Technical Consultation on the draft Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022

1. Introduction

1.1 Freshfields Bruckhaus Deringer LLP (***Freshfields***) welcomes the opportunity to respond to the Competition and Markets Authority (***CMA***)'s technical consultation on the draft Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022 (the ***Order***).

1.2 This response is based on our significant experience and expertise in advising on issues raised by vertical agreements of many types, and, in particular, complex agency and exclusive and selective distribution arrangements. This response is submitted on behalf of the Firm and does not represent the views of any of the Firm's clients, which comprise a wide range of companies, including distributors, manufacturers and suppliers of different sizes and with differing scopes of activity.

1.3 Likewise, this response does not necessarily in all respects represent the personal views of every partner in the Firm.

2. General remarks

2.1 We are pleased to see that the CMA has taken account of a number of the comments provided by Freshfields and other respondents to the CMA's previous consultation on the retained Vertical Block Exemption Regulation.[1] It is encouraging that the stated purpose of the draft Order is to ensure that businesses are not prevented or disincentivised from entering into agreements that the CMA considers to be overall beneficial and not anticompetitive. Likewise, it is reassuring that the draft text of the Order is - for the most part - broadly in line with the new draft legislation proposed by the European Commission (the ***Commission***), albeit with the introduction of some amendments to improve the current legal framework aimed at ensuring that the exemption is most effective and appropriate for the UK market. We underline our previous comment in relation to the importance of consistency for businesses distributing goods and services in both the UK and the EEA (and particularly those with distribution networks covering both Northern Ireland and the Republic of Ireland), and will refer to this again later in this response.

2.2 Our comments on some of those specific amendments or retained provisions are set out in the remainder of this submission. We would like to emphasise at the outset, however, the critical importance of the CMA's Vertical Guidance intended to accompany the Order. In the same way that the Commission's Guidelines on Vertical Restraints (the ***EU Vertical Guidelines***) are essential for the interpretation of the EU Vertical Agreements Block Exemption Regulation (***EU VABER***), the CMA's Vertical Guidance will be equally indispensable for the interpretation of the new UK regime, in particular, with respect to the treatment of agreements *not* caught by the Chapter I prohibition or falling *outside* of the safe harbour provided by the Order. We note that the Consultation Document proposed that a number of issues, including those relating to agency for example, be addressed in the CMA's Vertical Guidance and we look forward to being able to comment in more detail on the scope and breadth of such guidance in due course.

[1] See the Retained Vertical Agreements Block Exemption Regulation Consultation Document, 17 June 2021 (CMA145con) (the ***Consultation Document***).

3. SPECIFIC ISSUES

Market share threshold

3.1 Whilst retention of the 30% market share safe harbour provided in Article 6 of the draft Order is consistent with the draft text of the new EU VABER, the inclusion of an additional market share threshold in Article 7(3) of the Order, for agreements entered into by parties whose market share subsequently exceed 35%, is an unnecessary divergence from current practice and the proposed approach under the draft EU VABER. Market shares can - and do - vary over time, such that it is helpful to have provision in both the draft Order and the EU VABER for a certain amount of flexibility to be shown to parties whose shares subsequently exceed the 30% threshold. However, to draw a distinction between those agreements where the parties' market shares are subsequently greater than 30% but less than 35% on the one hand (which would continue to benefit from the safe harbour for a period of two consecutive calendar years) and those that subsequently rise above 35% on the other (in relation to which the duration of the benefit of the safe harbour would be halved) is unnecessarily prescriptive. It is not clear why the draft Order should differ from the EU position in this respect, and we caution against UK law being less permissive – a theme we reiterate further below in relation to both parity clauses (paragraphs 3.15 to 3.18) and non-compete obligations (paragraph 3.19).

Dual distribution

3.1 The proposed inclusion of wholesalers and importers in the category of 'agreements with competitors' permitted under the dual distribution exception contained in Articles 3(5)(iii) and (iv) of the draft Order is a logical one, since there is no reason to distinguish between suppliers and these types of sellers. We also agree with the CMA's approach of not introducing the additional layer of complexity as initially proposed by the Commission in its draft legislation, which would expressly exclude information exchange from the exemption in cases where the retail market share of the parties is over 10%.

3.2 Nevertheless, it would be helpful if the CMA's Vertical Guidance could provide:

(a) greater clarity around the definition of dual distribution for the purposes of Article 3(5) of the Order, in particular, as regards the treatment of platforms offering online intermediation services (***OIS***) (we note that the new draft EU VABER excludes OIS from the dual distribution exception and addresses this in the draft EU Vertical Guidelines); and

(b) some flexibility in indicating a reasonable interpretation of Article 3(5) so that the exemption remains applicable to agreements where any competing relationship at manufacturing level between the parties is marginal or not relevant (e.g., if it concerns products completely unrelated to the agreement, or if the distributor has a de minimis manufacturing presence thereby not affecting the vertical nature or "centre of gravity" of the agreement in question).

