



Department for
Business, Energy
& Industrial Strategy

Draft Vertical Agreements Block Exemption Order

Government Response to Consultation

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Executive summary

Introduction

- 0.1. The Vertical Agreements Block Exemption Order (VABEO) will give effect to the recommendation¹ by the Competition and Markets Authority (CMA) that certain vertical agreements should be exempted from the competition law prohibition of agreements between firms that prevent, restrict or distort competition. The VABEO will ensure that businesses are not prevented or disincentivised from entering into agreements that the CMA considers to be overall beneficial and not anticompetitive.
- 0.2. The VABEO replaces a similar block exemption, the retained Vertical Agreements Block Exemption Regulation (retained VABER)², which was made under EU law and retained in UK law after the UK's withdrawal from the EU. The retained VABER expires on 31 May 2022.

Technical consultation

- 0.3. The Department for Business, Energy and Industrial Strategy (BEIS) launched a technical consultation on the legal drafting of the Order in February 2022.³ This consultation ran from 21 February to 16 March 2022 and sought views on the draft VABEO to make sure it delivers the policy correctly and effectively. BEIS expresses its appreciation for the 16 responses received. A list of all respondents can be found at Annex A.
- 0.4. Respondents welcomed the introduction of the VABEO and the opportunity to provide comments on its draft. While generally content that the VABEO achieved the intended outcome, certain improvements to the technical drafting were proposed. Having carefully considered all returns, this response outlines the technical issues raised by respondents and how BEIS intends to proceed. It does not discuss in detail matters raised by some respondents that will be addressed in accompanying CMA guidance.
- 0.5. This response does not comment on issues of policy addressed by the CMA's recommendation which has been accepted in full by the Secretary of State. For example, several respondents commented on the appropriate treatment under the VABEO of parity obligations, dual pricing, exclusive and selection distribution systems and non-compete obligations. The CMA considered these matters in detail, including during the consultation on its recommendation to the Secretary of State.

Next steps

- 0.6. Following this consultation, BEIS is proceeding with *The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022*.

¹ <https://www.gov.uk/government/consultations/retained-vertical-block-exemption-regulation>

² <https://www.legislation.gov.uk/eur/2010/330>

³ <https://www.gov.uk/government/consultations/draft-vertical-agreements-block-exemption-order>

Citation and commencement (Article 1) and Interpretation (Article 2)

Categorisation of providers of online intermediation services (OIS) as 'suppliers'

- 1.1. Respondents⁴ suggested that the VABEO's definition of 'supplier' indicates that providers of OIS (e.g., online travel agents) would exclusively be considered suppliers and cease to be categorised as buyers even where they act as a buyer. They argued that this should be addressed by an amendment to the definition of 'buyer'. This would clarify that a supplier of OIS to a particular undertaking shall not cease to be a buyer in relation to such an undertaking in so far as it purchases goods or services from such an undertaking or sells goods or services on behalf of such an undertaking.
- 1.2. BEIS does not consider that such a clarification is necessary. The existing definitions of 'supplier' and 'online intermediation services' make it clear that an undertaking is only a 'supplier' for the purposes of providing OIS (defined as services that facilitate direct transactions between others). If the undertaking providing OIS also purchases goods or services to supply itself, then it would be treated as a 'buyer' in that context. The CMA will provide further clarity on this issue in its VABEO guidance.⁵

Definition of 'end user'

- 1.3. One respondent⁶ suggested adding a definition of 'end user' into the VABEO. The respondent considered that, while an accepted definition exists in the Motor Vehicle guidelines⁷, for increased legal certainty it would be preferable for it to also be included in the VABEO. The proposed definition would clarify that 'end user' includes leasing companies and consumers who purchase through an intermediary.
- 1.4. 'End user' is not defined in the retained VABER and the CMA did not recommend that it should be defined in the VABEO. As the request originates from within the motor vehicle sector and was not raised by respondents from other sectors, BEIS does not consider it necessary to add such a definition into the VABEO itself. However, BEIS does recognise the value of increased clarity and the CMA will seek to provide this through guidance.

