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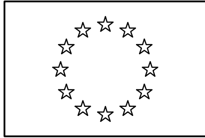

EUROPEAN COMMISSION

Brussels, 20.4.2010
SEC(2010) 413

COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying document to the

Draft COMMISSION REGULATION (EU) No …/..

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

and

Draft COMMISSION NOTICE

Guidelines on Vertical Restraints

{C(2010) 2365 final}
{SEC(2010) 411}
{SEC(2010) 414}

TABLE OF CONTENTS

1. Background 5
1.1. Introduction 5
1.2. Vertical agreements 6
1.3. Substantive rules 6
1.4. The current review of the Regulation and Guidelines 7
1.4.1. Competition authorities' experience with the Regulation and Guidelines 7
1.4.2. The Commission's draft Regulation and draft Guidelines as submitted to the national competition authorities and to public consultation 8
1.4.3. Results of the consultation of the relevant national authorities 10
1.4.4. Results of the public consultation 10
1.4.5. Elaboration and assessment of future options 11
2. Issues to be addressed: − the "WHY" 12
2.1. Market power of buyers 12
2.2. Increasing sales on the internet 16
3. Objectives − the "WHAT" 18
3.1. General objectives of the review 18
3.2. Specific objectives concerning the market power of buyers 18
3.3. Specific objectives concerning the increasing sales on the internet 19
4. Policy options − the "HOW" 19
4.1. Identification of the "baseline" scenario 19
4.2. Other scenarios 20
4.3. Identification of the Policy Options to be assessed 22
4.3.1. Policy Options concerning the market power of buyers 22
4.3.2. Policy Options concerning sales on the internet 23
5. Analysis of impact: Identification of assessment criteria and methodology 25
6. impact assessment of the policy options related to the exercise of market power by buyers 25
6.1. Economic impacts 25
6.1.1. Effective and undistorted competition in European supply and distribution through effective competition law enforcement and the deterrence of anticompetitive practices 25

6.1.2. Impact on companies, in particular SMEs and the compliance costs borne by them 27
6.2. Impact on consumers 29
6.3. Impact on public administration and the Community budget 30
6.4. Other impacts: social and environmental impacts 31
7. Impact Assessment of each policy option related to Internet sales 32
7.1. Economic impacts 32
7.1.1. Impact on effective competition 32
7.1.2. Impact on companies, in particular SMEs and the compliance costs borne by them 38
7.2. Impact on consumers 39
7.3. Impact on public administration and the Community budget 39
7.4. Other impacts: social and environmental impacts 40
8. Conclusion 40
9. Monitoring and evaluation 45

ANNEX 1: The competition rules applicable to vertical agreements 46
1. Evolution of the regulatory framework applicable to vertical agreements 46
2. Practical application of the current rules 49

ANNEX 2: Competition policy on resale restriction over the internet in the context of the review of the rules on Verticals Restraints 51
1. Current competition policy on resale restrictions 51
2. Current competition policy on resale restrictions applied in the context of the internet 52
3. Changes in the draft Regulation and Guidelines subject to a public consultation 53

ANNEX 3: Stakeholder consultation 55
1. Comments on the proposal to introduce a buyer's market share threshold 56
2. Comments on the Commission's proposals regarding the rules to be applied to on-line sales 57
3. Comments on the Commission's proposed approach to hardcore restrictions 59

ANNEX 4: Evolution of online sales in the EU and summary of the evidence used in the Report 60
1. Evolution of on-line sales in the EU 60

1.1 E-commerce compared to other retail channels 60
1.2 Number of online shoppers in the EU 60
1.3 Sectors concerned by the development of e-commerce 61
2. Summary of the evidence used in the Report 62
2.1. The restrictions of active selling within exclusive distribution 62
2.2 The requirement to have a brick and mortar shop 62

1. BACKGROUND

1.1. Introduction

1. This Impact Assessment Report accompanies the draft Commission Block Exemption Regulation applicable to vertical agreements and the draft Guidelines on vertical restraints submitted to the College (hereinafter referred to as "the draft Regulation" and "the draft Guidelines"). These texts revise and update Commission Regulation (EC) 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices[1] and the Commission Notice providing guidelines on Vertical Restraints[2] (hereinafter referred to as "the Regulation" and "the Guidelines"), and will replace the latter two upon their expiry in May 2010.

2. The Directorate-General for Competition ("DG COMP") is the lead service for the review of the Regulation and Guidelines. The other departments involved are: DG Enterprise, DG Internal Market, DG Health and Consumer Affairs, DG Economic and Financial Affairs, DG Information Society and Media, DG Transport and Energy, DG Justice Freedom and Security, the Legal Service, and the Secretariat-General.

3. The scope of this impact assessment is determined by the fact that it was carried out after a draft Regulation and Guidelines were approved by the College in July 2009 for the purpose of launching a public consultation. In this public consultation stakeholders focussed on the few changes to the existing rules proposed by the Commission, which confirms that the Commission's proposals addressed the key issues at stake in this review, namely buyer power and the rules to be applied to online sales. In view of this procedure, the Report briefly mentions why some other policy options have not been retained, but does not carry out a fully–fledged impact assessment on them. In this context it should also be noted that because the Commission is bound by the Treaty on the functioning of the European Union ("TFEU") and by the case law of the European Courts, it is limited in the choice of the policy options that it can propose.

4. It should also be emphasised that a block exemption regulation and guidelines set out the criteria that the Commission uses in assessing the compliance of vertical agreements with the competition provisions of the TFEU in all sectors of the economy. It can therefore be seen as a sum of individual exemption decisions, the individual impacts of which will differ depending on the facts of the case in question. For this reason the present Report outlines the expected general impact of the policy options identified, but does not bring forward any quantitative data.

5. Finally, this impact assessment excludes the automotive sector since this sector is covered by a specific block exemption regulation. A separate impact assessment was undertaken in the context of the review of that specific regulation which takes into account possible changes to the general rules applicable to vertical agreements.

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[1] OJ L 336, 29.12.199, p. 21–25.
[2] OJ C 291, 13.10.2000, p. 1–44.

1.2. Vertical agreements

6. Vertical agreements are agreements for the sale and purchase of goods or services which are entered into between companies[3] operating at different levels of the production or distribution chain. Typical examples are distribution agreements between manufacturers and distributors, or supply agreements between a manufacturer of a component and a producer of a product using that component.

7. The vast majority of agreements entered into by economic players are vertical as this term covers all agreements relating to the purchase of inputs and sale of outputs. In other words vertical agreements are pervasive. An open and competitive supply and distribution system for both intermediate and final goods and services is therefore of major importance in helping EU business, and in particular SMEs, to realise its potential contribution to innovation and growth.

1.3. Substantive rules

8. The competition rules currently applicable to vertical agreements are enshrined in the Block Exemption Regulation and Guidelines that were adopted in 1999 and 2000 respectively. The latter formed the first package of a new generation of block exemption regulations and guidelines inspired by a more economic and effects-based approach[4], which provides that for a proper assessment of a vertical agreement it is necessary to analyse its likely effects on the market, both negative and positive[5].

9. The basic aim of the Regulation and Guidelines was to simplify the rules applicable to vertical agreements by providing a "safe harbour" for these agreements on condition that the market share of the supplier does not exceed 30%. Below this threshold vertical agreements are block exempted; i.e., it is presumed that because the firm has no significant market power these agreements will either not have anticompetitive effects or, if they do, that the net balance will be positive. This allows market players, in particular SMEs, to enter into agreements they can assume to be compatible with EU competition law, enabling them to flexibly conclude or adjust them.

10. Above the 30% there is no presumption that the agreement breaches Article 101. In such a situation the Commission must first establish likely negative effects under Article 101(1) and then, if the firms concerned bring evidence that the agreement gives rise to efficiencies as provided by Article 101(3), weigh whether the negative or positive effects prevail.

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[3] For the purposes of the application of competition rules, agreements between companies and end-consumers are not vertical agreements.

[4] The same approach was subsequently introduced in other block exemption regulations and guidelines regarding the application of Article 101, such as those concerning technology transfer agreements and horizontal cooperation agreements.

[5] In general, an effects-based approach implies that likely effects have to be assessed both for the application of Article 101(1), where the authority must show that the agreement in question has actual or likely negative effects, and for the application of Article 101(3) EC, where the firm must show that the agreement causes actual or likely positive effects, which then have to be weighed against the negative effects.

11. The benefit of the Regulation does not, however, extend to agreements containing a so-called "hardcore restriction", such as minimum resale price maintenance (whereby the supplier imposes on its buyers a fixed or minimum resale price) or some other resale restrictions, such as restrictions on passive sales and parallel trade, listed in Article 4 of the Regulation. In the presence of such restrictions, there is a double presumption, namely that the agreement will have actual or likely negative effects and that it is unlikely that it will have positive effects. However, the above does not mean that Article 101(3) cannot apply to an agreement containing a hardcore restriction. It is always possible for the firm in question to come forward with substantiated claims that the hardcore restriction will bring about efficiencies and that also the other conditions of Article 101(3) are fulfilled, and thereby obtain an individual exemption.

12. Annex 1 outlines in more detail the evolution of the regulations at EU level applicable to vertical agreements over time and how these rules are applied in practice.

1.4. The current review of the Regulation and Guidelines

13. Because of the expiry of the current Regulation on 31 May 2010, the Commission initiated a review in 2008. The review consisted in assessing, together with the stakeholders (in particular the national competition authorities, business, consumer associations and the legal community) the functioning of the current rules and identifying areas for improvement in the light of recent market developments.

1.4.1. Competition authorities' experience with the Regulation and Guidelines

14. DG COMP examined the way in which the Regulation and the Guidelines have been applied so far in the EU. As a first step, DG COMP examined its decisional practice and the case law of the European courts. In addition, DG COMP asked the national competition authorities ("NCAs"), by means of a questionnaire, about their experience with the current rules. Subsequently, in May 2008, DG COMP met with the NCAs to discuss the respective experiences with applying the Regulation and Guidelines.

15. The contribution of the NCAs to the review is particularly important because since the entry into force of Council Regulation 1/2003[6], there has been a decrease of the cases concerning vertical restraints dealt with by the Commission. Given that cases concerning vertical agreements have very often a "national" dimension, these cases have mostly been treated at the national level. According to a rough estimate, they represent a quarter of the draft decisions that have been submitted to the Commission within the European Competition Network ("ECN")[7] since 2004. For instance, while

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6 Council Regulation 1/2003 implementing Articles 81 and 82 of the EC Treaty ("Regulation 1/2003") abolished the system whereby companies had to notify their agreements to the Commission to get an exemption under Article 101 and thus made the parties to an agreement responsible for carrying out the assessment of their agreements under Article 101 ("modernisation"). This Regulation also empowered the national competition authorities to apply Articles 101 and 102 ("decentralisation"). National courts can also apply these provisions directly, for instance in case of actions for damages brought before them.

7 The ECN is a network comprising the Commission and the Member States' competition authorities.

the Commission adopted decisions in a dozen cases concerning vertical restraints in the period 2000-2009, in France the NCA dealt with more than thirty vertical restraints cases under Article 101 in the period 2004-2009.

16. These discussions resulted in the following findings. The enforcement of the EU competition rules on vertical agreements is satisfactory. The Regulation and Guidelines have enabled the authorities to develop a flexible and meaningful enforcement policy on foreclosure and softening of competition, while taking account of possible efficiencies. They have provided a clear analytical framework for companies, thus contributing to legal certainty.

17. Although the principle that a company's market share determines whether the agreement is block exempted or not was a focal point of opposition to the new approach at the time of the consultation on the current Regulation, the introduction of the market share threshold has not caused problems in practice. Also its level of 30% (as a proxy for determining the existence of significant market power) seems to have been well chosen at the time. The Commission's and the national competition authorities' enforcement also shows that the presumptions which led to some practices being categorised as "hardcore restrictions" in the 1999 Regulation are still valid today.

