NFDA Update -

Re: Vertical Agreement Block Exemption Order (VABEO)

Background

In anticipation of Brexit, the UK transposed the EU's Vertical Agreements Block Exemption Regulation (**VABER**)[1] into domestic law as a 'retained' regulation, so its terms would continue to have effect in the UK pending any future domestic replacement.

The VABER (in the EU) and the UK's equivalent retained regulation determine the competition law compliance of most so-called "vertical" agreements i.e. distribution and supply agreements (generally between parties that operate at different levels of the supply chain).

Put simply, provided a vertical agreement conforms to the conditions for exemption set out in the VABER etc. then - even if it contains certain restrictions - it is automatically protected from the prohibition against anti-competitive agreements set out in Article 101 of the Treaty on the Functioning of the European Union (**TFEU**) or, in the case of a UK-centric agreement, the 'Chapter I prohibition' set out in section 2 of the Competition Act 1998 (**CA98**).

Relevance

Since the discontinuation of Regulation 1400/2002 (the previous motor vehicle block exemption regulation, which was phased out between 2010 and 2013), the VABER and its guidelines have been particularly relevant to the contractual terms applying to supply and distribution (dealer) agreements in the automotive sector. The VABER and its guidelines, while supplemented by a motor industry-specific aftermarket regulation (often referred to as the aftermarket Motor Vehicle Block Exemption Regulation or MVBER[2]), provides the main blueprint against which OEMs measure their agreements for compliance with competition law.

While it should be stressed that an agreement that does not comply with the terms of the VABER (or any other block exemption) is not automatically anti-competitive, most corporates are unwilling to take the risk involved in departing from its conditions if at all possible, so trying to ensure that agreements conform to the terms of the VABER is a priority.

Replacement

The VABER and its accompanying guidelines expired on 31 May 2022, which was also the situation in the UK as the rules were transposed with the same expiry date.

At EU level, the VABER (and its guidelines) have been replaced with a new regulation[3] (and new guidelines) from 1 June 2022 (**New VABER**); the same has happened in the UK. That said, the replacement UK regulation (called the **VABEO**[4]) and guidelines differ slightly – on some issues - from the new EU position. In other words, the conditions for exemption set out in the New VABER and the VABEO have diverged to a small extent, although the areas of divergence are not of obvious importance to the automotive sector at this stage.[5]

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[1] Regulation 330/2010.
[2] Regulation 461/2010. The VABER (Regulation 330/2010) applies to the distribution of all different types of products and services, including vehicles, however, certain issues which the European Commission regarded as being specific to the automotive industry were set out in a separate Regulation (461/2010) to supplement the broader terms of the VABER.
[3] Regulation 2022/720.
[4] The Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022.
[5] The substantive differences, although slight, fall within the following areas: territorial and customer restrictions, indirect measures restricting online sales and parity obligations.

The VABEO (and its guidelines) will also apply for only six years (from 1 June 2022 to 31 May 2028 inclusive), which can be contrasted with the EU's New VABER, which will be in situ for 12 years. Both the VABEO and New VABER do, however, provide for a 12 month transitional period, in which agreements already in existence at EU and UK level as at 31 May 2022 and conforming to the then current regulations can continue to benefit from the safe-harbour until 1 June 2023. The upshot of this is that there is no immediate pressure on OEMs to update their agreements with dealer networks, although some are already choosing to do so (albeit not necessarily as a result of regulatory change).

Key topics[6]

Dual distribution

Dual distribution has become a hot topic from a competition law perspective in recent years as increasing numbers of OEMs have launched their own online retail operations to sell direct to end customers (thereby placing them in direct competition with their retailers).

Direct distribution and agency share certain characteristics, most notably that a direct contract is created between the supplier (the OEM) and the end-customer in both scenarios (albeit via an intermediary in the latter); however, it is perhaps more likely (certain brands like Tesla aside) that direct sales are intended to sit alongside sales made through independent dealer networks, whereas an agency model might envisage a wholesale transition in the longer term. In any event, where a manufacturer operates direct sales or agency sales alongside an independent retail network, competition issues concerning dual distribution are relevant.

The fact that an OEM also competes with its dealers at the retail level does not, in itself, take the relevant agreement outside the scope of the New VABER/VABEO; however, concerns have been raised about the risk of commercially sensitive information being shared and distorting the dynamics of competition between the parties at the retail level of supply. One example might be where an OEM asks dealers for information about their retail price offers or promotional plans and then uses that information to adjust its own downstream offering, or even about their customers which places dealers at a disadvantage.

