This note is submitted by the European Union to the Competition Committee FOR DISCUSSION under Item VII at its forthcoming meeting to be held on 26-27 February 2013.
1. The Application of Article 101 to Vertical Restraints and On-line Sales: Introduction

This Roundtable is dedicated to “Vertical Restraints for On-line Sales”. In order to address some of the issues that this topic raises, this note will describe the EU competition rules applicable to vertical restraints. This is not just useful as general background for analysing the issues, but is also necessary for understanding the Commission’s perspective on the issues to be discussed, as the EU competition rules applicable to vertical restraints are the same for and are generally applied in the same way to off-line and on-line vertical restraints. In the course of this general description, a number of the specific online issues will be addressed.

2. The EU competition rules applicable to vertical restraints

The goal of the European Union’s competition policy is to protect and develop effective competition in the common market for the benefit of consumers. The legislative framework of European competition policy is provided by the Treaty on the Functioning of the European Union (TFEU), in particular in Articles 101–109. Article 101 of the TFEU applies to agreements that may affect trade between Member States and which prevent, restrict or distort competition. If an agreement appreciably restricts competition, this agreement is automatically null and void according to Article 101(2). However, Article 101(3) renders this prohibition inapplicable for those agreements which create sufficient benefits to outweigh the anti-competitive effects. Such agreements are said to be exempted under Article 101(3).

3. Article 101 applies amongst others to vertical agreements. Vertical agreements are agreements for the sale and purchase of goods or services which are entered into between companies operating at different levels of the production or distribution chain. Distribution agreements between manufacturers and wholesalers or retailers are typical examples of vertical agreements. However, an industrial supply agreement between a manufacturer of a component and a producer of a product using that component is also a vertical agreement.

4. Vertical agreements which simply determine the price and quantity for a specific sale and purchase transaction do not normally restrict competition. However, a restriction of competition may occur if the agreement contains restraints on the supplier or the buyer (hereinafter referred to as ‘vertical restraints’). Examples of such vertical restraints are an obligation on the buyer not to purchase competing brands (i.e. non-compete obligation) or an obligation on the supplier to only supply a particular buyer (i.e. exclusive supply).

5. Vertical restraints may have not only negative effects but also positive effects. They may for instance help a manufacturer to enter a new market, or avoid the situation whereby one distributor ‘free rides’ on the promotional efforts of another distributor, or allow a supplier to depreciate an investment made for a particular client.
6. Whether a vertical agreement actually restricts competition and whether in that case the benefits outweigh the anti-competitive effects will often depend on the market structure. In principle, this requires an individual assessment under Article 101. However, the Commission has adopted Regulation (EU) No 330/2010, ‘the Block Exemption Regulation’ (the BER), which entered into force on 1 June 2010 and which provides a safe harbour for most vertical agreements.¹

7. The BER contains certain requirements that have to be fulfilled before it renders the prohibition of Article 101(1) inapplicable for a particular vertical agreement. The first requirement is that the agreement does not contain any of the hardcore restrictions set out in Article 4 of the BER. If the agreement contains one or more hardcore restrictions, this leads to the exclusion of the whole agreement from the benefit of the BER. Hardcore restrictions are considered to be severe restrictions of competition because of the likely harm they cause to consumers and it is considered unlikely that vertical agreements containing such hardcore restrictions fulfil the conditions of Article 101(3). The second requirement concerns a market share cap of 30% for both supplier and buyer. Thirdly, Article 5 of the BER contains conditions relating to three specific restrictions.

8. Above the market share threshold of 30%, the BER does not apply. However, exceeding the market share threshold of 30% does not create a presumption of illegality. This threshold serves only to distinguish those agreements which benefit from a presumption of legality from those which require individual examination. To assist firms in carrying out such an examination, the Commission also published ‘Guidelines on Vertical Restraints’ (the Guidelines).²

9. The Guidelines set out general rules for the assessment of vertical restraints and provide criteria for the assessment of the most common types of vertical restraints: single branding (non-compete obligations), exclusive distribution, customer allocation, selective distribution, franchising, exclusive supply, upfront access payments, category management agreements, tying and resale price restrictions. This should enable firms to carry out their own assessment of their vertical agreements under Article 101(1) and (3).

