

# A Look At New Vertical Laws, Their Opportunities And Pitfalls

By **Gabriela da Costa, Jennifer Marsh and Annette Mutschler-Siebert** (January 23, 2023)

The start of 2023 marks six months since the new vertical distribution laws came into effect across the EU and the U.K.[1]

As brands embark on the new year looking for ways to shore up their resilience and profitability in the face of challenging economic headwinds, we take a snapshot of trends that have gained the most traction under the new rules, big opportunities up for grabs, and lessons learned on pitfalls to avoid.

## Dual Pricing Full-Steam Ahead

Perhaps the most obvious opportunity for brands in the new EU and U.K. rules was the legalization of dual pricing for hybrid customers.

Charging a hybrid reseller different wholesale prices for the products it sells in bricks and mortar stores compared with those it sells online swung from being a serious restriction of competition to being automatically exempted under the EU's Vertical Block Exemption Regulation and the U.K.'s Vertical Agreements Block Exemption Order for most brands, provided it is not aimed at restricting cross-border sales or online sales.

Fast-forward six months and this is unsurprisingly the area where we have seen the most traction.

As the new rules on dual pricing are sufficiently flexible to work well across different distribution structures, brands across product categories are adopting a wide variety of dual pricing models to suit their business needs and practicalities.

These range from incorporating very specific additional discounts or rebates for particular offline investments into detailed performance pricing matrices through to blunter offline/online price lists and offline discounts.

Although parties are not necessarily required to carry out complex cost calculations or share detailed cost information, the guidance published by the European Commission[2] and the U.K. Competition and Markets Authority — the Vertical Guidelines[2] and Vertical Agreements Block Exemption Order guidance,[3] respectively — require that differential pricing should, as a general rule, be reasonably related to the different costs and investments between the channels to avoid infringing the competition laws.

We expect the takeup of dual pricing to continue and grow as a priority area for brands in 2023. It offers producers a highly effective and legal way to disincentive a race to the bottom in pricing and quality, and limits unfair free riding by websites or stores that make lower investments.

By contrast, enforcing adherence to recommended resale prices, a minimum price, or a minimum advertised price remains blacklisted and aggressively enforced by competition authorities in Europe, with large financial penalties.

The greater leeway to directly reward partners' investments in their stores and websites will also be a powerful tool as brands look for ways to reinvigorate their offline networks



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and explore exciting new offline and omnichannel brand experiences to meet evolving consumer expectations.

### **Discriminatory Marketplace Ban May Be Possible, But Look for Hidden Snares**

On the face of it, the new EU and U.K. guidelines appear to take a surprisingly relaxed stance on discriminatory or inconsistently applied marketplace bans for most brands.

A technical reading of the new text suggests that a company with a market share of 30% or less can, in principle, ban one reseller from selling on a particular online marketplace but not another — or itself — without any objective quality criteria and purely for commercial reasons.

On plain reading, such a marketplace restriction will not be regarded as a hardcore restriction of competition, and should be automatically exempted where both parties fall under the market share thresholds. This is provided that it does not have the object of preventing the reseller's effective use of the internet.

The simplicity and convenience of this neat approach is extremely attractive for many brands, particularly if fixing online marketplace disruption is their main priority and there is an appetite for modest risk.

However, while it can be a useful device for some, it is not a one-size-fits-all solution. An inconsistent marketplace ban can potentially throw up some difficult legal or commercial questions in some cases, for example:

- Where market definition or market shares are hard to pin down, and there is a risk of the brand's or customer's market share exceeding 30%.
- Where the brand operates a selective distribution system and thus imposes criteria for the sale of its products across other channels, including other websites.
- Where implementing or enforcing the restriction involves data exchanges between the brand and the marketplace.
- In certain EU member states — notably Germany — where the national authorities historically took a stricter approach than the European Commission and are yet to express alignment in this area.
- In particular product categories where marketplaces are regarded as critical routes to market.

### **Questions Brands Should Ask Themselves**

Some interesting questions emerged as brands moved increasingly closer to selling directly to end customers during the COVID-19 pandemic and throughout 2022.

Many brands are still unaware of or confused about the extra layer of rules that apply when they start to sell directly to consumers in competition with their own reseller customers, or directly to retailers in competition with their distributor customers.

Here, competition laws prevent brands from colluding with their distribution networks to restrict intrabrand competition or from exchanging certain information.

In practice, the interplay between the horizontal rules and the vertical ones can be bewildering for sales teams. So brands should be asking themselves:

- "Can we separate our sales team from the direct to consumer team?" If feasible, this can help to limit inappropriate information flows without unnecessarily stifling the sales team's discussions with its customers on legitimate topics that are central to a healthy supply/resale relationship, but that could easily stray into competitively sensitive topics.
- "Are our sales teams sufficiently aware of topics to avoid in discussions with our competing customers?" Particularly where meaningful internal separations are not possible, training is always recommended to equip sales teams with a strong grasp of the no-go areas.