The following extract from the CMA's VABER consultation recommendation[7] notes this potential risk:

> *"The vast majority of responses to the CMA's consultation that addressed this issue agreed with the CMA's recommendation, and confirmed concerns that information sharing between the supplier and the buyer could lead to an unfair competitive advantage for the supplier.[42] Two respondents in the automotive sector raised concerns about manufacturers increasingly asking for access to final user data and one of these considered that the CMA's proposed recommendation on dual distribution might still leave open the possibility of franchised dealers being exploited by manufacturers through such data access.[43] [BVRLA and NFDA]"*

In light of these types of concern, the new rules deal with the risk of anti-competitive information exchange in the following ways:

- The New VABER specifically states that the block exemption does not apply to an exchange of information that is "*not directly related to the implementation of the vertical agreement or is not*

[6] This is far from an exhaustive list of changes; it just highlights some changes of greater relevance to dealers.

[7] CMA145con, 3 October 2021, page 15

necessary to improve the production or distribution of the contract goods or services, or which fulfils neither of those two conditions."

In other words, the New VABER does not provide carte blanche for an OEM (engaged in dual distribution) to insist on the provision by dealers of whatever information the OEM would like to see (at least without the implementation of strict safeguards); so, any information exchange must be limited to what is necessarily for the implementation and operation of the "vertical" relationship between the parties and must serve a legitimate commercial purpose in that context.

The text of the VABEO does not include this specific clarification; however, the underlying CMA guidance makes it clear the same principles apply in the UK. Moreover, the VABEO guidance notes the merits of applying robust information barriers to ensure that information that an OEM might request/need to receive in its capacity as a manufacturer, is not then shared on an unrestricted basis internally, such as to cause competition concerns.

> *"In some cases, competition concerns arising from the provision of competitively-sensitive information between suppliers and their distributors can be addressed through the use of information barriers.*[52] *[This may also be the case where potential competition concerns arise from other information provision, or data access arrangements, for example the scenario described by some respondents in the automotive industry (BVRLA and NFDA) where franchised dealers are asked by manufacturers to provide them with data on end users.] Information barriers are internal arrangements that can be put in place within a business to restrict the flow of competitively-sensitive information handled by one part of the organisation (eg obtained via a supplier's relationship with a distributor) and prevent it from being used inappropriately. The CMA considers that assessing and addressing potential competition concerns arising from information flows in connection with dual distribution is a matter best left for self-assessment by businesses. However, given the responses received during the CMA's consultation, the CMA is minded to provide more guidance on information exchange in the context of dual distribution in CMA Verticals Guidance.*[53] *In particular, a point of clarification which the CMA will include in the CMA Verticals Guidance is the fact that the dual distribution exception does not exempt horizontal agreements between a supplier [e.g. an OEM] and a competing buyer [e.g. a dealer] that have the object of restricting competition."*[8]

- Both the CMA and the Commission's guidelines provide non-exhaustive examples of the types of information exchange that are likely to be permissible in the context of a vertical relationship between competitors.

> Examples include technical or regulatory information in relation to the contract products, or information relating to production, inventory, stocks, sales volumes and returns.[9] The guidelines also set out some procedural safeguards that can be put in place to enable the exchange of more sensitive information, for example aggregation of sensitive data and internal firewalls.

- The guidelines also describe examples of information exchanges that are likely to be problematic and fall outside the scope of the New VABER/ VABEO, for example, information in relation to actual future pricing or customer-specific sales data, including non-aggregated information on the value and volume of sales per customer.[10]

- In addition, in the EU, the dual distribution exemption under the New VABER does not extend to "hybrid" online platforms that act both as intermediaries and also sell products and services in direct competition with suppliers who use the platform.

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[8] Ibid, pages 17 and 18.
[9] Further examples can be found at paragraph 10.175 of the draft CMA guidelines and paragraph 99 of the Commission guidelines.
[10] See paragraphs 10.176 of the draft CMA guidelines and paragraph 100 of the Commission guidelines for further examples.

The rationale provided in the Commission guidelines is that the "horizontal" risks to competition (i.e. collusion between direct competitors) are too great in these circumstances to merit any kind of safe harbour under New VABER. This is consistent with the Commission's investigation into Amazon, where it was alleged that the platform exploited information received from marketplace sellers to give an unfair advantage to its direct sales offering. It is notable however that the UK's VABEO does not go as far as carving out online intermediary services from the dual distribution exemption.

