



Concurrences

REVUE DES DROITS DE LA CONCURRENCE | COMPETITION LAW REVIEW

Vertical restraints and e-commerce

Law & Economics | Concurrences N° 1-2018

www.concurrences.com

Georgios Petropoulos

georgios.petropoulos@bruegel.org

Research Fellow, Bruegel, Brussels

Georgios Petropoulos*

georgios.petropoulos@bruegel.org
Research Fellow, Bruegel, Brussels

ABSTRACT

In this paper, I present how e-commerce has affected market strategies and competition in European markets and I analyze the economic and legal aspects of vertical restraints that are commonly applied in online markets. By combining available empirical evidence with theories of harm and by reviewing relevant case law I define the main anticompetitive concerns related to each category of vertical restraints. While the competition policy framework is adequate to address these concerns, we need updated guidelines that provide guidance on how the new vertical restraints linked to e-commerce should be treated. I provide recommendations over the priorities and challenges that need to be addressed in light of the preparation of the new vertical agreements guidelines of 2022.

Dans cet article, je présente la façon dont le e-commerce a affecté les stratégies de marché et la compétition sur les marchés européens, et j'analyse les aspects économiques et juridiques des restrictions verticales couramment appliquées sur les marchés en ligne. En combinant les données empiriques disponibles avec les théories du préjudice, tout en faisant référence aux cas juridiques pertinents, je définis les principales préoccupations concernant la libre-concurrence, relatives à chaque catégorie de contraintes verticales. Si le cadre de la politique européenne de concurrence nous permet de répondre de manière adéquate à ce genre de préoccupations, nous avons cependant besoin de nouvelles lignes directrices qui nous indiquent comment traiter ces nouvelles restrictions verticales relatives au e-commerce. J'apporte certaines recommandations sur les priorités et les challenges qui doivent être considérés dans le cadre de la préparation des nouvelles lignes directrices des accords verticaux de 2022.

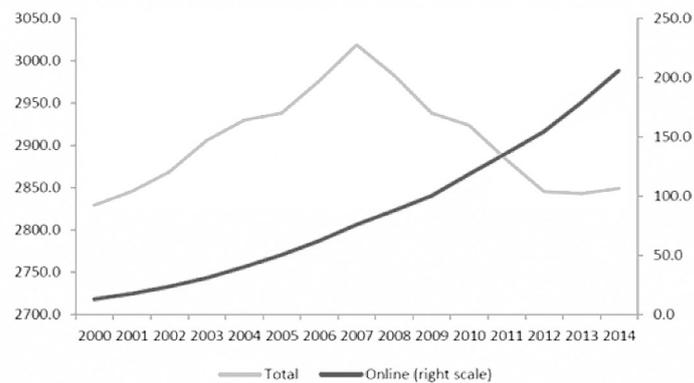
*I am very thankful to Yana Myachenkova for her research assistance.

Vertical restraints and e-commerce

I. Introduction

1. Online purchases are growing rapidly within the European Union (EU), generating benefits for the broader European society. Electronic commerce (e-commerce) exhibits an average annual growth rate of 22%, surpassing €200 billion in 2014 and reaching a share of 7% of total retail sales.¹ Even if the increasing pattern in total sales was reversed after 2007 (with the crisis being quoted as one of the main reasons for that), e-commerce continued to grow over the years in a non-concave way (see Figure 1). This suggests at least some degree of substitution between online and offline channels of commerce.

Figure 1. Evolution of total and online retail sales in goods, 2000–2014 (€bn)



Source: Duch-Brown and Martens (2015)

1. The market disruptive forces of e-commerce

2. The development of e-commerce has impacted both demand and supply fundamentals of markets affecting the way competition works.²

3. On the supply side, three common business models in the e-commerce today are:

- Pure online firms that rely exclusively on the Internet for their operations.
- Brick-and-click companies that split their source of revenue between online and offline activities (e.g., operation of brick-and-mortar shops).

1 European Commission (2015): A Digital Single Market Strategy for Europe- Evidence and Analysis, SWD (2015) 100 final, pp. 1-109.
2 Lieber E. and C. Syverson (2012): Online Vs. Offline Competition. The Oxford Handbook of the Digital Economy, pp. 189-223. OECD (2013): Vertical restraints for online sales. DAF/COMP (2013)13, pp. 1-275.

- Online platforms, such as marketplaces, search and price comparison tools and online auction sites.

4. These new business models imply relevant changes for the structure of some industries, which rely on the disruptive forces of e-commerce. The Internet has led to a drop in the distribution costs, by disrupting the relationship between producers and consumers.

5. On the one hand, the web contributed to the reduction of the intermediate stages in the supply chain, in some sectors, by allowing consumers to develop a more direct access to the production points. In the travel industry, for example, the role of travel agencies has been dramatically reduced, since the majority of consumers prefer to make their reservations through the Internet. Lieber and Syverson (2012) report that between 1997 and 2007, the number of travel agency offices fell from 29,500 to 15,700.

6. On the other hand, the Internet has increased the intermediation in some other sectors. For instance, as Saloner and Spence (2002)³ illustrate, in the US automotive industry, where physical middlemen are mandated by law, online technologies were devoted in helping consumers to reach the most appropriate dealer in order to purchase their desired car. In one way or the other, e-commerce contributes to faster communication along the supply chain and consequently to significant cost savings. Retailers can quickly turn demands into orders to their suppliers, and they can have a much wider product offering choice. While in their brick-and-mortar shops they will only carry a product if it reaches a certain volume of sales (due to cost-related reasons), in their online shops all their products can be available for sale. Brynjolfsson, Hu and Smith (2003)⁴ show that it is exactly the increased variety of products that is responsible for the consumer welfare gains from e-commerce. E-commerce allows firms to reduce their inventory holdings and to decrease costs from tighter control of the flow of inputs into the production line. According to the October 2017 Manufacturing and Trade Inventories and Sales report of the US Census Bureau, the (adjusted) retail inventory-to-sales ratios have dropped from around 1.66 in October of 1992 to 1.43 in October 2017. The respective drop in total business (manufacturers, wholesalers and retailers) for the same period was from 1.52 to 1.35.⁵

7. On the demand side, it is generally accepted that Internet lowers search costs for consumers. The enormous amount of available information and the emergence of websites that enable quick and readable access to aggregate information such as price quotes from different online sellers for the same good or service. In this way, consumers are able to easily compare existing offers and

make the best possible choice based on their preferences. For example, in the insurance sector, Brown and Goolsbee (2002)⁶ find that the increased use of the Internet reduces the average price of life insurance by 5%. However, search costs do not vanish. Bajari and Hortaçsu (2003)⁷ find that the implicit price of entering eBay auctions is \$3.20, while Hann and Terwiesch (2003)⁸ estimate that the participation cost on reserve auction websites ranges between \$3.54 and \$6.08. In the same line, Brynjolfsson, Dick and Smith (2010)⁹ conclude that the maximum cost of searching a book in one of the major price comparison websites is \$6.45, while Hong and Shum (2006),¹⁰ using a different methodology, find that the median consumer search cost for textbooks ranges between \$1.30 and \$2.90.

8. Moreover, e-commerce reduced the geographical barriers and therefore led to broader geographic scope for transactions. As empirical studies¹¹ suggest, the Internet helped individuals located in rural areas overcoming the problem of distance and trade with retailers that are located in big cities. In fact, the trade participation rate in rural areas significantly increased, reducing the importance for individual consumers to be located in cities.

9. Nonetheless, geographical distance still matters. Hortaçsu, Martinez-Jerez and Douglas (2009)¹² look at data from eBay and MercadoLibre and find that buyers and sellers that live in the same city have particular preference for trading with one another instead of someone located outside the metropolitan area. Cultural factors and the fact that proximity of the trading parties can ensure easier contract enforceability are the main arguments put forward to justify this result. The finding of Blum and Goldfarb (2006)¹³ that geography matters even for purely digital goods like online music and movies, where transport costs are nil, also suggests that cultural factors are particularly important.

3 Saloner, G. and A.M. Spence (2002). *Creating and Capturing Value—Perspectives and Cases on Electronic Commerce*. Crawfordsville: John Wiley & Sons, Inc.

4 Brynjolfsson, E., Y.J. Hu, and M. D. Smith (2003): Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety at Online Booksellers. *Management Science* 49 (11), pp. 1580–1596.

5 <https://www.census.gov/mtis/www/data/text/mtis-ratios.txt> (retrieved on 02/01/2018).

6 Brown, J. R., and A. Goolsbee (2002): Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry. *Journal of Political Economy* 110 (3), pp. 481–507.

7 Bajari, P., and A. Hortaçsu (2003): The Winner's Curse, Reserve Prices, and Endogenous Entry: Empirical Insights from eBay Auctions. *The RAND Journal of Economics* 34 (2), pp. 329.

8 Hann, I.-H., and C. Terwiesch (2003): Measuring the Frictional Costs of Online Transactions: The Case of a Name-Your-Own-Price Channel. *Management Science* 49 (11) (January 11), pp. 1563–1579.

9 Brynjolfsson, E., A. A. Dick, and M. D. Smith (2010): A Nearly Perfect Market? *Quantitative Marketing and Economics* 8 (1), pp. 1–33.

10 Hong, H., and M. Shum (2006): Using Price Distributions to Estimate Search Costs. *The RAND Journal of Economics* 37 (2), pp. 257–275.

