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E-commerce Sector Inquiry Final Report Heralds Renewed Enforcement by the Commission

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The European Commission published the hotly anticipated final report of its two year E-commerce Sector Inquiry on 10 May[1]. As predicted by our client briefing on the **Commission's Preliminary Report**, which the Commission published in September last year, the Final Report and the accompanying Staff Working Document[2] largely restate the earlier Preliminary Report[3] and thus leave many critical questions open. Significantly, however, the Commission has confirmed that, with the sector inquiry now concluded, it will now press ahead with targeted enforcement cases in the e-commerce sector. It has also announced a "broadened dialogue" with national competition authorities on e-commerce related enforcement to help ensure more consistent application of EU competition law in domestic cases.

Background

The E-commerce Sector Inquiry was launched in May 2015 as part of the Commission's wider Digital Single Market strategy, with the objective of enabling the Commission to gain a better understanding of the functioning of e-commerce markets within the EU and to identify existing and emerging restrictions of competition that could infringe EU antitrust law. The underlying motivation was the Commission's wish to promote cross-border e-commerce in Europe, as a manifestation of its overriding policy goal of creating a meaningful single market across the EU that provides visible benefits to consumers.

Within the broad category of e-commerce, the Commission separated its work into identifying restrictions on the sale of certain consumer goods, on the one hand, and on the provision of digital content, on the other. The resulting inquiry was the largest the Commission has initiated since it gained the power to undertake sector inquiries in 2004. It is important to note that the Commission's powers to undertake sector inquiries do not extend to the ability to impose remedies or change the law. Rather, the Commission is able to use information gathered in the course of a sector inquiry as the basis for enforcement action against specific businesses, under the antitrust provisions of the Treaty on the Functioning of the European Union (TFEU) or to inform wider policy initiatives.

The legal framework within which restrictions on online sales are assessed is largely set by Article 101 TFEU, which prohibits anticompetitive agreements, and the Vertical Agreements Block Exemption Regulation (VBER), which exempts vertical supply agreements from Article 101 as long the parties' market shares do not exceed 30% and provided that they do not contain hardcore restrictions of competition. The legal status of common restrictions of the online sale of physical products is extensively considered in the Commission's 2010 Vertical Agreements Guidelines, which attempt (not always successfully) to strike a balance between the often conflicting interests of brands and online retailers. As the VBER and Vertical Guidelines are set to remain in place until their expiry in 2022, the basic legal framework is effectively fixed. Consistent with this, the Final Report confirms that the VBER will remain unchanged until its expiry.

The Final Report

The Final Report is split into two documents: a short summary document, at only 16 pages, and a 298-page Staff Working

Document, which is itself largely a restatement of the Preliminary Report. Both documents adopt the same structure as the Preliminary Report, in that they consider the competition issues arising from the sale of consumer goods separately from those associated with the supply of digital content. As was the case for the Preliminary Report, the former section is more detailed and contains more specific legal analysis, whereas the section on digital content is more high-level. As a result, this note will focus on the consumer goods section.

Consumer goods

The Final Report contains extensive analysis of trends in e-commerce in the EU and the prevalence of different practices across product categories and Member States. Overall, the Commission observes that the increase in e-commerce over the past decade has led to increased price transparency. While this has produced significant consumer benefits, the Commission acknowledges that it can also result in free-riding by online retailers on investment in physical shops (although it also acknowledges the reverse, where a physical shop free rides on investment by online retailers). The Commission also observes that greater price transparency has led to increased price competition, as well as greater price monitoring by retailers and manufacturers. According to the Commission, manufacturers have responded to the challenge posed to their distribution models by e-commerce with a range of measures, including selling their products direct to consumers themselves through their own websites and imposing a wider range of vertical restraints on retailers, especially through increased use of selective distribution.

Selective distribution is a sales model under which products are sold only to retailers that meet certain admission criteria, with members of the network being prohibited from selling to anyone except other network members or consumers. Although EU case law has long recognised that selective distribution tends to lead to higher prices, it has generally been accepted as a valid model, particularly for luxury goods or technically complex products. In essence, selective distribution is assumed to protect the value of brands and encourage investment by retailers in non-price aspects of their offer such as customer service. As a result, certain forms of selective distribution fall outside Article 101 TFEU altogether, while selective distribution agreements that do not contain any hardcore restrictions of competition are protected by the VBER safe harbour.

