Dual distribution - speech of Joseph Vogel at the Florence Competition Program on 8 October 2021

An assessment of the positive and negative aspects of the draft VBER and VGL

for EU distribution networks:

the main issue of the excessive hostility towards dual distribution leading

to the exclusion of almost all existing networks from the exemption

The proposals published by the Commission regarding the draft VBER and VGL include major advances and even some radical innovations for distribution networks. These positive aspects concern both the structure of the networks and the behavior of their members and include:

- The recognition of shared exclusivity.
- The better protection of exclusive distribution.
- The better protection of selective distribution.
- The new evaluation of Internet sales with the admission of dual pricing and the end of the strict principle of equivalence of conditions.
- The more flexible regulation of the duration of contractual non-compete obligations.
- The clarification of the assessment of parity clauses, etc.

Even if certain improvements are still possible (for example, shared exclusivity should not be subject to a minimum volume of business, the conditions of appointment of commercial agents are too strict, the reluctance to admit RPM restrictions and general fulfilment contracts are not in line with the economic analysis of law, the combination of exclusive and selective distribution should be admitted at wholesale level), all these innovations are welcomed.

However, those positive aspects are overshadowed by one significant flaw that needs to be addressed before the new legislation comes into force: the excessive hostility towards dual distribution leading to the exclusion of almost all existing networks from the exemption.

1. **Dual distribution** consists of a supplier selling its products or services both to distributors and directly to end customers, through its own stores, subsidiaries or website. This widespread form of distribution is typically block exempted in the case of non-reciprocal vertical agreements between competing undertakings if the supplier is a producer and distributor of goods and the buyer is a distributor and not a competing undertaking that manufactures, with the same rule applying mutatis mutandis to services. The draft regulation rightly extends block exemption to importers and wholesalers, who were overlooked in the previous regulations even though economically they are in a similar situation to producers.

2. **Unfortunately, while the draft broadens the potential scope of the exemption, it subjects it to such draconian conditions that it results in the de facto exclusion of dual distribution from its**

scope. The exemption of all aspects of a dual distribution agreement would be contingent on the supplier and the distributor having a market share on the retail market not exceeding 10%. This first exemption will therefore hardly ever apply. In effect, market shares in local catchment areas are not usually known. There may be several hundred local markets in any one Member State. The transaction costs of calculating market shares would be disproportionate, even if it were possible. Finally, distributors are often multi-brand. As a result, their local market share is generally more than 10%. Finally, the management in each Member State is generally entrusted to a subsidiary or an importer who must adopt a single distribution method, whereas the assessment of local market shares, if they can be calculated at all, will lead to disparate market shares below or above the 10% threshold and make the first threshold unmanageable in practice. These factors led the drafters of the two previous vertical restraints regulations to consciously avoid calculating the exemption thresholds on the basis of local markets. The first 10% threshold would therefore be very theoretical, impractical and rarely met in practice.

3. **The second threshold, between 10% local market share and 30% general national market share, preserves the exemption, except for exchanges of information that must be assessed according to the rules applicable to horizontal agreements. This limit is particularly problematic.** Vertical exchanges of information are inherent to distribution agreements and allow them to function. They do not in principle raise any appreciable competition concerns, should be block exempted and certainly not assessed under the guidelines on horizontal agreements. In reality, all this restrictive regulation of dual distribution makes no sense as the current regime is perfectly suited to deal with possible horizontal information exchanges between the supplier and distributor since the competition authorities already exclude such exchanges from the benefit of the block exemption regulation (cf. Danish Competition Authority decision, 20 June 2020, Hugo Boss, Concurrences, June 2020). It is therefore sufficient to continue with the current regime as interpreted by the NCAs to address the positive and possibly negative effects of dual distribution.

4. **The exceptions to the very limited exemption for dual distribution effectively finalize the exemption for virtually all current distribution networks.** The text seems to ignore the fact that a very large number of distribution networks today practice some form of dual distribution. All franchise networks are dual by nature, with know-how being tested in the franchisor's stores before being duplicated by the franchisees. In selective or exclusive distribution systems, suppliers sell through their networks but also through branches, subsidiaries, direct sales to major customers such as rental companies or fleets, or through their websites: this is the case e.g. for perfumes, cosmetics, luxury goods and motor vehicles.

5. **The exemption for dual distribution would not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors over which the parties have control, have as their object the restriction of competition between the competing supplier and the buyer.** This exception would apply regardless of the parties' market share. It would be a source of considerable legal uncertainty since the restrictions by object concerned are not covered by the regulation and the competition authorities tend to interpret the concept very broadly, which relieves them of the need to demonstrate the effects of a practice and are frequently challenged by the courts. A whole series of vertical restraints allowing the operation of networks could be interpreted as horizontal restrictions by object in this context. Circulating recommended retail prices to

distributors competing with its own direct sales could be seen as a horizontal exchange of information on prices. Similarly, the designation of an independent distributor in one area and a branch in another with the tacit agreement of the network or one of its members within the *numerus clausus* of a quantitative selective network or exclusive distribution could be considered as market or customer allocation. Such an approach would deprive almost all dual networks of the exemption and would result in never-ending charges of horizontal cartels.

6. **The error underlying the premise of the draft regulation lies in equating dual sales of the same contractual product by the network head and its members with sales of two different products by two competitors.** As long as inter-brand competition is strong, such as below the 30% exemption threshold in general or the 40% exemption threshold in motor vehicles, a small reduction in intra-brand competition due to vertical restrictions of competition inherent in the operation of the network, such as recommended prices or the geographical distribution of distributors, does not lead to any appreciable reduction in competition and should be block exempted.

7. **Likewise, the dual distribution exemption is generally excluded if a provider of online intermediation services that also sells goods or services in competition with undertakings to which it provides online intermediation services enters into a non-reciprocal vertical agreement with those undertakings.** The road to hell is paved with good intentions: the intention may have been to deny the automatic benefit of the block exemption to large online sales platforms suspected of receiving confidential information from suppliers selling their products on the platform and using it to their advantage at the expense of those suppliers. In law, it is always bad practice to create a general rule to deal with a particular problem. In this case, such an exception excludes from the exemption all suppliers which, in order to help their distributors sell online, allow them to sell their products or services from a supplier's website. Rather than obstructing these developing pro-competitive initiatives, this type of interference should be reserved for ad hoc regulation like the DSA or DMA, targeting only very large platforms, or should exclude the heads of exclusive or selective distribution networks from the exception. **We fail to understand the hostility of the drafters of the regulation to dual distribution, which amounts to depriving almost all networks of the exemption, whereas dual distribution meets the needs of customers and its possible restrictive effects on competition can be easily avoided by functional separations and Chinese walls, compliance with which the current rules are perfectly capable of regulating.**

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