RESPONSE TO COMPETITION AND MARKETS AUTHORITY CONSULTATION

Draft guidance on the application of the Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022

1. Introduction and general comments

1.1 This response represents the views of the law firm Allen & Overy LLP on the Competition and Markets Authority (**CMA**)'s consultation on its draft guidance on the application of the Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022 (**Draft Guidance**), dated 31 March 2022.

1.2 We welcome the opportunity to respond to this consultation. We would be happy to discuss any of the points made in this response if the CMA would find it helpful to do so.

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

1.4 Overall, we welcome the CMA's Draft Guidance. It is generally well structured and clear, making it an important tool in assisting undertakings and their advisers to apply the Vertical Agreements Block Exemption Order (**VABEO**), once finalised. Chapter 3 (Overview of the assessment of vertical agreements) is a good example – the three step process is clear and helpfully signposts the relevant sections of the Draft Guidance to look to for more detailed guidance at each stage. Similarly, the steps for assessing whether a vertical agreement falls within the scope of the Chapter I prohibition at paragraph 5.2 provide a useful checklist for undertakings to use.

1.5 We also welcome the fact that much of the Draft Guidance broadly reflects the EU draft guidelines on vertical restraints (**EU Draft Guidelines**). This is crucial, as the CMA points out, to avoid so far as possible creating legal uncertainty for businesses that operate in both the UK and the EU.

1.6 However, there are some aspects of the Draft Guidance where the guidelines could be clearer, or where we consider additional guidance would be helpful. We have set out these specific comments below.

2. Purpose of the Draft Guidance (Chapter 1)

2.1 Paragraph 1.8 of the Draft Guidance states that the "*Guidance is relevant to both existing and new vertical agreements*". It goes on to say: "*[i]t replaces the European Commission's Guidelines on Vertical Restraints and the CMA guidance on Vertical Agreements*".

2.2 The application of the Draft Guidance to existing vertical agreements warrants further explanation. In particular, it should refer upfront in this section to the 12-month transitional period, either explicitly in the text or by cross-referring to paragraph 12.2. This will help to ensure that undertakings are aware of this 'grace period'. Only mentioning the provision in the penultimate chapter of the Draft Guidance is, in our view, insufficient because it is likely to be overlooked.

3. Vertical agreements which generally fall outside the scope of the Chapter I prohibition (Chapter 4)

3.1 Paragraph 4.2 helpfully lists the types of vertical agreement that typically do not fall within the scope of the Chapter I prohibition before going on to give more detailed guidance in the remainder of the chapter.

3.2 However, paragraph 4.3 notes that "*[o]ther types of vertical agreements may also fall outside the scope of the Chapter I prohibition*". Part 8 of the Draft Guidance is mentioned, which it notes "*describes examples of exceptional circumstances in which restrictions that are identified as 'hardcore' in the*

VABEO may actually fall outside of the scope of the Chapter I prohibition". But there is no further indication of what these types of restriction are. The Draft Guidance would be easier to navigate and apply if it listed here (even if only in a high-level way) the other types of agreement which may fall outside the scope of the prohibition, and where to find the relevant guidelines.

3.3 Footnote 15 of the Draft Guidance refers to OFT401 (the guidance on agreements and concerted practices). While we appreciate that the CMA is currently concentrating its efforts and resources on creating new guidance materials on the retained block exemptions, as well as other policy areas such as sustainability and digital markets, we see merit in the CMA also reviewing old guidelines such as OFT401, updating them where necessary, and reissuing them.

3.4 Paragraphs 4.22 to 4.25 deal with the concept of dual role agents. In general, the Draft Guidance is clear on this issue, and the inclusion of the worked example at the end of paragraph 5.25 is particularly useful.

3.5 However, in paragraph 4.23 the CMA recognises that where an operator undertakes a number of activities, it may be difficult to assess if it is operating as an agent. It gives some examples of when the assessment may be particularly complex (e.g. the pricing policy of the principal for the products sold under the agency agreement might influence the incentives of the agency/distributor to price independently the products that it sells as an independent distributor). But the Draft Guidance does not go on to say how these factors will impact the assessment, i.e. will it make it less likely that an agreement will be categorised as an agency agreement in such circumstances? Further explanation would be helpful.

