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CMA consults on draft guidelines on vertical agreements

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The UK Competition and Markets Authority (CMA) **has published for consultation** its much-anticipated draft guidance on vertical agreements (Draft Guidance).

The EU Vertical Block Exemption Regulation (VBER) exempts certain categories of vertical arrangement (agreements between businesses at different levels of the supply chain) from the prohibition on anti-competitive agreements. It was retained into UK law post-Brexit and is due to expire on 31 May 2022 in the UK and the EU. Regulators in both jurisdictions have been separately consulting on whether to extend the block exemption and, if so, how the block exemption and its associated vertical guidelines should be updated.

The UK and the EU both propose to renew and update the application of the block exemption once it expires. The UK government had previously **released** a draft of the proposed Vertical Agreements Block Exemption Order (VABEO) in February. The Draft Guidance follows on the heels of the proposed VABEO and provides guidelines on how businesses should apply the VABEO as well as how to assess vertical arrangements that do not fall within the scope of the proposed VABEO.

When finalised, the VABEO and the Draft Guidance will, in the UK, supersede the VBER and the European Commission (EC)'s guidelines on vertical agreements. Crucially, this means that businesses will need to comply with two sets of rules.

Changes to key aspects of the rules

The VABEO and Draft Guidance contain important updates to the rules on vertical agreements.

In some cases, the changes proposed mean that the rules will be relaxed, with the block exemption extended to cover a larger number of agreements. In others areas, the rules will be tightened.

Helpfully, many of the draft UK updates are in line with the amendments **tabled by the EC** in the EU version of the rules. The CMA says that it wants to avoid, as far as possible, creating legal uncertainty for businesses operating in both the UK and the EU by limiting the extent of divergence.

Despite this, some key differences in approach have emerged. Companies with activities across the UK and EU will need to pay close attention to these to ensure that they are compliant with both sets of rules.

We set out below the main changes proposed in the UK, and how they compare with the planned approach of the EC.

Tightening the approach to wide retail parity obligations

The UK (and EU) proposals will tighten restrictions in relation to retail parity obligations (also called Most Favoured Nation clauses). These require one party to an agreement to offer the other party goods or services on terms that are no worse than those offered to its own customers or to third parties.

'Narrow' parity clauses (which require parity only with terms offered on the restricted party's own direct sales channel, for example a supplier's own website) will be distinguished from 'wide' parity clauses (which require parity against products sold on indirect sales channels and include, for example, requirements by intermediaries such as price comparison websites or online market places that a supplier will offer its products to them at prices or on terms that are no worse than those offered to other intermediaries). The EC will also make this distinction, which reflects the current approach of certain EU Member States.

However, the UK looks set to diverge from the EC's approach in two important ways:

- The VABEO and Draft Guidance treat wide retail parity obligations as a 'hardcore' restriction. This means that where such clauses are included, the entire agreement falls outside the block exemption. By contrast, the EC will treat wide retail parity obligations as an 'excluded' condition. In this case, the benefit of the block exemption is only lost for the clause itself – the rest of the agreement can remain exempt.

- The EC's excluded condition will only apply to wide retail parity obligations that are imposed by online platforms, whereas the UK's hardcore restriction will cover these obligations regardless of the type of company that imposes them (and no matter whether they are online or offline).

Importantly, under both sets of proposed rules, narrow parity clauses and wide business-to-business parity clauses will be able to benefit from the block exemption.

Dual distribution exemption extended

Under the existing VBER, the block exemption is not currently available for agreements between competitors except for non-reciprocal agreements between a manufacturer and a distributor, or between a service provider and a retailer, where the parties do not compete upstream (known as 'dual distribution' arrangements).

The VABEO and Draft Guidance will extend this dual distribution exemption to also cover agreements where the upstream party is a wholesaler or an importer. This is in line with the EC's proposed approach.

The exchange of information in dual distribution arrangements is an area of concern for antitrust authorities. The CMA clarifies in the Draft Guidance that information exchange in this context will be block exempted as long as it does not restrict competition by object and is 'genuinely vertical' (ie it is required to implement the vertical agreement). The CMA provides detailed guidance on what types of information are covered, and sets out a range of safeguards that companies can adopt to help ensure compliance. Again, this is in line with the EC's approach. The EC – in its consultation from February – proposed that the block exemption will only apply to the exchange of information between a supplier and buyer that is necessary to improve the production or distribution of the contract goods or services by the parties. The EC has also issued guidance on this issue.

The EC drafts, however, take a more restrictive approach to online platforms which have a hybrid function (ie they supply online intermediation services while at the same time selling goods or services downstream in competition with their online intermediation service customers). The EC proposes that these should not be able to benefit from the dual distribution exemption (whereas the UK proposals do not contain this restriction).

More flexibility to design distribution systems

The VABEO and Draft Guidance will allow for more flexibility in designing distribution systems than is currently allowed under the existing VBER. The CMA has aligned its approach with the EC proposals in most respects:

- Suppliers will be able to combine customer group exclusivity and geographical exclusivity in one distribution system (ie by allocating to a specific customer group in a specific territory).
- It will be possible to appoint exclusive territory/customer groups to more than one buyer (ie shared exclusivity).
- It will be possible to combine exclusive distribution with selective distribution. However, under the proposed UK rules, if such systems are used in the same territory, they will need to be established at different levels of the value chain (eg exclusivity at wholesale level and selective distribution at retail level), and the exclusive wholesaler cannot also be a member of the selective distribution system. By contrast, the EU proposals will not allow the combination of exclusive and selective distribution in the same territory, although a supplier will be able to commit to only supplying one or a small number of authorised distributors within the territory where a selective distribution system operates (and will also be able to commit not to make direct sales itself into that territory).

