

Retained Vertical Agreements Block Exemption Regulation Consultation

ICLA UK Response

22 July 2021

CMA's proposed recommendation

Introduction

The In-House Competition Lawyers' Association UK ("ICLA UK") is an informal association of in-house competition lawyers in the UK comprising around 100 members. ICLA UK meets usually twice a year to discuss matters of common interest, as well as to share competition law knowledge. ICLA UK does not represent companies but rather is made up of individuals who are experts in competition law. As such this paper represents the views of the ICLA UK members and not the companies who employ them, and it does not necessarily represent the views of all its members.

ICLA UK is part of the wider In-house Competition Lawyers' Association of in-house competition lawyers across Europe and in South East Asia which currently numbers more than 450 members based in different countries around the globe.

Because of their role, in-house competition lawyers have a clear interest in a simple and straightforward competition law regime that prioritises legal certainty, minimises costs, and does not represent a disproportionate demand on businesses' time and resources.

ICLA UK is grateful for the opportunity to provide feedback on the CMA's consultation on its proposed recommendation that the Secretary of State replaces the retained Vertical Agreements Block Exemption Regulation ("retained VABER") when it expires on 31 May 2022 with a UK Vertical Agreements Block Exemption Order ("UK VABEO"), tailored to the needs of businesses operating in the UK and UK consumers, and updating the arrangements to take account of market developments.

ICLA UK's response to the CMA's consultation is set out below. ICLA UK has not sought to respond on every aspect, but rather on the issues most relevant to its members.

Policy and impact questions

Question 1: Do you agree with the CMA's proposed recommendation to the Secretary of State to make a Block Exemption Order to replace the retained VABER with a new UK VABEO, rather than letting it lapse without replacement or renewing without varying the retained VABER?

1.1 Yes

Question 2: Please explain your response providing, where possible, examples and evidence to support your answer.

2.1 ICLA UK supports the continuation of a block exemption in this area as it is a relevant and useful tool for business in creating more certainty around what vertical arrangements are acceptable, thus minimising the need for multiple individual assessments and increasing efficiency.

Question 3: How will the proposed UK VABEO as outlined in the CMA's proposed recommendation impact consumers?

a) Significant positive impact YES

Dual distribution

Policy questions

Question 9: What are your views on the CMA's proposed recommendation on dual distribution?

- 9.1 ICLA UK agrees with the CMA's recommendation to retain the exception for dual distribution. Dual distribution is common in many industries. Suppliers typically rely in parallel on different routes to market for their products / services. They may opt for indirect distribution by selling to wholesale distributors (in a two-tier supply chain where the wholesaler resells the products / services to retail dealers) or to retail dealers (in a one-tier supply chain). Moreover, they may also decide to sell their products directly online or via their own brick and mortar stores. The growth of online sales has made it particularly easy for suppliers to sell their products directly through their own online shops. Likewise, the growth of online sales is increasingly blurring the lines between the different levels of the supply chain. Wholesale distributors may also sell directly to end-users through their online stores (in particular with regard to B2B sales, it can be difficult to distinguish whether business customers purchase for resale or for end-use).
- 9.2 These developments mirror changing consumer behaviour, and consumers' expectations today of a seamless omni-channel experience that allows them to switch easily between different sales channels.
- 9.3 Removal of the exception would significantly harm competition, businesses and consumer welfare in the UK. With dual distribution being widespread across different industries, numerous relationships between suppliers and their distributors could not benefit from the safe harbour of the retained VABER absent the exception. If removed, vertical agreements that are normally – and rightfully – exempted under the retained VABER would require an individual assessment, including:
- i. restrictions to sell to unauthorised dealers in selective distribution,
 - ii. legitimate active sales restrictions,
 - iii. restrictions for wholesale distributors to sell directly to end users,
 - iv. non-compete obligations of less than five years, and
 - v. maximum resale price agreements.
- 9.4 Without the exception, many of these agreements could be considered as anti-competitive horizontal agreements between competitors (such as horizontal market/customer sharing or even price fixing).

Lack of horizontal competition concerns raised by the exemption

- 9.5 Firstly, before discussing the harms that removing the exemption would result in, we would like to note that competition between a supplier and its distributors primarily affects intra-brand competition, and that concerns for intra-brand competition should be addressed by the vertical rules. Moreover, competition between a supplier and a distributor is by definition a different nature of competition than between independent distributors, as the supplier owns the brand, designs the products and drives the brand image.
- 9.6 ICLA UK believes that the current rules and threshold remain appropriate also for the dual distribution scenario. The relationship is primarily vertical and should not be assessed in the same way as a relationship between competitors on the same level (such as between manufacturers). Introducing another threshold would add complexity and lead to increased uncertainty and costs for companies.
- 9.7 Further, it should be noted that the relationship does not become “more horizontal” simply because the parties’ market shares are higher. The relationship remains vertical. This should be stressed in any future UK vertical guidelines.

Harm to suppliers and distributors

- 9.8 It is widely accepted that an exchange of commercial information between operators at different levels of a vertical supply chain – i.e., between a supplier and its distributor(s) – is part of a normal business dialogue. It is also recognised that such a business dialogue is generally a source of efficiency. For example, such commercial discussions allow the supplier to benefit from feedback from its distributors on the price positioning of its products, and on consumer demand that are likely to improve the effectiveness of its distribution network. A vertical exchange of information between the supplier and its distributors may also be the only means to create a level playing field for competition between distributors and online platforms which have access to large amounts of data as part of their business model. However, being considered competitors has an impact on what suppliers can do or share with their distributors.
- 9.9 Therefore, if the exception was to be removed, the collection of information that is relevant in the vertical relationship (e.g. retail sales data for better planning and logistics that ensures better availability of products to meet consumer demand and limits over production) could raise horizontal concerns.
- 9.10 This would significantly increase costs and create difficulties for businesses in the vertical supply chain. It would require a self-assessment whenever distributors enter a distribution relationship with a supplier that also engages in direct sales. They would even risk being accused of horizontal collusion with the consequence of severe fines. Confronted with such risks, distributors may be deterred from entering into business relationships with suppliers. Moreover, suppliers that lose flexibility to engage in multiple sales channels may opt for selling directly, particularly via online shops. This may reduce intra-brand competition, stifle investment, lead to less choice and higher prices for consumers as a result.

