

## **2018 Evaluation of the Vertical Block Exemption Regulation**

### **Position Paper<sup>1</sup>**

We are grateful for the opportunity to participate in the European Commission's (the "Commission") public consultation on the Vertical Block Exemption Regulation ("VBER") and the accompanying Vertical Guidelines ("VGL"). We submit this short note to complement our replies in the evaluation questionnaire and to provide further context to the information we have submitted in the questionnaire. This note also adds examples that illustrate how the current legal regime affects our distribution practices, in particular related to the distribution of our growing range of hardware products, in the EEA.

#### **1. OUR DISTRIBUTION ACTIVITIES RELATED TO HARDWARE PRODUCTS**

We are a well-known multinational technology company that offers various internet-related services and products. However, we also supply a wide, and growing, range of hardware products in the EEA.

We supply our hardware products in highly competitive and rapidly developing markets, with many established and lesser known competitors developing and offering similar devices. Many devices tend to be novel and are not yet widely used by consumers in the EEA, and there is continuous development of new devices that will be introduced in the marketplace.

We seek to maintain and further develop a distribution system in the EEA that ensures wide availability of our devices for consumers, both through online and offline retailers, provides consumers tailored information and advice, and, if consumers desire, technical assistance, and helps to protect our brand.

#### **2. OUR VIEWS OF THE CURRENT RULES GOVERNING VERTICAL AGREEMENTS AND POSSIBLE REVISIONS**

##### **2.1 The VGL Provides Important Legal Certainty and Predictability for All Market Participants**

We consider that the VBER, which exempts many vertical distribution agreements from the Article 101 TFEU prohibition, subject to market share thresholds and other conditions, provides important legal certainty and predictability for all market participants.

Our distribution system in the EEA relies on numerous participants at different levels in the distribution chain, including wholesalers, distributors, and retailers, which may

---

<sup>1</sup> This paper complements our answers to questions under the headings Effectiveness, Efficiency, Relevance, Coherence, and EU Added Value.

have both online and offline activities. In our experience, all parties are greatly aided by the predictability of the legal framework created by the VGL when entering into distribution agreements that determine the parties' rights and obligations, as the boundaries set by competition law are reasonably clear to most market participants.

The VBER greatly facilitates our ability to maintain a consistent distribution system throughout the EEA. Uniform criteria can be applied within each group of equivalent participants in the distribution system, and we do not have to adapt our distribution agreements in light of particular competitive conditions in certain markets or potential enforcement preferences by national competition authorities or courts. The legal framework provided by the VBER also makes it possible for us to carefully plan the launch of new hardware products in the EEA, ensuring that novel hardware products are available to consumers once the necessary support system is in place as well.

A decision not to prolong the VGL, which would require market participants to rely on a pure self-assessment regime, would create major disadvantages and challenges. Article 101 TFEU and case law precedent do not create a sufficiently predictable legal framework, and an individual assessment of the legality of our distribution agreements and possible enforcement risks would be a resource-intensive exercise, not least given the high number of agreements that are required to establish a distribution network that covers most or all EEA member states. Self-assessment is of course in certain instances already required in today's legal framework, but the costs and uncertainty that come with self-assessment would multiply without the VGL. Compliance costs would increase, and the introduction of new hardware products could be delayed as a consequence. There are no apparent advantages that such a system would create for suppliers, distributors, or consumers, and that could counterbalance higher compliance costs and the higher degree of legal uncertainty.

The decentralized enforcement system in the EEA would exacerbate the uncertainty accompanying a pure self-assessment regime and greatly increase the compliance costs for us and other firms operating in the EEA. National divergences already arise in areas where the VBER and VGL provide insufficient guidance (such as with respect to online sales restrictions), and in some instances even courts within a single member state have reached inconsistent conclusions on a particular issue. This trend could materially increase in a pure self-assessment regime. Considering the central role of online sales for our hardware products, and the inevitable cross-border effects of online sales, we could well be forced to adjust our distribution practices to the strictest interpretation of EU competition law prevailing in a single EU member state.

