



DG Competition, Unit A2 - Antitrust and Mergers
Policy and Scrutiny
European Commission

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Dear Sir

Vertical Block Exemption Regulation

(HT.1171 - stakeholder input, Which?'s ID number: 02395381285-80)

Which? is an independent, not-for-profit consumer organisation with over 700,000 members and is the largest consumer organisation in Europe. Which? is independent of Government and industry, and is funded through the sale of Which? consumer magazines, online services and books.

Which? welcomes the opportunity to respond to the draft vertical block exemption regulation (vBER) and Guidelines on Vertical Restraints ('the guidelines').

Summary

E-commerce and the benefits of Internet sales are fundamental to transform consumers' experience of markets, putting consumers in the driving seat. There are many examples of where consumers' have benefited- notably for music and books but also travel services, electrical products or even weekly groceries. Price comparison services, access to other consumer's reviews and market intelligence can further empower the consumer. Which? is sceptical of any claims by firms that consumers' will benefit from restrictions to online sales. In particular, claims that retailers must operate a 'brick and mortar' shop before being permitted to sell a manufacturer's products unfairly limit retailers' from meeting consumers' expectations of what modern retailers can and should provide. The Commission should be very cautious about accepting such arguments at face value. Where firms

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for all consumers

benefit from the block exemption, they should be prepared to publish the terms and conditions of their selective distribution agreements. These terms should be objectively necessary to improve distribution of their goods or services and ensure a fair share with consumers.

Areas of concern

Block exemption regulations provide considerable benefit to firms through the safe-harbour from competition law. The guidelines accompanying the vBER explain that vertical agreements are generally considered less harmful to competition. The parties to a vertical agreement are less likely to be competitors, instead engaged in a complementary relationship to supply goods and services to the market. Although the guidelines recognise that vertical agreements may limit competition, a range of positive effects are identified that may improve distribution of goods, facilitate non-price competition and in some cases prevent free-riding.¹

Despite the possible benefits to consumers arising from vertical agreements, Which? has considerable concerns over the Commission's approach to online sales or any presumption that restricting access or use of the Internet will necessarily benefit consumers. Which? has previously set out to the Commission its concerns with restrictions to online sales and the development of e-commerce.² The vertical block exemption guidelines deepen our concern that consumers will increasingly be denied the full benefits of e-commerce and cross-border sales. As a result, the guidance in respect of online sales appears compromised, allowing firms considerable latitude to restrict passive sales and the development of consumer-led innovation of Internet value-add services.

Which? is concerned with the extent to which the guidelines accept arguments that access to Internet sales should be restricted, rather than presuming that the Internet is a key driver of dynamic competition to which firms must adapt. The guidelines are likely to influence attitudes of firms considering applying vertical restraints to online sales. The guidelines will also affect the individual assessment of restraints imposed by firms exceeding 30 per cent market share, but where dominance cannot be presumed. As a result, the guidelines may weaken the development and penetration of online sales as a competitive challenge to incumbent firms. Where a network of similar agreements has a cumulative effect,

¹ See paragraphs 96 - 105 of the guidelines. Negative effects on competition include foreclosing markets or limiting consumers' ability to purchase from across member states.

² 'Opportunities in online goods and services, DG Competition issues paper, Which? response', 19 September 2008 and response to 'online commerce roundtable - online distribution of music (HT-1241)', 3 June 2009.

the permissive approach of the Regulation that requires its specific withdrawal may further inhibit development of online sales and e-commerce.

These points allow firms to continue to justify restrictions on the use or access to online sales, regardless of consumer preferences or demand. The benefits of e-commerce are significant, transforming the way services are offered and driving innovation. These benefits go further than simple facilitation of passive sales. The Commission should take a considerably more sceptical view of the genuine value of vertical restraints that affect Internet trade and whether such restraints favour incumbent firms rather than consumers or the conditions of effective competition.

Restrictions to online trade are likely to be implemented through selective distribution agreements, Which? has two concerns:

- > The opportunities for selective distribution systems to prevent or restrict the significant benefits of e-commerce, especially via ‘brick and mortar’ or other ‘quality’ standards for online sales; and
- > The role and impact of territorial intellectual property rights (IPR) as part of selective distribution systems that may segment markets preventing consumers purchasing services from other Member States;

Selective distribution and online sales

Paragraph 52 of the guidelines states that ‘every distributor must be free to use the Internet to advertise or sell products’. Other statements in the guidelines attempt to establish online sales as a commercial ‘norm’, usually constituting passive sales (and therefore covered by prohibitions on hardcore restrictions). Despite this rhetoric the Commission allows selective distribution agreements to include a number of significant restrictions to online trade yet still qualify for exemption. These include restrictions that allow suppliers to set volume or value targets for off-line trade before allowing online sales or insisting that a retailer operates a bricks and mortar shop before any online sales may take place.³

This has resulted in guidelines that appear compromised, providing consumers’ little comfort and manufacturers or distributors with considerable protection from innovative and competitively challenging distribution models. The existence of borders for online sales will therefore be maintained, to the detriment of consumers.

