STEPHENSON HARWOOD

June 2017

# European Commission's E-Commerce Sector Inquiry

**On 10 May 2017 the European Commission (EC) published its final report after a two-year inquiry into the e-commerce sector ("Final Report")[1] together with accompanying Q&As[2] and a long Staff Working Document.[3] The Final Report is divided into two main sections, covering e-commerce issues in relation to consumer goods and digital content. It identifies various business practices that the EC considers give rise to competition concerns, limit consumer choice, negatively impact cross-border trade and increase barriers to entry.**

**Given the potential for the EC and the National Competition Authorities, i.e. NCAs, of the EU Member States to take further enforcement action against practices that adversely impact the functioning of the Digital Single Market, it is key that e-commerce businesses ensure their commercial practices are fully compliant with relevant competition laws.**

## Background

The EC launched the sector inquiry into e-commerce as part of its Digital Single Market strategy in May 2015 with the aim of analysing market trends as well as any existing and emerging restrictive business practices that might infringe the EU competition rules – in particular, Article 101 of the Treaty on the Functioning of the European Union ("**TFEU**") that prohibits anticompetitive agreements. The EC wanted to better understand whether the Digital Single Market was operating in an effective and competitive manner delivering benefits to consumers.

The EC gathered evidence from 1,900 operators connected with the online sale of consumer goods (e.g. electronics, clothing, shoes and sports equipment) and online distribution of digital content (e.g. movies, music, etc.). It also analysed around 8,000 distribution agreements. This was the largest sector inquiry ever completed by the EC since first obtaining its powers to undertake such inquiries.

The initial findings of this sector inquiry were published in March 2016,[4] and following these findings, the EC proposed various legislative changes aimed at boosting e-commerce in the EU. In particular, with a special focus on ending unjustified geo-blocking (i.e. practices where online sellers either deny consumers access to a website based on their location, or re-route them to a local store or website with different prices) and reviewing copyright rules to ensure better cross-border access to online content (i.e. music or videos).

The EC then published a preliminary report on the e-commerce sector enquiry on 15 September 2016,[5] which was followed by a public consultation open to all interested stakeholders.

---

[1] See: http://ec.europa.eu/competition/antitrust/sector_inquiry_final_report_en.pdf
[2] See: http://europa.eu/rapid/press-release_MEMO-17-1262_en.htm
[3] See: http://ec.europa.eu/competition/antitrust/sector_inquiry_swd_en.pdf
[4] See: http://europa.eu/rapid/press-release_IP-16-922_en.htm and http://ec.europa.eu/competition/antitrust/ecommerce_swd_en.pdf
[5] See: http://ec.europa.eu/competition/antitrust/sector_inquiry_preliminary_report_en.pdf

As a result of those findings, the EC launched three different investigations on online sale of consumer electronics, video games and holiday accommodation. These investigations are looking at issues around retail price restrictions, discrimination on the basis of location and geo-blocking.

On 10 May 2017, the EC published its Final Report, setting out the EC's main competition concerns and confirming that the Vertical Agreements Block Exemption Regulation ("**VBER**") which exempts vertical agreements from Article 101, TFEU and the Vertical Guidelines would remain in place until their expiry in 2022. The VBER exempts certain vertical agreements provided the parties' market shares do not exceed 30% and the agreements do not contain hardcore restrictions.

## Consumer Goods

The main findings of the EC's Final Report are set out below:

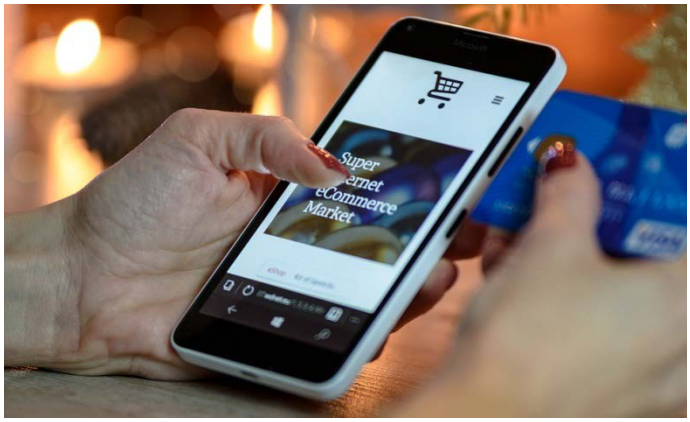
### Price Transparency and Monitoring

The EC notes in its Final Report that there has been a significant increase in on-line shopping / e-commerce over the last decade which has led to increased price transparency producing significant benefits for consumers who are able to compare prices and quality more quickly. However, the EC has also acknowledged the phenomena of free-riding whereby consumers first use pre-sales services offered in a physical shop (e.g. demonstrations, personal advice) before buying them online. This can result in online retailers being able to free ride on the investment of physical shop owners, the latter of which find it difficult to recoup their investment. The EC's Final Report has also recognised that the rise of online market places (e.g. Amazon) has enabled retailers to access large consumer bases with a minimum investment.

