**European Commission Evaluation of the Vertical Block Exemption Regulation**

**Response to the Public Consultation – Euclid Law Ltd.**

## Introduction

1. Euclid Law Ltd. (**Euclid Law**) is a boutique competition law firm, with offices in London and Brussels. We advise on all aspects of EU and UK competition law. Euclid Law is also the founding coalition member of eControl Global™, through which we work closely with US law firm Vorys, Sater, Seymour and Pease. Our EEA eControl practice has a particular focus on advising brands on the roll-out of selective distribution systems in Europe.

2. Our lawyers advise on the compatibility of distribution agreements with EU competition law on a daily basis. We also have experience of representing clients in investigations of their distribution arrangements by the European Commission (**Commission**) and National Competition Authorities (**NCAs**). As well as advising a wide range of brands, from globally established companies to start-ups, we have advised online retailers, marketplace operators, brick and mortar retailers, software companies, sporting rights companies, financial services companies, insurance companies, gaming companies and pharmaceutical companies on their distribution arrangements.

3. Euclid Law are submitting this paper as a supplement to our response to the Commission's public consultation questionnaire on the Vertical Block Exemption Regulation (**VBER**) and Verticals Guidelines.

## General observations

4. We agree with the Commission's overall evaluation that the current iterations of the VBER and Verticals Guidelines remain useful and relevant. We also agree that the regime needs some updating to take account of market and case law developments since 2010.

5. We would suggest that most of the necessary updating can be achieved through revision of the Verticals Guidelines, rather than any substantive amendments to the VBER itself. In particular, we do not see why the growth of online retail and platforms requires fundamental changes to the structure of the VBER, which has proved to be broadly fit for purpose in practice. There are significant benefits in retaining a regime that is stable and predictable in its key aspects.

Introducing material new elements to the VBER, such as a different market share threshold for the application of the VBER to agreements involving dual distribution, would introduce additional complexity and reduce legal certainty.

6. It is the nature of block exemptions that they introduce a degree of rigidity as a price of legal certainty. It may be hard to justify in individual cases by reference to market impact why one agreement is protected by a block exemption, and thus immune from legal challenge, while another is outside the safe harbour and presumptively unlawful because a restriction is defined as hardcore. This is particularly difficult where the hardcore nature of a restriction is based on subjective factors. That said, it is inevitable that a block exemption's safe habour has a boundary that divides agreements that are automatically and definitively lawful from agreements whose legal status is uncertain. We would suggest that the fact that this basic architecture may create uncertainty, or a degree of logical inconsistency, when defining that boundary does not invalidate the utility of having the safe harbour in the first place.

7. This tension is apparent in the way the VBER currently operates. For example, as noted by the Commission, it can be difficult to tell in practice whether an online sales criterion in a selective distribution agreement respects the equivalence principle, and is therefore protected by the VBER safe harbour, or does not, and is therefore viewed as a hardcore restriction of competition that renders the agreement presumptively unlawful. **We would strongly suggest that this does not mean that the equivalence principle is defective, as it provides a useful and coherent guide for a self-assessment.** Similarly, we do not think that this issue reveals a fundamental problem with the VBER.

8. Similar tensions arise in other areas. For example, a pricing recommendation can in principle shift from being entirely lawful to a hardcore restriction if the context indicates that it is in reality part of a wider resale price maintenance strategy. To give another example, while it may be hard to justify by reference to market impact why a restriction on marketplace sales is protected by the VBER, and hence immune from legal challenge, while a restriction on the use of a price comparison site (which may look very similar to a marketplace) is presumptively unlawful as a deemed restriction on online sales, a line has to be drawn somewhere. **The current boundary, which focuses on distinguishing between restrictions on where/to whom a product is sold and restrictions on how it is sold, is at least legally coherent.** Similarly, while it can be hard to explain to a retailer why a decision to purchase search advertising on a country-specific website that is targeted at users in a neighbouring territory may be lawfully prohibited by a brand, while a decision to purchase online display adverts on a website that is

not associated with a particular country may not be, **this does not mean that the distinction between active and passive sales needs a complete overhaul.**