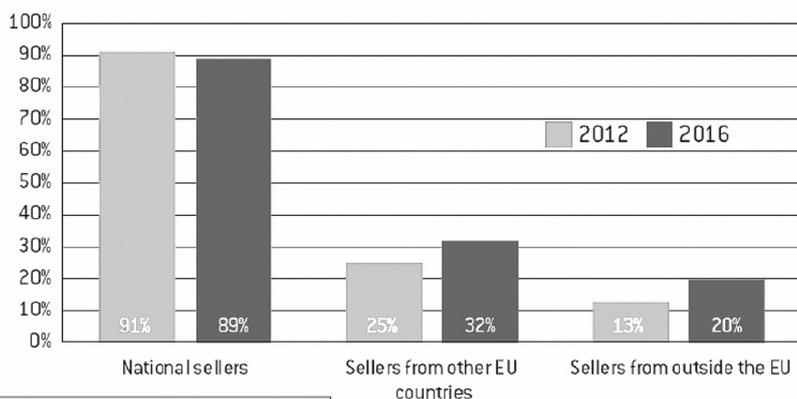
11 Forman, C., A. Goldfarb, and S. Greenstein (2005): *How Did Location Affect Adoption of the Commercial Internet? Global Village Vs. Urban Leadership*. *Journal of Urban Economics* 58 (3), pp. 389–420. Sinai, T., and J. Waldfogel (2004): Geography and the Internet: Is the Internet a Substitute or a Complement for Cities? *Journal of Urban Economics* 56 (1) (July), pp. 1–24. Kolkó, J. (2000): The Death of Cities? The Death of Distance? Evidence from the Geography of Commercial Internet Usage. In *The Cities in the Global Information Society: An International Perspective*, Newcastle Upon Tyne, pp. 73–98. MIT Press. (2000).

12 Hortaçsu, A., F. A. Martínez-Jerez, and J. Douglas (2009): The Geography of Trade in Online Transactions: Evidence from eBay and MercadoLibre. *American Economic Journal: Microeconomics*, pp. 53–74.

13 Blum, B. S., and A. Goldfarb (2006): Does the Internet Defy the Law of Gravity? *Journal of International Economics* 70 (2) (December), pp. 384–405.

10. Especially for cross-border e-commerce, additional barriers are in place.¹⁴ Figure 2 shows that consumers mostly prefer to buy online domestically. Nevertheless, in recent years there is a small tendency of individuals to be more engaged in cross-border e-commerce.

Figure 2. National and cross-border purchases by e-shoppers, EU, 2012 and 2016, % of individuals who bought or ordered goods or services over the Internet for private use in the previous 12 months



Source: Marcus, Morales and Petropoulos (2017)

11. On the supply side, firms that sell cross-border identify a range of challenges. Particularly prominent are delivery costs, the complexity of dealing with foreign taxation, concerns with data protection when selling abroad, and payments from other countries that are not sufficiently secure. More generally, lack of language skills and differences in consumer protections also play a role.¹⁵

12. On the demand side, consumer surveys on behalf of Google¹⁶ show concerns over price (reported by 10% of respondents in a simple average across the Member States), delivery costs (14%), customer service (17%), possible difficulty with returns (23%), payment arrangements (11%), the complexity of possibly having to deal with a foreign language (11%), and lack of trust in general (21%).

13. The digital single market strategy adopted by the European Commission in May 2015 has as a major goal to remove such impediments of cross-border e-commerce in EU28 through a series of legislative actions. As we move forward with the strategic goal of creating a single market, cross-border e-commerce is growing and the national borders play a smaller role in online trade. That also has implications for market competition and its broader geographic definition due to the Internet.

14 Marcus, S., M. Morales and G. Petropoulos (2017). *Strengthening cross-border e-commerce in the European Union*. Bruegel Publications. Edited Volume *Remaking Europe: the new manufacturing as an engine for growth*, pp. 217-251.

15 TNS (2015): *Companies Engaged In Online Activities*, Flash Eurobarometer 413.

16 www.consumerbarometer.com (retrieved on 21/02/2017).

14. The emergence of alternative Internet distribution models such as online platforms makes it easier for retailers to access consumers that are in distant location. This is particularly important for small retailers which, with limited investments and effort, can become visible and sell products to a large consumer base in multiple Member States through such marketplaces and platforms.

15. The E-commerce Sector Inquiry (hereafter, “ESI”) of the European Commission¹⁷ extends this analysis of market trends under e-commerce by providing a recent survey with the participation, among the others, of 1,051 retailers; 37 marketplaces; 89 price comparison tools; 259 manufacturers and 248 digital content providers (mostly from audiovisual and music industry) from the 28 Member States. The main findings of ESI are:

- Price transparency has increased with online trade. This is because consumers are able to instantaneously obtain and compare product and price information at small (search) cost and switch swiftly from one distribution channel to another (online/offline).

- Price competition has increased due to the ability of consumers to compare prices of products across several retailers. This affects both online and offline sales. It may also affect other dimensions in which firms can compete such as quality, brand image and innovation. A key observation of ESI is the divergence in the views of retailers and manufacturers of branded goods on what the most important parameters of competition are. Manufacturers consider product quality, brand image and the novelty of the products as the most important parameters of competition. In contrast, retailers consider price as a major parameter of competition.

- Monitoring of prices becomes easier. The retailers use automatic software programs that observe the prices of their competitors in real time and adjust their own prices accordingly.

- There exists free-riding between online and offline sales, but with uncertain direction. On the one hand, consumers can use pre-sale services of brick-and-mortar shops before purchasing the product online. On the other hand, consumers can search and compare products online before purchasing in brick-and-mortar shops. The ESI reports that 72% of manufacturers acknowledge the existence of free-riding by online sales on offline services. 62% acknowledge the existence of free-riding by

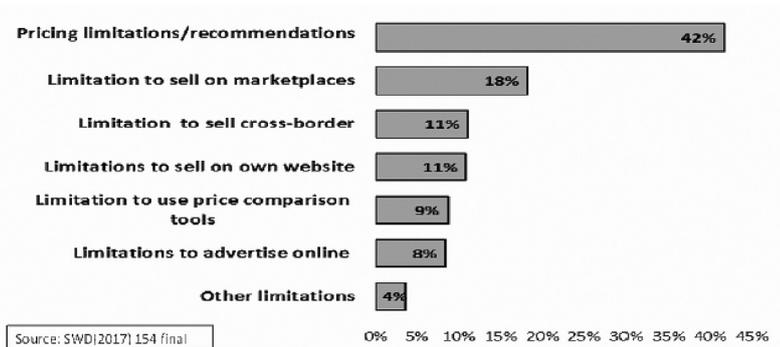
17 European Commission (2017): *Final report on the E-commerce Sector Inquiry*, SWD(2017) 154 final.

offline retail on services offered online. It is difficult to conclude over the overall direction of the free-riding effect. But, given that the offline distribution channel incorporates higher costs, it is the free-riding of online retail on brick-and-mortar shops that generates the higher concerns.

- Lower information asymmetries. The possibility to easily switch between different distribution channels and receive better information about products and services can significantly reduce asymmetric information between buyers and sellers. Akerlof (1970),¹⁸ with his “market for lemons,” showed how the quality of goods traded in a market can degrade if buyers and sellers do not have equal access to information. If a buyer is unable to distinguish between a high-quality and a low-quality car, he or she will only be prepared to pay a fixed price for a car that averages the value of both. But, sellers know the exact quality of the car they hold (private information). Given the fixed price at which buyers will buy, sellers will sell only when they hold a low-quality car, and will leave the market when they hold a high-quality car. Eventually, the average willingness-to-pay of buyers will decrease because the average quality of cars on the market will decrease, leading even more sellers of high-quality cars to leave the market. It is possible that this will lead to a market failure in which no trade takes place because there are only low-quality cars available. So, removing asymmetric information from the market reduces the risk for market failures and leads to more efficient transactions.

16. As a result of these market trends, ESI reports an increased effort by manufacturers to obtain a greater influence over distribution networks, in order to better control price and quality of their products in the downstream market. This is done through:¹⁹ (i) an increased use of selective distribution systems, where manufacturers set the criteria that retailers must meet to become part of the distribution network and where all the unauthorized retailers are prohibited; (ii) a more extensive use of vertical restraints which can take the form of pricing restrictions, platform bans and the exclusion of pure online players from distribution networks. Such vertical restraints are imposed in most cases as a part of the selective distribution system in place. Figure 3 presents the proportion of the retailers that are subject to restraints, per type of restraint.

Figure 3. Portion of retailers with contractual restrictions, per type of restriction



17. The most popular restraints refer to price restrictions and recommendations, while limitations to sell on online marketplaces are also popular in the case of branded goods. Before we discuss in detail these restraints that we often find in e-commerce markets, we summarize the basic principles and logic of vertical restraints and the main EU competition policy instruments that are used to address their potential anticompetitive effects.

2. The logic of vertical restraints and the relevant EU competition policy instruments

18. Vertical restraints refer to agreements between firms at two different levels of the supply chain. In the upstream market, manufacturers compete against each other to sell their products to retailers who compete with each other in the downstream market. The former type of competition is called “inter-brand competition” as it occurs among suppliers whose products are mainly identified through the use of specific brands. The downstream competition among retailers that sell the products of the same manufacturer is called “intra-brand competition.” A vertical restraint between a manufacturer and a retailer is typically imposed through a sophisticated contractual relationship with complex clauses and several obligations imposed on the contracting parties.