3.6 The sections of the Draft Guidance on agency agreements could usefully cross-refer to the guidance on fulfilment contracts at paragraph 8.18.

4. Scope of the VABEO (Chapter 6)

4.1 The final sentence in paragraph 6.12 is missing some text.

4.2 We suggest that at paragraph 6.21 on dual distribution arrangements, the Draft Guidance cross-refers to the later guidelines on information exchange in dual distribution (paragraphs 10.170-10.179).

4.3 Paragraph 6.39 describes how, in respect of trade marks, an exclusive licence granted to a distributor amounts to exclusive distribution. It would be helpful if the Draft Guidance clarified that the agreement could therefore benefit from the block exemption provided by the draft VABEO.

5. Market definition and market share calculation (Chapter 7)

5.1 The final sentence in paragraph 7.9 is missing some text.

5.2 Paragraph 7.11 notes that in the case of dual distribution of final goods, the market definition and market share calculation should include the supplier's sales of its own goods made through its vertically integrated distributors and agents. A worked example to demonstrate this would be useful. Footnote 57 could also be more clearly drafted.

6. Hardcore restrictions (Chapter 8)

6.1 We welcome the inclusion of practical examples given at paragraph 8.9. Whilst circumstances under which a hardcore restriction may fall outside the scope of the Chapter I prohibition or fulfil the conditions for individual exemption are the exception, they are not rare.

6.2 In the example on genuine entry, the Draft Guidance notes that a distributor which is the first to sell a new brand/existing brand on a new market may have to commit substantial investments, and that it

may not enter the distribution agreement without protection for a "*certain period of time*" against active or passive sales by other distributors. Such restrictions on passive sales may fall outside the scope of the Chapter I prohibition "*during the initial period over which the distributor is selling the contract products*". It would be helpful if the Draft Guidance could give an indication of how long this period could be. If it is dependent on the individual circumstances/industry, this could at least be made clear.

6.3 Paragraph 8.22 gives examples of when RPM can lead to efficiencies. However, only two situations are listed – the CMA does not include the example on pre-sales services that is contained in the EU Draft Guidelines (at paragraph 182(c)). In our view, this is a helpful example and we consider that it should also be included in the Draft Guidance.

6.4 In addition, one of the examples of potential RPM efficiencies provided in paragraph 8.22 is that of fixed resale prices in the context of a coordinated short-term low-price campaign. The paragraph explains, that fixed resale prices "*may be necessary to organise such a campaign in a distribution system in which the supplier applies a uniform distribution format, such as a franchise system*." Our view is that consumers can potentially benefit from coordinated short-term low-price campaigns regardless of the nature of the distribution system implementing them. We would therefore encourage the CMA to broaden the wording so that it covers all distribution systems. Alternatively, the paragraph should at least further elaborate on what kinds of distribution systems have a "*uniform distribution format*" besides franchise systems. In particular, does it include selective distribution systems?

6.5 The guidance on restrictions on online sales (paragraphs 8.32 to 8.44) is generally in line with the EU Draft Guidelines. As noted above in section 1, this consistency is vital in terms of creating legal certainty for businesses. However, in general we think that the section suffers from some repetition and could be clearer. It would therefore be helpful if the online sales guidance were set out in a separate section that is organised and separated by sub-sections (for instance, one sub-section setting out the general principle, then a sub-section for restrictions targeting online sales channels, followed by a sub-section for restrictions targeting online advertising).

6.6 More generally, given the importance that the new guidance on online advertising channels will have for businesses, we think that a clear and comprehensive definition of "online advertising channel" should be added to the Draft Guidance. Currently paragraph 8.38(f) only gives price comparison tools and online search engines as examples and paragraph 8.50 mentions targeted online advertising. Paragraph 10.132 refers to digital comparison tools (**DCTs**) as online advertising channels. It would be helpful if the CMA could confirm whether those are the only online advertising channels within scope of the new guidance, or if other channels (such as email, social media and online video marketing) are also within scope.

6.7 We welcome Article 8(3) of the draft VABEO, which gives suppliers increased flexibility over how they set up their distribution arrangements and, in particular, the clarification that more than one buyer can be exclusively allocated to a territory or customer group. This is referenced at paragraph 8.69 of the Draft Guidance. We consider that it should also be expressly mentioned (or at least a cross-reference made) earlier at paragraph 8.56 which discusses the exception allowing a supplier to restrict active sales by a distributor into a territory or customer group exclusively allocated to other buyers, or reserved to the supplier.