9.11 Moreover, the removal would significantly increase the burden in particular for small and medium size distributors (such as local brick and mortar stores) that may already be facing significant competitive pressure from suppliers' direct sales, as well as from the activities of large online platforms. This pressure has significantly increased since the beginning of the COVID-19 pandemic, and to remove the exemption could have the effect of hampering economic recovery.

Harm to consumers

9.12 A removal of the exception may also severely harm consumers who nowadays expect a fluid omnichannel experience. The European Commission's Staff Working Document on the evaluation of the EU Vertical Block Exemption Regulation highlights the importance for consumers to switch between multiple different sales channels. However, this presupposes that suppliers enjoy flexibility to use multiple sales channels, including direct and indirect sales. This flexibility would be significantly restricted if the exception for dual distribution was to be removed.

9.13 This lack of flexibility to choose the routes to market would result in increased costs for, and limit competition between, suppliers. Without dual distribution, the original equipment manufacturer cannot maintain the same coverage of different geographic areas and different segments of the customer base with its direct sales. Further, reducing the supplier's flexibility to use multiple distribution channels will also significantly disturb consumers' multichannel experience.

9.14 This will lead to less choice for consumers, who will suffer from reduced inter-brand and intra-brand competition. Moreover, the quality of pre-sales services for consumers may deteriorate if they cannot shop at independent (indirect) brick and mortar stores, based on the supplier's decision to rely solely on direct sales.

Harm to sustainability objectives

9.15 Finally, removing the exception may also have a negative impact on sustainability objectives. Absent the benefit from the safe harbour, vertical agreements between a supplier and distributors on sustainability may potentially raise horizontal concerns. Therefore, suppliers and distributors may refrain from including such objectives in their contracts.

Question 10: Do you think that additional guidance on information exchange in the context of dual distribution would be helpful? If so, please provide your views on what that guidance should say.

10.1 ICLA UK believes it would be useful for the CMA to clarify the assessment of information exchanges that occur in the context of a dual distribution relationship. Current guidelines lack clarity as to whether such information exchanges are ancillary to the vertical relationship and therefore included in the scope of the exception for dual distribution, or if they need to be assessed separately as a horizontal arrangement.

- 10.2 A consistent approach to the treatment of dual distribution across both vertical and horizontal regulations and guidelines is vital for legal certainty. ICLA UK submits that UK VABEO and future UK vertical guidelines ought clearly to recognise that these vertical information flows are generally a source of efficiency and should identify the conditions under which the UK VABEO provides a safe harbour for information exchanges in a dual distribution scenario.
- 10.3 Indeed, the current lack of guidance may deter companies from sharing commercial information with their respective business partners upstream or downstream in the vertical supply chain at all. This may, in turn, cause significant inefficiencies (e.g., overstocking, delay in supplies, etc.), which may ultimately harm the consumer.
- 10.4 ICLA UK therefore invites the CMA to clarify in its guidelines the types of vertical information exchanges that are unproblematic, because they cannot be considered a restriction of competition and fall outside the scope of Chapter 1 of the Competition Act 1998 (for example, information on quantities sold, customer information, quantities on stock and quantities returned by customers, as well as demand forecasts). It would be useful if the CMA detailed what contexts might increase or decrease the risks of such information exchange leading to competition issues, and what additional guardrails and other recommendations the CMA may expect companies to implement internally to minimise risks of competition issues arising in such instances.
- 10.5 Finally, the guidelines ought to clarify the legal test and the standard of proof in order to assess whether an information exchange that originates from a vertical supply relationship constitutes horizontal collusion or not. A test and standard of proof that is not sufficiently clear risks casting a suspicion of illegality on all discussions between a supplier and its distributors relating to their commercial activities, despite the fact that there are legitimate business reasons that justify such exchanges and pro-competitive efficiencies aligned to it.

Impact questions

Question 11: To what extent does the dual distribution exception for non-reciprocal vertical agreements, as outlined in the retained VABER, positively impact your business's operations or the operations of those you represent? Please explain your answer.

a) Completely YES – see answer to Question 10 for explanations.

Question 12: To what extent does the dual distribution exception for non-reciprocal vertical agreements, as outlined in the retained VABER, negatively impact your business's operations or the operations of those you represent? Please explain your answer.

e) Not at all YES – see answer to Question 10 for explanations.

Question 13: What would be the likely impact on your business's operations, or the operations of those you represent, if the dual distribution exception was not included in the UK VABEO at all? Please include examples and where possible, quantitative and/or qualitative evidence in your answer.

- 13.1 In addition to the comments in the response to Question 10 above, removing the exception for dual distribution would have a very negative impact on competition, legal certainty, businesses and consumers. In particular, it would make it very difficult for dealers to enter into a distribution relationship with a manufacturer that also sells directly, because many of the business practices that are fully legitimate and accepted as efficiency enhancing in a vertical context may give rise to competition law concerns if the supplier and its dealers were considered to be competitors.
- 13.2 It may also increase the economic pressure on small and medium dealers, particularly brick and mortar dealers, as suppliers may choose a direct (online) sales model if they lose the flexibility to use multiple direct and indirect routes to market. Competition between a supplier and its distributors is, by definition, of a different nature than competition between independent distributors as the supplier owns the brand, designs the products and drives the brand image. The increased relevance of dual distribution since the adoption of the current retained VABER does not alter the nature of competition. Likewise, it does not make the relationship between a supplier and its distributor "more horizontal". It remains primarily a vertical relationship. This should be clearly recognised in the VABEO and future UK vertical guidelines.

