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COUNTDOWN | 5 April 2022

Distribution Law Center Countdown XVI - Dual distribution (Market share threshold)

What?

Dual distribution occurs where a supplier sells goods or services both directly and through independent distributors, thereby competing with these independent distributors on the downstream market. A classic example would be that of a manufacturer of a clothing brand who sells these clothes in his own stores but also relies upon independent retailers to sell the clothes in their stores.

Dual distribution is hardly a new phenomenon. Already in 2010, it was applied by manufacturers for various reasons. To set an example for their independent distributors in so-called "flagship stores", to offer more choice to the end-customers, etc. Over the past decade, however, dual distribution has become increasingly important due to the significant increase in online sales.

The increased use of dual distribution has led the European Commission to examine whether the existing legal framework is still adapted to the changed market conditions, but it has also prompted stakeholders to point out certain shortcomings of the legal framework. This countdown discusses the specific market share limit for dual distribution as introduced by the draft revised VBER published in July 2021.

Now?

The current Vertical Block Exemption Regulation (the “VBER”) excludes vertical agreements entered into between competitors from the block exemption, but specifically provides in Article 2(4) that dual distribution agreements are covered by the safe harbour for vertical agreements.

The general market share limit of 30% stipulated in Article 3(1) of the VBER also applies to dual distribution agreements.

The future as of 1 June 2022?

With the aim of narrowing down the safe harbour for dual distribution arrangements, the European Commission proposed in July 2021 to exclude all information exchanges from the benefit of the block exemption for dual distribution, unless the parties’ aggregate retail market share is below 10%. When this market share limit is

exceeded, any exchange of information between the parties to a dual distribution arrangement would have to be assessed under the rules applicable to horizontal agreements (Articles 2(4) and 2(5) of the draft revised VBER). In other words, in addition to the general market share limit of 30% a new 10% retail market share limit would be introduced for information exchanges.

The European Commission's proposal to introduce this additional 10% limit was heavily criticized.

In the Distribution Law Center's observations on the draft revised VBER and Vertical Guidelines in the context of the European Commission's public consultation it is pointed out that the choice of a limit of 10% with reference to the De Minimis Notice is remarkable in a block exemption context. Furthermore, one would have expected to find here at least the 15% safe harbour limit applicable to joint commercialization agreements pursuant to the Horizontal Guidelines (see paragraphs 240-241).

The Distribution Law Center further observed that the introduction of a market share limit on the downstream retail market is at odds with the regime currently in place, where the buyer's market share in relation to the 30% market share limit is measured on the purchasing market and not on the downstream market. The arguments for this approach are equally applicable in the context of dual distribution. Defining the relevant retail market and measuring retail market shares correctly is notoriously complicated in practice. It requires considerable fact finding and on retail markets with a narrow geographic scope (local or regional) market shares might be subject to considerable fluctuations that are outside the control of the parties (the opening or closure of one additional competing retail store may bring the parties above or below the threshold overnight).

Additionally, the Distribution Law Center observed that, in order to measure the retail market share correctly, it is necessary to include not only the supplier's products, but also all competing products. In order to assess its legal position under the block exemption, the supplier would therefore need access to up-to-date and detailed information on the performance of its buyers in terms of competing products. It is the Distribution Law Center's view that this could trigger a requirement for information exchanges which the current drafts may consider anti-competitive.

For the above reasons, the Distribution Law Center recommended that the dual distribution regime should not be dependent on any market share limit and in any event not on one that is so difficult to define as that pertaining to the retail market. In addition, many stakeholders requested the European Commission to provide more detailed guidance on the types of information that can be exchanged in a dual distribution relationship.

In response to this feedback, on 4 February 2022, the European Commission published a draft new section (also available on the DLC website) to be included in the revised Vertical Guidelines dealing with information exchange in dual distribution. Paragraph 9 of the draft new section states that "*if the conditions of Article 2(4), points (a) and (b) of the Regulation are fulfilled, the exemption provided for in Article 2(1) of the Regulation applies to all aspects*

of the vertical agreement, including any exchange of information between the parties that is necessary to improve the production or distribution of the contract goods or services".

It is the understanding of the Distribution Law Center that this new language implicitly eliminates the market share limit of 10% from the draft VBER. The new section indeed also states that the revised VBER would include a provision stating that the block exemption generally does not apply "*to the exchange of information between the supplier and the buyer that is not necessary to improve the production or distribution of the contract goods or services by the parties*", thus apparently doing away with the 10% market limit as originally foreseen.

In practice?

The European Commission's initial proposal to block exempt information exchanges between a supplier and a distributor in a dual distribution arrangement on condition that the parties' market share is less than 10% seems to have been abandoned. It has been replaced by a carve out from the draft revised VBER of exchanges of information that are not necessary to improve the production or distribution of the contract goods or services.

Assessment?

The adjustment of the draft VBER on the topic of exchanges of information in dual distribution is to be welcomed. Although the Distribution Law Center understands that the European Commission has a concern that a dual distribution scenario may lead to "false positives" (i.e. information exchanges that raise significant horizontal concerns, but are nevertheless block exempted), the introduction of an additional market share limit is not an appropriate way to address such concern. The new test, where the draft VBER would cover exchanges of information necessary to dual distribution, is an improvement, also because examples are given in the draft revised Vertical Guidelines.

Want to know more? Stay tuned...

Counting down towards 1 June 2022 we aim to provide you with regular updates and the necessary legal knowhow in order to fully prepare your business for the future. Please also check out the Distribution Law Center platform and our LinkedIn page for much more information on the laws governing vertical agreements, covering both competition and commercial law. 27 specialized teams from all over the EEA are working hard to turn the platform into your favourite source of guidance and information.

A translation of this Countdown newsletter is available in the following languages: Czech, Portuguese,

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Romanian, Slovakia, Swedish.

Read the available DLC Countdown newsletters on the changes to be expected here.