27 May 2019

Linklaters' reply to the European Commission consultation on the revision of the Vertical Block Exemption Regulation and Guidelines on Vertical Restraints

1. Linklaters LLP, an international law firm headquartered in London, appreciates the opportunity to participate in the public consultation launched by the European Commission (the "**Commission**") on the revision of the Vertical Block Exemption Regulation (the "**VBER**") and accompanying vertical guidelines (the "**Vertical Guidelines**")[1].

2. Overall, we think that the VBER and the Vertical Guidelines give useful guidance to undertakings regarding the application of Article 101 of the Treaty on the Functioning of the European Union ("**TFEU**") to vertical arrangements, as well as an appreciable degree of legal certainty. In this regard, we believe that it is important to retain the concept of block exemptions, and we agree that the VBER does not require a major overhaul.

3. We therefore encourage the Commission to renew the VBER and the Vertical Guidelines upon expiry of the VBER.

4. However, we believe that this consultation is a good opportunity to clarify some provisions which remained grey zones for businesses, and to adapt the rules to the significant changes that society has undergone since 2010, which have impacted commercial relations and will continue to have a substantial impact in the coming years.

5. We would welcome that the new VBER and Vertical Guidelines be drafted in such a way as to enable companies to adapt to technological innovations and changing consumer trends, which require flexibility in the organisation of vertical relationships.

6. To this end, we encourage an approach more responsive to business needs, so that the new rules and guidelines cover the diverse and hybrid situations in which undertakings may find themselves, and the inclusion of new examples in the Vertical Guidelines that are less theoretical and more pragmatic.

7. Our comments focus on six topics:

   - Agreements generally falling outside the scope of Article 101(1) TFEU (**1**);
   - Dual distribution (**2**);
   - Market share thresholds (**3**);
   - Hardcore restrictions (**4**);
   - Excluded restrictions (**5**); and
   - Online sales (**6**).

[1] Commission's Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, p. 1–46.

1 Agreements generally falling outside the scope of Article 101(1) TFEU[2]

1.1 Further flexibility for the notion of agency

8. The determining factor for the definition of an agency agreement for the purposes of Article 101(1) TFEU is the commercial or financial risk borne by the agent in relation to the activities for which the principal has appointed it[3].

9. Three types of risk are relevant to the definition of an agency agreement[4]:

- **Contract-specific risks** (cost of inventory, distribution, transport, loss or deterioration of products, etc.).
- **Market-specific investments** (fitting-out of premises, specific equipment, financing of promotional activities, etc.) when these investments are irrecoverable.
- **Risks related to other activities** carried out in the same product market if the principal asks the agent to carry out these activities at his own risk.

10. Paragraph 15 of the Vertical Guidelines specifies that the agreement will be considered as an agency contract <u>if the agent bears no risk, or only a negligible part of it</u>.

11. The <u>negligible</u> nature of the risk is a key element in the case law which adopts a flexible and pragmatic approach when assessing the risks incurred by agents[5].

12. Several European decisions[6], including a judgment of 15 July 2015, in the *pre-stressing steel* case[7], state as a principle that: "*in order to determine the existence of an economic unit between the agent and one of his principals, it is necessary to ascertain whether that agent is in a position, as regards the activities entrusted to him by that principal, to act as an independent trader free to determine his own business strategy. <u>If the agent is not in a position to act in that way, the functions which he carries out on behalf of the principal form an integral part of the latter's activities</u>*".

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[2] See Section II of the Vertical Guidelines.

[3] Vertical Guidelines, para. 13.

[4] Vertical Guidelines, para. 14.

[5] In the *Daimler Chrysler* case, the Commission considered that Mercedes-Benz agents were false agents since they bore risks seen as significant, such as: the risk linked to the selling price (the discounts granted to customers were deducted from the commission); and the risks linked to the transport, promotion, interventions under guarantee, after-sales activity and stock management of purchased spare parts (see Commission Decision, COMP/36.264 – Mercedes-Benz, paras. 157-160). The Court of First Instance ("**CFI**", now the *General Court*), on the contrary, judged that each of the risks retained by the Commission were, in fact, ***<u>negligible</u>*****,** and that the Commission had exaggerated the significance of the risks borne by the agents (see CFI, 15 October 2005, *DaimlerChrysler v Commission*, case T-325/01).

[6] We also refer to the French case law in this respect and, in particular, French Competition Authority ("**FCA**") Decision No. 09-D-23 of 30 June 2009, on practices implemented in the distribution of women's ready-to-wear clothing and accessories (the *Mango/Punto Fa* case). The FCA also has a pragmatic approach – it noted a number of financial risks incurred by the "partner distributor", namely an entry fee of €100,000, the financing of the facilities, all equipment, consumables and clothing, transport costs, a bank guarantee up to the value of the stock and the purchase of insurance. Nevertheless, it considered that each risk, as a percentage of turnover, was not significant. However, the FCA found that the partner distributor could not have its own strategy, only had a limited margin of manoeuvre to determine its selling price independently and, above all, noted that it did not assume the main commercial risk in the textile market, namely the risk of unsold goods. The FCA thus considered that Punto Fa and its distributor partners formed a single economic unit within the meaning of competition law, and that their relations therefore fell outside the prohibition of anti-competitive agreements.

[7] General Court, 15 July 2015, *voestalpine AG v Commission*, case T-418/10, para. 153.