19. The motivations for vertical restraints and their impact on economic welfare have been actively debated by academics. The so-called Chicago School was very influential in this debate by elaborating the beneficial aspects of vertical restraints and the efficiency gains they incorporate.²⁰ In particular, vertical agreements can substantially help to solve coordination problems that arise at different levels of the supply chain.

18 Akerlof, G. A. (1970): The Market for Lemons-Quality Uncertainty and the Market Mechanism. *The Quarterly Journal of Economics*, pp. 488–500.

19 ESI also finds that manufacturers also have an increased tendency to sell directly in the downstream market. The analysis of vertical integration from a competition policy perspective goes beyond the scope of this article. The literature on vertical integration and competition is quite rich. See, for example,

Hart, O. and J. Tirole (1990): Vertical Integration and Market Foreclosure. *Brookings Papers on Economic Activity: Microeconomics*, pp. 205-286..

20 Posner, R.A. (2005): *Vertical Restraints and Antitrust Policy*. *University of Chicago Law Review* 72, p.p. 229-241..

20. The best-known such problem is the so-called “double marginalization” and occurs when both the manufacturer and the retailer enjoy some degree of market power and they both make uncoordinated pricing decisions. Since the manufacturer adds a margin on the production cost to set the wholesale price and the retailer adds a margin on the wholesale price to set the retail price, the consumer pays a double margin in the downstream market. A vertical agreement can help the manufacturer and the retailer coordinate their pricing decisions and maximize their joint profits, so consumers do not have to pay excessive prices in the retail market.

21. The same argument can extend to other firms’ strategic decisions and can carry over the choice of prices. For example, it may be desirable that retailers can invest in demand-enhancing practices such as advertising, pre-sale assistance services or other investments that improve the brand image. Coordination on the supply chain through vertical restraints can again lead to a better consumer experience at reasonable prices increasing the success of the vertical structure in the final market.

22. Long-term contractual relationships between manufacturers and retailers can also solve the so-called “hold-up problem.”²¹ Vertical agreements with this respect can clearly define the aspects of the relationship and the responsibilities of each of the two parties to make sure that both undertake the appropriate level of effort and investment for making their collaboration profitable and benefit consumers with good quality products and services. Vertical restraints may also be helpful by internalizing horizontal externality effects among retailers that compete in the product market and buy from the same manufacturer. If the product requires specific promotion investments in the downstream market (e.g., pre-sale assistance services) then the free-riding problem arises. The consumer can receive the pre-sale services from one retailer but choose to buy from another one that sells the same product. Retailers may under-invest due to such an externality. Again contractual agreements can remove such problems by clearly specifying the obligations of all the involved parties.

23. Moreover, the information sharing between manufacturers and retailers may incorporate efficiency gains for both parties and consumers. In many cases, retailers are better informed about local competitive conditions and about the specific preferences of local consumers, while suppliers are better informed about the characteristics of the products they sell. Since both sets of information may be necessary to design and execute an optimal marketing strategy, suppliers and retailers may want to coordinate in setting the retail price and selling conditions to maximize profits given consumers’ preferences as well as the price and characteristics of competing products.

24. Nevertheless, Post-Chicago School academics illustrate how vertical restraints may create anticompetitive effects. In particular, vertical agreements may have a foreclosure effect by preventing entry to all or some levels of the supply chain, or by driving competitors out of the market. Exclusive dealing is a restraint that received a particular attention by the academic literature for its potential foreclosure effect.²² On the one hand, potential entrants may be discouraged as they anticipate having limited access in the downstream market. On the other hand, competitors can be pushed out of the market as distribution possibilities are reduced and it becomes more difficult for them to remain profitably active.

25. In addition to such foreclosure effects, vertical restraints can significantly restrict intra-brand and/or inter-brand competition. For example, by applying a resale price maintenance (RPM), a manufacturer reduce the intensity of competition among its retailers. Similarly, by allocating exclusive territory rights to its distributors, a manufacturer induces a monopoly power for each retailer in a given territory. Moreover, through an exclusive territorial distribution system a manufacturer may commit to price less aggressively, but this in turn gives incentives to rival manufacturers to raise prices.²³

26. Last but not least, vertical restraints may also facilitate collusion either in the upstream or downstream market. For example, RPM agreements improve price transparency which can foster the ability of the manufacturers to collude as they can better monitor retail prices of the other manufacturers and detect deviations.²⁴ The similar argument can also apply for the ability to sustain collusion at the retail level.

27. Vertical restraints can generate important efficiency gains that make them necessary in our market economy, but they can also have anticompetitive effects. It is therefore important to use available instruments for assessing their overall impact. For example, if they incorporate substantial efficiency gains that increase consumer welfare, they are socially desirable practices even if they reduce to some extent competition.

28. In the European competition law, promoting competition is not a goal in itself but only a means to achieve efficient transactions with benefits for market participants and especially consumers. Under Article 101(1) of the Treaty on the Functioning of the European Union (TFEU), any agreement which may affect trade between Member States and which has as (its) object or effect the prevention, restriction or distortion of competition within the common market is prohibited.²⁵ A particular fea-

21 See Williamson, O.E. (1985). *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: Free Press.

22 Comanor, W. and H.E. Frech (1985): *The Competitive Effects of Vertical Agreements*. *American Economic Review*, 75, p.p. 539-546. Aghion P. and P. Bolton (1987): *Contracts as a Barrier to Entry*. *American Economic Review*, 77, p.p. 388-401.

23 Rey P. and J. Stiglitz (1995): *The Role of Exclusive Territories in Producer’s Competition*. *European Economic Review*, 32, p.p. 561-568.

24 See Jullien B. and P. Rey (1997): *Resale Price Maintenance and Collusion*. *The RAND Journal of Economics* 38 (4): 983-1001.

25 Official Journal. of the European Union. C 115, 09.05.2008.

ture of EU competition law is that, under Article 101(3), agreements that fall under the scope of Article 101(1) and should therefore be banned may be exempted if they contribute to improving the production or distribution of goods or to promoting technical or economic progress while allowing consumers a fair share of the resulting benefit. Exemptions can be possible only if such agreements (i) do not completely eliminate competition and (ii) they are necessary for the realization of the associated efficiency gains.

29. Another relevant instrument for the application of the EU competition law is the Vertical Restraints Block Exemption Regulation (VBER) adopted in 2010 (replacing the previous block exemption regime),²⁶ which clarifies when vertical restraints can be exempted with respect to Article 101(3) TFEU. According to the VBER, competition concerns related to vertical restraints can arise if there is insufficient inter-brand competition. If inter-brand competition is fierce, then it is unlikely that any reduction in the intra-brand competition (e.g., due to vertical agreements) will have negative impact on consumers. This condition signals the importance of inter-brand competition for consumer welfare. Inter-brand competition can be very important for the quality and novelty of the products that arrive in the downstream market as well as for the production of products that meet consumers' preferences. A key criterion for the exemption of a vertical restraint from Article 101(1) is that the market share held by the supplier (buyer) does not exceed 30% of the relevant market on which it sells (purchases) the contract goods or services. However, this does not apply for the so-called "hardcore restrictions," or restrictions by object (see Article 4a VBER). For them, even if none of the involved parties exceed the market share threshold, the vertical restraints are presumed to be illegal as they fall within the scope of Article 101(1) TFEU. Involved parties have the possibility to plea and bear the burden of proving that conditions of Article 101(3) TFEU are satisfied in order to be granted an exemption.

30. Having reviewed how e-commerce has disrupted market strategies and distribution channels as well as the efficiency justifications and the anticompetitive concerns associated with vertical restraints, it is now time to focus on the main restraints we meet in online markets. We start with the analysis of price restraints and then we discuss the non-price restraints.

II. Price restraints

31. According to ESI, the most common price restraint in the EU e-commerce market is the retail price recommendations by the manufacturers. The latter justify their inclination to impose some form of control in the retail price as a way to ensure the appropriate positioning of the brand or of the specific product in the downstream market. Another reason that they put forward is that products tend to be designed and manufactured taking already into consideration an estimated retail price level. With an expectation of the retail price level, manufacturers are investing in R&D and other quality-related aspects.

32. The practice of recommending a non-binding resale price or requiring the retailer to respect a maximum resale price is covered by the VBER provided that the designated market share thresholds are not exceeded and that the recommended price or the maximum price does not amount to a fixed or minimum sale price. When the manufacturer sets a fixed or a minimum sale price, the restraint corresponds to RPM, which is considered a hardcore restriction according to VBER. Hence, any efficiencies RPM may lead to should be evaluated on the basis of the specific circumstances of the case.

33. The economics of such restraints has been extensively analyzed²⁷ in the offline economy, and e-commerce does not bring substantial additional insights on the way such restraints should be treated or analyzed. With this respect, the implications of using price monitoring software, dual pricing practices and price parity restraints are interesting cases to cover, since they are motivated by the growth of e-commerce.

1. Online price monitoring and dual pricing

34. ESI reports that price monitoring software is extensively used and can generate competition constraints:

- Retailers use software to monitor the prices of their competitors, and the majority of them adjust consequently their own prices to those of their competitors. That could give rise to price coordination or collusion at the retail level since detection of deviations from the collusive agreement is easier and more immediate.²⁸ How to deal with this risk is an open question that requires a satisfying response.

²⁶ Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

²⁷ See for example Rey P. and T. Vergé (2008): Economics of Vertical Restraints. In Handbook of Antitrust Economics, edited by Paolo Buccirossi. MIT Press, Cambridge, MA, for an overview.

