# ADDLESHAW GODDARD

Our reference PCM/BREEG

28 September 2009

BY EMAIL

European Commission
DG Competition
Unit A2 – Antitrust and Mergers Policy and Scrutiny

E-mail: comp-greffe-antitrust@ec.europa.eu

Ref: HT.1171 – stakeholder input

Dear Sirs

**Public consultation on review of competition rules applicable to vertical agreements**

We set out below our comments on the Commission's draft Regulation on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (**Revised Block Exemption**) and accompanying guidelines (**Revised Guidelines**), which the Commission intends replace the current regulation and guidelines on the same subject (**Current Block Exemption** and **Current Guidelines**, respectively) from 1 June 2010.

General Comments

We agree with the Commission's overarching view that the Current Block Exemption and Current Guidelines have generally worked well in practice. We welcome the Commission's attempt to update the rules to reflect developments over the past ten years (notably an increase in buyer power and the growth of online commerce). It is noted that the Revised Block Exemption would be in force for a period of ten years and, as such, there are likely to be further developments which are not adequately addressed in the revised rules. In light of this, we hope that the Commission takes a flexible approach when interpreting the Revised Block Exemption and Revised Guidelines.

Status of the Block Exemption

We note that the structure of the revised rules (as with the current rules) is that the Revised Block Exemption contains the legislative provisions and the Revised Guidelines provide clarity and further detail as to the practical implications of those provisions. This clarity and detail is welcome (and, indeed, necessary) in a regime of self-assessment. In our experience the Guidelines are referred to far more in practice, and are considered more relevant to practitioners, than the narrow terms of the Block Exemption.

However, one element of this two-tiered approach which causes us concern is that, by including much greater detail in the Guidelines, the Commission may introduce hardcore restrictions here rather than set them out explicitly in the Block Exemption. For example, Article 4(b) of the Block Exemption explains that market partitioning is a hardcore restriction (subject to certain exceptions), but it is the Guidelines which provide the real detail on this point. This is particularly the case in the context of passive sales; it is in the Guidelines that the important distinction is made between "active" and

10-870393-2

Addleshaw Goddard LLP, 100 Barbirolli Square, Manchester M2 3AB
Tel +44 (0)161 934 6000 Fax +44 (0)161 934 6060 DX 14301 Manchester
www.addleshawgoddard.com

Addleshaw Goddard LLP is a limited liability partnership registered in England and Wales (with registered number OC318149) and is regulated by the Solicitors Regulation Authority. A list of members' names is open to inspection at our registered office, Milton Gate, 60 Chiswell Street, London EC1Y 4AG.

"passive" sales and it is here that the Commission sets out the general principle that restrictions on sales over the internet will be regarded as hardcore.

Removal of exemption for significant buyers

The Revised Block Exemption will only be applicable where both parties to a vertical agreement have a market share of 30% or less. While we note that this amendment is designed to address the growth of significant buyers, we do have some concerns with this approach:

- Compliance costs – the parties to vertical agreements in which one party is a "significant" buyer will be required to review their existing vertical agreements in order to consider whether they can enjoy the benefit of the Revised Block Exemption. If they do not, further consideration will need to be given as to whether they can enjoy individual exemption under Article 81(3). This will therefore create an additional compliance burden (with the related cost implications) for a broad group of parties. It is also noted that there is no transition period between the Current Block Exemption and the Revised Block Exemption; this means that parties do not have the comfort of a period during which to review their vertical agreements, and as such they must employ resources to conduct this analysis in a short period of time. This cost may not be proportionate where the remaining term of the agreement is relatively short (say less than 2 years).

- Exchange of commercially sensitive information – the market share requirements will mean that parties negotiating a vertical agreement will be forced to exchange market share information in order to determine whether the proposed agreement will enjoy the benefit of the Revised Block Exemption. Although the current rules do involve an element of information exchange, the Revised Block Exemption raises some concern due to the fact that, in future, such exchanges will be reciprocal. During the course of sharing the relevant information, it may become inevitable that the parties exchange commercially sensitive information. Where the parties are actual or potential competitors (which could be the case even in a vertical arrangement) this raises obvious concerns. At any point in time, a single supplier may be in receipt of market share data from a number of customers (and vice versa). In the UK, where "hub and spoke" information exchanges are the subject of OFT investigations, there is a risk of "mixed messages" emanating from the national and EU competition authorities in relation to the type of information which parties can be comfortable sharing.

Online commerce

We acknowledge the Commission's view that obstacles to online trade are a barrier to the achievement of a truly single market. However, in our view this general approach should not mean that suppliers are forced to allow their distributors to sell their products online.

