Eversheds Sutherland (International) LLP

Response to BEIS' consultation on the Draft Vertical Agreements Block Exemption Order

16 March 2022

BEIS consultation on the Draft Vertical Agreements Block Exemption Order

Introduction

1. Eversheds Sutherland (International) LLP welcomes the opportunity to comment on BEIS' consultation on the Draft Vertical Agreements Block Exemption Order. Our comments are based on the experience of our Competition, EU and Trade team in advising clients on all aspects of their vertical agreements and distribution networks. The comments and observations set out in this response are ours alone and should not be attributed to any of our clients.

2. We confirm that this response does not contain any confidential information and we are happy for it to be published on BEIS' website.

Draft Vertical Agreements Block Exemption Order

3. We welcome the publication of the Draft Vertical Agreements Block Exemption Order, which, we note, is largely based on the Competition and Markets Authority's ("**CMA**") recommendation to the Secretary of State to make a Block Exemption Order to replace the retained Vertical Agreements Block Exemption Regulation ("**VABER**") with a new UK Vertical Agreements Block Exemption Order ("**VABEO**"), once this expires in May 2022; a recommendation which we supported. The draft explanatory memorandum is also a helpful document.

4. As noted in our response to the CMA's consultation on its recommendation, we firmly support the adoption of a UK-specific VABEO, as this will provide legal certainty for businesses active in the UK, reducing the burden of compliance and facilitating investments in more efficient distribution systems. We believe that this can generate significant efficiencies for consumers, in the form of better prices, increased choice and better access to goods and services provided the VABEO enables businesses to self-assess.

CMA guidance

5. Whilst we have set out below some comments on the draft VABEO, we note that our ability to provide meaningful and complete comments is somewhat limited by the fact that we do not have the proposed CMA's guidance that will accompany the draft VABEO. This guidance will form an integral part of the new framework for vertical agreements, as it is expected to be illustrative of the CMA's approach to the analysis of vertical agreements and to provide more clarity on issues of central importance, such as agency and dual distribution. Many of our clients are very keen to have further guidance on these issues, as this will essentially determine the future shape of their distribution systems.

6. As noted in our response to the CMA's consultation[1], it would be, in particular, very helpful for the CMA to provide specific guidance (with practical examples, where possible) on a number of issues of central importance for businesses:

   - **information exchanges in the context of dual distribution:** considering the recent publication of the European Commission's draft section on information exchanges in dual distribution relationships[2], we strongly believe that a clear position on behalf of the CMA will be necessary. We would welcome a more permissive approach from the CMA and note that any guidance on this matter must necessarily recognise that information exchanges in a dual distribution context form part of what is essentially a vertical relationship and should not be treated as equivalent with an exchange of information between "pure" competitors;

   - **agency issues in a dual distribution model, namely by reference to the so called "dual role agents":** some of our clients are considering engaging in dual distribution (i.e. distributing some products direct to consumers while also maintaining a network of third party distributors) using agents, some of whom may already act as distributors;

   - **agency:** as noted in our responses to the CMA's consultation, the concept of 'genuine agency', which is based on the risk allocation between the parties is, in practice, difficult to apply in 'grey area' scenarios. Our firm belief is that a flexible treatment of the concept of agency is merited.

7. Overall, the focus of the guidance should be to ensure that the CMA's approach to vertical agreements reflected in the draft VABEO and guidance is as liberal as possible to provide UK businesses with the greatest opportunity to design and operate their distribution systems in a way that meets their business needs. It is essential that the CMA guidance provides clarity on the CMA's approach to the analysis of vertical agreements for the benefit of businesses and their legal advisors, so that the VABEO and guidance provide a clear and genuinely broad safe harbour.

Territorial scope of the VABEO

8. An issue of particular importance for businesses, which is not currently addressed in the draft VABEO, is the relationship between the proposed regime and the new EU framework, which will apply once the current EU Vertical Agreements Block Exemption Regulation lapses. For businesses with operations both in the UK and in the EU, this is a critical issue, in particular, in relation to territorial restrictions.

9. We note that the Explanatory Memorandum states that the territorial extent and application of the draft VABEO is the entirety of the UK, and this implies that a ban on exports outside the UK would not fall within the hardcore restrictions listed in Article 8 of the draft VABEO. However, our view is that the CMA should explicitly clarify the position with regards to exports outside of the UK and imports into the UK, rather than leaving it to inference.

