dual distribution **covered** by the VBER, cf. Article 2(4)(a)



6. However, the current language of Article 2(4)(a) creates uncertainty as to whether the exemption in Article 2(1) of the VBER applies to dual distribution, an independent retailer is appointed by a non-manufacturing, genuine wholesaler. The uncertainty is created by the fact that Article 4(1)(a) only applies if the supplier is *"a manufacturer **and** a distributor"* of goods, which appears to exclude non-manufacturing wholesale distributors. This is illustrated in the figure below.

Dual distribution by a wholesaler – not covered by Article 2(4)(a) with sufficient clarity:



7. However, there is no reason for excluding dual distribution by wholesale distributors from the scope of Article 2(1) of the VBER. Paragraph 28 of the VGL explains the underlying rationale of block-exempting dual distribution, which is equally valid in relation to dual distribution by manufacturers and wholesalers: *"[i]n case of dual distribution it is considered that in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing or retail level".*

(b) Clarifying that Article 2(4)(b) of the VBER applies even where the party active downstream does not sell to consumers

8. Article 2(4)(b) of the VBER should be clarified to eliminate any uncertainty as to whether it also applies to dual distribution where the downstream *"retail"* party resells the services to undertakings, and not to consumers. This clarity could be achieved e.g., with the following amendment: *"the supplier is a provided or services at several levels of trade, where the buyer provides its goods and services at the ~~retail~~* ***downstream*** *level and is not a competing undertaking at the level of trade where it purchases the contract services".*

9. There is at least one example of an NCA taking the position – with reference to paragraph 29 of the Vertical Guidelines – that the VBER did not apply simply because the purchaser resold the services to undertakings rather than consumers, and thereby its sales did not qualify as "retail level" sales under Article 2(4)(b). The Danish Competition Council's (the **"DCC"**), in its decision of 30 August 2017 in case 16/03827, *Customer sharing between MCD and MPE Distribution,* rejected the application of the VBER on the basis of Article 2(4)(b) on several grounds. One of the grounds was that the DCC did not consider the purchaser as being active at *"retail level"* despite acknowledging that the purchaser's customers were the *"end-customers"* of the services in question, cf. paragraph 29 of the DCC's Decision. The DCC's reasoning was the following in paragraphs 306-307 in the DCC's decision (translation from Danish):

> *"The Authority notes in addition that in the Commission's guidelines on vertical agreements distributors at retail level are defined as "distributors reselling goods to final consumers". As [the purchaser] does not sell the distribution services to final consumers, [the purchaser] is not active at "retail level" in the sense of the VBER. [footnote]*

The Authority considers on that basis that Article 2(4)(b) in the VBER does not apply to the agreement between [the seller] and [the purchaser]"

10. Paragraph 306 of the decision as cited above was followed by a footnote citing paragraph 29 of the Vertical Guidelines and a previous DCC decision on the same market containing the same reasoning (Decision of 25 May 2011 in case 4/0120-02040219). Accordingly, the DCC considers that the term *"End-customer"* is broader than the term *"Final consumer"* and that *"retail level"* in Article 2(4)(b) covers only the latter and not the former.

1.3 Manufacturing non-compete obligations

11. The current VBER is unclear as to whether a non-compete obligation can benefit from the block exemption, if the distributor's non-compete commitment relates to manufacturing, rather than to sale/purchase. To enhance the clarity of the rules, we suggest considering clarifying either the VBER or the VGL – perhaps in the VBER's preamble recitals or in Article 1(c) containing the definition of competing undertaking – that for the purpose of applying the VBER, the existence of a non-compete obligation cannot in itself be evidence that the parties to the agreement are actually or potentially competing manufacturers, and that therefore, the VBER does not apply.

12. Articles 5(1) and Article 1(d) of the VBER are designed to create a block exemption (provided all relevant other conditions are met) if a distributor undertakes not to manufacture goods or services that compete with the contract goods. In particular, a non-compete obligation is defined under Article 1(d) as including restrictions causing a buyer not to manufacture competing products.

13. However, Articles 2(4) and 1(c) lacks clarity as to whether the block exemption in Article 1(2) of the VBER can apply to such manufacturing non-compete agreements at all. Article 2(4) excludes from the block exemption all agreements between undertakings that compete at manufacturing level. Article 1(c) provides that such exclusion applies to agreements between actual as well as potential competitors. Beyond these provisions, the VBER lacks further clarity as to when it considers two undertakings as actually or potentially competing manufacturers.

