The new competition rules for vertical agreements in the UK

Key headline points

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Introduction

From 1 June 2022, new rules govern how competition law applies to vertical agreements in the UK and EU. The new rules apply to all types of vertical agreement, including exclusive and selective distribution, franchising, sub-contracting and agency. Almost all businesses are therefore impacted by them.

Whilst the key underlying message for businesses is that the new rules are a case of evolution not revolution (indeed, for the most part they reflect and update the existing position), they do make some important changes.

Businesses should be alert to the changes and any opportunities (or threats) that they present. Businesses that operate in both the EU and UK should also bear in mind that separate (albeit similar) sets of rules apply in each jurisdiction.

This note highlights the main points that we consider businesses need to know in relation to the new rules for the UK. We have focused on eight core topics, set out below. We would, of course, be very happy to offer further guidance on these and other aspects of the new rules – please contact a member of our Competition team for further support.

Overall structure of the new rules

Evolution not revolution

The new rules retain the current framework of a block exemption and accompanying guidelines.

In the UK, the new block exemption is the Vertical Agreements Block Exemption Order (VABEO). The block exemption retains a 30% market share threshold and creates a "safe harbour" from the competition law prohibition of anti-competitive agreements for vertical agreements unless they contain "hardcore" restrictions (albeit with certain other types of restriction being excluded from the safe harbour).

The accompanying CMA guidelines provide guidance on the application of the block exemption and on how competition law applies where the block exemption does not (for example, where the market share threshold is exceeded).

At an EU level, meanwhile, the European Commission has introduced its new parallel Vertical Agreements Block Exemption Regulation (VABER) and accompanying guidelines.

There is a one year transition period from 1 June 2022 for agreements that benefited from the previous block exemption.

Resale Price Maintenance (RPM)

There are no significant changes to the underlying rules, but there is expanded guidance

Whilst there were calls from some quarters for the UK to relax its stance of RPM and adopt a more permissive US approach, the CMA signalled fairly early on that it was not minded to make radical changes.

However, whilst the CMA's guidelines stick to familiar territory and reflect the existing position, they seek to offer more concrete guidance on when RPM might be lawful.

The guidelines also contain new guidance in an e-commerce context, in relation to price monitoring and how the rules apply to "fulfilment contracts". They also underline that, in relation to online platforms, a provider of online intermediation services is a supplier and must not engage in RPM with regard to the intermediated goods or services.

For our further insight on RPM under the new rules, click here.

Exclusive distribution

The rules remain largely unchanged – although they allow for "pass on" of restrictions to customers and they introduce scope for "shared exclusivity"

As was the case under the previous rules, the new block exemption permits suppliers to operate distribution systems in which they can allocate territories or customer groups exclusively to resellers, in which case they can protect the exclusive resellers from "active" (but not "passive") selling by other resellers.

Suppliers also continue to be allowed to reserve territories and customer groups to themselves.

Potentially helpful developments for suppliers are that they are now permitted to require distributors to pass on active sales restrictions to their own customers (ie affording other distributors greater protection against active selling into their exclusive territory or customer group), appoint distributors on a "shared exclusivity" basis (ie with more than one distributor being appointed to an exclusive territory or customer group) and to restrict distributors (and their customers) in territories outside of the exclusive distribution system from actively selling to customers within the exclusive distribution territory.

For our further insight on exclusive distribution under the new rules, click here.

Selective distribution

The rules remain largely unchanged – although suppliers are now able to apply selective distribution alongside exclusive distribution in separate territories

Selective distribution arrangements in principle remain block exempted regardless of the products in question. Where the block exemption applies, suppliers continue to be able to select authorised resellers on the basis of both qualitative and quantitative criteria, with authorised resellers being limited to selling only to end-users and other resellers within the authorised network.

Suppliers are able to restrict distributors outside the selective distribution system (and their customers) from selling to unauthorised distributors within the system.