²⁸ See also the relevant discussion in Ezrachi A. and M. Stucke (2016): Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy. Harvard University Press.

- Manufacturers use software monitoring practices to detect whether their retailers comply with the price they recommend. Since manufacturers may retaliate against retailers that do not comply with pricing recommendations, the incentives of retailers to deviate from such pricing recommendations in the first place are limited. In such cases, price recommendations could potentially be equivalent to RPM restraints. Competition authorities should therefore signal that under the presence of such effective price monitoring tools they will be very strict against any retaliation attempt (or threat) by the manufacturers emphasizing on the freedom that retailers have to set the downstream market price.

35. Dual pricing refers to agreements with the same retailer that contain higher wholesale prices for goods that are sold online compared to the price for the goods that are sold offline. ESI finds that this is rarely the case as only 2.5% of retailers reported that they pay a different price depending on whether the product is sold online or offline. This is not a surprise since dual pricing is considered as a hardcore restriction under VBER. However, dual pricing may have objective justifications, when, for example, the manufacturer faces different costs, or the value of the transaction is different in online and offline channels. Following this reasoning, the District Court of Zutphen concluded²⁹ that AEP, a producer of home appliances that charged higher prices for products intended to be sold online, was covered by VBER because of the different transaction value between online and offline channels. In addition, Dertwinkel-Kalt, Haucap and Wey (2016) illustrate that dual pricing may incorporate pro-competitive effects. In particular, they show that price discrimination in the wholesale level between different distribution channels tends to have positive effects on allocative, dynamic and productive efficiency, while a discriminatory ban tends to facilitate exit of relatively inefficient firms, thereby strengthening downstream market concentration.

2. Price parity clauses

36. Price parity clauses are used in business models characterized by agency relationships between suppliers and online platforms. Under such (often long-term) contractual agreement, the supplier commits to charge on the platform a price that is not higher than the price charged on other platforms (and retailers in general) it supplies its products and services.³⁰ This agreement is also called “retail Most Favored Nation clause” (retail MFN clause).

37. The efficiency justification of this restraint relies on the incentives that it provides to online intermediaries to invest on promoting the product, offer pre-sale services and preserve the brand image in the final market by eliminating the free-riding problem. A platform that wants to offer high-quality services needs to undertake the appropriate investments in order to offer the best possible shopping experience to consumers. In the absence of any price parity clause a buyer could use this high-quality/high-cost platform to search for products, but then buy on a lower-quality/lower-cost platform. Since due to free-riding the high-quality platform will not anticipate substantial return from its investments will have less incentive to invest. So, price parity clauses can solve this free-riding problem by ensuring that the buyer cannot find the product at a cheaper price in another platform.

38. We should note that trading platforms are typically two-sided and the so-called “circulation spiral effect” between the two sides of the platform applies: If a platform offers better services to its buyers, it sells more products and attracts more buyers. So, suppliers are more willing to place their products in the platform in order to reach more consumers. Losing some buyers may have a tremendous impact on the viability of the platform as it may make the platform less appealing for sellers, which in turn diminishes the value of the platform for buyers, and so on.

39. Despite these efficiency gains, such practices also raise competition policy concerns. The e-books market is a characteristic example with interesting cases in which such restraint was applied.³¹ The most publicized case which involved wide (retail) MFNs concerned Apple and its iBookstore.³² The restraint referred to the agency agreement between major publishers (Hachette; Harper-Collins Publishers, Simon & Schuster; Macmillan; and Penguin Group) and Apple according to which publishers had direct control on retail prices on the iBookstore, and Apple would collect its 30% fee on the top of book revenues. It also ensured that no other retailer would sell an e-book title at a lower price than Apple. The European Commission concluded that such practices infringe competition law as they soften competition. Through its December 2012 decision, the European Commission accepted legally binding commitments proposed by Apple and four out of the five publishers involved which entail the termination of existing price-restricting agency agreements.

40. More recently, Amazon was forced to drop a similar price parity condition across Europe in the face of antitrust concerns in the UK and Germany.³³ The clause in question lay within Amazon’s standard contract for

²⁹ District Court of Zutphen (Rechtbank Zutphen), 30 December 2005, Case 74100, KG ZA 05-309, *Groen Trend B.V. and Schouten Keukens B.V./Atag Ema Pelgrim Home Products B.V.*

³⁰ See Lear (2012): Can Fair Prices Be Unfair? A Review of Price Relationship Agreements OFT 1438. Report prepared for the OFT, for illustrations of this relationship.

³¹ OECD (2013): Vertical restraints for online sales. DAF/COMP (2013)13 and in particular its background note by Paolo Buccirossi provide an excellent review of relevant cases up to 2013.

³² See Case COMP/C-2/39.847.

³³ See the press releases by the Office of Fair Trading (OFT) on August 29, 2013, under the title “OFT Welcomes Amazon’s Decision to End Price Parity Policy,” and the German Competition Authority on November 26, 2013, under the title “Amazon Abandons Price Parity Clauses for Good.”

traders selling through the company's online retail platform, the Amazon Marketplace. It prohibited a trader from selling a product for a lower price (including the delivery charge), on its own website or on another retail platform.³⁴

41. A number of European national competition authorities have taken action against such clauses in the context of online hotel booking platforms. In 2013, the German Competition Authority issued an infringement decision against HRS, an online booking portal in Germany, requiring it to delete its "best price" clauses.³⁵ In the UK, the OFT accepted commitments from online travel agents Expedia and Booking.com in 2014 to alter their contracts to allow (limited) discounting of hotel rooms by rival platforms.³⁶

42. More recently, and with an unprecedented level of inter-authority coordination, the competition authorities in France, Italy, and Sweden announced that they had accepted identical commitments from Booking.com in relation to its MFN clauses. Following the decision, the French government went one step further and imposed a law prohibiting any form of price parity (or control by the platforms) for hotel room bookings.³⁷

43. An interesting element of these recent cases is that they distinguish Broad Retail Price MFNs from Narrow Retail Price MFNs, and only prohibit the former.³⁸ Broad Retail Price MFNs require the suppliers to set wholesale prices for the platform no higher than those they set through any other channel. Narrow Retail Price MFNs require the suppliers to set prices for the platform no higher than those they offer through their own vertically integrated retail websites only.

44. Because Broad Retail Price MFNs restrict a supplier's pricing choices across the market, they have the potential to impact competition market-wide. By contrast, Narrow Retail Price MFNs only restrict a supplier's pricing on its own websites, and are not expected to have any significant (negative) impact on competition between platforms. As long as there is sufficient competition across platforms in the market, the overall impact of the narrow clause is likely to be far more limited than that of the broad one.

45. More specifically, major competition concerns of retail MFN clauses put forward by the competition authorities in these cases are:³⁹

- They limit competition between platforms on the level of the commissions they charge to suppliers. This leads to higher commissions and eventually to higher prices being charged to final consumers. This anticompetitive effect is confirmed by Boik and Corts (2016),⁴⁰ and Johnson (2017).⁴¹ However, Johansen and Vergé (2017) challenge this reasoning. They show that when suppliers reach consumers both indirectly by choosing to which intermediary platform(s) to list their products and directly through their own website, price parity clauses can simultaneously lead to higher profits for platforms and suppliers, and increase consumer surplus if inter-brand competition is sufficiently high.
- These clauses may hinder entry into the retail market because they effectively lock all prices at the same level. In the OFT's case against Expedia and Booking.com discussed above, the small online travel agency Skoosh.com complained that the clause raised barriers to entry and harmed Skoosh's ability to build a presence in the market, to the detriment of competition and customers. However, Boik and Corts (2016) show that when the potential entrant has a business model relatively similar to the incumbents, MFNs could actually encourage entry. This is because MFNs could signal to potential entrants that the existing business model is successful in the particular market and therefore can motivate investment and entry by new platforms with similar characteristics.

46. While RPM as a practice is considered a hardcore restriction of competition, the legal and economic analysis of the implications and status of retail MFNs is still ongoing. By reviewing the relevant competition policy cases so far we conclude that it is the wide price parity restraints that are considered problematic with respect to market competition and consumer welfare, and that they could even be potentially viewed as hardcore restrictions. On the other hand, narrow clauses should not be considered a major threat to market competition and welfare but as normal business practices. It would be helpful if such practices will be extensively discussed and analyzed in the new vertical guidelines that will come into force in 2022. Especially, since recent research underlines some particular cases under which efficiency gains can be achieved even under the broad version of retail MFNs.

³⁴ Interestingly, Amazon was also investigated by the European Commission for abusing its dominant positions on the markets for the retail distribution of English language and German language e-books, by applying non-price-related parity clauses. It was forced to drop the clauses under concern and the case closed.

³⁵ Press Release on December 20, 2013, by the German Competition Authority: www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilunggen/2013/20_12_2013_HRS.html.

³⁶ OFT, Hotel Online Booking: Decision to Accept Commitments to Remove Certain Discounting Restrictions for Online Travel Agents, on January 31, 2014: www.warechive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/shared_of/ca-and-cartels/of1514dec.pdf.

³⁷ See Johansen B.O. and T. Vergé (2017): Platform Price Parity Clauses with Direct Sales, No 01/17, Working Papers in Economics from University of Bergen, Department of Economics, for a brief relevant discussion.

³⁸ See also CMA (2014), Private Motor Insurance Market Investigation: Final report.

