DUAL DISTRIBUTION IN THE DIGITAL AGE: THE EUROPEAN COMMISSION DRAFTS NEW COMPETITION RULES

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Dual distribution has flourished with the rise of e-commerce and is a key focus of current reforms to vertical agreement rules by the European Commission, which published a draft revised Vertical Block Exemption Regulation and draft revised Guidelines on Vertical Restraints on July 9, 2021. Public consultation feedback was largely critical of the draft new vertical rules with respect to dual distribution. In particular, as the contemplated regime for information exchange in dual distribution was perceived as unreasonable, impractical and adding legal uncertainty as compared to the current regime, the European Commission recently returned to the drawing board to address these issues. This article compares and discusses the main differences between today's rules and the European Commission's envisaged new rules, which are expected to enter into force on June 1, 2022.

I. THE CONTEXT

The European Commission ("EC") is currently revising the rules governing vertical agreements under EU competition law, which will expire on May 31, 2022. In this respect, on July 9, 2021, the EC published its long-awaited draft revised Vertical Block Exemption Regulation ("Draft VBER") and draft revised Guidelines on Vertical Restraints ("Draft VGL"). Initial public consultation on the suggested new rules closed on September 17, 2021.

The EC is now finalizing these drafts, and the revision process is nearing completion. If the new rules are adopted according to the planned timetable, they would take effect on June 1, 2022, with a transitional period until May 31, 2023 to adapt vertical agreements already in place at the time of adopting the rules. The new rules are intended to expire on May 31, 2034.

These drafts follow the Commission's extended evaluation process, spanning over two years, which included a 2019 public consultation, a stakeholder workshop, support studies, and a working paper. The EC's specific proposed changes were first unveiled when publishing the Draft VBER and Draft VGL in July 2021, followed by a revision to the Draft VGL in February 2022 to respond to certain stakeholder concerns.

The revamp of the EU competition rules on vertical agreements reflects the expanding digitalized economy, and the EC's main proposed changes focus on novel issues raised by increasingly complex business models that mix elements of traditional and online distribution channels and models.

The rules applicable to dual distribution are a key subject of the reform. In dual distribution, a supplier sells both through independent distributors and directly to customers in competition with its own distributors. A dual distribution relationship thus combines vertical aspects (a supply-distribution relationship) and horizontal aspects (the parties compete at downstream level).

With the ease and limited costs of e-commerce channels, suppliers are increasingly directly selling their products on their own websites, in combination with their traditional sales channels through distributors. This has led to a significant rise in dual distribution agreements, leading the EC to reconsider the currently broad exemption applicable to such agreements.

On dual distribution, public consultation responses to the Draft VBER and the Draft VGL were overall rather critical. The draft new rules on information exchange in a dual distribution context were perceived as unreasonable, impractical, and adding legal uncertainty as compared to the current regime. In response to the criticism, the EC initiated an additional consultation (closed February 18, 2022) on new draft guidance on information exchange in dual distribution, which clarified that information exchange that is "*necessary to improve the production or distribution of the contract goods or services by the parties*" would be covered by the revised VBER's safe harbor (provided that the dual distribution scheme otherwise complies with the revised VBER's conditions).

This article compares and discusses the currently applicable rules and the draft new rules for dual distribution.

II. DUAL DISTRIBUTION – RELATED ANTITRUST ISSUES

In a dual distribution system, a vertical agreement between a supplier and a distributor also involves horizontal aspects since the parties compete at the downstream level. From an antitrust perspective, dual distribution agreements can therefore raise a number of issues.

One of the main questions concerning such dual distribution agreements is the exchange of commercially sensitive information between a supplier and its distributor. Information exchange (e.g. on sales, products, marketing campaigns and market trends) is, however, inherent to any effective vertical relationship.

Current EU rules distinguish between legitimate vertical information exchanges and purely horizontal information exchanges, which are treated much more strictly.

III. DUAL DISTRIBUTION UNDER CURRENT EC RULES

Dual distribution involves vertical agreements between companies that may be prohibited as anticompetitive agreements under Article 101 TFEU. Currently, dual distribution agreements are exempted without any specific limitations other than the general conditions of the Vertical Block

Exemption Regulation ("VBER," Regulation 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices).

