

Comments by the Luxembourgish Competition Council on the draft VBER and draft Guidelines

1. Comments on the draft VBER

The Competition Council wishes to comment on the new article 4.

1.1. Reducing the number of provisions in article 4

The draft VBER proposes to restructure article 4. Whereas the substantial rules remain unchanged compared to the current VBER, article 4(b) is split into three separate provisions specifying the rules in the case of exclusive distribution (new article 4(b)), selective distribution (new article 4(c)) and general rules if no such system is applied (new article 4(d)). Each of these three provisions states that restrictions on active or passive sales are considered to be hardcore restrictions except in specific circumstances, which are specified as exceptions for each case (exceptions from the exceptions from the exemption).

This restructuring aims to reduce the complexity of these rules. A reader can identify the rules applicable in a specific situation i.e. according to the nature of the distribution network. However, the Competition Council has doubts whether these changes indeed reduce complexity.

Exceptions are the same in all three cases

The new paragraphs 4(b), 4(c) and 4(d) essentially state that the restrictions of active or passive sales are considered to be hardcore restrictions. Each article then indicates the exceptions that apply for each type of distribution system. However, it seems as if the rules and exceptions are basically the same in each case, or at least confusingly close to each other.

For each case, there are 5 exceptions:

- (i) Active sales into a territory or a customer group exclusively allocated to another buyer or the supplier can be restricted.
- (ii) Active or passive sales to unauthorised distributors in a territory where a selective distribution system is operated can be restricted.
- (iii) The place of establishment of a buyer can be restricted.
- (iv) Active or passive sales to end users by wholesalers can be restricted.
- (v) Sales of components to customers who would use them to manufacture the same types of goods as those produced by the supplier can be restricted.

These exceptions are identical in all three cases. The only difference is the wording to designate the buyer to whom they apply (“buyers” for 4(b) and 4(d), “members of the selective distribution system” for 4(c)), but the rules are the same.

Additional rules for selective distribution are redundant

The only difference between the three provisions seems to be that 4(c) on selective distribution adds two additional hardcore restrictions, in 4(c)(ii) and 4(c)(iii), apart from the general ban on active and passive sales restrictions:

- (ii) Restriction of cross-supplies between members of a selective distribution system are hardcore restrictions.
- (iii) Restrictions of active and passive sales to end users by members of a selective distribution system operating at the retail level are hardcore restrictions.

Considering the ban on active and passive sales restrictions in 4 (b) and (c) (i), and the exceptions seen above, these two hardcore restrictions seem redundant as they simply repeat the ban on sales restrictions.

By keeping these two hardcore restrictions included in 4(c), the draft VBER conveys the impression that such restrictions are allowed in the case of exclusive distribution since 4(b) does not contain such additional hardcore restrictions. However, the draft Guidelines state in paragraph (97) that more than one distributor can be appointed in the framework of exclusive distribution and paragraph (100) states that *“active and passive sales between these distributors cannot be restricted.”*

Thus, the same rules apply for exclusive and selective distribution. There are two ways to address this inconsistency:

- 1) Include such additional hardcore restrictions also in 4(b) if rules indeed differ.
- 2) Drop these two hardcore restrictions from 4(c) if they are redundant.

Option 2) appears to be the more appropriate one in our view since it will reduce the number of provisions and increase clarity of the VBER.

Wording of 4(d) seems enough

Even if the new extended wording pursues to clarify article 4 by stating the rules according to the nature of the distribution system, it seems as if it only repeats the same rules multiple times. Whether this indeed increases the understanding and readability of this article is in our view doubtful.

