Response to Consultation on the Draft Vertical Agreements Block Exemption Order published on 21 February 2022

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INTRODUCTION

1. We submit this response on behalf of Amazon. Amazon has previously contributed to the public consultation[1] by the Competition and Markets Authority ("**CMA**") and now welcomes the opportunity to engage with the Department for Business, Energy, and Industrial Strategy ("**BEIS**") on the draft Vertical Agreements Block Exemption Order ("**draft VABEO**") for the UK[2].

2. We are committed to ensuring that UK consumers benefit from competition and choice through all the sellers that operate on the Amazon Store, both third parties and Amazon's own retail offers. As such, Amazon fully supports the decision of BEIS to adopt a new VABEO that will replace the current legal regime ("**retained VABEO**") by 31 May 2022. Through the new VABEO, BEIS will ensure that a common and easily applicable framework remains in place for all UK businesses. In order to avoid repetition, Amazon will comment in this submission only on select aspects of the draft VABEO; namely those that we previously identified as having major relevance for UK consumers and retailers.

3. We welcome that BEIS preserved many pro-competitive principles from the retained VABEO in the draft VABEO, while at the same time considering UK-specific market conditions and the particular interests of UK consumers and retailers (see para. 7.20 of the Explanatory Memorandum[3]). In doing so, BEIS has in many cases found more pragmatic and proportionate solutions than the European Commission in its parallel consultation about the new vertical block exemption regulation for the EU ("**EU Vertical Block Exemption**").[4] For example, Amazon particularly supports the decision to preserve the dual distribution exemption – without the addition of a new market share threshold or an exclusion of retailers that also operate online marketplaces ("**Hybrid Retailers**") –, which will provide much needed legal certainty and clarity for many UK businesses. We also consider it sensible to confine the duration of the new VABEO to six years. This will allow BEIS and the CMA to verify whether the new VABEO still sufficiently reflects the realities for UK consumers and businesses. As it is vital for all retailers that they can make full use of online distribution when addressing UK consumers, we also welcome that the draft VABEO expressly identifies all preventions

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1 See https://www.gov.uk/government/consultations/retained-vertical-agreements-block-exemption-regulation-consultation. The previous submission of Amazon is available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1030660/Amazon_Response.pdf.

2 Draft: The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022.

3 Draft Explanatory Memorandum: The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022.

4 https://ec.europa.eu/competition-policy/public-consultations/2018-vber_en.

to effectively using the internet as a hardcore restriction[5], but we encourage BEIS to clarify expressly that this also excludes online marketplace bans from the application of the VABEO.

4. We are nonetheless concerned that the draft VABEO includes provisions which do not align with the interests of UK consumers and retailers in having access to products on competitive terms. The permission of dual pricing and the abandonment of the equivalence principle do not create a level playing field for different distribution channels. Rather, these changes allow brands to discriminate against online sales and distort the conversion to omnichannel distribution, which will ultimately raise consumer prices in the UK. Similarly, the additional protection afforded to exclusive and selective distribution encourages brands to introduce such systems in the UK, even for everyday products. This would restrict the flow and availability of goods for consumers and retailers in the UK. Amazon thus encourages BEIS and the CMA to reconsider these provisions before the Secretary of State adopts the final order.

5. Beyond these substantive concerns, Amazon notes that the draft VABEO includes an overly broad competence for the CMA to request information from undertakings about all their vertical agreements. The proposal does not strike the necessary balance between the interests of UK businesses and the well-understood need for the regulator to monitor compliance with competition law, and we suggest an alternative, more proportionate, approach below.

UK CONSUMERS AND RETAILERS WILL BENEFIT FROM PRO-COMPETITIVE ASPECTS OF THE DRAFT VABEO

6. We first focus on select pro-competitive aspects in the draft VABEO, which BEIS should carry over into the final order, and suggest clarifications in respect of the definition of hardcore sales restrictions.

Dual distribution exemption is pro-competitive

7. Amazon welcomes that the draft VABEO maintains the general exemption for dual distribution in Article 2(5), which has proven itself a valuable addition already under previous EU law. We share the view of BEIS and the CMA that, on the one hand, brands in the UK tend to have greater involvement in direct distribution to consumers and, on the other hand, consumers expect to have access to goods through a variety of direct and indirect distribution channels at the same time. Keeping the exemption for dual distribution is thus in the interests of brands and consumers alike.

