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COMMENTS OF THE GERMAN BRANDS ASSOCIATION MARKENVERBAND ON THE

## **REFORM OF (EC) REGULATION No. 2790/1999 ON THE APPLICATION OF ARTICLE 81(3) OF THE TREATY ON CATEGORIES OF VERTICAL AGREEMENTS AND CONCERTED PRACTICES**

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### **I. Preliminary remarks**

The German Brands Association MARKENVERBAND very much appreciates the opportunity to comment on the reform of the Block Exemption Regulation on Vertical Restraints.

MARKENVERBAND reserves the right to make additional comments on this issue in future.

We would request you to treat the following comments of MARKENVERBAND **confidentially** and not to disclose these to the public.

### **II. About MARKENVERBAND**

The German Brands Association MARKENVERBAND has represented the interests of manufacturers of the brand-focussed industry in Germany since 1903. With its approximately 400 member companies MARKENVERBAND represents sales volume of ca. € 600 million and ca. 1.5 million direct employees. MARKENVERBAND is a registered interest representative at the EU Commission (No. **2157421414-31**).

Originally founded by German manufacturers of branded consumer goods such as Henkel and Dr. Oetker, MARKENBVERBAND today represents many small, medium-sized and large manufacturers of consumer goods and durable goods. Since expanding the scope of its membership in 1999 MARKENVERBAND has also represented the interests of service companies with a brand-oriented business policy.

Many MARKENVERBAND members market their products via the highly concentrated German food retail industry and are dependent on the major German retailers as buyers because no appropriate or acceptable possibilities exist for switching to other distribution partners or channels. Preventing the abuse of buyer power on purchase markets is therefore of particular importance to MARKENVERBAND and its members.

Many MARKENVERBAND members also pursue a strategy of selective distribution, which is of critical significance for the appropriate presentation and marketing of the products in question. Selective distribution is therefore also a major focus of MARKENVERBAND.

### **III. Fundamental comments**

The (EC) Regulation No. 2790/1999 on the application of Article 81 (3) of the Treaty on categories of vertical agreements and concerted practices (Block Exemption Regulation) took account of the need of companies in Europe for legal certainty. This was based on the knowledge that vertical agreements and decisions usually have a less restrictive impact than horizontal agreements and decisions and that in practice the effects of vertical agreements and decisions which serve consumers, companies and common welfare and promote competition in fact actually outweigh any negative impact.

The application of the Block Exemption Regulation in the last ten years has confirmed these assessments. On the basis of the framework established by the Block Exemption Regulation companies selling branded articles and their retail partners have with a great deal of legal certainty been able to invest in innovative products and their successful distribution and increase the added value created for European consumers. This has also contributed to securing Europe as a business location and safeguarding and creating jobs, in particular in industries with demanding development and consultation requirements and high personnel costs.

At the same time the market environment has changed permanently for the suppliers of numerous product categories due to developments in retail concentration, which could already be foreseen ten years ago. (Retail) trade buyer power has led to the fact that the balance of power between trade and industry is skewed to the disadvantage of the supplier side. For powerful retailers this means that commercial success increasingly depends less on the successful sale of products to consumers and more on the successful purchasing of products from suppliers with less structural power. The interest of retailers in actually selling products therefore diminishes – to the detriment of both consumers and competition.

This development is reflected in the increasing number of major purchasing cooperations at European level and the strategic development of private label ranges, which in turn mean that retailers enter into competition with their suppliers, but due to exclusivity and limited comparability with one another, in some cases evade the brand competition which benefits consumers.

MARKENVERBAND therefore emphatically advocates a reform of the Block Exemption Regulation and supports the approach being pursued by the European Commission of a cautious amendment of the Block Exemption Regulation 2790/1999 to reflect the current situation.

MARKENVERBAND does, however, in some areas see the need for additional discussion, also with respect to the changes already proposed by the Commission in the available draft version. This will be addressed below.

## IV. Comments on the content of individual provisions

### 1. Multiple market share threshold (Article 3 – Recital 8ff. – GL Paragraph 23 and 83ff.)

The application scope of the Block Exemption Regulation has to date been restricted to agreements for which the share of relevant market accounted for by the supplier does not exceed 30%. The new Block Exemption Regulation stipulates that the application scope of the Block Exemption Regulation is to be restricted to the cases in which none of the undertakings party to the agreement, i.e., at least neither the supplier, nor the buyer holds a market share exceeding 30% in any of the "*relevant markets affected by the agreement.*"

This introduction of a (at least) dual market share threshold is to be welcomed insofar as it takes the circumstance into account that harmful vertical restraints of competition can result not only due to a high market share on the supplier side, but also due to a high market share on the buyer side. Retail concentration has in the meantime led to an oligopolistic structure in the majority of EU Member States. This in particular has a negative impact on competition where retailers have additionally developed their own private label ranges, with which they in some cases evade the brand competition which is transparent for consumers. This further worsens the structural imbalance between suppliers and buyers both to the advantage of buyers and also to the disadvantage of consumers. Competition is jeopardized where retail sales interest in the successful selling of specific products decreases.

There is also the fact that vertical restraints can on the one hand impact both the affected sales market and the affected purchase market. On the other hand there can be interaction between these two markets with the result that an agreement on the purchase market also penetrates the sales market.

Potentially restrictive effects usually originate vertically from the distribution level with the higher concentration because its members can demonstrate their market power both on the sales market and on the purchase market (gatekeeper or bottleneck effect).