³ See footnote 29, page 18 and paragraph 54 of the guidelines.

In summary, the guidelines for treatment of online sales under selective distribution appear to:

- > Place the interests of firms, with established business practices and distribution channels, before dynamic competitive developments and ultimately consumers;
- > Accept, at face value, arguments that consumers are necessarily likely to benefit from restrictions on free-riding to the same degree as firms wishing to impose such restrictions;
- > Underestimate the wider dynamic benefits of e-commerce, which can enable consumers more direct and immediate influence over market outcomes facilitating consumer-led innovation;
- > Condone explicit practices likely to prevent or deter online retailers, such as the 'Brick and Mortar' condition or imposition of 'quality standards', that will raise retailer costs, weaken price competition and deter innovation in distribution or value-added services.

Which? considers that consumers, through their purchasing decisions, are best placed to make judgements over the standards or service quality required. The competitive process should require manufacturers and wholesalers / retailers to respond to consumer preferences, not dictate the terms on which consumers may access products. The use of selective distribution to limit or discourage passive sales is likely to be a greater obstacle to cross-border trade than existing differences in standards of consumer protection across Member States.⁴

Selective distribution and IPR

Which? has made a detailed response to the Commission on the potential harm from selective distribution and IPR in respect of online music downloads.⁵ IPR is often licensed on a Member State specific basis. Distribution agreements are likely to mirror these territorial restrictions. This in turn creates or reinforces market segmentations that prevent passive sales, allowing discriminatory terms to be imposed on consumers by suppliers and distributors, significantly weakening price competition and limiting choice. Examples of this effect are the iTunes case and different pricing for air travel within the EU or channel tunnel purchased in different territories.

⁴ Which? at present opposes proposals for an EU consumer rights directive, that seeks maximum harmonisation of consumer rights across the EU and thus would remove hard-won rights from UK consumers. See <http://www.berr.gov.uk/whatwedo/consumers/policy/eu/review/index.html>

⁵ 'Opportunities in online goods and services, DG Competition issues paper, Which? response', 19 September 2008.

The vBER or guidelines do not address the territorial or Member State specific nature of IP agreements, or the impact this may have on the application of the vBER or the analysis of any vertical restraints. The issue is considered indirectly in the context of selective distribution where territorial restrictions may be applied to prevent active sales.⁶ However, it is not clear whether, under the proposed vBER, any IP clauses must (or are able to) cover the same territorial area of the relevant distribution agreement seeking to benefit from exemption. Further, it is not clear whether suppliers are prevented from operating a series of selective distribution agreements that effectively partitions territory but still gain the benefit of the block exemption. Such agreements could differ in small ways to justify multiple agreements across the EU. The interaction of competition law and IPR remains complex, and the proposed guidelines may not be sufficient to encourage wider IPR agreements that cover more than one Member State.

New brands and passive sales

Paragraph 56 of the guidelines outlines a general case to justify the restrictions of passive sales for selling a 'new brand or first to sell an existing brand on a new market'. Which? has a number of concerns with this. First, restricting passive sales in order to insulate a firm from consumers' competitive response essentially amounts to a form of price-protection or retail price maintenance. A restriction on active sales may perhaps, under the right circumstances be justified. But a restriction to passive sales is significantly contradictory to the general statements of the Commission regarding passive sales. Second, the definition of terms such as 'new brand' or 'customer group' is insufficiently precise to prevent abuse. Third, the protection of a firm from competition for its 'new brand' for a period of two years seems arbitrary. It is not clear why this period of time relates to any specific level of sunk cost, presuming that the rationale for insulating firms from competition is accepted in the first instance. The protection of trade-mark and know-how is already governed by separate law and is intended to help reward firms for investment in research and development. Any additional sunk costs are a competitive risk that firms should face. Without the pressures of effective competition firms will face less, not more, pressure to innovate and offer good quality products. Recoupment of sunk costs is achieved by delivering high-quality products that consumers genuinely value, not by circumventing the normal process of competition.

⁶ Paragraphs 31 - 46 of the Commission's guidance.

Proposed remedies

Which? has outlined a number of concerns with the proposed block exemption and accompanying guidelines. To remedy our concerns we propose the Commission:

- > Introduces transparency into the terms of selective distribution systems claiming the benefit of the block exemption. Specifically firms benefiting from the safe harbour should be prepared to publish the relevant distribution agreement, containing the selective criteria, on request by any party. It will then be clear whether these terms meet the conditions of Article 81(3), or whether the exemption should be withdrawn.
- > The guidelines should be reviewed and amended to ensure that any restrictions to online sales or use of the Internet by any party to a distribution agreement is prohibited in the absence of a verifiable case that the conditions of Article 81(3) are met. Any obligations to operate a bricks and mortar shop should be removed from the guidelines as wholly inconsistent with the principles of free trade and consumer sovereignty.

Please contact me if you have any questions.

Yours faithfully,

A handwritten signature in black ink, appearing to read "John D Holmes". The signature is written in a cursive, slightly slanted style.

John D Holmes
Principal Economist,
Which?