9. As with any block exemption, the VBER provides increased legal certainty across large parts of the economy at the price of a degree of rigidity and 'rough justice' at the margins. Attempts to reduce the latter by materially altering the boundaries of the safe harbour **risk increasing complexity and reducing the very legal certainty that the regime exists to provide.** If the Commission or an NCA considers that a protected agreement is resulting in an appreciable restriction in an individual case, then the benefit of the block exemption can be withdrawn. We would suggest that this is a more appropriate course of action than interfering with the careful balance reflected in of the VBER.

**Specific points addressed by the Evaluation Document and Questionnaire**

*Assessment restrictions of online sales and advertising*

10. There is clearly a need for the Verticals Guidelines to be updated to reflect recent case law and decisional practice, including in particular the *Coty* judgment and *Guess?* Commission decision. As far as the former is concerned, incorporating key parts of the Commission's April 2018 policy brief on *Coty* would improve legal certainty in this area and make it harder for NCAs or national courts to introduce uncertainty through divergence in decisional practice.

11. It would also be helpful for the Verticals Guidelines to be updated to summarise the Commission's current thinking on the status of restrictions on the use of price comparison sites and on AdWord bidding by resellers, as reflected for example in the final report on the E-commerce Sector Inquiry.

*Dual pricing*

12. While we agree that dual pricing has the potential to act as a restriction on online sales, the approach reflected in the current Verticals Guidelines can be unduly rigid in practice. For example, it can make it difficult for a manufacturer to provide promotional funding to support sales activities that are focused on a certain channel where that funding is linked to sales volumes (as is almost invariably the case). At a minimum, we would support incorporating the helpful guidance on dual pricing provided in the Commission's final report on the E-commerce Sector Inquiry, in particular the clarification that differential pricing between different retailers is generally not a problem. We would also suggest that additional guidance could be provided in the Verticals Guidelines to support the proposition that variable

promotional support can be provided in some circumstances without this amounting to hardcore dual pricing, for example if the promotional support is broadly related to variable costs incurred by the buyer to support the promotion in question.

*Active vs passive sales*

13. We consider that the distinction between active and passive sales is well understood and provides a workable differentiator between lawful and unlawful restrictions in individual cases. While the list of examples provided in the Verticals Guidelines could usefully be extended with examples that reflect current market practice, the approach itself remains sound.

*The equivalence principle*

14. Criteria for online and offline retail will inevitably need to be adapted to take account of the different characteristics of these sales channels. This can be readily achieved, while avoiding undue discrimination against either channel, through application of the equivalence principle. While it inevitably creates some theoretical uncertainty as to where the precise boundaries of hardcore conduct lie, in practice the principle is conceptually sound and logical. As long as it is applied in a pragmatic and proportionate way by the Commission, NCAs and national courts, for example to avoid selective distribution agreements unintentionally falling outside the VBER safe harbour due to a particular interpretation of a legitimate quality criteria, we **strongly believe this principle should be retained**.

15. We would, however, suggest that the Verticals Guidelines be extended to clarify that the equivalence principle can be applied equally to criteria for other sales channels. Most importantly, we consider that the **Vertical Guidelines should be updated to clarify that specific quality- or quantity-based criteria may be applied equally for specific authorisation of marketplace sellers**, alongside differentiated criteria for authorisation of sellers wishing to sell only on their own websites.

16. This specific issue was addressed during one of the roundtable discussion topics at the Commission's stakeholder workshop on the VBER, in which we participated. Following the roundtable discussion, it was agreed by participants that "qualitative and quantitative selective distribution criteria in the context of selective distribution systems should be applicable to all distribution channels, including marketplaces, in line with the principle of equivalence."