MARKENVERBAND also therefore explicitly welcomes the fact that the Commission is also now including the buyer side and is introducing a dual market share threshold.

In practice it will, however, in many cases be difficult for one party in connection with the conclusion of a vertical agreement to assess the market shares of its contractual partner at least in its respective sales markets. MARKENVERBAND therefore advocates that the market share of the buyer is determined on the basis of its significance on the purchase market. MARKENVERBAND therefore requests the Commission to reconsider its position on this to date and also to clarify this explicitly in the Guidelines.

Furthermore, the dual market share threshold should not lead to the fact that the market share exceeding 30% (on the purchase or sales market) of a buyer with relative market power leads to the exemption effect of the Block Exemption Regulation no longer applying for selective distribution systems of suppliers, who are fully within the scope of the Block Exemption Regulation in terms of (their own) market share and regulatory content (affecting the supplier). This then applies in particular if within the scope of selective distribution systems a decision is

made in favour of supplying a buyer with a high market share exceeding 30% because not supplying this buyer would constitute a violation of the (national) requirement for the non-discriminatory treatment of the selective distribution system.

MARKENVERBAND would point out in this context that the antitrust law control of abusive practices contained in Section 20 of the German Act against Restraints on Competition, which is also applied in Germany besides European competition law, leads to the fact that even undertakings with a market share clearly under 30% are also subject to a prohibition of discrimination if they – for example due to the significance of their brands – are attributed to the top group and this results in a dependency for buyers. The operation of a selective distribution system in compliance with the Block Exemption Regulation is then first of all taken into consideration as factual justification of a system which is otherwise treated in a non-discriminatory fashion.

The dual market share threshold which also takes the market share of the buyer into account and which should indeed prevent restrictive effects originating on the demand side, should therefore not lead to the fact that vertical agreements (initiated and practiced by suppliers) on markets in which a potential buyer has a market share exceeding 30% cannot be practiced with the exemption effect of the Block Exemption Regulation. In such a case namely the agreement, which should cover all buyers of the (selective or other) system uniformly, is not exempted with certainty precisely with respect to the indeed biggest buyer with over 30% market share, which could conceivably lead to the fact that these retailers will be even less willing to accept the agreement, with the risk that these buyers will attempt to gain an additional advantage over their smaller competitors.

**Example:** The exemption effect of the Block Exemption Regulation with respect to agreements of a selectively distributing cosmetics manufacturer with a market share of 10% should not cease to apply because it – in compliance with the principle of non-discrimination – supplies a retail company which exceeds the 30% threshold on a regional sales market. Even if the disapplication of the exemption did not refer to the manufacturer's entire system, but only to the concrete agreement with the retailer, the obligations of the buyer within the scope of a selective distribution system which are particularly difficult to assert with respect to a powerful buyer would be subject to the restriction that these would not profit from the certain competition law effect of the "safe harbour" of the Block Exemption Regulation and would therefore be even more difficult to assert.

Accordingly it urgently needs to be made clear in the Guidelines (GL) that Article 3 is based on a narrow understanding of the market, which is restricted to the sales and purchase market directly affected by the agreement and the markets directly affected by the subject matter being regulated by the agreement.

Ideally the market share threshold would only be applicable for the respective side on which the potentially restrictive agreement originates. This would mitigate the issues described above.

## 2. Definition of market power which is neutral in terms of distribution level

The definition of “market power” should also fundamentally be formulated such that it is neutral in terms of distribution level. This is not yet the case in **Paragraph 93 GL**, where market power is still exclusively defined with reference to *suppliers*, which makes its application to *buyers* and the purchase market more difficult:

Market power is the ability to maintain prices above competitive levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time.

This can be achieved with the additional reference that the definition of supplier power on the purchase market corresponds with the ability of a buyer to secure prices, terms and conditions from its suppliers which are not in line with the market for a not insignificant period of time.

Potentially restrictive effects usually originate vertically from the distribution level with the higher concentration because its members can assert their market power both on the sales market and on the purchase market. The definition of market power must also take this into account.

Finally, it should also be clarified explicitly in connection with the multiple market share threshold of Article 3 that exceeding this does not lead to the impermissibility of the agreement in question, but merely leaves the normative framework of the Block Exemption Regulation and instead facilitates the direct review of an individual exemption under Article 81(3).

## 3. Online distribution in general (Article 4(b) – Recital 11 – GL Paragraph 17off)

(See 4(d) with respect to peculiarities which result from online distribution within the scope of selective distribution.)

For a large number of small and medium sized authorized dealers online distribution can in particular be a sensible and important addition to their distribution system. Brand-focussed industry therefore accepts the fundamental decision of the Commission to characterize online distribution in principle as “passive sales” and only to permit a restriction of such within narrow limits.

Online distribution is not, however, suitable for all products to the same extent. This also applies, but is not limited to the safety and health reasons and public bans addressed by the Commission in Paragraph 54 GL. In addition, the recitals developed for a restriction of the mail order trade are correct and transferable for the online distribution of many products. It has also become evident in practice since the adoption of the Block Exemption Regulation in 1999 that there are legitimate reasons (also outside selective distribution) for restricting online distribution.

The decision of the Commission to treat online distribution fundamentally as passive sales should also not lead to an inappropriate preferential treatment of online distribution over classic distribution.

Concerns therefore exist with respect to **Paragraph 52 Bullet Point 4**, where the Commission generally and without any possibility for differentiation notes that a hardcore restriction of (passive) online sales exists

- when a distributor is required to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line

insofar as it is additionally pointed out in footnote 30:

This does not exclude the supplier offering the buyer a fixed fee to support its off-line or online sales efforts.

