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European Commission Evaluation of the Vertical Agreements Block Exemption Regulation (VBER)

Response to the Public Consultation on the draft revised Regulation and Guidelines

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 a founding coalition member of eControl Global™, through which we work closely with US law firm Vorys, Sater, Seymour and Pease. Our European eControl practice has a particular focus on advising brands on the roll-out of selective distribution systems.

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. We are submitting this paper from the position of practitioners who see merit in having a rational, predictable and up to date competition law regime for vertical agreements. The views stated are our own and do not necessarily represent the views of any client of our firm.

Welcome changes

4. We congratulate the Commission VBER review team on undertaking what has clearly been a comprehensive and thorough exercise that promises materially to improve the EU verticals regime. In particular, the expanded Guidelines provide helpful additional guidance on the regime, including by taking account of recent case law developments.

5. While we were initially surprised by the extent of the Commission's proposed changes to the VBER, as opposed to simply updating the Guidelines, we agree that the changes generally

improve the clarity and structure of the Regulation. In particular, the revised structure of Article 4 helps to clarify the application of the VBER to different forms of distribution.

6. To the extent that the changes alter, rather than clarify, the scope of the VBER safe harbour, we welcome the Commission's proposed changes that will enable suppliers to require that **exclusivity obligations** they impose on their buyers are passed through to the customers of buyers within the safe harbour, as the inability to do so is a major practical issue with the current VBER. We also welcome the proposed change that will enable suppliers to restrict active and passive sales by buyers located outside of a territory where the supplier operates a **selective distribution system** to unauthorised distributors located within that territory, as the inability to do so at present is another material flaw with the current VBER. The proposed change in the treatment of tacitly renewable **non-compete obligations** in Article 5 is also welcome and will materially reduce complexity for businesses in this respect.

7. As noted in our submission of 26 March 2021, we do not consider that the VBER needs to be amended to make specific provision for **retail parity clauses**. While that remains our view, we consider that the Commission's proposal for defining a specific category of such clauses as excluded restrictions, under the new Article 5(1)(d), is proportionate and should be reasonably straightforward to apply in practice. As such, to the extent that the Commission wishes to change the VBER to take account of such restrictions, this is the best way to do so.

8. As also noted in our March submission, we consider that it is not necessary to deal explicitly with the treatment of **online sales** or the **active vs. passive sales distinction** in the VBER itself, given the extensive guidance provided by the updated Guidelines. In addition, the European Court case law has demonstrated that the existing legal framework is flexible enough to adapt to new developments, without any need for the VBER itself to be changed. We nevertheless agree that the changes to the VBER and Guidelines regarding these aspects are broadly helpful, albeit at the cost of making both documents longer and arguably more complex.

9. We also welcome the specific confirmation in the new VBER text that providers of **online intermediation services** should generally be viewed as *suppliers* under the VBER. This is because, as the Commission notes, in a typical online marketplace platform sale scenario, the platform is supplying such services to sellers of goods or services that in turn use those intermediation services to sell those goods or services to their customers. As such, the vertical agreement under which the platform supplies services to the third party seller is distinct from the agreement under which the third party seller sells the relevant goods or services to the end customer. While this is usually the correct framework in which to analyse such a scenario,

experience has shown that uncertainty in application of the VBER in such cases has sometimes caused confusion for undertakings and competition authorities (for example, regarding the correct approach for analysing RPM in an online platform context). As such, the confirmation that the concept of supplier under the VBER includes providers of online intermediation services is helpful. As noted below, however, we have reservations about the Commission's other proposals for applying the VBER to the 'online platform economy'.

10. The extensive proposed changes to the Guidelines largely meet the Commission's stated objective of updating the guidance to take account of case law and market developments, while improving the overall structure of the document. For example, we agree that moving the general analysis of specific restrictions under Article 101 to the corresponding sections that consider the treatment of those restrictions under the VBER makes the Guidelines easier to read. The extensive new guidance on the treatment of **online sales**, **dual pricing**, application of the **equivalence principle**, **agency**, the difference between **active and passive sales**, **marketplace restrictions** and **fulfilment contracts** is helpful and should materially resolve any remaining legal uncertainty in these areas.

Concerns

11. In contrast, we have some concerns over the proposed changes with respect to **dual distribution**, **shared exclusivity** and the treatment of **hybrid online marketplaces**. Our concerns are explained below.

