

Title: UK Vertical Agreements Block Exemption Order (UK Order) IA No: BEIS025(F)-22-CCP RPC Reference No: RPC-BEIS-5174(1) Lead department or agency: Department for Business, Energy & Industrial Strategy Other departments or agencies: Competition and Markets Authority	Impact Assessment (IA)			
	Date: 05/05/2022			
	Stage: Final			
	Source of intervention: Domestic			
	Type of measure: Secondary Legislation			
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Summary: Intervention and Options			RPC Opinion: Green	

Cost of Preferred Option (in 2019 prices)			
Total Net Present Social Value	Business Net Present Value	Net cost to business per year	Business Impact Target Status
-5.9	-24.1	1.07	Non-qualifying provision.

What is the problem under consideration? Why is government action or intervention necessary?

The retained Vertical Agreements Block Exemption (retained VABER) can reduce compliance costs for businesses and increase their confidence to engage in transactions that have a benign or beneficial effect on competition, by avoiding the need for businesses to self-assess whether their agreements comply with competition law. The retained VABER expires on 31 May 2022. This means that UK businesses' vertical agreements will cease to be automatically exempt from competition law even if the agreements previously met the conditions set by the block exemption.

Government intervention is necessary to ensure that the block exemption is replaced when it expires, and that the current block exemption is reviewed and updated for the UK market.

What are the policy objectives of the action or intervention and the intended effects?

The objective of this policy is to i) retain the benefits currently provided by the retained VABER by replacing it with a UK Vertical Agreements Block Exemption Order (UK VABEO), and ii) consider the specificities of the UK market to replace the retained VABER with an up-to-date block exemption suitable for UK businesses and consumers. Taken together, the intended outcome is to ensure that the UK's competition regime continues to protect UK consumers and business from anticompetitive behaviour while ensuring that it does not unduly restrict pro-competitive behaviours and impose unnecessary burdens on businesses and the CMA as competition enforcement agency.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

- Option (i): Renew retained VABER unamended
- Option (ii): No intervention, i.e. let the retained VABER expire on 31 May 2022
- Option (iii): Replace retained VABER with a UK VABEO

Options (i) and (ii) are not able to fully and effectively deliver the outlined policy objective and Option (iii) is therefore the preferred option. Assessment focuses on the impacts of this option (option (iii)), relative to the baseline, a renewal of current arrangements (option (i)).

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 05/2028				
Is this measure likely to impact on international trade and investment?		No		
Are any of these organisations in scope?		Micro No	Small No	Medium Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)		Traded: N/A		Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by **Paul Scully MP**
Parliamentary Under Secretary of State
Department for Business, Energy and Industrial Strategy



Date: 05/05/2022

Summary: Analysis & Evidence

Policy Option 1

Description: Replace the retained Block Exemption with the UK Vertical Agreements Block Exemption Order

FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years 6	Net Benefit (Present Value (PV)) (£m)			
			Low: N/A	High: N/A	Best Estimate: -5.9	
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)	
Low	N/A		6.2		40.1	
High	N/A		N/A		N/A	
Best Estimate	5.9		13.3		79.3	
Description and scale of key monetised costs by 'main affected groups'						
<p>The main cost is to comply with the change to treat wide retail parity obligations as hardcore restrictions (ie classifying as hardcore any restrictions imposed eg by sales platforms, on the businesses that sell through them, which prevent the businesses from selling more cheaply through other routes). Relevant businesses (eg sales platforms or agencies) currently imposing these clauses may need to self-assess their agreements, incurring a compliance cost made up of legal advice and expert consultancy. We consider that this affects travel agencies. Our best estimate for the total compliance cost is around £5.9m. The change to treat wide retail parity obligations as hardcore restrictions is likely to lead to a change in business behaviour, specifically we expect the use of wide parity clauses to decrease. This is likely to lead to a weaker ability for some travel agencies to charge high commission rates. We consider there to be an indirect cost to such businesses of around £13.3m annually. This is offset by a benefit of the same value, split between businesses such as hotels, and relevant consumers in this industry. A reduction in the prevalence of wide retail parity clauses could expand the market in the longer term by reducing barriers to entry for accommodation providers utilising online sales platforms, which in turn could lead to further consumer benefits.</p>						
Other key non-monetised costs by 'main affected groups'						
<p>Under the preferred option, the block exemption would be expanded to cover agreements that treat online and offline sales differently, including charging the same distributor a higher price for products intended to be resold online than for products intended to be sold offline (dual pricing). Some online businesses could also face an ongoing reduction in their advantage resulting from the block exemption being expanded, but this depends on actions taken by businesses as well as a change in the behaviour of consumers. Relative to the status quo, the policy should level the playing field between online sales channels and offline channels by removing one advantage currently afforded to online channels. Given</p>						
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)	
Low	N/A		6.2		33.6	
High	N/A		N/A		N/A	
Best Estimate	0.0		13.3		73.4	
Description and scale of key monetised benefits by 'main affected groups'						
<p>The change to treat wide retail parity obligations as hardcore restrictions is likely to lead to a change in business behaviour, specifically we expect the use of wide parity clauses to decrease. This is likely to lead lower commission rates in the affected industries, notably the travel industry. We consider there to be an indirect benefit to hotels and brands of around £10m annually, and lower end prices to consumers saving around £3.3m annually. This is offset by a cost of around £13.3m to agencies charging those commissions.</p>						
Other key non-monetised benefits by 'main affected groups'						
<p>There is likely to be some indirect benefits associated with changes to the treatment of territorial and customer restrictions. The changes allow businesses greater flexibility in the design of distribution systems, and we expect there to be some efficiencies resulting from any change businesses make. These are not quantified.</p> <p>There are also likely to be benefits from the change to no longer treat dual pricing as a hardcore restriction. Relative to the status quo, the policy should level the playing field between online sales channels and offline channels by removing one advantage currently afforded to online channels. This is likely to benefit some retailers through their offline channels.</p>						
Key assumptions/sensitivities/risks					Discount rate (%)	3.5

There are gaps in the analysis relating to the number and types of businesses in scope of changes under the preferred option. Wide retail parity obligations represent an area where the preferred option is likely to lead to new direct cost burdens to business. CMA case precedent suggests that these clauses may have been historically prevalent in some insurance markets, but there is uncertainty about the scale of current prevalence in other industries. In addition, there is also uncertainty around the validity of quantitative estimates of the effect of wide parity clauses on commissions, a key assumption in our analysis. There is also limited evidence available to quantify indirect benefits and costs that may result from businesses engaging in new measures to restrict online sales.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: 1.07	Benefits: 0	Net: 1.07	Non-qualifying provision

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Policy background and rationale for intervention

Retained Vertical Agreements Block Exemption Regulation

1. The Competition Act 1998 prohibits agreements between firms that prevent, restrict or distort competition (known as the Chapter I prohibition). Agreements may be exempt from the Chapter I prohibition if they are overall pro-competitive. This requires businesses to self-assess to consider whether they meet the statutory criteria.
2. The Act allows the Secretary of State for Business, Energy and Industrial Strategy (Secretary of State), on advice of the Competition and Markets Authority (CMA), to make a Block Exemption Order (BEO) covering agreements which fall under a particular category of agreements that are likely to be exempt. An agreement which falls into a category specified in a BEO is then exempt from the Chapter I prohibition.
3. By avoiding the need for businesses to self-assess whether their agreements comply with competition law, block exemptions can reduce compliance costs for businesses and increase their confidence to engage in transactions that have a benign or beneficial effect on competition.
4. A similar instrument exists under EU law, a so-called block exemption regulation. Before the UK's withdrawal from the EU, the EU Vertical Agreements Block Exemption Regulation (EU VABER) applied in the UK. Following EU Exit, the UK retained EU block exemption regulations and so, as of January 2021, the EU VABER became the retained Vertical Agreements Block Exemption Regulation (retained VABER) under UK law.
5. The retained VABER sets out a block exemption from the Chapter I prohibition for vertical agreements, provided that certain conditions are met. Vertical agreements are agreements, for the sale and purchase of goods or services, between businesses operating at different levels of the production or distribution chain, for example, between manufacturers and wholesalers or retailers.
6. The retained VABER expires on 31 May 2022. This means that UK businesses' vertical agreements would cease to be automatically exempt from competition law. As of May 2022, they will lose the legal certainty that VABER provides and may incur extra costs in respect of agreements that benefit consumers. Government has therefore reviewed the current regime and intends to replace the retained VABER with a UK Vertical Agreements Block Exemption Order (UK VABEO).

Review

7. As the retained VABER nears its expiration, the CMA reviewed the retained VABER for the purpose of making a recommendation to the Secretary of State about whether to replace the retained VABER and, if so, how. Post EU Exit, the UK government is able to determine the most appropriate approach to block exemptions in the context of the UK market, and for the benefit of UK consumers and UK businesses.
8. The CMA recommended that the Secretary of State replaces the retained VABER with a UK VABEO. This recommendation was based on a review of the retained VABER and its effect on UK markets. It drew on relevant evidence from an evaluation of the EU VABER and related Guidelines on Vertical Restraints (the EU Vertical Guidelines), to which the CMA and UK stakeholders contributed. The CMA also gathered additional evidence relating specifically to the application of the retained VABER in the UK to supplement the evidence obtained during the EU evaluation. This evidence was gathered by the CMA during roundtables and bilateral meetings with interested parties, including businesses, law firms and economists, industry associations, and consumer organisations.

9. On 17 June 2021, the CMA published a draft recommendation and consulted on it publicly (until 22 July 2021).¹ 37 responses from a wide variety of stakeholders were received and carefully considered, resulting in the CMA's final recommendation submitted to the Secretary of State on 13 October 2021 and published on 3 November 2021².

Rationale for intervention

10. Competition law and its enforcement ensures that market failures are prevented or remedied by prohibiting agreements between businesses that prevent, restrict or distort competition. This can include, for example, price-fixing, dividing up markets or obligations to supply a product exclusively to a particular buyer. In so doing, competition law protects UK businesses and UK consumers from illegal, anticompetitive behaviours across the economy.
11. However, certain types of agreements – which would ordinarily be captured by this prohibition – are generally considered to be beneficial and not anticompetitive. Following its review, the CMA confirmed that ‘the evidence gathered indicates that a vertical agreements block exemption is a relevant and useful tool for businesses. In particular, it is beneficial to have a ‘safe harbour’ for categories of vertical agreements that are considered likely to satisfy the requirements for exemption [...] as such agreements will often generate benefits through promoting efficiencies, promoting non-price competition, and/or promoting investment and innovation.’³
12. Regulation is therefore an appropriate and proportionate measure as it disapplies unnecessary prohibitive regulation where the benefits of doing so outweigh any potential costs, including familiarisation costs for businesses.
13. In particular, there is a rationale for the government to intervene as the block exemption is due to expire on 31 May 2022 and the removal of the block exemption could lead to increased uncertainty among businesses and potentially fewer benign or economically beneficial vertical agreements being made. Government intervention thus helps to avoid future harm to businesses and consumers alike. A vertical agreements block exemption has benefits for businesses. Firstly, it provides legal certainty by ensuring businesses that their vertical agreements comply with competition law. Secondly, it avoids placing on businesses the burden of scrutinising many essentially benign vertical agreements. Thirdly, it ensures consistency of approach by providing a common framework for businesses to assess their vertical agreements against.
14. In addition, a UK VABEO will also ensure that the CMA does not need to scrutinise essentially benign agreements and allows the UK's competition authority to effectively use its resources to enforce competition law across the UK by targeting the most detrimental forms of anti-competitive agreements and practices.
15. Given the evidence in favour of a vertical agreements block exemption, Government considers it is not appropriate to allow the current retained VABER to expire without intervention.
16. There is no alternative to this proposal that would be able to produce the desired outcome as a non-legislative intervention is not available. Absent a block exemption regulation, the general competition law prohibition would apply and any business that were to consider a vertical agreement to be beneficial would need to self-assess and carry the risks of associated legal uncertainty when engaging in this kind of essentially benign behaviour. The benefits outlined above could not be replicated without legislation.