13. However, the Vertical Guidelines are more rigid in this respect, which can lead undertakings to consider systematically, in their self-assessment, that they are in the presence of a *false agency* contract. Indeed, paragraphs 17[8] and 16 of the Vertical Guidelines, as drafted, suggest that only one of the risks listed is sufficient to consider that an agreement does not constitute a genuine agency contract, and may lead undertakings to adopt a conservative approach.

Linklaters would therefore welcome a revision of the Vertical Guidelines on these points, in line with the General Court's position, by:

- **updating Section II of the Vertical Guidelines on agency agreements in light of the most recent case law, including the notion of "*economic reality of an independent trader*"; and**
- **clarifying that the notion of negligible or economically insignificant risk is key in the assessment of agency agreements.**

1.2 A section 2 of the Vertical Guidelines not limited to genuine agency agreements

14. We also call for an update of the Vertical Guidelines in relation to, and the adoption of a more pragmatic approach towards, tripartite relationships existing between certain suppliers, intermediaries and final customers.

15. Indeed, in numerous sectors[9], intermediaries increasingly apply the commercial policy agreed between suppliers and final customers, and focus on logistical functions. These tripartite agreements currently raise unjustified resale price maintenance ("**RPM**") risks for the undertakings involved, because such intermediaries very rarely qualify for the definition of *genuine agents* under paragraph 16 of the Vertical Guidelines (since they purchase (becoming the legal owner) the goods intended for resale, and are not part of the supplier's group). To illustrate this point, we note that for a number of key customers, suppliers are increasingly asked to negotiate volumes at European (or even global) level with dedicated purchasing entities. Commercial negotiations are becoming more and more centralised in a number of sectors. In practice, while those customers require a centralised commercial negotiation for global price reduction purposes, they also very often ask for the goods to be purchased and delivered by intermediaries.

16. Because these intermediaries own the contractual goods within the meaning of paragraph 16 of the Vertical Guidelines, the notion of agency does not apply to them. Intermediaries continue to be perceived by European vertical rules as autonomous distributors, but this qualification does not adequately reflect the economic reality of their activities. Indeed, their actual role is to provide logistical services. In most cases, the only risk these intermediaries

[8] Paragraph 17 states that: "*where the agent incurs one or more of the risks or costs mentioned in paragraphs (14), (15) and (16), the agreement between agent and principal will not be qualified as an agency agreement. (…) If contract-specific risks are incurred by the agent, it will be enough to conclude that the agent is an independent distributor. On the contrary, if the agent does not incur contract-specific risks, then it will be necessary to further continue the analysis by assessing the risks related to market-specific investments. Finally, if the agent does not incur any contract-specific risks and risks related to market-specific investments, the risks related to other required activities within the same product market may have to be considered*".

[9] By way of example, the electronic products, food industry, pharmaceuticals, automotive and insurance sectors.

bear is related to warehousing. Even then, such risk is often quasi-inexistent due to the intermediary insuring itself against theft and possible damages[10].

17. The consequence is that undertakings involved in these *tripartite* relations are currently exposed to an unjustified risk of sanctions for RPM, when the supplier and the end-customer agree commercial conditions applicable to their relationships.

18. In light of the current development of centralised commercial negotiation between suppliers and distributors, we call for a pragmatic approach to existing commercial relations between: (i) a supplier; (ii) an intermediary solely providing a logistical service but legally purchasing the goods for resale; and (iii) a customer having a direct commercial relationship with the supplier. In this situation, we believe that agreements with these intermediaries should be treated, under the competition rules, as agency contracts, so that suppliers and final customers can freely negotiate prices and commercial conditions. In light of the volume of purchases at stake, there is a need for certain suppliers and end-customers to negotiate globalised commercial conditions applicable at national or even at European level, despite the fact that they are working with intermediaries which are not *genuine* agents within the meaning of the VBER and the Vertical Guidelines, without taking the risk of very high fines[11].

19. The inapplicability of Article 101(1) to the scenario described above seems even more justified to us since, in the context of these direct negotiations: (i) inter-brand competition is intense; and (ii) there is very strong competition between wholesalers on the quality of the logistical services (delivery times, product availability, stock situation, etc.) and the additional services offered to final customers.

In light of the above, Linklaters invites the Commission to consider the following revisions:

- **Paragraphs 12 to 17 of the Vertical Guidelines should be amended to take into account the notion of an intermediary acting within the framework described above.**
- **Alternatively, agreements involving intermediaries which provide logistical services, but who, legally (i.e. become the owner), purchase the goods for resale, should either:**
  - **be covered by the concept of the agency agreement described in paragraphs 12-21 of the Vertical Guidelines, with it being expressly stated that this type of agreement must be treated as an agency agreement; or**
  - **be the subject of a new category of agreement not falling within the scope of Article 101(1), in the same way as the other three categories provided for in Section II of the Vertical Guidelines.**

2 Dual Distribution

20. According to Article 2(4) of the VBER:

"*the exemption provided for in paragraph 1 shall not apply to vertical agreements entered into between competing undertakings"*. An exception to this rule is provided for when "*competing undertakings enter into a non-reciprocal vertical agreement and: (a) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level; or (b) the supplier is a provider of services*

[10] In this regard, the French Competition Authority has already considered in a case that such insurance "*can be considered as inherent to the activity of an agent*". See the aforementioned case 09-D-23 of 30 June 2009.