### Creation of Online Retail Shops by Manufacturers

The EC observed in its Final Report that manufacturers are seeking to take back control over the distribution of their products (in particular, in terms of price and quality). Of the manufacturers that responded, 64 per cent decided to open their own online retail shop in the last 10 years, thereby increasingly competing with their own independent distributors.

The EC acknowledged that the creation of online retail shops is legitimate. However the EC warned that given a manufacturer's online retail shop may compete with its existing independent distributors, there is the potential for any exchanges of commercially sensitive information (e.g. prices or quantities sold) between a manufacturer and its independent distributor to be analysed as a horizontal agreement/concerted practice between two competitors (contrary to Article 101, TFEU).




### Increasing Use of Selective Distribution System

The EC's Final Report also notes an increase in the use of selective distribution systems by manufacturers (i.e. a system whereby distributors are selected according to specific criteria and cannot resell the goods to unauthorised distributors), including in respect of non-luxury and non-technically complex products.

Whilst the EC reminds companies that selective distribution agreements may be exempt under the VBER (e.g. if the market share of the parties falls below the relevant threshold and such agreements do not contain any hardcore restrictions), the EC warns that selective distribution systems can make it easier for manufacturers to implement and monitor

unlawful vertical restraints, such as bans on online sales and resale price maintenance ("**RPM**").

In particular, the EC's Final Report takes the example of the requirement that member distributors of a selective distribution system must have a brick and mortar shop. This type of restraint can have the effect of excluding "pure online" players unless it can be justified on the basis of quality or brand image protection. Consequently, these types of restriction may require further scrutiny on a case-by-case basis.

The EC also highlights that a number of retailers complained about the lack of transparency and objectivity of selective criteria. The Final Report indicates that although a manufacturer is under no legal obligation to publish these criteria, it is advisable to provide retailers with the minimum level of information to allow them to better understand why they may have been refused admission to the selective distribution system.

## Problematic Vertical Restrictions

The EC's Final Report also identifies several restrictions in agreements that may give rise to significant competition concerns, and in particular, make cross-border or online shopping more difficult and harm consumers by limiting their choice and increasing prices in e-commerce.

*Price Recommendations & Monitoring*

According to the EC's Final Report, pricing restrictions are widespread. Almost half of the distribution agreements reviewed impose some form of price limitation or recommendation on distributors. The EC takes the opportunity to reiterate that where manufacturers set or attempt to set minimum or fixed resale prices on their distributors (i.e. RPM) this can be illegal.

Only in situations where the manufacturer is truly recommending resales prices (i.e. without recourse to threats, pressures or incentives) and where both the manufacturer's and the retailer's market shares are below the VBER's 30% threshold, could such pricing restrictions potentially benefit from exemption under the VBER.

The EC also indicates that it is concerned that the use of price monitoring software could enable manufacturers and retailers to monitor prices more efficiently. This could enable manufacturers to retaliate against retailers who deviate from recommended prices or even limit the retailers' incentives to do so. In addition, the EC highlights that such software may also facilitate collusion between retailers by making it easier to detect deviations from a collusive agreement.

*Dual Pricing*

The EC's Final Report clarifies that charging different wholesale prices for the *same products* to the *same retailer* depending on whether the products are sold online or offline is generally considered a hardcore restriction of competition. However, dual pricing agreements may not always be illegal and need to be assessed on a case-by-case basis. For instance, such a practice may be indispensable to avoid free-riding and to improve the distribution of the goods to the benefits of customers (e.g. brand image, customer services) (albeit these elements may be difficult to prove).

*Online Marketplaces / Price Comparison Tools*

The EC's Final Report recognises that marketplaces bring together sellers, buyers and advertisers. Furthermore, price comparison tools can also be

beneficial in increasing transparency and promoting competition and facilitating access to customers.

However, the EC also notes that a manufacturer should be able to require quality standards in relation to the advertising and promotion of its products, such that an absolute ban on price comparison tools which are not linked to quality criteria may well amount to a hardcore restriction of competition. Such bans can be considered a restriction of passive sales under the VBER.