<u>Dual distribution</u>

12. As noted in our submission of 26 March 2021, we support adding distributors and importers to manufacturers as suppliers that benefit from the dual distribution exception. As a result, we are pleased that the Commission has decided to extend the exception in this way, rather than limiting it to manufacturers or even removing it altogether. We are nevertheless concerned that the way in which the new Article 2 is drafted, combined with the Commission's other proposed changes, add material complexity and uncertainty to the application of the exception, for limited or no benefit.

13. The Commission's proposed changes also appear to *narrow* the application of the exception, by adding a new market share threshold, limiting application to situations where competition occurs at the retail (rather than wholesale) level and removing most sales through hybrid online platforms from the VBER safe harbour altogether. As explained further below, as well as being contrary to the objective that a block exemption should be clear, business model agnostic and

relatively easy to apply, these changes are likely to lead to more legal uncertainty and *less* direct selling by all categories of supplier, which would ultimately reduce competition.

New market share threshold

14. The creation of a secondary market share threshold for application of the dual distribution exception, in and of itself, adds complexity to the VBER. In practice, it is often difficult for a company to assess its market share and the new threshold adds a new area of uncertainty in this respect. Admittedly, the adverse consequences of exceeding the 10% threshold are limited, namely that any exchange of information between competing parties is not covered by the exception and is hence excluded from the VBER safe harbour. Considering that such an exchange may well be outside the current VBER safe harbour in any event (to the extent that it goes beyond the conditions under which the parties purchase, sell or resell the contract goods or services), the legal impact of this change may admittedly be limited. We would nevertheless question the value of adding the new threshold, given the increased complexity it creates for the VBER regime.

Treatment of object restrictions

15. The new Article 2(6) states that the dual distribution exception shall not apply to agreements that have the object of restricting competition. While it would be surprising if the current VBER were to exempt such agreements, given that they are essentially horizontal in nature,[1] stating this explicitly may create additional uncertainty as to the application of VBER in practice. At best, it adds little while increasing the length and complexity to the VBER text. As a result, we would question its value.

Treatment of wholesale competition

16. Whereas the current exception applies in any situation where a manufacturer and distributor compete at the distribution level, regardless of the level of the supply chain at which such distribution competition takes place, we note that the new exception would apply only to situations where the parties compete at the retail level. This interpretation arises from the requirement in Article 2(4)(a) that the parties not be competitors "at the manufacturing, wholesale or import level" and by the reference to the parties' relevant combined market share being "at the retail level".

[1] See paragraph 90(e) of the new Guidelines, which refers to Article 2(6) as applying to "*horizontal* restrictions of competition by object".

17. This change has the potential to limit the application of the exception without clear justification, rendering agreements that are currently protected vulnerable to challenge in future. For example, whereas the exception would currently apply in a scenario (which is relatively common) where a manufacturer supplies some retailers direct, alongside and in competition with its network of wholesalers, this would be specifically excluded from the exception in future. Manufacturers may decide to retreat from such involvement in their supply chain as a result of this change, reducing supply options open to retailers.

18. It is not clear why the Commission has made this change or indeed whether this is the intended effect. It would be helpful if the Commission could review its proposal in this light and, at least, provide further guidance on the rationale for the change and on how supplies to wholesalers should be treated under the revised exception.

Treatment of hybrid online platforms

19. The exclusion of agreements with hybrid online platforms from the dual distribution exception appears to be part of a wider move to exclude all agreements from such platforms from the VBER safe harbour. As such, it is covered under a separate heading below.

Shared exclusivity

20. Notwithstanding the observations contained in the Commission's *Expert Report on active sales restrictions in different distribution models and combinations of distribution models*, we have rarely experienced situations in practice where a supplier wishes to implement shared exclusivity. Generally speaking, the benefits for both parties of exclusivity being allocated to a single distributor, combined with the simplicity of such an approach, mean that sole exclusivity is far more common.

21. The challenges faced by the Commission in expanding the VBER safe harbour to include shared distribution arguably demonstrate why it has to date been limited to sole exclusivity. As recognised by the extensive case law in this area, the restrictions inherent in exclusivity can typically be justified by reference to the associated benefits that arise from it, including incentivising investment in product promotion by the distributor. While sharing exclusivity amongst more buyers reduces the restrictive effect, by allowing for more competition between buyers within a territory or customer group, the incentives for each buyer to invest in the product may also be reduced, thereby reducing the benefits. It follows from this that any move away from the simplicity of sole exclusivity is likely to involve a degree of case-by-case

analysis. It is ultimately difficult to take account of such factors within the framework of a block exemption.

22. While we appreciate that the Commission nevertheless wishes to address the issue to permit such practices where they arise, we would suggest that the caveats to the application of VBER to shared distribution that it has also included in the new text are flawed and materially undermine the proposed change. Indeed, they are likely to create such a high degree of uncertainty that parties are unlikely to risk agreeing to shared exclusivity in practice.