³⁹ See Hviid M. (2015): Vertical Agreements Between Suppliers and Retailers That Specify a Relative Price Relationship Between Competing Products or Competing Retailers, paper prepared for the OECD Competition Committee Hearing on Across Platform Price Parity Agreements, DAF/COMP(2015)6. Paris: OECD, and Ezrachi A. (2015): The Competitive Effects of Parity Clauses on Online Commerce, European Competition Journal, 11, pp. 488-519, for a comprehensive analysis.

⁴⁰ Boik, A. and K. Corts (2016). The Effects of Platform Most-Favored-Nation Clauses on Competition and Entry. Journal of Law and Economics, 59, pp. 105-134.

⁴¹ Johnson J.P. (2017): The Agency Model and MFN Clauses, mimeo.

Adding some clarity on market conditions under which these restraints generate competition concerns will help antitrust authorities to work more efficiently on similar cases and will bring more uniformity on their treatment across the EU.

III. Exclusive distribution

47. A widely used vertical restraint is the allocation of territories or customer groups exclusively to specific distributors. According to ESI, manufacturers are motivated to use such restraints in order to launch and establish a brand/product in a new market, to expand sales and reach a viable scale of operations, as well as to preserve the incentives of independent distributors to invest in facilities and human resources specifically related to selling the manufacturer's products. In the EU this pro-competitive effect is balanced against the risk of attributing market power to each distributor over the allocated territories or customers. Exclusive distribution agreements are generally accepted by competitive law if the restriction concerns only active sales, but it does not prevent distributors to make passive sales outside the allocated territories. Restrictions to active sales can be justified under the provisions of Article 101(3) TFEU or when the corresponding market shares do not exceed the threshold set by VBER. Restrictions on passive sales are considered hardcore restrictions of competition.

48. According to the European Commission's guidelines, active sales refer to actively approaching customers in a specific territory through advertisement in media, on the Internet or other specifically targeted promotions. Passive sales, on the other hand, mean responding to unsolicited requests from individual customers (including delivery of goods or services to such customers). General advertising or promotion that reaches customers in other distributors' exclusive territories but which is a reasonable way to reach customers in one's own territory is considered passive sales.

49. In the Internet era, the distinction between active and passive sales requires some further clarifications. In e-commerce, transactions that occur online (visiting the shop, acquiring information, inspecting the good, etc.) become (at least, partially) immaterial. Moreover, as discussed above, the geographic dimension of the retailers' activity completely changes its meaning due to the increased and broader scope and shopping possibilities. Hence, e-commerce makes the separating line between active and passive sales blurred. Further clarifications that take into account the new business strategies that e-commerce facilitates should be provided.

50. One of the common types of exclusive distribution agreements in the EU online markets has to do with preventing consumers that are located in one country from accessing and purchasing from the website of an e-trader that is located in another country by applying geo-block-

ing practices. However, geo-blocking may also arise as a unilateral business decision without being imposed by a vertical agreement. Whatever the reason, geo-blocking is widespread in Europe (identified in 63% of all websites assessed by the European Commission's mystery shopping survey⁴²), and it can be experienced at various points in the process of an online purchase: at the point where the website is accessed, at the point where the prospective purchaser attempts to authenticate himself or herself, at the point where the prospective purchaser attempts to arrange for delivery, or at the point the prospective purchaser attempts to pay for the goods or services. In the end, the likelihood of a successful cross-border purchase is only about one in three. Consumer dissatisfaction with this state of affairs is high. Retailers usually collect some type of information about the location of customers (e.g., IP address, payment card details, choice of language, country of residence and so on). They do so for a variety of reasons, including, delivering goods or verifying that orders are legitimate. According to ESI, 38% of retailers collect such data for geo-blocking purposes.

51. One of the motives for which retailers apply geo-blocking practices is to price discriminate across different Member States. In an attempt to promote the Single Market, and in line with its Digital Single Market Strategy⁴³, the Commission made legislative proposals on 25 May 2016 to create a new regulation to remove such price discrimination practices by prohibiting "*geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment*."⁴⁴ On November 20, 2017, the proposal was approved to become part of EU legislation.⁴⁵ While this regulation does not concern goods that are for resale, it is expected to limit the justification of using geo-blocking measures for commercial reasons. So, it is expected that it will make it more difficult for exclusive distribution agreements to include such measures and motives.

52. In principle, the impact of price discrimination on welfare is ambiguous. A general criterion is that when price discrimination increases demand and consequently the volume of trade, then it also increases welfare.⁴⁶ Duch-Brown and Martens (2016)⁴⁷ estimate the impact of prohibiting geo-blocking for purely price discrimination purposes in order to assess the welfare effects of the

42 See GfK (2015): Consumer survey identifying the main cross-border obstacles to the DSM and where they matter most. European Commission.

43 European Commission (2015). Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions a digital single market strategy for Europe. COM(2015) 192 final.

44 European Commission (2016). Proposal for a Regulation of the European Parliament and of the Council on addressing geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC, COM(2016) 289 final.

45 See the press release on November 20, 2017: http://europa.eu/rapid/press-release_IP-17-4781_en.htm.

46 See Varian H. (1985): Price Discrimination and Social Welfare. American Economic Review, 1985, vol. 75, issue 4, p.p. 870-875, for an exposition.

47 Duch-Brown, N. and Martens, B. (2016). The Welfare effects of lifting geoblocking restrictions in the EU Digital single Market. JRC/IPTS Digital Economy Working Paper.

proposed regulation. They find that prices across Member States will not converge because of the different cost structures, costs of delivery as well as language barriers and cultural reasons that limit cross-border demand. They conclude that the regulation will only have positive welfare effects to consumers and producers due to the efficiencies of the online trade channel. In particular, by eliminating price discrimination through geo-blocking measures, prices would decrease across all countries, both online (-1% on average) and offline (-0.5% on average). Trade is expected to increase by nearly €630 million. Based on these estimates, they find that the removal of geo-blocking restrictions on products would increase the consumer surplus in the EU28 by 1.2%, primarily based on the reduction in the price paid for goods and to a lesser degree on the ability of consumers to choose from a wider range of goods and services. They suggest, however, that the increased cost of transportation would tend to restrict arbitrage opportunities, and would consequently tend to limit price convergence across Member States. They also find an increase of producer surplus of 1.4%.

53. While the gain in consumer surplus is unsurprising, the gain in producer surplus is driven by two factors:

- Increased consumption (and thus sales) of goods due to the lower price, which is stronger than might have been expected because they find a price elasticity of demand ranging between -2.5 and -8 for the goods modeled.
- Reduced costs of supply, because many purchases that are made from brick-and-mortar retailers today would instead be made online. The cost of producing the goods is unchanged, but the cost of making the sale online is less than the cost of making the equivalent sale offline, and is sufficient to explain the predicted increase in producer surplus.

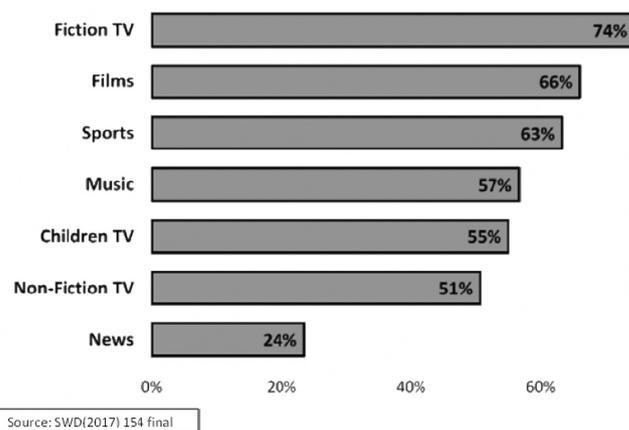
54. It is important to underline that the regulation refers to consumer goods other than copyrighted digital content services (such as films, TV series, broadcasts of sports events, software, e-books, online games and music). Namely, the services in which exclusive distribution agreements with territorial restrictions are very common.

55. In the European market for online copyrighted contents, rights are to large extent licensed on a national basis between right holders and digital content providers. As ESI reveals, right holders build their business models on licensing rights on a national basis. 57% of the online rights licensed under all the licensing agreements submitted by content providers were granted for the territory of one Member State only. This licensing practice allows providers to extract the highest possible value from the rights in terms of revenues.

56. Moreover, 74% of all licensing agreements with suppliers of television fiction submitted by digital content providers require them to geo-block. Licensing agreements for TV drama and TV series, and films and sports

events include requirements to geo-block more often than licensing agreements for other digital content categories, as illustrated in Figure 4.

Figure 4. Proportion of agreements requiring providers to geo-block by category (average for all respondents in EU28)



57. In European case law, an illustrative case of an exclusive licensing agreement with territorial restrictions is the one of Paramount and Sky.⁴⁸ Paramount granted Sky exclusive pay-TV and subscription video-on-demand rights with regard to certain films in the UK and Ireland. The agreement required Sky to prevent the unauthorized Internet transmission outside the UK and Ireland by means of geo-blocking. It also required Paramount to prohibit or limit pay-TV broadcasters located within the European Economic Area, but outside the UK and Ireland, from providing their retail pay-TV services in response to unsolicited requests from consumers residing or located in the UK and Ireland. The European Commission concluded that such an agreement is a restriction of competition by object because it limited cross-border passive sales of retail pay-TV services.