18. Two issues were particularly discussed with the NCAs, namely the need to take account not only of the supplier's market power, but also that of the buyer, in determining whether an agreement should be block exempted, and the scope of the hardcore restrictions to be included in the revised regulation, in particular in the light of the continuous increase in online sales.

19. Regarding buyer power, there was a consensus that market power held and exercised by buyers in the context of vertical agreements can in some circumstances lead to consumer harm. Regarding online sales, there was agreement that with the increased use of the internet as a distribution channel, there is a need to provide more guidance on the circumstances in which restrictions on distributors' use of the internet should be considered as a hardcore restriction.

1.4.2. The Commission's draft Regulation and draft Guidelines as submitted to the national competition authorities and to public consultation

20. Based on the above described experience with the implementation of the currently applicable rules, the Commission prepared a draft Regulation and draft Guidelines, which were discussed at an ECN meeting on 18 and 19 May 2009. They were then approved by the College on 8 July 2009 for the purposes of launching a public consultation. As required by Council Regulation 1/2003, the draft texts were subsequently also submitted to the Advisory Committee on Restrictive Practices and Dominant Positions (i.e., NCAs and responsible ministries of the Member States), which met on 22 July 2009 and marked its support for the draft texts. The draft texts were published for a two month public consultation on the website of DG COMP on 28 July 2009.

(i) Main changes proposed to the Regulation

21. The following summarises the main changes proposed to the Regulation and to the Guidelines as submitted to public consultation in July 2009. The reasons for proposing these changes are explained in detail in Chapter 2 below ("the WHY").

22. The first change proposed is that for a vertical agreement to benefit from the block exemption, not only the supplier's market share – as is the case today - but also the buyer's market share should not exceed the threshold of 30% in the downstream market in which it sells the contract goods. This change responds to the need to tackle anticompetitive agreements resulting from the exercise of market power by buyers (see Chapter 2 below) and also brings the Regulation in line with what has been done since its adoption in 1999 in other block exemption regulations like the technology transfer block exemption regulation[8] and the Commission's "*De Minimis*" Notice[9] .

23. Regarding the treatment of hardcore restrictions, the Commission introduced new language in the recitals, which should make it clearer that companies may present efficiency defences in individual cases involving hardcore restrictions (see below on the Guidelines). This is not a change of substance, but is aimed at better explaining the notion of "hardcore restriction", which has often been confused with *per se* illegality and has thus led to some misunderstanding about the current rules.

(ii) Main changes proposed to the Guidelines

24. Certain changes were proposed to the Guidelines to complement the above-mentioned new language in the recitals, i.e.; to clarify the legal possibility that also hardcore restrictions may fulfil the conditions of Article 101(3).

25. The Commission also proposed to further clarify the circumstances in which restrictions on distributors' use of the internet should be considered as hardcore restrictions. These clarifications respond to the need to update the current rules in the context of increasing online sales. The current competition rules on online sales and a more detailed explanation of the changes proposed in the draft Guidelines are explained in Annex 2 to this Report.

26. In order to reflect the increased attention to buyer power issues, the Commission added two new sections on restraints which are mainly buyer driven. In concrete terms, these sections provide guidance for the assessment of the possible positive and negative effects of two new types of vertical restraints, namely upfront access fees[10]and category management[11].

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[8] Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (OJ L123, 27.04.2004, p. 11), in particular Article 3(2) thereof.

[9] Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community ("de minimis") (OJ C368, 22.12.2001, p. 13-15), in particular paragraph 7(b).

[10] Upfront access payments are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. This category includes various practices such as slotting allowances the so called pay-to-stay fees payments to have access to a distributor's promotion campaigns etc.

1.4.3. *Results of the consultation of the relevant national authorities*

27. In the light of the Commission's above-described earlier meetings and discussions with the national competition authorities, the NCAs expressed large support to the draft revised Regulation and Guidelines. In essence, they confirmed their support to the proposal to make the benefit of the Regulation rely not only on the market share of the supplier, but also that of the buyer. They also considered that the Commission's proposals with respect to the treatment of online sales constituted a reasonable approach. The NCAs also generally agreed with the usefulness of keeping a category of hardcore restrictions and the clarifications proposed by the Commission that in certain circumstances such restrictions can also benefit from an individual exemption.

28. Only for resale price maintenance was there some discussion as to whether it should be treated as a hardcore restriction. Four NCAs questioned this, but the other NCAs considered that RPM should continue to be treated as a hardcore restriction. In their many cases these NCAs have found that RPM leads to negative effects and that efficiencies are rarely argued and when argued have never been established. It was also noted that some Member States still have concentrated markets where the use of RPM would lead to considerable anticompetitive effects which could not be easily remedied if RPM were removed from the list of hardcore restrictions. Some large Member States[12] also reported on empirical evidence pointing to the negative consequences that ensued after RPM was allowed at the national level.[13]

1.4.4. *Results of the public consultation*

29. Following the publication of the draft Regulation and draft Guidelines in July 2009, the Commission received 162 contributions from a wide range of stakeholders, including businesses, consumer organisations, national authorities, academics and the legal community. The comments received have been published on the website of DG COMP at the following address:

    http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html

30. As the NCAs, the stakeholders expressed strong support to maintain in force a system of block exemption and accompanying Guidelines, which is considered to have worked very well or globally well in practice.

31. Two major issues were particularly debated during the public consultation: the extension of the market share threshold to buyers and the treatment of the restrictions on the use of the internet. The first issue was seen as reducing the "safe harbour"

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[11] Category management agreements are agreements by which, within a distribution agreement, the distributor entrusts the supplier (the "category captain") with the marketing of a category of products including in general not only the supplier's products, but also the products of its competitors

[12] In particular, in France the "Loi Galland" prohibiting sales below costs was used by suppliers/retailers to achieve RPM since the costs were defined as the purchase price paid by the retailer mentioned in the invoice (invoice price) without including the rebates acquired later (Loi n°96-588 sur la loyauté et l'équilibre des relations commerciales, 01.07.1996)

[13] See the Report of the expert group to the French Government on the effects of the Loi Galland in the retailing sector. This Report may be found at the following address: http://www.ladocumentationfrancaise.fr/rapports-publics/044000494/index.shtml

provided by the block exemption and bringing about considerable compliance costs for firms, while the second issue sparked conflicting comments between those (mostly brand owners) who would like to have full freedom to restrict their distributors' use of the internet and those that argue that such restrictions harm consumers by preventing the development of new, more efficient means of distribution. Beyond the issue of the treatment of online sales, the Commission's proposed approach to hardcore restrictions was generally welcomed, with only a small minority arguing for a relaxation of the rules on RPM for example. Annex 3 to this Report provides a summary of the main comments made by the stakeholders.

1.4.5. Elaboration and assessment of future options

32. An inter-service steering group was set up for this Impact Assessment Report and met on 30 July 2009, 2 October 2009 and 9 December 2009. A draft of this Impact Assessment Report was submitted to the Impact Assessment Board on 18 December 2009, which met on 27 January 2010. In its opinion dated 29 January 2010, the Board found that while the Report provided a clear presentation of the changes proposed, more evidence should be provided to clarify the nature and the magnitude of the problems identified and the reasons why the initiative focuses on two specific issues (buyers' market power and internet sales). The Board also found that the analysis of impacts on consumers, employment and compliance costs, as well as the proposed monitoring and evaluation mechanism should be strengthened.

33. The Report has been amended in accordance with the Board's comments. Chapter 2 describes in more detail the theories of harm associated with buyers' market power and refers to some industry data and to competition authorities' experience with markets where buyers' market power has been an issue. Regarding online sales, it also develops further the implications of the distinction between active and passive sales in the online context by using some examples of what would constitute active or passive sales online. The Report also discusses in greater detail why a requirement that a distributor have a brick and mortar shop - if agreed between companies not having significant market power - normally does not lead to competition problems but rather benefits consumers overall. In Chapter 4, it is explained why some "high level" policy options have not been retained. Throughout the impact assessment, it is now more clearly stressed that competition policy and rules, including the proposed ones, are about making markets work for the benefit of the consumers. Chapter 6 explains the nature and scope of the compliance costs associated with the policy options concerning buyer power. It should be read in conjunction with Annex 1 to which a description has been added of how the system of a Block Exemption Regulation complemented by Guidelines works in practice. In Chapter 6 the section on the proposed options' impact on employment refers to the Commission earlier findings and to OECD work in this area, which shows that effective and undistorted competition has a positive impact on employment. Finally, in Chapter 9 the monitoring and evaluation mechanism has been strengthened.

34. The draft Guidelines contain a clarification of the current policy in relation to the use by distributors of third party platforms to sell contract products. This clarification was incorporated at the request of stakeholders at a later stage after the meeting with the Impact Assessment Board. This clarification does not result in any negative impact as compared with the baseline scenario and is not subject to any further assessment. Indeed, since under the current rules suppliers are free to agree with their

distributors not only on the appearance but also on the location of the latter's shops (e.g. a supplier may require that its products only be sold in high street shops), they should also be free to agree with their distributors on the location of the latter's "virtual shops" (e.g. a supplier may require its products not to be sold on a third party platform). However, to promote the use of the internet the draft Guidelines ensure that distributors are not prevented from using the services of third party platforms if those services help them to fulfil the conditions agreed with suppliers for the use of the internet.

2. ISSUES TO BE ADDRESSED: – THE "WHY"

35. The current Block Exemption Regulation expires in May 2010, which makes it necessary to examine whether there are any legal, market or other developments that should be taken into account when designing the rules to be applied from that date. Two major developments have marked the ten-year period following the adoption of the current rules: increased attention to, and evidence on the effects of the market power of buyers and an increase in the use of the internet as a sales vehicle.

2.1. Market power of buyers

36. Under the current Regulation, the benefit of the block exemption depends on the supplier not having market power, i.e., on its market share being below 30%. This reflects the fact that previously, there was a tendency in the economic literature to focus on situations in which manufacturers try to influence the behaviour of retailers and impose restraints that may potentially harm competition. Also, in 1999 when the current Regulation was prepared, there was much debate regarding the use of the supplier's market share threshold as the factor determining whether or not an agreement could benefit from the Regulation. Less attention was paid to the possibility that buyers could have and exercise their market power in an anti-competitive way[14].

37. In the last ten years, economic research has increasingly recognised that in reality, vertical restraints need not generally be supplier-led[15]. Rather, in many instances,

[14] The issue of market power of buyers was only addressed in the specific case of exclusive supply agreements. Indeed, according to Article 3(2) of the current Regulation, an agreement containing exclusive supply obligations can only benefit from the block exemption if the buyer's market share does not exceed 30%. However, this is easily circumvented due to the fact that exclusive supply is defined in such a way that there is only one buyer in the whole of the European Union. On a more general level, the current Guidelines also acknowledge that vertical restraints can be used by each level. The Guidelines note that market power of buyers will often increase the negative effects of the restraints

[15] See for example the works of Paul W. Dobson for the European Commission (May 1999) and for the American Bar Association Antitrust Section handbook. (2007). See also Scheelings, Richard and Wright, Joshua D., "*Sui Generis"?* : *An Antitrust Analysis of Buyer Power in the United States and European Union*, 2006. Akron Law Review, Vol 39, NO. 1, pp. 207-243, 2006; George Mason Law & Economics Research Paper No. 05-30.; *The New Kid on the Block: Buyer Power*, Antitrust Institute, in The Next Antitrust Agenda: The American Antitrust Institutes' Transition report on Competition Policy to the 44th President (Albert A.Foer, ed. 2008); Jeanine Miklos-Thal, Patrick Rey and Thibaud Vergé, *Buyer Power and Intra-brand Coordination,* Journal of the European Economic Association (2010); Roman Inderst and Christian Wey, *Buyer Power and Supplier Incentives*, Social Science Research Centre Berlin, (June 2003); James Mellsop and Kevin Councel, *Assessing the Implications of Upstream*

large buyers can also use their buyer power to negotiate or impose restraints on suppliers that may create or extend market power to the detriment of consumers. Of course, such restraints (as in the case of supplier-led vertical restraints) may often have both beneficial and harmful effects.