3.3 We further reiterate our previous comment that additional guidance on the handling of competitively sensitive information pertaining to distributors by manufacturers/suppliers who engage in dual distribution would also be welcome. It would be helpful if the CMA's Vertical Guidance could clarify how the rules on information exchange apply in dual distribution situations, in particular, what information the CMA recognises may need to be exchanged in such contexts and further direction on when exchanges of information are likely to be

problematic. The CMA's Vertical Guidance could also incorporate how any competition concerns can be addressed as a practical matter and what steps firms should take to prevent inappropriate information exchanges and ensure that legitimate exchanges of information which are part of a normal vertical relationship are not treated as horizontal exchanges subject to more rigorous scrutiny under Chapter I Competition Act 1998 (***CA98***). This is of particular importance in the case of vertical exchanges of data between online marketplaces and third-party sellers. The approach to information exchange in these situations should necessarily recognise that a manufacturer/supplier is not prevented from having normal discussions about a vertical relationship with its distributors simply because the manufacturer/supplier also competes at the downstream retail level.

Resale Price Maintenance

3.4 The fact that under the retained regime RPM is considered hardcore, deters businesses from engaging in RPM and has created a perception that RPM is illegal *per se*, even in circumstances where no anticompetitive effects are likely to arise or where a procompetitive rationale for the agreement exists (e.g., where it results in improved inter-brand competition through suppliers incentivising retailers to promote a new product for an introductory period or provide improved pre-sale services). Since the draft Order seeks to maintain RPM as a hardcore restriction in Article 8(a), as a minimum, we strongly urge the CMA to provide clarity in the UK Vertical Guidance as regards the circumstances in which RPM might be found *not* to infringe Chapter I CA98 following an individual analysis of the agreement in question. Further guidance on the criteria and circumstances under which RPM can be justified is necessary. The CMA's Vertical Guidance should consequently clarify that:

(a) RPM does not necessarily restrict competition by object. It may not do so, for example, if following an analysis of the relevant context, proven pro-competitive effects cast reasonable doubt on the conclusion that the agreement has a restrictive object (see e.g., *Budapest Bank*[2] and *Generics (UK)*[3]). Where a plausible efficiency rationale exists, the claimant is required to establish actual or likely restrictive effects before the parties can be required to justify their agreement under section 9 CA98; and

(b) all agreements are capable of satisfying the section 9 CA98 criteria and there is no presumption that agreements incorporating hardcore restraints do not do so. Clearer guidance would consequently be welcomed on when RPM might be considered to be 'indispensable' to achieve established efficiencies, and how it can be demonstrated that consumers will receive a fair share of those benefits.

3.5 Such additional clarity and guidance are especially important given that online RPM might be considered to be a crucial means of supporting the provision of dealer services in bricks and mortar stores and that RPM may be necessary to support the launch of new products for a few years or support occasional discounting campaigns. It seems crucial, therefore, that the CMA's Verticals Guidance recognises the potential *pro-competitive* benefits and provides guidance on how those benefits are to be reflected and given real and sufficient weight within the framework of the CA98. Without this, potentially pro-competitive arrangements may be deterred.

3.6 By way of further examples, it would be helpful if the CMA's Vertical Guidance clarified:

[2] Case C-228/18, EU:C:2020:265.
[3] Case C-307/18, EU:C:2020:52.

(a) that the practice of manufacturers agreeing with (key) customers a price for products, then commercialised via one or several (competing) distributor(s), does not amount to RPM to the extent the agreed price between the manufacturer and the client is a maximum price as there remains genuine room for further negotiations and discounts agreed between the customers and the distributor(s);

(b) how it would analyse so-called 'fulfilment contracts' under CA98, and in particular whether this diverges at all from the analytical framework described in the draft EU Vertical Guidelines[4] published alongside the new draft EU VABER.

3.7 We also consider it necessary for the CMA to reflect on how the rules governing RPM apply to agency agreements in so far as they are caught by Chapter I CA98 (see further paragraphs 3.20 - 3.21 below dealing with agency agreements).

Territorial and customer restrictions

3.8 Since the CMA is minded to maintain territorial and customer restraints as hardcore restraints in the new Order, the CMA could consider following the approach taken by the Commission in the new draft EU VABER by clearly and separately articulating the rules relating to each of exclusive, selective and free distribution in order to provide clarity and an administrable system which can be applied easily by undertakings, competition agencies and courts. Whilst in substance the two sets of rules are largely consistent, it would be helpful to businesses seeking to self-assess to have both frameworks articulated in a similar form.