8. Introducing a special market share threshold for dual distribution, as initially considered during the consultation (see June 2021 Consultation[6], para. 3.10) would have created unnecessary complexity and uncertainty for UK businesses. The CMA had rightfully

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[5] See Article 8(4)(a) of the draft VABEO.

[6] The retained Vertical Agreements Block Exemption Regulation Consultation document, 17 June 2021, CMA145con.

abandoned this proposal already in its October 2021 Recommendation[7]. Amazon also shares the CMA's view that there are no reasons for excluding Hybrid Retailers from the dual distribution exemption (October 2021 Recommendation, para. 4.19 (c)). Such an exclusion would not only negatively affect the many Hybrid Retailers in the UK but also the many small and medium-sized UK businesses selling on their online marketplaces or supplying Hybrid Retailers. Amazon strongly believes that maintaining the distribution exemption (with the extension to wholesalers and importers, as currently suggested) will have a broadly positive impact on UK consumers and retailers in the years to come.

Review of the VABEO after six years is sensible

9. According to Article 16 of the draft VABEO, the new regime will remain in place until 1 June 2028, i.e. for six years. We consider such restriction very sensible. It will ensure that the VABEO remains fit for the future and can reflect new developments in particular in the retail sector, some of which may not even be currently foreseeable for market participants.

10. The current legal regime has been in place for a total of twelve years. As rightfully acknowledged by BEIS (see para. 7.19 of the Explanatory Memorandum), businesses in the UK have seen significant changes during these twelve years, including the increased popularity of online sales, the advent of omnichannel distribution, the UK's exit from the EU, and the recent challenges raised by the COVID-19 pandemic. However, the competent regulators did not even engage in discussions about potential revisions of the retained VABEO or the previous EU Vertical Block Exemption to reflect these developments.

11. Amazon thus welcomes the willingness and flexibility of BEIS and the CMA to re-engage with the VABEO at shorter intervals. This will allow them to assess whether the VABEO still sufficiently reflects the realities for UK consumers and businesses. The proposed duration of six years thereby strikes a reasonable balance between the need for UK businesses to get familiar with the VABEO, a sufficient period for the VABEO to show its practical effects and the need to enable amendments to the VABEO at sufficiently regular intervals to properly account for significant market changes.

Commitment to online distribution is paramount

12. We fully support the clarification in Article 8(4)(a) of the draft VABEO, according to which any prevention of effective use of the internet for the sale of goods constitutes a hardcore restriction. Such prevention can thus not benefit from the safe harbour of the VABEO. BEIS rightfully acknowledges that *"[o]nline distribution channels are effective channels for reaching a greater number and variety of customers*" and that

[7] UK competition law: Vertical Agreements Block Exemption Regulation, CMA's recommendation, 3 October 2021, CMA145con.

"[i]n principle every distributor should therefore be allowed to use the internet to sell products" (para. 7.25 of the Explanatory Memorandum).

13. However, Amazon strongly suggests to BEIS and the CMA – if not in the final orders then at least in the upcoming vertical guidance – that it be stated expressly that a prohibition of sales on online marketplaces is a prevention of effective use of the internet and thus is considered a hardcore restriction. Online marketplaces provide significant benefits to UK consumers and retailers, such as:

    (i) Allowing consumers to access a larger number of retailers at the same time (and *vice versa*),

    (ii) Lowering initial investments for selling online (as retailers do not need their own online store and can benefit from the build-in features of online marketplaces),

    (iii) Increasing the visibility of small and medium-sized retailers, as consumers may already be familiar with the online marketplace (and trust the brand), but not with the individual retailer, and

    (iv) Ensuring, if need be, a dedicated sale's environment complying with technical and marketing requirements that are necessary to protect and promote the brand image.