Both the Current Guidelines and the Revised Guidelines prohibit restrictions on passive sales, which (because of the definition of passive sales) means that distribution via the internet cannot be restricted. We believe that, in some circumstances, it may in fact be quite legitimate for a supplier to wish to restrict online sales. For example:

- A supplier may be more than able to offer its products for sale by internet and so wish to reserve that route to market to itself, while utilising the bricks and mortar channel of specialist retailers;

- A supplier may wish to ensure its offline bricks and mortar distribution system is not compromised by online sales;

- The characteristics of certain products may mean that they cannot appropriately be distributed online;

- A brand owner may seek to restrict online sales in order to protect its brand from counterfeit products.

In our view, in the absence of market power, a supplier should be free to structure its distribution system as it wishes, and should not be forced to distribute online or allow others to do so. The uniform approach of the Revised Guidelines (i.e. that online distribution must always be permitted) is therefore too prescriptive.

We note that the Revised Guidelines do give some indication as to when a restraint on passive sales may be objectively justified. However, these examples are very limited and are unlikely to be of much relevance in practice.

Resale price maintenance

We note that, under Article 4(a) of the Revised Block Exemption, resale price maintenance (**RPM**) remains a hardcore restriction. The Revised Guidelines indicate that RPM is considered to be presumptively hardcore (paragraph 219) but, in some circumstances, may lead to efficiencies. Although the Commission has provided three examples of when RPM may provide efficiencies (in paragraph 221), these are, in our view, extremely limited. RPM could lead to efficiencies in a broader range of circumstances. For example, a supplier-led fixed price during a short-term promotion may in fact enhance competition. Although the Commission has begun to address this in the examples in paragraph 221, we do not see why this should be limited to franchise systems or the introduction of a new brand onto the market.

Selective distribution and exclusivity

During a recent discussion with Luc Peepercorn of the Commission, we explained a particular concern that the interface between the rules on selective distribution and exclusive distribution is, in some situations, unclear.

The Current Guidelines state in several places that a combination of selective distribution and exclusive distribution is permitted (see paragraphs 53 and 162). The Current Guidelines go on to say that the combination cannot restrict active or passive sales anywhere. This raises an issue as we understand that the Commission's interpretation of this is that a brand owner may appoint an "exclusive distributor" within a territory under a SDS, but that other distributors must be free to sell actively or passively into the exclusive distributor's territory. In other words, this is what is commonly referred to as a "sole appointment": the only protection that the distributor has is that the brand owner will not appoint anyone else within the territory. We suggest that the Revised Guidelines should be far more explicit on this point, especially given that there is a risk of committing a hard-core infringement if the parties do not correctly interpret the meaning of "exclusive" in this context.

An additional area of concern on this point arises in relation to Articles 4(c) and 4(d) of the Block Exemption. Article 4(c) of the refers to restrictions of active or passive sales to end users by members of a selective distribution system (**SDS**) operating at the retail level. Article 4(d) refers to cross supplies between distributors within a SDS, including between distributors operating at different levels of trade. The following points arise:

- Article 4(c) deals with active and passive sales, but Article 4(d) does not. This could lead to the conclusion that passive selling bans might be allowed under 4(d). However, our understanding is that this is not the Commission's view; passive selling must be allowed under both (c) and (d). We suggest that this be clarified.

- Article 4(d) refers to "distributors". This term conventionally refers to distributors (as in the party under a distribution agreement) or wholesalers, but we understand that the Commission's view is that "distributors" is a generic term referring to anyone who resells goods (and so it therefore includes retailers). We suggest that this be clarified as, in this sense, "distributors" and "members of a SDS" seem to have exactly the same meaning when referring to sales within a SDS.

Terminology

More generally, there is a lack of consistency in the terminology of the Current Block Exemption and the Current Guidelines. For example, in relation to a SDS, the following seem to be interchangeable:

- “Distributors”, "buyers", “selected distributors”, “appointed distributors within the network”, “authorised distributors” and “members of a SDS”. These terms appear to be generic for any reseller within the SDS whether at the wholesale or retail level; and

- “Dealers” and “members of a SDS operating at the retail level”. These appear to mean retailers within a SDS.

It is important to employ consistent terminology. For example, depending on whether “distributors” includes “retailers”, Article 4(d) may allow or prohibit restrictions on cross-supplies by a wholesaler/distributor in one territory to a retailer in another territory. We would welcome the Commission reviewing the terminology in the Revised Block Exemption and Revised Guidelines, in order to ensure that terms are used consistently. The Commission may wish to consider using a definitions section to clarify the correct meaning for each term, and should ensure that both the Revised Guidelines and the Revised Block Exemption use the same terminology.

Please do not hesitate to contact either Phil McDonnell (+44 (0)161 934 6700) or Grace Breen (+44 (0)161 934 6204) should you have any queries arising from this submission.

Yours faithfully

**Addleshaw Goddard LLP**

Direct line +44 (0)161 934 6700
Email phil.mcdonnell@addleshawgoddard.com