6.8 Paragraph 8.66 mirrors the text in 8.71. We are not convinced that this repetition is required, and suggest that paragraph 8.66 is removed.

6.9 Paragraph 8.70 notes that a selective distribution system can be combined with an exclusive distribution system within the same territory if they are established at different levels of the value chain. This is a welcome clarification. However, the caveat that the exclusive wholesaler should not also be "*a member of the selective distribution system*" is unclear, as is the rationale for including this

point. How would this apply in a situation where a manufacturer appoints an exclusive distributor for a specified territory at wholesale level and requires the exclusive wholesaler to appoint selective retailers on its behalf? The exclusive wholesaler will be a party to the agreements with the selective retailers, and in a broad sense could be regarded as " *a member of the selective distribution system*",[1] albeit that it may not have had to meet the selection criteria applicable to the retailers. This kind of distribution structure is relatively common and we can see no compelling reason why the benefits of the block exemption should not be available. But more generally, we think this section of the Draft Guidance needs further explanation as the underlying policy objection to situations where the exclusive wholesaler is "*a member of the selective distribution system*" is not clearly spelled out.

6.10 We welcome the inclusion of the statement at paragraph 8.85 that "*the CMA is open to considering on a case-by-case basis, any efficiency arguments made in the course of any investigations under the CA98 relating to the use of wide retail parity obligations*". The divergences in approach to parity clauses in the draft VABEO as compared to the EU's revised draft Vertical Agreements Block Exemption Regulation is likely to cause uncertainty and increase regulatory complexity for businesses operating in both the UK and the EU, particularly in relation to existing agreements containing wide retail parity clauses. We therefore consider that it is important that businesses have the ability to put forward efficiency arguments and seek comfort from the CMA that the conditions of section 9(1) are fulfilled.

6.11 Text for footnote 83 is missing.

7. Excluded restrictions (Chapter 9)

7.1 The draft VABEO continues to remove the benefit of block exemption from non-compete obligations that have a term that is indefinite or that exceeds five years. The draft VABEO goes on to provide that a non-compete which is automatically renewable beyond a period of five years is deemed to have been concluded for an indefinite period. Paragraph 9.5 of the Draft Guidelines reflects these provisions.

7.2 By contrast, the EU approach (as set out in the EU Draft Guidelines at paragraph 234) is that non-compete agreements that are tacitly renewable beyond a period of five years can benefit from the block exemption if the buyer can effectively renegotiate or terminate the agreement with a reasonable notice period and at reasonable cost. The EU's approach therefore distinguishes restrictions that genuinely 'lock in' the restricted party beyond five years against restrictions that allow the buyer to choose an alternative supplier after five years.

7.3 In our view, the EU's approach is preferable as it allows for more flexibility in designing non-compete obligations that are capable of block exemption while still addressing the substantive concern posed by long-term non-compete obligations. Not only is the divergence between the UK and EU proposals subtle and potentially easily missed by businesses, but it is unfortunate that the UK's position appears to be less conducive to businesses entering into what should be regarded as benign renewal arrangements.

8. Assessment of vertical agreements which do not meet the legal conditions of the VABEO (Chapter 10)

8.1 The introductory section to Chapter 10, which sets out the effects of vertical agreements on competition, is clear. We agree with the CMA including this material at this point in the Draft Guidance, rather than at the beginning of the document (as in the EU Draft Guidelines).

8.2 Paragraph 10.41 states that "*single branding obligations exceeding five years are for most types of investments not considered necessary to achieve the claimed efficiencies or the efficiencies are not*

[1] Cf. the approach of the Commission in Case AT.40428, *Guess*, at section 5.2.4 where the exclusive wholesalers were treated as being members of the selective distribution network.

sufficient to outweigh their foreclosure effect ". This appears to apply even if the market shares of the parties are below 30% (i.e. if the obligation has lost the benefit of the block exemption because its duration exceeds five years). In the case of such small market shares, it is unclear why the Draft Guidance proposes what is effectively a presumption of anti-competitive effects and declares that individual exemption under section 9(1) will be unlikely. This is inconsistent with paragraph 9.5, which states that non-compete obligations must be assessed on a case-by-case basis if their duration exceeds five years.

