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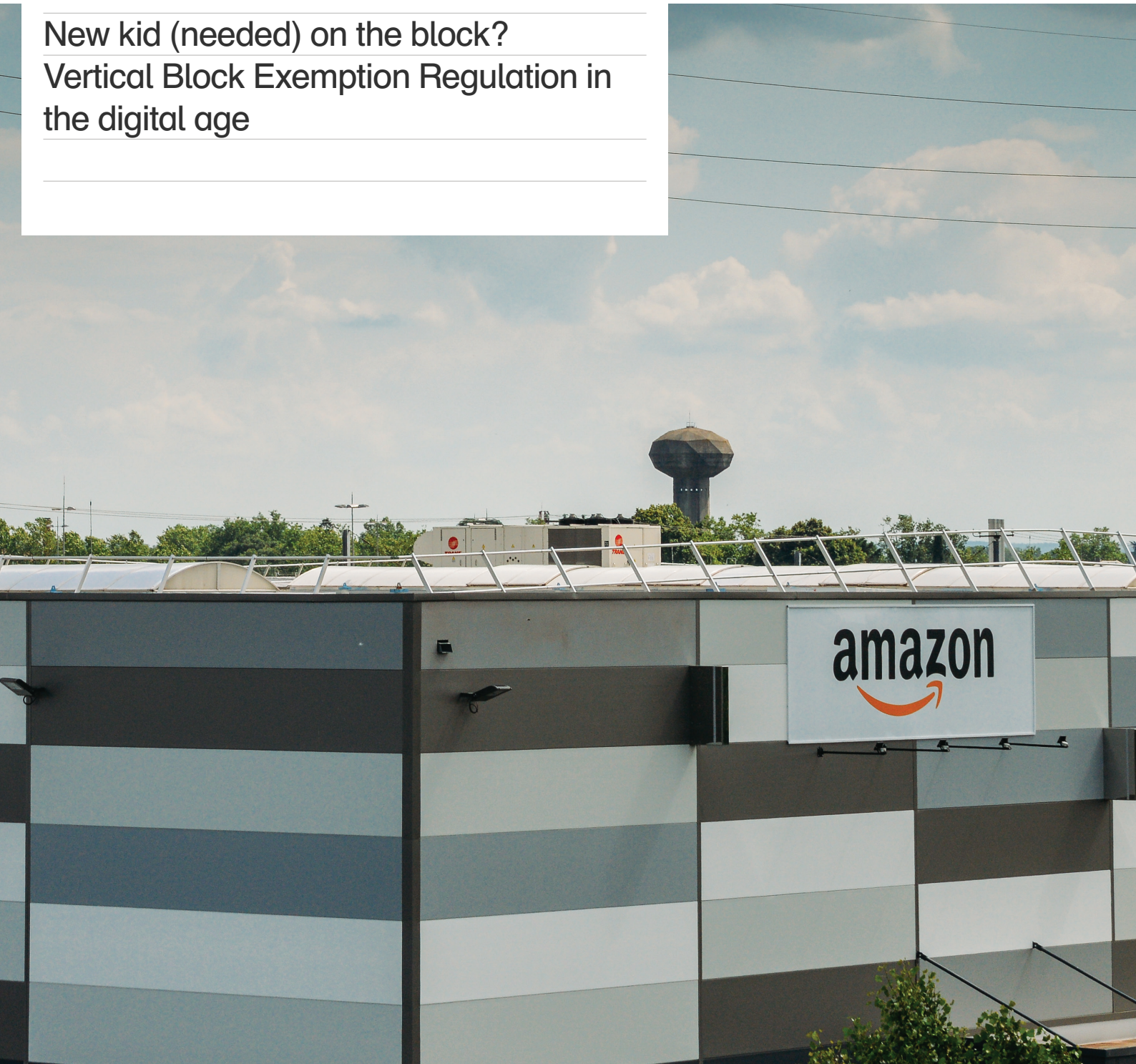
August 2019

New kid (needed) on the block? Vertical Block Exemption Regulation in the digital age



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The recent rise of ecommerce has triggered debate around vertical agreements between suppliers and distributors/retailers. Against this backdrop, is the European Commission's current Vertical Block Exemption Regulation (VBER) still fit for purpose, or should it be revised? Do its Guidelines on Vertical Restraints (VGL) also need to change? Drawing on Oxera's response to the Commission's 2019 consultation, we discuss a few areas where revision and further guidance might be welcome

This article is based on Oxera's response to European Commission (2019), 'EU competition rules on vertical agreements – evaluation', public consultation, 4 February–28 May, https://bit.ly/2HUCxQ9.