Definition of 'know-how'

- 1.5. One respondent⁸ suggested that the definition of 'know-how' may create uncertainty as it would be subjective as to whether a franchisor's know-how (usually contained in the franchisor's operations manual) is secret, substantial and identified. BEIS considers the existing definition to be sufficiently clear.

⁴ EU Travel Tech; Joint Working Party of the Bars and Law Societies of the United Kingdom

⁵ As requested by the International Air Transport Association

⁶ British Vehicle Rental and Leasing Association

⁷ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52010XC0528%2801%29>, paragraphs 51-52

⁸ British Franchise Association

1.6. The definition of ‘know-how’ has been moved, unamended, from Article 3 to Article 2.

Block Exemption (Article 3), Calculation of annual turnover (Article 4) and Block exemption subject to conditions and obligation (Article 5)

Specification of agreements

1.7. Two respondents⁹ suggested that it should be made clearer that agreements specified under the VABEO for the purposes of section 6 of the Competition Act 1998 are exempt from the Chapter 1 prohibition of that Act. BEIS has adopted this suggestion through the addition of a footnote in Article 3(1) of the VABEO.

Rent and lease agreements

1.8. One respondent¹⁰ noted that an express exclusion of rent and lease agreements in the VABEO would provide greater legal certainty, rather than relying on guidance. Article 3(6)(b) now provides this clarification.

Definition of ‘potential competitor’

1.9. A number of respondents¹¹ asked for the definition of ‘potential competitor’ to retain the wording ‘on realistic grounds and not just as a mere theoretical possibility’ to make it clear that the prospect of entry into the relevant market must be more than merely hypothetical. The definition has been amended accordingly.

Annual turnover

1.10. One respondent¹² noted that the reference to 110 per cent in the provision on the calculation of annual turnover was confusing. BEIS has amended Article 4(2) to clarify that the block exemption remains applicable where, for any period of two consecutive financial years, the total annual turnover does not exceed the total annual turnover threshold by more than 10%.

Market share threshold (Article 6) and Rules for applying market share thresholds (Article 7)

Market share threshold

⁹ Euclid Law; Linklaters LLP

¹⁰ British Vehicle Rental and Leasing Association

¹¹ Eversheds Sutherland (International) LLP; Linklaters LLP; Joint Working Party of the Bars and Law Societies of the United Kingdom

¹² Linklaters LLP

- 1.11. One respondent¹³ argued that the inclusion of an additional market share threshold for agreements entered into by parties whose market share subsequently exceed 35% was an unnecessary divergence from current practice.
- 1.12. The proposed market share threshold provisions are in line with the retained VABER and have been retained unamended. BEIS does not consider there to be a need to divert from the current rules.

Sales to vertically integrated distributors

- 1.13. One respondent¹⁴ suggested clarifying that the inclusion of sales to vertically integrated distributors in the calculation of market shares applies across the market. The suggested amendment has been made.

Hardcore restrictions (Article 8) and Effect of breach of conditions in article 6 or 8 (Article 9)

Cancellation

- 1.14. One respondent¹⁵ suggested that the drafting of the provision on hardcore restrictions is somewhat unclear and unnecessarily departs from the way this has been described in the retained VABER. The provision states that their inclusion has the effect of ‘cancelling’ the block exemption for that agreement.
- 1.15. The effect of the breach of a condition set in a block exemption Order is based on section 6(6) of the Competition Act 1998. This determines that a block exemption is ‘cancelled’ in such an instance, wording which has to be reflected in the drafting of the Order.

Effect of including a hardcore restriction

- 1.16. One respondent¹⁶ also noted that the drafting of Article 8(1) was confusing and potentially misleading. The respondent felt that ‘A vertical agreement must not contain a hardcore restriction’ could be misinterpreted as amounting to an independent prohibition. Instead, the provision should state that including a hardcore restriction in an agreement would lead to the exemption not applying to the agreement, or to the agreement being removed from the benefit of the block exemption.
- 1.17. BEIS agrees that the wording of the relevant provision could be improved. Article 8(1) has been amended to remove the wording ‘must not contain a hardcore restriction’ and instead now applies the block exemption on condition that it does not contain a hardcore restriction.

