

COMPETITION RULES FOR DISTRIBUTION SECTOR

CBI's response to Commission's consultation – 28 September 2009

The CBI is pleased to respond to this consultation and comments first on the four particular topics highlighted by the Commission. We comment later on some further aspects of the Commission's drafts.

1. OVERALL FUNCTIONING OF THE CURRENT RULES

The move to an effects based and less formalistic approach is welcome and has general support from our members. The relative clarity of the existing Regulation and Guidelines has provided a welcome degree of legal certainty and consistency across the EU.

It is crucial that the revised Regulation does not increase legal uncertainty and regulatory burden. It must also allow new approaches to distribution and not inhibit innovation.

Self- assessment is now well established but to meet the needs of business the safe-harbours must be as clear as possible. In the absence of notification there is also a need for guidance from the Commission on novel aspects of distribution. The hurdles for obtaining this have been set at a very high level and we have suggested that the Commission is more forthcoming with guidance when needed.

Equally, there is a need for clear guidance from the Commission on the circumstances in which regulatory intervention may be justified where the block exemption safe harbour is not available. This is especially so given that most enforcement takes place at the level of competition authorities and national courts. Across 27 EU Member States, there is scope for divergent interpretations and the prospect of more complex rules creates a real risk to suppliers seeking to manage complex distribution systems on a European basis.



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In our view vertical agreements and vertical restraints generally present a lower level of risk to competition. We feel therefore that the Commission could have been bolder in taking the opportunity of this review to deregulate. For example, the present market share threshold of 30% for the seller's market share could be increased to 40%. This would be in line with the lower level of dominance from the case law.

2. EFFECT OF RECENT MARKET DEVELOPMENTS

Some recent developments which we see as having an important impact are:

- The growth of services and franchising
- The expansion of the Single Market, both in geography and in the range of goods and services available, with increasing cross-border activity
- The growth of global and pan-European distribution networks
- The financial crisis and recession leading to pressure on small retailers
- Lastly, and perhaps the most important, is the enormous growth of the internet and the impact it is having on traditional distribution channels

The main implication of these developments is that the rules for distribution need to be more flexible and less prescriptive on what is not permissible. Internet sales are growing exponentially and in our view will continue to do so for the foreseeable future. Suppliers must be able to adapt their sales strategies to accommodate developments in the market and new demands from consumers.

3. APPROACH TO BUYERS' MARKET POWER

In view of the above comments it is unfortunate that the Commission is proposing a new restriction based on the market share of the buyer. While it is the case that there has been a growth in large-scale distribution networks in some sectors it is not obvious that this has resulted in consumer detriment, given the active competition that exists between networks. We should also like to point out that the Commission already has the power to remove the Block Exemption safe harbour for individual vertical agreements where anti-competitive effects may arise.

But apart from the question of principle, the proposed limitation in our view fails on a number of tests:

- A safe harbour needs to be clearly defined and capable of being applied in a regime of self-assessment. This is not the case.
- The new threshold would significantly narrow the scope of the present Block Exemption resulting in increased compliance costs for business and a lack of legal certainty for many agreements. The economic rationale for such a significant change is not obvious, raising questions about the extent of the regulatory impact assessment.
- The supplier and their distributors need to have confidence in the stability of their arrangements in order to justify their investments. It cannot be assumed that the supplier will be able confidently to know the buyer's share of the relevant market. Having to ask a buyer for its market share would be problematic in practical terms and increases the regulatory burden on firms, which we assume is not the Commission's intention. The distribution agreement will be subject to a new set of variables, not only the changing market share of the supplier, but also the wholesaler and the retailer.
- The threshold requirement introduces an undesirable risk that commercially sensitive information about market shares would need to be exchanged between supplier and distributor in order to assess the legality of their arrangements.
- The relevant markets, in terms of both product and geographic scope, may be different at the wholesale and retail level. So a supplier may be unable, in practice, to make the relevant assessments that would be required. All the parties to the arrangements would need to co-operate to carry out potentially multiple assessments of the relevant market(s), further adding to the regulatory burden on firms.
- The industrial supply of components and intermediate products is an important business activity which could be significantly hampered by this new restriction. It would be practically impossible for a business supplying an intermediate product to monitor the buyer's position on all of the markets, product and geographic, in which the buyer's end products compete.
- Not only the product market but also the geographic market(s), on all levels of distribution, need to be kept under review during the lifetime of the distribution agreement, in order to remain within the block exemption safe harbour.
- The apparent risk of consumer detriment from a buyer's share on its downstream market is much less obvious where there are no exclusive supply obligations between buyer and seller.
- The Commission has not explained the theories of harm it is seeking to address, nor in which circumstances regulatory intervention would be merited. The broad application of the buyer share threshold appears disproportionate given the lack of enforcement in this area to date.