As a result, a self-assessment regime may well result in us refraining from certain pro-competitive practices that currently seek to ensure that the incentives of all members of our distribution system are aligned and that our hardware products are widely available to all groups of consumers. Ultimately, consumers could be harmed

as our hardware products may be less available which would reduce consumer choice.

## **2.2 The VBER's Market Share Threshold should be Retained**

In our view, there is no reason to lower the currently applicable 30% market share threshold in the VBER.

As indicated above, we distribute our hardware products in highly competitive markets, characterized by robust product development, the introduction of novel hardware products by numerous competing suppliers, and robust competition among retailers. Thus, in our experience there are no indications that the current 30% market share threshold systematically exempts agreements where a party with a market share of close to the threshold has such a degree of market power that its vertical agreements would be capable of having anti-competitive effects.

In fact, based on our experience in the intensely competitive markets in which we supply our hardware products, we believe that it should be considered whether the benefit of an Article 101(3) exemption should be extended to suppliers that have a market share above 30%, at least in certain circumstances. This could be the case where, for example, a supplier is the first to introduce a novel, particularly attractive device, but where a high share disappears in the short run when competitors enter this novel product segment. A supplier who is the first to launch a new and innovative consumer product may per definition have 100% of the product segment in the initial and low volume launch period. But competitive entry typically would substantially reduce this share in a short period of time. In the absence of any degree of durable market power, there is no reason to assume that vertical distribution agreements in these markets generally are capable of having anti-competitive effects.

The current tolerance provided for under the VBER where the 30% threshold is temporarily exceeded is unnecessarily conservative, as it only applies provided the market share does not exceed 35% during a maximum of one year. There are good arguments to make this tolerance considerably less proscriptive, for example by raising the market share cap to 50% during 2 years. In any event, the VGL should incorporate the general principle that, regardless of the level of market share achieved, where a market share is temporarily high following the introduction of a novel product, the conditions of Article 101(3) will generally be presumed to be met on an individual assessment for a period of two years where an agreement would otherwise comply with the requirements of the VBER (without prejudice to the ability to justify further restrictions in respect of new products as currently provided in paras 61 & 62 of the VGL).

### **2.3 The VBER and VGL Provide Reasonable Flexibility for the Design of Selective Distribution Systems**

The ability to distribute our hardware products in the EEA in the framework of a selective distribution system, which is currently possible under the VGL, is of great importance to us. As indicated above, we use a distribution system comprising wholesalers, distributors, and retailers. Within the distribution system, our hardware products are sold to consumers, but also to customers that acquire our hardware products for installation in their customers' homes.

In such a complex environment, a selective distribution system enables us to set uniform, equally applicable requirements for each group of similarly situated members of our distribution system, including those that do not have a direct supply relationship with us. This ensures that all equivalent members operate under the same general conditions and support the effective distribution of our hardware products while protecting our brand.

Our conditions to join the selective distribution network are aimed at ensuring that our hardware products are offered in a way that meets the legitimate expectations of consumers, and that consumers can have the opportunity to receive sufficient services and advice, which is important to preserve the quality of the hardware products and the value of our brand in the eyes of consumers.

Having a set of uniform conditions also helps to ensure that the incentives of equivalent distributors are aligned, and that distributors and retailers that are willing to invest in the promotion and presentation of our hardware products do not have to be concerned that their efforts may be undermined by other distributors or retailers that do not undertake the same efforts.

### **2.4 Dual Distribution**

The VBER currently covers vertical agreements within dual distribution systems, i.e., systems whereby a supplier uses a distribution system to sell its hardware products, and also sells its hardware products directly to consumers. In our view, it is important that a revised VBER maintains the same approach to dual distribution systems. There would be no sound competition law or policy reasons to change the current approach.