14. As evidenced in a study by Copenhagen Economics "*selling products via an online marketplace reduces transaction costs, leverages economies of scale and scope (a firm does not need to build a website from scratch) and allows firms to access a large pool of customers (who are already shopping on the marketplace).*"[8] Selling through online marketplaces also broadens the selection for consumers in peripheral, rural areas of the UK, and for vulnerable, less mobile consumers, for whom access to brick-and-mortar stores may be more difficult. Amazon is fully convinced that BEIS should not allow brands to deny UK consumers and retailers these benefits by employing online marketplace bans.

15. We are aware the European Commission is adopting a different approach in the EU Vertical Block Exemption. According to the published drafts, it considers the safe harbour to extend also to online marketplace bans, which does not appear grounded in competitive effects for consumers. The European Commission has not assessed online marketplace bans in general or their consequences for consumers and retailers in particular (in the EU or elsewhere). Rather, this direction follows a very formalistic approach, which is based on an incorrect reading of the *Coty* decision of the European Court of Justice[9], which only permitted online marketplace bans for luxury goods, and on misconceptions that certain brands have promulgated about online marketplace sales. Amazon encourages BEIS not to adopt this misguided approach for the UK but

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8 Copenhagen Economics, *The economic opportunity for peripheral postal e-commerce in the EU*, p. 5.

9 Case C-230/16 *Coty Germany GmbH v Parfümerie Akzente GmbH*, judgment of 6 December 2017.

rather – taking into account the interests of UK consumers and retailers – expressly state that online marketplace bans prevent the effective use of the internet, i.e. are hardcore restrictions.

DISCRIMINATION AGAINST ONLINE DISTRIBUTION CHANNELS WILL HARM UK CONSUMERS AND RETAILERS

16. Beyond these broadly positive aspects, the draft VABEO promotes an artificial distinction between offline and online distribution by allowing dual pricing and abandoning the equivalence principle. This will empower brands to impose stricter requirements on UK retailers that want to sell to consumers online and on products that retailers intend to sell online.

17. BEIS justifies these changes (see para. 7.29 of the Explanatory Memorandum) through the alleged need to:

    (i) Address free riding by online retailers on the investments made by their offline counterparts, and

    (ii) Encourage further investments in offline product promotion, including pre- and aftersales services.

18. BEIS assumes that – with these changes – the draft VABEO contributes to a level playing field between online and offline distribution. However, the opposite will be the case. Consumers want and expect online and offline distribution channels to converge (so-called omnichannel distribution). Under the current legal regime, retailers have introduced business models such as "click and collect", "in-store-pickup" or "curbside pickup". These have not only gained more and more popularity also in the UK but become standard in the retail sector, as shown by the likes of Argos, Tesco, Morrisons and John Lewis. In its 2021 review of the *JD Sports Fashion/ Footasylum* merger, the CMA also noted that "*there are significant linkages between the in-store and online channels*" and that retailers "*increasingly facilitate consumers' switching between channels*".[10] In complete contrast – and ignoring what UK consumers want and expect – the draft VABEO encourages brands to distinguish between offline and online distribution again. It remains unclear why the CMA assumes that the proposed changes will "*promote innovation in the design of omni-channel distribution*" (October 2021 Recommendation, para. 5.75). Such innovation has already taken place and continues to take place under the retained VABEO – the draft VABEO effectively threatens this level playing field, rather than empowering any positive developments.

19. It seems that BEIS and the CMA assume that online distribution generally provides an inherently inferior consumer experience, which needs to be "regulated" by the brands. However, this is an unjust generalisation, not backed by any facts. There are low quality and high quality brick-and-mortar stores just like there are low quality and high quality

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[10] CMA, Completed acquisition by JD Sports Fashion plc of Footasylum plc, report dated 5 November 2021, appendices and glossary to the final report (5.11.21), para. 1.53 and 1.67.

online stores, and not every online marketplace provides for the same sales environment and experience. There is simply no need to encourage specific investments in any of these distribution channels.

20. Similarly, it remains unclear why BEIS and the CMA consider that only offline distribution channels need protection from free riding. The CMA itself previously acknowledged that free riding affects both online and offline distribution (October 2021 Recommendation, para. 5.65). In fact, as shown by Amazon's previous submission, there is evidence that around 69% of consumers "*webroom*" (i.e. check prices and products online before or while being in a brick-and-mortar store) whereas only 46% "*showroom*" (i.e. first go into the store but complete the purchase online).[11]Again, there is simply no need to set up special protection for any distribution channel.