8.3 Paragraph 10.59 explains that the number of exclusive distributors should be restricted to one or a limited number for a particular territory or customer group, determined in proportion to the allocated territory or customer group in such a way as to secure a certain volume of business that preserves their investment efforts. We suggest that this point is mentioned (or at least cross-referenced) earlier in the Draft Guidance at the point at which Article 8(3) of the VABEO is discussed. This would be in line with the EU Draft Guidelines and would avoid any confusion that the UK is taking a different approach to the European Commission on this issue.

8.4 Paragraph 10.78 contains a cross-reference to paragraph 11.54, which appears to be incorrect. We think this should instead refer to paragraph 10.69, which states that foreclosure of other suppliers does not arise as long as exclusive distribution is not combined with single branding.

8.5 Having said this, we are not in fact convinced of the need to repeat this statement at paragraph 10.78 – it would perhaps be clearer if the guidance at paragraph 10.78 were added to paragraph 10.69. If the CMA were minded to keep both paragraphs in the Draft Guidance, we suggest that the text in paragraph 10.78 more directly tracks the wording of paragraph 10.69, rather than stating "*foreclosure of other suppliers is unlikely to arise unless exclusive distribution is combined with single branding*". This would aid clarity.

8.6 Paragraph 10.83 provides guidance for when allocation of exclusive customer groups in an exclusive distribution system can benefit from individual exemption under section 9(1). It explains that the depreciation period for certain investments made by distributors can be used as an indication of the duration for which exclusivity can be justified. This includes investments that either: (i) build a brand image, (ii) develop specific equipment, skills or know-how to adapt to the requirements of an exclusive customer group, or (iii) create economies of scale or scope in logistics. We would welcome similar guidance on the extent to which depreciation periods of investments can be used as an indication for the justified period for territorial exclusivity. We note that paragraph 10.58 mentions that suppliers often use territorial exclusivity to incentivise distributors to make financial and non-financial investments in a specific territory, which suggests that investment depreciation periods potentially could be a relevant factor to consider for both types of exclusivity.

8.7 Paragraph 10.89 sets out the three conditions in the *Metro* judgment for when purely qualitative selective distribution is generally considered to fall outside of the scope of the Chapter I prohibition. Paragraph 10.124 refers back to that description and then proceeds to describe the *Metro* criteria again in a different order and in a more abbreviated form. While we do not think that there are any material inconsistencies between the two descriptions, our view is that the description in paragraph 10.89 should track across to paragraph 10.124 for the sake of consistency and clarity.

8.8 Paragraph 10.105 states that provisions that are strictly necessary for the functioning of a franchise distribution system can be considered to fall outside of the Chapter I prohibition. It gives as an example "*a non-compete obligation with regard to the goods or services purchased by the franchisee that is necessary to maintain the common identity and reputation of the franchise network*". We note that the CMA states in paragraph 10.11(f) that non-compete restrictions following the transfer of substantial know-how would normally fall outside the Chapter I prohibition. A genuine franchise distribution system will typically always involve the transfer of substantial know-how from the franchisor to the franchisee. We therefore suggest that the wording in paragraph 10.105 should be widened to include

all non-compete obligations with regard to the goods or services purchased by the franchisee in genuine franchise arrangements (rather than just those that are necessary to maintain the common identity and reputation of the franchise network).

8.9 We welcome the examples included in relation to many of the types of vertical agreement featured in Chapter 10 (e.g. exclusive distribution, selective distribution, franchising, exclusive supply). But we query why there are no similar examples for restrictions on the use of online marketplaces and DCTs. Given the novelty of much of the guidance on these issues, we consider it would be useful to include at least some worked examples.

8.10 In the context of DCTs, paragraph 10.128 states that "*DCTs typically do not enter into the primary contract with consumers*". In the following paragraph, the Draft Guidance notes that " *DCTs typically do not offer sale and purchase functionality, but rather re-direct customers to the website of the retailer, enabling a direct transaction between the customer and the retailer*". We consider that for clarity these two statements could usefully be combined into the same paragraph.

8.11 We welcome the inclusion of the section on information exchange in dual distribution arrangements, which is broadly in line with the EU Draft Guidelines on this issue. We consider that it is an extremely important clarification for businesses.

Allen & Overy LLP
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