The dual distribution system serves an important role for us and for consumers who consider purchasing our hardware products. The dual distribution system enables consumers to obtain information about our hardware products directly through our own webstore, where, if they decide to purchase the product, they can directly and seamlessly make a purchase without the need to search for alternative online or offline stores. At the same time, relying on a network of independent wholesalers, distributors, and retailers enables us to reach a much wider group of consumers, including those who prefer to purchase devices in brick and mortar stores or who prefer other online stores.

Dual distribution systems are, as such, benign from a competition law perspective because they simply allow a supplier to reach potential customers through an additional sales channel and to promote its hardware products in an environment that is directly associated with the supplier's brand. Dual distribution systems have existed for many years, before the emergence of online sales, as certain brands have distributed their hardware products through both directly owned stores and third-party distributors and retailers. The use of dual distribution systems has become even more common in an online environment as it has become much more cost effective for a supplier to operate its own webstore. There are no competition law or policy reasons to treat dual distribution in an online environment differently than dual distribution systems in a traditional, offline environment.

While dual distribution could be said to result in a supplier competing with third-party retailers, the supplier's relationship with its distributors or retailers is nonetheless vertical. The same reasons that justify in general exempting certain vertical agreements under the current VBER – the agreements are unlikely to have harmful effects and are, on the contrary, highly likely to meet the exemption criteria under Article 101(3) TFEU – equally apply to vertical agreements within a dual distribution system. Excluding these vertical agreements from the scope of VBER simply because the supplier also sells its hardware products directly would not be justified on competition policy grounds and ultimately result in reduced and less efficient distribution systems with no apparent benefit for consumers.

To the extent there could be concerns about information flows from retailers to suppliers and the supplier's use of such information, it should also be recognized that such information flows may allow suppliers to distribute their hardware products more effectively, and therefore can have pro-competitive effects. In any event, if there are justified competitive concerns, the revised VGL could be used to address such information flows in more detail and provide guidance to the industry.

## **2.5 Incentivizing Offline Retailers**

As mentioned above, we offer internet-based digital services, and our success therefore has always depended on the opportunities that a thriving online environment offers suppliers and consumers. This applies equally to the distribution of our hardware products. We sell directly through our own webstore, encourage online sales by distributors and retailers, and admit pure online retailers to our selective distribution system.

Nevertheless, ensuring a presence of our hardware products in brick and mortar stores remains an important component of our distribution strategy. Offline outlets remain important to certain consumers who consider the purchase of hardware products. Viewing such hardware products, being able to compare them directly with alternative hardware products, and receiving unbiased, individualized and personal advice (for example on performance parameters, on how to connect and command

smart hardware products, or on how to transfer data from prior devices to new hardware devices) is often important to a consumer's decision to purchase a product.

For these reasons, we consider the continued ability of offline outlets to effectively compete important. Accordingly, we are willing to work with certain offline retailers and support their efforts to display and promote our hardware products and to train and retain staff that can offer consumers additional, important services. In our view, offline retailers incur additional costs for services they provide to the supplier and their customers that competing online retailers do not incur, and should be compensated for these services.

We consider the current approach of the VGL towards dual pricing arrangements unnecessarily restrictive. With online sales vastly increasing, the VGL's assumption that dual pricing arrangements are a tool to limit competition by online sales is outdated and removed from practical market developments. The VGL's current, restrictive approach may be linked to the initial concern that restrictions on online sales could be a form of territorial restraint impeding cross-border sales. In our view, however, suppliers generally would consider dual pricing systems not as a tool to limit online sales, and even less so cross-border sales, but as the most efficient method to preserve the important role of offline retailers. The approach currently adopted by the VGL, which considers only support in the form of a fixed fee compatible with Article 101 TFEU, is not as efficient as dual pricing. The support provided to retailers in the form of fixed fees may be too high or too low and result in inefficient incentives for distributors across the distribution network. Moreover, for practical reasons such support may well be limited to selected, key retailers and may not be available to all offline retailers in a distribution network.

There is therefore, in our view, no basis for assuming that a dual pricing system would be capable of restricting competition. The VGL's guidance on the assessment of dual pricing strategies should therefore be reviewed and should be adjusted to conform to present (and future) market conditions.