If a brand is terminating any partnerships as it grows its direct businesses, have notice requirements been checked and is there any compensation risk? Are talking points prepared?

Finally, we see brands grappling with some anxiety of not wanting to alienate or harm their customers as they increasingly compete against them.

In addition to exploring new distribution structures to address this concern lawfully, a useful trend we have picked up in projects over the last year has been for the brand's direct to consumer website to be an experiential site designed around increasing brand awareness and engagement.

This can be less confrontational for partners than a traditional transactional site aggressively focused on orders and can also serve to grow overall brand demand from which all partners benefit.

### **Are Brands Missing Opportunities?**

The new EU and U.K. rules introduced numerous flexibilities that can help producers to better design their European distribution systems around local market dynamics and needs, as well as afford stronger brand controls.

These are starting to be looked at, but at a slower pace, perhaps because they involve a bigger long-term rethink, business adjustment and investment.

Key changes in the EU and U.K. include possibilities for:

- Granting shared exclusivity to more than one distributor in a particular territory or geographic area — the EU specifies up to five; the U.K. a limited number.

- Obliging distributors to pass active sales restrictions down to their customers, so that exclusive distributors can now benefit from stronger protections.
- Operating a mix of distribution structures, e.g., open, exclusive, selective or franchise across different EU member states, depending on what suits the local market best.

Brands should, however, be aware that the EU rules now prohibit a combination of exclusivity at the wholesale level and selective distribution at the retail level in the same territory, unless the protections are sufficiently justified by the need to protect the exclusive partner's or partners' investments. The U.K. has no such prohibition.

An important reminder in the past six months has been that brands should embark on any strategy refreshers or revamps with the full context in mind.

Each distribution model has its own nuanced and often elaborate rules, so it is critical to check that a system is workable in practice, i.e., can it be easily explained to a customer? Also, within the EU, a device used in one member state would not undermine that used in another member state.

Additionally, some national authorities have indicated that they will treat the use of the new structural devices with some skepticism if these are not sufficiently objectively justified, e.g., by the need to protect investments or quality, and appear solely motivated by maintaining higher prices.

In short, there are potentially some cerebral points to navigate here, but brands stand to benefit enormously from highly optimized structures if they are prepared to do a deep dive into their market needs, realities and the multitude of legal options now available to them.

### **Export Bans to and From the U.K., Post-Brexit**

Amid the fanfare of the EU rules that were published a few months earlier, many brands missed an important clarification in the CMA's final Vertical Agreements Block Exemption Order guidance published in July 2022. This concerned the extent to which they can now restrict their distributors and resellers outside the U.K. from selling to customers in the U.K.

The CMA's draft guidance had left the door wide open for the CMA to investigate these as serious antitrust violations and the CMA's attitude had been left elusive.

However, the final text of the Vertical Agreements Block Exemption Order guidance introduced welcome clarification.

While the CMA can still find an import or export ban unlawful, it has clarified that it is unlikely to regard these as having the object of restricting competition within the U.K.

Rather, it would assess whether a term has the effect of restricting competition within the U.K., taking into account the nature of the products or services, the operating conditions and the structure of the market.

This is good news, since the CMA, like the European authorities, typically focuses more on bringing "by object" cases, where the agreement is presumed to seriously restrict competition and the CMA does not need to adduce detailed evidence of the effect on the market.

"By effect" cases, in contrast, usually involve much more work for the authority, and the CMA has therefore set a high bar for itself to bring a case relating to a U.K.-border sales restriction.

While the risk will differ by product category and so it cannot be entirely excluded, this factor, combined with the political sensitivities of bringing such a case, significantly lowers the likelihood that the CMA would pursue an investigation of this kind in relation to many branded products.

We should get more certainty on the position in the coming years, but the direction is useful for brands who have chosen to implement a U.K. distribution system that is separate from the EU.

## **Conclusion**

The transition period for brands to ensure that their terms are compliant with the new vertical laws comes to an end on June 1, 2023.

The next six months should be used wisely. Not only do they allow brands to ensure their terms are aligned with the current legal framework, but they present an important business opportunity for brands to look at their go-to-market strategies with a fresh pair of eyes and a new set of tools to ensure they are future proof.

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[1] See K&L Gates' previous alert announcing the new rule changes here: "Extra, Extra - Read All About It: Final European and UK Brand Distribution Rules Published". <https://www.klgates.com/Extra-Extra-Read-All-About-ItFinal-European-and-UK-Brand-Distribution-Rules-Published-5-13-2022>.

[2] European Commission's Guidelines on Vertical Restraints (2022/C 248/01), available here. [https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52022XC0630\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52022XC0630(01)&from=EN).

[3] CMA Guidance on the Vertical Agreements Block Exemption Order (12 July 2022; CMA166), available here. [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1091830/VABEO\\_Guidance.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091830/VABEO_Guidance.pdf).