In the EU, the legal framework governing vertical agreements between businesses at different levels of the value chain (for example, a manufacturer and retailer of the same product) includes Article 101 of the Treaty on the Functioning of the European Union (TFEU) and the European Commission's VBER.[1] The accompanying VGL[2] provides crucial guidance on the application of these legal frameworks in a variety of settings (see the box).

The current VBER and VGL do take some account of the economics literature on the potential anti- and procompetitive effects of different vertical restraints. For example, it is recognised that selective distribution systems, whereby the number of retailers of a product is limited by the manufacturer, may not infringe Article 101 due to having potential efficiency benefits. However, this is not always the case. For example, the fixing of retail prices by a manufacturer—known as resale price maintenance (RPM)—is considered a 'hardcore' infringement of Article 101, despite the existence of economics literature on the potential benefits of this.[3]

In addition to long-standing debates such as this, the growth of ecommerce and online platforms in the last decade has raised new issues relating to vertical agreements. In particular, online platforms have emerged as a critical player in ecommerce, performing roles ranging from information provision and retail sales to operating marketplaces that facilitate transactions among third-party buyers and sellers. Airbnb, Amazon, Expedia, Idealo, TaskRabbit, VBO, Volagratis, and USwitch are all examples of this.

Few would disagree that these developments have had a strong positive impact on market functioning, innovation and consumer welfare. At the same time, however, there has been an increase in the use of contractual restrictions between suppliers and retailers to increase control over product distribution. This has included pricing restrictions, bans on sales through online platforms, restrictions on the use of price comparison tools, and the exclusion of online marketplaces from distribution networks.[4]

Many of these aspects are not explicitly covered in the current VBER or VGL. More generally, the rise of novel issues has spurred a debate among practitioners on the relevance and future of VBER in an age of ecommerce. The Commission's recent consultation on the evaluation of the VBER and VGL, ahead of their expiry in 2022, was therefore timely and very welcome.[5]

What did the consultation focus on?

The Commission's consultation took place earlier this year and received 164 responses (including a response from Oxera).[6] The outcome was published by the Commission in July 2019.[7]

The aim of the consultation was to collect views about the functioning of the VBER and VGL. The focus was on five evaluation criteria: effectiveness, efficiency, relevance, coherence, and EU added value. These criteria were aimed at better understanding the impact that the VBER and VGL have had on businesses, and the potential effects of letting the guidelines lapse.

Of the 164 responses, the majority were positive about the impact of, and need for, the framework. For example, most respondents noted that the VBER and VGL add value in the assessment of vertical agreements and contribute to legal certainty in many areas. Many also highlighted that although the current system is costly for their business, self-assessing compliance with Article 101(1) in the absence of the VBER and the VGL would be even more costly, which would potentially deter businesses from developing new business models. At the same time, many respondents supported an update to the regulations in order to respond to the new trends in the online world.

In which areas are revisions, or at least further guidance, necessary? We discuss this below from an economics perspective.

Legal framework governing vertical agreements in the EU

To sell their products or services, manufacturers/suppliers often contract with retailers or distributors that may have broader reach than that of the manufacturer/supplier. For example, a manufacturer of high-end bicycles may have supply agreements with large sports retailers that have stores across the country. Such supply agreements can include restrictions for either party. For example, the manufacturer of bikes may limit the overall number of sports retailers that are allowed to sell its products.

These agreements are governed by Article 101(1) TFEU, which prohibits agreements that prevent, restrict or distort competition. Specific agreements might be exempt if it can be shown that they satisfy Article 101(3). To be exempt, they have to contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits.

An example of a vertical agreement that would be scrutinised under Article 101(1) is selective distribution systems, where the number of distributors/retailers through which a particular product is sold is restricted by the supplier, and which therefore necessarily limits the extent of intra-brand competition to some extent. However, because there can be efficiency benefits from such restrictions, selective distribution systems are not illegal per se. Rather, they need to assessed on a case-by-case basis.

The Commission Regulation No 330/2010, or VBER (Articles 2 and 3), provides conditions for exemption from Article 101 where there is sufficient certainty that the agreements satisfy the conditions of Article 101(3). The VBER also lists vertical agreements that are considered 'hardcore' infringements and thereby do not benefit from the VBER.

The need for change

The growth of ecommerce and online platforms has fundamentally changed the traditional competitive dynamics among manufacturers, retailers and distributors. As discussed in the Commission's ecommerce inquiry report,[8] and a qualitative survey-based study commissioned by the UK Competition and Markets Authority (CMA),[9] the rise of ecommerce and online platforms has reduced search costs for consumers, increased transparency, and made monitoring of rivals' prices easier for suppliers. This has both intensified competition and led to a 'market expansion effect' by allowing businesses to reach a wider set of customers (often through online platform intermediaries).