In practice this therefore means that a manufacturer will have to relinquish orienting fees designed to specifically honour distribution efforts to the success of the buyer's distribution efforts. This could in general considerably discourage suppliers from making such payments, which could overall lead to a price-increasing effect for consumers. We therefore propose that the possibility of granting performance-related fees for the contractual partners online and offline sales efforts is created and formulated as follows:

This does not exclude the supplier offering the buyer a ~~fixed~~ fee to support its off-line or online sales efforts.

#### **4. Selective distribution (Article 4(b) and (c) – Recital 11 – GL Paragraph 17off)**

##### **a. Multiple market share thresholds and selective distribution**

In view of the multiple market share thresholds which now also include the purchase market and – at least in specific cases – also the downstream sales market of the buyer, it should be established clearly that individual buyers on the purchase or sales market exceeding the market shares does not lead to disapplication of the exemption effect of the Block Exemption Regulation with respect to the selective distribution *system*, but at most affects the individual agreement.

##### **b. Special permissibility of selective distribution for the purpose of brand protection**

The majority of the Guidelines with respect to selective distribution have not been revised, although this could be deemed necessary in the light of most recent legal developments. The ECJ's COPAD ruling (C-59/08) in particular contains important detailed definitions with respect to European law, which are also important for a correct understanding of selective distribution and their content should therefore be referred to in the Guidelines. The interdependence of European trademark and competition law, as is made clear in the COPAD ruling, should also be reflected in the Guidelines.

What should explicitly be included in the Guidelines – for example after **Paragraph 170 GL** – is the fact that the special features and arrangements of a selective distribution system can in themselves preserve the quality of such products (namely “luxury goods” in the sense of “high-class goods” Paragraph 24 ECJ COPAD Ruling) and ensure their proper use (Paragraph 28 ECJ COPAD Ruling).

**c. Additional prerequisites for the permissibility of selective distribution**

The Commission rightly notes in Paragraph 103 (in particular in points (1) and (9)) of the Guidelines that the pro-competitive effects of vertical restraints and in particular selective distribution systems are also realized in connection with promoting brand image and solving the problem of free-riders.

The permissibility of selective distribution is also given if this is required to achieve these objectives. These legitimate objectives, however, go beyond the “criteria relating to the nature of the product” described in Paragraph 172 GL in the stricter sense and should also cover the aspects addressed in Paragraph 103 Points (1) and (9) of the Guidelines.

This is particularly the case in view of the fact that the Guidelines rightly point out that qualitative selective criteria do not fall under Article 81.

It must therefore be clarified that circumstances resulting from the marketing concept of the product (Paragraph 103 Point (1)) or consumer expectations with respect to the product (Paragraph 103 Point (9)) justify selective distribution. To this end we would propose amending Paragraph 172 as follows:

(172) Qualitative and quantitative selective distribution is exempted by the Block Exemption Regulation as long as the market share of both supplier and buyer does not exceed 30 %, even if combined with other non-hardcore vertical restraints, such as non-compete or exclusive distribution, provided active selling by the authorised distributors to each other and to end users is not restricted. The Block Exemption Regulation exempts selective distribution regardless of the nature of the product concerned. However, where the nature of the product, *its fundamental marketing concept or consumer expectations* do not require selective distribution, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in intra-brand competition. If appreciable anti-competitive effects occur, the benefit of the Block Exemption Regulation is likely to be withdrawn. In addition, the following guidance is provided for the assessment of selective distribution in individual cases which are not covered by the Block Exemption Regulation or in the case of cumulative effects resulting from parallel networks of selective distribution.

**Paragraph 173** is incorrect insofar as it suggests that another important factor for the permissibility of selective distribution is the number of selective distribution networks. The

pro-competitive effects occur independent of whether one supplier pursues this approach or whether this is the case for a large number of market participants, as long as sufficient inter-brand competition exists. In addition, the last sentence of **Paragraph 173**, which also confirms this assessment, would make more sense in **Paragraph 174** in terms of its content. We therefore propose amending **Paragraph 173** GL as follows:

(173) The market position of the supplier and his competitors is of central importance in assessing possible anti-competitive effects, as the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the position of the supplier, the more problematic is the loss of intra-brand competition. ~~Another important factor is the number of selective distribution networks present in the same market. Where selective distribution is applied by only one supplier in the market, quantitative selective distribution does not normally create net negative effects provided that the contract goods, having regard to their nature, require the use of a selective distribution system and on condition that the selection criteria applied are necessary to ensure efficient distribution of the goods in question. The reality, however, seems to be that selective distribution is often applied by a number of the suppliers in a given market.~~

The remarks contained in **Paragraph 174** GL have not been confirmed in the practice of the last ten years. For reasons of better understanding we would therefore propose that this paragraph is shortened considerably and worded as follows:

(174) *In practice this distribution method is ~~however~~ often applied simultaneously by several suppliers in one and the same market.* The position of competitors can have a dual significance and plays in particular a role in case of a cumulative effect. ~~Strong competitors will mean in general that the reduction in intra-brand competition is easily outweighed by sufficient inter-brand competition. However, when a majority of the main suppliers apply selective distribution there will be a significant loss of intra-brand competition and possible foreclosure of certain types of distributors as well as an increased risk of collusion between those major suppliers. The risk of foreclosure of more efficient distributors has always been greater with selective distribution than with exclusive distribution, given the restriction on sales to non-authorized dealers in selective distribution. This is designed to give selective distribution systems a closed character, making it impossible for non-authorized dealers to obtain supplies. This makes selective distribution particularly well suited to avoid pressure by price discounters on the margins of the manufacturer, as well as on the margins of the authorized dealers.~~