[11] We refer, for example, to the EUR 19 million sanction imposed on petfood suppliers in France for resale price maintenance at wholesale level (see decision n°12-D-10 of 12 March 2012).

at several levels of trade, while the buyer provides its goods or services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services".

21. In short, the principle arising from Article 2(4) is that implementing a dual distribution system is not presumed to raise horizontal competition concerns, and that the supplier's relationships with its distributors / retailers continues to be analysed under the VBER and the Vertical Guidelines. **We strongly consider that this approach should be maintained in the next version of the VBER and the Vertical Guidelines**.

22. In practice, most distribution relationships imply flows of information between the supplier and its distributors / retailers (whatever the level of distribution). The supplier and its distributors / retailers have reporting obligations in relation to performance.

23. We would welcome a clarification in the VBER or the Vertical Guidelines that the exchange of information in the framework of distribution relationships is necessary for their implementation, even in the context of dual distribution schemes falling within the scope of the VBER[12].

Linklaters would welcome that the next generation VBER and Vertical Guidelines:

- **Confirm that information exchange in the context of dual distribution schemes is exempted under the same conditions as purely vertical information exchanges.**
- **Should the Commission consider that certain information exchanges in the context of dual distribution may raise competition issues, clarify the types of information exchanges that are likely to be exempted, and those that are likely to raise competition concerns.**

3 Market share thresholds

24. According to paragraph 8 of the VBER:

"*Where the market share held by each undertaking party to the agreement in the relevant market does not exceed 30%, it can be presumed that vertical agreements which do not contain certain serious restrictions of competition generally have the effect of improving production or distribution and giving the consumers a fair share of the benefits resulting therefrom*".

25. Article 3(1) of the VBER provides that:

"*the exemption provided for in Article 2 shall apply provided that the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract, goods or services and that the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract, goods or services* (…)".

26. When conducting their market shares assessment, undertakings cannot rely on a uniform set of market definitions. They generally verify their market shares level under market definitions in the sector concerned at national level and EU level, as well as under the segmentations considered in antitrust, cartel and merger control cases. Due to these multiple

[12] We consider that the footnote added by the Commission at paragraph 212 of the Vertical Guidelines (category management) concerns direct information exchanges between competing suppliers *via* retailers (so-called hub-and-spoke practices), and not information exchanges between suppliers and retailers in the framework of their distribution agreements (even in the context of a dual distribution scheme).

sources of market definitions, the market share assessment, which is at the centre of the block exemption mechanism, raises difficulties for undertakings.

- First, the current trend of the Commission and the national competition authorities ("**NCAs**") is to consider excessively narrow product and geographical markets, despite the Europeanisation of flows, particularly in the field of merger control, which has the effect of almost automatically excluding certain agreements from the benefit of the block exemption. Such narrow market segments sometimes result in artificially high market shares for one party (or both parties) to the agreement, which does not necessarily reflect the party's (or parties') position for the contractual products or services. The direct consequence is that, considering the risks involved, undertakings tend to adopt overly conservative approaches when assessing their distribution arrangements.
- Second, there are gaps, or even divergences, in the case law, either between NCAs, or between the Commission and certain NCAs. Some authorities have adopted extremely narrow market definitions while others have not. Undertakings may also face discrepancies before the NCAs as between merger control and antitrust cases. Again, given the risks involved, the lack of legal certainty leads undertakings to adopt very conservative positions with regards to their distribution agreements.
- Third, undertakings which operate European-wide distribution networks, and which opt for a harmonised distribution system (e.g. selective or exclusive networks) may exceed the 30% threshold in only a minority of Member States.
- Finally, there is a need to clarify how undertakings' market positions (and therefore the market share thresholds) should be assessed in the current context of the development of online sales and alternative distribution models, such as platforms or dual distribution.

27. We note that the context in which market definitions / segmentations are considered by competition authorities in Europe (e.g. mergers) are not always relevant in the framework of vertical agreements self-assessment. For example, a number of multinational companies put in place distribution arrangements which are multi-product, multi-channel and multi-jurisdictional, and which are not designed in consideration of what relevant product market definitions say from time to time. As explained *supra*, suppliers are increasingly required to negotiate at European (or even global) level with purchasing entities that require more and more global arrangements. In those situations, the current thresholds and approach can be a bit too rigid in light of industry practice.

In these circumstances, Linklaters invites the Commission to:

- **Provide concrete guidance concerning the market definitions relevant to the assessment of market share thresholds (including in the context of online sales, platforms and dual distribution).**
- **Raise the market share threshold from 30% to 40%, in order to correct the exclusionary effect of narrow market definitions considered by competition authorities in Europe in contexts which are not necessarily relevant when assessing increasingly globalised vertical agreements. This 40% threshold seems even more relevant insofar as it is used by the Commission in at least two contexts:**
    - **First, in the additional guidelines on vertical restraints in agreements for the sale and repair of motor vehicles, and the distribution of motor vehicle**

spare parts, which states in paragraph 56 that *"with regards to the specificities of the distribution of new motor vehicles, quantitative selective distribution will generally fulfil the conditions set out in Article 101(3) of the Treaty, if the parties' market share does not exceed 40%".*

- **Second, in the Commission's orientations on Article 102 TFEU, in which paragraph 14 states that there is a negative presumption of lack of market power below 40%: *"(...) modest market shares are a good indicator of the absence of strong market power; (...) if the company's market share represents less than 40% of the relevant market, it is unlikely to be in a dominant position 'save in exceptional circumstances'"*.**

- **Clarify that, in the case of European-wide networks, it is relevant for companies whose market shares exceed the 30% threshold in a minority of Member States either to check their market shares at European level or, as is envisaged in the case of car distribution, to include a second 40% threshold in the context of the individual analysis below which the agreement generally meets the conditions of Article 101(3) TFEU.**

4 Hardcore restrictions

4.1 Resale price maintenance

28. **A quasi *per se* European approach towards price restrictions** – Pursuant to Article 4(a) of the VBER "*the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties*" constitutes a hardcore restriction.