38. Partly due to the political attention that it has attracted[16], the focus of economic research has mostly been on buyer driven vertical restraints in the retail sector. Concentration has increased in this sector in the last years and while large multi-product chains often account for a high share of a manufacturer's production, the business of an individual manufacturer usually represents a small proportion of business for those chains. Therefore, the role of the restraints that such large retail groups put in place and the harm they may cause to consumers has led to considerable discussions and studies.

39. According to Euromonitor International, in eighteen of the twenty Member States for which data are available, the market shares of the top one, top three and top five grocery retailers (this includes hypermarkets and supermarkets that also sell non grocery goods) increased in the period 2004-2007[17]. Yet in some cases these market shares were already high in 2004: for example in Finland, the top three retailers had a combined market share of 70% in 2004, which increased to 77% in 2007. In fact, this is a long standing trend: from 1993 to 1999 the five-firm concentration in grocery and daily goods retailing rose from 41% to 49% in the EU-15[18]. Most recent Planet Retail (of July 2009) data also suggests that in seven Member States, the market share of the single biggest grocery retailer exceeds or is only slightly below 30%[19]. Competition authorities from 20 out of 23 Member States consider that their retail (food) markets can be qualified as oligopolistic[20].

40. In view of these developments, the OECD organised a roundtable on the buying power of multiproduct retailers already back in 1998 and noted that "*the last twenty years have seen momentous changes in retail distribution including significant increases in concentration and increased reliance, especially in the grocery sector,*

Buyer Power on Downstream Consumers NERA Economic Consulting, Antitrust Insights (Summer 2009); Clarke, R, Davies, S, Dobson, P, and Waterson, M, *Buyer Power and Competition in European Food Retailing*, Edwards Elgar, Cheltenham (2007); Davis, R.W. *Slotting Allowances and Antitrust*, Antitrust (Spring 2001); Chen, Z. *Dominant retailers and the countervailing power hypothesis*. Rand Journal of Economics 34, 4.; Chen, Z. *Monopoly and Product diversity. The role of countervailing buyer power,* Mimeo, Carleton University (November 8, 2003); Ellison, S.F, and C. M. Snyder *Countervailing power in wholesale pharmaceuticals*, MIT Working Paper 01-27 (19 July 2001); Salop, S.C. A*nticompetitive Overbuying by powerful buyers*, Research Paper, Georgetown University Law Centre (2004)

16 See for example the Declaration of the European Parliament on investigating and remedying abuse of power by large supermarkets operating in the European Union of February 2008.

17 Euromonitor International, Country Market Insights, March 2008.

18 Estimates based on data from Corporate Intelligence on Retailing's European Retail Handbook, quoted by Paul W. Dobson "Retailer Buyer Power in European Markets: Lessons from Grocery Supply", 2002. The figures put forward by Euromonitor International are conservative compared with the ones published by Planet Retail, according to which in eight Member States the top five retailers made up more than 70% of the grocery market in 2005 (Planet Retail: Global retail Concentration, 2006.

19 Planet Retail Reports on Grocery Retailing, Country Reports, July 2009.

20 Discussions between the Commission and the national competition authorities on competition in the food supply chain in the context of the European Competition Network, 2008-2009.

on private (i.e. retailer owned) labels. It may no longer be true to regard retailers as basically competitive distributors of consumer goods"[21].

41. Although grocery retailing is the sector that has most been researched as regards the role of buyer power, few large buyers are also present in other sectors. For example, regarding retailing, in an overview of supplier-buyer relations, the French Ministry of Industry noted an increase of buyer power as concerns the specialised distribution of household appliances and sports articles[22]. It should also be noted that buyer power issues do not only arise in the retail sector. In fact, EU competition authorities have studied and/or investigated cases where there have been concerns with regard to the arrangements or behaviour of strong buyers in sectors such as computers (software and hardware), games consoles, diamonds, electricity, gas and petrol, pharmaceuticals, media and TV sports rights. Many of these sectors are among those with the highest concentration levels in Europe[23].

42. As mentioned above, buyer power can both benefit and harm consumers, depending on the circumstances. If the buyer uses its power to obtain a lower purchase price from a supplier, this will normally benefit consumers. Indeed, this puts pressure on the margins of the suppliers, on rival buyers to obtain similar conditions, and if competition is effective downstream, will result in lower prices for the consumer. In this regard, many studies suggest that the strengthening of buyers' bargaining power with respect to powerful suppliers has often benefited the consumers (e.g. in the form of lower prices)[24]. However, these studies also recognise that in some circumstances the increase in the buyers' market power can also have anticompetitive effects[25], namely foreclosure of other buyers and softening of competition. Indeed, a buyer may use its power to incorporate restraints (e.g. exclusivity arrangements) in its agreement with the supplier that will foreclose competing buyers. Softening of competition may occur for example when the same excusive distribution agreements

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[21] OECD Policy Roundtables: Buying Power of Multiproduct Retailers, Executive Summary of the Secretariat, 1999.

[22] Ministère de l'Industrie, de la Poste et des Télécommunications, Les relations entre producteurs et distributeurs de biens de grande consommation, May 1997.

[23] The most concentrated sectors in the EU comprise tobacco and the manufacture of coke, refined petroleum products, nuclear fuels, office machinery, computers, electricity, gas, steam, water, air transport. (Sectoral Growth Drivers and Competitiveness in the European Union, 30 May 2009, Editor: Michael Peneder for the European Commission). The Report by DG Enterprise and Industry on the industrial structure of the EU also shows that the following sectors are those with the highest share of large enterprises: tobacco, communications, motor vehicles, mineral oil refining and nuclear fuel, other transport equipment, air transport, radio and TV equipment, electronic components, electricity, gas and water supply, chemicals, basic metal, office machinery and electrical machinery. (EU industrial structure 2009 – Performance and Competitiveness, European Commission, DG Enterprise and Industry, Enterprise and Industry Magazine). Finally, the following sectors are in the process of consolidation or expected to consolidate: aeronautics, automotive, biotechnology, chemicals, plastics and rubber, defence industries, electrical and electronic engineering,), some business services, lime, the purchase of medical devices and steel (Commission Staff Working Document: European Industry in a changing world, Up-dated sectoral overview 2009, Brussels, 30.7.2009, SEC(2009) 1111 final). This same source also points to existing high concentration levels in the cement industry and for glass (e.g. flat glass), primary aluminium, the space industries and ICT industries (office machinery, computers, radios, televisions and communications equipment).

[24] OECD Roundtable on Monopsony and Buyer Power, 22-23 October 2008. See for example the response of the United Kingdom. See also the study on the Dutch retail sector by CPB Netherlands Bureau for Economic Policy Analysis, April 2008.

[25] OECD Competition Committee Roundtable on Monopsony and Buyer Power, 22-23 October 2008.

are concluded by two main buyers in different parts of the same Member State: since each of them has its own exclusive area, they may be less inclined to enter each other's market. In both cases the result for consumers is reduced intra-brand and inter-brand competition.

43. The same theories of harm (i.e., foreclosure of buyers and softening of competition) can be applied to agreements involving other vertical restraints than those mentioned above, such as resale price maintenance, exclusive customer allocation, quantity forcing on the supplier[26], etc. This is explained in the relevant sections of the Guidelines.

44. In addition to the vertical restraints described in the currently applicable Guidelines, there is a new series of vertical restraints and related conduct that are typically led by buyers, such as refusals to stock or delisting, quantity forcing on manufacturers and the imposition of slotting allowances. Such practices are not intrinsically detrimental to consumers; evidence rather shows that they may have both pro- and anticompetitive effects, depending on the circumstances. As with the other restraints, the draft Guidelines provide methodological tools to assess both their negative and positive effects under Article 101. Evidence shows that both their incidence and magnitude are positively correlated with retailers' market power[27].

45. As mentioned above, competition authorities have investigated vertical restraints involving buyer power in individual cases. In addition, in 2000, the UK Competition Commission analysed more generally the incidence of buyer induced vertical restraints and found that they were widespread. Of the 52 practices identified by the Commission as capable of distorting competition, 42 had effectively been used by major retail chains, 30 of which distorted supplier competition, and 18 of these also distorted retailer competition. Overall, after taking into account potentially off-setting efficiencies, 27 were considered to be against the public interest[28].

46. In view of the above considerations, the fact that the benefit of the block exemption currently only relies on the market position of the supplier in practice means that there is also a "safe harbour" for agreements concluded between suppliers whose market share is below 30% and buyers that have market power and that are thus capable of putting in place vertical restraints that may harm consumers.. The following real-life example illustrates this point: a buyer had concluded exclusive distribution agreements with a number of suppliers, each individually with a market share below 30%. The buyer's market share exceeded 30% and the competition authority had concerns about possible foreclosure at the distribution level. However, the agreements benefited from the block exemption because the suppliers' market shares were below 30%.

47. In such a situation, in order to remedy the problem, the Commission and the competition authorities can only proceed to withdraw the benefit of the block

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[26] Requirements that minimum quantities or percentages of total output be supplied to a particular buyer.

[27] Federal Trade Commission, Report on the FTC Workshop on Slotting Allowances and Other marketing Practices in the Grocery Industry, 2001, *Slotting Allowances in the retail Grocery Industry, Selected Cases in Five Product Categories*, 2003

[28] UK Competition Commission, *Supermarkets: A Report on the supply of groceries from multiple stores in the United Kingdom* (2000)

exemption. A withdrawal decision constitutes a bigger procedural burden than a decision establishing an infringement of Article 101, and has only been used to a very limited extent. Indeed, in a case not covered by the block exemption, the competition authority has to establish an infringement of Article 101(1), after which the firm(s) concerned must bring forward evidence of efficiencies. In contrast, in the case of a withdrawal, the competition authority must not only show that Article 101(1) is breached, but it also has the burden to prove why the presumption that Article 101(3) is fulfilled is not valid in the particular case at hand.

48. More importantly, a withdrawal decision only has effects for the future and the authority cannot sanction (fine) past anticompetitive practices. For the same reason, the victims of anticompetitive practices can also not undertake actions for damages before the courts for past behaviour. In any event, only competition authorities, not the courts, can withdraw the benefit of the block exemption, which deprives complainants from an effective remedy before the national courts. The risk is then that powerful buyers, comforted as they may be by the fact that it is only the supplier's market share that determines whether the agreement is block exempted, are not deterred from including anticompetitive restraints in their vertical agreements. This hinders effective enforcement of Article 101 with regard to vertical agreements that are driven by powerful buyers.

2.2. Increasing sales on the internet

49. The Commission's Report on cross-border e-commerce in the EU, which identifies e-commerce trends and potential cross-border obstacles, was published in February 2009.[29] It provides some useful information on the evolution of online sales compared to other retail channels, the number of the EU online shoppers, and the sectors mostly concerned by this evolution.

50. E-commerce is the second most commonly used retail channel. In the EU 27 in 2008, 51% of retailers made sales via e-commerce. Only direct retail sales were more common, used by 79% of retailers.

51. The e-Commerce Report shows the year-on-year growth rates of retail sales over the review period (2002-2007) across the different retailing channels: internet retailing was by far the fastest developing channel, growing by 45% between 2002 and 2003, though slowing in the following years to about 25% annual growth, still an impressive pace. Annex 4 provides for a more detailed description of the development of e-commerce in the EU.

52. The main finding of the Commission's e-Commerce Report was that while e-commerce is taking off at national level, it is still relatively uncommon for consumers to use the internet to purchase goods or services in another Member State. The main conclusion of the Report is that the gap between domestic and cross-border e-commerce is widening inter alia as a result of cross-border regulatory barriers to online trade such as consumer protection laws, intellectual property and taxation rules.