58. Territorial (in the national level) exclusive vertical agreements are very common in the audiovisual industry in the EU. Together with the widespread use of release windows, this leads to a partitioning not only in terms of geography, but also of time. There is a natural temptation to view this partitioning of the European audiovisual market as harmful, and there is indeed no question that it runs counter to the logic of the Digital Single Market.

59. However, a prohibition on geo-blocking of audiovisual content carries certain risks. There are several arguments that the industry puts forwards to justify the degree of market fragmentation: (i) creation of audiovisual works is expensive; (ii) profitability is unpredictable because audiovisual works are experience goods whose

⁴⁸ The final commitments and decision summary can be found at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_40023.

value is only known once they have been experienced; (iii) pre-financing consequently plays a critical role in enabling audiovisual works to be produced; (iv) territoriality and windowing are crucial in generating the predictable returns that are needed in order to obtain pre-financing; and (v) changes that jeopardize the predictability of financial returns put pre-financing at risk, and in doing so also put the production of audiovisual works at risk.⁴⁹

60. Multiple studies support these concerns. Charles Rivers Associates (2014) in its study for the European Commission concludes that “*Licensing on a territory-by-territory basis appears to be essential in financing audiovisual productions.*”

61. Marcus and Petropoulos (2017) identify an aggregate EU-wide trade opportunity of €378 million per annum from prohibiting geo-blocking restrictions in the audiovisual content, with a lower bound of €189 million per annum and an upper bound of €945 million per annum. Nevertheless, they also acknowledge (i) that market partitioning in terms of both geography and time exists for a number of valid reasons, and (ii) that it generates benefits for European consumers, not just costs. Notably, lifting geo-blocking restrictions in the audiovisual sector raises concerns about the creation of new content and how it would be financed. There is a risk that less content would be produced, thus reducing consumer choice and consumer welfare.

62. The exclusivity and territoriality practices of the audiovisual sector may not always be fully in line with the passive sales rules of EU competition law. Especially, since, as discussed, in the Internet era, the distinction between active and passive sales requires some further clarifications. In the case of Paramount and Sky, the European Commission accepted the commitments of removing from licensing agreements the provisions that restricted passive sales. The arguments for the viability of new content creation through the pre-financing mechanism may make such restrictions necessary and bring them closer to meet the conditions of Article 101(3). Hence, a case-by-case analysis is the correct approach to identify potential anticompetitive effects in this context.

IV. Selective distribution

63. Selective distribution agreements allow manufactures to make a proper choice on objective, quantitative and qualitative selection criteria linked to the nature of the product, which distribution services should satisfy. In this way, these agreements limit both the number of authorized distributors and the possibilities for resale of the contract goods by the selected distributors.

⁴⁹ See Oxera (2016): The impact of cross-border access to audiovisual content on EU consumers, and Charles Rivers Associates (2014): Economic Analysis of the Territoriality of the Making Available Right in the EU. European Commission.

64. ESI finds that the use of selective distribution agreements has significantly increased with the growth of e-commerce. It also underlines that changes to the selective distribution systems represent one of the most frequent reactions of manufacturers to the growth of e-commerce. In fact, many restrictions to online sales are mainly found in the context of selective distribution systems. This is because within a closed network of distributors, vertical restraints can be applied more effectively than outside such a system. For example, within a selective distribution system, it may be easier for a manufacturer to control pricing, effectively engage in resale price maintenance or prohibit certain forms of online sales or advertisement.

65. Qualitative and quantitative selective distribution is exempted by the VBER as long as the market share of both supplier and buyer each do not exceed 30%. The main risk is whether a selective distribution system may reduce intra-brand competition with subsequent anticompetitive effects. This is not likely to be the case when there exists sufficient inter-brand competition. When the selective distribution has a limited ability to alter the upstream competition among different brands, there is a general presumption that its benefits overcome the competitive risks.

66. Such distribution systems are almost always used to distribute branded final products and allow manufacturers to eliminate free-riding in the downstream market and to keep control of the environment where the product is presented, the coherent brand marketing of the product and the quality of the display of the product itself. xxx Please consider revising the previous sentence xxx In this way, they can ensure a high quality distribution, the good perception of their brand image, the good quality of pre- and after-sales services and the overall good experience of final customers.

67. A selective distribution system may foreclose certain types of distributors; especially in case of cumulative effects of parallel selective distribution networks in a market. That is a particular concern in e-commerce where online sales present some characteristics that may conflict with the objectives of a selective distribution organization. According to ESI the majority of manufactures using selective distribution agreements report that they do not accept pure Internet retailers, as they require their distributors to operate at least one brick-and-mortar shop. This exclusion responds to a large extent to brand image and distribution quality concerns, reflected in the qualitative criteria set out in the respective selective distribution agreements (e.g., better visualization of products, the necessity for a qualified staff that provides proper recommendations, adequate demonstration of the technical specificities and so on).

68. According to EU competition law, such a practice is exempted by the VBER to the extent that it can be justified. Specifically, a selective distribution system does not constitute an appreciable restriction on competition, when the following three criteria are satisfied:

- the nature of the product requires a selective distribution system, in order to preserve the brand image and quality and ensure the correct use of the product;
- distributors are selected on the basis of transparent and objective qualitative criteria, uniformly applied to all potential distributors in a non-discriminatory way⁵⁰;
- the criteria do not exceed what is necessary.

69. A typical example of a case that followed this reasoning was the Yves Saint Laurent Parfums selective distribution system in which online sales were only permitted to those retailers already operating a physical sales point. The European Commission approved⁵¹ the agreement as it found that the three criteria were satisfied. Similarly, Bijourama, a pure online retailer specialized in the sales of watches and jewelry, complained to the French Competition Authority alleging that the manufacturer Festina denied access to its selective distribution network on the grounds that it does not operate a brick-and-mortar shop. The problem for Festina was that in its distribution agreement there was no provision for limiting online sales. After the manufacturer committed to amend its selective distribution with such a provision, the French authority concluded⁵² that since Festina does not exceed the threshold of 30%, it is allowed to set criteria on how to select its distributors, in a way that satisfied the above three criteria. So, it has the right to exclude Bijourama from its distribution network.

70. There have been cases of selective distribution agreements that are far more restrictive by banning completely online sales. The decisions on the *Pierre Fabre* case were proven very important for the viability of such a restriction in the e-commerce era. Pierre Fabre Dermo-Cosmétique is a cosmetics and personal care products manufacturer. Distributors are selected on the basis of the quality of the physical point of sale and the requirement of a qualified pharmacist to assist the sales. The latter criterion eliminated the possibility for a distributor to sell products online. Pierre Fabre claimed that banning online sales was justified by health protection purposes and by the need to prevent counterfeits. The French Competition Authority⁵³ as well as the Court of Appeal of Paris⁵⁴ rejected such justifications because Pierre Fabre's products were not medicines, and therefore selecting specialist distributors was sufficient to guarantee product quality. The decisions concluded that despite the fact that

the manufacturer had only a 20% market share and inter-brand competition is not limited, the company failed to prove the existence of significant efficiency gains associated with this restriction and that a complete ban of online sales was not indispensable to achieve these efficiencies. As a result, the agreement could not be exempted with respect to Article 101(3) TFEU. Since that case, a de facto ban on the use of the Internet as a channel of sales is considered as a restriction by object, within the meaning of Article 101(1) TFEU and it is not *ex ante* objectively justified. Therefore VBER cannot apply for such restraints.

71. Note that some years earlier, Belgian courts⁵⁵ concluded that the Internet ban imposed by Makro in its selective distribution was justified because, given the nature of the products, personal expert guidance at the points of sales is required—namely, services that cannot be replicated over the Internet.

72. Despite that the nature of the good is crucial in cases of Internet bans, we should not ignore the fast pace with which the Internet is evolving. As the volume of online sales increases, the online environment improves and adopts higher quality standards. Moreover, a restriction to ban Internet sales ten years ago would have had much smaller impact than now that both the supply and demand in online shopping have increased to a large extent. The improvement of the conditions and environment of online commerce makes de facto Internet bans more difficult to be exempted, especially, given that according to Article 4 VBER they are considered hardcore restrictions.

73. While after the *Pierre Fabre* case, restrictive conditions like de facto Internet bans are considered hardcore restrictions, there are two narrower restraints that usually come together with selective distribution agreements and whose treatment is subject to a debate among competition policy experts: vertical agreement that restrict retailers to sell in online marketplaces and/or online price comparison tools. According to ESI, 92% of respondent retailers are selling via their own website (which does not exclude that they also sell via other sales channels). 34% are selling via a marketplace and 36% use price comparison tools in order to advertise their products. We will now discuss in turn restrictions related to these two types of platforms.

50 We should clarify here that if criteria are applied in a discriminatory way but such discrimination is i) objectively justified; and ii) necessary for achieving the efficiency gains in the distribution network (e.g., protection of the brand image), then it is unlikely to generate competition concerns.

51 Commission press release, 17 May 2001, Commission approves selective distribution system for Yves Saint Laurent perfume, IP/01/713.

52 French Competition Authority, 24 July 2006, Decision No. 06-D-24, *Festina France*.

53 French Competition Authority, 29 October 2008, Decision No. 08-D-25 regarding practices in the sector of distribution or personal care and cosmetics products sold upon pharmaceutical advice, *Pierre Fabre Dermo-Cosmétique*.