3.9 We welcome the additional flexibility afforded by the new Order, which provides businesses with the ability to design their distribution systems according to their needs, and the explicit confirmation in Article 8(3) allowing:

(a) the combination of exclusive and selective distribution in the same or different geographical areas, where the Commission has thus far taken a less permissive approach by limiting the combination of such systems to *different* territories only;

(b) shared exclusivity in a geographical area or for a customer group by allowing the allocation of a geographical area to more than one distributor; and

(c) 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.

3.10 We further welcome the additional clarity around the distinction between active and passive sales, particularly in the digital environment, set out in Article 8 of the new draft Order.

3.11 However, more detailed guidance in relation to some of these provisions would be helpful, notably around the notion of "shared exclusivity" and what the CMA would consider acceptable in terms of "a limited number" of distributors. Likewise, the new draft EU VABER allows active sales restrictions to be "passed on" to the customers of a supplier's buyer, whereas these are explicitly prohibited by the new draft Order. In the interests of consistency between the two regimes, the CMA could consider amending Article 8(2)(b)(i) so as to permit restricting the customers of buyers.

[4] See paragraph 178 of the EU's draft EU Vertical Guidelines.

Online sales restrictions

3.12 We support the fact that, under the Order, both dual pricing and the imposition of criteria for online sales that are not overall equivalent to the criteria imposed on brick-and-mortar shops in a selective distribution system, will no longer be regarded as hardcore restrictions, thereby helping to create a more level playing field between online and bricks-and-mortar retailers. This is consistent with the approach envisaged by the Commission.

3.13 However, some further guidance on these two issues would also be well-received. In respect of dual pricing, it would be helpful to clarify that differential pricing between different retailers is generally not problematic. Additionally, in line with the Commission's approach, further guidance on acceptable justifications for price differentiation with respect to the same reseller, depending on whether sales are made online or offline (for example related to differences in costs/investments between the two channels), would be welcome.

3.14 In respect of the equivalence principle, it would be helpful to clarify that operators of selective distribution systems can impose different qualitative or quantitative criteria for online and offline channels that are reflective of the different characteristic of such channels, provided these are not applied with the object of inhibiting online sales (similar to the guidance provided in the new draft EU Vertical Guidelines).

Parity obligations

3.15 We are supportive of the amendments to the definition of "wide retail parity clause" in the Order, which is clearer and less confusing than the previous approach set out in the Consultation Document.

3.16 However, the CMA's approach of including a wide retail parity clause within the list of hardcore restrictions in Article 8 of the Order stands in contrast to the Commission's more lenient treatment with regard to wide retail parity clauses imposed by providers of OIS only, which will only be considered excluded restrictions under the new proposed Article 5(1)(d). The inconsistency between the draft Order and the new draft EU VABER as regards the treatment of parity obligations is regrettable.

3.17 With that in mind, it would be helpful if the CMA's Vertical Guidance could set out a structured analysis for:

(a) determining whether parity obligations are in an individual case likely to have anticompetitive effects under section 2 CA98;

(b) determining whether parity obligations give rise to relevant efficiencies and procompetitive benefits; and

(c) assessing how any identified restrictive effects are to be weighed against efficiencies and procompetitive benefits under section 9 CA98.

3.18 It would also be useful if such guidance covered: (i) the assessment of parity obligations relating to non-price terms; and (ii) factors that may make wide retail parity obligations more or less problematic in a given context (particularly if the CMA is minded to continue to recommend that such parity obligations are treated as a hardcore restriction under the new Order).

Non-compete obligations

3.19 By preserving the status quo as regards the treatment of tacitly renewable non-competes and maintaining them in the list of excluded restrictions in Article 10 of the Order, the CMA is taking a more restrictive approach than the Commission, which intends to remove such non-competes form Article 5 of the new draft EU VABER. Again, a more desirable outcome would be for both sets of rules to be aligned. As stated in our previous submission, we also consider this a missed opportunity by the CMA to further facilitate the UK Government's Net Zero objectives and on sustainability more generally, where the risk and reward that is the subject of a vertical arrangement may take more than 5 years to come to fruition.

Agency

3.20 It would be helpful if the CMA's Vertical Guidance could state more clearly the principles that govern the question of when genuine agency relationships are so closely interrelated that the relationship is characterised by economic unity (that they fall outside the scope of Chapter I CA98).