The Final Report notes an increased use of selective distribution by manufacturers, including for products that are neither luxury goods nor technically complex, as well as a tendency for manufacturers to introduce new selection criteria for admission. While the Commission has concluded that the general framework for analysing selective distribution set out in the VBER and Vertical Guidelines does not need to be changed, the Final Report does acknowledge that selective distribution may make it easier for manufacturers to implement and monitor unlawful vertical restraints, such as resale price maintenance or online sales bans.

In light of concerns over the potential misuse of selective distribution, as well as ongoing debate among national competition authorities over the law, the sector inquiry examined particular restraints, namely:

- the requirement that member retailers of a selective distribution network must operate a physical shop, effectively banning pure-play online retailers from their networks;
- bans on the use of third-party online marketplaces by authorised retailers;
- bans on the use of price comparison tools; and
- bans on the use of a manufacturer's brand when bidding for online advertising.

The Commission accepts that such practices have the potential to restrict competition. For example, the Final Report notes that "brick and mortar" requirements may simply be designed to shield products from price competition by online retailers without enhancing competition on parameters other than price. It also notes that marketplace bans may be hard to justify if a manufacturer is selling its products on a marketplace itself or has admitted a marketplace operator into its network.

The Commission nevertheless concludes that most of these practices do not constitute hardcore restrictions of competition.[4] As

such, they will be protected from challenge by the VBER safe harbour, unless the parties' market shares exceed the 30% threshold or a competition authority decides to lift the benefit of the block exemption in an individual case. This conclusion essentially restates the position that is set out in the Vertical Guidelines.

The main exception is that the Final Report indicates that restrictions on the use of price comparison tools may amount to a hardcore restriction if they rule out any use of such tools by retailers, without any reference to quality criteria. This is because, in the Commission's views, preventing the use of such tools restricts the effective use of the internet as a sales channel by taking away an effective means to guide customers.[5]

While similar logic should be applicable to bans on the use of manufacturers' brand names for online advertising, including when bidding for paid search advertising, the Final Report stops short of categorising such restrictions as hardcore, observing simply that such restrictions could "raise concerns under Article 101(1) TFEU".

The Final Report notes that a number of respondents to the consultation on the Preliminary Report challenged the Commission's position that the charging of differential wholesale prices according to whether products are destined to be sold online or offline ("dual pricing") amounts to a hardcore restriction of competition. Notwithstanding these objections, the Final Report sticks to the position that, while manufacturers are not obliged to offer the same prices to all retailers, applying dual pricing to a retailer that sells on- and offline is a hardcore restriction. The Commission nevertheless notes that it "remains open to consider efficiency arguments" justifying dual pricing in particular cases, for example if it is essential to support investment in the offline retail environment. The burden would be on the manufacturer to demonstrate this, however, and the evidential threshold when seeking to justify hardcore restrictions is high.

The Final Report notes the increased use of price monitoring software and automated repricing and observes that, combined with the increased price transparency online, such tools enable easier detection of retailers that deviate from manufacturers' pricing recommendations and may facilitate or strengthen collusion between retailers.[6] This falls well short of implying that the vendors of such software may themselves be liable for use that restricts competition unless they build in safeguards.[7]

Perhaps surprisingly considering the proliferation of recent enforcement cases, the Final Report contains very limited analysis of "most favoured nation" or parity clauses. Observing that such clauses may have restrictive effects but may also lead to efficiencies, the Commission simply concludes that they have to be assessed on a case-by-case basis.[8]

The most interesting part of the Final Report is a new section on the use of data in e-commerce. Consistent with the Commission's emerging interest in "big data", the Final Report observes that "the exchange of competitively sensitive data such as on prices or sold quantities between marketplaces and third-party sellers or manufacturers or retailers may lead to competition concerns where the same players are in direct competition." It also notes that, where the same company operates a marketplace and a retail arm, competitively sensitive data relating to sales by third-party sellers on the marketplace could be used to boost retail activities of the marketplace operator. Similarly, manufacturers that sell directly online may use sensitive data from authorised distributors for "anticompetitive purposes." The Commission does not develop its theories in this area, however, concluding simply that "such behaviour could potentially raise competition concerns."[9]

The Final Report also notes that the sector inquiry has revealed a persistent minority of agreements that clearly infringe competition law, primarily by imposing resale price maintenance, prohibiting cross-border sales between Member States or preventing online sales. Since the law concerning such restrictions is well-settled, this may be the most fruitful territory for future enforcement cases.