21. Not only are the underlying assumptions of the draft VABEO are incorrect, but the introduction of dual pricing and the abandonment of the equivalence principle will have negative consequences for competition in the UK, as described below.

Dual pricing will be detrimental to UK consumers and retailers

22. Dual pricing will translate to higher prices for online purchases. It is a tool for brands to make online sales by retailers less attractive, just falling short of excluding online sales entirely, which the draft VABEO expressly prohibits in Article 8(4)(a). While online distribution channels will feel the impact first, an overall higher price level will eventually spill over to brick-and-mortar stores in the UK. Dual pricing reduces overall price competition, and all UK consumers will experience less selection and higher prices across the board, regardless of distribution channel.

23. Beyond the direct implications for the pricing of goods, dual pricing entails further negative consequences for competition in the UK. Brands may need to monitor the offline and online sales of their retailers to apply differentiated sales prices, which gives raise to significant concerns regarding anticompetitive information exchanges (hub-and-spoke collusion). Brands may also use higher online sales prices to their retailers to reserve online distribution to themselves, a behaviour that is otherwise a hardcore restriction under the draft VABEO. Dual pricing may also force retailers to predict, stick to, and account for their sales in each specific distribution channel, rather than flexibly selling the same stock through multiple channels. Had the latter happened during the COVID-19 pandemic, many UK retailers would have been unable to resell their stock through their online distribution channels. In Amazon's view, dual pricing will not benefit small and medium-sized businesses in the UK – many of them sell online or at least take an omnichannel approach – but, rather, will simply act to confer an advantage on large suppliers that want to control the distribution chain.

24. Not only are the consequences of dual pricing negative – there is also no practical need for it. Already under the retained VABEO, brands can take into account the characteristics of their retailers, their sales channels and pre- and aftersales efforts when

[11] See para. 46 of Amazon's previous submission (fn. 1).

setting the sales prices for their goods or make additional contributions to support particular investments or marketing efforts by any retailer. This provides sufficient flexibility for brands to reward retailers for specific investments, if needed, without discriminating between online and offline distribution.

BEIS must maintain the equivalence principle

25. Amazon expects equally negative effects for competition in the UK if BEIS abandons the equivalence principle. The draft VABEO allows brands to distinguish between restrictions for offline and online distribution without the need to provide <u>any</u> justification. Such change will ultimately lead to stricter requirements for retailers that want to sell their goods and services online. In fact, there is an inherent risk that such different restrictions could in many cases lead to a *de facto* ban of online sales.

26. The CMA considers that "*absolute equivalence is not appropriate*" between offline and online sales (October 2021 Recommendation, para. 5.67 (d)). That may well be. However, "*absolute equivalence*" is also not required under the retained VABEO. Rather, according to para. 56 of the vertical guidelines[12], restrictions for offline and online distribution channels "*should pursue the same objectives and achieve comparable results and [...] the difference between the criteria must be justified by the different nature of these two distribution modes*". In Amazon's view, this is a far more balanced approach. It reflects the interests of brands and retailers alike and ensures a level playing field.

27. The July 2021 Consultation states that market participations suggested during the consultation that offline and online distribution constitute "*very different sales environments*" (Annex D, para. 61). Amazon maintains that such differences do not exist *per se*, but depend on the individual retailer. Nonetheless, the new regime could factor in all such alleged differences by maintaining the approach under the retained VABEO, as laid out above in para. 26 of this submission.

THE DRAFT VABEO INSULATES DISTRIBUTION SYSTEMS FOR EVERY DAY PRODUCTS FROM INTRA BRAND COMPETITION

28. Article 8(3) of the draft VABEO allows brands to:

    (i) Combine exclusive and selective distribution systems,

    (ii) Appoint more than one retailer for the same area or consumer group in an exclusive distribution system (so-called shared exclusivity), and

    (iii) Establish greater protection against sales from outside a selective distribution system to unauthorised retailers.

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[12] Official Journal of the European Union, C 130, 19. May 2010, p. 1 et seqq.