While these developments have increased opportunities for all businesses, there have also been new challenges. In particular, faced with a loss of control in product distribution, there has been increased use of certain business practices such as online platform bans or most-favoured-nation (MFN) clauses.[10]

Many of these practices are not discussed in the VBER, and experts agree that there is a clear need to update it to explicitly consider these agreements. In addition, there is a need to revise the existing guidance in order to provide more legal certainty in light of the above developments.

Agency agreements

Agency agreements can be exempt from Article 101(1) under the current VBER. These are agreements between two parties, one of which (the agent) incurs no risks and has no influence on the final price paid by consumers.

More clarity on the assessment of agency agreements would be a key area for any revision of the VBER and VGL. For example, this would be important for intermediary platforms such as comparison websites and meta-sites. These sites primarily aim to increase transparency for consumers and decrease search costs, and do not necessarily engage in re-selling the product/service in question. While they invest in their brand and potentially ancillary services, and may also be 're-selling' in a technical sense, the level and/or type of risk borne by these online platforms is very different from that of traditional 'bricks and mortar' distributors. As such, more clarity would be needed on when an intermediary online platform might qualify as an 'agent'.

This is important from a market efficiency perspective given that, in order to have more control, many manufacturers are changing their distribution strategy away from agency arrangements and towards direct distribution to consumers. This is supported by the ecommerce sector inquiry and the CMA study (where respondents noted that the development is due to scrutiny around agency agreements and the legal uncertainty). However, from an economics perspective, a move to such a business model does not exploit the economies of scale and density that large online retailers and platforms may have, and could therefore be inefficient. More clarity around agency arrangements was also requested by other respondents as a key aspect of new regulations.

Resale price maintenance

Currently, RPM is considered a hardcore infringement that does not benefit from the VBER (Article 4).

However, as is well established in the economics literature, RPM can be beneficial to efficiency and market functioning (for example, in helping to prevent free-riding and encouraging sales efforts by retailers, or signalling the quality of a good), particularly if there is sufficient 'inter-brand' competition.[11] Similar benefits can arise from recommended retail prices (RRP), as acknowledged in the VGL—and in fact, RRPs benefit from the VBER given their potential benefits. An economic approach would therefore be to assess RPM and RRP cases similarly based on their effects—in terms of both the degree of harm to competition and the potential efficiencies.

While historically there might have been policy reasons for treating RPM in this way, it is important to consider whether a more lenient approach to RPM is warranted in the digital era, in order to reduce the risk of over-intervention in cases where such practices have limited negative effects and/or are beneficial to consumers. For example, the low search costs and high transparency of online prices across different brands are likely to have increased inter-brand competition in many markets. In this context, the reduction in intra-brand competition due to RPM may not have negative effects. The online purchasing environment may also support the use of RPM for certain products due to potential uncertainties around the quality of the product, where the price may act as a quality signal.

Overall, this area would benefit from further consideration, including further guidance on when an RRP and RPM can be exempt due to efficiencies.

Online sales restrictions and selective distribution

Another key area where revision of the framework would be necessary is with regard to online sales restrictions. The current guidance on this is driven largely by the importance of online sales as a key route to market and the potential effect on consumers of a restriction of passive sales. While this was an important policy concern a decade ago, the enormous growth of ecommerce now raises concerns about its detrimental impact on bricks and mortar stores and on consumers. Various reports highlight the potential value of preserving physical stores, and hence potential justifications for online sales restrictions (such as ensuring quality of service and safety of consumers, preventing free-riding, managing stock, and ensuring access).[12]

In accepting the potential justifications for a ban on authorised retailers re-selling through an online marketplace, the Court of Justice of the European Union (CJEU) provides some guidance on this practice in *Coty*, at least for luxury products.[13] However, *Coty* leaves many questions unanswered. For example, are similar justifications for other types of product likely to be accepted? What is the threshold of the technical characteristics or brand image of a product below which such bans will not be justifiable? Other questions, such as those around the competitive impact of the qualitative criteria in a selective distribution system, also warrant further guidance. For example, is there a need to assess the (qualitative) selection criteria on a case-by-case basis as well as with reference to consumer behaviour in the specific market?

Most-favoured-nation clauses

MFN agreements between intermediary platforms and suppliers have become commonplace in the last decade. However, this area is not covered by the current framework.

The importance of detailed guidance on MFN clauses is demonstrated by the significant differences in the decisions adopted by various national competition authorities (NCAs) over the last five years. For example, in the online hotel booking sector, while some NCAs have found narrow MFNs (those that limit price reductions only by the supplier and not at other retailers/platforms) to be anticompetitive, others have allowed these. In addition, ex post assessments carried out by the Commission and a number of NCAs after the online hotel booking cases were heard revealed little evidence that commission rates actually changed after the removal of wide MFN clauses across Europe.[14] This calls into

question the numerous interventions or, at the very least, the lack of a harmonised approach in this area.