For our further insight on selective distribution under the new rules, click here.

Online sales

Some important relaxations to the rules – but care still needs to be taken

The CMA's guidance reflects a recognition of the significant development of the e-commerce sector since the current guidelines came into force back in 2010.

Whilst the underlying principle remains that resellers must be free to sell online, the new rules introduce a number of important changes that reflect a welcome relaxation of the rules for suppliers.

In particular, where the block exemption applies:

- there is now scope for suppliers to engage in "dual pricing" and to apply non-equivalent criteria to online/offline selling;
- there is clarification of the distinction between "active" and "passive" selling in an online context; and
- suppliers may generally place restrictions on the use of specific search engines or price comparison services, or a specific online sales channel (e.g. third party marketplaces), provided that effective online selling is not impeded.

For our further insight on online sales under the new rules, click here.

Agency arrangements

The underlying rules remain unchanged, but with expanded guidance

Whilst the block exemption does not apply to agency arrangements (rather, the underlying law is determined by case law), agency arrangements are covered by the accompanying guidance.

The CMA's guidance on agency arrangements largely reflects well-established principles and is consistent with the European Commission's own new guidelines (both sets of guidance are considerably longer than the existing EU guidance, seemingly reflecting a greater focus on agency by both authorities).

Of note, however, is that the CMA's guidance also contains new content (not reflected in the Commission's guidelines) that, among other things, suggests that multi-brand agents may be less likely to be agents for competition law purposes.

For our further insight on agency agreements under the new rules, click here.

Information flows in the context of dual distribution

There is welcome (albeit cautious) guidance from the CMA regarding what information can and cannot be shared where the supplier and its customer compete with each other at the downstream level

Dual distribution occurs where a supplier supplies its products to third party customers for resale but also supplies at the downstream level itself. It is common across many industries including FMCG (where, for example, a supplier might operate its own webstore), automotive and financial services.

The CMA's guidance helpfully confirms that, where an agreement benefits from the block exemption, the benefit extends to exchanges of information between the parties – but only to the extent that the exchange is "genuinely vertical" (by which the CMA means the information is required to implement the vertical agreement) and does not restrict competition by object. The guidance provides examples of what this means in practice.

For our further insight on information flows in the context of dual distribution under the new rules, click here.

Consistency with the equivalent new EU rules

For the most part, the new rules for the UK are closely aligned to those that have been adopted at an EU level

In particular, the CMA appears to have adopted a conscious policy of reflecting in its guidance the European Commission's position in its own guidelines.

Some potentially significant proposed differences between the two jurisdictions evaporated during the consultation phase. For example, the European Commission dropped at a late stage a proposal that dual distribution agreements between competitors should be subject to a lower (10%) market share test.

Generally speaking, therefore, businesses are able to operate safe in the knowledge that arrangements that are lawful in the UK are likely to also to be lawful in the EU, and vice versa.

Perhaps inevitably, however, the two sets of rules are not precisely the same. For example: the UK has rendered wide retail parity obligations "hardcore" restrictions, whereas the EU has not; the CMA guidance on agency arrangements goes slightly beyond what the EU has offered; and the EU guidelines arguably offer greater comfort in relation to tacitly renewable non-compete provisions exceeding five years' duration.

Resale price maintenance

Resale price maintenance (RPM) covers a range of behaviour aimed at restricting a reseller's freedom to determine its own resale price.

Suppliers of goods may often seek to avoid what they perceive to be erosion of their brand positioning and a "race to the bottom" on price by seeking to assert a minimum or fixed resale price on their retailers. However, pressurising or incentivising resellers to adhere to (or otherwise agreeing with resellers) a fixed or minimum resale price has long been considered a "hardcore" restriction of competition.

US antitrust law recognises a defence to resale price maintenance based on brand erosion. Brexit, coupled with the expiry of the current EU block exemption, presented an opportunity for the UK regime to consider departing from the traditionally strict approach to a more permissible regime.