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[29] Commission Staff Working Document Report on cross-border e-commerce in the EU

53. The Report does not contain information on the barriers created by companies in their distribution agreements which are relevant for policy formulation in the competition field. However, the Commission is concerned that in addition to many regulatory barriers, some barriers set up by companies through vertical agreements - such as web-redirections, or termination of the transaction process once the credit card data reveal an address which is different of the territory where the distributor is located - still prevent EU consumers from accessing and benefiting from goods and services online, wherever these consumers are located and despite the technology available and the growing demand for such goods and services.

54. It should be recalled that the possibility to buy cross border helps to protect the right of consumers and companies to purchase products wherever they want in the EU, subject to the freedom to contract that is also applicable in the EU. Hindrances to cross border sales contained in vertical agreements between, for instance, manufacturers and their distributors are generally considered in the jurisprudence of the European Courts as severe restrictions of competition under Article 101.

55. On the other hand, the development of the internet as a distribution channel may considerably affect the operation of some existing distribution models that include (re)sales restrictions, and so potentially restrictions on sales over the internet, which are in certain circumstances block exempted under the current competition rules. These are (a) exclusive distribution and (b) selective distribution systems which are widely used by companies in the EU and can lead to substantial efficiencies for European consumers.

i) Exclusive distribution

56. One of the distinctive features of the internet as a distribution method is that it allows distributors to reach easier and relatively at low costs customers from a wide geographic area, including customers in areas exclusively allocated to other distributors. The use of the internet may make selling to such customers more efficient, and therefore reduce considerably the protection of the exclusive dealers' investments, which, consequently, may lead to a sub-optimal distribution of products. Given that under the Regulation suppliers can restrict active, but not passive sales to areas (or customer groups) where they operate an exclusive distribution system (see Annex 2), one of the important issues which needs to be addressed in this review is the distinction between active and passive sales in the online context. First, it is important to determine whether this distinction is relevant in the online context and, secondly to further clarify in the Guidelines what restrictions are or are not be covered by the Regulation.

ii) Selective distribution

57. The use of the internet as a distribution channel may result in a free riding problem when consumers use the pre-sales services (showroom, advice, etc.) offered in the brick and mortar shops, but then buy those products over the internet where, if the same or similar pre-sales services are not offered, the price may, as a result, be lower. The free riding problem may lead to sub-optimal provision of pre-sales services necessary to build demand and thereby reduce the performance of the distribution chain. In the run up to the review of the current rules, the Commission was repeatedly asked for explicit guidance as to the question whether under the

Regulation a manufacturer may require, as a selection criterion, its distributors to have a brick and mortar shop to allow consumers to taste/feel/experience the product, thereby excluding internet-only distributors from their distribution network. The importance of this question is reflected in the numerous comments it sparked during the public consultation on the draft Regulation and Guidelines (see Annex 3).

58. A proper assessment of the vertical restraints used in the online context, in particular with regards to exclusive and selective distribution, should allow the Commission to address the concern of "private" barriers to online trade in a broader "Digital Agenda" of the Commission, which aims at promoting the internal market on the internet, while at the same time encouraging efficient distribution in the EU.

59. Having regard to all the issues examined above and the results of the public consultation, the Commission now has to take position regarding the most appropriate legal framework which should apply to vertical agreements following the expiry of the Regulation. To this end, the present Impact Assessment Report identifies the relevant objectives (see Chapter 3) and proposes a number of possible options to achieve these objectives (see Chapter 4). On the basis of a set of impact assessment criteria (see Chapter 5), it carries out a comparative analysis of the costs and benefits of each option in respect of these assessment criteria (see Chapter 6) with a view to determining the preferred option (see Chapter 7).

3. OBJECTIVES – THE "WHAT"

3.1. General objectives of the review

60. In the wider context of achieving an integrated internal market, the general objective of EU competition rules is to make markets develop, for instance thanks to new technologies such as the internet, and function for the benefit of consumers. The Commission's policy towards vertical agreements, as embodied in the current Regulation, is to ensure undistorted and effective competition in European supply and distribution so that consumers can benefit from the lower prices, increased quality and variety of products and services and the greater incentives to innovate that are delivered by competitive markets.

61. Since the current Regulation lapses in 2010, the Commission must analyse whether and how, keeping in mind the above objectives, it should be revised. The legal and factual background to the competition rules is not static, and the review should in particular address the two above-identified major developments that have marked the ten-year period following the adoption of this Regulation in 1999.

3.2. Specific objectives concerning the market power of buyers

62. As has been described in Chapter 2 above, buyer market power linked with vertical restraints can lead to anti-competitive foreclosure and softening of competition, i.e., to a restriction of competition that harms consumers. In this regard, there are two specific objectives pursued by this review:

63. First, the review should enable the Commission, the NCA and national courts to take effective enforcement action s against vertical restraints linked with the exercise of market power of buyers.

64. Secondly, the review should allow deterring powerful buyers from concluding agreements which include anti-competitive vertical restraints

3.3. Specific objectives concerning the increasing sales on the internet

65. In the light of the issues identified in Chapter 2, there are two specific objectives pursued by this review.

66. First, in the context of exclusive distribution, it is particularly important to strike the right balance to allow on the one hand European consumers to fully take advantage of the internet to overcome geographic barriers, and on the other hand to allow manufacturers to prevent free riding between distributors and distribution formats, and to achieve other efficiencies in order to help them improving the distribution of their products for the benefit of consumers overall.

67. Secondly, in particular in the context of selective distribution, it is particularly important to strike the right balance between the need to impose conditions on distributors and in particular to have a brick and mortar shop, notably to prevent free riding from internet-only-shops, and the consumers interests of benefitting from new online forms of distribution.

4. POLICY OPTIONS – THE "HOW"

4.1. Identification of the "baseline" scenario

68. No NCA and less than a handful of the more than 160 stakeholders that reacted in the public consultation proposed that there should be no block exemption regulation at all (the "no EU action" option).

69. Although the main historical reason for introducing a block exemption regulation (i.e. to avoid repetitive notifications) has disappeared, there is a consensus across the stakeholders that:

    (i) A block exemption regulation provides more freedom and legal certainty for companies to enter into vertical agreements and is justified where the risk of harm to consumers is low;

    (ii) A block exemption regulation frees competition authorities' resources to deal with the most harmful agreements, i.e. those concluded by companies that have significant market power

    (iii) A block exemption regulation combined with guidelines provides guidance to businesses that need to assess by themselves the compatibility of their agreements with the EC competition rules

(iv) Also, a block exemption regulation combined with detailed guidelines provides a common framework for the NCAs and for the courts, which contributes to a European-wide level playing field. Indeed, a block exemption regulation is binding not only on the Commission, but also on the NCAs and the national and Community courts, and even though guidelines are in principle binding only on the Commission, other authorities generally refer to them. Through its regulations and guidelines the Commission establishes the policy in the field of vertical agreements, and under Regulation 1/2003 the Commission is responsible for ensuring that the EU competition rules are consistently applied by the NCAs.

70. In view of the overall positive experience with the Regulation and the broad support from stakeholders (see Annex 3) and NCAs to keep a block exemption regulation, it can safely be concluded that not having a block exemption regulation and guidelines at all is not a sound policy option. Therefore the baseline scenario is to have the Block Exemption Regulation, complemented by Guidelines in uncharged form. Chapters 6 and 7 assess the impact of making changes to only some parts of the regulation and the Guidelines, including the impact of leaving those particular parts unchanged.

4.2. Other scenarios

71. For the reasons explained in the Introduction, this impact assessment concentrates on policy options relating to the issues of buyers' market power and online sales. Another set of options could theoretically be considered, but have not been retained (and have thus not submitted to a fully-fledged impact assessment) either because there was no demand for them, or because they were not feasible in the light of the case law.

72. This is the case of the option not to have any block exemption regulation at all, which was not considered for the reasons mentioned above, in particular the fact that virtually no stakeholder suggested it.

73. Similarly, while there was a lot of discussion on what restraints especially in the online context should be treated as hardcore restrictions (see the options assessed in Chapter 7), there was only limited debate on whether in general it is still meaningful to define certain practices as hardcore restrictions. For some restraints, this would not even be legally possible. For example, there is constant case law according to which restrictions of passive sales (parallel trade) are hardcore restrictions. For other restraints, the Commission's and the NCAs' enforcement over the years shows that the presumption that in general they have negative effects which are not outweighed by positive effects is correct[30]. Therefore the existence of such a category is consistent with an effects based approach, and the option of having a Regulation without a category of hardcore restrictions was not considered appropriate.

74. Also, although in 1999 the 30% market share threshold was a very contentious issue, its use is generally accepted by the stakeholders, including firms that originally complained about the costs in terms of legal analysis associated with defining the

[30] See for example the discussion on RPM in Chapter 1 and Annex 5

supplier's market share and by academia who criticised the threshold as being a too rough and simplistic estimate of the existence of market power. In reality, both the threshold and its level have proved to be practicable across sectors and practices.

75. While a very limited number of sectors still have their own block exemption regulations, there has been no need to devise special rules (with for example different market share thresholds) to accommodate specific sectors or to tackle specific forms of restraints. On the contrary, the policy trend towards an effects-based rather than form based approach and towards generally applicable rules has continued and accelerated in the last ten years (see Annex 1). The proposed policy options are consistent with this overall policy trend.

76. The same considerations apply to the proposal to take account of the buyer's market share. In the public consultation, the Commission proposed that the same threshold of 30% be applied to suppliers and buyers. This is because a buyer in a vertical agreement is also a supplier in the downstream market(s) and it is in these downstream market(s) that any negative effects on consumers are felt. There is also no compelling reason to consider that competition problems such as foreclosure or softening of competition will be triggered at different levels for manufacturing than for distribution. Competition authorities' experience with enforcement also shows that a market share above 30% will usually be a clear indication that the buyer has a significant degree of market power and can use it to put in place anticompetitive restraints. Although the principle of taking into account the buyer's market share in determining the scope of the block exemption raised criticisms about increased compliance costs similar to those expressed in relation to the supplier's market share in 1999, the vast majority of stakeholders did not comment critically on the proposed level of the threshold.

77. Finally, as with supplier-led vertical restraints, it would not make sense to have a sectoral approach to competition issues stemming from buyers' market power. As has been noted in Chapter 1, vertical agreements are pervasive, and markets defined for competition law purposes do not necessarily mirror sectoral definitions made for other, for instance statistical, purposes. As explained in Chapter 2, there can be buyer power at all levels of the supply and distribution chain, and the variety of the forms of vertical restraints is such that it is neither practical nor appropriate to take account of buyers' market power only as regards some of them (e.g. only exclusive supply or distribution arrangements). It would also not be meaningful to have a form based approach to buyer power issues, but an effects-based approach to supplier power issues. In a particular case the restraint can be instigated by either the supplier or the buyer or by both of them[31], and what matters under Article 101 is the detrimental effect on consumers.