In **Paragraph 175** GL it is pointed out in connection with the conditions for the withdrawal of the block exemption that the conditions for a block exemption are unlikely to be fulfilled if selective distribution systems prevent access to the market by new distributors. Reference is made here to "price discounters" as an example. The arbitrary mention of discounters would

appear inappropriate here because – also in the opinion of the ECJ (see COPAD ruling) – discounters per se are in many cases not in a position to distribute the selectively distributed products “appropriately”. A possibly existing market access barrier would therefore result on the basis of qualitative criteria, which also in the opinion of the Commission do not fall under Article 81(1). The unsuitable example of “price discounters” should therefore be omitted in connection with cumulative effects, which would result in **Paragraph 175** GL being worded as follows:

(175) Where the Block Exemption Regulation applies to individual networks of selective distribution, withdrawal of the block exemption or disapplication of the Block Exemption Regulation may be considered in case of cumulative effects. However, a cumulative effect problem is unlikely to arise when the share of the market covered by selective distribution is below 50 %. Also, no problem is likely to arise where the market coverage ratio exceeds 50 %, but the aggregate market share of the five largest suppliers (CR5) is below 50 %. Where both the CR5 and the share of the market covered by selective distribution exceed 50 %, the assessment may vary depending on whether or not all five largest suppliers apply selective distribution. The stronger the position of the competitors not applying selective distribution, the less likely the foreclosure of other distributors. If all five largest suppliers apply selective distribution, competition concerns may in particular arise with respect to those agreements that apply quantitative selection criteria by directly limiting the number of authorised dealers. The conditions of Article 81(3) are in general unlikely to be fulfilled if the selective distribution systems at issue prevent access to the market by new distributors capable of adequately selling the products in question, **especially price discounters**, thereby limiting distribution to the advantage of certain existing channels and to the detriment of final consumers. More indirect forms of quantitative selective distribution, resulting for instance from the combination of purely qualitative selection criteria with the requirement imposed on the dealers to achieve a minimum amount of annual purchases, are less likely to produce net negative effects, if such an amount does not represent a significant proportion of the dealer's total turnover achieved with the type of products in question and it does not go beyond what is necessary for the supplier to recoup his relationship-specific investment and/or realise economies of scale in distribution. As regards individual contributions, a supplier with a market share of less than 5 % is in general not considered to contribute significantly to a cumulative effect.

**d. Selective distribution and online distribution (Article 4 – Paragraph 52ff)**

In **Paragraph 52** GL the Commission details which restrictions of the Internet should in its opinion be considered hardcore restrictions. In **Paragraph 52, Bullet Point 3** the Commission notes in this respect that

– requiring a distributor to limit the proportion of overall sales made over the Internet

is a hardcore restriction of passive selling.

This prohibition of the proportional restriction of the sales of a distributor made over the Internet meets with serious concerns at least for selective distribution because it removes the possibility of stipulating appropriate minimum sales in a brick and mortar shop.

Article 4(c) Block Exemption Regulation rightly also allows the restriction of passive selling from unauthorized places of establishment. The possibility of making the operation of a brick and mortar shop a prerequisite for admission to a selective distribution system is of high practical significance. In many cases it can only be ensured with a –serious – brick and mortar shop that products requiring consultation can be sold by trained personal with the required expertise and product knowledge.

The objective of creating and maintaining a brand image which the Commission acknowledges (explicitly in Paragraph 103 GL) in addition necessitates the operation of a seriously run brick and mortar shop in order to increase the attractiveness of the product for end consumers and increase its sales.

Within the scope of selective distribution systems it is therefore a legitimate concern of suppliers to ensure by means of a quota with respect to sales in a brick and mortar shop that the buyers make this contribution and do not free-ride on the basis of an “alibi shop” to the detriment of the supplier and other buyers. The German Federal Supreme Court has therefore held an arrangement as permissible, according to which at least 50% of the total sales of an authorized distributor have to be made in a brick and mortar shop (German Federal Supreme Court [BGH] ruling “Selectively distributed cosmetics on the internet” [“Depotkosmetik im Internet”] of 04.11.2003).

The solution approach currently proposed in footnote 29 to Paragraph 52 does not help here because when it is applied in a non-discriminatory fashion it is hostile to small and medium-sized enterprises and promotes concentration on the buyer side, unless the option of also being able to determine proportional minimum sales is added. The option established in footnote 29 of at least being able to restrict free-riders in this respect by means of minimum sales is pointless in cases in which a small to medium-sized retail structure exists in a certain market, with the result that minimum sales due to the obligation to apply such in a non-discriminatory fashion would even have the effect of promoting concentration and restricting supply. It must therefore be possible either to restrict the overall sales in Bullet Point 3 which have to date been prohibited or alternatively to determine a proportion of offline sales.

We would therefore propose that footnote 29 to Paragraph 52 is worded as follows:

This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products off-line to ensure an efficient

operation of its brick and mortar shop, nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model (see paragraphs 54 and 57). This absolute amount of required off-line sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location.