54 CA Paris, 31 January 2013, RG 2008/23812, *Pierre Fabre Dermo-Cosmétique*.

55 Cour de cassation Belgique, 10 October 2002, No. C.01.0300. F, *Makro v. Beauté Prestige International AO*.

V. Restrictions to sell in online marketplaces

74. Marketplace sales are especially important for small and medium-sized retailers. ESI reports that the proportion of retailers selling via marketplaces is significantly lower for retailers with high turnover. Small and medium downstream firms prefer marketplaces because:

- Retailers can reach a wide audience at low cost: Marketplaces help firms to reach a wide base of consumers very cheaply. In particular, they make cross-border e-commerce much easier for small firms that do not have the capacity to establish their own cross-border trade network.
- The mobile revolution facilitates the use of online smartphone applications for an efficient shopping experience. Consumers are more likely to use an online marketplace application which allows them to reach a great variety of products.
- Online marketplaces provide personalized services, such as shopping assistants. Their matching algorithms are based on advanced machine learning techniques which minimize search costs⁵⁶ and lead to efficient transactions for the benefit of both firms and consumers.

75. Despite these benefits, manufacturers sometimes incorporate in their selective distribution systems restrictions to access online marketplaces. The main arguments that they put forward for such a practice are related to their brand image:

- In some cases, suppliers are unable to check the conditions under which the goods are sold by marketplaces. So, to their view, there is a risk of deterioration of the online presentation of those goods, which may harm their luxury image.
- Such restrictions are necessary to preserve the luxury brand image in the case online marketplaces do not impose the appropriate (probably product specific) qualitative standards in their online environment. Therefore, restraints can contribute to sustaining the quality of those goods.
- Online marketplaces constitute a sales channel for goods of all kinds. That may have an impact on the preservation of the main characteristics of the goods sought by consumers and the perception of the brand image.

56 See relevant discussion in the introduction.

76. A recent case in which these arguments have been used is the one of *Coty Germany GmbH*, a supplier of luxury cosmetics established in Germany. Coty, in its selective distribution system prohibited its authorized distributor, Parfümerie Akzente GmbH, to sell the luxury goods through the marketplace Amazon.de (Parfümerie Akzente GmbH was allowed to sell the goods from its own website). The European Court of Justice (ECJ) concluded⁵⁷ that Article 101(1) TFEU must be interpreted as not precluding a contractual clause which prohibits authorized distributors in a selective distribution system from selling the contract goods through online marketplaces, provided that the clause:

- has the objective of preserving the luxury image of those goods;
- is laid down uniformly and not applied in a discriminatory fashion;
- is proportionate in the light of the objective pursued.

77. The main take away from this decision is that marketplace bans are not hardcore restrictions. In particular, when the marketplace cannot guarantee that the luxury good will be sold according to the qualitative standards that meet the requirements set by the selective distribution system, then the marketplace ban is justified and does not violate competition law. If the marketplace cannot meet such standards, it is likely to damage the brand.

78. According to the ECJ, market competition is multidimensional and apart from the price component there are also other relevant dimensions like product quality and brand image. So, marketplace sales that reduce brand image could eventually lead to a restriction of competition in some of these additional dimensions. Hence, prohibiting marketplace sales can protect (non-price) competition instead of restricting it.

79. Copenhagen Economics (2016),⁵⁸ in a study prepared for eBay, finds that €26 billion are at risk in a scenario where online marketplace bans become pervasive and small and medium retailers will be restricted from using online platforms. While the ECJ decision on the *Coty* case can have broader implications for future cases related to marketplace bans, a crucial point is to what extent the marketplace meets the qualitative standards of the selective distribution agreement. This depends on many factors such as the nature and the characteristics of the product and the marketplace environment. The assessment of this point suggests that a case-by-case analysis is the appropriate approach to follow. This, in combination with the fact that marketplaces are constantly improving their online interfaces and quality standards in order to meet the challenges of the high-speed growth of e-commerce, can make harder for such restrictions to be justified.

57 Press Release No. 132/17 Luxembourg, 6 December 2017, Judgment in Case C-230/16 *Coty Germany GmbH v. Parfümerie Akzente GmbH*.

58 Copenhagen Economics (2016): Economic Effects of Marketplace Bans. A study prepared for eBay.

80. So, in the frame of the EU digital market strategy⁵⁹ we should promote policies that lead to significant improvements in the design and operation of online platforms and reduce access impediments for small and medium firms. In particular, online marketplaces can be designed in a way that makes a clear distinction between mass market and selective brands. Depending on the rank of the brand, the appropriate requirements in terms of sales strategy, online support by qualified staff and delivery standards can be applied. In this way, the marketplace qualitative standards will not leave so much room to manufacturers to impose platform bans.

81. It is worth noting the recent expansion of Yves Saint Laurent's luxury products in China through marketplace sales. The company agreed to sell its products via the online marketplace of Farfetch and JD.com. This illustrates how online marketplaces can be designed to serve the needs of luxury brand owners and how manufacturers operating in the luxury segment can benefit from the use of those platforms.

VI. Restrictions to use online price comparison tools

82. Apart from restrictions to sell in marketplaces, selective distribution agreements may incorporate restrictions for retailers to use online price comparison tools—namely, websites that allow potential consumers to search for products and compare their prices across several retailers. They also provide links that lead directly or indirectly to products, without offering the possibility to purchase the products directly through their website. Price comparison tools typically do not charge buyers for access to the services on their websites or apps, but they are rather financed via payments by the sellers whose products are listed on the websites (typically on a pay-per-click basis).

83. Price comparison tools allow customers to quickly compare prices for the same product across a large number of sellers. In this way, they increase price transparency and consumers can find more easily the best available option that matches their preferences. This intensifies intra-brand and potentially inter-brand price competition.

84. Despite these gains, some agreements between manufacturers and retailers contain contractual restrictions under which the retailers are limited in their ability to actively provide information or otherwise promote their online products with price comparison tools. According to ESI, the most widespread type of such a restriction is a prohibition to use any price comparison tool.

85. Manufacturers that impose such conditions believe that:

- Because price comparison tools focus mainly on prices, they do not incentivize retailers to differentiate themselves sufficiently in terms of other factors that equally affect the choice of customers such as luxurious image, quality, special features, and style of the products.
- It becomes more difficult for retailers to differentiate themselves in terms of service quality and delivery when they use price comparison tools. As a result, retailers with low service quality might free-ride on other retailers' investments and eventually the brand image is damaged.
- Prices of authentic products can more easily be compared with counterfeit ones that are also listed in such tools. In such a case, the brand image can again be damaged.
- As price comparison tools intensify price competition, they may contribute to making customers increasingly price sensitive, which in turn could bring a downward pressure on prices and reduce profit margins to an extent that may be detrimental for specialized retailers with brick-and-mortar shops which have higher cost structures because of the additional services they provide. Hence, price comparison tools may lead to less incentive by specialized retailers to invest in quality and services.

86. While the validity of these arguments is difficult to quantify in order to arrive to a safe conclusion, we should not forget that customers increasingly use these tools to make their purchasing decisions. Price comparison tools allow potential customers to find authorized retailers and direct them to their websites. They can enhance visibility for the brand on the Internet and often provide product and seller reviews which further inform customers about the products and the sellers. Most price comparison tools offer the possibility to the retailers to display their logo as well as product pictures on their website. Some of them also offer objective information on features and reviews of products that do not interfere with brand image or the quality of product distribution.

87. ESI reports that the price comparison tools have taken particular steps in the last few years to increase their quality and their image of the services. Some examples include improved layout of the website, increase in the number of retailers, use of videos, inclusion of expert reviews, improved accuracy of information provided on the website, improved functionality of the website, optimization of search relevance, ability for retailers to include promotions of certain products, and so on.

88. The status of restrictions to use price comparison tools is a gray area from the perspective of competition law. The current version of the vertical guidelines that accompany VBER does not specify how to assess a restric-

⁵⁹ In the midterm review of May 2017, the European Commission considers in the top 3 priorities to review digital platforms' business trading practices in order to ensure a fair and innovation-friendly business environment: <https://ec.europa.eu/digital-single-market/en/content/mid-term-review-digital-single-market-dsm-good-moment-take-stock>.

tion or ban to use price comparison tools. On the side of the case law, an interesting case has emerged. ASICS is a manufacturer of sports clothing and running shoes. ASICS was fined by the German Competition Authority for restricting Internet sales of authorized distributors in its selective distribution system between 2012 and 2015. One of the major imposed restrictions was the prohibition of authorized distributors to use online price comparison tools. The authority concluded⁶⁰ that such constraints could not be justified to protect its brand image and pre-sales services because consumers of running shoes did not necessarily need or want such services or if so could inform themselves via the Internet. In addition, such constraints were prone to restrict intra-brand competition. In this regard, specific attention was paid to the effects on small and medium-sized distributors, who cannot compete effectively without access to price comparison websites and advertising services. On 5 April 2017, the Düsseldorf Higher Regional Court upheld the German Competition Authority's decision⁶¹ by confirming that contractually prohibiting retailers from using price comparison websites constitutes a "by object" infringement of competition law.

89. Note that the increase in price transparency with the use of price comparison tools mostly concerns (and benefits) consumers. With the extensive use of price monitoring software that can provide a high level of granularity, scope and immediate access to pricing data, firms are able to monitor hundreds of websites in real time. So, they do not really need price comparison tools to observe prices in the market. That presumably implies that such tools do not significantly affect the likelihood of collusion in the market.