Digital content

As was the case with the Preliminary Report, the Final Report limits its comments in this section to a survey of the various

commercial models for the distribution and exploitation of digital content, noting that digital content is a "key determinant of competition" in this area. Overall, it focuses on concerns over the potential exclusionary effects of exclusive licensing and related contractual practices, which it concludes could cause and create significant barriers to entry for new market players.

Recognising the complexity of digital distribution and the wide variety of business models, the observations in this section are far more general than in the consumer goods section. Ultimately, the Commission concludes that any application of the competition rules “would have to take into account the characteristics of the content industry, the legal and economic context of the licensing practice and/or the characteristics of the relevant product and geographic market.” As such, this adds little to the debate.

Observations

Taken on its face, the Final Report adds little to the legal position reflected in the 2010 VBER and Vertical Guidelines. Assessed on such terms, therefore, one would question the value of the sector inquiry, especially given the enormous effort expended by companies and commission staff. Crucially, however, the Commission appears to be treating the conclusions, including evidence of continued conduct that appears to infringe settled law, as justification for a newly aggressive enforcement policy regarding vertical restraints.

The Commission has demonstrated limited appetite for bringing vertical cases since the decentralisation of EU competition law enforcement to Member States in 2004. While at least some national competition authorities willingly took up the burden of enforcing the law in this area, results were patchy and in some cases inconsistent.[10] Spurred partly by these developments, as well as a desire to promote e-commerce within the Commission’s wider Digital Single Market strategy, the Commission has now taken the decision to take a closer look at enforcement by national competition authorities to ensure greater consistency.

The Commission also clearly wishes to lead by example by adopting a more active enforcement approach against vertical restraints. In light of this threat, the Commission viewed the sector inquiry as a useful spur for companies to review their agreements to ensure their compliance with competition law. It is therefore particularly interesting to note that the Commission’s press release announcing the Final Report took the highly unusual step of naming a number of clothing companies and consumer goods manufacturers that “reviewed their practices” as a result of the inquiry. Unfortunately, there is no information on what these companies were doing or why they were singled out by the Commission for a special mention. Presumably, the companies become aware of problematic contracts in the course of responding to the sector inquiring and took the opportunity to reinforce them with more compliant agreements.

The fact that the sector inquiry provided justification for renewed enforcement by the Commission was already evident in January, when the Commission announced the opening of three new antitrust investigations, concerning PC video games, holiday accommodation and consumer electronics pricing. In the most significant part of the Final Report, the Commission commits to “target enforcement of the EU competition rules at the most widespread business practices that have emerged or evolved as a result of the growth of e-commerce and that may negatively impact competition and cross-border trade.” Quite where the Commission’s attention will focus remains to be seen, but it seems likely that companies will not have to wait long before new enforcement cases are announced.

Notes

1. Available at http://ec.europa.eu/competition/antitrust/sector_inquiry_final_report_en.pdf
2. Available at http://ec.europa.eu/competition/antitrust/sector_inquiry_swd_en.pdf
3. Available at http://ec.europa.eu/competition/antitrust/sector_inquiry_preliminary_report_en.pdf

4. While acknowledging that the legal status of marketplace bans is currently being considered by the Court of Justice of the EU on a preliminary reference in Case C-230/16 *Coty Germany v. Parfumerie Akzente GmbH.*
5. Final Report, paragraphs 551-552. In reading this view, the Commission appears to be adopting the approach of the German Federal Central Office in the ASICS case (upheld on appeal in April 2017)
6. Final Report, at paragraphs 607-608.
7. An approach suggested by the UK Competition and Markets Authority following their recent investigation of online poster sales (see **https://www.gov.uk/government/case-studies/online-sellers-price-fixing-case-study** and by the EU Competition Commissioner when speaking in March – see: **https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/bundeskartellamt-18th-conference-competition-berlin-16-march-2017_en**
8. Final Report, at paragraphs 623.
9. Ibid., paragraph 651.
10. The divergent approaches taken by a number of national competition authorities to the question of the legality of MFN clauses in online hotel booking agreements being the most notable.

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