Question 14: Do you consider the CMA's proposed recommendation, which also applies the exception to dual distribution by wholesalers and by importers, to have a positive or negative impact on business operations? Please explain your answer.

a) Significant positive impact YES

- 14.1 ICLA UK agrees that the dual distribution exception should be expanded to include wholesalers. Agreements between a wholesaler, which is also active at the retail level, and its distributor do not raise competition concerns and therefore ICLA UK suggests that this situation should be treated similar to that of a supplier and its distributors.
- 14.2 The growth of online sales is increasingly blurring the lines between different levels of the indirect supply chain. Wholesalers may also sell directly to end-users via their online shops. In particular, in the B2B space, it may be impossible for a wholesaler to distinguish whether its business customers purchase for resale or for end-use.
- 14.3 However, the positive effects of these developments (e.g., increased number of players active on the retail level and enhanced omni-channel experience for end-users and consumers) clearly outweigh any potential residual horizontal concerns. Therefore, the scope of the exception for dual distribution should be extended to wholesalers that are also active on the retail level of trade.
- 14.4 Furthermore, in ICLA UK's view, it is unclear why an independent importer that takes over the role of the supplier to market the products in a particular region and that is also active

downstream should be treated differently from a manufacturer engaging in dual distribution. Thus, the scope of the exception for dual distribution should also be extended to include independent importers that are also active on the retail level.

Efficiencies generated by expanding to include wholesalers and importers

- 14.5 An extension of the scope will have a positive impact on efficiencies as wholesalers, resellers and importers can engage in efficiency-enhancing vertical information exchanges, the benefits of which have been discussed above in relation to suppliers and distributors. The increased efficiencies realised from vertical information exchanges will result in reduced costs for each level of the supply chain that will be passed on to consumers, who will benefit from increased intra-brand competition and more efficient supply chains which will ultimately result in reduced prices and better quality. Moreover, consumers can benefit from a strengthened seamless multichannel experience, the importance of which has been discussed above.
- 14.6 Further, the extension of the scope will create legal certainty and increase flexibility for suppliers and distributors and will therefore incentivise them to invest in the indirect distribution channel. Reduced costs due to increased efficiencies in supply chain will also free-up resources for investment into innovation.
- 14.7 Specifically, as regards importers, an extension of the scope to include importers will enable suppliers to rely on local importers to manage and expand the distribution network. This will positively impact competition. Likewise, an extension will increase legal certainty for businesses (both importers and resellers) that can benefit from the safe harbour of the VABEO.
- 14.8 Lastly, extending the scope of the exception will enable importers, wholesalers and retailers to include sustainability objectives in their contracts without having to fear that these may give rise to horizontal concerns.

Resale Price Maintenance

Policy questions

Question 16: Based on your experience, do you have any examples in practice of circumstances where RPM would lead to efficiencies that outweigh the restriction of competition? If so, please provide these examples.

- 16.1 In addition to the exceptions in the EU Commission's new draft guidelines, RPM may lead to efficiencies including in the following instances:
- i. Manufacturers that are concerned with maintaining a strong brand name and a reputation for quality or durability with end customers, might want to use minimum resale price contracts so that its products are not offered at a discount. When prices are discounted by wholesalers and retailers, the end customer may ultimately purchase the product at a price point that undermines the brand image perception that the manufacturer wants to

project. This can ultimately create repercussions as consumers might associate lower prices with lesser quality. For example, for certain (luxury, exclusive or high end) products high prices are an essential element of the brand image. In addition, the supplier may wish to protect the reputation or image of the product and prevent it from being used by retailers as a loss leader to attract customers. The loss of image and reputation might make it more difficult for the manufacturer to sell at as high prices in the future. This may force the manufacturer to cut costs and thus reduce product quality, which ultimately would be detrimental to consumers.

- ii. Suppliers may also want to ensure that the distribution channel maintains a certain level of investment into the creation of a qualitative and specialised sales environment in order to bring certain products to the market. Distributors that are faced with low-price competition see their margins come under pressure, and might lead them to reduce investments, ultimately to the detriment of the customers who are no longer able to benefit from the professional sales and support environment that some products may require.
- iii. RPM may also be used to prevent free riding by retailers on the efforts of other competing retailers which spend time, money and efforts promoting and explaining the technical complexities or attributes of the product to create a sales environment to attract new customers, or to convey the image of the brand to consumers. For example, a retailer may choose to price its products at a higher price, but in return invest in a highly trained and skilled sales personnel that can properly explain and demonstrate to customers the use of a complex product such as computers or other high-tech equipment. The customer may after acquiring this information choose to buy the computer from a retailer that sells it at a lower price and does not explain or demonstrate its uses. This will cause the initial retailer to rethink its business strategy, ultimately lowering its prices and reducing the skill-level of its trained sales force –to the detriment of the customer.

Similarly, one retailer may invest heavily into creating experiences for its consumers rather than purely focusing on sales. With the world at a consumer's finger tips on their smart phones, such retailers deserve protection against free riding. RPM would therefore lead to increased competition on the merits of other criteria like quality, service, sustainability without being detrimental to competition.

