OPPORTUNITY FOR PRODUCT MANUFACTURERS TO COMMENT ON EU DISTRIBUTION RULES

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EU Antitrust, Competition and Trade Regulation Alert

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On 8 November 2018, the European Commission published a “Roadmap” inviting manufacturers and other interested market participants to provide feedback on the Vertical Agreements Block Exemption Regulation (the “*Block Exemption*”).

The Block Exemption is an important practical tool for brands, providing an automatic legal exemption for their agreements with distributors and resellers where certain conditions are met. Its purpose is to provide companies with certainty that their agreements will not expose them to EU competition law risk, including investigation, fines and unenforceability.

As the current Block Exemption expires in May 2022, the Roadmap lays out the Commission's plans to conduct a “fitness check” of its provisions and evaluate whether these require any revision, in particular to reflect more appropriately the major developments that have altered the e-commerce landscape since its publication in 2010.

This initiative provides brands which sell products in Europe with a rare and valuable opportunity to share their views and help to shape the rules that will define how products can be sold in future, in particular online and via marketplaces.

HOW THE BLOCK EXEMPTION OPERATES

Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) prohibits agreements that have the object or effect of restricting competition. Article 101(1) applies both to agreements between competitors (“*horizontal agreements*”) and agreements between companies operating at different levels of the production or distribution chain (“*vertical agreements*”). Typically, an agreement in breach of Article 101(1) will be void or unenforceable and can raise significant risk. However, Article 101(3) provides a legal exemption for agreements where they deliver sufficient consumer benefits (by improving the production or distribution of products or promoting technical or economic progress) to outweigh the anti-competitive effects.

The Commission is empowered to adopt so-called “block exemptions” for certain agreements or practices that it can be assumed with sufficient certainty satisfy the conditions of Article 101(3). The Block Exemption is one such measure, implemented to give parties to vertical agreements certainty in an efficient manner about when their agreement will meet the requirements for exemption. The Commission has adopted other block exemptions, including in relation to technology transfer agreements, R&D agreements, motor vehicle supply agreements, state aid, and sector-specific matters, among others. Like the Block Exemption, these perform an important role in giving comfort and predictability to businesses that their conduct and terms are legally compliant.

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In summary, a vertical agreement will be Block Exempted where both the supplier and purchaser's market shares do not exceed 30% and the agreement does not contain any of the listed “hardcore restrictions”, such as unlawful resale price maintenance, unlawful territorial or customer group restrictions (e.g. a passive sales restriction in an exclusive distribution network, or an active or passive sales restriction in a selective distribution network), and the restriction of cross-supplies between authorised resellers within a selective distribution system (including between authorised distributors / resellers operating at different level of trade).

The Block Exemption is accompanied by the Commission's Notice providing guidance on the interpretation of the Block Exemption (the “*Vertical Guidelines*”). Although strictly-speaking the Vertical Guidelines are not binding on national authorities, they generally carry strong authoritative and interpretative weight across Europe. In practice, they have proven highly influential in directing how brands design their go-to-market strategies and assess their legal risk. The Commission's reinvigorated enforcement efforts also provide more clarity and guidance to the national authorities on the Commission's thinking, which is a Commission priority, helping to ensure consistency across EU Member States. These efforts thus further emphasize the future importance of the Block Exemption and Vertical Guidelines for market players.

WHAT THE COMMISSION IS LOOKING FOR

The Commission aims to gather views whether the Block Exemption and Vertical Guidelines:

- have proven *effective* in identifying the types of vertical agreements that should benefit from its safe harbour;
- have led to *efficiencies* in the form of lower costs for businesses and competition authorities in ensuring compliance with Article 101(1) TFEU;
- remain *relevant* in light of the new market developments (in respect of which, please see further below);
- are *coherent* insofar as they are aligned with the developments of the Commission's overall enforcement policy and practice; and
- *add value* by contributing to ensuring a consistent application of Article 101(1) TFEU by the national competition authorities and courts.

MAJOR DEVELOPMENTS IN E-COMMERCE ON WHICH THE COMMISSION WILL WELCOME VIEWS

The unprecedented growth and changes in the online landscape in Europe since the Block Exemption's publication in 2010, in particular the emergence of marketplaces and proliferation of high-volume, low-price resellers, have triggered a wave of renewed interest in vertical agreements by both the national competition authorities and the Commission.

However, these developments have challenged the relevance and appropriateness of certain Block Exemption or Vertical Guidelines provisions, with national authorities diverging in their approaches as to how the traditional rules should fit around the new and evolving e-commerce concepts.

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Marketplace bans

A key example is marketplace bans. Whilst the Vertical Guidelines suggest that a manufacturer may impose an absolute marketplace ban on resellers, several national authorities took a stricter view and sought to qualify these as hardcore restrictions until the Court of Justice helpfully clarified the issue in the *Coty* case last year, agreeing with the Commission (see here and here). Whilst the outcome was ultimately helpful for manufacturers, the stark inconsistency between national approaches created significant uncertainty for companies and authorities for several years - costing money and time as opposed to saving it. The Commission will therefore no doubt be keen to clarify its position on this topic.

The topic of marketplaces also raises other complexities not dealt with in the *Coty* case on which the market would welcome guidance. For instance, there remains some doubt about if (and if so, how in practice) the *Coty* judgment or the Block Exemption might apply in other scenarios, such as outside a selective distribution system (e.g. in an “open” distribution model) or where a manufacturer itself or through a preferred partner sells to consumers via a third party platform (providing excellent consumer experience and quality controls) but bans third party resellers from doing so where it cannot directly guarantee these standards.