3.21 The principles and current guidance are difficult to apply in many situations, especially where sales are made online *via* a platform. More guidance on how the agency principle applies to agency arrangements concluded between platforms and suppliers, and in digital markets, is consequently required. The CMA's Vertical Guidance should clarify that platforms can in certain circumstances be genuine agents, in particular, where ownership of the products/services is not passed to the platform (the platform does not buy products from suppliers for resale), where contracts concluded are formed between the supplier and customer, and where the platform does not bear any of the risks related to the sale or provision of the goods or services, but receives a commission or remuneration for concluded contracts (and that this may be the case even when they bear the entire risk of investing in infrastructure and/or simultaneously work for various smaller principals). It cannot be right in principle that platforms are barred from such status. In so far as agency agreements involving online platforms do fall within the scope of the Chapter I prohibition, however, the CMA's Vertical Guidance should recognise that different principles to those governing other vertical agreements should apply where ownership of the products/services is not passed to the platform (there is no resale by the platform to the customer) and where the contracts are formed between the supplier and customer. In such cases, the platform is merely providing intermediation services and the principal should remain free to set its own prices. We note that a number of these points are addressed in detail in the draft EU Vertical Guidelines.

Withdrawal and non-application of the Order

3.22 In so far as the CMA considers a particular agreement not to be an exempt agreement and proposes to cancel the block exemption in respect of that agreement, we agree that the CMA should give prior notice in writing of its intention to cancel or withdraw the benefit of the Order in an individual case, and consider any representations made to it by or on behalf of the parties to the agreement (as set out in Article 13 of the draft Order). We further agree that any notice should state the facts on which the CMA bases its decision or proposal and its reasons for making it. Since this new power for the CMA necessarily undermines some of the certainty afforded by the safe harbour created by the draft Order, we would welcome further details

regarding the cancellation procedure and the circumstances in which the CMA may seek cancellation of the benefit of the block exemption to be set out in the CMA's Vertical Guidance.

3.23 Likewise, such guidance should also recognise that agreements are naturally entered into by at least two parties who may not be equally culpable in respect of any provisions contained therein and which the CMA may find objectionable. The CMA's Vertical Guidance should also confirm that if the CMA cancels the benefit of the exemption provided by the Order, such cancellation can only have *ex nunc* effects, i.e. the exempted status of the agreement in question will remain unaffected for the period preceding the date on which the cancellation becomes effective.

3.24 As regards the CMA's ability to cancel the benefit of the exemption pursuant to Article 12(2) of the draft Order, it would be helpful to understand what the CMA has in mind with regard to "reasonable excuse".

Obligation to provide information

3.25 The obligation on parties to provide the CMA with information in connection with vertical agreements to which they are a party imposed by Article 12 of the draft Order is a new obligation and one that is not contained in the draft EU VABER. As such, we consider it appropriate for the CMA's Vertical Guidance to set out the circumstances in which the CMA may make such a request, as well as the format and process for doing so. We restate our previous suggestion that a time limit that is longer than 10-working days ought to be given to parties so that businesses have sufficient time to be able to comply with such a request (especially given the important consequences of not doing so).

Extra-territorial application of the Order

3.26 An issue that is not explicitly dealt with in the draft Order, but in relation to which we are receiving a number of questions from business, is the status of restrictions such as export bans and a supplier's ability to impose contractual restrictions on a buyer's ability to make active or passive sales *into the UK* from EEA jurisdictions (as well as *vice versa*). This lack of clarity brings with it great uncertainty for businesses operating cross border and who – post-Brexit – are now considering carving out the UK from EEA-wide supply chains and distribution arrangements.

3.27 In this respect, it is crucial that the CMA's Vertical Guidance addresses the UK's anticipated approach to, and enforcement priorities in respect of, jurisdiction and agreements incorporating restraints on selling *outside of*, or *into*, the UK, in particular:

(a) When agreements covering third countries and undertakings located in third countries may affect trade within the UK. For example, the compatibility with Chapter I CA98 of an agreement appointing a distributor outside of the UK and prohibiting that distributor from making sales into the UK. Will the CMA apply the approach adopted in the EU, that the conduct may affect trade if, in the absence of the agreement, resale to the UK would be both possible and likely (see *Javico*[5])? Or might it take an approach similar to that adopted in Switzerland, ensuring that Swiss competition law captures

[5] Case C-306/96, EU:C:1998:41.

contracts that prohibit sales into Switzerland with the aim of maintaining higher prices there? Further how will it be determined whether such an agreement appreciably restricts competition in the UK (by object or effect)? and

(b) When a restraint on a distributor selling *into the EEA* might affect trade, and restrict competition, within the UK and, if it does not, provide confirmation that the incorporation of such a restraint would not prevent the application of the new UK Order.

4. Conclusion

4.1 As mentioned, we look forward to receiving and commenting on the CMA's accompanying draft Verticals Guidance and would be very happy to discuss in further detail any of the points raised in this response.

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March 2022