Rules for types of distribution systems

¹³ Freshfields Bruckhaus Deringer LLP

¹⁴ Joint Working Party of the Bars and Law Societies of the United Kingdom

¹⁵ Linklaters LLP

¹⁶ Euclid Law

1.18. Respondents¹⁷ advocated consolidating and restructuring the provisions on exclusive, selective and free distribution systems to clearly and separately articulate the rules to provide increased clarity. BEIS has amended Article 8(2) and (3) accordingly. This also addresses further points of clarification raised by several respondents.¹⁸

Passing-on of exclusive and selective distribution restrictions

1.19. Respondents¹⁹ suggested clarifying that the exclusive and selective distribution restrictions can be passed on to the next level of buyers. This would provide more flexibility for suppliers and help preserve the essence of these distribution systems by enabling suppliers to incentivise and protect their distributors' investments in the distribution networks. The proposed amendment has been made in Article 8(3)(a).

Reference to wholesalers

1.20. One respondent²⁰ asked for the addition of a reference to 'wholesalers' to clarify the position of independent wholesalers with regards to territorial or customer restrictions. BEIS has added such a reference in Article 8(2)(e).

Digital comparison tools

1.21. The reference to 'price comparison tools' has been amended to 'digital comparison tools' and a definition added.

Definition of 'active sales'

1.22. One respondent²¹ proposed clarifying that the definition of 'active sales' is a non-cumulative list. Article 8(7) has been amended accordingly.

Definition of 'exclusive distribution'

1.23. One respondent²² noted that the definition of 'exclusive distribution' should consistently refer to both 'geographical area' and 'customer group'. BEIS has adopted this suggestion in Article 8(7).

Definition of 'passive sales'

1.24. Respondents²³ suggested that the definition of 'passive sales' was confusing. BEIS has amended to clarify that general advertising or promotion that reaches customers in other distributors' geographical areas or customer groups can be considered passive selling if it is a reasonable way to reach customers not in those other distributors' geographical areas or customer groups.

¹⁷ Linklaters LLP; Freshfields Bruckhaus Deringer LLP

¹⁸ Eversheds Sutherland (International) LLP; Linklaters LLP; Joint Working Party of the Bars and Law Societies of the United Kingdom; Walpole

¹⁹ Linklaters LLP; Freshfields Bruckhaus Deringer LLP

²⁰ Linklaters LLP

²¹ Walpole

²² Linklaters LLP

²³ Eversheds Sutherland (International) LLP; Joint Working Party of the Bars and Law Societies of the United Kingdom

Excluded restrictions (Article 10) and Effect of breach of condition in article 10 (Article 11)

Cancellation

- 1.25. One respondent²⁴ suggested that the provision on excluded restrictions is somewhat unclear and unnecessarily departs from the way this has been described in the retained VABER. The provision states that their inclusion has the effect of cancelling the block exemption for that restriction.
- 1.26. As noted above, the effect of the breach of a condition set in a block exemption Order is based on section 6(6) of the Competition Act 1998. This determines that a block exemption is 'cancelled' in such an instance, wording which has to be reflected in the drafting of the VABEO.

Effect of including an excluded restriction

- 1.27. A number of respondents²⁵ suggested that the drafting of Articles 10(1) and 11 was confusing and potentially misleading. They noted that the effect of containing an excluded restriction in an agreement is not to remove the agreement itself from the block exemption's safe harbour but, if severable, to remove only the offending restriction.
- 1.28. BEIS agrees that the wording of the relevant provisions could be improved and has amended to clarify. Article 10(1) has been amended to remove the wording 'must not contain an excluded restriction' and instead applies the block exemption on condition that it does not do so. Article 11 then sets out that including an excluded restriction in an agreement has the effect of cancelling the block exemption only if it is not severable from the agreement. If it is severable, the block exemption is cancelled in respect of that excluded restriction only.