Role of online retailers and platforms

Some of the Commission's recent investigations in the online space also raise interesting and novel questions on the future role of major online retailers and third party platforms. For example, in August of this year a luxury fashion retailer, which represents independent designer boutiques, announced that it was facing an antitrust complaint in Europe from a now-defunct online rival, which accused it of breaching EU competition rules by locking in boutiques with exclusive contracts. Traditionally exclusivity has only raised concerns where the retailer has market power. This case could lead to useful guidance on how market power is determined in the online retail space and whether this metric remains the correct test to assess for restrictive effects. The Commission is also currently investigating a major third party platform, which “wears several hats”, namely as (i) a platform for third party resellers, (ii) a reseller in competition with the third party resellers it hosts on its marketplace, and (iii) a manufacturer producing its own brands in competition with the brands it and third party resellers sell on its platform. Specifically, the Commission is assessing whether the platform's access to and use of competing independent resellers' data could enable it to “squeeze out” these rivals, given their increasing dependence on the platform. The Block Exemption evaluation will no doubt touch on these dynamics in identifying possible rules and guidelines for the future.

Selective distribution systems

Helpfully, the Block Exemption accepts that a manufacturer may require its resellers to meet quality standards to sell its products offline or online, where this is justified by the nature of the product (a so-called selective distribution system). The Commission's e-Commerce Sector Inquiry (see our previous updates here and here) also clearly confirmed that competition is driven not just by price but also other factors such as quality.

Nevertheless, it would be encouraging to see fresh thinking reflected in the new Block Exemption and guidance regarding how selective distribution might have wider application. Whilst traditionally selective distribution has been reserved (legally) for luxury and high-technology products, in practice there has been a significant expansion in the scope of products being sold under this model, beyond even “premium” items. The Internet, and particularly the fast-moving sale of high volumes of products from major warehouses direct to consumers, has

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given rise to certain significant risks for brands and consumers that previously did not exist on this scale - such as an increase in damaged packaging, incorrect goods being delivered, counterfeit products, less recourse to personal assistance or repairs in the event of problems, and so on. Currently, the only legal option available to manufacturers to protect their consumers and brands is through selective distribution, so an express recognition of this ability for manufacturers who do not fall under the “traditional” categories but whose products and businesses very clearly justify basic quality standards and controls of some sort to guard against these risks, could be highly beneficial for EU consumers and businesses, as well as grow trust in online shopping in EU countries where this is still lagging behind.

Finally, other important questions may well arise in this context, such as whether a qualitative cap can be implemented on the number of qualifying online resellers in a manufacturer's system, given that this is possible for offline resellers. In principle, this should be permissible, but the cloud of uncertainty surrounding online restrictions has left many companies in a state of inaction due to the potentially significant legal risks involved.

Price monitoring tools/algorithms

We can also expect to see some attention given to the use of price monitoring tools, since the Commission has recently warned that these pose a risk if used inappropriately to facilitate resale price maintenance (see here).

Online-only players

Additionally, whilst the Vertical Guidelines currently allow manufacturers to require resellers to operate at least one brick and mortar store to qualify for inclusion in a selective distribution network, the Commission itself has more recently suggested this might not be appropriate for all products and there is currently a lawsuit before the UK courts challenging a manufacturer's system on this basis (see here).

In this context, stakeholders should not miss out on the chance to have a say on these or other issues affecting their businesses.

Opportunities for stakeholders to shape the law - next steps

The Commission's evaluation provides market players with a rare opportunity to share their experiences and influence important rules that will govern their businesses for some time to come.

The Commission has invited *feedback on its Roadmap before 6 December 2018*, which will be followed by a *public consultation of 12 weeks to be launched in Q1/2019*. In previous evaluation processes, the Commission has in fact launched a second consultation. Depending on the feedback, this may well occur again here. Finally, an open public stakeholder workshop on areas of particular interest for a possible review of the Block Exemption is then planned for Q4/2019 in Brussels.

The findings of the public consultation will be summarised in a summary report which will be made available to stakeholders in order to ensure full transparency. Stakeholders who participate in the consultation process will be able to see if their views have been taken into consideration and, if not, why.

Constructive input on topical issues, either raised as feedback on the Roadmap or in response to the fuller consultation, could assist the Commission in formulating pragmatic and up-to-date guidance which reflects current realities and is sufficiently flexible to accommodate questions as they arise in future as the Internet and consumer

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habits develop. This could help to ensure greater legal certainty for industry participants and the authorities in the longer term.

Stakeholders' evidence could also be central in highlighting the importance of designing and applying the law in a pragmatic as opposed to formulaic way. In most if not all cases, vertical contractual controls ought reasonably to be based on their actual effects on competition. Market evidence could also reaffirm that such effects are typically insignificant where the restrictions are limited to intra-brand competition as opposed to inter-brand competition (i.e. resellers and consumers still have access to other brands on the market), and usually counterbalanced or indeed outweighed by significant benefits for consumers, long-term sustainability of high quality retailer networks (both brick and mortar and online), strengthened brand trust, and increased incentives to invest in innovation, choice and quality.

How K&L Gates' Brand Erosion and Gray Market Mitigation Practice can assist your business

It is our “bread and butter” to design and enforce modern, effective and legally compliant go-to-market strategies for product manufacturers worldwide, including in Europe. We therefore have a deep understanding of the challenges brands are facing and pride ourselves in designing highly tailored, creative and pragmatic solutions to these issues.

Coupled with this we have broad experience in advocating our clients' interests before the Commission and national authorities. We acted for a number of stakeholders in the Commission's recent e-Commerce Sector Inquiry, helping them to shape and refine their submissions and gather the necessary information, so as to ensure their views were strongly heard.

We would be happy to speak with you to understand the level at which you might want to participate in the Commission's evaluation and can work with your business to promote its interests, with a view to shaping sensible, workable and fruitful laws.

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