[31] For example, exclusive distribution, in addition to possible efficiency related reasons, may be induced by the supplier in order to segment markets so as to be able to levy higher prices in some of them, but it may also be imposed by important buyers who want to shield themselves from competition from other buyers

4.3. Identification of the Policy Options to be assessed

78. The following policy options have been identified in relation to the two main issues identified in Chapter 2.

4.3.1. Policy Options concerning the market power of buyers

79. Three policy options are discussed below. The first two entail that the benefit of the block exemption should not only depend on the supplier's market share not exceeding 30%, as is the case today, but also on the buyer's market share not exceeding 30%. The first option suggests looking at the buyer's market share in the downstream market in which it sells the contract goods and services, while the second option focuses on the buyer's share in the upstream market in which it purchases the contract goods and services. The third option is the baseline scenario i.e., the benefit of the block exemption would continue to depend on the supplier's market share only (as is the case currently).

i) Policy option 1: Making the benefit of the block exemption depend on the buyer's market share in the downstream market

80. This policy option was the one proposed by the Commission in the draft Regulation and Guidelines that were submitted to public consultation. It entails that the Regulation be modified to the effect that agreements between a supplier and a buyer, if the latter's market share exceeds 30% in the downstream market no longer benefit from the block exemption, even if the supplier's market share is below 30%, and thus that the legality of such agreements is assessed on a case-by-case basis. Below this threshold, just like with the market share of the supplier, it can be presumed that the agreements in question in general will satisfy the conditions of Article 101(3) and can thus safely be block exempted.

ii) Policy option 2: Making the benefit of the block exemption depend on the buyer's market share in the upstream market

81. This policy option is formulated taking into account the results of the public consultation, in particular the criticism expressed regarding policy option 1 (see Annex 3). Like policy option 1, it entails that the Regulation be modified to the effect that agreements between a supplier and a buyer no longer benefit from the block exemption, even if the supplier's market share is below 30%, if the buyer has a certain degree of market power (i.e., a market share exceeding 30%). However, instead of looking at the buyer's market share in the downstream market, this policy option would take account of the buyer's market share in the upstream market in which it purchases the contract goods and services.

82. The legal consequences would be the same as for policy option 1, namely that (i) if the buyer's market share in this upstream market exceeds 30%, the legality of the agreements is assessed on a case-by-case basis and (ii) where the buyer's market share in this upstream market does not exceed 30%, it can be presumed that the agreements in question in general will satisfy the conditions of Article 101(3) and can thus safely be block exempted.

iii) Policy option 3: Making the benefit of the block exemption depend on the supplier's market share alone (baseline scenario)

83. This policy option entails that the benefit of the block exemption would continue to apply in all situations where the supplier's market share does not exceed 30% whatever the market share of the buyer - with the exception of exclusive supply for which the benefit of the block exemption is already conditional upon the market share of the buyer not exceeding 30%[32].

4.3.2. Policy Options concerning sales on the internet

84. Since there are two main issues in relation to online sales, there are two sets of policy options in relation to these two issues.

(i) Delineation between active and passive sales for the internet

a) Policy option 1: Keeping the distinction between passive and active sales for the internet as it is in the current Guidelines

85. According to this policy option, the distinction between passive and active sales in the context of the internet is kept as it is in the current Guidelines with no modifications (baseline scenario). According to the Guidelines, having a website and selling the products to consumers through that website without previously soliciting them is a form of passive selling. On the contrary, the use of the internet to target a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory (on this distinction in the current Guidelines, see Annex 2).

b) Policy option 2: Keeping and refining the distinction between passive and active sales in the context of the internet

86. According to this policy option, which was proposed in the draft Guidelines that were submitted to public consultation, the Commission elaborates further on the criteria used for the distinction between active and passive sales with the aim to identify the most common practices to be considered as restrictions of passive sales, which generally infringe Article 101(1). The draft Guidelines make it clear that practices such as imposing web-redirections, limitations of the proportion of overall sales made over the internet, dual pricing, etc. are restrictions of passive sales which infringe Article 101(1) (see point 52 draft Guidelines). In the proposed Guidelines, in addition to a general definition of active sales, the Commission also provides for some concrete examples of active selling. For instance, paying a search engine or online advertisement provider to have advertisement displayed specifically to users in a particular territory is active selling into that territory.

c) Policy option 3: All restrictions on the use of the internet are hardcore restrictions

[32] Exclusive supply is however defined in a very narrow way in the current Block Exemption Regulation in that it covers situations where there is only one buyer in the whole of the Community.

87. Another option would be to state that any restriction of online sales infringes Article 101(1). In practice, this would mean that unless they show efficiencies on a case by case basis, suppliers would not be able to use exclusive distribution in an online context since even restrictions of active sales, i.e., those which are specifically targeted at a customer group or customers located in an exclusive territory, would not be block exempted and would infringe Article 101(1).

d) Policy option 4: No hardcore restrictions in the context of the internet

88. Since some stakeholders argued that the use of the internet should be rather considered as a form of active selling (see Annex 3), another policy option would be to block exempt all the restrictions of the use of the internet beneath the applicable 30% market share threshold.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

a) Policy option 1: Block exemption of the requirement for distributors to have a brick and mortar shop

89. This policy option, which was chosen in the draft Guidelines that were submitted to public consultation and also in the now proposed Guidelines, maintains the existing rule according to which selective distribution in general, and therefore also the requirement for dealers to have a brick and mortar shop, is block exempted beneath the applicable 30% market share threshold (baseline scenario).

b) Policy option 2: Block exemption of the requirement for distributors to have a brick and mortar shop and the requirement for distributors to limit the proportion of overall sales made over the internet

90. Another policy option was proposed by some stakeholders, in particular the brand owners (see Annex 3). According to this option, in addition to a block exemption of the requirement to have a brick and mortar shop, the suppliers should also be allowed to require their selected dealers to limit the proportion of overall sales made over the internet. Another possible sub-option is to block exempt the practice of "dual pricing" by which a supplier requires the distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line. This sub-option will lead to similar impacts as the proposed option of limiting the proportion of overall sales made over the internet and therefore will not be assessed separately.

c) Policy option 3: No benefit of the block exemption for the requirement for distributors to have a brick and mortar shop

91. The last policy option was proposed by other stakeholders, especially the online platforms (see Annex 3). They questioned the indispensability of the physical presence for the distribution of many types of products, and on this basis concluded not to block exempt the requirement to have a brick and mortar shop.

5. ANALYSIS OF IMPACT: IDENTIFICATION OF ASSESSMENT CRITERIA AND METHODOLOGY

92. The present Impact Assessment relies on a selected set of assessment criteria which are relevant for appraising the comparative advantages and disadvantages of each option both in relation to the general and specific policy objectives mentioned above in Chapter 3

93. The Commission first assesses the economic impacts of each option starting with the wider economic impacts. Regarding the market power of buyers, there is an assessment of the contribution of each option to more effective competition law enforcement and deterrence of anticompetitive practices so that European supply and distribution becomes or remains competitive and not plagued by distortions of competition. Regarding internet sales, the impacts are assessed from the point of view of their contribution to allowing European consumers' to fully take advantage of the internet to overcome geographic barriers and to benefit from new forms of distribution and at the same time allowing manufacturers to prevent free riding between distributors and distribution formats, and to achieve other efficiencies to the benefit of consumers overall.

94. The Commission then assesses the economic impacts at the level of individual companies, in particular the effects on SMEs, and the compliance cost borne by them. Under "Impact on consumers" the Commission further addresses the effects on consumers of the identified policy options.

95. A fourth set of criteria examine the impact of each option on public administration and the implications on the Community budget.

96. Finally, the present Report takes also into account other more general impacts, such as social and environmental impacts.

6. IMPACT ASSESSMENT OF THE POLICY OPTIONS RELATED TO THE EXERCISE OF MARKET POWER BY BUYERS

97. This section sets out the Commission's assessment of the positive and negative impacts of the three policy options related to the exercise of market power by buyers.

6.1. Economic impacts

6.1.1. Effective and undistorted competition in European supply and distribution through effective competition law enforcement and the deterrence of anticompetitive practices

98. In view of the continuous increase in concentration and the possible effects of the market power held by buyers, Policy Option 1 would make the benefit of the block exemption depend not only on the supplier's but also on the buyer's market share. The impact of this policy option would be to allow the Commission, the NCAs and the courts to effectively remedy any anticompetitive agreement where the buyer's market share in the market where the buyer sells the contract goods or services exceeds 30%.

99. The impact of Option 1 would also be that not only suppliers, as is the case today, but also buyers who hold market power would have to assess whether their agreements with suppliers contain provisions whose restrictive effect on competition is such that it is not outweighed by the efficiencies that they may bring, i.e. whether their agreements are consumer welfare reducing or enhancing. Buyers would be encouraged to do this self assessment and refrain from conduct that harms consumers in the knowledge that the Commission, the national competition authorities and the courts may take action and sanction (fine) such agreements. This should deter anticompetitive conduct on the part of strong buyers.

100. Option 1 does not, however, entail a negative presumption against buyers' market power as such, since it just means that where the buyer's markets share is above 30%, its negative and positive effects will be assessed on a case by case basis. As explained in Chapter 1, the burden of proof that the agreement breaches Article 101 is on the prosecutor, i.e., the Commission (or the NCAs). This means that Option 1 does not refrain businesses, whether large or small, from developing contracting models that boost the efficiency of European supply and distribution as long as they do not harm consumers.

101. Policy Option 2 would essentially have the same impact as Option 1 in terms of empowering the Commission, the NCAs and the courts to effectively deal with buyers' market power and deterring buyers from using their power to the detriment of consumers. The difference with Option 1 is the market that is taken into consideration in determining the market share of the buyer.

102. The downstream market share of the buyer is the most precise criterion when assessing whether consumer harm is likely to result from a vertical agreement, because strong buyer power upstream can also result in a pro-competitive outcome from the point of view of the consumers. This is because a strong buyer can get a better deal from a strong supplier, and if the downstream market is competitive, the buyer will be compelled to pass on any resulting benefits to the consumers.

103. However, restrictions imposed by buyers that have purchasing power in the procurement market can also prejudice consumers. Such prejudice results from the foreclosure of both suppliers and other buyers and from collusion among strong buyers (e.g. where buyers benefit from large exclusive distribution areas). In any event, buyer power in the procurement market is often closely linked with market power on downstream markets[33]. For example a distributor which purchases 40% of the products on the procurement market will often have a 40% market share on the downstream market where it resells the products. Where an intermediate product such as steel has multiple uses, it is difficult to see how a buyer with a strong position in a particular downstream market, such as cars, but having only a small position as purchaser on the steel market, can use its purchasing agreements to foreclose other car manufacturers from having access to the steel market. Hence the upstream market share can be expected to be a reasonable proxy for the buyer's

[33] See Dobson: "Chapter 4: Buyer Driven Vertical Restraints" in the Pros and Cons of Vertical Restraints, Konkurrensverket, Swedish Competition Authority, 2008: "[…], *a further reason for emphasising consideration of the impact of buyer-driven restraints in sectors like retailing is that buyer power often goes together with seller power*, *with the exercise of one offering the prospect of reinforcing the other*, *and vice-versa*".

market power downstream and to allow removing the benefit of the block exemption from agreements that are most likely to have harmful effects.

104. Contrary to Policy Options 1 and 2, Policy Option 3 (baseline scenario) makes the block exemption extend to agreements where the supplier may have a market share below 30%, but the buyer may have significant market power and use its power to impose anticompetitive restraints.

105. Under Option 3, the only way the Commission or a national competition authority could address such a situation would be to withdraw the benefit of the block exemption regulation with respect of the agreement in question. Courts, on their part, cannot withdraw the benefit of the block exemption, which undermines firms' access to justice. As explained in Chapter 2, a withdrawal decision constitutes a bigger procedural burden than a decision establishing an infringement of Article 101.Also, and more importantly, a withdrawal decision only has effects for the future and the Commission cannot sanction (fine) past anticompetitive practices. This falls short of providing the deterrence achieved with Options 1 and 2 which remove the “safe harbour” in the case of agreements concluded with powerful buyers and thus make them responsible for assessing the compatibility of their agreements with Article 101.

106. The risk is then that in their dealings with suppliers that lack market power powerful buyers may more frequently impose restraints which result in harm to consumers. Since vertical agreements are pervasive, the risk of being caught by an antitrust authority is rather low unless the supplier lodges a complaint before the latter. In the presence of powerful buyers that act as “gatekeepers” to the retail market, less powerful suppliers rarely dare complain to the competition authorities for fear of retaliation, namely that the buyer turns to other suppliers. Option 3 therefore entails a risk that competition is distorted by powerful buyers to the detriment of consumers.