¹ The retained Vertical Agreements Block Exemption Regulation Consultation document: <https://www.gov.uk/government/consultations/retained-vertical-block-exemption-regulation>

² See <https://www.gov.uk/government/consultations/retained-vertical-block-exemption-regulation>

³ The retained Vertical Agreements Block Exemption Regulation Consultation document, pg. 8

Rationale and evidence to justify the level of analysis used in the IA (proportionality approach)

17. This Impact Assessment considers the costs and benefits of the preferred option – to replace the retained VABER with the UK VABEO in line with the CMA recommendation (ie including some changes vs the retained VABER) – relative to the baseline option of renewing the block exemption unchanged and preserving the status quo. The areas where the preferred option deviates from the status quo is outlined in more detail below.
18. There is limited quantitative evidence available to assess the costs and benefits associated with the preferred option. To supplement the evidence base, we have drawn upon detailed qualitative responses to the CMA consultation, which considers views of stakeholders representing a wide scope of businesses, of varying size and across a large number of industries. Additionally, we have drawn on the academic economic literature where available, particularly relating to wide retail parity obligations, which is an area where the preferred option, relative to the status quo, imposes restrictions on businesses when forming vertical arrangements. This approach helps to mitigate against relying only on stakeholder evidence.
19. We believe that this is a reasonable and proportionate approach given the dearth of quantitative evidence in this area. The impact of the preferred option on competition and consumers is considered as well as any familiarisation costs to business.

Policy objective

20. The intended outcome is to ensure that the UK's competition regime continues to protect UK consumers and business from anticompetitive behaviour while ensuring that it does not unduly restrict pro-competitive behaviours and impose unnecessary burdens on businesses and the CMA as competition enforcement agency.
21. Government wants to ensure that UK businesses are able to engage in benign activities without unnecessary burdens being imposed on them due to the absence of a block exemption that would provide legal certainty about the application of competition law to certain agreements. The intervention therefore seeks to extend the benefit from a vertical agreements block exemption after the retained VABER expires on 31 May 2022, to the extent that the evidence and analysis suggests this to be overall beneficial. This should allow for associated compliance costs incurred by businesses to remain as low as possible and increase legal certainty as well as limit resources used by the CMA to deal with essentially benign agreements.
22. The UK VABEO is intended to prevent a significant increase in uncertainty and costs for businesses compared to no intervention. At the same time, it will ensure that potentially harmful agreements are excluded from the block exemption to ensure the UK's competition regime continues to effectively protect UK consumers and businesses from harmful anticompetitive behaviour.
23. Government is keen to ensure that the UK VABEO remains effective and appropriate. It will therefore expire after 6 years to allow the CMA to review its operation and to recommend to the Secretary of State whether to replace or vary the UK VABEO. A shorter block exemption duration would reduce legal certainty for businesses and would not allow the CMA sufficient time to assess as comprehensively the effect of the UK VABEO after its implementation. A longer duration on the other hand would mean a much later review of the new block exemption and delay any adjustments in response to EU Exit, the COVID-19 pandemic, and fast-developing digital markets. On balance, Government considers that the 6-year period strikes a reasonable balance under the current circumstances.

Description of options considered

24. Government considered three options:

- Option (i): Renew retained VABER unamended
- Option (ii): No intervention, i.e. let the retained VABER expire on 31 May 2022
- Option (iii): Replace retained VABER with a UK VABEO

25. Options (i) and (ii) are not able to fully and effectively deliver the outlined policy objective and Option (iii) is therefore the option being taken forward. This assessment focuses on the impacts of this option (option (iii)), relative to the baseline, a renewal of current arrangements (option (i)).

(i) Renew retained VABER unamended (baseline scenario):

26. This option would entail renewing the retained VABER without amendment and would therefore represent no change from the status quo.
27. This would achieve many of the intended policy objectives, in particular providing legal certainty for businesses, however it would be less effective than replacing the retained VABER with a UK VABEO.
28. As noted above, the retained VABER originated with an EU regulation which was adopted on 1 June 2010. Since then, there have been many changes in the UK market. These market changes include the exponential growth of online sales, increased price transparency and monitoring, access to a wider customer base, increased direct-to-customer sales, and a rise in the use of selective distribution systems. There has also been a rise in the number of online platforms acting as intermediaries and/or making direct sales.
29. In addition, the original EU VABER was adopted with a view to market conditions across the EU and did not reflect specific characteristics of the UK market. Following EU Exit, the Secretary of State and the CMA are now able to take account of specific UK market conditions and the interests of UK customers and UK businesses.
30. A vertical agreements block exemption will offer increased benefits to businesses and consumers if it is updated to better reflect the current UK market conditions. This option would not make use of this opportunity.
31. This option is therefore not fully able to achieve the intended policy objectives.

(ii) No intervention:

32. This option proposes to allow the retained VABER to expire on 31 May 2022, without replacement or extension.
33. Without a vertical agreements block exemption, however, businesses would have to individually self-assess vertical agreements to ensure they comply with Chapter I of the Competition Act. This would place a considerable burden on the CMA, national courts and parties to vertical agreements.
34. Parties who were previously exempt under the retained VABER would have to assess whether their current vertical agreements comply with Chapter I, which can be costly and time consuming, thus increasing compliance costs for businesses. They would have to rely on the enforcement practice of the CMA, as well as existing UK case law to determine whether an agreement was in compliance with competition law. However, decisions are case-specific and would not provide as much legal certainty as a vertical agreement block exemption.

35. This option could also require the CMA to individually assess a greater number of vertical agreements, which would negatively impact its ability to target behaviour that poses the greatest threat to consumer welfare and prevent the effective and efficient use of the CMA's resources.
36. Government therefore considers that letting the retained VABER expire without providing for a replacement is not currently appropriate in the UK. This option is not able to achieve the intended policy objectives.

(iii) Replace retained VABER with a UK VABEO:

37. The preferred option is that Government replace the retained VABER with a UK Vertical Agreements Block Exemption Order. The UK VABEO is in line with the CMA recommendation and will be tailored to the needs of business operating in the UK and UK consumers.
38. A vertical agreements block exemption has numerous benefits to businesses, and whereas VABER was adopted by the EU, VABEO will be specific to the UK market. As such, a few amendments will be necessary, such as territorial and customer restrictions, online sales and parity obligations.
39. Based on the evidence and the CMA's recommendation, definitions, exemptions, market share thresholds and excluded restrictions are going to be carried over generally unamended.
40. The VABEO will introduce some changes to hardcore restrictions⁴. In general, hardcore restrictions remain unchanged, with the exception of the following which are explained in more detail below:
 - Territorial and customer restrictions – to make certain changes to the current regime in order to give businesses more flexibility in designing their distribution systems;
 - Indirect measures restricting online sales – to remove the prohibition of dual pricing and the requirement for overall equivalence from the list of hardcore restrictions; and
 - Parity obligations – to add wide retail parity obligations to the list of hardcore restrictions.

Territorial and customer restrictions

41. Vertical agreements that restrict the territory into which, or the customers to whom, a buyer can sell are treated as hardcore restrictions of competition under Article 4(b) of the retained VABER. These territorial restrictions will continue to be treated as hardcore in the VABEO as this supports consumer choice across all parts of the UK and promotes intra-brand competition. Existing exceptions in the retained VABER to be carried forward into the UK VABEO ensure that agreements can already benefit from the block exemption in cases where territorial and customer restrictions are likely to bring about efficiencies that outweigh any reduction of intra-brand competition and consumer choice.
42. However, the UK VABEO will make certain changes to the current regime with the aim of giving businesses more flexibility to design their distribution systems according to their needs. Specifically, the list of exceptions to the hardcore restriction in Article 4(b) of the retained VABER will be revised in the UK VABEO and clarified in the CMA VABEO Guidance to permit the following to be included in agreements captured by the block exemption:

⁴ Hardcore restrictions are provisions in agreements that are considered anticompetitive. If they are included in an agreement that would otherwise be covered by the block exemption, it falls out of scope of the block exemption and would be covered by competition law.

- a) the combination of exclusive and selective distribution in the same or different territories;
 - b) 'shared exclusivity' in a territory or for a customer group by allowing the allocation of a territory to more than one 'exclusive' distributor; and
 - c) the provision of greater protection, for members of selective distribution systems, against sales from outside the territory to unauthorised distributors inside that territory.
43. These changes will bring additional agreements into the scope of the exclusion order and therefore offer increased business opportunities and foster innovation by making it possible to design a broader range of distribution systems.

Indirect measures restricting online sales

44. Online distribution channels are effective channels for reaching a greater number and variety of customers than traditional distribution channels. In principle every distributor should therefore be allowed to use the internet to sell products since this is a reasonable way to allow customers to reach the distributor.
45. The retained VABER provides for preferential treatment for online sales. Certain online sales, such as the sales from a distributor's own website, are accordingly treated as a form of passive sales (passive sales are sales by distributors responding to unsolicited requests from individual customers and restrictions on passive sales are hardcore restrictions under the retained VABER). Moreover, any blanket bans - preventing distributors from selling through the internet at all - are considered to restrict competition 'by object' and are hardcore restrictions not exempted by the retained VABER.
46. Other indirect measures restricting online sales are also considered to be hardcore restrictions under the retained VABER, including:
- a) charging the same distributor a higher price for products intended to be resold online than for products intended to be sold offline – 'dual pricing'; and
 - b) imposing criteria for online sales that are not overall equivalent to the criteria imposed in brick-and-mortar stores in the context of selective distribution – the 'equivalence principle'.
47. This preferential treatment of online sales at EU level was first introduced at a stage where online distribution was still at a developmental stage and was seen as an industrial policy tool to achieve market integration within the EU single market.
48. Retaining the status quo would not be able to achieve the policy intent of ensuring pro-competitive agreements are block exempted and other aren't as effectively. Evidence collected by the CMA as well as by the European Commission show that in the context of a selective distribution system, it is necessary to provide offline distributors with the necessary incentives to invest in promoting products and to prevent free-riding by online distributors that focus mainly on price, without offering comparable pre-sales services. The need for the current treatment of indirect measures restricting online sales is removed by market developments such as the exponential growth of online sales⁵, additional costs incurred and increased challenges faced by brick-and-mortar retailers, and the existence in case law of sufficient safeguards against outright online sales bans.
49. The following changes will therefore be made:

⁵ Internet sales as a percentage of total retail sales in the UK increased from 6.4% in June 2010 (when the EU VABER entered into effect) to 37% in January 2021, a trend likely exacerbated by the COVID-19 pandemic. As of August 2021, the percentage stood at 25.5%, reverting to the more gradual increase and level expected pre-pandemic. See: <https://www.ons.gov.uk/businessindustryandtrade/retailindustry/timeseries/j4mc/drsi>.

