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ANALYSIS | 28 February 2022

UK Government publishes draft UK Vertical Agreements Block Exemption Order

On 21 February 2022, the Department for Business, Energy & Industrial Strategy ('BEIS') published its draft Vertical Agreements Block Exemption Order ('draft VABEO'). This is intended to replace retained EU law – the Vertical Agreements Block Exemption Regulation ('retained VABER')- which provides the framework for the assessment of vertical agreements and will expire on 31 May 2022.

This follows on from the Competition and Markets Authority's ('CMA') recommendation to BEIS in November 2021 that the retained VABER should be replaced with a UK specific Order. The purpose of the draft VABEO is to ensure that businesses are not prevented or disincentivised from entering into agreements that the CMA considers to be beneficial and not anticompetitive.

The European Commission ('Commission') has also been consulting on its proposed draft replacement for the EU Vertical Agreements Block Exemption Regulation ('VBER'), which also expires on 31 May 2022.

Proposed new regime

In accordance with the CMA's recommendation to BEIS, the draft VABEO in large part preserves the existing approach to vertical agreements under the retained VABER. However, there are a few key changes:

- Wide parity obligations to be treated as hardcore: the CMA has previously taken a strict approach as regards wide retail parity obligations, namely clauses specifying that a product or service may not be offered on better terms on any other direct or indirect (intermediaries, online) sales channels. In 2020, the CMA fined ComparetheMarket over £17 million for breaching competition law by imposing wide parity clauses in its agreements with home insurance companies. In line with this decisional practice, the draft VABEO treats wide retail parity obligations as hardcore restrictions, meaning that agreements containing such a restriction will not be block exempted. Narrow parity obligations and wide parity obligations that apply to business-to-business markets will remain block exempted.
- Creating a level-playing field for brick-and-mortar retailers: BEIS' Explanatory Memorandum accompanying the draft VABEO recognises the exponential growth of online distribution channels as a means to reach a greater number and variety of customers, as well as the challenges faced by brick-and-mortar stores. In this context, the draft VABEO will end some of the previous preferential treatment for online sales, and level the playing field by no longer treating as hardcore restrictions:

- dual pricing: this means that suppliers will be able to set a higher price for products intended to be resold online than for products intended to be sold offline by the same distributor;
- equivalence principle: this will allow different criteria for online and offline sales in the context of a selective distribution system.

- Flexibility of distribution systems: the draft VABEO will provide more flexibility to businesses in designing their distribution systems, by permitting:
  - the combination of exclusive and selective distribution in the same or different geographical areas;
  - 'shared exclusivity' in a geographical area or for a customer group by allowing its allocation to more than one distributor; and
  - greater protection for members of selective distribution systems against sales from outside the geographical area to unauthorised distributors inside that geographical area.

Divergence between the draft VABEO and the draft EU VBER

The draft VABEO shows some signs of divergence from the proposed regime that will replace the EU VBER. The main points to note are the following:

- Dual distribution: the UK Government intends to adopt a more permissive approach to dual distribution, by extending the current exception to cover wholesalers and importers, in addition to manufacturers. This recognises the importance of dual distribution models for businesses, in particular as online sales are becoming more prevalent. By contrast, whilst the Commission also proposed extending the exemption to cover wholesalers and importers, their approach to dual distribution appears at this stage to be stricter, with such systems only fully block exempted within a market share threshold of just 10%. The introduction of a lower market threshold for dual distribution and a separate set of rules for information exchanges has caused criticism from stakeholders and the Commission has recently run its own consultation on a draft section dealing specifically with information exchanges in dual distribution. While the position that will be adopted at the EU level is currently not clear, UK businesses engaging in dual distribution in the EU, or with effects in the EU, will need to carefully conduct business moving forward.
- Information exchanges: the treatment of information exchanges in the context of dual distribution remains unaddressed in the draft VABEO, and could be another area of potential divergence. It is expected that this will be dealt with in guidance to be published by the CMA. This is a particularly critical issue for businesses and any divergence between the UK/EU regime is likely to give rise to compliance queries for manufacturers

with cross-border operations.

- Wide retail parity obligations are treated as excluded restrictions in the draft VBER, whereas BEIS has taken a stricter approach, treating them as hardcore restrictions.
- The UK Government has limited the duration of the draft VABEO to six years. The new VBER is likely to have a much longer duration (until 2034). This appears to allow the possibility of more significant changes in the UK regime with greater divergence in the future, once the UK Government has had more time to develop its approach.

Commentary

The draft VABEO marks an important change for manufacturers and distributors and reflects some of the significant developments over the past ten years since the publication of the VBER. The exponential growth of online sales has resulted in increased direct-to-customer sales, but has also reversed the balance between online/offline sales to the detriment of brick-and-mortar stores. The new rules are expected to create more flexibility for manufacturers in designing their distribution models and incentivising investment from their distributors. At the same time, the draft VABEO could provide a framework for the protection of high street retailers. The new regime could lead to the re-design of existing commercial arrangements in a more efficient and flexible way.

The draft VABEO also signals the departure of the UK from the Single Market imperative, which had guided, and continues to guide, the drafting of the current EU regime and its draft revised version. The draft VABEO remains largely consistent with the EU approach, but does show some signs of divergence, recognising that the EU approach does not necessarily reflect the specific characteristics of the UK market any more.

Parties interested in replying to the technical consultation on the drafting of the draft VABEO can do so by 16 March 2022. The CMA is expected to publish and consult on further guidance to accompany the draft VABEO shortly.

More information

- *BEIS/ CMA press release*
- The retained VABER is one of the 'retained exemptions' created by a combination of the operation of the European Union (Withdrawal) Act 2018 and the Competition (Amendment etc.) (EU Exit) Regulations 2019 (as amended by the Competition (Amendment etc.) (EU Exit) – see here:

https://www.legislation.gov.uk/eur/2010/330/contents.

- CMA Recommendation to the Secretary of State and Annexes to the CMA's recommendation
- Eversheds Sutherland's response to the CMA's consultation