6.1.2. Impact on companies, in particular SMEs and the compliance costs borne by them

107. Where an agreement is not covered by the block exemption, the companies must make a self-assessment of its compliance with Article 101, i.e. assess its negative and positive effects. This entails certain costs, which were the main argument that was put forward against Option 1 during the public consultation (see Annex 3).

108. However, it is important to assess the scope and nature of these costs. Indeed, they only concern a certain category of companies. Firstly, small and medium sized buyers are unlikely to possess market shares of the level that would make the agreements concluded by them to fall outside the benefit of the block exemption. On the contrary, they have all to gain from the Commission having more effective means to redress practices involving powerful buyers that negotiate with their suppliers terms that foreclose other, less powerful buyers, and from such conduct being deterred as a result of it no longer being covered by a block exemption.

109. Secondly, if the buyer's market share is below 30% the agreement will benefit from the block exemption (provided that the supplier's market share is also below 30% - if it is not, then the agreement is already not covered under the current rules, so there are no "additional" compliance costs). Thirdly, parties to an agreement where the buyer's market share exceeds 30% will only have to assess the agreement if it

contains restrictions of competition in the first place. If no restrictions are included, then the agreement will not be caught by Article 101.

110. In other words, it is only when one or both parties' market share exceeds 30% and the agreement contains restrictions of competition that it is in the parties' interest to self assess its compliance with Article 101, either by their in-house lawyers or by external legal counsel so as to avoid a situation where the Commission or an NCA would find that the agreement breaches Article 101 and accordingly could sanction them. This is where certain compliance costs will arise.[34]

111. Two types of costs can be identified. The first type relates to the need to estimate the parties' market share, the second to the need to review existing agreement in order to assess whether they contain restraints that should be removed in order to ensure compliance with Article 101. Regarding the former, it is mainly an issue for companies whose market share is close to 30%. It will normally not be an issue for small companies given that 30% is a high market share. Also, large companies, whether sellers or buyers, can usually be expected to know or have an accurate estimate of what their share of the market is.

112. As highlighted by stakeholders, there may however be some practical problems if the supplier uses the same distribution agreement with respect to several buyers or several goods and services, and the buyers sells the contract goods and services in a multitude of downstream markets, some of which may be national or local. In some markets the buyer's market share may not exceed 30% while in others it could.

113. Regarding the second type of costs, the Guidelines assist the companies in assessing the vertical restraints included in their agreements. It should be recalled that even where the 30% threshold is exceeded and the agreement falls outside the block exemption, there is no presumption that the agreement violates Article 101: indeed, the forces of competition at play may still be such that the company eventually does not have enough market power that could be exercised to the detriment of consumers, for instance because of countervailing supplier power, or low entry barriers into the downstream market. Companies will usually be well aware of such structural market conditions, and in the context of evaluating the currently applicable competition rules, the Commission noted that firms seem to be comfortable with assessing for themselves whether their agreements are likely to be caught by Article 101[35].

114. The above considerations largely apply also to policy option 2. Option 2, by narrowing the scope of the safe harbour and forcing companies to self assess the compliance of their agreements under Article 101 would undoubtedly also involve compliance costs, but compared with policy option 1, those costs are likely to be

[34] Although compliance costs was also a concern at the time when the current Regulation was adopted, no stakeholder – at the time or since then - has however been able to provide reliable quantitative information on these costs. Since no relevant data thus exists either at the micro or the macro level, the Commission cannot quantify the compliance costs borne by companies following the introduction of the 30% threshold for sellers in 1999 or the additional compliance costs that would arise from Option 1.

[35] Commission Staff Working Paper accompanying the Communication from the Commission to the European Parliament and Council - Report on the functioning of Regulation 1/2003 (COM(2009)206 final)

significantly lower. This holds true both with respect to alleged difficulties in knowing/establishing the market share of the buyer and the costs associated in having to review existing distribution agreements. This is why a series of respondents to the public consultation in fact suggested that the Commission look at the market power of the buyer in the upstream market.

115. First of all, this upstream or purchase market at hand is known by both the supplier and buyer, which means that the supplier need not be concerned about the buyer's market position in the possibly many product and geographic markets for which it incorporates or where it resells the procured products. Secondly, the upstream market in which the buyer purchases the contact goods and services can in most cases be expected to be wider than the downstream market(s) in which he acts as a seller. The wider the market, the more companies it may include and the smaller the likelihood that companies have high market shares Thirdly, it follows that the parties will know or be able to reasonably estimate the position of the buyer in the procurement market. Fourthly, since it will be rather straightforward for the supplier and buyer to detect situations where the buyer's market share threshold of 30% is exceeded, it will also be easier to detect those agreements that may include restraints that necessitate an assessment under Article 101 and that may therefore have to be reviewed to bring them in compliance with that Article.

116. Option 3 (baseline scenario) would not change the current situation with regard to compliance costs and is therefore more favourable to companies from this point of view. However, it does not shield smaller buyers, in particular SMEs, from anticompetitive conduct aimed at foreclosing them, such as exclusive dealing arrangements. It therefore leads to higher costs for SMEs to protect themselves against anticompetitive practices by others.

6.2. Impact on consumers

117. Competition policy and enforcement is about ensuring that the competitive process is not distorted because that process is considered to deliver the best outcomes for consumers in terms of price, quality, product variety, choice and innovation. Competition policy is therefore about preserving consumer welfare.

118. Thus all that has been said in the above section that dealt with wider economic impact of the considered policy options also applies when assessing the impacts of the policy options on consumers. The possible harm to consumers associated with the exercise of buyers' market power has been described in Chapter 2. By allowing effective competition law enforcement and deterring anticompetitive agreements Option 1 protects consumers from the adverse effects of the anticompetitive exercise of market power by buyers.

119. The following operational example shows the way in which buyer induced restraints can harm consumers, and which Option 1 would allow to address. The example concerns upfront access payments, which are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant

period, in order to get access to their distribution network[36]. While up-front access payments most often represent a normal and acceptable remuneration for a service provided, the more market power the buyer has, the bigger the risk that they may result in anticompetitive foreclosure of other distributors, in particular when the buyer can require payments of such magnitude that they induce the supplier to channel its products through it only or a limited number of large distributors. Such upfront access payments are likely to increase the price charged by the supplier for the contract products since the supplier must cover the expense of those payments. Higher supply prices may then reduce the incentive of the retailers to compete on price on the downstream market. If these effects materialise, the outcome is detrimental to consumers.

120. Again, by and large Option 2 is expected to have the same positive impact on consumer welfare as Option 1. Option 1 may be a more direct way of addressing the issue, given that generally vertical restraints will affect consumers if the buyer not only has bargaining power with respect to the suppliers, but also has market power as a seller. However, as has been mentioned above, in many if not most circumstances, the upstream market share may be expected to be a reasonable proxy for the buyer's market power downstream.

121. Contrary to Options 1 and 2; under Option 3 (baseline scenario) the Commission could not effectively remedy and sanction anticompetitive practices, such as in the above example, if the supplier's market share is below 30%. Yet here it is the buyer's market power that is of significance as this type of practices can normally only be instigated by powerful buyers. The same applies for all other types of buyer led conduct, such as exclusive supply obligations and category management.

6.3. Impact on public administration and the Community budget

122. Options 1 and 2 have the potential of triggering more alleged cases of anticompetitive conduct being brought to the Commission's attention, whether through formal complaints or other data submissions or information gathering. However, in the light of the reduced number of cases involving vertical restraints that have been investigated by the Commission since the adoption of the current Regulation and in particular the implementation of Regulation 1/2003, no such increase is expected that would require a major shift or increase of existing administrative resources. Therefore, no impact on the Community budget is expected.

123. Given that vertical cases are mostly dealt at the national level, Option 1 could entail a greater workload for national competition authorities. This in fact is known to them and was discussed in the ECN meeting of May 2009, but it was not considered to be an obstacle outweighing the merits of Option 1 by any national competition authority. The issue was raised by one national competition authority that has to take a formal decision in each case that is formally lodged before it. At the same time that competition authority was particularly supportive of Option 1 in that it had been

[36] The draft Guidelines contain a new section allowing companies to self-assess these practices, as well as some other buyer-led practices, in particular category management agreements.

faced with cases involving buyer power earlier, which Option 1 would have allowed to deal with in a more straightforward and effective manner.

124. Option 2 may also entail an increased workload for national competition authorities. However, this risk is smaller than in the case of Option 1 given the fact that there is likely to be much less discussion about the market position of buyers in regional or local markets. To the extent that some procurement markets encompass several Member States, national competition authorities may also wish to refer cases to the Commission, e.g. on grounds of the usefulness of the Commission setting a precedent. Regarding both Option 1 and Option 2, the majority of national competition authorities have their own procedures and criteria for priority setting, which means that just like the Commission, they may decide to refrain from an in-depth investigation and from taking a formal decision, for example if the case at hand does not involve an appreciable restriction on competition, etc. This allows them to manage their workload and make their enforcement more effective. These considerations also apply to vertical restraints.

125. In terms of workload, Option 3 (baseline scenario) is not a neutral option either, because in order to address anticompetitive restraints set by powerful buyers, if the market share of the supplier is below the 30% threshold, a withdrawal decision is necessary. As has been explained in Chapter 2, such a withdrawal decision entails a more burdensome procedure for the Commission and the national competition authorities than where an agreement is not covered by the block exemption.

6.4. Other impacts: social and environmental impacts

126. The impact of Option 1 and Option 2 in terms of employment and social issues as well as the environment are not measurable. None of the identified options has any apparent adverse effects in this regard.

127. As noted in the Commission Communication on restructuring and employment[37], vigorous application of the competition rules significantly contributes to long-term growth and employment, and helps bring about better products and services. The same Communication notes that although the restructuring of enterprises is often seen as an essentially negative phenomenon, and its immediate effects on employment or working conditions are highlighted in most cases, restructuring is essential to the survival and development of enterprises. Indeed, competition in the internal market promotes prosperity and lasting employment, since it is the main driving force behind innovation, the creation of new products and services and economic revival.

128. The OECD has also discussed the positive link between competition and employment. Empirical evidence shows that differences in competitive pressures have played an important role in explaining the variation in economic performance across OECD countries, and indicates that reforms that enhance competition have positive effects on employment performance. The effect is however not straightforward and depends on the characteristics of the labour market, and there

[37] COM(2005)120, 31.5.2005.

may be short term adjustment issues.[38]. Since Option 1 and 2 allow preserving effective and undistorted competition in European supply and distribution, they should have an overall positive effect on employment.

129. Undistorted competition between firms is positive for creating a competitive economy which will be more able to face the environmental challenges. To this extent the latter are best met by Options 1 and 2.

7. IMPACT ASSESSMENT OF EACH POLICY OPTION RELATED TO INTERNET SALES

130. This section sets out the Commission's assessment of the positive and negative impacts that the identified policy options would be likely to have if implemented.

7.1. Economic impacts

7.1.1. Impact on effective competition

(i) Delineation between active and passive sales for the internet

131. Policy option 4 would block exempt all kind of restrictions of sales over the internet, including the situations where the consumer takes the initiative (i.e., traditionally considered in competition law as passive sales). This option would lead to more market segmentation/price discrimination to the detriment of the consumers because suppliers would be free to require their distributors not to sell to customers located outside exclusively allocated territories even in the situations where the customers take the initiative (i.e., passive sales). Therefore, practices such as for instance imposing web re-direction according to the territory where the consumer is located would be block exempted. This would seriously undermine the single market.

132. Furthermore, there is also a legal obstacle to such a policy option. As mentioned above, restrictions of consumers' and companies' right to buy cross border are generally considered in the jurisprudence of the European Courts as severe restrictions of competition under Article 101. For these reasons, this policy option is not a realistic and legally sound one, and will not be subject to further assessment of its impacts on consumers, public administration, SMEs, etc.