**In addition the stipulation of proportional minimum sales in a brick and mortar shop can also be required in selective distribution.**

The approach of the Commission described in Paragraph 54, according to which the supplier may require quality requirements for the use of the Internet for the resale of its products, meets with approval. Nothing else can or should in this respect apply for online distribution than can or should apply for the distribution of products in brick and mortar shops. The quality requirements and additional admission criteria of selective distribution systems are also justified with respect to online distribution. This is particularly the case since the Commission rightly compares online distribution with mail order, which is unsuitable for many products intended for sales shipment, for example due to their consultation requirements or their exclusivity. These considerations also apply for online distribution, which the Commission gives preference to for political rather than objective reasons.

The exception made by the Commission in Paragraph 56 GL, according to which for the amortization of considerable initial investments on the part of participating distributors a restriction of active and passive sales should be possible in the first two years following market launch also meets with approval. In the majority of cases a period of two years will be sufficient for amortization.

**e. Tied places of establishment (Article 4(c), Paragraph 57ff.)**

The possibility established to date in Article 4(c) Block Exemption Regulation of tying the sale of selectively distributed products to an authorization from the supplier which is restricted to a certain specific place of establishment has proven successful in the last ten years and should definitely be maintained in the opinion of the brand-focused industry.

The quality criteria defined with the scope of selective distribution systems for the location, design or personnel and equipment of the "point of sale" are of great significance for brand management and the successful distribution of selectively distributed products. The contractually confirmed willingness of the distributor to support the distribution strategy of the supplier in terms of its content must also be verifiable for the selective distributor. For this reason alone the restriction of distribution activities to jointly determined and specifically authorized places of establishment is necessary. Furthermore, only the specific definition of the underlying selection criteria in the restriction of the authorization to specific places of establishment guarantees that a selective distribution system is applied transparently and comparably for suppliers and interested distributors in a non-discriminatory fashion.

MARKENVERBAND therefore welcomes the intention of the Commission to adhere to **Article 4(c)** of the Block Exemption Regulation.

The Commission rightly points out in this context in **Paragraph 57ff** GL that the criteria imposed by manufacturers for online sales must be identical to those imposed for off-line sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution channels.

The practice of recent years has shown that the appropriate distribution of selectively tied products over the Internet can only be ensured if the criteria defined for offline sales can be transferred analogously and not literally to online sales. This in particular includes the possibility of being able to exclude certain distribution models which have lesser practical significance in offline trade. In particular the distribution of products within the scope of online auctions in which products are presented in inadequate surroundings is often unsuitable for the distribution of selectively tied products because the specific requirements with respect to product presentation and sales performance of the distributor cannot be met in such a format.

#### **5. Single branding (Article 5(a) – GL Paragraph 103(4) and 125ff.)**

Brand-focussed industry continues to support the threshold of 30% market share and the five-year contractual term as limit for the agreement of activities which the Commission describes as establishing “single branding”.

MARKENVERBAND explicitly welcomes the fact that according to Paragraph 127 in future not only the market share of the supplier, but also that of the buyer may not exceed 30%. This takes into account the fact that in particular in the relationship between the branded goods industry and retailers the balance of power has shifted clearly to the disadvantage of suppliers and due to the “gatekeeper” role retailers even suppliers who have a market share of over 30% cannot do without strong customers.

Therefore in the opinion of MARKENVERBAND not only the market position of the supplier, but also that of the buyer is to be taken into consideration when the permissibility of an agreement is assessed. The Commission takes this into account in Paragraph 133 when it introduces “countervailing power” as an additional assessment criterion. The Commission restricts its assessment of the impact of existing retail power here to assuming that the supplier asserting single branding (additionally) has to provide compensation to convince strong retailers to accept the single branding.

We would on the other hand point out that the consequence of buyer power regularly observed in practice is that single branding in the sense of excluding competing suppliers of the manufacturer cannot be asserted. In the opinion of MARKENVERBAND retail power exists when the relevant retail partner accounts for more than 7.5% of the relevant supplier’s sales.

To the extent that the Commission in **Paragraph 142** GL fundamentally includes relationship-specific investments of the supplier in accordance with Paragraph 103(4) GL in the scope of the

application of the Block Exemption Regulation, this is to be explicitly welcomed from the perspective of the brand-focussed industry. This in particular applies for the possibility of determining a period of more than five years for very high investments. In practice the rigid limitation of the agreement term to five years has in such cases in particular led to restraints, which have in some cases also had a hindering effect on investments. MARKENVERBAND, however, advocates increasing the objective scope of the exception's application area. The restriction to "relationship-specific investments" as defined in Paragraph 103(4) is very narrow because it is restricted to cases in which the buyer cannot use them in connection with other products after the agreement has expired. In light of the fact that such investments of manufacturers are demanded on the part of powerful buyers irrespective of this, leads to a high degree of legal uncertainty for the suppliers affected. MARKENVERBAND therefore suggests wording Paragraph 142 as follows:

(142) In the case of a relationship-specific investment made by the supplier (see efficiency 4 in paragraph 103), a non-compete or quantity forcing agreement for the period of depreciation of the investment will in general fulfil the conditions of Article 81(3). In the case of high relationship-specific investments, a non-compete obligation exceeding five years may be justified. A relationship-specific investment could, for instance, be the installation or adaptation of equipment by the supplier when this equipment can be used afterwards only to produce components for a particular buyer, **a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, or the supplier profits particularly from the investment for the duration of the agreement.** ~~General or market specific investments in (extra) capacity are normally not relationship specific investments. However, where a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, this new capacity may only be economically viable when producing for this particular customer, in which case the investment would be considered to be relationship specific.~~

## 6. Exclusive distribution (Article 5(a) – GL Paragraph 147ff.)

MARKENVERBAND supports the reform of the guidelines developed with respect to exclusive distribution in many areas.