23. Applying the new definition of 'exclusive distribution system' together with the new Article 4, the Commission is proposing that restrictions on active sales into an exclusive territory or customer group will be protected under the VBER only where the territory or customer group has been: (i) reserved to the supplier; (ii) allocated to a single buyer; *or* (iii) allocated to "a limited number of buyers, determined in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts".

24. The new third permitted category to cover shared exclusivity is inherently uncertain and subjective, making it hard to apply. For example, will it be sufficient for a supplier to demonstrate simply that it has placed a set numerical limit on the number of distributors in a territory and allocated more distributors to large territories and fewer to smaller territories or will it need to demonstrate that, when setting the limit, it has specifically quantified and compared the volume of business to be generated for each distributor against the investment to be provided? Experience with undertaking Article 101(3) analysis demonstrates that such an exercise is inherently difficult, fact-intensive and uncertain. The requirement to undertake such an analysis would be contrary to the basic purpose of a block exemption, namely providing a safe harbour that can be relied on with a reasonable degree of confidence, without the need for expensive fact-specific analysis. Depending on the standard of proof demanded by the Commission, NCAs and courts when applying this provision, it seems unlikely that a supplier would in practice be able to know whether it has met this requirement with any degree of confidence.

25. Were an undertaking to get the analysis wrong and fail to meet this requirement when implementing shared exclusivity, this would have two consequences:

    a. any active sales restrictions into the shared exclusive distribution territory or customer group will be treated as hardcore restrictions, meaning that all agreements between

the supplier and all distributors subject to those restrictions will fall outside of the VBER safe harbour and will be presumptively unlawful; and

b. all agreements between the supplier and the distributors who benefit from the shared exclusivity will be at risk of being removed from the VBER safe harbour (Guidelines, para 107).

26. Weighing up the risk of such significant adverse consequences against the uncertainty noted above suggests that, faced with the Commission's present proposal, parties are unlikely to risk implementing shared distribution in practice. While this may be an acceptable outcome from the Commission's perspective, it would beg the question as to why the Commission would wish to make this change in the first place if it cannot be safely relied upon.

27. If the Commission decides that it would like to retain provision for shared exclusivity in the VBER, which may well be beneficial in some commercial scenarios, we suggest that the following options should be explored to make it easier to apply:

    a. provide additional guidance (including case study examples) to make it clear that, when determining whether the "limited number of buyers" has in fact been "determined in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts", the Commission or an NCA should simply require evidence that the supplier has undertaken some form of high level business assessment of this point, rather than (for example) complex economic modelling;

    b. amending the language in the VBER to state that the number of buyers should have been "determined ***broadly*** in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts" (potentially in combination with option a); or

    c. apply the VBER safe harbour to all instances of shared exclusivity, while expressly noting the ability to remove such systems from the safe harbour in individual cases where an authority considers that the number of distributors in an exclusive territory has *not* been determined "in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts". By shifting the risk in favour of the supplier, this approach would reflect that taken on other aspects of the VBER regime that involve the assessment of 'edge cases', where a degree of legal certainty is provided by the safe harbour for broad categories

of agreements, while recognising certain factors may render an agreement unworthy of protection by the safe harbour *in specific circumstances*. While suppliers implementing shared exclusivity would still face some uncertainty, and hence risk, under this approach, the costs of getting an assessment wrong would be less dramatic. It would also be more proportionate and would not undermine the coherence of the block exemption as a whole.

28. We leave it to the Commission to determine which option best meets its objectives.

Treatment of hybrid platforms

29. The Commission has clearly decided, as a matter of policy, to reduce the extent to which the activities of providers of online intermediation services that also sell goods or services in their own name (commonly referred to as 'hybrid platforms') should be protected by the VBER safe harbour. As the new Recital 12 states, "*Providers of online intermediation services should not benefit from the block exemption … where they have a hybrid function*". This move is in addition to the new guidance in the Guidelines on the 'genuine agency', which will materially reduce such platforms' ability to rely on that exception, as well as the new exclusion of certain retail parity clauses.