133. Policy option 3 would not allow any restriction on online activity of the distributors and would therefore undermine the very rationale of exclusive distribution even in the absence of significant market power of supplier and buyer. Indeed, in an exclusive distribution agreement the supplier agrees to sell his products only to one distributor for resale in a particular territory. At the same time the distributor is usually limited in selling into other exclusively allocated territories. When the supplier does not have significant market power, i.e., its market share is below 30%, restrictions aimed at protecting its exclusive distributor from active sales from other distributors, such as direct visits, mails or targeted advertisement are block exempted. This is because it is presumed that in the absence of significant market power the pro-competitive effects of exclusive distribution are likely to offset any anticompetitive effects. Indeed, because exclusive distribution can lead to

[38] OECD Economic Outlook 2002, Product market competition and economic performance.

efficiencies, such as preventing free riding between distributors and compelling them to make investments in their allocated territories, a supplier may restrict its distributors from actively selling into each others' territories. In general, the case for efficiencies is stronger for new and complex products where important investments made by the distributors are required to sell those products and where the risk of free riding is higher. However, to avoid market partitioning and preserve the freedom of distributors to supply parallel traders, restrictions on the passive sales of distributors (i.e., sales that result from the buyer taking the initiative of contacting the distributor) are hardcore restrictions which cannot be block exempted.

134. The development of e-commerce does not change the economic logic of exclusive distribution, i.e., the need to protect exclusive distributors which make important investments from active selling of other distributors. This means that a stricter treatment of the restrictions on online sales as compared with off-line sales is not warranted in the context of exclusive distribution.

135. In fact, in the online context, there is a greater need to protect exclusive distributors from active sales by other distributors since the use of the internet may make active selling easier, and therefore reduce considerably the protection of the exclusive dealers' investments. Experience and empirical data show that the internet allows dealers to actively prospect, promote, and sell their products into wider territories, which may include territories exclusively allocated to other dealers and this active selling can often be often more efficient than the possibilities offered in the off-line world. For instance, an advertising technique which consists of sending electronic messages to individual customers may achieve better results than the equivalent technique in the offline world. More information and empirical data on this point can be found in Annex 3.

136. Internet may also make passive selling easier. Indeed, the use of the internet allows consumers to visit the websites of different distributors, to compare prices and to order products without physically visiting the distributors' shops. This can put some additional pressure on exclusive distributors, in particular where there is important price differentiation across different territories. This is a positive effect of the internet since it frustrates market segmentation. On the other hand, where prices across different territories are rather homogeneous, consumers normally do not actively seek to buy cross-border. In this latter scenario, in order to be found on the web in a particular region or by a particular customer group, a company will usually have to undertake many additional efforts that would be defined as active selling into that region or to that customer group (i.e. pay third party websites, a search engine or a search engine optimiser to have its website being found more easily in the target territory).

137. Options 1 and 2 would maintain the distinction between active and passive sales in the context of the internet by allowing suppliers to restrict active selling into territories exclusively allocated to other dealers, thereby providing for a sufficient protection of the exclusivities while preventing any abuse resulting in market segmentation. In view of the low risk of harm to competition stemming from exclusive distribution networks set up by suppliers and buyers with no significant market power (i.e., with market shares below 30%), these options seem to best accommodate the interests of the suppliers who may want to set up exclusive distribution systems and the interests of the European consumers to fully take

advantage of the internet to overcome geographic barriers in case of important price differences across different Member States.

138. These options would allow suppliers to restrict active sales over the internet of their exclusive dealers into each others' exclusive territories while at the same time allowing consumers to buy wherever they want, in particular where there is an important price difference across different Member States (since the suppliers would not be able to restrict passive sales). This means that these options would allow suppliers to maintain an exclusive distribution system, but would not allow them to partition the market, which ensures that these options are also in line with the broader "Digital Agenda" of the Commission. By providing some examples of restrictions of passive sales over the internet, Option 2 scores higher than Option 1 (base line option) in terms of preventing market partitioning.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

139. Policy option 3 would not block exempt the requirement to have a brick and mortar shop imposed by suppliers with no significant market power. Although the competition risk of anticompetitive foreclosure seems remote, by removing the safe harbour for distribution agreements containing such a requirement, this option would in effect reduce the freedom of suppliers from organising their distribution system as they feel appropriate and this is unlikely to be a desirable policy, especially in industries where suppliers have no significant market power and have made substantial investments to build a brand and/or a reputation that they wish to protect through the provision of appropriate services in their distribution network.

140. This option would thus fail to solve efficiently the problem of free riding, which arises when consumers use the pre-sales services (showroom, advice, etc.) offered in the brick and mortar shops, which are costly and possibly not capable of being replicated over the internet, but then buy those products over the internet where those pre-sales services are not offered and the price may, as a result, be lower. For example, consumers may test a high-tech product or a perfume at a traditional brick and mortar dealer, and subsequently purchase the chosen products online from an internet-only distributor which does not provide for such a testing, and therefore may offer a lower price. While this may seem to confer an immediate benefit to individual consumers in the form of lower prices, such free riding may reduce the incentives for brick and mortar shops to provide a high level of pre-sales services for technically complex products, such as cars or high-tech products, and for the so-called "experience" goods, such as fine fragrances or perfumes, also where the provision of such services is crucial to promote these products and build demand for this type of products. This is because no distributor would accept to provide costly pre-sales services if he cannot recover the costs thereof through a sufficient number of sales. This would lead to a suboptimal provision of those services from the perspective of the supplier, and, possibly, also of consumers in the situations where the provision of pre-sales services is crucial to promote a product and build demand for that product[39]. Indeed, without an optimal provision of such services to consumers, the sales of those products could be seriously undermined.

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[39] It has also been pointed out that brick and mortar shops can free ride on the services of online retailers. This reverse free riding is not a competition policy concern because the reverse condition, that is that

141. There is some support for this claim in the economic literature, and also empirical data and the public consultation which show that the free riding problem is likely to occur in some industries producing technically complex or so called experience goods where demand is mainly built on sales efforts provided in the physical outlets. The summary of the empirical data on this point can be found in Annex 4.

142. Policy option 1 would continue to block exempt the requirement to have a brick and mortar shop (baseline scenario). This option would allow suppliers with no significant market power to organise their distribution systems as they feel appropriate by requiring if necessary the operation of a physical outlet, in order to exclude internet-only retailers from the distribution system, which would free ride on the efforts of the dealers who operate physical outlets necessary for testing products and building demand for that type of products. For those industries where the free riding problem is relevant, the block exemption of the requirement to have a physical presence may efficiently solve the identified free riding problem for the companies with no significant market power (market share below 30%) and reduce their compliance costs given that their agreements will benefit from the safe harbour.

143. The key question here is whether this option would lead to an abusive use of the requirement to have a brick and mortar presence in industries where such a requirement is not necessary to solve a free riding problem (i.e. presentation of the products in a showroom with the possibility to test the products is not essential to build demand). During the public consultation some stakeholders argued that the exclusion of online-only distributors may deprive European consumers of cheaper and powerful new online distribution channels for many products (see Annex 3). For instance, one large online company argued that buyers in the UK, Germany and France can obtain savings of around 17% for a range of new products by purchasing online rather than in an off-line store[40]. This company argues that the main reason to impose a brick and mortar requirement is to segment the common market, to charge higher prices, and to foreclose the more efficient online-only distributors to the detriment of consumers.

144. To reply to the above concern it is necessary to establish whether negative effects, such as anticompetitive foreclosure at the distribution level, are likely in the absence of significant market power, i.e., where the market share of the undertakings concerned remains below 30%, and, whether, if there are such negative effects, there

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the distributor is required to sell online only, would not undermine the possibility of these distributors to reach customers located elsewhere and would not restrict the availability of the product to these customers. It would generally not be possible to use such a restriction to segment the market and harm consumers. In addition, although there are no available data on the costs of such sales services provided by online retailers, the economic literature (Carlton & Chevalier, *"Free Riding and Sales Strategies for the Internet"*, 2001) points at two factors which make free riding by online retailers a potentially greater problem than free riding in the reverse direction. First, much of the effort of the brick-and-mortar retailers takes the form of a per customer cost, while online-only retailers are more likely to incur fixed costs in providing support. Secondly, because the promotional effort of a brick-and-mortar retailer consists of personal interaction between customers and sales consultants, it is much more difficult to directly verify and compensate for these efforts.

[40] Some empirical data show indeed that prices are overall lower online if compared with offline distribution. Friberg et al. (*"Pricing Strategies in e-Commerce: Bricks v. Clicks"*, 2001) showed that in the Swedish markets for books and CDs, retailers which only sell online have on average 15% lower prices than retailers who also sell through conventional stores.

are nonetheless efficiencies that outweigh these negative effects (i.e. whether the exclusion of online-only players may or may not be block exempted).

145. Firstly, experience shows that in the absence of significant market power and if facing sufficient competition from other companies (inter-brand competition), suppliers have no interest in hindering new methods of distribution if they are more efficient for the promotion of their products. Therefore, if demand could be enhanced without a physical presence, through a cheaper method of distribution such as internet-only distribution, suppliers would have strong incentives to adopt it. Depending on the characteristics of the product at stake, the optimal combination of off-line and online distribution will vary and in some industries, the existence of an upmarket brick-and-mortar network will constitute an important element of image building while in others, it will not. For instance, airlines have traditionally used travel agents to provide sales assistance to consumers. Over the last few years, market circumstances have changed and it is now in the airlines' best interest to choose a system which is much more focused on online distribution. That is the reason why the travel industry is one of the sectors in which online distribution, including online-only agents, are used extensively. The cosmetics and luxury industry uses off-line distribution, in combination with online distribution[41], since the use of the off-line channel is indispensable for testing some of its products and building demand for those products.

146. Secondly, the alleged foreclosure of internet-only retailers in some industries is only likely when the supplier and/or the buyer have significant market power. The agreements concluded by suppliers with significant market power, and thus in most cases a market share exceeding 30%, fall outside the scope of the block exemption. Concrete enforcement cases show that foreclosure problems have not arisen below this threshold, but rather at market shares ranging well above the 30% market share threshold. In addition, the studies provided during the public consultation did not point to any serious foreclosure problem in industries with sufficient inter-brand competition where the companies hold market shares below 30% and where the brick and mortar requirement is used. Finally, the proposed change to extend the market share threshold to buyers will ensure that also agreements concluded by buyers with significant market power will not benefit from the block exemption but will only be exempted if efficiency gains can be expected to outweigh potentially harmful competition effects.

147. However, in those rather exceptional situations of cumulative effects of different agreements excluding systematically online-retailers without a credible efficiency justification, the Commission or the NCA may withdraw the benefit of the block exemption and take action if an anticompetitive foreclosure effect is demonstrated.

148. Thirdly, the fact that some brand owners have decided not to use internet-only retailers does not seem to have eliminated the development of internet distribution. The respondents to the public consultation, such as the luxury brands in particular,

[41] Indeed, even the upmarket fashion industry has witnessed the development of specific online websites that satisfy the selective requirements of luxury brands (see for example, the upmarket website Net-A-Porter that specialises in luxury designer fashion brands such as Chloé or Fendi).

indicated that they do not intend to prohibit the online activity of their dealers and that most of their products can be bought online via suppliers' and dealers' websites.

149. Fourthly, the current policy and proposed policy on resale restrictions do not allow suppliers to prohibit or restrict without an efficiency justification the online activity of their dealers because such a restriction is considered to be a hardcore restriction regardless of the market share of the supplier. Therefore, by encouraging competition between dealers, including over the internet, the EU policy on resale restrictions addresses the issue of market partitioning in the EU.

150. All in all, under Policy option 1, i.e., to continue to block exempt the requirement to have a brick and mortar shop (baseline scenario), consumers would not be hurt since anticompetitive foreclosure of online-only retailers seems to be unlikely because absent significant market power and subject to sufficient competition, suppliers have in general no interest in hindering the most efficient ways of distributing their products. In addition, competition between authorised dealers, who are required to operate a physical shop, would be preserved and the market partitioning would be prevented by the existing rules on resale restrictions in line with the broader "Digital Agenda" of the Commissioner, since the authorised dealers are free to use the internet to sell to end users.