Concerns exist, however, insofar as the Commission notes in Paragraph 148 that agreements in which exclusive distribution is combined with selective distribution can only be exempted if no restrictions are placed on active selling in other territories.

This fundamental definition means that suppliers no longer have the possibility of arguing in individual cases that an exemption is also possible in cases which the Commission predicts as

having a negative outcome. MARKENVERBAND therefore suggests wording Paragraph 14.8 as follows:

(14.8) Exclusive distribution is exempted by the Block Exemption Regulation when both the supplier's and buyer's market share does not exceed 30 %, even if combined with other non-hardcore vertical restraints, such as a non-compete obligation limited to five years, quantity forcing or exclusive purchasing. A combination of exclusive distribution and selective distribution is ~~only~~ **unlikely to be** exempted by the Block Exemption Regulation if active selling in other territories is ~~not~~ restricted. Above the 30 % market share threshold, the following guidance is provided for the assessment of exclusive distribution in individual cases.

#### **7. Upfront access payments (Article 5(a) – GL Paragraph 199ff.)**

MARKENVERBAND would like to express its strong approval of the fact that the Commission has also used the reform of the Block Exemption Regulation and the associated Guidelines to carry out a more detailed review of the restrictive effects which originate on the buyer side.

These include upfront access payments (e.g., slotting allowances, as well as other conditions without any counter-performance and which de facto have the effect of being an access requirement), which are often levied by powerful buyers.

Such demands do not, however, only have a restrictive effect when a buyer has a market share in excess of 30%, but already then when a supplier is dependent on the buyer in question such that reasonable possibilities for switching to another buyer do not/no longer exist. The national competition authorities in various Member States have assumed in the past that this is already the case when the sales share of a buyer has a significance of approximately 7.5% or 8% for a supplier.

In European retail this situation is already reality in many national markets. In Germany the competition authorities assume that retailers have a gatekeeper function, with the result that the four leading retailers (with market shares of between 15% and 25%) are all no longer dispensable for the manufacturers of branded goods. In the United Kingdom the Competition Commission has in the past assumed a position establishing buying power for sales significance of 8% and recently included all food retailers with annual turnover of over GBP 1 billion within the scope of the Groceries Supply Code of Practice, which is designed to counter abusive, restrictive requests.

In view of this situation MARKENVERBAND has misgivings as to whether intrinsically right considerations in Paragraph 203 GL with respect to reducing information asymmetry are addressed correctly in connection with slotting allowances. The assumption that the sales risk would otherwise be inappropriately shifted to the buyer overlooks the fact that already with its decision to produce a product a supplier has its own considerable sales risk and risk of failure, which is considerably higher than for the retailer due to the lower flexibility of the supplier to adapt its production. For this reason no additional corrective action is necessary here.

Slotting allowances also make it more expensive for suppliers to launch innovations and there is therefore a risk that such slotting allowances lead to less rather than more innovation. There is also nothing to indicate that the supplier who is willing and able to pay the (highest) listing fee demanded by a powerful buyer also offers the products most in line with the market and the interests of consumers.

It is rather the case that slotting allowances generally have the inherent risk that the interest of the buyer in successful sales shifts to the successful sale of products, which goes against a demand-oriented, consumer-focused understanding of the market.

It should therefore also be pointed out that an extensive shift of the sales risk to the supplier would at least appear unjustified as long as this is not linked to marketing sovereignty at the point of sale.

There is also the fact that private label brands are not affected by slotting allowances with the result that slotting allowances distort competition because they make branded articles artificially more expensive in comparison to private labels products.

MARKENVERBAND would therefore firstly propose that Paragraphs 203 and 204 GL are deleted.

MARKENVERBAND would also propose that explanations are added to Paragraph 199 which make it clear that upfront access payments can also then have a restrictive effect if the market share of the buyer is below 30%:

(199) Upfront access payments are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. This category includes various practices such as slotting allowances<sup>53</sup>, the so called pay-to-stay fees<sup>54</sup>, payments to have access to a distributor's promotion campaigns etc. Upfront access payments are **usually** block exempted when both the supplier's and buyer's market share on their respective downstream markets does not exceed 30%. The following guidance is provided for the assessment of upfront access payments for individual cases in which this market threshold is exceeded **or the negative anticompetitive restraints prevail due to the buyer's power.**

MARKENVERBAND would also finally request the Commission to review to what extent the reform of the Guidelines can be used to publish rules for the fair competitive behaviour of powerful undertakings modelled on the British Groceries Supply Code of Practice.

## **8. Category management agreements (Article 5(a) – GL Paragraph 205ff.)**

For the first time the Commission is in its Guidelines dealing with limits for category management agreements. This is very much welcomed from the perspective of MARKENVERBAND. Category management can help to make inventory management more efficient and consumer-friendly.

Category management can, however, only develop this potential if the limits of permissibility for the set-up and execution of category management projects can be determined with sufficient legal certainty for the undertakings involved in category management projects.

