Distribution Duel: UK and EU Competition Reforms Threaten To Create Conflicting Rules on Parity Clauses and Dual Distribution

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1. Summary

The European Union and United Kingdom have each proposed modifications of their antitrust rules on distribution.[1] The proposals diverge significantly on common distribution practices, creating legal challenges for distribution agreements caught by both sets of rules.

- **Dual distribution:** The U.K. proposes to preserve the status quo. Under current rules, suppliers who sell through both captive outlets and independent dealers benefit from a 30% market share safe harbor. Under the pending U.K. proposals, there is no need to re-engineer distribution arrangements or create information barriers. The EU, however, proposes to limit the safe harbour threshold to 10% for information sharing between supplier and resellers in a dual distribution context.
- **Parity or most favoured nation (MFN) clauses:** The U.K. proposes a much stricter rule for certain MFN clauses. The consultation proposes to make "wide" parity clauses (where a seller promises a reseller/platform the best terms available to any indirect distribution channel) a hard core restriction — *i.e.*, terms that are presumed illegal. The EU's proposal on these terms is more nuanced. Parity clauses would continue to be exempt except in specific circumstances: at the retail level only, and only when the restriction is sought by online intermediaries from sellers across all retail platforms. Moreover, there would be no presumption that these terms are illegal in the EU; they would be subject to an effects-based test.
- **Marketplaces, online selling and subsidizing bricks and mortar:** Both proposals seek to address much-debated issues involving distribution arrangements. They both permit suppliers to restrict the marketplaces into which resellers market goods; clarify that suppliers may restrict reseller online sales only in very limited circumstances; and relax the rules on dual pricing. Dual pricing was previously considered presumptively illegal when a supplier charged a lower price in physical stores than online. Under both proposed revisions, dual pricing would be permitted, provided the practical effect is not to prohibit online sales.

The consultation on the U.K. changes runs through 22 July 2021, while the EU's comment period extends to 17 Sept. 2021. The new rules come into force in both jurisdictions in June 2022, with a transition period for prior existing agreements to May 2023.

The threatened divergence between the regimes is regrettable. On the EU side, by restricting the current exemption for dual distribution to those with minor market shares, the revision is likely to create legal uncertainty for the 64% of suppliers who have their own direct-to-consumer channel.[2] There has been no enforcement action by the EU or national authorities concerning dual distribution arrangements, and no concerns were expressed in the consultation process. Hence, there is no guidance as to how suppliers should seek to restrict information exchanges between their direct and indirect channels.

[1] The European Commission's 9 July 2021 notice of public consultation includes links to the Draft Revision of the Vertical Block Exemption Regulation (Revised VBER) and the Draft Revised Vertical Guidelines (Revised Vertical Guidelines). The U.K. Competition and Market Authority's proposals were set out in The retained Vertical Agreements Block Exemption Regulation – Consultation Document (CMA Consultation Document) on 17 June 2021.

[2] eCommerce Sector Inquiry Final Report Staff Working Document (2017) (eCommerce Sector Inquiry), ¶179 (64% of respondent manufacturers launched their own websites within the last 10 years, a figure that will have certainly increased in the four years since the report)

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Given that direct channels account for only around 3% of suppliers' sales,[3] it is unclear what this revision intends to achieve. It is highly undesirable to deter suppliers from reducing intermediation costs and providing a greater choice of channels to consumers. The U.K. rightly concluded, by contrast, that withdrawing the exemption for dual distribution systems would create damaging legal uncertainty.

On the U.K. side, the proposal to make wide parity clauses presumptively illegal is based on limited enforcement experience: a 2020 Competition and Markets Authority (CMA) decision involving a website offering home insurance price comparisons with a large market share that required insurance companies to agree that they would not offer lower prices to competing price-comparison websites.[4] It is unclear on what basis this could have broader application.

Parity/MFN clauses are widely used in all sectors of the economy for efficiency-enhancing pro-competitive reasons.