Following this case, some policymakers have suggested that wide MFNs (those that apply across a number of channels) should be considered 'by object' restrictions. It is important that the revisions of the VBER and VGL provide clarity on this point as, from an economics perspective, this approach increases the risks of over-intervention. As shown in the economics literature, MFN clauses can bring a number of benefits to consumers, much like many other vertical agreements can do (an important one is reducing free-riding and incentivising investment by platforms; another is incentivising consumer engagement and switching). While wide MFNs could ultimately be found to be anticompetitive in some markets, relying on a comprehensive analysis of the effects on the market to arrive at this conclusion is likely to ensure a more harmonised approach across cases and jurisdictions.

The need for balance

Notwithstanding the above gaps, the existing VBER and VGL have added considerable value to market functioning in the EU for nearly a decade, as is evident from the responses to the Commission's consultation. A revised framework that provides more clarity and is well adapted to the age of ecommerce would ensure that it continues to do so in the near future.

An overarching aspect that the revised framework would need to tackle through its guidance on specific practices is ensuring a balance between the bargaining powers of the manufacturer, the retailer and any intermediary platform, and not distorting the dynamism of online markets with their continually changing business models and strategies. For example, while it is important to ensure that inter-brand competition is sufficient and consumer access is not limited, excessive constraints on the manufacturer's strategies and the strong bargaining power of platforms (or vice versa) could in the longer run distort inter-brand competition in some markets. A key part of this balance is therefore determining what weights to attach to the short-term effects of vertical restraints (for example, on price and quality of service) and their long-term effects (such as new business models, better products or service, and a wide range of access through various online and offline distribution channels). This is critical for ensuring that all aspects of consumer welfare are taken into account.

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[1] European Commission (2010), 'Regulation (EU) No 330/2010 of 20 April 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', https://bit.ly/2TZaf9t.

[2] European Commission (2010), 'Commission notice: Guidelines on Vertical Restraints', SEC(2010) 411, https://bit.ly/2zd7qrQ.

[3] For example, see Winter, R. (1993), 'Vertical control and price versus non-price competition', *Quarterly Journal of Economics*, **108**:1, pp. 61–76; and Marvel, H. and McCafferty, S. (1985), 'The welfare effects of resale price maintenance', *Journal of Law and Economics*, **28**, pp. 363–379. For a fuller discussion, see Oxera (2016), 'Vertical restraints: new evidence from a business survey', prepared for the Competition and Markets Authority by Oxera Consulting LLP and Accent, March, https://bit.ly/2ziYNfq, section 4.

[4] European Commission (2017), 'Antitrust Sector inquiry into e-commerce', https://bit.ly/2TZQvm7.

[5] European Commission (2019), 'EU competition rules on vertical agreements – evaluation', public consultation, 4 February–28 May, https://bit.ly/2HUCxQ9.

[6] European Commission (2019), 'EU competition rules on vertical agreements – evaluation', public consultation, 4 February–28 May, https://bit.ly/2HUCxQ9.

[7] European Commission (2019), 'Factual summary of the contributions received in the context of the open public consultation on the evaluation of the Vertical Block Exemption Regulation (EU) No 330/2010', 30 July, https://bit.ly/2HlyUjA.

[8] European Commission (2017), 'Report from the Commission to the Council and the European Parliament: final report on the E-commerce Sector Inquiry', COM(2017) 229 final, 10 May, https://bit.ly/2U1a11I.

[9] Oxera (2016), 'Vertical restraints: new evidence from a business survey', prepared for the Competition and Markets Authority by Oxera Consulting LLP and Accent, March, https://bit.ly/2ziYNfq.

[10] For example, see Oxera (2017), 'Parity agreements and theories of harm in the hotel booking sector: a "no-show"?', *Agenda*, June, https://bit.ly/30yR1tW.

[11] Inter-brand competition refers to the competition between different brands or manufacturers of products. This is different from intra-brand competition, which refers to the competition between different retailers of the same product/brand.

[12] See Oxera (2016), 'Vertical restraints: new evidence from a business survey', prepared for the Competition and Markets Authority by Oxera Consulting LLP and Accent, March, section 5. Also see the Commission's ecommerce inquiry report: European Commission (2017), 'Report from the Commission to the Council and the European Parliament: final report on the E-commerce Sector Inquiry', COM(2017) 229 final, 10 May, https://bit.ly/2U1a11I.

[13] Judgment of the Court (First Chamber) (2017), Case C230-16, *Coty Germany GmbH v Parfümerie Akzente GmbH*, December.

[14] See European Commission (2016), 'Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities in 2016', https://bit.ly/2ZcgvR8.