This competition law treatment of certain types of platform may be of particular interest to diversified groups such as Constellation, which wear a number of different hats in the supply chain.

Agency

Strictly speaking, the New VABER and VABEO are, in many respects,[11] irrelevant to true or 'genuine' agency agreements, on the basis that Article 101 and the Chapter I prohibition apply to agreements between independent firms or 'undertakings', whereas in a genuine agency, the agent is regarded as part of their principal's organisation (and not independent). In other words, a genuine agency does not need block exemption as (with certain exceptions) its terms are not otherwise caught by any competition law prohibition.

That said, guidelines accompanying both the New VABER and VABEO are of critical importance in assessing whether an agency agreement is truly 'genuine' and, as a result, any restrictions contained in it (including pricing controls) can escape sanction.

The CMA's guidance sets the bar for 'genuine' agency at a high level. It echoes the EU requirement that for a genuine agency agreement to arise, the agent should bear no more than insignificant commercial risk associated with; i) the products in respect of which it has been appointed as agent; ii) the relationship-specific investments it is required to make in support of the sale of its principal's products; and iii) any other activities linked to its agency appointment that it is required to undertake in the same market for its principal but at the agent's own risk.

The VABEO guidelines offer more detailed guidance, which indicates that a genuine agency agreement is one in which, subject to very limited exceptions, the agent:

- does not normally take ownership of the goods bought or sold under the agency agreement and does not itself supply the contract services;
- does not contribute to the costs relating to the supply/purchase of these goods, including the costs of transporting the goods;
- does not maintain at its own cost or risk stocks of the contract goods, including the costs of financing the stocks and can return unsold goods to the principal without charge;
- does not take responsibility for customer bad debt, with the exception of the loss of the agent's commission;
- does not assume responsibility towards customers or other third parties for loss or damage resulting from the supply of the goods, unless, as agent, it is liable for fault in this respect;
- is not, directly or indirectly, obliged to invest in sales promotion, including through contributions to the advertising budget of the principal or to advertising or promotional activities specifically relating to the goods;

[11] This does not mean that (even genuine) agency agreements are wholly immune from competition law, for example, in circumstances where an extensive network of exclusive agency agreements could foreclose market access.

- does not make market-specific investments (confined to the contract goods) in equipment, premises or training of personnel;
- does not undertake other activities within the same product market required by the principal under the agency relationship;
- does not undertake responsibility towards third parties for damage caused to the goods sold;
- does not take responsibility for other types of financial risk such as the risk of incurring costs due to deferred payments from credit cards or the risk of customer insolvency; and
- does not make market-specific investments in customer support services, such as after-sales and technical support, to the extent that these services affect the relationship between the agent and the principal in that market, unless these activities are fully reimbursed by the principal.

The VABEO guidelines suggest different methods by which a principal can reimburse an agent for investments or activities that the agent should not be required to bear if it is to be regarded as a genuine agent. For example, a principal may choose to reimburse the precise costs incurred, or it may cover the costs by way of a fixed lump sum, or it may pay the agent a fixed percentage of the revenues from the goods or services sold in accordance with the agency agreement; however, the key point is that all relevant risks should be covered, and the guidelines recommend that:

- the principal develops a simple method for the agent to declare and request the reimbursement of any costs exceeding agreed lump sums or fixed percentages;
- the principal systematically monitors any changes to the relevant costs and adapts the lump sums or fixed percentages accordingly;
- if the principal chooses to reimburse investments or costs by way of a percentage of the price of the agency goods sold, the model used should not deny the agent reimbursement where it makes only limited or no sales for a certain period;[12] and
- reimbursement is made in a timely manner (no doubt recognising that substantial investments made by the dealer/agent and used for agency activities will need to be reimbursed quickly).

The guidelines also suggest that when contemplating a transition from distribution to (genuine) agency, and identifying the market-specific investments (whether or not already made) that it should reimburse, the principal should consider the hypothetical situation of an agent that is not yet active in the relevant market in order to assess which investments are relevant to the type of activity for which the agent is appointed.