- iv. Efficiencies may also arise in case of so-called 'fulfilment models', where a manufacturer becomes directly involved in the negotiation of the conditions of a business transaction with an end-customer – either upon request of the customer or due to the highly technical nature of the products concerned. Often the negotiation is initiated by way of a tender procedure or a request for quotation to several manufacturers. However, to facilitate the ordering and support process, the supply will run through a distributor which buys the

products from the manufacturer as an independent contractor and resells them to the end-customer. The same situation may arise in a two-tier distribution set-up, where a manufacturer and a reseller rely on a wholesale distributor to “fulfil” a deal. On both scenarios, being able to set resale pricing in these circumstances would ensure that pricing benefits are passed on downstream. Having to leave room for independent margin setting by the distributor may not allow the supplier to be as aggressive in pricing as it could be absent that requirement, in particular where competition occurs at the level of the pricing negotiations with the end-customer and in fierce competition with other manufacturers.

Such a fulfilment model should not be seen as a restriction to competition, because competition has already taken place at the moment of the tender or request for quotation. The fact that both parties (intentionally) rely on an intermediary to fulfil this arrangement does not result in any harmful effect on competition.

The alternative may be for the manufacturer to distribute the products itself to the end-customer in such instances. However, in some industries this may ultimately be unviable for a manufacturer given the possible limitations, such having to invest in distribution capability or technology, additional staff, likely higher costs and lesser support quality for the end-customer, especially if a manufacturer does not customarily operate end-customer distribution compared to a distributor-managed process.

- 16.2 Finally, it should be noted that manufacturers which would like to have more control over their final price could choose not to distribute products through independent distributors but rather to organise the distribution themselves, which ultimately means that no intra-brand competition whatsoever remains. One may argue that this outcome would be less beneficial to consumers.

Question 17: Do you think that additional guidance on when RPM may lead to efficiencies would be helpful? If so, please provide your views on what that guidance should say.

- 17.1 It would be helpful to receive additional guidance in any future UK vertical guidelines, by listing the relevant assessment criteria as well as the precise circumstances under which RPM does not raise competition law concerns, including by way of examples.
- 17.2 Currently, it is not clear whether and under what circumstances a possible efficiency defence could be successful. For example, would elements such as the protection of strong brand name and reputation or avoiding free riding have a reasonable chance to be taken into account? Any future UK vertical guidelines should contain more clarity on this point.
- 17.3 Furthermore, it would be helpful for any future UK vertical guidelines to clarify under which circumstances RPM would be allowed for the introduction of a new product. What would be considered a ‘new’ product (and what about new or updated versions of products), for how long

can such practice last, and what are the elements that can be taken into account in terms of the suppliers' interest to promote the product?

17.4 ICLA UK submits that when it comes to the exception of a coordination short-term low-price campaign, these have pro-competitive effects and consumer benefits across all types of distribution, not just in franchise systems.

17.5 Finally, there should be clarity that in case of significant competition on a given market, maximum or recommended resale pricing should by default not lead to competition concerns.

Impact questions

Question 18: What would be the likely impact on your business, or those you represent, if RPM were not treated as a hardcore restriction for the purposes of the proposed UK VABEO? Please explain your answer.

a) Significant positive impact YES

Question 19: Are you aware of, or have you encountered, any difficulties in your business as a result of the treatment of RPM as a hardcore restriction for the purposes of the retained VABER? If so, please give examples.

19.1 RPM concerns arise in many circumstances not explicitly contemplated by the UK VABER or the current vertical agreements guidelines.

19.2 For example, revenue share agreements: it is increasing common in the context of B2B sales for companies to form partnerships, or "virtual JVs", to deliver products and services to customers. For example, a provider of IT security software to SMEs may partner with a telecommunications company who sells connectivity services to SMEs. Each company may need to invest in the relationship to make it work, and each party wishes to share in the upside, through a revenue share arrangement. The parties may agree to exclusivity that limits (but does not eliminate) the scope for the software company to sell via other channels to SMEs. The telecommunications company may sell the product subscription, but requires significant amounts of sales and product lifecycle support from the software company. In order for both parties to be incentivised to maximise the quality (and value) of the product, a revenue share arrangement is desirable. Uncertainty over future pricing trends render a standard wholesale floor price unrealistic. While the telecommunications company may set the pricing for individual customers, the software company may wish to have some ability to review the sales prices and seek to influence them (as this impacts its own revenue). The software company has a market share below 10% and the telecommunications company has a market share of less than 30%.

19.3 Under the current rules, there is a concern that this could be viewed as RPM, despite the low market shares and limited scope for intra-brand competition (in light of the exclusivity that the software company has agreed to). The only way to mitigate the RPM risk is to introduce a cost-price floor for the benefit of the software company. While the guaranteed cost-price floor reduces the risk that the software company may seek to influence resale prices, it also has a

reduced incentive to provide a high quality service and high quality product support (in exchange for certainty on cost price, it will have a lower share or revenues). Further in fast developing tech markets, cost and retail prices for software products can reduce quickly, leaving the telecommunications company exposed to having to pay high minimum charges to the software company, rendering the deal less attractive.

- 19.4 In such circumstances, the ability to use RPM would deliver consumer benefits by incentivising such efficiency enhancing JVs, ensuring that both JV partners are incentivised to provide the best customer service and support and enabling the JV to have sufficient price flexibility to be able to compete with inter-brand rivals.

Territorial and customer restrictions

Policy questions

Question 20: What are your views on the CMA's proposed recommendation on territorial and customer restrictions? In particular, what are your views on the CMA's proposed recommendation to:

- a) continue to treat territorial and customer restrictions as 'hardcore' restrictions so as to remove the benefit of the block exemption (subject to exceptions);**
- b) maintain a distinction between active and passive sales;**
- c) revisit the distinction between active and passive sales for certain types of online sales in the CMA VABEO Guidance; and**
- d) change the current regime in order to give businesses more flexibility to design their distribution systems according to their needs?**

In your response please consider whether:

- a) there are any features of the UK internal market militating in favour or against retaining the treatment of territorial restrictions as 'hardcore' restrictions for the purposes of the UK VABEO;**
- b) the distinction between active and passive sales remains valid and whether changes to this categorisation should be made in order to:**

i. clarify the situations where online sales amount to passive or active sales; or

- 20.1 Yes this ought to be clarified – please refer to ICLA UK's response to Question 21 below.

ii. give businesses more flexibility to combine different distribution models.