*Online marketplace restrictions*

17. As far as marketplace restrictions are concerned, this would be a good opportunity for the Commission to revisit the wording on marketplace restrictions in the last sentence of paragraph 54, to clarify that the sentence is intended to state an example of the application of the principle, as described in the preceding sentence, that a supplier may apply "standards and conditions" (including qualitative and quantitative criteria) for the sale of its products on the internet, rather than amounting to a free-standing principle. The relevance of the reference in paragraph 54 to "subsequent changes" to brick and mortar requirements could also be made clearer. (It is not clear from the current wording whether the Commission views changes to a selective criterion as raising any particular issues, compared with implementing a criterion from the outset of a selective distribution system.)

*Combining selective and exclusive distribution*

*18.* Although the Verticals Guidelines provide useful guidance on this point, we would encourage the Commission to take things a step further. In particular, there **may be merit in amending the text of VBER itself to provide that systems that combine territorial exclusivity at the wholesale level with selective distribution at the retail level are compatible** with the block exemption, as long as passive sales to end customers in the EEA remain possible wherever the relevant products have been put on sale.

19. While paragraph 63 of the current Verticals Guidelines acknowledges that such a system may meet the requirements for individual exemption under Article 101(3), in practice the hurdles faced when proving that an agreement is exempt can be significant, and therefore costly, for businesses. As a result, the comfort provided by this statement has its limits. Extending the block exemption to this limited extent would create greater legal certainty.

20. We note that paragraph 55 of the Verticals Guidelines already explains that a supplier may restrict an appointed distributor in a selective distribution system from selling to unauthorised distributors located in any territory where the system is currently operated *or where the supplier does not yet sell the contract products*, by extensively interpreting the reference to "the territory reserved by the supplier to operate that system" in Article 4(b)(iii). We would suggest this concept could be extended further to allow the supplier to prevent sales by selective distribution network members to unauthorised resellers in EEA territories where the contract products *are* available but the selective distribution system is not in operation, for example if the supplier has reserved such territories to itself on an exclusive basis or because it has

appointed exclusive resellers in those territories (potentially because it is waiting for the term of current exclusive agreements to expire before rolling out selective distribution in those territories or it has simply decided that exclusive distribution is more appropriate on an ongoing basis). Alternatively, such sales may be permitted only on condition that the requesting reseller meets specified quality criteria (on which, see further paragraph 24 below). Otherwise, allowing passive sales from selective distribution network members to unauthorised resellers in these circumstances risks the integrity of the selective distribution system being undermined in territories where it is in operation, due to the risk of re-import into those territories, as well as leading to unsatisfactory customer experience in territories where it is not.

21. It would in any event be helpful to clarify that a supplier may lawfully restrict any sales from outside the territory in which selective distribution is in operation to unauthorised distributors inside that territory. Otherwise, an exclusive distributor based in the EEA but outside the selective distribution territory could potentially sell the relevant products to an unauthorised reseller within the territory. Confirming that such sales can be prohibited, even where an unauthorised reseller within the selective distribution territory approaches a distributor outside the selective distribution territory on an unsolicited basis, would help maintain the integrity of selective distribution networks, while at the same time giving suppliers more scope to tailor their European distribution networks to local market characteristics.

22. While implicit, the Verticals Guidelines could also make it clearer that a supplier operating a selective distribution system that is protected by VBER may lawfully introduce additional quantitative thresholds within its network, enabling it, for example, to appoint only one authorised wholesaler within a specific country, as long as all network members remain free to sell across the entire network on an active and passive basis.

23. Finally, it would be useful to clarify in the Vertical Guidelines that it is entirely permissible for a supplier to impose quality requirements on distributors within an exclusive distribution model. This is made explicit in the Commission's FAQ document (MEMO/138), published on 20 April 2010, which states that suppliers are free to sell "only to shops in exclusive areas which provide a particular quality of service". It is also implicit in paragraph 54 of the Vertical Guidelines, which states that "under the block exemption the supplier may require quality standards for the use of the internet site to resell his goods, just as the supplier may require quality standards for a shop or for selling by catalogue or for advertising and promotion in general. This may be relevant *in particular* for selective distribution" (emphasis added).