On the other hand, bans on the use of online marketplaces which do not meet specified criteria may well be justifiable (e.g. protection of the image and brand of the product). Indeed, currently, the Court of Justice is considering whether agreements preventing retailers from selling on third party online platforms on the basis of preserving the image and quality of luxury products are compliant with EU competition rules.[6]

*Geo-Blocking Selling and Advertising*

The EC's Final Report notes that agreements between companies which contain restrictions aimed at partitioning the EU Single Market are considered illegal by object (i.e. the EC does not need to show adverse effect on the market). In particular, the EC makes clear that geo-blocking measures such as blocking access to a website on the basis that the customer is located in another EU country or re-routing the customer to the website of the EU country where (s)he is located are likely to infringe EU competition law.

There are limited exceptions when territorial restrictions may be allowed under the VBER but that will depend on various factors, such as: (i) the type of distribution agreement entered into by the parties, whether it is exclusive (specific territory allocated to the retailer) or selective (retailers selected on the basis of specific criteria); (ii) the type of sales that are being restricted, i.e. whether active (solicited by the retailer, e.g. through advertisement) or passive (unsolicited by the retailer); and (iii) whether the market share threshold of the two parties is met or not (whether each of the parties has a share above or below 30% in the applicable markets). Restrictions on passive sales will be problematic.

*Most Favoured Nation / Parity Clauses*

Despite the numerous recent cases brought by competition authorities across the EU against most favoured nation or parity clauses, the EC's Final Report interestingly does not delve into these types of restrictions in much detail. Such clauses can help prevent free riding but they can also reduce incentives to compete and create barriers to entry to other marketplaces. The EC merely recognises that such clauses need to be assessed on a case-by-case basis.

*Big Data*

Although not a specific focus of the EC's Final Report, the EC also recognises that the collection, processing and use of large amounts of data is of increasing importance in the e-commerce sector. This can create competition concerns to the extent it becomes easier to exchange competitively sensitive information between competing marketplaces and manufacturers with own shops.

## Digital Content

The EC's Final Report also finds that the online transmission of digital content (i.e. audio-visual and music products) has changed the way such content was traditionally accessed and consumed. This has provided new business models for the distribution of music and videos which are based on the acquisition/licensing of certain rights in order for digital content providers to lawfully sell content online.

[6] C-230/16 Coty Germany GmbH v Parfümerie Akzente GmbH

Although this section of the Final Report is more general than the section on consumer goods, it identifies that certain types of restrictions commonly found in such licensing arrangements can give rise to competition law concerns. They need to be reviewed on a case-by-case basis according to amongst other things, the *"the content industry, the legal and economic context of the licensing practice and/or the characteristics of the relevant product and geographic market".*

### Bundling / Licensing of Different Rights

According to the EC's Final Report, the use of exclusivity and/or bundling in licensing technology rights is a common practice. For instance, transmission of digital content can be bundled together with other rights to transmission technologies, such as terrestrial and satellite transmission. Although bundling does not necessarily automatically raise concerns, the EC indicates that under certain circumstances, bundling rights may lead to a restriction of output if the licensee of the bundle of rights does not exploit them or exploit them only partly. This can reduce innovation and in turn reduce consumer choice.

### Geographic Rights / Geo-blocking

The EC's Final Report finds that the rights associated with online distribution of digital content are, to a large extent, licensed on a national basis and that the vast majority of digital content providers usually use geo-blocking measures. However, only part of the digital content providers that responded to the inquiry used geo-blocking measures unilaterally. The majority imposed such restrictions in their contractual agreements with content's rights holders. Although exclusive licensing on a territorial basis does not necessarily raise competition concerns by itself, the EC recognised that such arrangements can restrict competition, for example, if there are contractual restrictions on cross-border passive sales. Any such restrictions need to be assessed on a case-by-case basis and may well be objectively justified.

### Duration of Licensing Agreements

The EC indicates that it is also concerned about the duration of licensing agreements for digital content. The EC's Final Report finds that more than half of the arrangements reviewed were concluded for more than three years (even up to 10 years). Furthermore, some licensing arrangements contained clauses which created very long-lasting contractual relationships (i.e. one or two decades) as a result of automatic renewal, first negotiation and first refusal clauses. This could hinder existing operators from expanding their current activities and make new players' entry more difficult to online services.