In summary, we believe that this threshold does not give business the confidence it needs to have in a safe harbour. It is essentially unworkable. There are so many variables that there would be great difficulties for National Competition Authorities in applying this consistently across the EU. We would strongly urge the Commission to reconsider its proposal and drop this threshold.

4. RESTRICTIONS ON ON-LINE SALES

The main challenge posed by the development of the internet is to maintain a clear distinction between active and passive sales, given the importance of e-commerce in the EU and its contribution to economic growth.

“Active sales” (paras.51 & 53)

In an on-line world, unsolicited emails will be sent through a person’s ISP (Internet Service Provider). These will be received independently of the person’s location. Thus a UK person resident in another Member State may well receive unsolicited emails from a UK based ISP who will be unaware of the location of that individual.

We suggest that this particular example needs to be further elaborated. It is difficult in practice to distinguish this form of marketing from general promotion on the internet, which is described as “passive sales”.

We further suggest that paragraph 53 be combined with paragraph 51 to provide a fuller explanation of what is meant by active selling over a website.

“Passive sales” (para.52)

We agree with the example given of passive selling and also that the language should not normally be considered a determinative factor.

We accept that the development of a foreign language web-site can raise suspicions that a distributor is targeting sales in other territories. But there are also perfectly legitimate examples of multi-lingual web-site within a single national territory. These are useful in reaching minority language groups.

We also generally agree with the first two examples of what are termed hardcore restrictions, namely re-routing on-line inquiries and terminating transactions if the credit card is outside the territory. As explained in paragraph 47 of the draft Guidelines, we note that such restrictions give rise to a rebuttable presumption and it is possible for undertakings to plead an efficiency defence. For example, an on-line retailer may wish to show that sufficient inventory was not available at the time to satisfy on-line demand.

We find it difficult to comment on the other two examples of proposed hard-core restrictions, with the explanatory footnotes. We feel further clarification, with more examples, is needed before the Commission takes the step of classifying them as hard-core restrictions. As we indicated earlier, on-line distribution is developing exponentially and some flexibility is needed. Our suggestion is that the Commission consults further on this section of the draft Guidelines in a few years' time.

We further propose that any such hard-core restrictions should be set out in the Regulation rather than the Guidelines.

On-line and off-line sales

It is correctly recognised that there are some products which are not suitable for on-line distribution. These may be because of health and safety reasons or because the product requires a high degree of instruction in order to be used satisfactorily.

There will be other products where the supplier may consider that they are required to be sold in a physical environment to maintain their aura of premium quality. There are other examples where the supplier feels the product needs to be experienced in some way by the consumer, through feel, smell or taste.

With regard to this second category of products we have not been able to establish a consensus among our members on the rules which should be applied to the distribution of these products under a selective distribution system. We would welcome a further consultation from the Commission in this area when the Commission has reviewed the responses from this consultation.

OTHER COMMENTS ON THE DRAFT REGULATION & GUIDELINES

1. Proposed removal of €100m threshold – Art.2.4(a)

The current Regulation applies where competing undertakings enter into a "non-reciprocal" vertical agreement and the buyer has a total annual turnover not exceeding €100 million. The Commission proposes to remove the benefit of the Block Exemption for this particular category of agreement. It is not clear why this change is being proposed.

This proposed removal of this exemption would affect the ability of small undertakings to benefit from a safe-harbour and would impose an unwelcome self-assessment burden on them. We propose that this exemption be maintained, which would assist small companies in the current environment.

2. Agency risks related to other activities

The classification of risks set-out in paragraphs 13 -17 appears to us unnecessarily restrictive. The supplier must first consider contract-specific risks and then market-specific risks. Even if these are positive indicators of genuine agency, the agreement may nevertheless not qualify as an agency because the undertaking concerned has to accept risks in respect of other activities. These are activities which are defined as “*indispensable* to engage in selling or purchasing the contract goods or services on behalf of the principal”.

In our view this is introducing an unclear requirement whose scope is uncertain. It would have the effect of undermining the stability of the principal/agent relationship and would result in a shaky foundation on which to build a business.

Accordingly, we would urge the Commission to reconsider these paragraphs.

3. RPM

We note the suggestion that such restrictions could benefit from exemption under Art.81(3) in certain limited cases as they may lead to efficiencies in allowing new brands to enter the market or new distribution systems to be established.

However, as RPM remains a hard-core restriction and would not therefore benefit from *de minimis* clear guidance on how parties can demonstrate efficiencies and benefit from Art. 81(3) is extremely important. It would be helpful if the examples in paragraph 221 of the draft Guidelines could be more explicit on how such efficiencies could be established.

In the interests of legal certainty, we welcome further clarification of what the Commission means by "indispensable" in this context. Worked examples would be most helpful.

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