- a) dual pricing will no longer be regarded as a hardcore restriction of competition; and
 - b) the imposition of criteria for online sales that are not overall equivalent to the criteria imposed on brick-and-mortar shops in a selective distribution system should no longer be regarded as a hardcore restriction.
50. The CMA will also revisit the treatment of certain online sales as passive sales in the context of the CMA VABEO Guidance, with a view to providing further clarity on the situations where online sales should more appropriately fall into the active sales category (active sales are sales made by actively approaching individual customers or potential customers).
51. These changes may help contribute to a more level playing field between online and bricks-and-mortar retailers.

Parity obligations

52. Parity clauses are obligations that require one party to an agreement to offer the other party goods or services on terms that are no worse than those offered to third parties.
53. The retained VABER does not refer to parity obligations, meaning that it is not a hardcore restriction and that the block exemption covers parity obligations in vertical agreements. However, parity obligations have become more common in recent years and in the context of agreements involving online platforms, have been the focus of close scrutiny by the CMA. Over the past decade there has been increased scrutiny of parity obligations that relate to terms offered by suppliers on the different sales channels they use. Following the growth of e-commerce, their use has particularly been observed in the context of online platforms, such as price comparison websites and online travel agents.
54. The evidence on the impacts of parity obligations is largely specific to digital platforms and discussed in further detail in this impact assessment. In order to reflect these developments and to provide greater certainty regarding their treatment under UK competition law, parity obligations are specifically addressed in the preferred option, to replace the retained VABER with the UK VABEO.
55. Parity obligations can be either wide or narrow. Wide parity obligations typically specify that a product or service may not be offered on better terms on any other channels (including, for example, a supplier's own website or through other intermediaries, such as other distributors or online platforms). By contrast, narrow parity obligations involve an agreement only that better terms will not be offered on a party's own sales channel (for example, a supplier's own website), without stipulating conditions for sales via other channels. Competition concerns have primarily been identified in relation to wide parity obligations.
56. Based on the CMA's experience of scrutinising parity obligations in its casework, the Government is concerned that wide retail parity obligations soften competition between horizontal competitors and reduce the incentives of intermediaries (such as online platforms) to compete on price, to innovate, or to enter markets and expand.
57. The retained VABER will therefore be replaced with a UK VABEO that treats wide retail parity obligations as hardcore restrictions, meaning that agreements containing wide retail parity clauses will no longer be block exempted by the UK VABEO, and businesses will no longer benefit from this coverage. Likewise, any anti-competitive harms previously arising from wide retail parity obligations will be mitigated.
58. In order for the hardcore restriction to be implemented effectively, the UK VABEO hardcore restriction would also apply to measures that have the same effect as a wide retail parity obligation contained in a contractual provision. Such equivalent measures will include any course of action, including entering into agreements or engaging in concerted practices,

which have the object of replicating the anti-competitive effects of a wide retail parity obligation.

59. The hardcore restriction under the UK VABEO will relate to wide retail parity obligations only. Wide retail parity obligations are defined as restrictions which ensure that the prices (or other terms and conditions) at which a supplier's goods or services are offered to end users on a sales channel are no worse than those offered by the supplier on any indirect sales channel, for example online platforms or other intermediaries.
60. Parity obligations can apply to retail markets (referred to as retail parity obligations) and business-to-business markets. Wide parity obligations that apply to business-to-business markets will not be treated as hardcore restrictions under the UK VABEO. Although these parity obligations could potentially soften competition between intermediaries in a similar way as in business to consumer (i.e. retail) markets, the overall competitive harm and direct effect on consumers is less clear and will depend on the complexity of the vertical supply chain and the strength of competition downstream. This represents no change from the renewal baseline option.
61. The hardcore restriction will apply to both online and offline intermediaries. This represents a deviation from the renewal baseline. While previous enforcement activity focused on online platforms, Government on advice of the CMA considers that wide retail parity obligations in online and offline sales channels should be treated in a consistent manner, given:
 - a) the theories of harm are the same for both online and offline intermediaries and therefore it would be inconsistent to treat them differently;
 - b) no credible evidence was provided during the consultation that efficiencies stemming from the use of wide retail parity obligations in offline markets are any greater than in online markets; and
 - c) the treatment of these clauses as hardcore restrictions does not prevent businesses from adopting them provided the conditions for individual exemption are met.
62. Finally, narrow parity obligations will not be included on the list of hardcore or excluded restrictions, given the possible efficiencies that may result from their use in particular markets. This represents no change from the renewal baseline option.

Summary and preferred option with description of implementation plan

63. Government therefore intends to replace the retained Vertical Agreements Block Exemption Regulation with a UK Vertical Agreements Block Exemption Order. This will require the making of a statutory instrument under the powers conferred to the Secretary of State under s.6 of the Competition Act 1998.
64. The UK VABEO would come into effect on 1 June 2022 to ensure that there is no gap and associated legal uncertainty between expiry of the retained VABER and entering into force of the UK VABEO.
65. The UK VABEO will provide for a transitional period of one year and expire after six years. The CMA will also publish further guidance to provide additional clarifications.
66. The CMA would oversee the implementation of the block exemption. The Secretary of State would be able to vary or revoke the Order under s.8 of the Competition Act 1998 where this is deemed appropriate, on recommendation of and in consultation with the CMA.

Costs and benefits

Summary of benefits and costs

67. This section outlines the expected benefits and costs of the preferred option, to replace the retained VABER with the VABEO.

68. Relative to the renewal baseline, the following sections of the VABEO are unchanged from the retained VABER, and therefore the impact of intervention is assumed equal to zero:

- a) Resale Price Maintenance
- b) Agency⁶
- c) Non-compete obligations
- d) Dual Distribution⁷

69. The benefits and costs of the following sections of the VABEO are considered in turn:

- Territorial and customer restrictions
- Indirect measures restricting online sales
- Parity obligations

Territorial and customer restrictions

1.1 Vertical agreements that restrict the territory into which, or the customers to whom, a buyer can sell are treated as hardcore restrictions under the retained VABER and will continue to be treated as such under the UK VABEO. However, certain restrictions will be removed from the list of hardcore restrictions, thus expanding the scope of the block exemption to give businesses more flexibility to design their distribution systems. Specifically, the CMA recommends that the list of exceptions to the hardcore restriction in Article 4(b) of the retained VABER should be revised in the UK Order and clarified in the Verticals Guidance to permit the following:

- (a) the combination of exclusive and selective distribution in the same or different territories;
- (b) 'shared exclusivity' in a territory or for a customer group by allowing the allocation of a territory to more than one 'exclusive' distributor; and
- (c) the provision of greater protection for members of selective distribution systems against sales from outside the territory to unauthorised distributors inside that territory

70. The CMA consultation considered different aspects of territorial and customer restrictions⁸, not all of which are proposed to change under the preferred option. As a

⁶ The CMA, in its final recommendation, include a slight clarification to make clear that providers of online intermediation services are to be treated as suppliers for the purposes of the block exemption. This will be clarified further in the Verticals Guidance.

⁷ Dual Distribution is already included as part of the block exemption in the baseline. The CMA proposes to outline examples where dual distribution could be used by importers and/or wholesalers. This will be part of the CMA's VABEO guidance. It is possible that this could represent a further widening of the block exemption and result in indirect impacts to businesses and consumers.

⁸ For instance, several respondents expressed views opposing the CMA's recommendation to continue to treat territorial restrictions as hardcore restrictions, given that the UK is no longer bound by the EU Single Market imperative. Additionally, some respondents noted that the current distinction between active and passive sales is complex and out-of-date with respect to the treatment of online sales as passive.

result, these areas are not in scope of the Impact Assessment analysis and we focus on the changes to the current regime that aim to give businesses more flexibility to design their distribution systems according to their needs.

Benefits

Direct benefits

71. There is no requirement to adopt new distribution systems, rather the preferred option offers businesses more flexibility. We consider that there are no relevant direct benefits to consider as part of this analysis.

Indirect benefits

72. The main benefit of introducing this measure is increased opportunities for some businesses in the form of greater flexibility when designing their distribution systems. If businesses do undertake improvements to the design of these distribution systems, there will likely be an associated indirect benefit.

Stakeholder evidence on territorial and customer restrictions

73. As outlined earlier in this Impact Assessment, we draw upon qualitative responses from the CMA consultation to assess the impact of the recommended change. Annex A provides a summary of the responses in relation to the expected impact of changes to the treatment of territorial and customer restrictions. Annex A summarises the responses by business type and industry.
74. Generally, there was wide support amongst respondents for the proposal to recommend giving businesses more flexibility to design their distribution systems according to their business needs, and respondents were of the view that these proposals should be adopted.
75. Legal representatives were overall moderately supportive of the change to allow businesses more flexibility in designing their distribution systems. Some asserted that there would likely be a positive impact to their business clients as a result of the change. However, some respondents in this category were concerned with the lack of clarity around territorial restrictions between the UK and the EU, with many commenting that this relationship is a new opportunity for UK businesses to reorganise their distribution. More clarity around the differences between UK and EU territories in the UK VABEO Guidance would be welcomed by these stakeholders, and potentially magnify the positive impact to business from this intervention.
76. Trade association respondents were supportive of the proposal, asserting that it would be beneficial to businesses in their respective industries by providing greater certainty and flexibility to businesses.
77. The theory behind this change under the preferred option is to allow businesses more flexibility, potentially creating new investment or opportunities for growth in certain sectors. The change represents a loosening of boundaries set by the block exemption, which itself is designed to provide efficiencies for business by removing the need to assess specific cases, ensuring greater legal certainty. This argument is supported by the responses from the CMA consultation.
78. The change provides businesses with the opportunity to adapt distribution systems, but there is no mandatory obligation to act. The changes proposed are likely to lead to positive business impacts overall through greater flexibility, legal certainty, and efficiency savings. These benefits, however, depend on businesses acting voluntarily under the new boundaries set by the block exemption. Any benefits are therefore indirect and not quantified as part of this Impact Assessment.

Costs

Direct costs

79. There is no requirement to adopt new distribution systems, rather the preferred option offers businesses more flexibility. It does not follow that new cost burdens are created from the preferred option. Therefore, we consider that there are no relevant direct costs to consider as part of this analysis.

Indirect costs

80. The indirect costs associated with this measure depend on businesses' voluntary actions to redesign distribution systems, so are not quantified. Any indirect costs of this change could be associated with businesses setting up and maintaining these systems.

