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# UPDATE

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## EU'S NEW TAKE ON DUAL DISTRIBUTION – LESSONS FOR INDIAN ENTERPRISES

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***Introduction***

In May 2022, the European Commission (EC) adopted the new Vertical Block Exemption Regulation (New VBER) and Vertical Guidelines which were implemented from 1 June 2022.

Agreements between firms operating at different levels of the supply chain are referred to as "vertical agreements". Competition regulators across the world typically penalise vertical agreements only if they cause an adverse effect on the state of competition in the market.

The EC allows certain vertical agreements to escape competitive scrutiny by providing them safe harbour under the previous Vertical Block Exemption Regulations (VBER), which expired on 31 May 2022. Typically, the VBER allowed vertical agreements to avoid competitive scrutiny when the parties to an agreement individually had a market share of less than 30%.

While the earlier provisions of the VBER have largely been retained, one of the key changes in the New VBER pertains to "dual distribution". This article provides a brief background regarding this change and attempts to identify the possible impact of this change on the Indian market.

***What is Dual Distribution?***

Dual distribution refers to situations where a manufacturer / supplier (Upstream Player) sells its goods or services to end customers both – directly, and indirectly through its distributors / resellers (Downstream Player).

Pertinently, dual distribution arrangements entail a vertical agreement between an Upstream Player and a Downstream Player, both of whom also act as competitors in the downstream market.

***What are vertical agreements with respect to Dual Distribution?***

In dual distribution arrangements, the Upstream Player has vertical supply agreement(s) with the Downstream Player(s). These agreements often allow for exchange of information relating to prices (including final resale prices), end-customer details, technical information, customer behaviour, demand patterns, etc. Such exchanges are relevant in improving the quality of supply and distribution. If the Upstream Player is engaged in dual distribution, the aforesaid agreements qualify as "vertical agreements with respect to dual distribution".

In a dual distribution situation, the exchange of the said information can lead to collusion or softening of competition between the Upstream Player and the Downstream Player in the downstream market. This can be done through the limiting supply of products / services, geographical / customer allocation, foreclosure, denial of market access, etc., considering that both the entities are essentially competitors from an end customer's point of view.

Simply put, where the Upstream Player is engaged in dual distribution, information exchange under vertical agreements can cause competitive concerns in the downstream / retail market.

### *What does the New VBER say about Dual Distribution?*

Agreements associated with dual distribution were mostly seen as kosher under the VBER. However, as direct sales (particularly website-based sales by manufacturers themselves) have picked up pace post 2020, dual distribution has become a contentious issue.

Originally, the draft New VBER proposed that a safe harbour would only be available for vertical agreements with respect to dual distribution where the combined market share of the parties is below 10%. Such a narrow threshold effectively took away the benefit of VBER from most dual distribution players.

However, after deliberation with relevant stakeholders, this threshold was done away with, and under Article 2(6) of the New VBER, safe harbours for information exchange in dual distribution situations were provided as long as the individual market shares of the Upstream Player and the Downstream Player are below 30%. Pertinently, this is the general threshold for all types of vertical agreements which benefit from VBER.

Curiously, the safe harbour for dual distribution under New VBER is made subject to additional qualifications. As such, the safe harbour remained inapplicable if the exchange of information, (i) is not directly related to implementation of the vertical agreement, or (ii) is not necessary "*to improve the production or distribution of the contract goods or services*".

As non-exhaustive examples, the EC clarified that the exchange of technical information, information regarding customer preferences and feedback (on an aggregated basis), etc. are likely to be non-problematic; while the exchange of information relating to actual / future prices, granular customer level information, etc. is problematic and thus outside the scope of the New VBER.

### *How does this change impact the Indian market?*

The EC's original position in narrowing the scope of VBER (by way of a 10% threshold), and the updated position by adding qualifications to the 30% market share threshold, clearly signal that the EC perceives that dual distribution could cause adverse effect on competition. Therefore, it is unwilling to give such agreements blanket protection from regulatory actions.

While the VBER has no application in India and the amendment has no direct impact on vertical agreements in India, the regulatory shift of the EC's perspective can have a significant impact on Indian firms engaging in dual distribution.

As a matter of practice, the Competition Commission of India (CCI) tends to follow experienced competition law jurisdictions such as the EC in its enforcement strategies and trends. In the past, the CCI has clearly taken inspiration from the EC in pursuing enforcement actions in sectors such as cement, steel, e-commerce, etc. The CCI has also aligned itself with the EC by initiating multiple enforcement proceedings against enterprises which are similar to cases agitated in the EC in both, fact and scope.

Given the above, it is highly possible that the CCI will adopt its enforcement strategies going forward to inquire into / take actions against entities engaged in dual distribution in India. Considering that dual distribution is seeing an uptick through established brands and the rise of "next-generation consumer goods companies", enterprises will need to engage in diligent sanitary checks / exercises to ensure that their existing practices don't fall foul of the Competition Act, 2002.

Considering that Indian competition law does not provide any market share based safe harbours for vertical agreements, entities engaged in dual distribution must safeguard themselves against risks of possible enforcement action by:

- getting vertical supply / purchase agreements vetted from a competition law standpoint to ensure that problematic information is not exchanged;

- establishing firewalls / clean team protocols / firewalls to ensure that the information received by an Upstream Player (in the capacity of a supplier) does not lead to anticompetitive behaviour in the downstream market; and

- updating existing agreements / arrangements to ensure their compliance with principles of competition law.

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