29. Under the VBER, RPM is qualified as a hardcore restriction of competition that withdraws the benefit of the block exemption to the entire distribution agreement.

30. In practice, this almost corresponds to a *per se* infringement[13].

31. **Need for clear exemptions** – We welcome the fact that the Commission, at the very end of the Vertical Guidelines (paragraph 225[14]), recognises that price restrictions may have pro-competitive effects, and opens the door to an individual assessment of RPM practices under Article 101(3) in specific situations, including:

    - The introduction of a new product by the manufacturer.
    - A coordinated short-term low-price campaign (2 to 6 weeks in most cases) within a franchise system, or a similar distribution system applying a uniform distribution format.

32. However, considering the financial and reputational risks incurred in the event that RPM practices are pursued and sanctioned by the Commission or NCAs (whether at the retail or wholesale level), to the best of our knowledge, undertakings rarely apply paragraph 225 of the Vertical Guidelines.

[13] To the best of our knowledge, we are not aware of any case in Europe having cleared a RPM practice under Article 101(3).

[14] "*However, RPM may not only restrict competition but may also, in particular, where it is supplier driven, lead to efficiencies, which will be assessed under Article 101(3)*".

33. Indeed, the VBER and the Vertical Guidelines do not provide for a clear exemption for RPM in certain specific situations (contrary to client or territorial restrictions). Thus, a number of undertakings refrain from entering into any form of price restriction. In certain jurisdictions, certain undertakings even refrain from issuing recommended prices to their distributors to reduce the legal risk attached to such price restrictions.

34. **Need for a change of approach –** Against that background, we call for a revision of the European approach towards price restrictions. Indeed, as exposed *supra* 1.1, the European approach towards RPM does not match the economic reality in many cases.

35. For example, as exposed *supra*, in a number of sectors, manufacturers negotiate directly with final customers while at the same time working with intermediaries, which triggers a risk of RPM. The rigid approach towards RPM in Europe in such cases seems largely inappropriate.

36. In these sectors, manufacturers have highly developed sales forces in direct relationships with retailers or final customers, with whom they negotiate prices directly. As part of these negotiations, <u>retailers or final customers fully stimulate inter-brand competition</u>.

37. In these tripartite relationships, wholesalers, from a legal point of view, often buy products to re-sell them (and therefore cannot be qualified as agents within the meaning of competition law) even if, in practice, their role is essentially to provide a logistical service. Competition between wholesalers exists (and is often very strong), and this does not concern the resale price, but rather the quality of logistical services provided (delivery times, product availability, stock status, etc.) and additional services offered to retail customers. Thus, these wholesalers can, in practice, simply apply the trade conditions that have been (rigidly) negotiated and contracted between the manufacturer and the retailer.

38. A strict approach to price restrictions in these situations is even more questionable as the use of a wholesaler is often requested by the final customer. In practice, the final customer generally wants an annual negotiation (at a national or even European level in some sectors) with manufacturers regarding the volumes and commercial conditions, but insists that goods be transferred through an intermediary which buys the goods and re-sells them to the final customers. <u>Suppliers and their final customers should be able to agree on a price and commercial terms, even in the presence of an intermediary</u>.

39. RPM has been considered problematic in these kinds of situations[15], even though inter-brand competition is sufficient to guarantee competitive prices, and the role of the wholesaler is closer to that of a logistician rather than that of a distributor.

40. The prohibition of RPM seems clearly unjustified at the wholesale level where final customers negotiate directly with suppliers and do not consider wholesalers to be their main trading partner.

41. **Comparison with other jurisdictions** – Two jurisdictions have drawn our attention as far as price restrictions are concerned.

- <u>Firstly, unsurprisingly, we will refer to the United States</u> and the so-called “*Leegin*”[16] decision, rendered in 2007 by the US Supreme Court, which approved RPM where pro-competitive advantages were demonstrated. Following this decision, the Federal

[15] We refer, for example, to a case of the FCA in the petfood sector: FCA Decision n°12-D-10 of March 2012, which sanctioned three suppliers.

[16] Leegin Creative Leather Products Inc. vs. PSKS. Inc.

Trade Commission ("**FTC**") granted a request from Nine West Footwear Corporation to relax a transaction agreement entered into in the context of RPM.[17] On the basis of the *Leegin* case, the FTC granted the company's request on the grounds that the practice of RPM was unlikely to harm consumers' interests.

- Secondly, we refer to Australia, where an exemption was granted in 2014 for a period of five years (the "RPM notification" procedure which permitted free rein to the ACCC on the RPM). It was reviewed again and renewed in 2018 for an indefinite period, because the competition authority noticed, in particular, that the concerned operators were experiencing relatively low market shares and were facing many competitors. In addition, it has been noted that the decisional practice had ensured a degree of certainty to the distributors, who were able to invest in additional services pre-sale and post-sale, thus allowing the consumer to make an informed decision regarding the purchase and the maintenance of relatively complex products[18].