Stakeholder evidence on territorial and customer restrictions

81. One retail respondent highlighted the concern that giving businesses more flexibility to combine exclusive and selective distribution models could lead to a reduction in competition because of discriminatory practices from brands. The respondent was concerned that the proposed change under the preferred option could represent a reduction in consumer choice and quality to provide brands greater control over the pricing and distribution of their products. This respondent was of the view that overall, combining exclusivity and selective distribution systems would generally be detrimental to consumers' ability to access a large range of products from different sellers at competitive prices and lead to a degree of territorial partitioning that is inconsistent with the promotion of competition. In this case, the change could negatively impact consumers.
82. As outlined above, the proposed change gives greater opportunities for some businesses to redesign distribution systems, but there is no mandatory obligation to act⁹. There are unlikely to be direct impacts as this represents a widening of the scope of the block exemption relative to the status quo and creates no new business burdens. Any costs depend on businesses acting voluntary under the new boundaries set by the block exemption and are therefore indirect and not quantified as part of this Impact Assessment.

Indirect measures restricting online sales

83. Agreement provisions that treat online and offline sales differently, including charging the same distributor a higher price for products intended to be resold online than for products intended to be sold offline are treated as hardcore restrictions under the retained VABER. The UK VABEO will remove such provisions from the list of hardcore restrictions and thus expand the scope of the block exemption.

Benefits

Direct benefits

84. There is no requirement to adopt new restrictions to online sales, so businesses will be taking voluntary actions in their agreements. We consider that there are no relevant direct benefits to consider as part of this analysis.

Indirect benefits

85. The main benefit of this measure is the removal of dual pricing and the equivalence principle as hardcore restrictions, leading to greater flexibility for manufacturers and retailers to price differentiate between offline and online channels.

⁹ There is no obligation to redesign distribution systems but there is an incentive, where inter-brand competition is strong, to set up and maintain innovative and efficient distribution systems.

86. If the use of dual pricing becomes common as part of vertical agreements, it is likely to increase fair competition between online and offline sales channels, which could translate into increased sales revenue on offline channels. As a result, there is likely to be an indirect benefit to businesses with offline sales channels compared to the baseline through greater protection against online competition.
87. We also consider that some types of consumers will benefit from greater choice and access to offline sales channels. Specifically, the possible efficiency gains in distribution via offline stores are likely to benefit groups of consumers who are particularly reliant on those stores. Consumers are likely to benefit from stronger competition between online and offline channels.
88. The consultation responses are generally very supportive of the proposal to remove dual pricing and the equivalence principle from the list of hardcore restrictions. We note that a particular benefit would be to increase the available choice to consumers, particularly more vulnerable consumers, by creating a level playing field between online and offline sales channels, helping to sustain the level of choice available offline¹⁰.
89. An additional indirect benefit of the preferred option is to help sustain bricks and mortar sales channels, including on high streets, which is a government objective¹¹.
90. The main benefit of the preferred option is potentially higher revenues for offline sales channels, both in the short and medium term. Moreover, by helping to level the playing field between online and offline retailers, the preferred option could promote inter-brand competition through encouraging investment and innovation in bricks & mortar sales channels. This in-turn provides a higher quality of service to consumers using offline channels. The scope of this benefit is expected to be wide as it can benefit many industries, particularly manufacturers and retailers. From the consultation responses, we do however conclude that the benefits to offline sales channels will be offset by costs to online sales channels, through potentially lower revenues and a reduced ability for free riding. As a result, this is a business-to-business transfer where the net indirect benefit is zero. There is limited available evidence to quantify this transfer and it would not be proportionate to do so.

Stakeholder evidence on indirect measures restricting online sales

91. As outlined earlier in this Impact Assessment, we draw upon qualitative responses from the CMA consultation to supplement the evidence base. Annex A provides a summary of the responses in relation to the expected impact of changes to the treatment of indirect measures restricting online sales. Annex A summarises the responses by business type and industry.
92. Manufacturers responding to the consultation were all supportive of the proposal under the preferred option to remove dual pricing and the equivalence principle from the list of hardcore restrictions. Respondents highlighted that the main benefit would be a more balanced playing field for brands in their offline and online engagement compared to the status quo, leading to a positive impact on manufacturing businesses. One respondent with a direct retail channel highlighted that the current rule treating restrictions to online sales as hardcore restrictions has led to free-riding by online retailers towards investment by offline sales channels. For example, bricks and mortar stores are prevented from being able to fully utilise the investment in the in-person experience, because they are currently unable to charge dual pricing. One respondent also highlighted that there is a need for coexistence between online and bricks and mortar channels, but the current

¹⁰ Older Generations to Rescue the High Street. Centre for Future Studies, 2017. This report by the Centre for Future Studies in 2017 argued the link between the ageing population and increasing loneliness in the UK, finding that the more vulnerable elderly population rely on additional human interaction via high street retail and the community. We hypothesise that this policy, by levelling the playing field between Bricks and Mortar retail and online retail, could have indirect positive impacts on elderly consumers.

¹¹ For example, <https://www.gov.uk/government/collections/new-levelling-up-and-community-investments>

VABER approach is outdated in that it significantly benefits online retailers. As a result, there is a negative impact to offline channels under the status quo, meaning that the proposed changes will lead to a significant positive impact to offline channels.

93. Retailers also highlighted the reduction of online channels' free-riding ability as a benefit falling to offline retailers. Specifically, one respondent highlighted that the sustainability of independent retail, and in turn the sustainability of premium quality brands, depends on the retailers' ability to effectively compete with online sales channels. One respondent noted that the current arrangements were originally designed to build the online sales channel, but the market environment has changed so much that the current arrangements give an unfair advantage to an already established channel, who free ride on the investment and specialist training undertaken by offline sales channels. One respondent also noted that the current treatment of the equivalence principle has caused major legal uncertainty, that could be mitigated by the clearer distinction in the future.
94. All legal representatives were supportive of the CMA's proposals to remove dual pricing from the list of hardcore restrictions, with all respondents highlighting the expected benefits for brick-and-mortar shops, given the recent growth in online sales, but some called for the CMA to provide further clarity, in its UK VABEO guidance, examples of acceptable justifications for price differentiation. One respondent mentioned that due to the large growth of online sales, offline sales channels will continue to struggle to compete, but the proposed change under the preferred option allows for different prices and/or criteria to be imposed on online sales relative to offline sales. The impact of this is to allow suppliers to be more flexible in designing networks and increasing the incentives for future investment in offline channels. This, in turn, could provide more choice to consumers, but particularly more vulnerable groups of consumers that may rely on physical stores.
95. While trade associations and consumer groups did not provide detailed response with respect to the impacts of this proposal, the majority are supportive of the preferred option, noting that it would be more representative of the current commercial reality.

Costs

Direct costs

96. There is no requirement to adopt new restrictions to online sales, so businesses will be taking voluntary actions in their agreements. We consider that there are no relevant direct costs to consider as part of this analysis.

Indirect Costs

97. The potential costs associated with this measure could be that online sales channels lose the current competitive advantage over offline sales channels, potentially leading to a loss in revenue and market power relative to the status quo. The impact of this is to limit the activity of online retailers and their ability to compete¹².
98. We also consider that some types of consumers that primarily use online channels could be negatively affected if dual pricing is used by some businesses. This raises the potential for higher prices on online channels. It should be noted that some types of consumers depend on online sales channels and could be adversely affected¹³.
99. As outlined in the indirect benefits section, there are consultation responses for and against this proposal, setting out potential indirect benefits and costs. We conclude that the costs to online sales channels will be offset by benefits to offline sales channels. As a

¹² It should be noted that in their recommendation, the CMA consider any negative impacts to be limited, as online sales channels are a clearly established route to market, and manufacturers or suppliers are unlikely to unduly restrict online distribution altogether.

¹³ However, there is no clear evidence that the use of dual pricing would lead to a drop in the use of online sales channels as a leading retail channel. We comment in this Impact Assessment on the remaining competitive advantages held by online sales channels, which is consistent with many of the responses to the CMA's consultation.

result, this is a business-to-business transfer where the net indirect benefit is zero. There is limited available evidence to quantify this transfer and it would not be proportionate to do so.

Stakeholder evidence on indirect measures restricting online sales

100. Most responses were supportive of the proposal under the preferred option. However, one digital retailer provided significant opposition to the proposal, arguing that the decision to remove dual pricing and the equivalence principle across all sectors was not proportionate, and a more in-depth sector by sector approach should be considered. The response also highlighted that the proposal would lead to significant negative impacts on online-only retailers. Further, the response argues that the recommendation does not properly account for specificities between the ways different sectors operate. The evidence above focuses on situations where manufacturers or retailers of fast-moving consumer goods will be able to price differentiate between online and offline channels but does not consider markets where the online retailers' do not purchase from a supplier, but their services act to provide marketing at an agreed commission rate. In these cases, the respondent argues, dual pricing restraints on online-only retailers is discriminatory, as suppliers can exempt their own website from such restraints. The impact of this is to limit the activity of online retailers and their ability to compete. It is possible that online-only retailers are adversely affected by this proposal, but we note that this represents a move to a more level playing field between online and offline channels, rather than imposing new restrictions.

Parity Obligations

101. The retained VABER will be replaced with a UK VABEO that treats wide retail parity obligations as hardcore restrictions, meaning that agreements containing wide retail parity clauses will no longer be block exempted by the UK VABEO, and businesses will no longer benefit from this coverage. Likewise, any anti-competitive harms previously arising from wide retail parity obligations will be mitigated.
102. It should be noted that the benefits and costs outlined below are not all a direct consequence of the changes the UK VABEO would introduce. As noted, parity obligations would not be prohibited and business practices not made illegal, but businesses would need to self-assess that their agreements to comply with competition law.

Benefits

103. The main benefit of the proposal to treat wide retail parity obligations as hardcore restrictions is to address the concerns raised by CMA market studies and investigations that wide retail parity obligations in vertical agreements may soften competition. Concerns have been raised that wide parity obligations:
- a) may reduce the incentives of intermediaries to compete on price
 - b) may impose barriers to entry
 - c) may result in less innovation by intermediaries.
104. To assess the benefits of restricting the use of wide retail parity obligations by limiting the scope of the block exemption (while still allowing them where they meet the criteria for individual exemption), we draw upon the academic literature and the stakeholder evidence provided as part of the CMA consultation. This is outlined below.