29. These planned changes encourage brands to introduce exclusive and selective distribution systems – even for every day products that do not require such arrangements – and thereby limit selection for UK consumers and retailers. During the consultation, the CMA emphasised the alleged need to give more flexibility to brands that want to control their distribution channels (October 2021 Recommendation, para. 5.54). However, the CMA did not properly assess the consequences of such enhanced flexibility for UK consumers and retailers.

30. Amazon acknowledges that brands producing technically complex, high end or luxury products may have a legitimate interest in operating exclusive and selective distribution systems. Provided those brands adhere to the equivalence principle, Amazon understands why BEIS wants to extend the protection afforded to them. However, the draft VABEO allows brands to set up exclusive or selective distribution systems even for everyday products. It does not require brands to take into account the products' characteristics or to show any legitimate interest in maintaining such a distribution system. Such unrestricted application is not justified. Exclusive and selective distribution involve restrictions of *intra brand* competition that are supposed to be proportionate to efficiencies – and such efficiencies do not exist in the case of everyday products.

31. In particular, we do not see any need to allow brands to combine exclusive and selective distribution at different levels of the distribution chain. The draft VBER should not allow brands to exclude authorised retailers from cross supplying as long as they meet the criteria for admission to the distribution system. Any combination of exclusivity at the wholesale level and selective distribution at the retail level reduces competition in the UK. Similarly, the draft VBEO should not allow brands to combine exclusive and selective distribution at the same level of distribution and in the same territory, as it will only insulate distribution channels.

32. By allowing shared exclusivities, the draft VABEO furthermore removes the key business risk of exclusivity, which is that the brand has <u>one retailer</u> in a given territory or for a given consumer group, on which the brand must rely. The calculation only pays off if the exclusive retailer makes the necessary investments in its exclusive territory or to its exclusive consumer group. The exclusive retailer must undertake sales efforts that make it more attractive for a brand to have one single retailer rather than many competing retailers. This business risk is the trade-off for allowing the brand to restrict competing retailers from actively selling its products and thus for denying consumers additional sources for purchasing the goods. With shared exclusivities, brands can shield their distribution channels from *intra brand* competition without taking such a risk.

33. Overall, BEIS should restrict the application of exclusive and selective distribution to products that warrant their application – or at least refrain from allowing the combination of selective and exclusive distribution, shared exclusivity and broadening the substantive protection, contrary to what is currently foreseen in the draft VABEO.

INFORMATION GATHERING POWERS ARE DISPROPORTIONATE

34. Amazon understands that the CMA needs tools to assess the compliance of UK businesses with Chapter I of the Competition Act 1998. However, the Competition Act 1998 already includes a balanced set of investigative powers for the CMA. In Amazon's view, there is no practical need for an addition. The VABEO should specify the agreements that are block exempt from the Chapter I prohibition of the Competition Act 1998 – not enhance the powers of the CMA. In any event, Article 12(1) of the draft VABEO goes beyond the powers reasonably required for compliance monitoring. The provision allows the CMA to request information about all vertical agreements from any undertaking without the need to fulfil any legal requirement or threshold. The undertaking also has an obligation to respond within a ten working day period. Otherwise, the CMA may withdraw the safe harbour of the VABEO.

35. While the CMA may use these powers to probe into individual contracts of select undertakings where it has concrete indications of anti-competitive conduct, the provision would also allow the CMA to request detailed information about hundreds of thousands of contracts, merely to gain insight into a specific market or industry. This could, in theory, enable extremely wide-reaching information gathering, similar to a sector inquiry or antitrust investigation, even in the absence of substantive concerns. Article 12(1) the draft VABEO does not strike a balance between the well-founded interest of the CMA to ensure effective enforcement of competition law in individual cases and the equally well-founded interest of UK businesses not to be confronted with overly broad requests without any specific reason, which may tie up significant internal resources.

36. It is correct, as stated by the CMA, that Articles 17, 18, 20 and 21 of the Public Transport Ticketing Schemes Block Exemption[13] bestow similar powers to the CMA. The proposal in Article 12 of the draft VBAO is therefore not new to the UK. However, the Public Transport Ticketing Schemes Block Exemption addresses a limited number of market participants and very specific contracts, namely narrowly defined public transport ticketing agreements. In contrast, the draft VABEO has a far broader reach, potentially applying to all undertakings operating in the UK and all of their vertical agreements. The approach from the Public Transport Ticketing Schemes Block Exemption is therefore not a relevant model for the VABEO.