Further clarifications on the distinction between active and passive selling

How online sales should be dealt with under the rules on vertical agreements has been the subject of much debate. Helpfully, the CMA provides further clarification on this in the Draft Guidance, which for the most part are aligned with the EC's approach.

For example:

- Setting up an online shop that customers outside of the seller's territory can use to make purchases, without those customers actively being targeted, will be considered a form of passive selling.
- Offering a website language option different to the one commonly used in the territory where the seller is established, or targeting online advertising to a specific region or customer group, will be classified as active selling.

Notably, the Draft Guidance states that prohibiting the use of price comparison sites could potentially amount to a restriction of passive sales if the price comparison tools are not targeted to specific groups.

New approach to online sales and advertising bans

Significantly, the Draft Guidance provides that restrictions having as their object the prevention of buyers or their customers from effectively using the internet to sell their products online will be considered to be hardcore restrictions of active/passive sales. This principle will cover restrictions in relation to both online sales channels and online advertising. The EC proposes to take the same approach, which reflects established EU case law.

Both the UK and EU proposals will provide some flexibility as to how this principle is applied. For instance, it could be possible to place restrictions on specific search engines or price comparison services, or on a specific online sales channel (such as online marketplaces) while retaining the benefit of the block exemption, provided there are sufficient other options available to allow effective online selling. It could also be possible to place quality standards for online selling and advertising activity (particularly in selective distribution systems), provided these quality standards do not violate the general principle set out above.

Relaxation of dual pricing arrangements for online and offline sales

The Draft Guidance is aligned with the EC's approach in relaxing the current requirement for price parity between goods intended to be resold online and those intended to be resold offline.

Dual pricing arrangements will now benefit from the block exemption provided that the difference in price is designed to incentivise an appropriate level of investments respectively made online and offline.

Likewise, non-equivalence will also be possible for other (non-price) criteria.

However, these dual pricing arrangements will not benefit from the block exemption if they violate the principle set out above by effectively making it unviable to sell goods or services online.

Agency agreements: clarity on online intermediation services and dual role agents

Genuine agency agreements fall outside the scope of the prohibition on anti-competitive agreements. An agreement will be categorised as an agency agreement if the agent bears no, or only insignificant, financial or commercial risk as regards the contracts entered into with the principal.

The CMA's Draft Guidance clarifies how the agency concept should be applied to digital markets. In particular it will categorise online platform providers as 'suppliers', which in principle makes them ineligible from being categorised as agents. The Draft Guidance also notes that online platform providers: (i) act as independent economic operators, (ii) often have significant market power which drives commercial decision-making in their relationship with sellers, and (iii) usually provide platform services to a large number of sellers in parallel. The EC proposes to take the same approach.

The Draft Guidance also considers the position of 'dual role' agents. These are companies that act both as an independent distributor of some products of a supplier, and also as agent for other products of the same supplier. The Draft Guidance (in line with the EU's revised vertical guidelines) acknowledges that this situation will likely entail a complex assessment of how costs are allocated between the two roles, and whether the commercial terms applied for each role impact incentives in the other role. The EC has previously released guidance through a **working paper** that considers these issues in detail.

The CMA expects to carefully assess compliance with the requirements for dual role agents in order to avoid the structure being used to facilitate resale price maintenance (RPM).

RPM remains a hardcore restriction

As expected, it will remain the case under both the UK and EU proposals that a supplier setting a fixed or minimum retail price constitutes a hardcore restriction and therefore cannot benefit from the block exemption.

The proposals now clarify that online platform service providers are treated as 'suppliers' for the purposes of the vertical rules, and therefore need to comply with the RPM restrictions in order to benefit from the block exemption.

Importantly, the Draft Guidance states that the use of specific price monitoring software does not constitute RPM as such. However, the CMA notes that such price monitoring does increase price transparency in the market. And using a price monitoring system can make direct or indirect means of achieving vertical price fixing more effective.

Tacitly renewable non-compete restrictions

The draft VABEO retains the current rules on non-compete obligations as they are – that is, non-compete obligations that are indefinite or exceed five years in duration are excluded from the block exemption.

This includes non-compete clauses that are automatically renewable beyond a period of five years (which are deemed to be indefinite).

By contrast, the EC proposes to allow, in certain circumstances, non-compete obligations which are tacitly renewable beyond five years to benefit from the block exemption going forward.

Timeline for implementation

The VABEO and the UK's revised vertical guidance will take effect from 1 June 2022 and will be in force until 1 June 2028.

Of crucial importance to businesses, there will be a 12 month transition period during which agreements that are currently block exempted under VBER, but which do not meet the requirements for block exemption under the new vertical rules, will retain the benefit of the block exemption.

For companies that are currently relying on the vertical block exemption in the UK, it is important to now assess whether any amendments will be needed to their vertical agreements to ensure compliance with the UK's rules beyond the end of the transition period. This will require an awareness and understanding of the subtle divergences that have emerged between the UK and EU approaches.

The CMA's consultation on the Draft Guidance will run until 5 May 2022.

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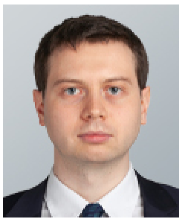

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