3. The EU competition rules and the internet – the general approach

10. The BER and the Guidelines apply both to off-line sales restrictions and to on-line sales restrictions. The policy for both types of sales restrictions is fundamentally the same. This does not mean that specificities are ignored, as they are also not ignored if rooted in the type of product sold, the level of trade in question or the market or sector under investigation. However, the policy is fundamentally the same because both the possible anti-competitive effects such as foreclosure and collusion and the possible efficiencies are fundamentally the same for off-line and on-line sales.

11. In addition, in reality there are not two neatly divided sales channels of off-line and on-line sales resulting in clearly distinct off-line and on-line purchases. Many distributors use both brick & mortar shops and the internet to sell their products, so-called multi channel distributors. Similarly also consumers search cross channel. The research behaviour of online consumers is not limited to using online tools. Nearly one in two (47%) used at least one offline research method before making their last online purchase..... At the same time, offline shoppers are using online tools for their research. For their last purchase, nearly one in


two offline shoppers (49%) used at least one online research method.\textsuperscript{3} It would thus be very difficult in practice to apply different rules to on-line and off-line sales. It would only lead to unproductive definitional and demarcation questions and increased possibilities for forum shopping.

4. The EU competition rules and the internet – some specific issues

4.1 Exclusive distribution and active versus passive sales

12. The hardcore restriction in Article 4(b) of the BER concerns restrictions concerning the territory into which or the customers to whom the buyer may sell. This hardcore restriction relates to market partitioning by territory or by customer. Distributors must remain free to decide where and to whom they sell. The BER contains exceptions to this rule, which, for instance, enable companies to operate an exclusive distribution system or a selective distribution system. If a manufacturer wants to operate a selective distribution system, an exception to this hardcore restriction allows it to prohibit its selected distributors to sell, both actively and passively, to non-authorised distributors. If a manufacturer wants to operate an exclusive distribution system, the exclusive distributors can be protected against each others’ active sales, i.e. they can be required not to actively approach, for instance by direct mail or visits, customers in each others’ exclusive territories and not to specifically target by advertising, in whatever media, customers in each others’ exclusive territories. However, passive sales, i.e. sales in response to unsolicited orders including delivery, must always remain free.

13. It is thus for exclusive distribution that a distinction between active and passive sales is made. This distinction applies both to off-line and on-line sales, as is clear from the definition in the Guidelines:

- ‘Active’ sales mean actively approaching individual customers by for instance direct mail, including the sending of unsolicited e-mails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory.

- ‘Passive’ sales 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 or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in one’s own territory, are considered passive selling. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors’ (exclusive) territories or customer groups.\textsuperscript{4}

14. There are a priori no reasons why this distinction would be less relevant for on-line sales. One argument that was sometimes heard during the public consultation before the adoption of the BER and the Guidelines, was that the internet would make it much easier to achieve passive sales and would thus reduce the protection of exclusive distributors if only active selling into their territories could be prohibited. Aside from the question why it would in general be good for consumers to be barred from a better offer they have found themselves, the argument seems to be based on a conviction, dating back to the beginning of the

\textsuperscript{3} Commission staff working paper – Bringing e-commerce benefits to consumers, Brussels, 2011. The figures are based on Consumer market study on the functioning of e-commerce, Civic Consulting, 2011.

\textsuperscript{4} Guidelines, point 51.
internet era, that having a website would be sufficient to be found by many consumers. The reality is different. It is very easy not to be found or not to be attractive in the abundance of offers on the internet and firms spend large sums to have qualitatively good websites and to improve the chance to be found and selected by consumers, for instance by acquiring a sponsored place on search engines or by online advertising in the form of pop-ups on other relevant websites.

15. There are also a priori no reasons why the distinction between active and passive sales would be more difficult to make for on-line sales. The principle of the definition above is that advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory. This may often be more easily applied to the on-line world than the off-line world. For instance, the price of a sponsored place on a search engine or online advertising in the form of pop-ups on another website is generally dependent on the country/region or even city that is targeted. Usually, the wider the area is where consumers will see the sponsored link or pop-up, the higher the price. This leads to a clear cut distinction between active and passive sales, possibly clearer than with more traditional advertising in paper copies of newspapers or magazines, where it may be less possible to target only a particular region or city.