14. The VBER should clarify that, when determining whether two undertakings are potentially competing manufacturers, it does not necessarily follow the strict approach that was adopted by the Commission and the General Court in horizontal cases. In such cases, the very existence of a non-compete obligation was sometimes considered as *prima facie* evidence of an actual/potential competitive relationship. For example, in the case of T−208/13, Portugal Telecom, the European Commission apparently submitted that *"entering into a non-compete agreement […] constituted recognition by the parties that they were at least potential competitors with respect to some services. In the absence of any potential competition, there would have been no need to conclude any non-compete agreement at all […]."*[1] The General Court itself held that *"The agreement impugned in the present case consisted of a non-compete clause […] its existence made sense only if there was competition to be restricted […]".*[2] Similar reasoning is contained in the pay-for-delay cases (in particular *Lundbeck*) that existence of the restriction is in itself evidence of a (potential) competitive relationship.

15. Such a strict approach is not appropriate in the context of vertical relationships. Under such a strict approach, there is a risk that the existence of a manufacturing non-compete

[1] See Judgment of 28 June 2016 *Portugal Telecom v Commission*, T-208/13, ECLI:EU:T:2016:368, para 170
[2] Id., para 178

obligation would by definition create a (potential) competitive relationship, and thereby remove the benefit of the block exemption. As a result, it would be impossible for manufacturing non-compete obligations to remain within the scope of the VBER.

2. AD QUESTION 1.14. – 1.16

1.14 Are there any types of vertical restrictions that the VBER considers as hardcore (Article 4 VBER), but for which it can be assumed with sufficient certainty that they generate efficiencies in line with Article 101(3) of the Treaty?

1.16 Please explain your selection by providing examples and explain how prevalent these restrictions are in your industry.

2.1 Dual pricing in case of online sales

16. Our association believes that the VGL should adopt a more flexible approach in relation to dual pricing that is designed to solve a free rider problem. Please see our more detailed comments below, in paragraphs 26 to 29 of this document.

2.2 Marketplace bans

17. The VGL needs to be revised to reflect the ECJ's judgement in *Coty.*[3] In Coty, the ECJ essentially held that selective distribution agreements may impose online marketplace bans on their members.[4] The ECJ said that Article 4 of the VBER must be interpreted as meaning that the prohibition imposed on the members of a selective distribution system for luxury goods, which operate as distributors at the retail level of trade, of making use, in a discernible manner, of third-party undertakings for internet sales does not constitute a restriction of customers, within the meaning of Article 4(b) of VBER, or a restriction of passive sales to end users, within the meaning of Article 4(c) of VBER. In particular, paragraph 54 of the VGL needs to updated to reflect this new development.

3. AD QUESTION 1.17 – 1.19

1.17 Does the list of excluded vertical restrictions (Article 5 VBER) exclude types of vertical restrictions for which it can be assumed with sufficient certainty that they generate efficiencies in line with Article 101(3) of the Treaty?

1.19 Please explain your selection by providing examples and explain how prevalent they are in the industry.

3.1 Non-compete obligations – the five-year rule is too formalistic

18. The block exemption does not extend to non-compete obligations that are longer than five years, even if they can be terminated by the distributor with a reasonably short notice. Our association suggests that such non-compete obligations should be block exempted (provided they can be terminated upon reasonable notice), because they are clearly less restrictive to competition than a five year-long non-compete obligation that cannot be terminated.

19. The five-year rule for non-compete clauses in Article 5(1)(a) of the VBER is unhelpfully formalistic in case of indefinite contracts that allow for termination with short/reasonable notice. The deciding factor for block-exempting non-compete clauses should not be

[3] Judgment of the Court, 6 December 2017, *Coty Germany GmbH* C-230/2016, ECLI:EU:C:2017:941

[4] See id., para 69

whether or not there is a fixed term (under five years) but rather how long the distributor is effectively 'locked in' to the non-compete obligation without the possibility of exposing the contract to competition between suppliers. For example, a contract with no fixed term where the distributor is free to terminate the contract with three months' notice is clearly less restrictive of competition than a five-year fixed term contract with no possibility of termination. However, only the latter, and not the former, is block-exempted.