The currently applicable framework (the VBER and the EC Guidelines on Vertical Restraints ("VGL")) provides a broad safe harbor for agreements falling under the VBER's scope, which are deemed compliant with the EU prohibition of anticompetitive agreements. The VBER is a critical tool from a business perspective, as it provides significant legal certainty on the validity of certain conduct.

The VBER's safe harbor applies to vertical agreements between parties whose market shares do not exceed 30 percent in any of the relevant markets (i.e. the market on which the supplier sells and the market on which the distributor purchases the contract goods or services). The vertical agreement also must not contain any so-called "hardcore" restrictions, such as minimum and fixed resale-prices or certain types of territorial protection.

Vertical agreements excluded from the safe harbor of the VBER may nevertheless be lawful, but they must be assessed on a case-by-case basis under Article 101 TFEU, which is a significant burden for the concerned parties (under the "self-assessment" principle). Under that analysis (conducted within the framework laid down by Article 101(3) TFEU), a vertical agreement is lawful only if the net effect, i.e. weighing its procompetitive benefits and anticompetitive harms, is positive.

While the VBER generally does not cover vertical agreements entered into between competitors, it provides certain exceptions to this rule. Under the so-called "dual distribution" exemption (Article 2(4) VBER), vertical agreements between competitors benefit from the VBER's safe harbor where:

- *"the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level; or*
- *the supplier is a provider of services at several levels of trade, while the buyer provides its goods or services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services."*

This exemption applies to agreements where the parties act in different economic roles and not at the same level of trade, where the following conditions are met:

1. The agreement must be *non-reciprocal* (i.e. only one party distributes for the other),
2. The *supplier* is either (i) a *manufacturer* of goods who also distributes these goods, or (ii) a *service provider* who operates at several levels of trade,
3. The *buyer* is (i) only a *distributor* (i.e. not competing with the supplier at manufacturing level) or (ii) only operating at the *retail level* (i.e. not competing with the service provider at the level of trade at which it purchases the contract services).

Importantly, the exemption that applies to dual distribution currently only covers vertical agreements entered into by manufacturers or service providers at the upstream level, not wholesalers or importers. In addition, it has generally been understood that the block exemption applying to dual distribution schemes also covers vertical information exchanges between the supplier and the distributor (even if they both compete at the retail level).

The rationale for such exemption is that in dual distribution, the vertical relationship predominates, while horizontal aspects are ancillary. When adopting the VBER, the EC considered that in dual distribution, any potential negative impact on the competitive relationship between the manufacturer and retailer at the retail level was of lesser importance than the potential positive impact of the vertical supply agreement on competition in general at the manufacturing or retail level (see VGL, para. 28).

IV. DUAL DISTRIBUTION EXEMPTION NARROWED UNDER EC'S DRAFT NEW RULES

The Draft VBER and Draft VGL maintain the exemption for dual distribution agreements but significantly reduce its scope and provide for a hybrid regime for information exchange under such agreements. The Commission justified these changes by the growth of direct online sales by suppliers and the fear that "*the current exception for dual distribution is likely to exempt vertical agreements where possible horizontal concerns are no longer negligible*." The draft new rules set out three main principles:

1. Non-reciprocal agreements in dual distribution systems are *fully exempted*, including information exchanges between the parties, provided that the parties' *combined market share* in the retail market *does not exceed 10 percent* and the supplier's and distributor's *individual market shares* on, respectively, the upstream (sale) and downstream (purchase) markets *do not exceed 30 percent* (Article 2(4) and Article 3 Draft VBER).
2. When the parties' *combined market share in the retail market is between 10 and 30 percent*, and the parties' *individual market shares* on, respectively, the upstream and downstream markets *do not exceed 30 percent*, the agreement is exempted, but the exemption does not cover information exchanges (Article 2(5) and Article 3 Draft VBER).
3. Irrespective of the above thresholds, the Draft VBER contains a *blanket limitation* such that it does not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the parties' control, have the object of restricting competition between the competing supplier and buyer, including by way of information exchange (Article 2(6) Draft VBER).

Under these new rules, as soon as the parties' market shares exceed 10 percent, information exchanges would no longer benefit from the safe harbor of the revised VBER. Such information exchanges would require assessment under the Guidelines on the applicability of Article 101 TFEU to horizontal cooperation agreements ("Horizontal Guidelines"), which could be viewed as inappropriate given the fundamental vertical nature and specificities of dual distribution agreements. In addition, as provided in the Draft VBER (Article 2(6)), information exchanges would be excluded from the block exemption, regardless of the parties' market shares, as soon as they amount to a restriction "by object."