Hardcore vs. excluded restrictions

- 1.29. One respondent²⁶ further suggested amending the Explanatory Memorandum to distinguish more clearly between hardcore and excluded restrictions. Paragraphs 7.14 and 7.16 have been amended accordingly.

Post term non competes

- 1.30. One respondent²⁷ suggested that the provision allowing post term non competes that meet certain conditions should be amended to clarify that services offered from vehicles (rather than from premises or land) are also covered. BEIS has amended accordingly.

²⁴ Linklaters LLP

²⁵ Euclid Law; Linklaters LLP; Eversheds Sutherland (International) LLP; Joint Working Party of the Bars and Law Societies of the United Kingdom

²⁶ In-House Competition Lawyers' Association UK

²⁷ British Franchise Association

Obligation to provide information (Article 12), Cancellation in individual cases (Article 13) and Notices in writing (Article 14)

Deadline for information requests

- 1.31. A number of respondents²⁸ challenged the 10-day deadline for responding to information requests from the CMA. A range of amendments to Article 12 were suggested, including extending the deadline or providing the CMA with discretion to extend this time period for more extensive information requests.
- 1.32. BEIS considers that 10 days should ordinarily provide sufficient time to respond to information requests. However, BEIS acknowledges this might not always be the case. The VABEO will therefore provide the CMA with the ability to agree a longer deadline, having regard to the particular circumstances of the case. The CMA will also set out in guidance how it will request information and ensure that parties are given sufficient time to respond (including through engagement in advance of a formal information request).
- 1.33. Finally, it should also be noted that the potential sanction for failing to comply with an information request (cancellation of the block exemption for the relevant agreement) requires the absence of a reasonable excuse.

Cancellation

- 1.34. Respondents²⁹ expressed concern about the CMA's ability to cancel the block exemption in respect of a particular agreement it considers does not meet the criteria for exemption and requested further guidance. One respondent³⁰ also suggested that the CMA should not be able to cancel the block exemption for failure to comply with an information request.
- 1.35. The power to cancel the block exemption in individual cases is based on section 6(6)(c) of the Competition Act 1998. This power is necessary to ensure that the 'safe harbour' provided by the block exemption is only available for those agreements that satisfy the conditions for exemption. The CMA has noted that this provision is likely only to be used in exceptional circumstances and will provide further clarifying guidance on how it would use this power.

²⁸ Amazon; Association of British Insurers; Eversheds Sutherland (International) LLP; In-house Competition Lawyers' Association; Linklaters LLP; Freshfields Bruckhaus Deringer LLP; Joint Working Party of the Bars and Law Societies of the United Kingdom

²⁹ Association of British Insurers; In-House Competition Lawyers' Association UK

³⁰ Euclid Law

Transitional provision (Article 15) and Expiry (Article 16)

Duration

- 1.36. One respondent³¹ suggested that the proposed expiry of the VABEO after six years would not provide sufficient certainty for longer term investments and planning, whereas a 12-year term would provide certainty and greater confidence to business to invest. Other respondents disagreed, noting that the shorter duration would allow for a further review in the not-too-distant future to adjust and reflect the characteristics of the UK market.³²
- 1.37. BEIS agrees with the CMA's recommendation for an expiry date after six years. This will allow the CMA to conduct a further review and take into account ongoing market developments, including the growth in online sales, the UK's withdrawal from the EU and the impact of the COVID-19 pandemic.

³¹ British Beer & Pub Association

³² Amazon, Eversheds Sutherland (International) LLP, Linklaters LLP

Annex A: List of respondents

1. Association of British Insurers
2. Amazon
3. Brands for Europe
4. British Beer & Pub Association
5. British Franchise Association
6. British Vehicle Rental and Leasing Association
7. Dentons UK and Middle East LLP
8. Euclid Law
9. eu Travel Tech
10. Eversheds Sutherland (International) LLP
11. Freshfields Bruckhaus Deringer LLP
12. In-House Competition Lawyers' Association UK
13. International Air Transport Association
14. Joint Working Party of the Bars and Law Societies of the United Kingdom
15. Linklaters LLP
16. Walpole

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