4. AD QUESTION 3.7

3.7 Do you see the need for a revision of the VGL (including Section VI) in light of major trends and/or changes during the past 5 years (e.g. the increased importance of online sales and the emergence of new market players)?

3.8 Please explain your reply:

4.1 Online platforms

(a) Agency agreements

20. The VBER and the VGL lack sufficient guidance as to how agency agreements should be treated in the case of online platforms. In particular, our association would welcome additional guidance on when an online platform can qualify as a genuine agent within the meaning of paragraphs 12-21 of the VGL, e.g. whether this depends on its degree of the responsibility for the transaction, ownership of the goods, its involvement in price setting, its investment in the platform or in the trade of specific products or transactions, etc.

(b) Platform bans and online sales restrictions

21. We suggest that the VGL (and in particular, its paragraphs 51-54) should reflect the most recent judgements of the EU Courts on contractual restrictions limiting the ability of retailers to sell via online marketplaces (*"marketplace bans"* or *"platform bans"*) (C-230/2016 *Coty Germany GmbH*).

22. More generally, the ECJ's judgment in *Coty* shows that limitation on online sales through third party platforms can indeed be justified in certain circumstances. More guidance would be welcome in the revised VGL on such lawful restrictions, also by generalizing *Coty* to areas other than luxury goods.

(c) Market share thresholds calculations

23. Chapter V.1. of the VGL gives guidance on the market definition and the market share calculation. This chapter could be updated to address how markets should be defined in the case of two-sided markets.

24. Online platforms serve several user groups, for example, sellers who sell their products on the platform, consumers who buy the products; advertisers on audience providing platforms or users of platforms etc. Such platforms' services may represent different products and may belong to different markets for each platform side. For example, from a merchant's perspective, the intermediary service would constitute the relevant market. However, from the end-consumer's perspective, the relevant market would be the retail market of a given product.

25. Our association would welcome additional guidance on how the relevant market would be defined and how the market share thresholds would apply in these situations.

4.2 Dual pricing of online sales

26. Paragraph 53(d) of the VGL should be reconsidered. It currently states that it is considered as a hardcore restriction, if parties agree that the distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line.

27. Paragraph 37 of the Commission's Final report on the E-commerce Sector Inquiry maintains this position, providing that "*[d]ual pricing for one and the same (hybrid) retailer is generally considered as a hardcore restriction under the VBER."*[5] However, it also recognises that *"[c]harging different (wholesale) prices to different retailers is generally considered a normal part of the competitive process."*[6] Our association would welcome if the VGL would also clearly set out that different wholesale prices for different retailers are a normal part of the competitive process, and are not necessarily hardcore restrictions.

28. In addition, we would also welcome if paragraph 53(d) of VGL provided more flexibility and options for suppliers to solve the free rider problem, by supporting those distributors which offer customer services in brick and mortar shops. The current text of paragraph 53(d) of the VGL allows the supplier to provide a fixed (but not a variable) fee to a distributor to support its offline sales. However, in the experience of our associations' members, in practice, this is very often not sufficient to address a free-rider problem. In practice the calculation of a fixed fee is very difficult if not impossible. Manufacturers have different incentives to honour the investments into brick and mortar stores depending on how many products and of which value the given retailer actually sells. But retailers' costs also vary depending on the volume and value of the goods they sell. Therefore, we think it would be appropriate to exempt not only fixed but also variable contribution amounts agreed by the parties. This is particularly important considering the recent expansion of online sales channels and their impact on increasing competition. This causes increasing competitive disadvantage to undertakings investing into showrooms and inventory. Such disadvantages do not only affect and endanger offline retailers, but also reduce consumer benefit. Consumers still prefer to take goods (particularly high-value goods) into their hands prior to making a purchase – even if eventually they make the purchase online.

29. In addition, the same paragraph 37 of the sector inquiry report points to the *"possibility of exempting dual pricing agreements under Article 101(3) TFEU on an individual basis, for example where a dual pricing arrangement would be indispensable to address free-riding."* It would be extremely helpful if the VGL provided further guidance on the conditions that should be examined in relation to such an individual exemption, because in practice free-riding is a problem in many sectors.

4.3 MFC clauses

30. It should be clarified in the Vertical Guidelines that most favoured customer (**MFC**) obligations fall within the VBER and there should be a chapter in the Vertical Guidelines on how to assess MFCs if the VBER's market share thresholds are not satisfied.