Academic evidence on the use of wide parity obligations

105. The CMA has previously found competition concerns arising from the use of wide parity obligations in the context of market investigations and Competition Act 1998 enforcement, in the context of digital platforms and retail sales of insurance.
106. For example, alongside detailed empirical analysis an econometric analysis conducted by the CMA in 2017¹⁴ tested the hypothesis that the use of wide parity clauses in agreements between digital intermediary services and insurance brands affected the commission charged by the digital intermediary. The study used a fixed effects model to isolate the effect of the parity clause by accounting for other time-invariant factors affecting the commission charged, such as the size of the insurance firm, and time-dynamic factors affecting commission charged, such as a general increase in all commission charged by digital intermediaries over time. The results indicate that on average, commissions were 3% to 4% higher when a wide parity clause was in place than they would have been in the absence of the wide parity clause. This was one piece of analysis that supported the overall finding¹⁵ that higher commissions charged by digital intermediaries are likely to result in higher end prices for consumers, and less choice when searching between competing intermediaries.
107. While the CMA analysis is consistent with the economic literature, that the use of wide retail parity clauses in agreements could lead to higher commissions paid by suppliers, it should be noted there are limitations to the empirical finding. For example, the study used a small sample size, and it was specific to the market for online retail of insurance. On this basis, caution is taken when using these estimates. Nevertheless, there is limited empirical estimates into the effects of wide parity clauses, and they can provide a useful contribution to the expected effects in terms of order of magnitude.
108. The CMA market investigations focused on insurance parities, supporting the Private Motor Insurance Market Investigation Order 2015¹⁶, which banned wide parity obligations. Parities have also been prevalent in other industries¹⁷, in particular, travel between online travel agencies (OTAs), which provide a service for consumers to compare hotel rooms, and hotel brands, which market their product both through a direct channel (their own website), and indirectly to consumers through multiple online travel agencies. Below we cite further academic evidence of the impact of parity obligations in the travel industry.

ECN Hotel Monitoring report

109. A key contribution to the evidence base on parity clauses is the wide scale monitoring report¹⁸ commissioned by the European Competition Network (ECN) to measure the effects of changes to parity clauses used between online travel agencies and hotels in the travel sector. At the time of the report in 2016, the UK and ten other countries were included.
110. The monitoring report used a mixed methodology, based upon an econometric analysis of data collected from online travel agencies, combined with a survey completed by hotel owners, focusing on the period before and after the switch from wide to narrow parity clauses across different Member States.

¹⁴ CMA Digital comparison tools market study 2017. Paper E: Competitive Landscape and effectiveness of competition

¹⁵ CMA Digital comparison tools market study 2017. Paper E: Competitive Landscape and effectiveness of competition. This paper includes the econometric analysis (Appendix 2) but is also supported by qualitative stakeholder evidence on the potential negative impacts of wide parity clauses on competition.

¹⁶ See CMA PMI investigation and final Order at: <https://www.gov.uk/cma-cases/private-motor-insurance-market-investigation>

¹⁷ The academic literature argues that the use of price parities is common by online travel agencies. The CMA's consultation on the UK VABEO supports this finding, with several respondents providing views on the current use of price parities in the sector.

¹⁸ Authorities, E.C., 2016. Report on the monitoring exercise carried out in the online hotel booking sector by eu competition authorities in 2016. Report retrieved from http://ec.europa.eu/competition/ecn/hotel_monitoring_report_en.pdf.

111. The research used a linear probability model and a differences-in-differences specification to estimate the effect, of a country level change in the treatment of parity clauses, on the probability of hotels deciding to differentiate prices rather than offer the same price for a room through all its online travel agency partners. The findings suggested that in most Member States, restrictions on the use of price parities increase price differentiation, but the results were driven by chain hotel groups and not independent hotels.
112. The survey part of the ECN report revealed some insights into hotels' awareness of changes to the treatment of parity obligations, hotels' use of price differentiation between online travel agencies, and perception of commission rates charged by online travel agencies. The results suggested that although online travel agencies had changed their treatment of parity obligations from wide to narrow across some Member States, 47% of the hotels said that they were not aware that certain online travel agencies had changed or removed their parity clauses. Of those that were aware of the changes, 60% said that they had not acted upon them in any way. Additionally, 79% of the hotels said that they had not price differentiated between online travel agencies in the period since some online travel agencies had switched from wide to narrow parity clauses. The findings suggest that a change in the treatment of wide parity clauses may not always lead to an immediate change in behaviour, and as a result, prices, if responsiveness is limited by other factors such as awareness or risk aversion.
113. Although the report did not provide conclusive evidence that commission rates had lowered, it represents the most relevant large study into the impact of price parity obligations, somewhat supporting the theory of harm that wide parity obligations restrict competition relative to narrow parity obligations, and relative to no price parities at all.

Piga, Mantovani and Reggiani

114. Piga, Mantovani and Reggiani¹⁹ conducted primary research in 2018, looking into the impact of price parities on the relationship between online travel agencies (OTAs) and hotel brands commissions and therefore final consumer prices. The theory of harm, as set out by the authors, is consistent with that described in the CMA study cited above: that wide parity obligations in the sector could stifle horizontal competition between online travel agencies, allowing for the increase in the commission rate paid by hotels, in turn raising the final price charged to a consumer.
115. The authors took advantage of varying levels of intervention by different National competition authorities across the EU between 2015-2017. This created an opportunity for comparative analysis, comparing prices on one online travel agency²⁰ in three Mediterranean countries, France, Italy and Spain, which differed in their commitment against price parity clauses²¹. The empirical findings showed that comparing the years 2014-2015 showed price drops in every country in the sample, but that France, where price parities had been prohibited, the price drop was more significant. In addition, comparing 2015-2016, where Mediterranean prices had increased generally due to external factors²², the price increase was much less sensitive in France and Italy, which had imposed restrictions on parity clauses. Although causality is not inferred by this analysis, the authors argue that country level investigations into price parities induced online travel agency Booking.com to eliminate wide parity clauses and invest in new innovations to improve the customer experience.

¹⁹ Mantovani, A., Piga, C. and Reggiani, C., 2018. On the economic effects of price parity clauses-what do we know three years later?. *Journal of European Competition Law & Practice*, 9(10), pp.650-654.

²⁰ Booking.com

²¹ France imposed Law Macron in 2015, prohibiting price parities. Italy also imposed restrictions, whereas Spain were less active in restricting price parities.

²² For instance, turmoil in Tunisia and Egypt in 2015 and 2016 had increased tourism demand for beach resorts in France, Italy and Spain.

116. The authors conclude that antitrust enforcement against price parities increased competition in the online travel agency sector, increased transparency, and incentivised online travel agencies to improve their services.

Wang and Wright

117. Wang and Wright²³ in 2020 presented a theoretical model investigating both wide and narrow parity obligations in vertical agreements, building on the literature on the use of parity clauses in the tourism sector.

118. In the case of narrow parity obligations, they argue that the phenomenon of 'showrooming' - where consumers willing to search across online platforms and direct selling channels may use the platform to compare prices but complete the end purchase on the brand's own website – could lead to freeriding by brands, reducing the incentives for online platforms to enter the market. Therefore, an argument in favour of narrow parity obligations is that they act as a defence against showrooming, preserving a platform's ability to operate. The authors conclude that any assessment of narrow parity obligations must balance the legitimate protection they provide to online platforms versus any anti-competitive effects preserving end prices paid by consumers.

119. In the case of wide parity obligations, they argue that there are two main anticompetitive effects. Firstly, wide (and also narrow) price parities suppress competition between online agency platforms and the brand supplier of the service (such as a hotel) because the presence of a parity obligation by definition prevents brands from undercutting online platforms. Secondly, wide parity obligations ensure that platforms cannot undercut one another, suppressing horizontal competition between platforms, in turn reducing the incentives for competing platforms to lower the commission rate charged. The authors therefore conclude that the level of fees and prices when wide parity obligations are included is always higher than without wide parity obligations, rendering wide-parity obligations as an anti-competitive practice. They also conclude that narrow parity obligations are a less restrictive alternative, and that consumers are always better off under narrow parity obligations compared to wide parity obligations, so the authors support restrictions imposed on the use of wide parities.

Ezrachi

120. Ezrachi (2015)²⁴ made arguments for and against the case for parity obligations, stating that evaluation should be context dependent. The author argues that wide parity clauses can benefit consumers through investment and innovation, which enhances choice for consumers by reducing search costs. Wide parity clauses can improve consumers' access to information by 'collating and aggregating quantitative and qualitative data about suppliers, price and 'product characteristics. This can increase competition between suppliers of services listed on price comparison websites, such as travel and accommodation. In addition, by increasing convenience and reducing search costs, parity clauses can benefit less informed consumers that have more limited access to information.

121. The author also argues that price comparison websites using wide parity clauses in agreements do mitigate both risk and investment costs faced by suppliers. This could reduce barriers to entry for suppliers who would otherwise be exposed to risk and costs associated with online advertising and commerce, particularly for some suppliers that may lack the economies of scale necessary to engage in major investment.

122. Ezrachi also argues that parity obligations, in particular wide parities, may lead to negative welfare effects due to a restriction of competition through excessive intermediation and price uniformity. Although there is more evidence for the positive

²³ Wang, C. and Wright, J., 2020. Search platforms: Showrooming and price parity clauses. the RAND Journal of Economics, 51(1), pp.32-58.

²⁴ Ezrachi, A. (2015) The competitive effects of parity clauses on online commerce, European Competition Journal, 11:2-3, 488-519

effects created by narrow parities, the author argues that the case for parities generally depends on conditions in the specific market or industry of interest, and as such there may be a case for detailed sector-by-sector investigations where there is uncertainty around the balance of the benefits and costs created by parity clauses.

Baker and Scott-Morton

123. Baker and Scott-Morton (2018)²⁵ argue that the use of parity obligations by platforms can generate efficiencies and increase the incentive to invest by protecting relationship-specific investments. For consumers, they also argue that parities can reduce transaction and negotiation costs, leading to greater choice for consumers.
124. In addition, the authors argue that engagement with platforms using parities can still be beneficial to suppliers, such as hotels, by allowing them to access a different set of customers that may prefer to book on price comparison websites than self-compare offers made by individual hotels. The authors state that the number of new customers available through price comparison websites are 'likely far more numerous than the customers that the hotel could reach on its own.'
125. Like much of the literature, Baker and Scott-Morton also make the case against the use of parity obligations, arguing that they 'can harm competition by keeping prices high and discouraging entry'. In their conclusion, they make the case for greater antitrust scrutiny in the United States, noting that "the European experience has shown that challenges to such practices can improve consumer welfare'.

Baker and Chevalier

126. Baker and Chevalier (2013)²⁶ also argue that the evaluation of the competitive effects of parity clauses depends on the specific market context in question. They consider that parities, also prevalent in some countries and industries, can have both positive and negative impacts on competition. On one hand, the existence of parities can reduce transaction costs and open new markets available to suppliers. On the other hand, parities can 'dampen competition' by causing firms to compete less aggressively as a result of a reduced incentive.
127. They argue that these effects are not mutually exclusive in 'any particular industry setting', and as such, it may be necessary to consider a range of potential economic outcomes during investigations into the use of parities in specific markets.
128. Overall, while the economic literature makes the case for and against the use of wide-parity obligations in a retail setting, the evidence suggests that the efficiencies created for either brands or consumers do not outweigh the anti-competitive effect. We conclude that the recommendation to treat wide-parity obligations in a retail agreement as a hardcore restriction should lead to benefits to brands, and consumers.