30. The reduction in the scope of VBER protection for hybrid platforms arises primarily from the new Article 2(7), which disapplies the dual distribution exception for most agreements entered into with such platforms. Article 2(7) is a complex provision, the application of which appears to require the following analytical steps:

    a. **Step 1** – Does an agreement contain restrictions of competition that may be caught by Article 101(1) TFEU?

    b. **Step 2** – Is the agreement in question one with a provider of online intermediation services that also sells goods or services (i.e. a hybrid platform)? If so, Article 2(7) may be relevant. (It seems to be irrelevant for these purposes whether the agreement in question is actually for the supply of online intermediation services.)

    c. **Step 3 -** Does the hybrid platform also sell goods or services[2] that compete with those sold by a customer of its online intermediation services (apparently irrespective of whether it does so with the aid of that platform's online intermediation services)? If

[2] Presumably this would only apply where the hybrid platform sells in its own name, through its retail arm, but this is unclear.

not, for example because the buyer of intermediation services is a manufacturer that does not sell its products direct to end customers,[3] then there is no need to rely on the dual distribution exception, so the analysis ends there. If the platform does sell competing products, then Article 2(7) applies and the dual distribution exception is not available, meaning that the agreement in question is not protected by the VBER, to the extent that it includes any restrictions of competition.

31. As a result, under the new Article 2(7), it appears that if *any* hybrid platform sells *any* products that compete with *any* products sold by a customer of its online intermediation services, *all* agreements between the hybrid platform and that customer, regardless of their subject matter, are removed from the VBER safe harbour. In contrast, such agreements would currently be protected by the dual distribution exception, under Article 2(4).

32. The Commission's reasons for this dramatic change are not fully explained. The new Recital 12 justifies the new approach by reference to hybrid platforms' retail activities, which the Commission claims "typically affect inter-brand competition", thereby raising "non-negligible horizontal concerns". Presumably, the Commission considers that there is an inherent risk to competition between suppliers selling products via such a platform and the platform's own retail operation that arises from the mere fact that the suppliers have decided to sell their products on that platform. The reasons for this conclusion, which appears to run counter to most brands' experience that selling on hybrid platforms typically leads to intensive price competition, including from the platform's own retail arm, are not explained.

33. While the wording of Recital 12 is reflected in paragraph 91 of the new Guidelines, no further details of the concerns are provided. Rather, paragraph 91 simply confirms that "*suppliers of online intermediation services … that have a hybrid function … cannot benefit from the exceptions for dual distribution*", with this applying "*not only … to restrictions that are stipulated in an agreement with a buyer of online intermediation services, but also to agreements regarding the purchase of the goods or services sold by the provider of online intermediation services that has a hybrid function.*" The first sentence of paragraph 92 confirms the consequences of this, namely that "Vertical agreements with hybrid online intermediation services providers must be assessed on a case by case basis."

34. The wording of the accompanying Explanatory Note suggests that the Commission considers that the revision is required because the increase in direct selling online by suppliers *in itself*

[3] As noted at paragraph 85 of the new Guidelines, a hybrid platform that contracts with a manufacturer for the production of products that will bear the platform's brand is not to be treated as a manufacturer of those goods. As a result, the platform is not a competitor of the manufacturer buying its intermediation services in this example.

means that agreements between such suppliers and hybrid platforms are likely to "*raise possible horizontal concerns [that] are no longer negligible*". Following this logic, the Commission claims that including such agreements in the VBER safe harbour results in 'false positives' and that this outcome is precluded by the Empowerment Regulation. Again, no further explanation or supporting evidence is provided.

35. Notwithstanding the repeated references to "non-negligible horizontal concerns", it is not clear why those concerns are sufficient to disapply the dual distribution exception for all agreements with hybrid platforms, regardless of the market, the size of the platform or the platform's market share. The only limitation would be whether the platform's retail arm competes with the supplier. Given the wide retail product selection typically offered by such platforms, a supplier is unlikely to be able to establish that this is not the case with any degree of confidence (especially over the period of the distribution agreement).[4] The fact that this move is likely to create many new false negatives, where agreements will be excluded from the VBER that would benefit from individual exemption under Article 101(3), is not discussed.

36. This is not merely a technical issue. For example, consider a scenario where a manufacturer operates a quantitative selective distribution system that does not meet the *Metro* criteria and hence relies on the VBER safe harbour for its enforceability. Assume that members of that system are permitted to sell to end customers through specific high quality online marketplaces and that one of those marketplaces also has a retail site and is hence a hybrid platform. Assume further that the hybrid platform's retail arm is a member of the manufacturer's selective distribution system.