5. AD QUESTION 3.10

3.10 Is there any area for which the VBER and/or the VGL currently do not provide any guidance while it would be desirable?

[5] See e.g. para 37 Final report on the E-commerce Sector Inquiry COM(2017) 229 final

[6] See e.g. para 37 Final report on the E-commerce Sector Inquiry COM(2017) 229 final

5.1 Exemption of single branding of spare parts within an OEM's service network

31. As set out in paragraph 59 of the VGL, the VBER block exempts obligations whereby an *"original equipment manufacturer … requires its own repair and service network to buy spare parts from it"*. Our association would welcome similar guidance outside the scope of the block exemption in relation to obligations imposed on an OEM's service network to use original spare parts. Such guidance would be valuable both in relation to warranty and off-warranty repair services.

32. Warranty repair services are very often carried out by the OEM's service network, based on a contract with the OEM. Our association believes that in such a case, an obligation to use original spare parts should not be considered a restriction under Article 101(1) at all. Such an obligation can be justified by the fact that ultimately OEMs are liable to ensure that warranty repairs are carried out appropriately. The Commission has already recognised this in relation to the automotive sector, in paragraph 39 of the Motor Vehicle Guidelines:[7] *"an obligation on an authorised repairer to use original spare parts supplied by the motor vehicle manufacturer for repairs carried out under warranty, free servicing and motor vehicle recall work would not be considered to be a single-branding obligation, but rather an objectively justified requirement.".* The same principles are applicable in relation to warranty services in relation to any other consumer products. Therefore, our association suggests considering including similar guidance in the VGL as provided in paragraph 39 of the Motor Vehicle Guidelines, albeit in relation to a wider range of consumer products.

33. When imposing similar spare parts related single branding obligations for non-warranty repair services, our association would also welcome general guidance in the VGL that recognises the possible efficiencies arising out of an enhanced brand image of the distribution and service network. Currently such guidance is provided only sector specifically in paragraph 30 of the Motor Vehicle Guidelines: *"positive effect of non-compete obligations in the motor vehicle sector relates to the enhancement of the brand image and reputation of the distribution network. Such restraints may help to create and maintain a brand image by imposing a certain measure of uniformity and quality standardisation on distributors, thereby increasing the attractiveness of that brand to the final consumer and increasing its sales."* Although this efficiency is potentially equally relevant in relation to a number of other consumer goods, the VGL currently fails to mention it in relation to single branding.[8]

6. AD QUESTION 6.1

6.1 Is there anything else you would like to add which may be relevant for the evaluation of the VBER and/or the VGL?

6.1 Enforcement against suppliers and distributors

34. In horizontal infringements of Article 101 TFEU, all parties to the agreement or concerted practice are generally found to be offenders and receive fines. With vertical restraints, however, there is an established practice that in appropriate circumstances the Commission only finds one party to the agreement liable for an infringement.

35. Recent European Commission examples include Nike (AT.40436). Philips (AT.40181) and Guess (AT.40428), but this approach was applied also in earlier cases such as in

[7] Commission notice — Supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles OJ C 138, 28.5.2010, p. 16–27

[8] See in particular paragraph 144 of the VGL, according to which only the free riding problem, the hold-up problem and capital markets imperfections are particularly relevant in relation to the assessment of single branding.under Article 101(3) of the Treaty

Volkswagen (COMP/F-2/36.693), and Opel (COMP/36.653) and PO/Yamaha (COMP/37.975). In certain other cases both the supplier and the distributors were held liable (see e.g. COMP/35.587 PO Video Games, COMP/35.706 PO Nintendo Distribution and COMP/36.321 Omega – Nintendo).

36. Our association considers that it would be helpful if the VGL would provide guidance on when – if at all – the downstream (or upstream) party to a vertical agreement (supplier, distributor or retailer, etc) can expect to be held liable for an infringement of Article 101 TFEU when it comes to, for example, RPM and export restrictions. In particular, in case of RPM, it would be welcome if the VGL could provide guidance as to when would RPM be seen as coercion by the supplier and when retailers can be deemed to have acquiesced. E.g. if a supplier uses price monitoring and effective threats to maintain RPM and as a consequence, high percentage of suppliers *"accept"* RPM, would both parties be liable for the infringement. Similar guidance would be welcome for other restrictions including MFN clauses.