- 20.2 The current rules are not in line with commercial reality and significantly limit flexibility and the possibility to incentivise investments. A seller should be free to set up its distribution system in the way that suits it, as long as there are no harmful restrictions and in the absence of market power.

- 20.3 The current rules also prevent suppliers from realising the full efficiencies from a selective distribution system. Currently, it is not viable for a manufacturer to run exclusive distribution

and selective distribution in parallel on different levels of the supply chain. Particularly on the wholesale level, exclusivity may provide an incentive for wholesalers to invest in the implementation, maintenance of a selective distribution system, to the ultimate benefit of the end-customer.

- 20.4 Currently, the exception for permitted active sales restriction is limited to situations where a customer group is allocated to one exclusive distributor. There seems to be no reasonable explanation why the manufacturer should not be allowed to appoint more than one exclusive distributor while at the same time protecting them from active sales. Shared exclusivity may increase intra-brand competition, while at the same time enable to manufacturer to protect the wholesale distributors' investment.
- 20.5 Typical restrictions around active sales restrictions include: no active sales to customers exclusively reserved for the supplier or exclusively allocated to another distributor; no sales to unauthorised dealers in a selective distribution system; prohibition for wholesale distributors to sell directly to end-users.
- 20.6 Some ICLA UK members work for manufacturers which maintain a variety of different types of distribution networks designed to maximise sales of the products in question taking into account the market conditions and customer preferences. Such distribution networks may include granting exclusivity for customer groups, limiting sales by the supplier and/or active sales by the customers as permitted by the retained VABER.
- 20.7 Several ICLA UK members are also employed by companies that operate selective distribution systems, wherein sales to non-authorised members are prohibited and authorised wholesalers are prohibited from selling directly to end-users.

Issues with the current rules and proposed changes

- 20.8 The current rules do not permit effectively combining exclusive and selective distribution. There are many good reasons for granting exclusivity to a distributor/wholesaler, such as the fact that manufacturers will often rely on their knowledge for particular markets and distributors/wholesalers need to protect their investments. Such knowledge can also be effectively put to use by manufacturers to operate a selective distribution network.
- 20.9 In ICLA UK's experience, some suppliers would like the option to rely on wholesale distributors to implement, manage and expand the selective distribution system. The wholesale distributor is often in a better position to identify suitable dealers, work with them to meet the selective distribution criteria, manage the authorisation process, monitor and enforce compliance. However, this requires significant and continuous investment, which needs to be protected against attempts from other distributors (or the manufacturer) free-riding on these investments by actively selling to the authorised dealers managed by the wholesaler.

20.10 Thus, granting exclusivity on the wholesale level would incentivise the wholesale distributor to invest in the selective distribution system, i.e., by expanding the network and improving the quality of services offered by authorised dealers. In return, the end-customer will benefit from a larger number of authorised dealers, increased competition between these authorised dealers and higher quality (e.g., pre-sales and after-sales services, presentation and marketing). More specifically, this will lead to:

- i. Increased intra-brand competition by adding more authorised dealers to the network (as wholesale distributor will be incentivised to invest in promotion and expansion of selective distribution network in the territory / with the customer group) thereby also eventually increasing inter-brand competition.
- ii. Improved legal certainty for businesses by adding clarity that granting exclusivity on the wholesale level is not a hardcore restriction and therefore benefits from the safe harbour of the retained VABER.
- iii. Increased efficiency: manufacturers can rely on wholesale distributors to manage selective distribution in a given customer group. Wholesale distributors will often be better suited to identify right candidates to add to the network, to work with them to reach the criteria and to manage the authorisation process and monitor and enforce compliance with the criteria.
- iv. Reduced costs for businesses: reduced costs for manufacturers; return on investment for wholesale distributors; reduced costs for authorised dealers that get support from wholesale distributors to meet selective distribution criteria.
- v. Consumer benefits from larger number of authorised dealers, increased intra-brand competition, higher quality of services, marketing and presentation.
- vi. Incentive for wholesale distributors to expand selective distribution network.
- vii. Relying on wholesale distributors may also enable manufacturer to include sustainability objectives in selective distribution system (e.g., as part of selective distribution criteria).

20.11 In practice, ICLA UK members are not aware of any significant combinations of such distribution systems. Under the current rules, it is difficult to combine selective distribution with exclusive distribution, as a manufacturer will not be able to protect its selective distribution system. Most manufacturers will either use selective distribution or exclusive distribution, with selective distribution being more common. Yet, ICLA UK members do have experience with operating the different types of distribution systems. From our experience, there would be clear benefits in being able to effectively combine such networks.

20.12 Therefore, in the absence of market power, ICLA UK suggests that the rules be changed to allow for exclusive distribution at wholesale level, while permitting selective distribution at retail level. This would mean allowing manufacturers to protect exclusive distributors from active sales from other resellers. Manufacturers should also have flexibility to adapt distribution networks to market conditions.

- 20.13 ICLA UK also suggests that the rules should be changed to allow the manufacturer to share exclusivity between two or more distributors for a customer group. Shared exclusivity may increase intra-brand competition, while at the same time enable to manufacturer to protect the wholesale distributors' investment.
- 20.14 Further, other actions should be considered in order to allow manufacturers to adapt its distribution systems to the market conditions and ongoing developments, such as: (i) allowing the manufacturer to require customers to pass-on active sales restrictions to their customers; and (ii) ensuring any future UK vertical guidelines better fit the current retail landscape and allow manufacturers to rapidly adjust to changing market conditions, in particular to remove the current special protection for the online channel.
- 20.15 Any future UK vertical guidelines should recognise the significant changes in the retail sector since the EU Vertical Guidelines were first adopted – in particular to make the UK guidelines neutral and not to give particular protection to one particular sales channel. In the absence of market power, manufacturers and suppliers should have the flexibility to design their distribution systems to best fit their product and maximise sales.
- 20.16 Changing the rules to allow for more flexibility for manufacturers and suppliers to design their distribution networks would have the positive effects identified above.