24. In our practical experience, it is nevertheless rarely understood by businesses that they can also impose quality criteria in a non-selective distribution system. As a result, further clarification in the Verticals Guidelines may be desirable.

*Agency agreements*

25. We agree that **the current treatment of agency agreements in the Verticals Guidelines could be improved**. For example, incorporating aspects of the Commission's Working Paper on distributors that also act as agents into the Guidelines would be valuable.

*Retail parity clauses*

26. As is the case with MFNs in general, assessing the legality of parity clauses can be challenging. We do not see any compelling need to change the VBER to deal with such clauses, however. **The assessment of parity clauses inevitably raises fact-specific issues for which a block exemption is not suitable**. It may be the case that such clauses are not protected by the VBER in the first place, on the basis that their effects may extend beyond the narrow vertical supplier/buyer relationship that is protected by VBER. If not, the benefit of the block exemption can be lifted in individual cases where a problematic parity clause is identified.

27. Attempting instead to define a category of parity clause that amounts to a hardcore restriction, or interpreting existing hardcore restriction definitions such as Article 4(b) VBER in a manner that would capture such parity clauses, would increase complexity and reduce legal certainty, while providing limited benefits to parties or competition.

*Dual distribution*

28. **The current treatment of dual distribution is broadly fit for purpose.** While it is increasingly common for brands to sell direct to customers, as well as supplying distributors and resellers, in itself this does not justify removing such agreements from the protective scope of the VBER. Quite the reverse. Increased direct sales by brands increase retail diversity and can enhance consumer feedback on product quality aspects, thereby speeding up innovation.

29. Although dual distribution does create greater risks of horizontal competition concerns arising, for example, if a brand acquires commercially sensitive information from its resellers that it could use to inform its own commercial decisions when selling products direct in competition with those resellers, these concerns arise from conduct that is distinct from the vertical supply relationship. As a result, the fact that the underlying distribution agreements are protected by the VBER should not prevent these concerns being addressed under Article 101. If there was

any uncertainty in a specific case, the underlying vertical agreement could be removed from the VBER safe harbour. **Removing all such supply agreements from the protective scope of the VBER would be grossly disproportionate to this issue**.

30. Similarly, as noted above, introducing a lower market share threshold for the application of VBER to supply agreements where the supplier engages in dual distribution would introduce significant additional complexity to the application of the regime and reduce legal certainty, for limited practical benefit.

31. **We would support adding distributors and importers to manufacturers as suppliers that benefit from the dual distribution exception**. Where a manufacturer and distributors engage in direct to consumer sales, there is no logical reason why a supply agreement between the manufacturer and a reseller should be protected under VBER, while an agreement between a distributor and a reseller is not. Such arrangements should be encouraged, as they bring greater retail diversity and competition, rather than discouraged. We would suggest that it may be possible to address this point by amending the Verticals Guidelines, by stating that a distributor or importer will be treated in the same way as a manufacturer for the purposes of applying the dual distribution exception. If this is viewed as providing insufficient legal certainty, then an amendment to Article 2(4) VBER may be warranted in this limited case.

*RPM*

32. We see insufficient need to change the approach set out in the current VBER and Verticals Guidelines and would simply encourage the Commission to ensure that NCA practice on defining RPM remains consistent.

*Non-compete clauses*

33. The limitation of the protection of non-compete clauses provided by the VBER to restrictions with a duration that is less than five years can create practical challenges. In particular, it is hard to reconcile with the common practice of drafting supply agreements that roll over automatically unless terminated. Although mechanisms can be drafted to address this, they can be difficult to apply in practice. While this is ultimately a policy decision for the Commission, we can see merit in removing Article 5(1)(a) from the VBER. To the extent that this leads to protection of non-compete obligations that raise concerns in individual cases, the benefit of the block exemption could be withdrawn.

**Concluding remarks**

34. We thank the Commission for the opportunity to comment on these points, congratulate it on the quality of the work that it has undertaken so far on this important topic and look forward to seeing revised texts of the VBER and Verticals Guidelines in due course.

**Euclid Law Ltd.**

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