2. Current UK and EU Antitrust Rules on Distribution Agreements

Until now, the U.K. has followed the EU rules on distribution arrangements set out in the Vertical Agreements Block Exemption Regulation 330/2010 (VBER) and Guidelines. Since Brexit, the U.K. has been weighing whether to renew the U.K. equivalent, the Vertical Agreements Block Exemption Order (VABEO), in 2022. The EU is evaluating the regulation in parallel. Both EU and U.K. take expansive jurisdiction in antitrust matters. Commercial agreements implemented in the U.K. that have a direct, substantial and foreseeable effect in EU must follow both sets of rules. That is likely to be the case for many distribution arrangements.

2.1 Resale price maintenance

Neither the EU nor U.K. reviews propose to change the rules on resale price fixing. It remains a hard core restriction to set a fixed or minimum resale price.[5] However, the EU's Revised Vertical Guidelines repeat current guidance that resale price maintenance may be allowed on a short-term basis when necessary to coordinate a short-term low-price campaign[6] or to support new product launches. The latter in particular is permitted where necessary to encourage resellers to invest in promoting the new product.[7]

Online platforms setting seller's prices

The EU proposal also tightens the circumstances in which online platforms can restrict sellers' prices. It is not uncommon for platforms to require sellers to list products at specific price points on the platform, in according with the platform's marketing strategy. This was commonly analysed as a genuine agency relationship to which rules on anticompetitive agreements do not apply.[8]

The EU proposal states that the genuine agency rule is not applicable.[9] It defines the platform as a "supplier" of "online intermediation services," rather than an agent.[10] The seller who uses the platform, counterintuitively, is defined as a "buyer" of those intermediation services. The platform is said to be independent, rather than an agent of the "buyer." It is not permitted to set the "buyer's" price.[11]

These definitions run counter to common sense. It is difficult to see how a platform's "intermediation service" is any different than the role an agent or any intermediary performs. But the outcome of the EU guidance may not be materially different. The proposed guidance accepts that a platform can recommend that the seller list at a competitive price,[12] and there is no general duty on the party of platforms to carry a seller's products.

Fulfillment arrangements

The EU proposal clarifies that setting resale prices is permitted in tripartite fulfillment arrangements. Where the supplier agrees to a price directly with the end customer and assigns fulfilment of the order to an independent dealer, then there is no resale price restriction. Price competition has occurred at the point the supplier settles the price with the end customer. Allocation of that order to a dealer is simply confirmatory, not resale price fixing.[13]

2.2 Exclusive and selective distribution

The rules on selective and exclusive distribution territories also will not significantly change. A supplier may appoint resellers to an exclusive territory, prohibiting "active" sales into that territory. It may also create an authorized network of resellers (a "selective" distribution system), permitted to sell only to end users or each other.

Both the EU and U.K. propose to update the rules to provide greater flexibility to mix selective and exclusive distribution systems in different territories. The new EU rules will also

[3] *Ibid.*, ¶184 (average sales via self-owned websites amount to less than 3% of the total sales of manufacturers, and direct sales by manufacturers via marketplaces average less than 1% of total sales)

[4] Competition and Markets Authority Case 50505 (*BGL*), Infringement Decision, 19 Nov. 2020

[5] Revised VBER, art. 4(a); Revised Vertical Guidelines, ¶¶170-186

[6] Revised Vertical Guidelines, ¶182(b)

[7] *Ibid.*, ¶182(a)

[8] *Ibid.*, ¶179

[9] *Ibid.*, ¶44

[10] *Ibid.*, ¶63; Revised VBER, art. 1(1)(d)

[11] Revised Vertical Guidelines, ¶179

[12] *Ibid.*

[13] *Id.*, ¶178

permit the appointment of multiple resellers for a co-exclusive territory.[14] This is a welcome tidying up of an oddity in the current rules. Those had exempted only single-reseller exclusive territories, but not those where co-resellers had been appointed.

