Response to the UK Competition and Markets Authority's public consultation on the draft guidance to the proposed Vertical Agreements Block Exemption Order

1. We appreciate the opportunity to comment on the public consultation launched on 31 March 2022 on the proposed Vertical Agreements Block Exemption Order ("VABEO") and in particular the draft guidance to the proposed VABEO ("Draft Guidance").

I. Exception for dual distribution

2. Like the currently applicable version of the EU Vertical Agreements Block Exemption Regulation ("VABER"), the draft VABEO[1] provides that the block exemption does not apply to vertical agreements entered into between competing undertakings, except in situations of dual distribution.[2]

3. In contrast to the EC's proposals, the CMA does not exclude online intermediaries from the exemption, and has not suggested amendments to the market share thresholds. We agree this is the right approach. We also agree with the extension to cover agreements with wholesalers and/or importers. We support the CMA's view that competition issues are unlikely to arise in relation to dual distribution arrangements where (i) the parties do not have market power and (ii) potential pro-competitive effects of the vertical agreement outweigh any potential negative impact on horizontal intrabrand competition between the parties at the retail level.[3]

4. We welcome the CMA's proposal to provide clear guidance on the type of information exchange between a supplier and a buyer that can benefit from the block exemption in a dual distribution scenario, which closely mirrors the equivalent provisions in the European Commission's proposed principles for information exchange in dual distribution.[4] The non-exhaustive list of examples at paragraphs 10.175 and 10.176 of the Draft Guidance are helpful in clarifying the scope of the block exemption, alongside the examples of precautions that can be taken by the parties to minimise the risk that an information exchange not covered by exemption will raise horizontal concerns.[5]

5. Further clarification on the types of permitted information exchange would be helpful:

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[1] *See*, Department for Business, Energy & Industrial Strategy, "Draft Vertical Agreements Block Exemption Order", 21 February 2022 ("Draft VABEO").

[2] *See* Draft VABEO, Article 3(5).

[3] *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraph 6.21.

[4] *See* European Commission, Draft new section dealing with information exchange in dual distribution, paragraphs 13 and 14. *See also*, EC, "Review of the VBER and Vertical Guidelines".

[5] *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraph 10.179.

(i) The CMA explains that the lists set out examples of information under dual distribution agreements that "*can generally be considered to be unlikely to constitute a restriction by object and are likely to be genuinely vertical*" or are "*generally likely to either restrict competition by object or otherwise would be unlikely to be genuinely vertical*". It would be helpful for the list of positive and negative examples also to include examples of cases where the general presumption would be unlikely to apply. This would provide more predictability for companies regarding the implementation of their distribution systems.

(ii) The Draft Guidance (paragraph 10.176(b)) specifies that "*customer-specific data, including non-aggregated information on the value and volume of sales per customer, or information that identifies particular customers*" are generally likely to either restrict competition by object or otherwise unlikely to be genuinely vertical, "*unless in each case such information is necessary to enable the supplier or buyer to adapt the contract products to the requirements of the customer or to provide guarantee or after-sales services or to allocate customers under an exclusive distribution agreement*." It would be useful to further clarify that exchanges of customer-specific and transaction-specific information can also be necessary (and allowed) to enable the supplier and buyer to agree more favourable conditions, including special discounts, for a specific customer or customer group, *e.g.*, to enable the buyer to meet particularly intense inter-brand competition in a bidding context for a particular customer, or to accommodate specific end-customer groups with different budgetary constraints, for instance, sales to academic institutions. Such arrangements can be competitively beneficial.

(iii) It would be useful for the CMA to clarify that paragraph 10.176(b) only concerns specific data relating to final customers. A supplier or wholesaler should remain free to obtain performance information on resellers that cannot be used for vertical price maintenance or passive sales restrictions. Otherwise, paragraph 10.176(b) could prevent suppliers from monitoring or supporting resellers' sales performance, or monitoring resellers' compliance with selective distribution criteria.

(iv) We welcome the exception in paragraph 10.176(a) for information exchange relating to "*actual future prices*" when "*necessary to organise a coordinated short-term low price campaign*" in accordance with the guidance in paragraph 8.22(b). However, it would be appropriate for the exception also to cover other efficiency defences to the RPM prohibition including information exchanges relating to the introduction of a new product as outlined in paragraph 8.22(a).