4.2 Selective distribution and the internet

16. Because internet commerce is a relatively new phenomenon, there were of course a number of new questions to be answered concerning online sales restrictions, in particular what is and what is not a restriction of passive online sales, when the rules were reviewed recently. Given that restrictions of the possibilities of distributors to sell passively to consumers are treated as hardcore restrictions, these questions are relevant in principle for all types of distribution. However, in practice they are mainly relevant for selective distribution systems.

17. As explained in the previous section, if a manufacturer wants to operate a selective distribution system, an exception to the resale hardcore restriction allows it to prohibit its selected authorised distributors to sell, both actively and passively, to non-authorised distributors. The BER thus covers setting up a closed distribution system, where selling by the authorised distributors to non-authorised third party traders is prohibited. In such a system it becomes extra important to ensure that the authorised distributors themselves are not restricted in their (active and passive) sales to consumers.

18. As explained by point 52 of the Guidelines: The internet is a powerful tool to reach a greater number and variety of customers than by more traditional sales methods, which explains why certain restrictions on the use of the internet are dealt with as (re)sales restrictions. The remainder of the same point then continues to provide examples of what are considered a restriction of passive online sales. In principle, every distributor must be allowed to use the internet to sell products. In general, where a distributor uses a website to sell products that is considered a form of passive selling, since it is a reasonable way to allow customers to reach the distributor. …If a customer visits the web site of a distributor and contacts the distributor and if such contact leads to a sale, including delivery, then that is considered passive selling. The same holds if a customer opts to be kept (automatically) informed by the distributor and it leads to a sale. Offering different language options on the website does not, of itself, change the passive character of such selling. The Commission thus regards the following as examples of hardcore restrictions of passive selling given the capability of these restrictions to limit the distributor’s access to a greater number and variety of customers:

- an agreement that the (exclusive) distributor shall prevent customers located in another (exclusive) territory from viewing its website or shall automatically re-rout its customers to the manufacturer's or other (exclusive) distributors' websites. This does not exclude an agreement
that the distributor’s website shall also offer a number of links to websites of other distributors and/or the supplier;

- an agreement that the (exclusive) distributor shall terminate consumers’ transactions over the internet once their credit card data reveal an address that is not within the distributor's (exclusive) territory;

- an agreement that the distributor shall limit its proportion of overall sales made over the internet. This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products off-line to ensure an efficient operation of its brick and mortar shop (physical point of sales), nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model…;

- an agreement that the distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line. This does not exclude the supplier agreeing with the buyer a fixed fee (that is, not a variable fee where the sum increases with the realised offline turnover as this would amount indirectly to dual pricing) to support the latter’s offline or online sales efforts.

19. Again as clarification on the same issue of what is considered a restriction of passive online sales, the Guidelines clarify in point 56 that the Commission considers any obligations which dissuade appointed dealers from using the internet to reach a greater number and variety of customers by imposing criteria for online sales which are not overall equivalent to the criteria imposed for the sales from the brick and mortar shop as a hardcore restriction. This does not mean that the criteria imposed for online sales must be identical to those imposed for offline sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes.

20. Undoubtedly other questions about what is or what is not a restriction of passive online sales will be raised over time in view of new internet developments. One such question is referred to in the list of suggested ideas and questions attached to the invitation for written submissions for this Roundtable, where it is asked how to deal with restrictions on the distributor to use search engine optimisation. Should such a restriction be considered a restriction of passive sales? While the answer will be provided by future case law, at first glance it seems a restriction that will hinder the distributor to use the internet effectively, both for active and passive sales, which would thus amount to a hardcore restriction. It is as if a distributor is allowed to use the telephone but is not allowed to be listed in the telephone directory, or is allowed to use a car to deliver its goods but only with petrol from one nearby petrol station, thus limiting effectively the number and variety of consumers it can reach.

21. While thus, for a distribution agreement to be covered by the BER, the distributor must be allowed to use the internet, this does not imply that a supplier necessarily will have to supply to on-line only distributors. As explained in the Guidelines (point 54), under the BER the supplier may require quality standards for the use of the internet site to resell its goods, just as the supplier may require quality standards for a shop or for selling by catalogue or for advertising and promotion in general. This may be relevant in particular for selective distribution. Under the Block Exemption, the supplier may, for example, require that its distributors have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system.