However, resale price maintenance infringements have persistently been vigorously enforced by the CMA with the CMA pursuing cases each year and the practice being seen as directly harming the consumer by leading to artificially inflated retail prices.

Further, with the CMA recently making use of innovative new price monitoring tools to actively police markets suspected of engaging in RPM, it is perhaps unsurprising that the focus of its guidance maintains the traditionally strict approach to RPM.

The CMA's guidance mentions the possibility of individual exemption for RPM, but we will have to see whether arguments for individual exemption are ever accepted through the decisional practice going forward (the current EU guidelines also envisage the possibility of justifying RPM in certain circumstances, but in practice such an argument has never been accepted). The CMA has however been striving to offer concrete examples of where RPM may be justified in efficiency ground. It offers two examples, as follows:

- RPM might be an efficient way to induce distributors to take into account the manufacturer's interest to promote a new product (particularly a completely new product) and to increase sales efforts. However, no less restrictive means should exist for any efficiency argument to succeed. E.g. suppliers could demonstrate that it is not possible to impose promotion requirements by contract on all buyers. In this scenario, the imposition of a fixed or minimum price for a limited period might be considered to be pro-competitive if provided it does not go beyond what is necessary to introduce the new product to market.
- Fixed resale prices might be required to organise a short-term low-price campaign (e.g. 2-6 weeks) which also benefit consumers, particularly in a franchise system where there is a uniform distribution format.

Much of the content of the guidance is familiar territory, bearing close resemblance to the existing EU block exemption. The guidance does contain some additional detail relating to the e-commerce context in particular:

- Price monitoring, increasingly used in e-commerce on both the supplier and retailer side, does not in and of itself constitute RPM. However, it does increase price transparency in the market, which allows manufacturers to track resale prices and act quickly if price decreases are detected.
- In relation to online platforms, a provider of online intermediation services is a supplier and must not engage in RPM with regard to the intermediated goods or service.
- The guidance identifies a category of agreement referred to as a 'fulfilment contract' in which a supplier sells a product to a buyer to resell to a specified customer, where the supplier has already concluded an agreement with that customer - in which case (subject to conditions) the supplier may specify the price at which the buyer resells to the customer.

US antitrust law recognises a defence to resale price maintenance based on brand erosion. The UK however, is maintaining a stricter stance."

Exclusive distribution

Under the new rules, the treatment of exclusive distribution arrangements remain largely unchanged, except that "shared exclusivity" is now permitted.

An exclusive distribution agreement is one where the supplier allocates a geographical area or customer group exclusively to itself and/or to one or a limited number of resellers.

The key commercial objective of an exclusive distribution agreement is that a reseller can have an expectation of a certain volume of business, so allowing the reseller to invest in marketing and promotion that benefits the reseller.

What an exclusive reseller cannot do

- The reseller cannot "actively" sell into the exclusive area or customer group reserved to another reseller or the supplier. This means the reseller cannot actively target the exclusive customers of another reseller or the supplier, for instance by sending e-mails. Additionally, targeted advertising to such reserved customers can be prevented, including not using targeted digital tools. However, this does not mean the reseller is unable generally to use online advertising channels.
- If the reseller is acting as a wholesaler, the supplier can prohibit the reseller from selling to end users.

What an exclusive reseller can do

- The reseller must be free to "passively" sell into the exclusive area or customer group reserved to another reseller or the supplier. This means the reseller can respond to unsolicited requests from and deliver to a customer, for example, that is inside the exclusive geographic area of another reseller. Additionally, general advertising and promotion is permissible, even if it unintentionally reaches customers reserved for another reseller. Moreover, the reseller can use both its bricks-and-mortar retail outlets as well as its own online sales site.