37. In order to strike an appropriate balance, Amazon suggests three amendments to Article 12 of the draft VABEO. The provision should

    (i) *Firstly*, require the CMA to have reasonable grounds for suspecting that the agreement in question does not comply with the VABEO, and

    (ii) *Secondly*, confine the first request of the CMA to the identity of the contractual partner and the submission of the existing agreement (e.g. no

[13] The Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001.

requirement to produce market shares or market data or supporting documents from the contract negotiation phase), and

(iii) *Thirdly*, require the CMA to set a deadline for the addressee's response based on the facts of the case at hand.

38. The standard of "reasonable grounds" (see (i) above) is already well established in UK competition law, for example in Section 25(1) of the Competition Act 1998. Even with the change, Article 12(1) of the draft VABEO would retain its own scope of application next to the other powers of the CMA, as the provision would only require a suspicion that a select agreement does not comply with the VABEO, rather than the suspicion of an actual restriction or distortion of competition.

39. Confining the first request to the identity of the contractual partners and the agreement as such (see (ii) above) would allow the CMA to start an investigation into a select contract and evaluate the substantive provisions, without putting an undue burden on UK businesses. Such restriction would also be in line with the significantly lower threshold for the application of Article 12(1) of the draft VABEO (suspicion of non-compliance with the VABEO rather than actual restriction or distortion of competition).

40. With these amendments, Article 12(1) of the draft VABEO would still allow for relatively broad requests by the CMA. For example, if the CMA has reasonable grounds for suspicion that a certain type of supply agreement may fall short of the VABEO's requirements, it may ask a retailer to produce the entire set of such supply agreements at once. In order to account for the different nature and scope of potential requests under Article 12(1) of the draft VABEO, the CMA should be required to set a proportionate deadline based on the circumstances of the case at hand (see (iii) above). It makes a significant difference whether the CMA requests information about one document, ten documents or hundreds of documents at once – and the CMA should reflect this in the deadline for the request.

41. We note that, already under the current draft, an addressee of an information request may excuse non-compliance with the statutory deadline pursuant to Article 12(2). However, this is not a sufficient corrective mechanism. The approach effectively shifts the burden of proof to the concerned undertaking. The CMA does not need to make any consideration about the reasonableness of the deadline. It can simply rely on the statutory ten working days. Rather, the concerned undertaking needs to show that it had a reasonable excuse for not complying with the request within the statutory deadline – with the risk of facing a withdrawal of the VABEO in the meantime.

CONCLUSION

42. Large parts of the draft VABEO would be a useful addition to UK law and support UK consumers and retailers. Amazon welcomes the many pro-competitive aspects, as laid out above. The final order should in particular adopt the currently foreseen dual distribution exemption (Article 2(5) of the draft VABEO), limit its duration to six years

(Article 16 of the draft VABEO), and keep the clear commitment towards online distribution as a sales channel (Article 8(4)(a) of the draft VABEO). In the latter case, however, Amazon suggests a clarification that BEIS considers online marketplace bans to be a hardcore restriction.

43. However, certain proposed changes in the draft VABEO would harm UK consumers and retailers, who would have access to less choice and face higher prices. Moreover, these proposed changes would clearly distort the natural conversion towards omnichannel distribution in the UK retail sector and all the benefits that it brings to UK consumers. We thus encourage BEIS to continue treating dual pricing as a hardcore restriction and to preserve the equivalence principle in the new VABEO. Furthermore, the application of exclusive and selective distribution should be restricted to products that warrant their application (i.e. technically complex, high end or luxury products). BEIS should also re-model Article 12(1) of the draft VABEO and bestow the CMA with more proportionate investigative powers.

44. If the above is not feasible to conduct within the legislative process for the VABEO, – which Amazon would consider regrettable – at least the upcoming revised vertical guidelines for the UK should provide very detailed guardrails for when dual pricing is allowed and when a differential treatment of offline and online sales is permitted. Without such guidance, many brands will likely use the newfound flexibility to discriminate against online distribution.