### Payment Structures

The EC also seems concerned by the payment structures used by the right holders of "attractive contents" (i.e. films and TV series). Such right holders often require advance payments, minimum guarantees and fixed fees per product which do not take into account the number of users. This can implicitly create an advantage for the more established players which are better placed to make upfront investments. This raises the concern whether such licensing practices may make it more difficult for market players with limited financial capacity to enter the market and for new online business to emerge.

## Enforcement Cases … Inevitable

As mentioned, the EC did not feel the need to wait until it had concluded its sector inquiry to open three investigations into suspected anticompetitive practices in the e-commerce industry earlier this year.[7] The sector inquiry also prompted high street names in the clothing industry (e.g. Mango, Pull & Bear) to change their commercial practices relating to cross-border sales; and Amazon has made a commitment to the EC to address competition concerns relating to a number of clauses in its distribution agreements with e-book publishers in Europe.


It is clear that the EC is adopting a more active enforcement approach against vertical restraints, albeit there is no reason to believe that NCAs will not continue to enforce their rules against any such anticompetitive practices. After all, to date, such vertical restraints have primarily been investigated by the NCAs rather than the EC.

Indeed, it is worth noting that, no matter whether there is a hard or soft Brexit, the UK's Competition & Markets Authority ("**CMA**") has already welcomed the EC's preliminary findings of September 2016 and agreed that online vertical restraints can be analysed under the UK's current competition legal framework. In addition, the CMA has already carried out significant enforcement work in relation to online RPM[8] and online sales ban.[9] Therefore, even post Brexit, the CMA is likely to continue to enforce its rules against e-commerce businesses it considers are breaching the competition rules (and take a similar approach to the EC and the other NCAs).

Although it is not clear what type of restrictions or companies the EC and/or the CMA have next set their sights on, companies should be reviewing their commercial arrangements closely with a fresh pair of "antitrust eyes" and ensuring they are fully compliant with competition law.

In particular e-commerce companies in Europe should be asking themselves:

- Do any of our distribution (including selective distribution) arrangements contain any:
  - Pricing provisions or policies on the use of price comparison tools that could be construed as an anticompetitive RPM restriction (i.e. minimum resale price)?
  - Sale restrictions in relation to the use of online marketplaces (e.g. Amazon)?
  - Unjustified sales restrictions on the basis of whether goods are sold online and/or offline?
  - Geo-blocking provisions or geographic restrictions regarding the sale of goods across the EU?
  - Any criteria used to select and refuse distributors that cannot be justified and/or any criteria which are not applied in a non-discriminatory manner?
  - Any brick and mortar requirements imposed on online distributors that are not linked to distribution quality, brand image and/or other efficiencies?

[7] See EC press release of 2 February 2017: http://europa.eu/rapid/press-release_IP-17-201_en.htm

[8] On 10 May 2016, the CMA issued a Decision against Ultra Finishing Ltd for preventing retailers from discounting online prices. See: https://www.gov.uk/government/news/cma-issues-bathroom-fittings-infringement-decision-and-fine

[9] On 9 June 2016, the CMA issued a Statement of Objections to golf equipment company Ping for preventing retailers selling Ping golf clubs online. See: https://www.gov.uk/government/news/cma-alleges-breach-of-competition-law-by-ping

- Have we entered into any licensing agreements:
  - Where services are being bundled unjustifiably in any digital market?
  - Which are of long duration, i.e. more than 5 years?
  - Containing any anticompetitive pricing or geo-blocking restrictions?


## We can help

If you have any concerns relating to your distribution and/or licensing arrangements, we can help by:

- Reviewing your commercial arrangements and providing practical guidance as to whether they benefit from the VBER or any other applicable block exemption as well as how to minimise any competition law risk;
- Reviewing your competition law compliance policies and providing refresher training;
- Responding to any information requests you may receive from the EC or any NCA – in particular, the CMA; and/or
- Assisting on any investigations you may face from a regulator.

## Contact us


**Marta Garcia**
Partner
T: +44 20 7809 2141
M: +44 7985 716 668
E: marta.garcia@shlegal.com

**Jean-François Guillardeau**
Associate
T: +44 20 7809 2383
M: +44 7702 141 047
E: jean-francois.guillardeau@shlegal.com

**Rhiannon Davies**
Associate
T: +44 20 7809 2033
M: +44 7702 142 473
E: rhiannon.davies@shlegal.com

**Simon Albert**
Associate
T: +44 20 7809 2314
M: +44 7808 100 882
E: simon.albert@shlegal.com