22. This is in line with the general approach to selective distribution in the BER and the Guidelines. As explained in point 176 of the Guidelines, the Block Exemption Regulation exempts selective distribution regardless of the nature of the product concerned and regardless of the nature of the selection criteria. It is considered that below the market share threshold qualitative and quantitative selective distribution systems
will in general benefit consumers, for instance by increasing the quality of distribution. Nonetheless, this sentence is immediately followed by the warning that where the characteristics of the product do not require selective distribution or do not require the applied criteria, such as for instance the requirement for distributors to have one or more brick and mortar shops or to provide specific services, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in intra-brand competition. Where appreciable anti-competitive effects occur, the benefit of the Block Exemption Regulation is likely to be withdrawn.

4.3 Resale price maintenance and the internet

23. In the invitation for written submissions for this Roundtable, it is asked whether the distinction between price and non-price restraints is useful for competition analysis in the context of online sales? It could be argued that this is not the right question. In most jurisdictions, including the EU, there is a difference in treatment of agreements where the distributor is required to apply a fixed or minimum resale price and agreements on a maximum resale price. The relevant question is not price versus non-price restraints, but restraints where experience has shown that they lead in general to negative effects for consumers and restraints where experience does not support such a conclusion.

24. Resale price maintenance, that is, agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are treated in the EU as hardcore restrictions. However, the practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price are not considered hardcore restrictions, provided that such maximum or recommended prices do not amount to a fixed or minimum price as a result of pressure from, or incentives offered by, any of the parties.

25. This continued hardcore treatment of resale price maintenance is not just the result of past case law which consistently has dealt with resale price maintenance as a restriction by object, it also resulted from the Commission services together with the National Competition Authorities taking stock of enforcement as part of the review process which led to the adoption of the BER and Guidelines. The discussion within the European Competition Network on the many resale price maintenance cases dealt with since 2000, mainly handled by the National Competition Authorities, pointed to the pertinence of a cautious approach towards RPM. In general, companies have been unsuccessful in their attempts to show efficiencies and justify RPM. It is considered that extensive recourse to RPM across the EU Member States, many of which have small and concentrated markets, would result in more harm than benefit for the European consumers as a whole.

26. There seems a priori no reason to change this policy where it concerns online resale price maintenance. In the list of suggested ideas and questions attached to the invitation for written submissions for this Roundtable, it is mentioned that there may be a need to off-set the risk of free riding by online distributors on off-line distributors' investments. At the same time, also the risk of inverse free riding, by off-line retailers free riding on online retailers' investments in technical product information and users reviews provision, is mentioned.

5 See Article 4(a) of the BER and points 48 and 49 of the Guidelines.
6 See Article 4(a) of the BER.
7 For more background on the current treatment of resale price maintenance in the EU, see Luc Peeperkorn, Revised EU Competition Rules for Supply and Distribution Agreements, published in Finnish Competition Law Yearbook 2010.
27. As already indicated in section 3 above, the reality is that consumers search cross channel. Nearly one in two (47%) used at least one offline research method before making their last online purchase. 18% of online shoppers visited a shop in person before making an online purchase. At the same time, offline shoppers are using online tools for their research. For their last purchase, nearly one in two offline shoppers (49%) used at least one online research method. Some of the most commonly used online research methods by offline shoppers are: visits to sellers’ websites (15%), search engines (15%), online consumer reviews (14%), price comparison websites (13%) and visits to manufacturers’/brand websites (13%). This indicates that possible free riding is certainly not going in one direction and that off-line and on-line sales efforts are complementary. It may thus be most efficient for manufacturers to support their distributors to use both sales modes (brick & click).

Conclusion

28. To paraphrase Commissioner Almunia, the principles of competition-law enforcement do not change when we leave the realm of brick-and-mortar, but we have to adjust our methods to the specific features of on-line sales and the internet. EU competition policy is fundamentally the same for off-line and on-line sales. This does not mean that specificities are ignored, but the possible anti-competitive effects and the possible efficiencies are fundamentally the same for off-line and on-line sales. The rules, in this case the BER and the Guidelines, are regularly updated and are flexible enough to take such specificities into account.

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9. When speaking on high tech sectors, Commissioner Almunia remarked recently "[t]he principles of competition-law enforcement do not change when we leave the realm of brick-and-mortar, but we have to adjust our methods to the specific features of these new sectors." Commissioner Almunia, Competition enforcement in the knowledge economy, Fordham University/ New York City 20 September 2012, http://europa.eu/rapid/press-release_SPEECH-12-629_en.htm.