Stakeholder evidence on parity obligations

129. As outlined earlier in this Impact Assessment, we draw upon qualitative responses from the CMA consultation to supplement the evidence base. Annex A provides a summary of the responses in relation to the expected impact on different types of

²⁵ Baker, J. B. and Scott-Morton, F. (2018), *Antitrust Enforcement Against Platform MFNs*, The Yale Law Journal

²⁶ Baker, J. and Chevalier, J. A., *The Competitive Consequences of Most-Favored-Nation Provisions* (2013). Articles in Law Reviews & Other Academic Journals. 1120.

businesses of restrictions to wide retail parity obligations²⁷. Since the view of stakeholders varied in relation to the treatment of parity obligations, Annex A summarises the responses by business type and industry.

130. From legal representatives, some responses did highlight that wide parity obligations could restrict competition, and therefore agreed with the preferred option. For instance, one respondent highlighted that although there may be some limited circumstances where wide parity obligation may generate efficiencies or help a platform avoid free riding, the circumstances are likely to be limited, giving rise to a net benefit from the change.
131. Stakeholders representing insurance firms also supported the proposals, citing the CMA's decision on the PMI Order, and highlighting that an approach in line with that decision would increase consistency across industries, and provide similar benefits to brands and suppliers as in the insurance industry.
132. There is a general desire from stakeholders for greater legal certainty and guidance to be provided about how to assess parity obligations. The preferred option will define the scope of parity obligations that are treated as hardcore restrictions, providing much-needed legal certainty. Some stakeholders also highlighted links between parity obligations and resale price maintenance, an area which is already a hardcore restriction (and will remain so under the preferred option).

Quantification of benefits

133. As outlined in the evidence from the academic literature and consultation, the main benefit of the preferred option to treat wide retail parity obligations as hardcore restrictions is to protect UK consumers from anti-competitive practices, avoiding the preservation of higher prices, and allowing greater freedom of choice when searching online or offline agencies.
134. The CMA also cites consultation responses in its recommendation that suggest that the smaller size of the UK market merits a stricter approach to the treatment of wide retail parity obligations than that taken, for example, by the European Commission because the smaller size of the UK market could exacerbate negative effects²⁸. Additionally, given the links between parity obligations and resale price maintenance, the preferred option ensures consistent treatment between the two, and mitigates potential for similar anti-competitive practices.

Indirect benefits

135. The benefits to some businesses of treating wide parity obligations as hardcore restrictions are the potential for suppliers or brands to pay lower commission rates to comparison tools such as online agencies.
136. Firstly, we define the scope of businesses affected. The preferred option only applies to wide retail parity obligations, and the CMA's PMI Order in 2015 prohibited the use of wide parity obligations relating to motor insurance, so in relation to these markets the change relative to the status quo is zero. More recently, the CMA infringement decision pointed out that wide parity obligations were historically widely used by price comparison websites across insurance products until the PMI market investigation. Since then, the use of those clauses has been progressively abandoned, including in home insurance.
137. The evidence both from the consultation responses and the academic research shows that price parity clauses are still prevalent in other markets other than insurance,

²⁷ The consultation also considered narrow parity obligations. Most responses agreed that with the recommendation not to change the treatment of narrow parity obligations, and therefore no additional costs are expected in relation to narrow parities.

²⁸ One legal firm responded that the treatment of wide parity clauses should differ to the approach taken by the EC, for a UK specific market where offline sales have fallen.

particularly the travel and tourism sector. We therefore define the scope as hotel bookings with travel agencies, both online and offline. This is a reasonable assumption consistent with the CMA's consultation. This consultation invited views from a range of stakeholders from a range of industries. The responses showed that parity obligations are likely prevalent in the travel industry but did not raise concerns that they may be particularly prevalent in other industries.

138. There is no available data on the prevalence of wide parity obligations within these agreements, but the theory of harm suggests that these are more prevalent in arrangements where online (and large) travel agencies are involved. For instance, some sales will still take place directly offline or through the hotels' own websites and will be largely unaffected by the change. The ECN hotel monitoring report finds that across all Member States and hotel types sampled, the share of sales delivered through online travel agencies was around 41%²⁹. We assume that these sales are in scope to be affected by the change proposed by the preferred option.

139. Some online travel agencies have already moved away from wide parity obligations. The ECN hotel monitoring report suggests that around 20% of hotels said that at least one online travel agency they dealt with obliged them by contract to give it a wide price parity relative to all other sales channels. This figure is an average across Member States, and there is a high degree of uncertainty around its reliability, since some hotels seemed unaware that some agency partners had moved away from wide parity obligations entirely. Nevertheless, we use it as an informative indicator of the number of bookings where parity obligations may be in play.

140. Using the data from the ECN's monitoring report, we estimate that around 8%³⁰ of room bookings are currently subject to wide parity obligations and could therefore be affected by a removal of such obligations from the block exemption. Based on the observed removal of wide parity clauses in insurance markets, and in tourism in some EU Member States, the analysis of indirect impacts considers that all remaining wide parity clauses are abandoned.

141. It should be noted that while this change would remove legal certainty from those party to such obligations, it does not prevent businesses from retaining them or entering into new agreements, if they self-assess that the agreements are pro-competitive. Therefore, the estimate of the number of bookings affected by the proposals is an upper bound estimate of the true effect, as it is possible that some agreements retain parity clauses.

142. Next, we cite the World Tourism Organisation's (UNWTO) tourism statistics on the number of rooms in 'accommodation, hotels and similar establishments' in the UK: around 790,000³¹ per night and average room occupancy of around 70%³². Therefore, the expected number of occupied rooms is around 550,000³³ per night, which we assume is equal to the number of bookings in scope.

143. The estimated upper bound for the number of bookings to be affected by the change to the treatment of wide retail parity obligations is around 45,000³⁴ per night. As noted, this figure assumes that all bookings currently imposing wide retail parity

²⁹ ECN hotel monitoring report – Table 1. The 2016 value represents a period after some Member States and travel agencies had moved away from wide parity obligations, so represents the most relevant estimate of the status quo.

³⁰ Estimated proportion of room transactions currently subject to wide parity obligations assumed to be the share of sales delivered through online travel agencies (41%) * the proportion of hotels participating in a contract with an online travel agency that subjects them to a wide parity obligation (20%) = 8%. Note there is a high degree of uncertainty in the 20% figure, leading to a high degree of uncertainty for the number of room transactions subject to wide parity obligations.

³¹ 786,775 rooms in the United Kingdom in 2016, the most recent pre-Covid 19 data available. UNWTO tourism statistics.

³² The room occupancy rate was 70.2% in 2016. UNWTO tourism statistics.

³³ 786,775 * 70.2% = 552,316

³⁴ 552,316 * 8% = 45,290

obligations no longer do so, though this is not required by the UK VABEO. There is some uncertainty around this estimate. As noted, two large travel agencies, Booking.com and Expedia, notified the CMA³⁵ that they will voluntarily extend formal commitments made in 2015 not to enforce 'wide' parity clauses, after they expired in July 2020. Given that some online travel agencies have moved away from wide parity obligations before this decision, and that the ECN highlights concerns with their survey of hotels, this is likely to be an overestimate of the number of bookings affected by the change, at least in the travel industry.

144. The theory of harm suggests that the removal of wide retail parity obligations from the block exemption could lead to a lower commission price charged by agencies, encouraging direct competition between agencies and likely increasing the share of revenues received by hotels or suppliers. This in turn could lead to lower consumer end prices. CMA's Digital Comparison Tool study of insurance parities estimates that commissions were between 3% and 4% higher when a wide parity obligation was in place than they otherwise would have been. As noted above when providing an overview of the literature there are limitations to this empirical estimate, including its specificity to insurance rather than the travel industry. Nevertheless, the purpose of this quantitative assessment is to provide an order of magnitude assessment of the impact of the proposed change to the Block Exemption, on businesses and consumers in the United Kingdom. We take this as an indicative figure of the effect of commission rates in the travel industry. Lower commissions could lead to lower end prices paid by consumers, but the total saving is unlikely to be fully passed on.

145. We assume that there is a direct benefit to hotels in partly preserving their revenues. The average pre-Covid daily rate per room was around £154 in London³⁶, and assuming an average commission rate of 15%³⁷, we estimate that the change in commission charged by travel agencies would be about £0.81 per room per night³⁸, or a total saving of around £37,000 per night³⁹. If hotels or suppliers hold on to around 75% of this saving, the total indirect annual benefit is estimated to be around £27,000⁴⁰ per night. This gives a total indirect benefit to these types of business of £10m annually⁴¹.

146. Consistent with the theory of harm identified, we expect there to be some saving to consumers in the form of lower prices paid for hotels due to increased competition between travel agencies. If 25% of the commission rate saved is passed onto end consumers, the total indirect annual benefit to consumers is around £9,000⁴² per night. The indirect benefit to consumers is therefore expected to be around £3m annually⁴³.

147. As noted, the estimates above are based on the assumption that the price charged for a hotel room is equal to the average pre-Covid daily rate per room in London. This is likely an upper bound relative to the true underlying price charged for a hotel room in the UK on average but represents our best estimate. This is because there is not sufficient data available to weight the room rates between London and non-London regions. We believe the London weight is a better representation of the average price paid by the final consumer relative to the regional rate, which is in part based on less frequently booked listings in areas of lower demand for accommodation. Additionally,

³⁵ CMA monitoring of pricing practices of online travel agents <https://www.gov.uk/cma-cases/online-travel-agents-monitoring-of-pricing-practices>

³⁶ PwC UK Hotels Forecast 2020-2021. Average daily rate of a hotel room in London = £153.54. We apply the London rate to the UK as a whole, so this should be interpreted as an upper bound.

³⁷ Booking.com

³⁸ The expected reduction in commission rate is around 3-4%, or 3.5%. So, $(£154 * 15%) * 0.035 = £0.81$, assumed to be the saving per room.

³⁹ $£0.81 * 45,290 = £36,508$.

⁴⁰ $£36,508 * 0.75 = £27,381$.

⁴¹ $£27,381 * 365.25 \text{ nights} = £10,000,779$.

⁴² $£36,508 * 0.25 = £9,127$.

⁴³ $£9,127 * 365.25 \text{ nights} = £3,333,593$.

given the limited direct costs to business expected from this policy, it is more proportionate present an upper bound over a lower bound. However, as a sensitivity check⁴⁴, we do present another estimate using the average pre-Covid daily rate per room in regions outside of London, around £71⁴⁵. Under this lower bound scenario, the change in commission charged by travel agencies is estimated to be lower, at about £0.37 per room per night⁴⁶. Under the sensitivity scenario, the total indirect benefit to hotels or suppliers would be lower, at around £4.6m⁴⁷ annually. The total indirect benefit to consumers would also likely be lower at around £1.5m⁴⁸ annually.