42. **Economic analysis** – Some economic studies suggest that, in a large number of cases, RPM would be pro-competitive, and that it is only in a limited number of circumstances that they may have anti-competitive effects. The economic analysis establishes that RPM, like other vertical restraints, may give rise to positive and negative effects which must be analysed in the context of a competitive assessment. To the best of our knowledge, there is no evidence suggesting that RPM would be more likely to produce anti-competitive rather than pro-competitive effects. Nor is it demonstrated that price restrictions would be more problematic than any other type of restriction. Therefore, a pragmatic approach based on these economic principles would be welcome to substitute, at least in certain situations, a control exercised within the framework of the rule of reason to the *per se* prohibition[19].

The revision of the VBER and the Vertical Guidelines is a great opportunity for the Commission to initiate a change of approach towards RPM.

Linklaters respectfully calls for a more economically-based approach towards price restrictions. In particular, Linklaters suggests that:

- **The Commission remove RPM from the list of "hardcore restrictions" under Article 4 of the VBER, and adopt a standard balancing analysis under Article 101(1) and Article 101(3), including it as a new point (d) under Article 5 with clear conditions of exemptions, which would allow other clauses of the vertical agreement to benefit from the block exemption and the safe harbour of the *de minimis* notice.**

- **Should the Commission retain the *hardcore* categorisation, specify and develop in the renewed Vertical Guidelines a precise evaluation grid for potential exceptions from the prohibition on RPM. We invite the Commission to include in such exceptions:**

[17] https://www.ftc.gov/news-events/press-releases/2008/05/ftc-modifies-order-nine-west-resale-price-maintenance-case.

[18] Tooltechnic Systems (Aust) Pty Ltd - Authorisation - A91433; Tooltechnic Systems (Aust) Pty Ltd - RPM20181.

[19] It is argued by the economists that the potential anti-competitive effects of vertical restrains arise mainly from their horizontal effects at the suppliers' or distributors' level. For such an effect to be plausible, there must be market power in relation to the market. In line with the economic thinking, the Commission could provide for a series of criteria establishing whether there is likely a convincing theory of harm such as unilateral market power or concentration upstream; significant downstream buyer power or concentration; or a network of RPM agreements involving a number of upstream suppliers who account for a significant share of the upstream market. In the event those criteria are not met, there would be no credible theory of harm, and the RPM practice at stake would be taken outside the hardcore box and would need to be analysed in reference to its effects (see Bennett, M., Fletcher, A., Giovannetti, E. & Stallibrass, D. 'Resale Price Maintenance: Explaining the Controversy, and Small Steps Towards a More Nuanced Policy' in Annual Proceedings of the Fordham Competition Law Institute. International Antitrust Law & Policy, ed. Hawk, B.E. (Juris Publishing, Inc., 2010).

- **Unilateral recommended prices;**
- **Maximum prices;**
- **RPM in the context of new products' launch and promotional campaigns; and**
- **Price labelling by the supplier insofar as it is at the request of the distributor / retailer in a franchise system, or a similar distribution system applying a uniform distribution format.**

  We also invite the Commission to consider introducing a set of criteria based on existing market power, to remove certain RPM practices from the hardcore qualification.

4.2 Dual pricing

43. Paragraph 52 of the Vertical Guidelines specifies certain examples of hardcore restrictions in the framework of online sales, including so-called *dual pricing* practices. Paragraph 52 (d) qualifies as hardcore: "*an agreement 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 offline. This does not exclude the supplier agreeing with the buyer a fixed fee (that is, not a variable fee where the sum increases with the realised off-line turnover as this would amount indirectly to dual pricing) to support the latter's off-line or online sales efforts*".

44. We note that if paragraph 64 of the Vertical Guidelines re-insists on the fact that dual pricing is a hardcore restriction, it also specifies that "*in some specific circumstances, such an agreement may fulfil the conditions of Article 101(3)*".

45. Paragraph 64 refers more specifically to circumstances where "*a manufacturer agrees such dual pricing with its distributors, because selling online leads to substantially higher costs for the manufacturer than offline sales. For example, where offline sales include home installation by the distributor, but online sales do not, the latter may lead to more customer complaints and warranty claims for the manufacturer. In that context, the Commission will also consider to what extent the restriction is likely to limit internet sales and hinder the distributor to reach more and different customers*".

46. As for online platform bans following the recent judgment of the European Court of Justice ("**ECJ**") in the *Coty*[20] case ("**ECJ Coty Judgment**"), we note that there seems to exist divergence between the Commission's and certain NCAs' approach towards dual pricing[21].

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[20] ECJ, 6 December 2017, Case C-230/16, *Coty Germany GmbH v Parfümerie Akzente GmbH*.