Thus, it seems as if articles 4(b), 4(c) and 4(d) could be reduced to a single hardcore restriction with the 5 mentioned exceptions without a risk of loss:

The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) [no change]

(b) the restriction of the territory into which, or of the customer group to whom, a buyer may actively or passively sell the contract goods or services, except:

- (i) *the restriction of active sales by the buyer and its customers into a territory or to a customer group reserved to the supplier or allocated by the supplier exclusively to one or a limited number of buyers,*
- (ii) *the restriction of active or passive sales by the buyer or its customers to unauthorised distributors located in a territory where the supplier operates a selective distribution system for the contract goods or services,*
- (iii) *the restriction of the buyer's place of establishment,*
- (iv) *the restriction of active or passive sales to end users by a buyer operating at the wholesale level of trade,*
- (v) *the restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier.*

(c) [no change]

1.2. TSCs as a hardcore restriction

Additionally, the VBER could benefit in our view from explicitly banning territorial supply constraints as a hardcore restriction. These are practices by suppliers or manufacturers to restrict buyers' (retailers and other businesses) ability to purchase goods in the country and from the source of their choice.

The underlying motivation for manufacturers is to apply different prices for the same goods in different countries in order to maximise profits at the expense of consumers. A producer wanting to charge a higher price in country A than in country B, has to prevent arbitrage between both countries. This means the producer has to prevent the trade of its goods from the low-price country B into the high-price country A. This is exactly what TSCs aim to do.

Price differences between countries can have many causes. Most notably, VAT rates, transportation costs, wages, etc. However, there is evidence that these objective, cost-related justifications cannot fully explain the price differences between countries.¹ Hence, these differences are induced by market power and TSCs.

So far, this issue is only addressed through the complex structure of article 4 seen above. An improvement would therefore be to include TSCs as an explicit hardcore restriction within article 4:

"The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

[...]

(X) Restrictions arising from the establishment of distribution networks along national markets if these significantly affect trade between Member states."

By changing the wording of the VBER in this way, it would become clear that restrictions for the sole purpose of segmenting the market along national borders are not exempted. This provision would not affect the ability of companies to organize their distribution networks as they wish. They obviously

¹ European Central Bank, "Retail Market Structure and Consumer Prices in the Euro Area", 2014.
European Commission "A study on territorial supply constraints in the EU retail sector", 2020.

may cling to their national networks as long as trade between Member states is not affected, i.e., cross border sales can freely happen.

Including TSCs as a hardcore restriction of their own seems justified for two main reasons:

First, this would make national fragmentations of the Single Market incompatible with competition law. A goal that lies at the heart of European Union and its competition laws:

“[...] an agreement between a producer and distributor which might tend to restore the national divisions in trade between Member States might be such as to frustrate the most fundamental objectives of the Community.”²

Second, by their very nature, TSCs are unlikely to fulfil two conditions of Article 101(3) TFUE, on which the exemption of the VBER is based. A first condition is that an agreement improves production or distribution of goods and services. TSCs, by limiting sales and trade, are unlikely to fulfil this condition. Moreover, to be exempted from Article 101(1) TFUE, an agreement must allow consumers a fair share of the resulting benefits. This condition does not hold either in case of TSCs, as these practices allow to increase consumer prices in some countries.

2. Comments on the draft Guidelines

Section 6.1.2 of the draft VGL gives explanations on how to apply articles 4(b) to (d) of the draft VBER. These articles state that restrictions of active or passive sales to certain territories or groups of customers are hardcore restrictions and not exempted by the VBER.

However, as seen above, these articles all come with a whole list of exceptions. This makes them particularly complex and hard to read. It is therefore somewhat surprising that the draft VGL does not further cover and explain this peculiar structure of article 4(b) to (d).

In order to offer interested parties as much clarity as possible, the Competition Council considers it therefore highly important for the draft VGL to state that:

- For the case of an exclusive distribution system, passive sales can under no circumstances be restricted by the supplier. The only sales that can be restricted are active sales into the territory where the exclusive distribution system is applied.
- For the case of a selective distribution system, only passive sales to unauthorised distributors within a territory where a selective distribution system is applied can be restricted. All other passive sales restrictions constitute a hardcore restriction.

By clearly stating that passive sales can (almost) never be restricted, the draft VGL could easily give interested parties certainty that parallel trade is always possible, without having to decipher articles 4(b) to (d) to the last detail. This would clearly represent an improvement of the draft VGL.

² Judgment of the Court of 13 July 1966, *Consten and Grundig v. Commission*, p. 340