What the supplier can do

- The supplier can prevent the reseller from dealing with goods/services that compete with the supplier's but only for a period that does not exceed five years.
- The supplier can require the reseller to purchase some or all its requirements for specified goods/services from the reseller, although again only for a period that does not exceed five years. Exceptions exist where the reseller is operating from the supplier's premises.

For both points above, if the period is longer than five years the provision itself does not benefit from the block exemption, even though the rest of the agreement can benefit from the block exemption.

What the supplier cannot do

- The supplier cannot restrict the reseller's ability to determine the resale price, although the supplier can recommend the resale price.
- The supplier cannot require the reseller to restrict or align its prices to the prices generally sold by the supplier's other sales channels.

Shared exclusivity

In a change to the previous rules, the new rules permit "shared exclusivity", ie appointing two or more distributors on an exclusive basis for a given territory or customer group. The rationale is that the justification for allowing an exclusive distributor protection against active selling into its territory or customer group may also hold where there is more than one distributor in that territory / customer group. That said, the CMA's guidance indicates that the number of appointed (shared exclusive) distributors should be proportionate to the territory or customer group in question such as to secure a certain volume of business that preserves their investment efforts.

Passing on restrictions to a distributor's customers

In a further change to the previous rules, suppliers are able to offer greater protection to exclusive distributors by not only restricting the supplier's own customers from actively selling into their territory of customer group but also restricting the customers of those customers.

> "Shared exclusivity and the ability to require distributors to pass on restrictions will be of interest to some suppliers."

Selective distribution

The treatment of selective distribution arrangements remains largely unchanged under the new rules.

A selective distribution agreement is one where the supplier sells the goods/services only to resellers that have been selected based on specified criteria, and where these resellers agree not to sell the goods/services to other resellers outside of the identified group.

The commercial objective is to create resellers who provide a defined level of value-added service and/or 'look and feel' to their sales outlets. Selective distribution is typically used for niche or luxury goods/services, but the CMA guidance confirms that selective distribution is permitted for any type of product (subject to the 30% market share threshold not being exceeded).

What an authorised reseller cannot do

- The supplier may (and, indeed, must) restrict the authorised reseller from selling products / services to resellers within the defined geographic territory that are not members of the selective distribution system.

What an authorised reseller can do

- The reseller, if operating at the retail level (so not a wholesaler) must be free to actively and passively sell to all end customers.
- The reseller must be free actively or passively to sell to other authorised resellers within the selective distribution system.

What the supplier can do

- The supplier can prevent the reseller from dealing with goods/services that compete with the supplier's but only for a period that does not exceed five years.
- The supplier can require the reseller to purchase some or all its requirements for specified goods/services from the reseller, although again only for a period that does not exceed five years. Exceptions exist where the reseller is operating from the supplier's premises.

> "The commercial objective is to create resellers who provide a defined level of value-added service and/or 'look and feel' to their sales outlets."

What the supplier can do

- Offer protection to authorised resellers within a selective distribution systems against sales from outside the territory to unauthorised distributors within the territory.
- The supplier can prevent the reseller from dealing with goods/services that compete with the supplier's but only for a period that does not exceed five years.
- The supplier can require the reseller to purchase some or all its requirements for specified goods/services from the reseller, although again only for a period that does not exceed five years. Exceptions exist where the reseller is operating from the supplier's premises.

For both points above, if the period is longer than five years the provision itself does not benefit from the VABEO, even though the rest of the agreement can benefit from the VABEO.

What the supplier cannot do

- The supplier cannot restrict the reseller's ability to determine the resale price, although the supplier can recommend the resale price.
- The supplier cannot require the reseller to restrict or align its prices to the prices generally sold by the supplier's other sales channels.

Protecting authorised resellers from sales from outside the selective distribution system

- Under the new rules a supplier may restrict distributors (and their customers) in territories where it does not operate selective distribution from selling to unauthorised resellers in territories where it does.

Online sales

Restrictions on online sales, including measures that disincentivise online sales, have traditionally been treated as hardcore restrictions of competition on the basis that sales via the internet are viewed as an important avenue for e-tailers to reach consumers in different territories within the EU.