Interestingly, the VABEO guidelines also identify a number of other factors that will militate against a finding of genuine agency. These factors include:

- Where the agent undertakes a very considerable amount of business on its own account (i.e. as an independent dealer) in the market for the goods in question. This suggests that a partial

[12] OEMs will also need to consider issues around security of tenure i.e. if they choose to terminate an agent, the then acceleration of payments owed to that agent to cover the reimbursement of outstanding investments already made.

agency covering only a limited range or type of goods for the principal, where the agent continues to sell similar goods in its own right, will be problematic.[13]

- Where the agent acts for multiple competing principals. In other words, it is difficult to square the idea of an agent being an integral part of a principal's organisation (and therefore outside the scope of competition law) if, in fact, it acts in a similar capacity for a number of other 'principals'.[14]

Dual-role agents

The VABEO guidelines devote particular attention to the scenario where an independent distributor of some products of a supplier (i.e. a dealer) may also be also be considered to act as an agent for other products of that same supplier.

The guidelines stipulate clearly that, in such a scenario, the activities and risks covered by the agency agreement should be effectively delineated and that all relevant risks linked to the sale of the goods covered by the agency agreement must be borne by the principal. The guidelines recognise the difficulties in distinguishing investments and costs that relate to the agency function, including market-specific investments, from those only related to independent activities also conducted in the same market by the agent/distributor.

The guidelines also raise particular concerns where any agency appointment (in a dual role model) is likely to constrain the incentives and decision-making freedom of the distributor/agent in its separate capacity as an independent retailer. Particular concerns will arise where the pricing policy of the principal for the products sold under the agency agreement limits the incentives of the agent/distributor to price competing products (whether those of the same or different brands) that it sells on its own account independently.

Finally, the guidelines warn that hitherto independent distributors must be genuinely free to enter into agency agreements, and that any new agency arrangement must not be *de facto* imposed by the principal through a threat to terminate or worsen the terms of the distribution relationship. This statement seems difficult to reconcile with the conduct of certain OEMs that present new agency terms on a 'take it or leave the franchise' basis, so it will be interesting to see how competition law enforcers, such as the CMA, apply this aspect of the guidance.

Non-genuine agency

Non-genuine agency is not a concept that is specifically defined in the VABEO guidelines; however, one is expected to infer that it captures any type of 'agency' agreement that falls short of the strict requirements of genuine agency. For competition law purposes, it is treated no differently to ordinary distribution or dealer arrangements.

OEMs that do not have the appetite to pursue a genuine agency model and take on the risks and costs involved may see this, superficially, as an attractive alternative; however, they should be warned that any attempt to apply agency style controls over the non-genuine agent's competitive proposition, including the prices it applies and might seek to advertise, has real potential to contravene competition law.

Competition is concerned with substance over form, and the guidelines list a wide variety of examples where indirect measures (e.g. restrictions on advertising and other controls) that are used to achieve anti-competitive outcomes, including de facto resale price maintenance, are likely to be prohibited.

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[13] Indeed, third party (e.g. customer) perception is also important, in the sense that if the agent is perceived as being quite distinct from its principal's organisation (perhaps because it is so diversified), this may also be a relevant factor against a finding of genuine agency.

[14] A supplier of online intermediation services (e.g. a platform or electronic marketplace) is unlikely to qualify as a genuine agent because, putting aside its own considerable influence over the end customer proposition and the substantial market-specific investments it is likely to make, the platform is likely to support a large number of sellers in parallel.

Indeed, the guidelines warn against the "misuse of the agency concept" as "an easy way to control retail prices for those products that allow high resale margins". They stress that the agency concept should not be misused by OEMs - through the application of agency style controls but without the assumption of risks - to control prices (or apply other anti-competitive restrictions on the non-genuine agent).

The emphasis placed on agency in the guidelines (both at UK and EU level) and the conditions that need to be met to satisfy genuine agency treatment suggest that competition authorities are alive to the risks to consumer welfare of such practices, and will be minded to intervene if the concept is abused by OEMs (although it should be noted that all parties to agreements that infringe competition law are potentially liable).

Other aspects of interest

Dual pricing

Under the new regime, UK (and EU) rules have now been relaxed for so-called "dual pricing" i.e. differential wholesale pricing structures for online vs. offline distribution. Under the (previous) VABER, dual pricing was treated as a hardcore restriction.

As far as the new regime is concerned, the relevant guidelines are clear that a requirement for a given buyer to pay a different wholesale price for products intended to be resold offline as opposed to online (and vice versa) **can** benefit from the block exemption. That is, however, subject to the following important caveats:

- The objective of the pricing structure must be to incentivise or reward the appropriate level of investments respectively made online and offline (which will generally involve compensating distributors for the higher costs associated with operating offline sales channels).