2.3 Restriction on reseller online sales

Both EU and U.K. rules prohibit bans on a reseller's use of online sales. This is considered a passive sales restriction, presumptively illegal under EU and U.K. law.[15] Both EU and U.K. authorities have levied significant penalties on suppliers seeking to prevent resellers selling online.[16]

The proposed Revised Vertical Guidelines give additional examples of illegal restrictions on the reseller's use of online advertising, including *de facto* restrictions such as preventing the reseller using the supplier's mark. This follows the EU's recent enforcement practice.[17]

Marketplace bans

A much-discussed question is whether a supplier may lawfully prevent resellers using third-party websites or marketplaces. Resellers often wish to use these as additional routes to market, while suppliers consider it important for brand management to control which third-party sites resellers use.

The proposed EU rules clarify that bans on online marketplaces are permitted in some circumstances. But a ban should not be a *de facto* prohibition on the reseller using any internet channels. The revised guidelines also point out that, if the supplier uses a third-party site to sell its products, then it cannot have double standards for its resellers.[18] The U.K. is likely to follow suit.[19]

Dual pricing: permitting subsidies for bricks-and-mortar versus online sales

The last revision of EU distribution rules in 2010 made clear that suppliers could not penalize online sales at the expense of a reseller's physical outlet sales. Differentiated pricing for offline and online sales was considered a restriction on online sales, and presumptively illegal. Belatedly, amid concerns that high-street retailers had suffered from lower-overhead online retailers, the revised EU guidelines now permit dual pricing. The supplier can subsidise reseller physical sales through lower prices, but the differential should not prevent effective use of the internet.[20]

The U.K., likewise, is proposing to permit dual pricing and allowing suppliers to specify criteria for physical outlets that may be more demanding than retail requirements, while disallowing outright online sales bans.[21]

2.4 Parity or MFN clauses

Parity (or MFN) clauses involve a seller's agreement to offer the best pricing or other commercial terms to a buyer. They are commonly used in commercial transactions for various purposes: to give assurance to a buyer in a long-term agreement where pricing variables can change; as a means of solving a commercial impasse; or to enable a buyer to assure its customers they will benefit from using it as a one-stop-shop because it has the best prices or widest content. Such agreements, for example, enable online aggregation sites to make "lowest price guaranteed" promises to customers.

So-called wide MFN clauses require the seller to offer the buyer the best terms the seller makes available to any channel, including its own direct and other third-party indirect channels. Narrow MFN clauses reference only the seller's own direct channel.

Prior iterations of the distribution rules permitted any type of MFN provided that the parties qualified for the safe harbor because their market shares were less than 30%.[22] A series of enforcement cases in online retailing (primarily ebooks, hotel reservations and insurance price-comparison sites) has prompted the EU and U.K. to contemplate tighter rules on MFNs.

EU proposes maintaining MFN exemption except for online platform wide retail MFNs

The Revised VBER exempts all parity obligations within the 30% safe harbour, with an exception for certain MFNs used by e-commerce platforms. Retail-level wide MFNs that providers of "online intermediation services" (*i.e.*, platforms) require of

[14] *Id.*, ¶¶100, 102

[15] Both EU and U.K. distribution rules distinguish between reseller "active" sales activity (*e.g.*, sales visits, unsolicited commercial communications, marketing or promotional activity targeted at a territory or customer group) and "passive" sales activity (*e.g.*, responding to unsolicited orders). Revised VBER, art. 1(l) and (m); Revised Vertical Guidelines, ¶¶197-201. Active sales may be restricted under limited circumstances. Restrictions on passive sales activities, however, are considered a by-object infringement — presumed illegal — and the enforcement authority is not required to demonstrate an anticompetitive effect. They may be justified only in very limited circumstances, and have been the target of aggressive enforcement and high fines. The distinction between the two in the online context is very difficult to police. Reseller-targeted emails, website language or search terms targeting another reseller's exclusive territory are considered "active" sales (Revised Vertical Guidelines, ¶199). All other forms of online selling is considered passive.