[21] On the one hand, the Final Report of the Commission on the e-commerce sector inquiry of 15 May 2017 clarifies at paragraph 37 that "*charging different (wholesale) prices to different retailers is generally considered a normal part of the competitive process. Dual pricing for one and the same (hybrid) retailer is generally considered as a hardcore restriction under the VBER. Moreover, the Final 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*". On the other hand, the Bundeskartellamt in it Lego decision specified that "A manufacturer can naturally set quality standards for the distribution of its products and also grant its retailers different levels of discount for different services. However, it may not put the online sales distribution channel at a structural disadvantage". Lego has undertaken to operate its discount system in future in such a way that online retailers will be able to obtain the same level of discount as brick-and-mortar retailers. Lego will introduce alternative or additional discount criteria for online sales which will be adapted to the particular features of this form of distribution. The Bundeskartellamt had reacted to complaints by retailers and initiated a proceeding. The authority has now been able to terminate the proceedings thanks to Lego's cooperation: https://www.bundeskartellamt.de/SharedDocs/Meldung/DE/Pressemitteilungen/2016/18_07_2016_Lego.html

47. The Commission's e-commerce final report, at paragraph 35, explained that "*dual pricing is often viewed by stakeholders as a potentially efficient tool to address free-riding. They argue that dual pricing may help to create a level playing field between online and offline sales, taking into consideration differences in the costs of investments. Comments in relation to dual pricing point to the need for a more flexible approach to performance-related wholesale pricing. A more flexible approach would allow for differentiation between sales channels, depending on the actual sales efforts, and would encourage hybrid retailers to support investments in more costly (typically offline), value added services*".

48. It concluded pointing to the possibility of exempting dual pricing agreements under Article 101(3) TFEU on an individual basis [referring to paragraph 64 above], for example where a dual pricing arrangement would be indispensable to address free-riding.

49. We would welcome a revision of the VBER and the Vertical Guidelines clarifying that dual pricing is not a hardcore restriction, and creating a clear block exemption.

Linklaters invites the Commission:

- **to remove dual-pricing from the list of hardcore restrictions; and**
- **to include an exemption for dual pricing in the VBER and to clarify in the Vertical Guidelines the conditions under which dual pricing is exempted.**

4.3 Exclusive distribution[22]

50. Article 4(b) of the VBER states that "*the exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object*: (…)

b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contracted goods or services".

51. Several exceptions to this rule are stated in the VBER, including the possibility of "*the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer*".

52. In this respect, the VBER Guidelines indicate at paragraph 51 that the exception referred to in Article 4(b)(i) "*allows a supplier to restrict active sales by a buyer party to the agreement to a territory or a customer group which has been allocated exclusively to another buyer or which the supplier has reserved to itself. A territory or customer group is exclusively allocated when the supplier agrees to sell its product only to one distributor for distribution in a particular territory or to a particular customer group and the exclusive distributor is protected against actively selling in its territory or to its customer group <u>by all the other buyers of the supplier within the Union</u>, irrespective of sales by the supplier. The supplier is allowed to combine the allocation of an exclusive territory and an exclusive customer group by, for instance, appointing an exclusive distributor for a particular customer group in a certain territory. Such protection of exclusively-allocated territories or customers groups must, however, permit passive sales to such territories or customer groups* (…)".

[22] Article 4(b) VBER and paragraph 51 of the Vertical Guidelines.

53. Some undertakings distributing their products in several Member States, and which would like to set up exclusivities for the distribution of their products, interpret paragraph 51 of the Vertical Guidelines as implying the establishment of an exclusive distribution network at European level - *i.e.* in all Member States in which the products are distributed (or alternatively none). In practice, this would mean that all the Member States concerned would be reserved either for an exclusive distributor or for the supplier. Failing that, these undertakings consider that, under the current wording of paragraph 51, their distribution agreements could be considered as containing a hardcore territorial restriction pursuant to Article 4(b).

> **Linklaters invites the Commission to clarify paragraph 51 of the Guidelines on the VBER by specifying:**
>
> - **That the exception provided for in Article 4(b)(i) does not imply that the companies should set up an exclusive distribution system in all Member States in which the contract products are distributed.**
> - **That it is possible for an exclusivity to cover only one Member State or a part of a Member State without the agreement being considered as containing a hardcore restriction.**
> - **Whether it is necessary, to benefit from the exception, to indicate in the agreement concluded with non-exclusive distributors the list of exclusive distributors at European level.**

4.4 Selective distribution

54. **Clarification to Article 4(b)(iii) VBER** – Article 4(b)(iii) VBER allows for "*the restriction of sales by the members of a selective distribution system to unauthorised distributors within the territory reserved by the supplier to operate that system*".

55. Paragraph 55 of the Vertical Guidelines specifies that this exception "*allows a supplier to restrict an appointed distributor in a selective distribution system from selling, at any level of trade, to unauthorised distributors located in any territory where* <u>*the system is currently operated or where the supplier does not yet sell the contract products*</u>".

56. This paragraph covers situations where the supplier does not yet market its products in a given country through a selective distribution system, but it does not cover situations where the supplier has chosen to market its products itself. It is important, in this case, that authorised distributors in these other countries cannot sell to unauthorised distributors in the country in which the supplier has chosen to distribute by itself.

> **Linklaters invites the Commission to amend paragraph 55, adding "*in which the supplier does not yet sell the contract products* <u>*or in which the supplier has reserved the distribution for itself*</u>'.**

57. **Flexible approach under Article 4(d) VBER** – *"The restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade"* is a hardcore restriction under Article 4(d) VBER[23].

58. In practice, to benefit from the block exemption, a supplier operating a selective distribution network in several Member States, and who appoints wholesalers in a defined territory, should not restrict active sales of its wholesalers to authorised retailers located in the territory of another wholesaler.