10. Paragraph 162 of the European Commission's draft revised vertical guidelines[3] confirms that hardcore restrictions, including territorial restrictions, "*apply to vertical agreements concerning trade within the Union*" only. As such, "*vertical restrictions concerning exports outside the Union or imports/re-imports from outside the Union cannot be regarded as having*

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1 Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1030674/Eversheds_Sutherland__International__LLP_Response.pdf

2 Available at: https://ec.europa.eu/competition-policy/system/files/2022-02/guidance_information_exchange_VBER_dual_distribution_2022_0.pdf

3 Available from: https://ec.europa.eu/competition-policy/public-consultations/2021-vber_en

the object of appreciably restricting competition within the Union or as being capable of affecting as such trade between Member States." We propose that the Explanatory Memorandum and the CMA's guidance include a statement to the same effect in relation to the VABEO confirming that vertical restrictions concerning exports from the UK and imports to the UK are outside its scope (and outside the Chapter 1 prohibition in the Competition Act 1998).

Parity obligations

11. We also note BEIS' proposal to treat wide retail parity obligations as hardcore restrictions – and welcome the clear terminology used in the draft VABEO, which is also consistent with the terminology used by the European Commission in its draft revised Vertical Agreements Block Exemption Regulation ("**VBER**"). As noted in our response to the CMA's consultation, we agree with the treatment of wide retail parity clauses as hardcore restrictions, considering the likely negative effects of such clauses on the UK market (as opposed to the much larger EU market) and for reasons of consistency with the CMA's recent decisional practice.

Duration of the VABEO

12. We note the proposed duration of the draft VABEO (six years) and the provision of a transitional period for businesses. The relatively short duration of the new regime will allow for its further review in the not too distant future, which would potentially allow the UK government to introduce further, more liberalising and wide-ranging changes, that will reflect more closely the particularities of the UK market at the point in time.

Information on vertical agreements

13. While we are not in principle opposed to the provisions relating to the obligation to provide information on vertical agreements, we consider that the CMA will need to provide further guidance on the circumstances where this might be the case and the procedural guarantees that will accompany such a request (e.g. measures to protect confidentiality of certain parts of the documents, disposal of documents).

14. However, we consider that a period of 10 working days to provide such information is too short, and we would suggest a period of 30 working days would be reasonable.

Other drafting points

15. **Definition of "potential competitor" in Article 3(7):** Article 1(1)(c) of the European Commission's draft revised VBER includes a definition of "potential competitor" as meaning an undertaking that *"in the absence of the vertical agreement, would, on realistic grounds and not just as mere theoretical possibility, in case of a small by permanent increase in relative prices be likely to undertake, within a short period of time, the necessary additional investments or other necessary switching costs to enter the relevant market"*.

16. We consider that the wording *"on realistic grounds and not just as a mere theoretical possibility"* should also be included in the definition of "potential competitor" in Article 3(7) of the draft VABEO. This wording is important to make it clear that the prospect of entry must be more than merely hypothetical.

17. **Cross referencing error in Article 4(1):** Article 4(1) of the draft VABEO refers to Article 3(4), this should be a reference to Article 3(3).

18. **Combination of distribution systems in Article 8(3)(c):** Article 8(3)(c) of the draft VABEO refers to the *"provision of greater protection"* for members of selective distribution

systems against sales from outside the geographical area to unauthorised distributors inside that geographical area. This is unclear and vague.

19. We assume the paragraph is meant to indicate that sales by distributors outside the area in which the selective distribution system operates to unauthorised distributors within that area can be prevented, which reflects the position taken by the European Commission in its draft revised VBER, but this should be clearly set out.

20. **Definition of passive sales in Article 8(5):** There is a lack of clarity in the drafting of the definition of passive sales in Article 8(5)(b) of the draft VABEO. We assume that the paragraph is meant to mean that general advertising or promotion that reaches customers in other distributors' geographical areas or customer groups should be considered to be passive selling when it is a reasonable way to reach other customers including in the advertising distributor's own geographical area (which is made clear by the text after *"for instance"*), but the use of "*outside those geographical areas*" in line three causes confusion.

21. We suggest that the text is amended to read *"…but which is a reasonable way to reach customers not in those other distributors' geographical areas or customer groups, for instance…"*.

22. **Excluded restrictions, Article 10(1):** Article 10(1) of the draft VABEO provides that a vertical agreement must not contain an excluded restriction. This formulation is not appropriate for excluded restrictions, which may be included in a vertical agreement, although they would not benefit from the block exemption. This is by contrast to hardcore restrictions, which remove the whole agreement from the protection of the block exemption. We consider that Article 10(1) should be amended to state that an excluded restriction cannot benefit from the block exemption.

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