II. Agency agreements

6. We welcome the additional guidance provided by the CMA on the assessment of agency agreements. However, (i) the CMA's approach to "hybrid" or "dual role agents", who

act both as agent and distributor for the same products of a supplier, is overly restrictive and (ii) its reasons for excluding suppliers of online intermediation services from being seen as agents are unclear. We have similar concerns about the EC's draft Vertical Guidelines.

7. ***Treatment of "dual role agents".*** As in the EC's draft Vertical Guidelines, the Draft Guidance requires that suppliers must reimburse dual role agents for all costs and risks not only with regard to the products sold via the agency model, but also for all of the party's costs associated with the products sold in the same market via the distributor model. This approach renders the dual role model unworkable in practice. It gives rise to a situation where a manufacturer bears all costs and risks, even for products sold via the distributor model, without the ability to determine at what price the distributor may resell its products. Whoever carries the risk should be able to set the price. A pro rata allocation of costs in relation to the distributor model would be more appropriate.

8. We encourage the CMA to reconsider its concern that agency arrangements may influence the pricing policy of dual role distributors, and limit their decision-making freedom as distributors.[6] The Draft Guidance does not adequately justify this overly restrictive view, and whether products belong to the same product market is often uncertain without in-depth analysis. Any concerns could be better addressed by requiring a separation of agent and distributor roles, for example by appropriate firewalls between teams working on activities under the agency agreement and other teams.

9. ***Suppliers of online intermediation services.*** Like the EC's proposals, the Draft Guidance suggests that suppliers of online intermediation services cannot be seen as agents.[7]

10. The proposed approach does not capture business reality. Merchants using online intermediaries often have legitimate reason to determine their own price and marketing policy, in particular on platforms serving multiple merchants.

11. The CMA's reasons for excluding agency include, first, that strong network effects can create a "*significant imbalance in the size and bargaining power of the contract parties*" resulting in the provider of online intermediation services determining the contract products and commercial strategy. It is ironic to suggest that because there may in some cases be an imbalance, merchants using online platforms should be deprived of the opportunity to rely on agency to preserve what is left of their ability to set prices and determine marketing policy. The proposal would restrict smaller merchants' access to agents and could lead to greater pricing power for online platforms, at the expense of merchants.

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6 *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraph 4.22.

7 *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraphs 4.19 to 4.21.

12. The second reason the CMA mentions is that providers of online intermediation services "*often serve a very large number of sellers in parallel which prevents them from effectively forming a part of any of the sellers' undertakings*" and that online intermediation services act as independent economic operators who are not "*part of the undertakings of the sellers for which they provide online intermediation services.*" We recognise that this reasoning was used in the past to explain why competition law should not apply to restrictions imposed on agents. More recently it has been recognised that the proper economic rationale for allowing principals to give instructions to agents is the principle that whoever bears the risk should set the price and the marketing policy.

13. As important is the possible implication of the exclusion of agency for online intermediaries: it could be misread to suggest that the intermediary should set the price rather than the merchant. This would exclude inter-merchant competition on the platform and replace multiple price setters by a single one. That reduces competition.

14. Third, it is suggested that online intermediaries "*typically make significant market-specific investments*", *e.g.*, in software or advertising, "*indicating that providers of online intermediation services bear significant financial or commercial risks"*. The reality is that these investments tend to be fixed costs, which are spread over a large number of transactions on behalf of a large number of merchants. Whereas the intermediary can spread the risks, merchants cannot.

15. For these reasons, we invite the CMA to reconsider the analysis, and allow merchants to use online intermediaries as agents, as they do today. If the CMA retains its proposal, we recommend that the Draft Guidance should at least make clear that even if agency agreements with platforms are re-qualified as agreements for the supply of platform services, that should not prevent merchants from setting terms and conditions for sales they make to end-users via platforms. Mere platform service providers should not set the price, where the merchants bear the risks, and may wish to engage in inter-merchant competition on the platform.