59. Paragraph 63 of the Vertical Guidelines has inserted a degree of flexibility in certain circumstances:

"*In the case of a selective distribution system, cross-supplies between appointed distributors must normally remain free (see paragraph (58)). However, if appointed wholesalers located in different territories are obligated to invest in promotional activities in 'their' territories to support the sales by appointed retailers, and it is not practical to specify in a contract the required promotional activities, restrictions on active sales by the wholesalers to appointed retailers in other wholesalers' territories to overcome possible free riding may, in an individual case, fulfil the conditions of Article 101(3)*".

60. However, similarly to the few existing exceptions for price restrictions (see *supra*), absent a proper exemption, the level of legal certainty of paragraph 63 is insufficient, and undertakings generally refrain from applying this exception, considering the level of fine incurred.

A supplier should be able to limit the active sales of its wholesalers to retailers located in the territory of other wholesalers to: (i) encourage wholesalers to make the necessary investments for the selective distribution network in its territory; and (ii) avoid any parasitism amongst wholesalers.

Linklaters invites the Commission to amend Article 4(d) VBER and paragraph 63 of the Vertical Guidelines, to allow restrictions of active sales by a wholesaler to retailers located in the territory that the supplier has reserved for another wholesaler for the establishment of the selective distribution system.

61. **Nature of the product eligible for selective distribution** – According to paragraph 175 of the Vertical Guidelines:

"*(…). Purely qualitative selective distribution is in general considered to fall outside Article 101(1) for lack of anti-competitive effects, provided that three conditions are satisfied. First, <u>the nature of the product in question must necessitate a selective distribution system</u>, in the sense that such a system must constitute a legitimate requirement, having regard to the nature of the product concerned, to preserve its quality and ensure its proper use. Secondly, re-sellers must be chosen on the basis of objective criteria of a qualitative nature which are laid down uniformly for all and made available to all potential re-sellers and are not applied in a discriminatory manner. Thirdly, the criteria laid down must not go beyond what is*

[23] See also paragraph 58 of the Vertical Guidelines: "*The hardcore restriction set out in Article 4(d) of the Block Exemption Regulation concerns the restriction of cross-supplies between appointed distributors within a selective distribution system. Accordingly, an agreement or concerted practice may not have as its direct or indirect object to prevent or restrict the active or passive selling of the contract products between the selected distributors. Selected distributors must remain free to purchase the contract products from other appointed distributors within the network, operating either at the same or at a different level of trade. Consequently, selective distribution cannot be combined with vertical restraints aimed at forcing distributors to purchase the contract products exclusively from a given source. It also means that within a selective distribution network, no restrictions can be imposed on appointed wholesalers as regards their sales of the product to appointed retailers*".

necessary (53). Quantitative selective distribution adds further criteria for selection that more directly limit the potential number of dealers by, for instance, requiring minimum or maximum sales, by fixing the number of dealers, etc".

62. Following the recent ECJ Coty Judgment, certain divergences have arisen amongst NCAs regarding the approach toward selective distribution and associated restrictions. While the FCA has applied the ECJ Coty Judgment to non-luxury products (outdoor equipment)[24], the Bundeskartellamt has adopted a much more restrictive approach[25].

63. We note that the VBER and the Vertical Guidelines do not limit selective distribution to certain product categories – in particular luxury or high-tech goods. EU legislation simply requires that the supplier justifies its choice to use a selective distribution system in light of the "*nature of the product concerned, to preserve its quality and ensure its proper use"*.

We invite the Commission to clarify in the Vertical Guidelines that selective distribution legitimacy is not limited to certain product categories such as luxury or high-tech goods, but rather that it depends on the quality of the products and the services associated with the products.

5 Excluded restriction[26]

5.1 Non-compete obligations tacitly renewable beyond five years

64. Tacitly renewable non-compete obligations beyond a period of five years are qualified as excluded restrictions, and do not benefit from the block exemption under Article 5(1) of the VBER.

65. In this respect, paragraph 66 of the Vertical Guidelines indicates: "(...) *Such non-compete obligations are not covered by the Block Exemption Regulation where the duration is indefinite or exceeds five years. <u>Non-compete obligations that are tacitly renewable beyond a period of five years are also not covered by the Block Exemption Regulation (see the second subparagraph of Article 5(1))</u>. In general, non-compete obligations are exempted under that Regulation where their duration is limited to five years or less and <u>no obstacles exist that hinder the buyer from effectively terminating the non-compete obligation at the end of the five-year period</u>.* (…)".

66. Undertakings, for the reasons exposed *supra*, generally do not take the risk to include tacitly renewable non-compete obligations in their agreements in light of the potential risk of breaching of competition rules, and the uncertainty linked with a self-assessment. In practice, economic operators limit the duration of their contracts to five years, without tacit renewal, and provide an appointment clause requiring them to renegotiate and, if necessary, sign a new contract in order to be able to continue their contractual relationship. Such appointment clauses do generate unnecessary transaction costs and may not be economically justified.

67. Based on paragraph 66 of the Vertical Guidelines, the key factor seems to be that "*<u>no obstacles exist that hinder the buyer from effectively terminating the non-compete obligation at the end of the five-year period</u>".*

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[24] http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=684&id_article=3290&lang=en.

[25] Bundeskartellamt, Competition restraints in online sales after Coty and Asics - what's next?, Series of papers on "Competition and Consumer Protection in the Digital Economy", October 2018.

[26] Article 5 VBER.

Linklaters invites the Commission to amend paragraph 66 of the Vertical Guidelines so that tacitly renewable non-compete obligations are not excluded restrictions under the VBER, so long as the parties have the possibility to effectively terminate the non-compete obligation at the end of the five-year period, and there is no disincentive to effectively terminate at the end of the five-year period and each renewed period.

