Distribution Law Center
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COUNTDOWN | 29 March 2022

Distribution Law Center Countdown XV - Dual distribution (Extension of exception to wholesalers and importers)

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 extension of the dual distribution exception to wholesalers and importers. Countdown no. 16 will focus on the specific market share threshold for dual distribution that was introduced in the draft texts published in July 2021. Finally, countdowns no. 17 and 18 will elaborate on information exchange in the context of dual distribution.

Now?

The current Vertical Block Exemption Regulation (the “VBER”) applies to vertical agreements, which are agreements or concerted practices entered into between two or more undertakings which operate, for the purposes of the agreement or concerted practice, at a different level of the production or distribution chain (Article 1(a) VBER).

Consequently, Article 2(4) VBER stipulates that the block exemption does not apply to vertical agreements entered into between competing undertakings. However, an exception is made for dual distribution *“where competing undertakings enter into a non-reciprocal vertical agreement and*

a. *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*
b. *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.*

Thus, under the current regime, the exception does not apply to all forms of dual distribution. The exception of Article 2(4)(a) VBER only applies to situations where the supplier is both a manufacturer and a distributor of goods. Consequently, importers and wholesalers who are not manufacturers cannot benefit from the block exemption when they compete with their independent distributors on the downstream market.

Smaller market players in particular are disadvantaged by this rule. Vertical integration is easier to achieve for market players with greater financial resources. Smaller manufacturers, on the other hand, will be more inclined to use independent importers and wholesalers in order to spread their financial risk. This leads in practice to the unequal treatment of similar vertical agreements. Within the same distribution network, the VBER will apply to some vertical agreements and not to others, even if these agreements contain the same contractual conditions.

Let's make this practical with an example. Suppose a Finnish car manufacturer wants to distribute its models in the Netherlands and Spain. In Spain, the manufacturer has a subsidiary (importer A) which will import the cars. In the Netherlands, on the other hand, the manufacturer will use an independent importer (importer B). Importers A and B have each set up a selective distribution network. If both importers A and B are also active at the retail level (for instance because they sell directly to larger end-customers or have some dealerships of their own), only the selective distribution network of importer A (because it is an economic unit with the manufacturer) will benefit from the block exemption. The same distribution agreements of importer B, on the other hand, are not covered. On the other hand, if importer B would refrain from direct selling (which paradoxically restricts supply and competition), its selective distribution agreements would be covered by the block exemption.

The future as of 1 June 2022?

Because of the above-mentioned problems, the draft VBER now stipulates in Article 2(4)(a) that the exemption applies to non-reciprocal vertical agreements between competing undertakings where the supplier is a manufacturer, wholesaler, or importer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing, wholesale or import level. Thus, the exception that the VBER does not apply to vertical agreements entered into by competing undertakings is extended to wholesalers and importers.

In practice?

Since the buyer must not be a competing undertaking at the production, wholesale or import level, the parties are only allowed to compete at the retail level. As a consequence, a manufacturer which is also an integrated importer/wholesaler and which, for example, appoints an independent importer/wholesaler in another country, cannot benefit from the exemption for that appointment. On the other hand, the distribution agreements between the independent importer/wholesaler and the independent dealers with whom the wholesaler competes would be covered.

Assessment?

The European Commission has addressed the request of stakeholders to extend the scope of the exception Article 2(4)(a) VBER to importers and wholesalers (for their downstream agreements). This extension is definitely an applaudable change which, to a certain extent, reduces the unequal treatment of similar vertical agreements, but it becomes clear in the above example that the European Commission has not provided a conclusive solution. Still not all vertical agreements within the same distribution network will be able to benefit from the legal certainty of the block exemption.

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, Romanian, Slovak, Swedish.

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