Costs

Stakeholder evidence on parity obligations

148. We draw upon qualitative responses from the CMA consultation to supplement the evidence base, and with respect to the recommendation on wide parity obligations, some respondents did provide views against the proposed change.
149. Firstly, it should be noted that the proposal set out in the consultation was for a more substantial change compared to the now preferred option. The previous proposal set out that all wide parity obligations should be treated as hardcore restrictions (including those in wholesale markets), whereas the now preferred option proposes that only retail wide parity obligations should be treated as hardcore restrictions.
150. The CMA now recommends that wide parity obligations that apply to business-to-business markets are not treated as hardcore restrictions. Although these parity obligations could potentially soften competition between intermediaries in a similar way as in business to consumer (i.e. retail) markets, the overall competitive harm and direct effect on consumers is less clear and will depend on the complexity of the vertical supply chain and the strength of competition downstream.
151. The proposal to only treat wide retail parity obligations as hardcore restrictions represents a smaller scope of agreements affected than as proposed under the consultation. Therefore, although some responses opposing the treatment of parity obligations as hardcore restrictions were informative for forming the current preferred option, they do not contribute to the assessment of costs under the preferred option. Any costs highlighted by stakeholders relating to wide parity obligations that apply to business-to-business markets only are not in scope, as these costs are expected to be zero under the preferred option.
152. One respondent interested in parity obligations in the travel sector strongly opposed the recommendation to treat wide parity obligations as hardcore restrictions. They argued that the CMA had based its recommendation on a very narrow set of evidence, based on a small number of enforcement cases in the insurance sector, and that there is limited evidence to apply this argument to other retail-based sectors across the economy.
153. Responses from legal representatives in relation to parity obligations were mixed. Several responses highlighted concerns with the recommendation to treat wide parity obligations as hardcore restrictions, raising the point that parity obligations are widely used across many sectors of the economy, and can offer material benefits, such as protecting retail investments made by retailers. Additionally, the inclusion of parity obligations in the block exemption allows for the benefit of legal certainty when forming

⁴⁴ This is a sensitivity check as there is not sufficient data available to weight the room rates between London and non-London regions. Therefore, we use the London rate as an estimate of the upper bound impact.

⁴⁵ PwC UK Hotels Forecast 2020-2021. Average daily rate of a hotel room in regions = £71.18.

⁴⁶ The expected reduction in commission rate is around 3-4%, or 3.5%. So, $(£71 * 15%) * 0.035 = £0.37$, assumed to be the saving per room under the sensitivity scenario.

⁴⁷ $(£0.37 * 45290) * 75% * 365.25 = £4,636,287$.

⁴⁸ $(£0.37 * 45290) * 25% * 365.25 = £1,545,429$.

agreements, particularly where market shares are small and therefore currently benefit from the block exemption. Under the preferred option, the protection of retail investments and legal certainty provided by the exemption is lost, potentially increasing costs to business, noting that such agreements could continue to operate where they are individually assessed as being pro-competitive.

154. Some trade associations in the travel and transport sectors raised concerns with the CMA recommendation, specifically that the EU VBER review is likely to impose a less restrictive approach to parity obligations, meaning there may be complexities for members with two sets of rules. However, we note that future divergence by the EU from the European Commission's existing rules is not in scope of this Impact Assessment, as we compare costs relative to a baseline of renewal of the current approach.

155. We note that several respondents highlighted that competition enforcement cases have primarily focused on the use of these clauses in online platform markets. The CMA accepts this in its recommendation but notes that the theory of harm is consistent across both online and offline channels. We note that under the preferred option, both online and offline agencies will be affected by the wider scope and could face similar cost burdens.

Academic evidence on parity obligations

156. We also note that the academic evidence has highlighted some efficiencies to business, which could be lost under the preferred option. Johansen and Verge (2017)⁴⁹ show that when there is close competition between hotels, price parity obligations do not always lead to higher commission rates and final prices, instead benefiting all parties, including platforms but also sellers and consumers.

Quantification of costs

Indirect costs

157. The costs associated with this measure are explored in more detail below. Since the preferred option to treat wide retail parity obligations as hardcore restrictions aims to protect consumers and encourage competition between online and offline agencies, particularly online travel agencies, there will be a transfer away from online travel agencies and towards consumers and hotels or suppliers.

158. The theory of harm argues that restrictions to the use of wide retail parity obligations should lower commission rates charged by online travel agencies. We assume that this represents a loss in revenue, as direct competition is likely to increase between these parties. The calculations set out above in the benefits section estimate that lower commission rates charged represent around £37,000 per night. This gives a total cost of around £13m annually⁵⁰. We assume that this is an indirect cost falling on travel agencies, and as indicated above, is partially offset by an indirect benefit to hotels or suppliers, with the remaining part transferring to consumers.

159. As outlined above, we include a sensitivity scenario for the change in commission rates, which assumes a lower average rate per room equal to the average pre-Covid daily rate per room in regions outside of London. Under this lower bound scenario, the estimated total change in commission rates is around £6m annually⁵¹

Direct costs

⁴⁹ Johansen, B.O. and Vergé, T., 2017. Platform price parity clauses with direct sales. University of Bergen.

⁵⁰ £36,508 * 365.25 nights = £13,334,372.

⁵¹ £4,636,287+£1,545,429 = £6,181,716

160. Additionally, one of the main costs of the preferred option is the potential for an increase in compliance costs and disruption for businesses currently operating wide retail parity obligations. This cost burden mainly falls on agencies who impose the wide retail parity obligations and may wish to seek legal or expert advice to clarify whether agreements are in line with the new restrictions and, where not, potentially redefine existing agreements and address short term disruption. Therefore, the direct compliance cost is primarily made up of the cost of legal advice.

161. We define the scope of those affected by these new compliance costs as all travel agencies, whether online or offline, though other industries may also be affected. Using the Interdepartmental Business Register, around 5,005 businesses operate as travel agencies and around 175 of these each generated turnover of at least £10m⁵². The theory of harm as evidenced in the academic literature⁵³ suggests that primarily larger travel agents, particularly those that operate online comparison tools, have sufficient market power to impose parity obligations in their agreements with hotels and accommodation providers. Smaller agents, which make up a large proportion of businesses in this SIC class, are less likely to have sufficient market power to impose these clauses on partners. We therefore define that the 175 travel agencies with a turnover of £10m or more are in scope of compliance costs during the one-year transition period.

162. There is no sound evidence on the scale of legal costs that would face the businesses in the short run, but we assume that each firm is subject to 40 hours⁵⁴ of solicitors' time in the transition period at an hourly rate of £480⁵⁵, and 40 hours⁵⁶ of economic consultants' time in order to self-assess their agreements, at an hourly rate of £360⁵⁷. This gives an average compliance cost per business of £34,000⁵⁸. Summing over 175 businesses in scope gives a total expected direct cost of £5.9m⁵⁹. This is expected to be an overestimate because some large travel agencies have already moved away from wide retail parity obligations⁶⁰, so the true number of businesses affected in the industry is likely lower than 175. The assumption that each business is subject to 40 hours of legal and expert advice is a BEIS assumption and true number of hours could vary substantially between firms, based on the number and complexity of agreements containing wide parity retail obligations that each firm participates in. As some online agencies have already moved away from using wide parity clauses in their agreements, some firms will be able to adjust agreements relatively simply at low cost. Others however will currently participate in a larger number of agreements which will be affected by the changes. On balance, BEIS believe the assumption to be a reasonable best estimate⁶¹.

⁵² ONS IDBR - UK business; activity, size and location, 2021. Table 9 - Number of VAT and/or PAYE based enterprises by Standard Industrial Classification (SIC) class and turnover sizebands. SIC Class 7911: Travel Agency Activities.

⁵³ See Johansen, B.O. and Vergé, T., 2017. Platform price parity clauses with direct sales. University of Bergen. When Interbrand competition is less fierce and platforms have a larger market share as a result, commissions are higher and the risk of losing market share is small, so platforms with a large market share benefit from the use of wide parity clauses.

⁵⁴ This assumes one week of one solicitor's time at 40 hours per week.

⁵⁵ HM Government Solicitors' guidance hourly rates. We conservatively assume London Grade 1, Class A: Solicitors and legal executives working with over 8 years' experience working in London (uprated to 2020 prices).

⁵⁶ This assumes one week of one specialist consultant's time at 40 hours per week.

⁵⁷ For example, we cite the average fee for a Compass Lexecon economic consultant as \$494 per hour, or using an exchange rate of 1:0.73 from USD to GBP, around £360.62 per hour. FTI Consulting Annual Report 2020.

⁵⁸ $40 \text{ hours} * (\pounds480 + \pounds360.62) = \pounds33,625$

⁵⁹ $\pounds33,625 * 175 \text{ businesses} = \pounds5,884,340$

⁶⁰ See CMA monitoring of pricing practices by online travel agents. <https://www.gov.uk/cma-cases/online-travel-agents-monitoring-of-pricing-practices>. Booking.com and Expedia confirmed to the CMA that hotels using either site remain free to offer different prices, terms and availability when listing their rooms on other online travel agents. Formal commitments made in 2015 from Booking.com and Expedia not to enforce 'wide' parity clauses expired on 1st July 2020 but the companies have confirmed that they will continue to act in accordance with the commitments going forward. Both companies have also confirmed that their commitments will still apply in the UK.

⁶¹ There is insufficient quantitative data available to estimate the number of hours of legal and expert advice required by each firm, so there is uncertainty surrounding this BEIS assumption.

163. Ongoing costs of legal advice to preserve certainty that parity obligations meet the requirements set out by the UK VABEO are expected to be minimal. This is because the CMA has committed to clarifying and reiterating in CMA Verticals Guidance the types of parity agreement in scope of the UK VABEO, so after the conclusion of the transition period, ongoing costs will be mitigated. It should also be reiterated that a removal of the block exemption from such agreements does not require their abandonment or prevent their agreement in future as long as such agreements are assessed as pro-competitive. The CMA has also stated that it is open to considering on a case-by-case basis, any efficiency arguments relating to the use of wide parity obligation.

Direct costs and benefits to business calculations

164. The CMA may face some increased review activity relating to the treatment of wide retail parity obligations as hardcore restrictions. The CMA will still review submissions from parties where efficiencies could outweigh costs. These costs are expected to be small.

Risks and assumptions

165. There are gaps in the analysis relating to the number and types of businesses in scope of changes under the preferred option.

166. Wide retail parity obligations represent an area where the preferred option is likely to lead to new direct cost burdens to business. CMA case precedent suggests that these clauses may have been historically prevalent in some insurance markets, but the PMI Order in 2015 banned the use of wide parities in the market for motor insurance. The CMA consultation showed responses made by representatives from the travel industry, which suggest that these clauses may be prevalent in this sector. As a result, the analysis of direct costs focusses on this industry as the primary scope. There is a risk that other industries face costs not quantified due to a lack of evidence on prevalence of parity obligations.

167. In addition to the issues highlighted on identifying the prevalence of parity obligations, and therefore the scope of businesses affected by changes, there are also significant gaps to ensure external validity of the available evidence on parity obligations. We cite a CMA market study on the use of wide parity obligations in the insurance market, and more specifically an econometrically estimated coefficient on the extent to which commission rates charged by digital comparison tools is affected by the presence of wide parity obligations. We use this as an indication of the extent to which parity obligations may affect commissions in the travel industry. There is no supporting evidence to suggest that the finding is externally valid, and this represents a limitation in our assumptions.