Question 21: Do you agree that additional guidance on this issue would be helpful? If so, please provide your views on what that guidance should say including examples of situations where online sales should be regarded as passive or active sales.

- 21.1 ICLA UK submits the following examples of situations where online sales should be regarded as active sales actively directing or encouraging customers to the online seller:
- i. Brand bidding, i.e. ensuring seller's the website name pops up as a search result or advert in response to a customer's search on a search engine.
 - ii. Paid search advertising or search engine advertising – e.g. popping up as the first listed Ads in a Google search result.
 - iii. Using, and therefore paying for inclusion in, a digital comparison tool search results.
 - iv. Paying for banner advertising on third party websites or within a digital comparison tool.
 - v. Personalised or tailored advertising targeting specific customer types or groups, or regions.

Impact questions

Question 22: Do you have any examples of circumstances where territorial and customer restrictions might lead to operational efficiencies? Please include examples of locations within the UK and, where possible, quantitative and/or qualitative evidence in your answer.

- 22.1 Consider outsourcing of certain service (the product and the sales teams) capabilities to third party providers: the outsourcing is likely to enable the outsourcer to deliver a more efficient and attractive service to its customers. However, the outsourcer (with a market share significantly below 30%) will want certainty that the service provider will not compete with it in respect of the outsourcer's customer base (by actively targeting the outsourcer's customers). In

the absence of such certainty, the outsourcer may decide not to outsource and will continue to provide a sub-scale service to its customers.

- 22.2 Consider the use of online distributors where the supplier is also distributing directly. The supplier wishes to engage the online distributor to reach customers in a specific region or customer group that the supplier itself is not able to reach or access, for example if it has less brand presence or relevance in that area/customer group. The supplier does not wish or does not have the ability or expertise to invest heavily itself and directly in a particular region but may wish to increase its coverage in the region.

Question 23: How helpful is the exemption for restrictions of active sales in the UK to your business or those you represent? Please explain your answer.

- a) Very helpful YES

Indirect measures restricting online sales

Policy questions

Question 24: What are your views on the CMA's proposed recommendation on dual pricing and on the equivalence principle?

- 24.1 ICLA UK agrees with the CMA's recommendation to no longer categorise dual pricing as a hardcore restriction.
- 24.2 ICLA UK notes that the online channel is well established and physical stores are facing increased pressure. This development has been clear for several years – but is even more apparent with the pandemic across all product sectors.
- 24.3 As concerns dual pricing, manufacturers have struggled with how to incentivise retailers to invest in physical stores. The current possibilities of granting a “fixed fee” to support physical stores or to require a minimum quantity sold through physical stores are not workable in practice – especially where a manufacturer has thousands of customers across the UK, which is often the case.
- 24.4 The simplest way of incentivising physical stores is through dual pricing, for instance by allowing manufacturers to grant an extra rebate to a hybrid dealer for the sales made through the physical stores or even to differentiate between different type of stores depending on quality / intensity of investments. This would allow manufacturers to effectively reward retailers depending on the needs and cost of each channel or type of store – which in turn would offer retailers incentives to invest in quality service, display, presentation and customer service. Having such flexibility could also help manufacturers launch new products by rewarding dealers willing to ensure demonstration to customers.
- 24.5 ICLA UK's experience with such dual pricing is limited due to the current rules. However, based on general experience with distribution systems and pricing, it is difficult to envisage situations

where such dual pricing would cause competition concerns. A lower transfer price for offline sales would merely compensate retailer for higher fixed costs for their local stores.

- 24.6 Manufacturers aim to maximise sales through any channels and online sales are very important in the current environment. Ensuring that investments are made both for online and offline presentation of products is however key.
- 24.7 Changing the rules to allow for more flexibility for manufacturers to use pricing to incentivise and reward retailers also for investments in physical stores would have very positive effects:
- i. Increased intra-brand competition by incentivising retailers to invest in service, presentation and displays in physical stores – including in offering value-added services to consumers.
 - ii. The costs of trying to reward retailers through fixed cost fees is very high. Rewarding retailers through the pricing structure is much simpler and easy to handle for manufacturers.
 - iii. As a result of the possibility to reward investments, consumers would benefit from additional services and maintaining the possibility to actually touch and try products.

Dual pricing would not result in a prohibition of online sales

- 24.8 Generally, manufacturers do not have an incentive to limit online sales, as it would likely lead to loss of turnover.
- 24.9 Dual pricing is only intended to incentivise a particular sales channel (i.e. how products are sold) and should be allowed unless such dual pricing is actually based on where or to whom sales are being made or would amount to a *de facto* ban of online sales by using a prohibitive price disadvantage which is not justified by the brick and mortar, service, quality or other investments into offline sales.
- 24.10 Online and offline sales channels are inherently different. Manufacturers need to have the freedom to adapt the criteria to each channel to ensure the best possible experience for consumers across all channels and to ensure a consistent brand image. Achieving “equivalence” under such circumstances can be difficult and will be subject to judgement.
- 24.11 The original aim with the “equivalence” requirement was to avoid retailers being dissuaded from online sales. However, as online retail development has shown, there is no longer any need for special protection of the online channel. It is hard to see the rationale for maintaining such requirement.
- 24.12 Removing the “equivalence” criteria would have the following impacts:
- i. Spur competition between online and offline sales by creating a level playing field that takes into account the inherent differences between the two sales channels. It would also allow manufacturers to more easily adapt the criteria for each channel taking into account market developments.