Sales via the internet are classed as "passive" sales i.e. on the basis that the consumer typically seeks out supply by going onto a website to order products. Under EU and UK competition law rules "passive" sales are protected to avoid absolute territorial protection and to retain the free movement of goods within the single market.

Dual pricing and non-equivalent criteria for online sales

With the rise of significance of e-commerce and corresponding difficulties faced by bricks and mortar retailers to survive in the new post-Covid, increasingly remote and virtual world, the CMA's guidance provides that the following will not be considered hardcore restrictions going forward:

- **Dual pricing** i.e. the practice of charging a distributor more for products that are intended to be resold online versus products that will be resold offline in bricks and mortar stores. Dual pricing is currently prohibited on the basis that it disincentivises online sales. However, the guidelines indicate that dual pricing is exempt provided that the difference in price is designed to incentivise investments which are appropriate according to whether they are made online/offline. Such dual pricing arrangements will not benefit from the block exemption if they effectively make it unviable to sell goods or services online.
- **Imposing non-equivalent criteria** for online sales versus the criteria imposed on brick-and-mortar shops. Provided that the differences are designed to incentivise investments which are appropriate according to whether made online/offline, such measures will be possible going forward according to the guidelines.

Online sales and advertising bans

Restrictions having as their object the prevention of buyers (or their customers) from effectively using the internet to resell their products online, such as restrictions on online sales channels and online advertising, continue to be treated as hardcore restrictions of competition.

The guidance signals however that it may be possible to place restrictions on specific search engines or price comparison services, or a specific online sales channel (e.g. third party marketplaces like eBay/Amazon), without foregoing the benefit of the block exemption, provided that effective online selling is not impeded e.g. because there are other options available.

The guidance also make it possible to place quality standards for online selling and advertising activity (e.g. in selective distribution systems).

> Protecting people's ability to sell online remains a core focus - but subject to some helpful modifications for suppliers."

Agency arrangements

The CMA signalled some time ago that it wished to offer more practical, and therefore more useful, guidance on how competition law applies to agency arrangements. That has now manifested itself in the guidance, in a beefed-up section on agency that is twice as long as the equivalent section in the previous European Commission guidelines.

How competition law applies to agency arrangements is well-established in the case-law. In outline:

- where a person is an agent for competition law purposes, they are treated as an integral part of the principal, meaning that any agreement regarding the agent's sales activities (including relating to matters such as where, to whom and on what terms (including price) the agent may offer the products) fall outside the competition law prohibition of anti-competitive agreements and do not therefore give rise to competition law concerns;
- by contrast, where a person is an agent in a broader commercial sense but is not an agent for competition law purposes, they are treated as akin to a reseller under competition law, meaning that an agreement with the supplier regarding matters such as where, to whom and on what terms (including price) the agent may offer the products is likely to infringe competition law);
- the test for what constitutes an agent for competition law purposes is a relatively strict one: an agent is an agent for competition law purposes only where they accept no, or only insignificant, risk in relation to the arrangements.

Very often, the practical challenge for businesses – and their advisors – is in working out what the test for agency under competition law means in practice, taking into account the commercial realities of the sectors in which they operate.

The core parts of the guidance closely reflect that contained in the current European Commission guidelines.
The key takeaways are that:

- For suppliers seeking to implementing agency arrangements, it remains important that the arrangements are appropriately "de-risked" (which, in practice, can be somewhat counter-intuitive for suppliers whose natural instinct may be to protect themselves, rather than necessarily trading partners, from commercial and legal risk).
- The guidelines provide practical – albeit non-exhaustive and still, inevitably, only somewhat high-level – guidance on what factors may be relevant in determining whether a person is an agent for competition law purposes. For example, the guidance provides that an agent should ordinarily not accept title in the products (unless it is on a very brief, temporary basis, without imposing risk on the agent), not maintain at its own cost or risks stocks, not accept responsibility for customer non-performance, not assume responsibility for matters such as product-liability, not be obliged to invest in sales promotions or customer support services, and so on.