This general limitation on exempting dual distribution agreements, based on the notion of restriction by object, is likely contrary to the main aim of both the current and Draft VBERs to provide business with legal certainty, a key driving principle for any company. By relying on the broad and undefined notion of restriction by object, the draft VBER creates significant uncertainty and triggers the need for at least some kind of self-assessment by undertakings active in dual distribution systems, even when meeting all other conditions of the Draft VBER.

Finally, although the Draft VBER largely reduces the scope of the dual distribution exemption, it also expands the exemption in one notable way: under the Draft VBER, wholesalers, importers, and online intermediaries (e.g. digital platforms) are now also covered by the exemption, subject to the exception discussed below concerning online intermediaries. The inclusion of wholesalers, importers and online intermediaries is a welcome development, since their role largely resembles that of manufacturers as far as dual distribution is concerned.

V. ONLINE INTERMEDIARIES AND SWEEPING EXCLUSION OF "HYBRID" PLATFORMS FROM DUAL DISTRIBUTION EXEMPTION

The Draft VBER's dual distribution exemption now generally covers online intermediation service providers (i.e. digital platforms) acting as intermediaries for retailers to sell their products to end-customers.

A significant exclusion from the Draft VBER, however, applies to so-called "hybrid" platforms, i.e. where a provider of online intermediation services that also sells goods or services in competition with businesses to which it provides online intermediation services enters into a non-reciprocal vertical agreement with such a competing undertaking (Article 2(7) Draft VBER). A hybrid platform operator therefore manages two distinct businesses: (i) an intermediary service (for retailers using the platform to sell their products) and (ii) the operator's own retail business (for selling its own products on the platform).

Thus, to benefit from the Draft VBER, a provider of online intermediation services cannot sell goods or services in competition with the businesses to which it provides the intermediation services. The EC considers that such a hybrid function typically impacts inter-brand competition and may therefore raise non-negligible horizontal concerns (see Draft VBER, Recital 12).

This total exclusion of all hybrid online intermediation service providers, which is probably inspired by equating hybrid platforms with "digital gatekeepers" (a concept stemming from the proposed Digital Market Act ("DMA") and referring to companies deemed with significant market power), results in indistinctly sweeping in the likes of Amazon with a variety of much smaller hybrid companies. On this basis, the EC seemingly considers that horizontal concerns would overshadow the vertical aspects of hybrid platforms. However, the goal of excluding potentially problematic cases from the Draft VBER may have been better served by narrowing the wholesale exclusion of all hybrid platforms by applying, for example, a market share threshold.

VI. UNCERTAINTIES IN INFORMATION EXCHANGE IN DUAL DISTRIBUTION

The contours of legitimate information exchange in dual distribution are also raising uncertainties. As explained above, the draft new rules (as initially published in July 2021) set out a specific regime for information exchanges in a dual distribution context. Currently, the Draft VBER exemption would cover such exchanges only where the combined market share of the parties to the agreement do not exceed 10 percent on the downstream market where they compete. If exceeding the 10 percent combined market share threshold, information exchange aspects would require assessment under the Horizontal Guidelines.

This initial proposed approach to information exchange in dual distribution drew significant criticism, both because of the 10 percent threshold and the reference to the Horizontal Guidelines. Stakeholders pointed out that information exchanges in vertical relationships, including in dual distribution, may generate efficiencies and sought more guidance from the EC on the kind of information that may (and may not) be safely exchanged in a dual distribution context. In challenging the EC's reference to the Horizontal Guidelines, many stakeholders argued that information sharing in a vertical relationship (including in a dual distribution one) is not comparable to information exchange in a purely horizontal relationship between competitors.

Responding to the negative public consultation feedback, in early February 2022, the EC released a new draft section on information exchange in dual distribution for inclusion in the Draft VGL. This new draft, which was briefly open to consultation until February 18, 2022, no longer refers to the 10 percent combined market share threshold, which suggests that the EC intends to remove it. However, this would also require modifying the Draft VBER. While the EC has not released an updated Draft VBER, the new section of the Draft VGL indicates that its proposed guidance is based on the assumption that the revised VBER will include a change reflecting the updated Draft VGL.