- If, in practice, the differential pricing has the objective of preventing internet selling, the pricing model would constitute a hardcore restriction. The guidelines clarify that this would be the case where the price difference makes the effective use of the internet for the purposes of selling online unprofitable or financially not sustainable.

Accordingly, the rules on dual pricing remain consistent with the underlying principle under the VABEO (and the New VABER) that distributors must be free to re-sell online, although now offer more flexibility to reward investments made by retailers in physical retail premises.

Exclusive and selective distribution

One of the core principles of the VABER (and its retained UK equivalent) has always been that suppliers must not impose blanket restrictions that stop onward distributors from targeting specific customer groups or territories (so-called "active sales" restrictions) or responding to unsolicited sales requests ("passive sales").

Blanket sales restrictions of this nature have always been classified as hardcore restrictions subsject to certain exceptions, noting that the rules have also permitted greater flexibility in cases where suppliers operate exclusive or selective distribution networks.

Under the VABEO (and New VABER) the rules in this area have been further refined in some respects, for example:

- **Exclusive distribution**. Under the old rules, suppliers operating exclusive distribution networks only benefited from certain carve-outs (e.g. the ability to stop an exclusive distributor in one territory from actively selling to customers reserved for an exclusive distributor in another territory) if a single exclusive distributor was appointed for each territory. However, the new rules introduce the concept of "shared exclusivity", which means that a supplier or OEM could appoint a number

of 'exclusive' distributors for a territory; moreover, the restriction on active sales into another's exclusive territory etc. can be passed on to a distributor's customers.

- **Selective distribution.** While allowing the combination of certain aspects of exclusive and selective distribution,[15] the new VBER and VABEO will make it more difficult for manufacturers or suppliers who operate selective distribution networks to restrict distributors from representing specific competing suppliers (although this really just reflects what was previously contained in guidance).

Conclusions

From an automotive industry perspective, the most notable aspect of the new (vertical) rules is the more detailed (and stricter) guidance around agency relationships. Reading between the lines, while it is not possible to prohibit this distribution model, its treatment in the guidelines signals some disquiet on the part of the competition regulator in terms of what a transition to this model could represent. This is particularly important at a time when household budgets are stretched and more price competition, not less, is likely to be desirable from a consumer's point of view.

In any event, for the automotive sector, the vertical block exemption review is, in some respects, simply the first half of the game, with the review of the motor vehicle block exemption (and any expansions to it) to follow later this year and next. There is still a lot to play for, both in terms of safeguarding a degree of competitive independence at the retail level in the sector and in ensuring optimal outcome for consumers.

If regulators fail to appreciate what is really on the horizon under certain agency models for consumers, notably a pricing model set by OEMs, which ultimately (through consumer data gathering and the application of AI) might be determined dynamically by a customer's propensity to pay rather than normal competitive forces, the outlook for maintaining current level of competition in the sector will be deeply uncertain. While recognising that agency is an established method of distribution, the NFDA will continue to work towards a balanced model, which places consumer welfare – and retailer interests aligned to that objective - at its core.

Source materials / further reading

VABEO

Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022/516

CMA draft guidance - 31 March 2022

New VABER

Commission Regulation 2022/720 on the application of Article 101(3) of the Treaty on the Functioning of the European Union (TFEU) to categories of vertical agreements and concerted practices (the new vertical agreements block exemption regulation (VBER))

Annex: Approval of the content of a draft for a Communication from the Commission - Guidelines on vertical restraints 10 May 2022

For further information, please contact Lena Patel or your usual NFDA contact, or Miles Trower, TLT LLP, miles.trower@tltsolicitors.com.

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[15] The new VBER and VABEO enable suppliers who operate selective (and exclusive) distribution networks from actively pursuing sales to end customers in territories reserved to the supplier or allocated to other distributors on an exclusive (or shared exclusive) basis.

Disclaimer: This update represents the views of the NFDA only; it does not comprise legal advice, nor should it be relied on as such. Members are free to (and the NFDA would recommend that they do) procure independent legal advice on any of the issues addressed in this update. Please note that as far as the UK is concerned, this 6 June 2022 update is based on draft UK guidelines, so the treatment of certain restrictions could be adjusted based on any final version once published.