[16] Ping Europe Limited v Competition and Markets Authority, C3/2019/2863 [2020] EWCA Civ 13; CMA Case CE/9857-14 (Bathroom Fittings), Decision 10 May 2016; *ASUS*, Commission Decision AT.40465 [2018]; *Denon & Marantz*, Commission Decision AT.40469 [2018]; *Philips*, Commission Decision 40181 [2018]; *Pioneer,* Commission Decision 40182 [2018]

[17] *Guess*, Commission Decision AT.40428 [2018]

[18] Revised Vertical Guidelines, ¶317

[19] CMA Consultation Document, §4.56

[20] Revised Vertical Guidelines, ¶¶188, 194, 195

[21] CMA Consultation Document, §4.54

[22] Revised Vertical Guidelines, ¶48

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sellers are not automatically exempt.[23] Rather, the draft guidance provides criteria by which such clauses can be assessed for any anticompetitive effect.[24] Conversely, other types of e-commerce MFNs, including wide MFNs applied at the wholesale level (for B2B platforms) and "narrow" MFNs (whether at retail or wholesale level) remain exempt.[25]

In some cases, the e-commerce platform may be outside the market share safe harbour. The enforcement practice has tended to focus on platforms with substantial market power.[26] The Revised Vertical Guidelines set out its analysis of parity provisions outside the safe harbour and justifications provided under art. 101(3) of the Treaty on the Functioning of the European Union. The new guidelines consider (i) the market power of the platform, (ii) whether sellers need to deal with the platform to access consumers and/or (iii) whether sellers can distribute effectively via direct or other channels.[27] It identifies potential efficiency justifications under art. 101(3) in reducing search cost or preventing suppliers "free riding" on the platform's efforts.[28]

U.K. proposes presumptive illegality for wide MFNs

By contrast, the U.K. proposes to treat wide parity clauses as a hardcore restriction, regardless of the market power of the parties or whether the MFN is used in an online or offline context, and it would apply the prohibition to all levels of the supply chain.[29]

Narrow parity clauses continue to be exempt, but exemption may be withdrawn if there is evidence that their use replicates the effects of wide parity clauses.[30]

The stricter U.K. approach is based on limited enforcement practice, confined to retail price-comparison sites in the insurance industry.[31] There is no apparent reason why that case, which was the result of detailed case-specific analysis, should be applicable to all MFN provisions, regardless of industry context or level of supply. It is to be hoped that the U.K. will reflect on this absolutist position in the context of the consultation.

[23] *Ibid.*, ¶336; Revised VBER, art. 5(1)(d)

[24] Revised Vertical Guidelines, ¶337 et seq.

[25] *Id.*, ¶¶348-350

[26] CMA Case 50505 (*BGL*), *supra*; Private Motor Insurance Market Investigation, Final Report, 24 Sept. 2014

[27] Revised Vertical Guidelines, ¶¶350-353

[28] *Id.*, ¶¶351-353.

[29] CMA Consultation Document, §4.75

[30] *Id.*, §4.74

[31] CMA Case 50505 (*BGL*), *supra.*

2.5 Dual distribution

It is common for suppliers to have both direct and indirect channels. For example, car manufacturers may have both captive dealerships in flagship locations as well networks of independent dealers. With the expansion of e-commerce, it would be unusual for a manufacturer not to have developed a direct-to-consumer channel. Still, as noted above, these account for a very small portion of total sales.

In a narrow sense, the supplier's captive outlets compete with its independent resellers. But, in practice, the supplier is motivated to optimize its distribution system to compete with rival brands, not with other sellers of its own brand. For that reason, authorities generally consider dual distribution benign, with a broad exemption under the current rules, and raising few concerns even outside the safe harbour.[32]

EU proposes tighter 10% market share test for dual distribution

The EU's proposed revisions create a complex set of rules around dual distribution:

- Dual distribution is exempt within the 30% safe harbour, but information sharing between supplier and reseller within dual distribution is not allowed above a 10% market share threshold.[33] There is no guidance as to what types of information sharing would cause concerns.
- Dual distribution is not exempt for e-commerce platforms (providers of "online intermediation services") that are themselves retailers competing with marketplace sellers using the platform.[34]
- Dual distribution is not exempt where it results in a by-object restriction.[35]