- ii. Improve legal certainty by clarifying the requirements. The meaning of the “equivalence” requirement has been unclear and resulted in legal uncertainty, removing this uncertainty will result in lower costs for businesses.
- iii. Allowing different criteria will enable manufacturers to take into account the inherent differences between the online and offline sales channels when setting up a selective distribution system.
- iv. Consumer welfare will benefit from rules that enable online and offline channels to compete on a level playing field. As stated above, the rules in the retained VABER and guidelines are aimed at protecting online sales. Today, the online sales channel does not require such specific protection.
- v. Applying criteria that are customised to the relevant sales channel will incentivise manufacturers to invest in setting up a selective distribution system across sales channels (under the current rules, the easiest solution is to simply exclude online dealers, and several suppliers have taken this route).
- vi. Applying different criteria may also enable suppliers to take into account sustainability goals.

24.13 ICLA UK submits that no additional safeguards are required. If the setting of different criteria has as its object to restrict where or to whom products are sold, this would be an object restriction falling outside the retained VABER. Otherwise, different criteria should be covered by the block exemption provided, of course, market share thresholds are not exceeded.

In summary

24.14 Allowing manufactures the flexibility to use dual pricing to incentivise investments in physical stores, would be beneficial for competition, consumer welfare and would lead to lower costs and more efficient distributions systems. Online and offline sales channels have different cost structures. Maintaining the hardcore restriction for dual pricing is not in line with economic reality, where resellers are struggling to maintain and invest in physical stores while facing price competition from online sales. This development has only been accelerated by the COVID-19 pandemic.

24.15 As there is uncertainty about the current rules (notably on what constitutes dual pricing), maintaining the status quo is not appropriate. The fixed fee solution is also not workable in practice – so limited in use. In the same way, maintaining the equivalence test is also not appropriate as it is no longer needed, it does not take into account the inherent differences between the sales channels and as it has restricted the ability of manufacturers to quickly adjust to market developments and consumer expectations.

Other comments

24.16 In addition, ICLA UK would like to raise the question of differentiated pricing to wholesalers depending on the channel the wholesaler sells to. While a manufacturer is generally free to

differentiate its sale price when selling directly to online and brick and mortar dealers, this becomes difficult under the current rules when a manufacturer relies on a wholesale distributor. Granting a wholesale distributor a different purchase price based on the channel to which the wholesaler resells the product might be regarded as an indirect type of customer restriction and thus a hardcore restriction according to Art. 4(b) of the retained VABER.

24.17 However, it does not make any economic sense why the manufacturer should be allowed to take the different cost structures into account when selling directly to dealers, whereas this risks becoming a hardcore restriction (with the risk of significant fines) if the manufacturer opts for a two-tiered indirect distribution channel.

24.18 Furthermore, without different purchase prices from the manufacturer, the wholesale distributor will not be in a position to support brick and mortar stores out of its own margin, as margins on the wholesale level are typically too low to compensate for the different cost structures between online and offline sales.

Question 25: Do you agree that additional guidance on this issue would be helpful?

If so, please provide your views on what that guidance should say.

25.1 Guidance including the criteria that would normally be considered a *de facto* prohibition of online sales, and thus of passive sales because a retailer cannot reasonably comply with them, would be useful.

Impact questions

Question 27: Does the treatment of online sales bans as a hardcore restriction have an overall positive or negative impact on your business? Where possible, please provide examples of the impact on online channels and offline channels in your answer. Please include qualitative and/or quantitative evidence where possible.

d) Moderate negative impact YES

Question 28: Do you consider that the CMA's proposed recommendation (to remove dual pricing and the requirement for overall equivalence in selective distribution from the list of hardcore restrictions) will benefit offline channels? If yes, please provide examples where possible.

28.1 Yes – see the response to Question 24 above.

Non-compete obligations

Policy questions

Question 34: The CMA invites views on the proposed recommendation in respect of non-compete obligations. In particular:

a) Should non-compete obligations that are tacitly renewable remain ‘excluded restrictions’ under the UK VABEO?

34.1 No. ICLA UK is of the view that the CMA may wish to consider the existing practice and directions of other competition regulators, in particular the EC which recently opted to remove this from the list of excluded restrictions. It is a common commercial practice for a supplier and buyer to enter into supply agreements for two- or three-year minimum terms that then continue to operate until either party terminates with reasonable notice. When both parties have market shares below 30%, the buyer will seek to renegotiate the agreement or switch to an alternative supplier at the end of the initial term, if it believes that it can get a better deal.

34.2 Further, procurement processes and competitive tenders generally require a lot of effort and take months, if not more, to complete. It is neither efficient nor commercially desirable in many cases to restart this process three or four years later, particularly in circumstances where the winning bidder has had to make significant investments to win the businesses (e.g. setting up a new operating unit in a new location where the purchaser is located, taking on new staff, investing in new equipment or IT). A fixed five-year term and/or non-compete may reduce the incentives for some companies to tender for the contract in the first place. Where market shares are less than 30% it is more efficient to allow each industry to determine the appropriate contract durations and accompanying non-competes. Provided contracts contain reasonable termination provisions there ought to be no constraint of competition as switching will not in practice be constrained. It should also be acknowledged that in long-cycle businesses, five years might not be the appropriate term of an agreement.

b) Are there any risks in allowing such obligations to be automatically exempt under the UK VABEO?

34.3 We would support the same qualifications as those laid out by the Commission in its draft vertical agreements guidelines (para 234).

Impact questions

Question 36: Relative to the current regime as set out in the retained VABER, what would be the likely impact on your business’s operations, or the operations of those you represent, if non-compete obligations that exceed 5 years in duration were no longer treated as ‘excluded’ restrictions? Please include examples and where possible, quantitative and/or qualitative evidence in your answer.