MARKENVERBAND would therefore first of all request that the definition of category management given in Paragraph 25 is brought in line with the definition of category management developed and used by GS1 which is generally accepted by suppliers and buyers and also to use such in the Guidelines making this the basis and to amend Paragraph 205 accordingly as follows:

(205) Category management agreements are agreements *governing the joint process of the distributor and the manufacturer in which categories are managed as strategic business units in order to achieve better results by increasing customer value. Category management combines the manufacturer's knowledge about consumers with the distributor's knowledge of buyers with the objective of achieving improved economic results by focusing on value creation for the customer. Of central significance in this respect is regarding a category as a strategic business unit, the close collaboration between retailers and manufacturers to develop category improvement strategies (e.g., decisions on product range, inventory level, shelf placement etc.) and the improved integration of purchasing and distribution functions.* ~~by which, within a distribution agreement, the distributor entrusts the supplier (the "category captain") with the marketing of a category of products including in general not only the supplier's products, but also the products of its competitors.~~ Category management agreements are block exempted when both the supplier's and buyer's market share on their respective downstream markets does not exceed 30%. Above the market share threshold the following guidance is provided for the assessment of category management agreements in individual cases.

MARKENVERBAND would also suggest supplementing the explanations planned to date and to address the following issues explicitly in this context:

- Is a category advisor allowed to have exclusivity assured or must a retailer be free if necessary to accept recommendations from competitors as well?

In practice category management agreements today are only recommendations.

The Commission notes, however, that category management agreements are vertical agreements as defined by the Block Exemption Regulation. In light of this, MARKENVERBAND assumes that Article 5(a) Block Exemption Regulation is to be applied to such agreements also with respect to duration and possibility of termination as well as with respect to the issue of a possible exclusivity of the advice.

- Which distribution data may be exchanged between retailers and suppliers within the scope of category management projects and how should appropriate restrictions possibly be placed on this exchange of information with Chinese walls within undertakings?

If category management advice should achieve maximum efficiency, should the category manager providing the advice only have access to information otherwise only available to the retail company being advised? The Commission points out in Paragraph 208 that the risk

of collusion between suppliers is increased when sensitive market information can be exchanged via retailers.

The Commission rightly assumes that joint category management of several suppliers is permissible provided that it is ensured that information is not exchanged in a way which leads to collusion.

MARKENVERBAND accordingly assumes that where sensitive market information is the subject of category management the provision of such information to suppliers is then permissible when the exchange of information is necessary for optimal category management advice and that it is ensured ( if necessary through compliance with Chinese walls within undertakings) that no collusion between suppliers results, for instance as the result of a systematic exchange of information between competitors within the scope of joint category management for one retail partner.

MARKENVERBAND would appreciate it if the Commission were to include these clarifications in the Guidelines.

## 9. Resale price restrictions (Article 4(a) – GL Paragraph 48 219-225ff.)

### a. Permissibility of price maintenance by supplier

Article 4(a) Block Exemption Regulation places narrow limits on the restriction of the *buyer's* ability to determine its sale price. Accordingly the wording does not therefore cover the restrictions of the *supplier's* ability to determine its sale price with respect to other buyers. Following adoption of the Block Exemption Regulation 2790/1999 this led to the fact that in some cases the opinion was held that so-called most-favoured-customer clauses are permissible if they are used by a buyer with respect to its supplier. This can mean that price competition on the buyer market is restricted in favour of powerful buyers.

MARKENVERBAND therefore proposes that Article 4(a) of the Block Exemption Regulation is amended as follows:

the restriction of ~~the buyer's~~ the ability **of one of the parties to the agreement** to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

### b. Permissibility of price maintenance by buyer

Whilst the per se prohibition of price maintenance of any kind was the rule on an international basis in the last decades, in many jurisdictions a reassessment of resale price maintenance can be observed, which questions more precisely the anticompetitive and pro-competitive effects of resale price management and rejects general and undifferentiated assessments.

By adopting the Block Exemption Regulation in 1999 the Commission clarified that the agreement of maximum prices is exempted. For the agreement of minimum prices it also

applies that these although described as “black clauses” in Article 4(a) are not exempted, but are not therefore illegal per se (although the Commission considers an exemption unlikely.)

In the United States of America the US Supreme Court rejected in its “Leegin” ruling of 27.06.2007 the per se prohibition of minimum resale price fixing and subjected such agreements to the “rule of reason”, having already exempted maximum price fixing several years prior to this within the scope of its “State Oil vs. Khan” ruling. The US Supreme Court has therefore adopted an approach which takes economic, pro-competitive and anti-competitive aspects into account and weighs these up against one another in individual cases, which is also the basis for the European understanding of competition law.

The application of the Block Exemption Regulation in recent years has, however, shown that prohibition of price maintenance set out in Article 4(a) is in practice misunderstood as a per se prohibition (also by competition authorities).

MARKENVERBAND therefore explicitly welcomes the fact that the Commission takes a differentiated look at the effect of resale price restrictions in Paragraph 219 ff. and refers in this respect to the pro-competitive effects of such a vertical agreement.

In order to provide undertakings with the necessary legal certainty for the agreement of pro-competitive and therefore permissible resale price restrictions additional signals are, however, in the opinion of MARKENVERBAND required from the Commission in order to refute the widespread assumption that any form of contractual or de facto price maintenance by a manufacturer is per se prohibited.

It is also apparent that the expected outcome is not the same for all types of resale price restrictions with respect to their potential pro-competitive or anti-competitive effects. It can in particular be established that in the case of de facto price maintenance the exertion of pressure by imposing disadvantages is much less likely to allow pro-competitive effects to prevail, while predominantly pro-competitive effects can be achieved by granting incentives. The latter are therefore more comparable with respect to their pro-competitive effect to the agreement of maximum prices than to the agreement of minimum prices.