90. The fact that the prohibition to use price comparison tools seems to have a different treatment from the prohibition to sell in online marketplaces can be attributed to the fundamental differences of the two online platforms: Marketplaces by definition constitute, as such, a distinct online sales channel for the concerned products. Conversely, the visitors of a price comparison tool are redirected to the website of the authorized distributor from which the product can be purchased and which generally fulfills all the criteria set out by the manufacturer of the product within its selective distribution system as to how its products should be sold. Hence, price comparison tools are not a distinct online sales channel, but offer retailers the ability to present and advertise their online

offerings to a wider audience, increase the findability of the online offering and generate traffic to the retailer's own website. Hence, while manufacturers are in principle allowed under the VBER to require quality standards when it comes to advertising and promotion of their products by retailers on the Internet, it is harder to justify prohibitions in using price comparison tools; in particular, given the significant improvement of these tools in recent years, as a response to the growth of e-commerce.

91. Nevertheless, in some cases, restrictions to use these tools may be related to restrictions of active sales. For example, price comparison tools can allow retailers to specifically target (potential) customers in certain territories outside their home Member State. In these cases, price comparison tools may be used to promote an online offering in certain other Member States. Limitations on the use of price comparison tools targeting specific territories may be a permissible restriction of active sales into this territory provided that it has been exclusively reserved for the supplier or has been exclusively allocated to another distributor.

VII. Concluding remarks

92. E-commerce provides many opportunities for the European markets and incorporates many efficiencies and benefits for all the types of online traders. In order to maximize these benefits, we should make sure that strong competition is present in online markets, so that consumers have access to a great variety of good quality products and firms are incentivized to innovate contributing to the growth of the economy. Vertical restraints are a necessary part of the market economy and substantially contribute to the coordination of different levels in the supply chain so that high-quality products are sold in the downstream market. The growth of e-commerce has affected the type of vertical restraints manufacturers impose in their supply distributions generating new theories of harm related to potential anticompetitive concerns. The new guidelines for vertical agreements that will be adopted in 2022 should provide the necessary clarifications so that traders operate in a secure and transparent online market environment. ■

⁶⁰ See the official version of the decision B2-98/11: http://www.mlex.com/Attachments/2016-01-15_8B27F7257PO4TSEV/B2-98-11.pdf?jsessionid=632F0148B0D-2DC3F91842E548CB01163.pdf.

⁶¹ See the Press Release of the German Competition Authority: http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2017/06_04_2017_Asics.html?jsessionid=137274BE2F12D627FD90C9713023CD6B.2_cid378.

Editoriaux

Jacques Attali, Elie Cohen, Claus-Dieter Ehlermann, Jean Pisani Ferry, Ian Forrester, Eleanor Fox, Douglas H. Ginsburg, Laurence Idot, Frédéric Jenny, Arnaud Montebourg, Mario Monti, Gilbert Parleani, Jacques Steenbergen, Margrethe Vestager, Bo Vesterdorf, Denis Waelbroeck, Marc van der Woude...

Interviews

Sir Christopher Bellamy, Lord David Currie, Thierry Dahan, Jean-Louis Debré, Isabelle de Silva, François Fillon, John Fingleton, Renata B. Hesse, François Hollande, William Kovacic, Neelie Kroes, Christine Lagarde, Johannes Laitenberger, Emmanuel Macron, Robert Mahnke, Ségolène Royal, Nicolas Sarkozy, Marie-Laure Sauty de Chalon, Tommaso Valletti, Christine Varney...

Dossiers

Jacques Barrot, Jean-François Bellis, David Bosco, Murielle Chagny, John Connor, Damien Gérardin, Assimakis Komninou, Christophe Lemaire, Ioannis Lianos, Pierre Moscovici, Jorge Padilla, Emil Paulis, Robert Saint-Esteben, Jacques Steenbergen, Florian Wagner-von Papp, Richard Whish...

Articles

Guy Canivet, Emmanuelle Claudel, Emmanuel Combe, Thierry Dahan, Luc Gyselen, Daniel Fasquelle, Barry Hawk, Nathalie Homobono, Laurence Idot, Frédéric Jenny, Bruno Lasserre, Luc Peeperkorn, Anne Perrot, Nicolas Petit, Catherine Prieto, Patrick Rey, Joseph Vogel, Wouter Wils...

Pratiques

Tableaux jurisprudentiels : Actualité des enquêtes de concurrence, Contentieux indemnitaire des pratiques anticoncurrentielles, Bilan de la pratique des engagements, Droit pénal et concurrence, Legal privilege, Cartel Profiles in the EU...

International

Belgium, Brésil, Canada, China, Germany, Hong-Kong, India, Japan, Luxembourg, Switzerland, Sweden, USA...

Droit & économie

Emmanuel Combe, Philippe Choné, Laurent Flochel, Frédéric Jenny, Gildas de Muizon, Jorge Padilla, Penelope Papandropoulos, Anne Perrot, Nicolas Petit, Etienne Pfister, Francesco Rosati, David Sevy, David Spector...

Chroniques

ENTENTES

Ludovic Bernardeau, Anne-Sophie Choné Grimaldi, Michel Debroux, Etienne Thomas

PRATIQUES UNILATÉRALES

Laurent Binet, Frédéric Marty, Anne Wachsmann

PRATIQUES COMMERCIALES DÉLOYALES

Frédéric Buy, Valérie Durand, Jean-Louis Fourgoux, Rodolphe Mesa, Marie-Claude Mitchell

DISTRIBUTION

Nicolas Ereseo, Dominique Ferré, Didier Ferrier, Anne-Cécile Martin

CONCENTRATIONS

Jean-François Bellis, Olivier Billard, Jean-Mathieu Cot, Ianis Girgenson, Sergio Sorinas, David Tayar

AIDES D'ÉTAT

Jacques Derenne, Bruno Stromsky, Raphaël Vuitton

PROCÉDURES

Pascal Cardonnel, Alexandre Lacresse, Christophe Lemaire

RÉGULATIONS

Orion Berg, Hubert Delzangles, Emmanuel Guillaume

MISE EN CONCURRENCE

Bertrand du Marais, Arnaud Sée

ACTIONS PUBLIQUES

Jean-Philippe Kovar, Francesco Martucci, Stéphane Rodrigues

DROITS EUROPÉENS ET ÉTRANGERS

Walid Chaiehloudj, Sophie-Anne Descoubes, Marianne Faessel, Pierre Kobel, Silvia Pietrini, Jean-Christophe Roda, François Souty, Stéphanie Yon-Courtin

Livres

Sous la direction de Stéphane Rodrigues

Revue

Christelle Adjémian, Mathilde Brabant, Emmanuel Frot, Alain Ronzano, Bastien Thomas

Concurrences est une revue trimestrielle couvrant l'ensemble des questions de droits de l'Union européenne et interne de la concurrence. Les analyses de fond sont effectuées sous forme d'articles doctrinaux, de notes de synthèse ou de tableaux jurisprudentiels. L'actualité jurisprudentielle et législative est couverte par onze chroniques thématiques.

> Abonnement Concurrences+

Devis sur demande
Quote on request

Revue et Bulletin: Versions imprimée (Revue) et électroniques (Revue et Bulletin) (avec accès multipostes pendant 1 an aux archives)
Review and Bulletin: Print (Review) and electronic versions (Review and Bulletin)
(unlimited users access for 1 year to archives)

Conférences: Accès aux documents et supports (Concurrences et universités partenaires)
Conferences: Access to all documents and recording (Concurrences and partner universities)

Livres: Accès à tous les e-Books
Books: Access to all e-Books

> Abonnements Basic

Revue Concurrences | Review Concurrences

HT Without tax TTC Tax included

- | | | | |
|--------------------------|---|----------|----------|
| <input type="checkbox"/> | Version électronique (accès monoposte au dernier N° en ligne pendant 1 an, pas d'accès aux archives)
<i>Electronic version (single user access to the latest online issue for 1 year, no access to archives)</i> | 545,00 € | 654,00 € |
| <input type="checkbox"/> | Version imprimée (4 N° pendant un an, pas d'accès aux archives)
<i>Print version (4 issues for 1 year, no access to archives)</i> | 595,00 € | 607,50 € |

e-Bulletin e-Competitions | e-Bulletin e-Competitions

- | | | | |
|--------------------------|---|----------|----------|
| <input type="checkbox"/> | Version électronique (accès monoposte au dernier N° en ligne pendant 1 an, pas d'accès aux archives)
<i>Electronic version (single user access to the latest online issue for 1 year, no access to archives)</i> | 760,00 € | 912,00 € |
|--------------------------|---|----------|----------|

Renseignements | Subscriber details

Prénom-Nom | *First name - Name*

Courriel | *e-mail*

Institution | *Institution*

Rue | *Street*

Ville | *City*

Code postal | *Zip Code* Pays | *Country*

N° TVA intracommunautaire | *VAT number (EU)*

Formulaire à retourner à | Send your order to:

Institut de droit de la concurrence

68 rue Amelot - 75011 Paris - France | webmaster@concurrences.com

Conditions générales (extrait) | Subscription information

Les commandes sont fermes. L'envoi de la Revue et/ou du Bulletin ont lieu dès réception du paiement complet. Consultez les conditions d'utilisation du site sur www.concurrences.com ("Notice légale").

Orders are firm and payments are not refundable. Reception of the Review and on-line access to the Review and/or the Bulletin require full prepayment. For "Terms of use", see www.concurrences.com.

Frais d'expédition Revue hors France 30 € | 30 € extra charge for shipping Review outside France