In addition, the Draft VGL introduces a new test, providing that the revised VBER will only apply to information exchanges "*necessary to improve the production or distribution of the contract goods or services*." In practice, this means that application of the block exemption to information exchange in a dual distribution context would no longer depend on the parties' combined market share on the retail market and that the only relevant market share threshold would be the 30 percent threshold applicable to the parties' individual positions in the sale and purchase markets (Article 3 VBER). The EC thus recognizes that the horizontal aspect in dual distribution is most often an ancillary concern to a business relationship that is essentially vertical in nature (and involves the sharing of information about sales, products, marketing campaigns, market trends and consumer preferences on a regular basis) and, as such, should be mainly addressed in the revised VGL. The new specification also acknowledges the valuable efficiencies that information exchanges can bring in a vertical context.

Towards addressing a related point of public consultation feedback, the new Draft VGL section also provides detailed guidance on information that can be considered as "*necessary to improve the production or distribution of the contact goods or services*." It sets out a non-exhaustive list of information that can be considered as meeting such condition and thus benefiting from the block exemption, including:

a) Technical information relating to the contract goods or services;
b) Information relating to the supply of the contract goods or services, including information relating to production, inventory, stocks, sales volumes and returns;
c) Aggregated information relating to customer purchases;
d) Information relating to the prices at which the contract goods or services are sold by the supplier to the buyer;
e) Information relating to the supplier's recommended resale prices or maximum resale prices for the contract goods or services and information relating to the prices at which the buyer resells the goods or services, provided that such information exchange is not used to restrict the buyer's ability to determine its sale price or to enforce a fixed or minimum sale price;
f) Information relating to the marketing of the contract goods or services;
g) Performance-related information, including aggregated information communicated by the supplier to the buyer relating to the marketing and sales activities of other buyers of the contract goods or services, provided that this does not enable the buyer to identify the activities of particular competing buyers, as well as information relating to the volume or value of the buyer's sales of the contract goods or services relative to the buyer's sales of competing goods or services.

Conversely, several examples are provided of types of information that "*generally*" do not fall under the exemption of the Draft VBER rules:

a) information relating to actual future prices at which the supplier or distributor will sell the goods or services,
b) customer-specific (non-aggregated) sales data, and
c) information relating to goods sold by a distributor under its own brand name with a manufacturer of competing branded goods.

Those types of information exchanges are not necessarily prohibited under Article 101 TFEU. However, they are subject to an individual assessment, which should take into account the Horizontal Guidelines (also currently under review) and the relevant EU case law relating to exchanges of information between competitors. In addition, such information exchanges are subject to the presumptions established by the EU Court of Justice's case law relating to exchanges of information between competitors (i.e. companies that participate in a concerted practice and that remain active on the market are presumed to take into account information exchanged with their competitors in determining their conduct on the market). Even if the information exchanges do not qualify for the safe harbor, parties to a vertical agreement may nonetheless benefit from the block exemption provided that the agreement otherwise complies with the VBER's conditions.

Precautions can be taken to minimize the risk of engaging in anticompetitive exchanges of commercially sensitive information in relation to the nature of the information exchanged (e.g. should be aggregated and sufficiently old) and the personnel receiving the information (e.g. by implementing technical or administrative measures, such as firewalls and clean teams, to ensure that information provided by the distributor is only accessible to personnel responsible for the supplier's upstream activities and not to personnel responsible for the supplier's downstream retail activities competing with the distributor's).

The new Draft VGL section on information exchange is a welcome improvement, as it reduces the uncertainty and complexity raised by the Draft VBER and initial Draft VGL and facilitates self-assessment. Still, the new Draft VGL section reflects little innovation, and the broad notion of "*necessary to improve production or distribution*" will most likely create uncertainty and trigger discussions as to the information that actually meets this test, which may also depend on the particular distribution model at stake (exclusive distribution, selective distribution, franchise).

While the revised VBER and Vertical Guidelines have yet to be finalized (and are not expected to enter into force before June 1, 2022, with a transitional period until May 31, 2023 to adapt existing vertical agreements), companies would be well-advised to anticipate the upcoming new rules applying to dual distribution and to start implementing possible precautionary measures.

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