36.1 Please refer to our response to Question 34 a) above.

Question 37: What are some of the benefits or efficiencies of non-compete obligations remaining exempt if the duration is less than 5 years? Please include examples and where possible, quantitative or qualitative evidence (or both) in your answer.

37.1 In-house lawyers would have to re-consider their guidance to business units who enter into agreements with non-compete obligations that are for less than five years, and we would need to conduct an individual assessment of each agreement, which would be very onerous.

Agency

Policy question

Question 38: The CMA invites views on the proposed recommendation in respect of agency issues and stakeholders to make any submissions they consider would help the CMA to develop useful guidance on this topic.

38.1 ICLA UK would welcome more detailed guidance in relation to agency issues and what constitutes genuine agency in particular. A number of ICLA UK's members have specifically avoided treating distributors as genuine agents, purely because of the legal uncertainty in this area and the associated risk of a finding of a hardcore restriction, if a company gets assessment wrong. ICLA UK has the following observations.

38.2 The threshold for the amount of risk the agent can bear before it ceases to be an agent is unclear. It has been very difficult for companies to get sufficiently comfortable that an agent is a "genuine agent" for competition law purposes, as the threshold appears high and is not clear. When the impact of getting it wrong may be e.g. a negative RPM decision companies are not incentivised to take any risk. Examples of companies having deliberately not taken the risk of considering agents as genuine exist in the airline and the telecoms industries at the very least.

38.3 Clearer guidance as to what constitutes more than "insignificant" risk is needed. In particular it can be very hard to be comfortable that a contract is a "genuine agency" where the agent is taking on a 'risk' that may never come to fruition e.g. where the contract provides for damages in the event of missed targets.

38.4 The line is also blurred between 'contract specific risks', 'market specific investments' and 'general costs'. ICLA UK queries whether a distinction between contract and market-based risks is necessary given in both cases the agent must not bear any more than insignificant risk. If the distinction needs to be maintained, more guidance on what constitutes 'market specific' risks would be helpful. For example: where a retailer is required by the principal to adequately train its sales staff (at its own cost) and such training may cover the product sold by the principal but may also cover additional/broader topics; or where website amendments, service improvements or marketing is required by the principal but such developments or materials not only drive the principal's brand/product but also the agent's brand too.

38.5 A specific challenge arises with regards to the Commission's existing guidelines and general costs. The Commission's Guidelines state that risks that are related to the activity of providing

agency services in general, such as general investments in for instance premises or personnel, are not material to this assessment (i.e. can be borne by the agent). However, the Guidelines go on to state that the agent must not make market-specific investments in equipment, premises or training of personnel, unless these costs are fully reimbursed by the principal. In a franchise agreement scenario, if the agent operates out of a shop and needs that shop to be able to perform in that specific market, it could be argued that the rent would amount to a market specific investment (rather than a general cost) and, as rent can be a large outgoing, this would certainly be held to be more than an insignificant risk. Clarity from the CMA around these sorts of issues would be helpful.

- 38.6 There is insufficient guidance around the extent to which genuine agency may apply to online distributors and whether there are any specific online considerations to be taken into account, such as the extent to which website creation and development is a market specific investment or simply a cost/risk relating to the provision of agency services in general.
- 38.7 There is also insufficient guidance around whether or not genuine agency may apply where an agent acts for a large number of distributors. ICLA UK contends that this ought to be possible provided relevant risks are met by the principals. Further, where an agent uses the same premises, staff, equipment, technology or advertising¹ for multiple principals, the extent to which these may be market-specific investments, rather than a cost/risk relating to the provision of agency services in general, what proportion ought to be attributed to each principal. In these circumstances, ICLA UK submits that an agent acting for multiple principals ought to fund those common costs as they are more related to its risk of being a successful agent that could be used for any type of activity, not just one principal's.
- 38.8 Further guidance would also be helpful around how a principal may reimburse an agent for its costs. The current commercial reality of such arrangements is often likely to be a percentage of or fee per sale(s) rather than a traditional commission. Guidance to confirm that different remuneration structures are acceptable, and specifying any that are not, would be helpful.
- 38.9 Following this theme, confirmation of whether agents may charge their own fees to customers, for example to cover the risk of being a successful agent is permissible. Or, whether a principal may determine or prevent such charging, on the basis that it may affect the competitiveness of the principal's products by adding cost to the customer, even when the fee is not related to contract-specific, market-specific or other investments given these are covered by the principal.

¹ For example, a travel agent may advertise a particular route, e.g. London-New York, on which a number of principal airlines offer flights (such advertising would not be specific to any one principal and could result in a sale for any one of them).

Environmental sustainability

Policy question

Question 39: The CMA invites views on the proposed recommendation in respect of environmental sustainability and stakeholders to make any submissions they consider would help the CMA to develop useful guidance on this topic.

- 39.1 The current absence of material guidance on what sustainability benefits may outweigh competition concerns creates legal uncertainty for companies and as a result companies may not be incentivised to consider sustainability principles or pursue them as an objective. Any guidance the CMA may add on what competition restrictions may or may not be acceptable in order to enable the pursuit of sustainability objectives will increase the legal certainty and may make companies more prone to explore this area.

VABEO Obligation to provide information

Policy question

Question 44: The CMA invites views on the above proposed recommendations in respect of the other provisions in the UK VABEO.

- 44.1 Regarding the CMA's proposal on the possible addition of a power under the UK VABEO to request information from companies benefitting from the block exemption. ICLA UK notes that the CMA already has powers of investigation should it suspect an infringement of competition law. The addition of such an overlapping power within the VABEO does not appear to add materially to the CMA's toolbox and may have the consequence of reducing the VABEO's attractiveness and therefore its efficiency.