The proposed revisions are unsatisfactory. The 10% market share threshold appears arbitrary. It is lower than EU *de minimis* guidance on vertical agreements and the EU guidance on agreements on distribution with competitors, both set at 15%.[36]

[32] Revised VBER, art. 2(4); Revised Vertical Guidelines, ¶¶27-28

[33] Revised VBER, art. 2(4) and 2(5); Revised Vertical Guidelines, ¶87 (makes clear that information sharing between suppliers and resellers is otherwise exempt)

[34] Revised VBER, art. 2(7); Vertical Guidelines, ¶¶91-92

[35] Revised VBER, art. 2(6)

[36] Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, ¶241

There is also no guidance on what types of information sharing could create competition concerns.[37] Suppliers will have many legitimate reasons to communicate with resellers in a dual distribution context: sharing market research on the products; suggesting recommended retail prices; understanding market take-up of products; assistance with product launches and promotions; and setting sales targets. Any of these types of information sharing might be of serious concern between independent competitors, but are benign and pro-competitive where the supplier shares with its reseller. So, too, there can be no objection to a supplier seeking market intelligence from its distributors to inform its own sales strategy. How else can it seek to improve the consumer experience via the direct channel?

If the objection to information sharing is that it might allow supplier predation of resellers' businesses by forcing them to share proprietary insights, that appears both (i) far-fetched (why would a supplier damage its own distribution channels?) and (ii) only a concern, if ever, where there is market power, and so should not be a concern with a 10% market share.[38]

Finally, the caveat that dual distribution must not give rise to a by-object restriction is difficult to understand. The block exemption cannot in any event apply to agreements that contain hard core restrictions. To the extent that the European Commission contemplates other by-object restrictions to be relevant, they need to be identified. To take one example, can a supplier provide resellers with recommended resale prices? It would clearly be an illegal cartel for one competitor to recommend pricing to its rival. But, within dual distribution systems, it is a common and benign practice.

[37] *Ibid.*, ¶244-245 (addresses information exchange in the context of commercialisation agreements, including distribution arrangements between competitors, but offers no guidance on dual distribution)

[38] The EU proposes to prohibit "gatekeepers" from requiring platform sellers to share information under the draft Digital Markets Act, Art 6(1) (a), and arguably (g), (h) and (i). But this rule is predicated on a gatekeeper being in a systemic position of market power. It does not read across to the Revised VBER, which, by definition, applies only where market shares are below 30%.

U.K. proposes to retain dual distribution exemption

In contrast the EU changes, the CMA proposes that the VABEO should retain an exception for dual distribution in the same form as the current EU rule, and for it to be extended to dual distribution by wholesalers and by importers.[39] It does not propose a lower threshold for the exchange of information, as it considered that adding an additional market share threshold is likely to add complexity and uncertainty for businesses and the benefits of doing so are currently unclear to the CMA.[40] It may, however, provide more guidance on information exchange in the context of dual distribution.[41]

3. Comment

The proposed divergence between the U.K. and EU rules is regrettable. Brexit notwithstanding, the two economies are closely connected. It is likely that any material distribution agreement between parties of any size will be subject to both sets of rules, requiring companies to conform to the strictest standard or risk significant legal uncertainty.

The stricter standards for dual distribution (in the EU) and MFNs (in the U.K.) make little sense in the commercial context, and do not seem to arise from any considered analysis of the enforcement practice. Moreover, the rules are poorly articulated and risk being unadministrable in practice.

Companies have until 22 July 2021 and 17 Sept. 2021, respectively, to respond to the U.K. and EU consultations. The CMA will make a recommendation to the Secretary of State on the VABEO in anticipation of its expiry on 31 May 2022. The European Commission will prepare an impact assessment before finalising the proposals, with a view to having new rules in place when the current VBER expires, also on 31 May 2022.

[39] CMA Consultation Document, §3.14

[40] *Ibid.*, §3.16

[41] *Ibid.*, §3.17