There is also the fact that the potentially restrictive effects of agreements with respect to resale prices are very much dependent on the actual competitive environment. The Commission for instance rightly notes in Paragraph 149 that the loss of intra-brand competition is only then problematic if inter-brand competition is limited. The Block Exemption Regulation therefore rightly stipulates that the exemption will be withdrawn if for instance due to cumulative effects a restriction which per se is unproblematic must in fact be assessed overall as being anti-competitive.

It also applies that the restrictive effects of an agreement on the resale price also heavily depend on the competition situation on the downstream sales market. In asymmetrical markets (fragmented supplier market, concentrated buyer market) and buyer markets with intense (price) competition a predominantly problematic effect caused by restricting intra-brand competition is unlikely. It is rather to be expected that at least when incentives are granted (for instance the payment of “price maintenance bonuses” by the supplier to the buyer to encourage a specific minimum price level for individual products) these (financial)

incentives directly influence the overall pricing of the buyer exposed to the strong (price) competition on its market and are therefore passed on to the consumer.

MARKENVERBAND therefore suggests that the prohibition of agreements in Article 4(a) of the Block Exemption Regulation is amended as follows:

**Article 4(a) (new):**

the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, ~~or incentives offered by,~~ any of the parties;

MARKENVERBAND is aware that such an amendment would in practice only have a very small impact because in many cases the not granting and advantage corresponds with imposing a disadvantage.

In light of scientific market research findings, according to which price is a key element of a consistent brand message, the proposed amendment would also have more than just symbolic significance for brand-focussed industry. Trademark law allows the owners of well-known brands rights to defend themselves against activities which impair or dilute the brand image. This is based on the protection of intellectual property to which the Commission is also committed in the international rivalry between different legal and judicial systems. It should therefore be a concern of European competition law to take appropriate account of the conflict between freedom of competition and the protection of property and to make this clear in a differentiated assessment of resale price restrictions.

MARKENVERBAND has also established that the regulation of the explicitly exempted agreements regarding maximum prices and recommended retail prices (as opposed to agreements relating to fixed or minimum prices) in Article 4 Block Exemption Regulation which addresses the "hardcore restrictions" for undertakings which have a market share of more than 30% (and even if this is only with individual products or individual product ranges) because although hardcore restrictions imposed by undertakings with a market share of more than 30% do not fall under any assumption of illegality in the system of the Block Exemption Regulation, an individual exemption by the Commission is considered less likely. At the same time the explicit exemption of maximum price agreements and price recommendations has high practical significance for suppliers.

MARKENVERBAND therefore suggests that the restriction of resale prices regulated to date in Article 4 is in future regulated in Article 5 Block Exemption Regulation.

The Commission rightly refers already in its Guidelines to scenarios in which the efficiencies which can result from price maintenance can outweigh the negative effects.

In the view of the Commission this also rightly includes scenarios in which a large distributor uses a specific brand as loss leader. The Commission adds that although "selling a product below cost as a loss leader" could in the short run benefit consumers, but may over time lead

to a reduction of inter-brand competition and to disadvantages for consumers if the product is delisted as the result of a price war.

This constellation is of no little significance for the branded goods industry. To the extent that retailers evade brand competition via the strategic development of their private labels, they also increasingly lose interest in the long-term sales success of individual branded products. For slow-moving products in particular, however, it is decisive for a broad listing that these products are not abused as pure benchmark products, which (alone) are used to facilitate price competition. This is also because such price competition reduced to benchmark products leads to margin losses and therefore to a loss of interest in listing a product amongst retail partners, if the price for the product in question has been eroded to the extent that retailers no longer earn any money with the product.

MARKENVERBAND therefore welcomes the possibility for countering such strategies which destroy the medium-term sales chances of a branded product.

Since, however, the difference between cost and retail price can in particular be so great for "slow-moving" products that a loss of sales interest already occurs long before "sale below cost" (due to a lack of a relevant cost contribution in particular compared to other products in the category), brand owners should have the possibility of intervening to rescue their products earlier. MARKENVERBAND therefore suggests already stipulating the emergency rule described in the Guidelines when a product is the subject of a loss-leader price which is detrimental to a brand, without it being important whether the product is also offered below "cost price" (in the sense of a purchase price).

MARKENVERBAND would like propose the following wording in this respect:

(221) However, RPM may not only restrict competition but may also sometimes lead to efficiencies, which will be assessed under Article 81(3). Most notably, where a manufacturer introduces a new brand or enters a new market, RPM may be helpful to induce distributors to better take into account the manufacturer's interest of developing demand for the product. RPM may provide the distributors with the means to increase promotional efforts and if the distributors in this new market are under competitive pressure this may induce them to expand overall demand for the product and make the entry a success, also for the benefit of consumers. Similarly, fixed resale prices, and not just maximum resale prices, may be necessary to organise in a franchise system or similar distribution system a coordinated short term low price campaign which will also benefit the consumers. In view of the short duration (2 to 6 weeks in most cases) this may not even have any appreciable negative effects. Occasionally, RPM may also be useful to avoid that a large distributor uses a particular brand as a ~~loss~~ leader (*e.g., loss leader*). This practice of selling ~~below cost~~ as a loss leader will in the short run benefit consumers but may also, if the product is delisted by other retailers, lead to a reduction of inter-brand competition over time to the disadvantage of consumers.

Berlin, 28.09.2009