5.2 Non-compete obligations exceeding five years

68. Depending on the characteristics of the market, the investments undertaken or the life cycle of the products in question, a non-compete clause may be justified for periods exceeding five years.

69. Paragraphs 146 and 148 of the Vertical Guidelines refer to two specific circumstances in which a non-compete obligation can be justified for a longer period.

70. The first example is a **<u>relationship-specific investment</u>** made by the supplier. Paragraph 146 states in this respect that:

- "*In the case of a relationship-specific investment made by the supplier, a non-compete or quantity forcing agreement <u>for the period of depreciation</u> of the investment will in general fulfil the conditions of Article 101(3)*"[27].

- "*In the case of high relationship-specific investments, <u>a non-compete obligation exceeding five years may be justified</u>*".

  "*A relationship-specific investment could, for instance, be the installation or adaptation of equipment by the supplier when this equipment can be used afterwards only to produce components for a particular buyer. General or market-specific investments in (extra) capacity are normally not relationship-specific investments. However, where a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, this new capacity may only be economically viable when producing for this particular customer, in which case the investment would be considered to be relationship-specific*".

71. The second example is the **<u>transfer of substantial know-how</u>**. In this respect, paragraph 148 indicates that:

"*The transfer of substantial know-how (paragraph (107)(e)) usually justifies a non-compete obligation <u>for the whole duration of the supply agreement</u>, as for example in the context of franchising*".

72. We invite the Commission to ratify the cases in which a non-compete obligation can be justified for a longer period.

In light of the above, Linklaters invites the Commission to create clear exceptions allowing for non-compete clauses exceeding the five-year period, under Article 5 of the VBER and / or paragraphs 65-67 of the Vertical Guidelines.

[27] Vertical Guidelines, paragraph 146.

6 Online sales

73. **Articulation with the geo-blocking regulation** – Paragraph 52 of the Vertical Guidelines specifies certain examples of hardcore restrictions in the framework of online sales. Paragraphs 52(a) and (b)[28] concern practices which are now covered by the geo-blocking regulation. Thus, we believe that these paragraphs shall be removed from the list of hardcore restrictions under the VBER and that the VBER should clarify the articulation between the VBER and the geo-blocking regulation.

74. **Brick and mortar requirement** – According to paragraph 54 of the Vertical Guidelines "*the supplier may, for example, require that its distributors have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system*".

75. In its final report on the e-commerce sector inquiry the Commission indicates that "*most of these brick and mortar requirements seek to promote competition on distribution quality. At the same time, certain brick and mortar requirements essentially aim at excluding pure online players from the selective distribution network, without enhancing competition on other parameters than price, such as the quality of distribution and/or brand image. As a result, while acknowledging that brick and mortar requirements are generally covered by the VBER, certain requirements to operate at least one brick and mortar shop without any apparent link to distribution quality and/or other potential efficiencies may require further scrutiny in individual cases*"[29].

76. As the Commission acknowledges in its Report, the current legal framework allowing brick and mortar requirements aims at avoiding free-riding effects, and protecting offline distributors investing significantly to promote products and contribute to competition on other elements than prices. We respectfully invite the Commission to maintain the possibility for suppliers not to market their products through the pure players channel through brick and mortar requirements imposed on their retailers.

77. **Pure players specific requirements** – Pure players are fully part of the distribution landscape and suppliers may also wish or even need to distribute their products through this channel. That said, suppliers operating selective distribution networks should be allowed to impose to pure players specific requirements / criteria aiming at preserving the brand image and the proper use of their products.

78. **Codification of *Coty*[30]** – Following the ECJ Coty Judgment we would welcome a revision of the VBER and the Vertical Guidelines to codify the ECJ's position and clarify that online marketplace bans are not hardcore restrictions in the framework of selective distribution.

79. As exposed *supra*, we would also welcome a clarification that selective distribution is not limited to luxury products, but may concern any products justifying the use of such a distribution system to preserve their quality and ensure their proper use. We also believe

[28] "(…) *The Commission thus regards the following as examples of hardcore restrictions of passive selling given the capability of these restrictions to limit the distributor's access to a greater number and variety of customers: (a) an agreement that the (exclusive) distributor shall prevent customers located in another (exclusive) territory from viewing its website or shall automatically re-rout its customers to the manufacturer's or other (exclusive) distributors' websites. This does not exclude an agreement that the distributor's website shall also offer a number of links to websites of other distributors and/or the supplier; (b) an agreement that the (exclusive) distributor shall terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's (exclusive) territory*".

[29] Final Report of the Commission on the e-commerce sector inquiry of 15 May 2017, para. 27.

[30] Aforementioned judgment, *Coty* Germany GmbH vs Parfümerie Akzente GmbH, C-230/16.

that it would be important for the Commission to clearly define what constitutes "*marketplaces*" and the boundaries of what constitutes a block exempted marketplace ban.

We respectfully invite the Commission to revise the VBER and the Vertical Guidelines to take into account the development of online sales since the last consultation. We would welcome the following clarifications:

- **Clear articulation between the VBER and the geo-blocking regulation.**
- **Maintaining the possibility to impose brick and mortar requirements on selected distributors.**
- **The possibility to impose specific criteria on pure players.**
- **Codification of the ECJ *Coty* Judgment with clear guidance concerning marketplace bans.**