37. If the manufacturer decides to sell direct to consumers (whether via the hybrid platform, a different platform or its own website), and assuming that the hybrid platform sells competing products, then all agreements between the manufacturer and the platform will fall outside the VBER safe harbour. It follows from this that the SDS agreement between the manufacturer and the hybrid platform would be removed from the VBER safe harbour. Since the SDS as a whole does not meet the *Metro* criteria, this means that the SDS agreement between the manufacturer and the platform will be void and unenforceable, unless it is individually exempt under Article 101(3). If the SDS agreement with the platform is ultimately unlawful on this basis, the question

[4] As the platform's retail selection may change over time, this opens the prospect of the legality of the platform's agreements shifting over time, depending on whether its selection includes competing products. This seems undesirable.

then arises as to whether this has an impact on the integrity of the SDS as a whole and hence on the manufacturer's SDS agreements with its other sellers. This is unclear.

38. Faced with such uncertainty, and the significant adverse consequences for its SDS if it gets its assessment wrong, the manufacturer may decide not to admit the hybrid platform to its SDS in the first place, not to permit sales via the marketplace arm of the hybrid platform or not to sell direct to end customers at all. Each of these outcomes is likely to lead to a reduction in downstream competition. We would suggest that this would be undesirable.

39. While the operation of hybrid online platforms might well raise competition concerns in specific cases, these concerns do not appear to justify what is effectively a *lex in personam* with the aim of removing *all* such platforms' activities from the protective scope of the VBER. Rather than removing an entire business model from the safe harbour in what appears to be an arbitrary manner, the Commission could instead define more clearly the specific restrictions in such agreements that raise concerns and exclude only such aspects from the safe harbour, as it has done with the new Article 5(1)(d). Should that not be possible with sufficient precision, the Commission or NCAs could instead simply disapply the VBER where it comes across agreements with a hybrid platform that raise concerns in a specific case. The fact that this has rarely (if ever) been done in practice does not mean that it should not be preferred as a course of action, compared with distorting the entire VBER regime to the potential detriment of an entire sector of the economy.

40. This is in any event unlikely to be necessary in practice, given that the VBER only applies where both parties have market shares below 30%, bearing in mind that concerns are more likely to arise where a platform has market power. Here, the Commission appears to be extrapolating a concern that might arise from the presence of market power in the online intermediation services market across to a retail market where there may well be no market power, with limited explanation or justification and without any consideration of market power at all. This is surprising and runs against the basic rationale of the VBER safe harbour of exempting all vertical agreements where the parties do not have market power, except to the extent that they contain specified restrictions of competition.

41. The online platform economy facilitates billions of Euros of trade across the EU and online marketplaces are an important route to market for a wide range of businesses, from multinational brands selling direct to customers through to SMEs. The fact that online marketplaces lacking a connected retail arm will not be affected by this change clearly demonstrates that the Commission is specifically targeting the hybrid platform business model.

While one hybrid online retail platform, in particular, has attracted the most attention from competition authorities, this change would adversely impact *all* hybrid platforms, regardless of their size. This would likely be particularly detrimental to new hybrid platforms that will need to attract a critical mass of users to be viable. It is also unclear why the Commission considers that online hybrid platforms raise sufficient competition concerns to justify them being removed from the protective scope of the safe harbour, without applying the same approach to hybrid operations in an offline context, for example where a manufacturer distributes its own products alongside competitors' products.

42. The result of the Commission's proposed change may well be a reduction in the use of such platforms by manufacturers and other sellers, given the attendant legal uncertainty and adverse consequences of falling outside VBER. It may also lead to the relative decline of hybrid platforms, compared with marketplaces that lack a connected retail operation. While this may indeed be the Commission's intention, it is hard to see how such an outcome would lead to an *increase* in inter-brand (or indeed intra-brand) competition, compared with the current state of affairs. Rather, the reverse seems more likely. Given the significance of this shift, it is unfortunate that the new Guidelines do not provide more analysis of the rationale behind it.

43. To the extent that the Commission is able to specify its concerns over vertical agreements with hybrid platforms in circumstances where the platform does have market power on a relevant market, and hence where the VBER is not available to protect agreements affecting that market, the Commission could usefully provide guidance on these concerns in the Guidelines. This would avoid any need to distort the VBER safe harbour by removing a wide swathe of agreements with hybrid platforms from its protective scope.

Concluding remarks

44. Subject to the concerns noted above, we consider that the new VBER and Guidelines are on balance a significant improvement on the current texts and are thus to be welcomed. We would nevertheless encourage the Commission to implement further incremental improvements to the texts to address those concerns.

45. Finally, we note that the Commission apparently does not intend to publish the final texts until shortly before they enter into force. While we acknowledge the transitional period provided by Article 9, it would be helpful if the Commission could provide some further updates on its thinking between now and publication of the final texts, to help undertakings prepare.

Euclid Law Ltd.

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