III. Exceptions to hardcore territorial and customer restrictions

16. The Draft Guidance explains the additional exceptions to the hardcore restriction on vertical agreements restricting territory or customers: (i) the combination of exclusive and selective distribution, (ii) shared exclusivity (where two or more distributors are appointed for a geographic area or customer group), and (iii) greater protection for members of selective distribution systems against sales from outside the geographical area to unauthorised distributors inside the area.[8]

17. These additions and the brief explanations in paragraph 8.70 enable efficient investment in inter-brand competition.[9] Further guidance would be helpful on whether there is any

[8] *See* Draft VABEO, Article (8)(2)(b)(i) to (iv).

[9] *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraph 8.70.

limit on the number of exclusive distributors for a system to be classified as shared exclusivity. Unlike the EC, the CMA does not specify a proportionality test for the definition of shared exclusivity. Both the CMA and EC's definitions of shared exclusivity leave room for interpretation. As this is an exception from a hardcore restriction, a proportionality test or further clarity on the limits of the exception would be useful.

IV. Online sales and dual pricing

18. The Draft Guidance removes the hardcore restrictions on (i) suppliers charging different prices depending on whether the buyer is reselling online or offline and (ii) suppliers relying on selective distribution imposing criteria for online sales that differ from those for brick-and-mortar shops. This reflects changes to the online sales environment since the policy was last reviewed in 2010, with some suppliers seeking to encourage investment in brick-and-mortar outlets. This guidance is welcome, yet further guidance on a number of points would be helpful.

19. First, the Draft Guidance (paragraph 8.43), mirroring the draft EC Vertical Guidelines, explains that the difference in price between products sold online and offline, *i.e.*, the wholesale price difference "*should take into account the different investments and costs incurred by a hybrid distributor so as to incentivise or reward that hybrid distributor for the appropriate level of investments respectively made online and offline*". It adds that if the wholesale price difference is "*entirely unrelated to the difference in costs incurred in each channel*" and "*has as its object preventing the effective use of the internet for the purposes of selling online*" it would amount to a hardcore restriction.

20. Whether the wholesale price difference is "*entirely unrelated to the difference in costs*" is a factual analysis, based on a vague criterion. This undermines the very purpose of a block exemption – of ensuring legal certainty. A reseller will not know whether a ban on online reselling of a cheaper product (intended for a physical outlet) is enforceable, absent a potentially complex economic analysis relying on data which the reseller may not have at its disposal – for instance, to what extent the resale online of products it buys for physical outlets could undermine investments by other resellers in brick-and-mortar facilities elsewhere (for example, because real estate is much more expensive). The legal uncertainty may deter suppliers from efficient dual pricing. Further guidance would therefore be helpful on how this will be interpreted.

21. Second, suppliers relying on selective distribution will also have greater freedom to impose criteria for online sales that differ from those for brick-and-mortar shops, unless such criteria "*have as their object preventing the buyers or their customers from using the internet effectively for the purposes of selling their products online*" (paragraph 8.67). Similar considerations apply, and we invite the CMA to provide further guidance on how this will be interpreted.

V. Parity Obligations (MFNs)

22. The draft VABEO adds wide parity/ wide MFN clauses (clauses that ban suppliers from offering better terms on any other platform) to the list of hardcore restrictions. The Draft Guidance explains that (i) they restrict competition between horizontal competitors, in contrast to obligations on a business's own sales, (ii) they "*reduce the ability and incentive of intermediaries to enter and expand*" and (iii) they are likely to "*soften competition between suppliers competing on intermediaries*".[10] In contrast, the EC, while removing the benefit of the block exemption for wide parity clauses, treats wide MFNs as an excluded restriction, rather than a hardcore one.

23. The Draft Guidance (paragraph 8.85) notes that undertakings have the possibility of seeking to justify a wide parity/wide MFN clause using efficiency arguments under section 9(1) of the Competition Act. One particular example of this would be where non-discrimination is reasonably necessary to protect investments by a newly entering platform, which has not yet achieved the efficiencies of scale and scope, and market recognition, of incumbent platforms. Merchants may wish to encourage and even subsidise such new entry to encourage inter-platform competition, but the new entrants would be discouraged from investing if they could not insist on getting at least as good a deal as the incumbent platforms. We invite the CMA to consider including this as an example in paragraph 8.85.

9 May 2022

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10 *See* CMA, "Draft Guidance: Vertical Agreements Block Exemption Order", paragraphs 8.74 to 8.84.