168. Furthermore, there are areas where assumptions have made been, and highlighted, in the calculations of the direct costs associated with parity obligations. In some areas, we assume that entire sets of businesses will be in scope to allow for an upper bound to be estimated. As a result, it is likely that calculations represent an overestimate to the costs to the travel industry, particularly as a large proportion of total sector GVA.

169. Despite the above issues highlighted, some confidence in our approach is provided by the fact that the CMA consultation invited views from a range of stakeholders from a range of industries. The responses showed that parity obligations are likely prevalent in the travel industry but did not raise concerns that they may be particularly prevalent in other industries.

170. There is generally a lack of quantitative evidence available to estimate the costs and benefits of the change to dual pricing and the equivalence principle, which are indirect measures restricting offline sales. We do note that these costs and benefits are likely to be offset as business-to-business transfers and will not generate new cost burdens to business.
171. There is also a lack of quantitative evidence to quantify potential benefits from allowing a greater level of flexibility for businesses to redesign their distribution systems. We draw upon responses from the CMA consultation to provide a qualitative overview of these benefits. We consider these benefits to result from voluntary business activity and class them as indirect benefits.

Impact on small and micro businesses

172. The Assessment considers costs to travel agencies and other agencies that currently impose wide retail parity obligations. Some of this cost burden could fall on small businesses but they are likely to be affected to a much lesser extent than large businesses. This is because most online agencies that already impose parity obligations are likely to have relatively large market shares to establish these arrangements in the first place. This theory is outlined in the academic literature and covered above. These businesses are therefore unlikely to all be small.
173. There will be some benefits to small businesses – particularly brands, manufacturers and retailers using offline sales channels from the proposal no longer to treat dual pricing and the equivalence principle as hardcore restrictions. This will be offset by indirect costs to online retailers.
174. The impacts on consumers and businesses of all sizes were considered in the CMA consultation and the opportunity to respond was given to stakeholders representing small businesses as well as businesses with larger market shares.

Wider impacts

175. The impacts on consumers have been considered throughout. Consumers will firstly benefit indirectly from the greater certainty given to businesses by replacing this block exemption, relative to letting it lapse.
176. Consumers will also likely benefit relative to the renewal baseline. Firstly, we calculate expected benefits to business of the changes to wide retail parity obligations. Consumers are likely to benefit from lower end prices in affected sectors, such as hotels, due to a potential increase in direct competition between online agencies.
177. Some consumers, particularly vulnerable consumers, will benefit from the proposed changes to the treatment of dual pricing and the equivalence principle. This is because offline channels stand to benefit in the form of a transfer from online channels. Consumers that rely on offline channels, and more widely local communities, will benefit from the transfer of benefit towards offline retail channels
178. Similarly, it is a government priority⁶² to commit to levelling up, to reform the High Street and build local communities surrounding offline retail channels. The proposed changes to the treatment of dual pricing and the equivalence principle should benefit offline channels in line with these priorities.

⁶² <https://www.gov.uk/government/collections/new-levelling-up-and-community-investments>

A summary of the potential trade implications of measure

179. The measures discussed in this Impact Assessment are primarily domestic facing measures and should not introduce different requirements for domestic and foreign businesses.
180. We note, however, that the proposals represent a deviation from the renewal baseline. The European Commission are reviewing the VABER in parallel. As a result, there is potential for future divergence in some areas, where the UK approach is inconsistent with the approach taken by the European Commission. This may impact businesses operating both in the UK and the EU, but these impacts are wider than the scope of this Impact Assessment. The annex summarises consultation responses which highlight concerns about inconsistencies between the two responses.

Monitoring and Evaluation

181. Once the Order is made, the CMA will oversee the implementation of the VABEO. It will continuously monitor its application and effectiveness in achieving the policy and operational objectives outlined above, especially with regard to developments in the UK market that would impact its operation.
182. As noted above, the VABEO will expire after six years. Ahead of its expiry, the CMA will review the VABEO and will make a recommendation to the Secretary of State about whether to replace it when it expires.
183. The expiration date will be set for the reason of providing an opportunity for the CMA to conduct a further review of the regime for vertical agreements, taking account of market developments since the last review. Government considers it is important to review the block exemption after a relatively short time frame given that developments such as the growth in online sales, the UK's withdrawal from the EU and the impact of the Coronavirus (COVID-19) pandemic are ongoing, and often fast moving.
184. As noted above, the VABEO would also retain appropriate flexibility through the ability of the Secretary of State to vary or revoke the Order under s.8 of the Competition Act 1998.

ANNEX A – Qualitative evidence base: Stakeholder feedback to CMA consultation

Respondent Type	View on CMA recommendation position – Replace retained VABER with new VABEO – Preferred Option	Summary
<i>Manufacturers</i>	No views provided.	
Distributors	<p>There was only one response for these proposals from the travel/transport sector.</p> <p>The response is largely against the proposals, except for additional guidance being provided. The main issue raised is that the CMA proposals are too sweeping to make many parity obligations hardcore, specifically indirect sales channel parity obligations being treated as hard-core.</p>	From the response given, the affect on the travel industry could have significant unintended negative consequences.
Retailers	<p>There was only one response for these proposals from the travel/transport sector.</p> <p>The response is largely against the proposals, except for additional guidance being provided. The main issue raised is that the CMA proposals are too sweeping to make many parity obligations hardcore, specifically indirect sales channel parity obligations being treated as hard-core.</p>	From the response given, the effect on the travel industry could have significant unintended negative consequences
Legal representatives	<p>Responses from legal representatives in relation to parity obligations are very mixed. Most responses are supportive of the recommendation not to treat narrow parity obligations as hardcore restrictions. Although some respondents did agree with the recommendation, several responses highlighted concerns with the recommendation to treat wide parity obligations as hardcore restrictions, given evidence is mainly based on digital platforms, or where agreements did not benefit from the VABER because one party's share exceeded 30%.</p>	<p>Several responses highlighted concerns with the recommendation to treat wide parity obligations as hardcore restrictions, raising the point that parity obligations are widely used across many sectors of the economy, and can offer material benefits, such as protecting retail investments made by retailers</p> <p>Responses also highlighted that the recommendation could deprive all sectors of the legal certainty offered by the exemption to wide parity clauses, particularly where parties' market share is small.</p> <p>It should be noted however, that since the consultation, the CMA has revised its recommendation, to only apply the hardcore restriction to wide retail parity obligation, not all markets.</p>

Trade Associations	<p>A few mixed responses with travel, transport and insurance representatives providing answers.</p> <p>Travel/Transport representatives raised concerns, specifically that the EU VBER review has taken a wider approach to MFNs, meaning there may be complexities for members with two sets of rules.</p> <p>Insurance representatives however welcome the MFN proposals, stating that it would be consistent with the CMA's approach to such arrangements in recent years.</p>	From the responses given, the impact will vary depending on sector. For those negatively impacted, the proposals could raise potential issues of compliance and complexity.
Consumer groups	Whilst there was one consumer group that responded, no views were provided on these specific proposals.	No views provided.

Respondent Type	View on CMA recommendation position – Replace retained VABER with new VABEO – Preferred Option	Summary
<i>Manufacturers</i>	All three respondents were supportive overall, highlighting that the main benefit would be a better balance for brands in their offline and online engagement.	Respondents were all in favour of the proposals, and stated that there would be a positive impact on their business as a result.
Distributors	All responses were supportive across a wide range of industries, such as beauty products and luxury products, with all respondents highlighting the expected benefits for brick-and-mortar shops.	
Retailers	<p>Two of the three respondents (who both sell online and offline) were in favour of removing the hardcore restriction. The third respondent was considerably against however, commenting that the hardcore restriction proposal was not proportionate across all sectors, as the impacts would differ negatively on strictly online retailers.</p> <p>All respondents did though support additional guidance on dual-pricing and the equivalence principal, and provided</p>	There are benefits for those that have a presence in offline sales but there could be significant negative impacts on businesses who are strictly online sales businesses. Guidance is welcome however across the board on dual-pricing and the equivalence principal.

	examples that would specifically help their sector.	
Legal representatives	<p>All were supportive of the CMA's proposals to remove dual pricing, with all respondents highlighting the expected benefits for brick-and-mortar shops, given the recent growth in online sales.</p> <p>However there were mixed responses regarding the current passive sales regime, with respondents providing positive and negative examples of how it affects their clients, which were exemplified by the mixture of positive and negative impacts of online sales bans as hardcore restrictions.</p>	
Trade Associations	Majority are supportive of new VABEO, as they say it would be more representative of the current commercial reality.	There will be significant benefits for offline sales but this should not come at the cost of significantly negatively impacting online sales.
Consumer groups	Whilst there was one consumer group that responded, no views were provided on these specific proposals.	No views provided.

Respondent Type	View on CMA recommendation position – Replace retained VABER with new VABEO – Preferred Option	Summary
<i>Manufacturers</i>	There was only one respondent from the beauty products sector, who welcomed the first two proposals but did not provide a response for the remaining proposals.	The current restrictions and distinction are beneficial for the respondent and further guidance would be welcome to increase legal certainty.
Distributors	<p>There were only two responses for these proposals from two large distributors.</p> <p>Both distributors agreed with the first two proposals, and stated they benefit from the existing distinction between active and passive sales.</p>	The current distinction is very beneficial for the respondents. Any amendments to the retained VABER might have a detrimental impact on UK business and consumers, as a selective distribution system with exclusive distribution could reduce intra-brand competition and result in increased prices.

	<p>However only one of the respondents provided answers for the remaining proposals and whilst largely supportive, they did not consider it necessary for further guidance to be provided as they stated the distinction is already well understood.</p>	
Retailers	<p>There was only one respondent from the beauty products sector regarding these proposals. They agreed with the first two proposals but did not provide answers on the remaining proposals.</p>	<p>Supportive of the first two proposals as they would impact their business positively.</p>
Legal representatives	<p>Responses were moderately supportive overall.</p> <p>However, respondents were largely concerned with the lack of clarity around territorial restrictions between the UK and the EU, with many commenting that this relationship is a new opportunity for UK businesses to reorganise their distribution, and grant them greater protection from outside territories.</p>	<p>Further guidance would be welcome on a whole but greater ambition and clarity around the differences between UK and EU territories would be more welcome and positively impact business more significantly.</p>
Trade Associations	<p>Largely supportive of the recommendation to allow greater flexibility in the design of distribution systems. They will provide greater certainty</p> <p>For those that did respond, some believed that the recommendation not to alter the distinctions between active and passive sales were not compelling enough and could go further in redefining active and passive sales for certain types of online sales. More detail is outlined in the CMA final recommendation document.</p>	<p>Whilst proposal to allow greater flexibility in the design of distribution systems will likely be beneficial to most businesses, CMA are advised by respondents to further redefine active and passive sales for specific sectors.</p>
Consumer groups	<p>Whilst there was one consumer group that responded, no views were provided on these specific proposals.</p>	<p>No views provided.</p>