Consistent with the European Commission's guidelines, the CMA's guidance also includes sections on "dual role" agents, being agents who also act as distributors in the same product market. The guidance sets the bar fairly high in terms of the steps that a principal must take to de-risk the arrangements for the agent in these circumstances.

Importantly, there is potentially significant "new" content in the CMA guidance, that is not reflected in either the European Commission guidelines. This includes a suggestion that the following factors may be relevant to assessing whether an agent forms an integral part of its principal's undertaking (ie such that it is an agent for competition law purposes):

- the level of influence that the agent has in determining its commercial strategy, including whether the agent is in a position to determine or influence the terms on which it makes sales;
- the extent to which the agent undertakes a very considerable amount of business on its own account on the market for the products in question;
- the extent to which the agent acts for a large number of principals, which may indicate that the agent is independent and not an integral part of its principals business;
- whether the principal and the agent are perceived by third parties and on the market as forming one and the same economic unit.

Information flows in the context of dual distribution

During its initial consultation last year, the CMA identified a wish from businesses for better guidance on how the competition law rules apply to information flows in the context of dual distribution.

Dual distribution occurs where a supplier supplies its products to third party customers for resale but also supplies at the downstream level itself. In practice, dual distribution is very common. For example, many brand owners will supply direct to consumers through their own website and/or stores whilst, at the same time, supplying third party retailers.

Competition law considerations arise from the fact that, in dual distribution, the supplier in a sense competes with its own customers in the downstream market.

Whilst the vertical agreements block exemption does not apply to agreements between competitors, it does broadly permit dual distribution.

In its guidance, the CMA confirms that, where an agreement benefits from the block exemption, the benefit extends to exchanges of information between the parties to the extent that the exchange is "genuine vertical" (by which the CMA says it means the information is required to complement the vertical agreement) and does not restriction competition by object.

The CMA has provided a list of examples of what information be regarded as "genuinely vertical". It includes:

- Technical information relating to the products.
- Information relating to the supply of the products, including production, inventory, stocks, sales volumes and returns.
- Aggregated (and anonymised) information relating to customer purchases of the contract products, customer preferences and customer feedback.
- Information relating to the marketing of the products (but excluding information relating to proposed pricing).
- Performance-related information, including aggregated (and anonymised) information communicated by the supplier to the buyer relating to the marketing and sales activities of other buyers.
- Details of the supplier's pricing to the buyer and of any recommended resale prices.

By contrast, the CMA identifies the following as unlikely to be "genuinely vertical":

- Information relating to future prices at which the supplier or buyer will sell the products downstream.
- Customer-specific sales data, including nom-aggregated information on the value and volume of sales per customer, or information that identifies particular customers (except where the information is necessary to enable the other party to provide guarantee or after-sales services, or to adapt the products, or to allocate customers under an exclusive distribution agreement).
- Information relating to goods sold by the buyer under its own brand name, where the supplier manufacture competing branded goods.

The above principles are intended to apply to any communication of information between the parties to a vertical agreement, irrespective of how the information is exchanged, whether or not it takes place on a formal or informal basis, and the frequency of the exchange.

The CMA's guidance on this issue is to be welcomed, even if the guidance itself perhaps inevitably strikes a somewhat cautious note. Where information is shared that oversteps the "genuinely vertical" test, the guidance signals that there may be scope for businesses to protect themselves from competition law risk through, for example, firewalls and other types of information barrier since, ultimately, competition concerns should rise only to the extent that the information might have an adverse effect on competition. If, for example, a supplier receives and retains information at an upstream level, and takes steps to ensure that the information is not accessible by people operating at the downstream level, it should be possible to avoid any potential anti-competitive effect.

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