151. Option 2 would provide for the possibility to limit the proportion of overall sales made over the internet by authorised distributors in order to avoid, in the opinion of certain suppliers, a circumvention of the requirement to have a brick and mortar shop (i.e., admitting in the distribution system distributors who will have a "sham" shop and develop massive online sales similar to an internet-only retailer).

152. Such a limitation would be problematic since it allows suppliers to limit the online sales of their retailers to the detriment of the consumers. This could also undermine the EU policy towards resale restrictions which addresses the issue of market segmentation. By limiting online sales to a given proportion, suppliers may frustrate the use of the internet overall. Normally, online sales are expected to increase when prices in one territory (Member State) are significantly higher than in another territory (Member State). Therefore, limiting online sales to a proportion established by the manufacturer in such a scenario deprives online sales from their function of "security valve" in case of important price differences across different territories (Member States).

153. Such a limitation could also easily be abused by the manufacturers in order to limit and effectively prohibit any online activity of their dealers. Having a website and the necessary infrastructure are fixed (sunk) costs for the dealer, which cannot be recovered if the amount of online sales is excessively limited by a proportion established in advance by the manufacturer.

154. Accepting such a proportion would also lead to legal uncertainty since it would be difficult to establish what an acceptable proportion is in an individual case (i.e., 50%, 25%, 10%, 5% or 1%). Therefore companies would not be in a position to know in advance whether their restriction is or is not a hardcore restriction. Lastly, this rule is not practical since the dealer may then have to reject online sales requests once he reaches the proportion, which could compromise its online sales in the future.

155. The potential free riding problem between authorised dealers may be solved in other ways, foreseen in the draft Guidelines, than limiting the online sales of the dealers to a given proportion (see Annex 2). In order to prevent its dealers from having a "mock" brick and mortar shop and become "pure online players", the supplier may require its dealer to have several shops if necessary and to sell at least a certain absolute amount (in value or volume) of the products off-line from its brick and mortar shop(s). At the same time, the draft Guidelines also make it clear that such requirements may not limit the online sales of the distributor and must be determined on the basis of objective criteria such as the buyer's size in the network. The supplier may also offer its dealers a fixed fee to support their off-line efforts in order to incentivise them to invest in their off-line activities. These alternative ways to solve the free rider problem without hindering the online sales do not in general prevent the effective use of the internet by the selective dealers and would be block exempted under the current Regulation (see draft Guidelines, § 52 as explained in Annex 2).

156. On the basis of the above, it seems that Option 1 (baseline scenario) best accommodates the freedom of suppliers with no significant market power to organise their distribution system and to achieve efficiencies, while protecting the interests of the consumers, and therefore will have a better impact on competition and consumer welfare than the other options.

7.1.2. Impact on companies, in particular SMEs and the compliance costs borne by them

(i) Delineation between active and passive sales for the internet

157. By seriously restricting the possibility for suppliers with no significant market power, in particular SMEs, to set up exclusive distribution systems, Policy option 3, i.e., consider all restrictions on the use of the internet to be hardcore restrictions, would undermine the effectiveness of the supply/distribution chain in cases where the competition risk is remote or non existent. It would also increase the compliance costs of the companies since the companies would have to make their self assessment under Article 101(3) , and argue for individual exemption by showing efficiencies in case of prosecution.

158. Policy options 1, i.e., keeping the distinction between passive and active sales for the internet as it is, and policy option 2, i.e., further refining this distinction, reduce the compliance costs of the companies which set up exclusive distribution networks by block exempting exclusive distribution arrangement in the context of the internet. By giving some additional examples of hardcore restrictions and examples of active sales, Option 2 clarifies better than Option 1 what can and cannot be done in order to benefit from the block exemption, in particular in relation to the limitation of the proportion of overall sales made by dealers over the internet and other restrictions limiting the use of the internet. Option 2 adds thus more legal certainty, thereby reducing the compliance costs of the companies.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

159. By continuing to block exempt the requirement to have a brick and mortar shop, Option 1 would allow suppliers with no significant market power, in particular the SMEs, to solve a possible free riding problem in an efficient manner with minimal compliance costs and therefore to improve the supply/distribution chain. In addition,

the draft Guidelines offer significant ways to solve the possible circumvention of this requirement (the problem of "mock" brick and mortar shops) without the risk posed by Option 2, i.e., of unduly limiting the online activity of the dealers.

160. Option 3 would increase the compliance costs of the companies with no significant market power since suppliers would have to justify on a case by case basis why they do not allow internet-only players to distribute their products in the situations where the competition risk is remote or non existent.

7.2. Impact on consumers

161. Since the main objective of competition policy and enforcement is to protect consumer welfare by ensuring that the competitive process is not distorted, the conclusions of the analysis of impacts on effective competition are relevant to assess possible impacts of different options on consumers.

(i) Delineation between active and passive sales for the internet

162. Option 1 and Option 2 maintain the possibility to apply exclusive distribution in the context of the internet while not hindering, through vertical arrangements, the consumers' right to buy cross-border, which is normally expected to be used to offset a market segmentation/price discrimination strategy of suppliers. These options will have therefore a positive impact on consumers overall. Option 3, by undermining the possibility to use exclusive distribution, would have a negative impact on the performance of the supply/distribution chain of companies with no significant market power and therefore indirectly would have a negative impact on consumers.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

163. Option 1 in combination with the general principle that restrictions of online sales are not block exempted seems to reconcile best the freedom of the manufacturers to organise their distribution system and the possibility of the chosen dealers to sell online to final consumers. While Option 1 allows excluding online-only distributors and therefore could remove an immediate benefit to individual consumers in the form of lower prices, this option allows suppliers to solve potential free riding problems, which would overall benefit consumers. In addition, this exclusion does not seem to be critical below the 30% market share threshold if companies face a certain degree of competition. Option 2 by increasing the possibility to prohibit online sales may deprive the consumers from buying online, thus allowing suppliers to segment the market to the detriment of the consumers. By excluding from the safe harbour the requirement to have a physical presence prior to entering a distribution system, option 3 would have a negative impact on the performance of the supply/distribution chain of companies with no significant market power and therefore indirectly would have a negative impact on consumers.

7.3. Impact on public administration and the Community budget

164. None of the options has a direct impact on the Community budget.

165. For both issues (i.e., active and passive sales and the requirement to have a brick and mortar shop), Option 3, (i.e. all restrictions on the use of the internet are hardcore restrictions and no benefit of the block exemption for the requirement for distributors

to have a brick and mortar shop) could encourage unmeritorious complaints by companies excluded from a distribution system. The NCAs and the Commission would be burdened with such complaints while there is no clear cut competition risk. That would increase the workload of the NCAs and the Commission which will have to examine and respond to those complaints, thereby using a suboptimal allocation of administrative resources.

166. Options 1 and 2 do not increase the administrative burden of the NCAs and the Commission, but differ in relation to other possible impacts.

7.4. Other impacts: social and environmental impacts

167. As for buyer power policy options, the impact of different options in relation to online sales in terms of employment and social issues as well as the environment are not direct and measurable.

168. As explained in the section 6.4, because undistorted competition between companies is positive for long term employment opportunities, the options which have positive impacts on effective competition would have a better impact on employment (Options 1 and 2 for the issue of the distinction between active and passive sales and Option 1 for the requirement to have a brick and mortar shop).

169. The development of online retailing may have indirectly a positive impact on the environment. It has been argued that online retailing may lower the cost of market transactions and allows suppliers to match better the consumer demand. First, the use of the internet can lead to a "dematerialisation" of the products which are progressively used more and more in an electronic format. In addition to this, the role of intermediaries such as wholesalers may be reduced, or even eliminated, leading to "disintermediation" (Gellman, 1996). The supply chains of traditional retailers are likely to be transformed so that they receive more goods directly from manufacturers, rather than through wholesalers. For instance, for information goods such as newspapers, music, videos and software, online distribution replaces more and more physical distribution systems, leading to substantial "dematerialisation" and "disintermediation" of wholesalers and distributors. This process leads to a rationalisation of the supply/distribution chain by eliminating some additional activities such as manufacturing physical goods, stocking and the use of intermediaries. This may have a positive impact on the environment, which however cannot be quantified in this context. Since the current and proposed policies dissuade suppliers from restricting the online sales of their dealers in the absence of credible efficiencies, it could be argued that by encouraging the development of online retailing, these policies may have a positive side effect on the environment.

8. Conclusion

170. The following summary tables show the impacts of the different policy options as compared with the baseline scenario (no change in the current rules).

a) Summary table: Impacts of the policy options related to buyer power

	Option 1: taking account of the buyer's market share in the downstream market	**Option 2 taking account of the buyer's market share in the upstream market**
Economic impacts		
- wider economic impact: effective and undistorted competition	+ + Very positive: allows tackling most cases involving anticompetitive restraints linked with the exercise of buyer power.	+ + Very positive. allows tackling most cases involving anticompetitive restraints linked with the exercise of buyer power.
- economic impact: impact on individual companies	- - Increased compliance costs for certain companies.	- Slight increase in compliance costs for certain companies.
Impact on consumers	+ + Very positive.	+ Clearly positive: the upstream market share is in most cases a good proxy for market power in the downstream market (i.e. the market that is closer to the consumer).
Impact on public administration	- - Some increase in workload possible.	- Slight increase in workload possible.
Impact on employment	+ Positive indirect effect.	+ Positive indirect effect.
Impact on the environment	+ Neutral or positive indirect effect.	+ Neutral or positive indirect effect.

b) Summary table: Impacts of the policy options related to internet sales

(i) Delineation between active and passive sales for the internet (compared with the baseline scenario)

	Option 2: keeping and refining the distinction between passive and active online sales	**Option 3: considering all restrictions online sales as hardcore restrictions**
Economic impacts		
- wider economic impact:	+ +	-

effective competition.	+ Very positive: allows the use of exclusive distribution to achieve efficiencies in distribution while ensuring the interests of consumers to take advantage of the internal market.	Negative: would undermine the use of exclusive distribution (i.e. also if used to protect the investments of the exclusive distributors against free riding).
-economic impact: impact on individual companies	+ Positive: adds more legal certainty and reduces compliance costs.	- Negative: increase in compliance costs.
Impact on consumers	+ Positive	- Negative effect on the performance of the supply/distribution chain (indirectly negative impact on consumers)
Impact on public administration	+ Neutral	- Some increase in workload possible.
Impact on employment	+ Positive indirect effect.	- Neutral or negative indirect effect
Impact on the environment	+ Neutral or positive indirect effect.	- Neutral or negative indirect effect.

(ii) The requirement for distributors to have a brick and mortar shop

	Option 2: block exemption of the requirement to have a brick and mortar shop and for distributors to limit the proportion of overall sales made over the internet	**Option 3: no block exemption of the requirement to have a brick and mortar shop**
Economic impacts		
- wider economic impact: effective competition.	- Negative: would limit the use of the internet and would allow more market segmentation	- Negative : would frustrate the freedom of suppliers with no significant market power to organise their distribution system to solve potential free riding problems while the competition risk is rather insignificant
- economic impact: impact on individual companies	- Negative indirect effect.	- Negative: increase in compliance costs.
Impact on consumers	-	-

	Negative indirect effect: deprives consumers from the use of the internet	Negative effect on the performance of the supply/distribution chain (indirectly negative impact on consumers)
Impact on public administration	+ Neutral	- Some increase in workload possible.
Impact on employment	- Neutral or negative indirect effect	- Neutral or negative indirect effect
Impact on the environment	- Neutral or negative indirect effect	- Neutral or negative indirect effect.

a) Policy options related to the exercise of market power by buyers

171. It follows that Options 1 and 2, which consist in making the benefit of the Block Exemption Regulation depend not only on the supplier's market share, but also the buyer's market share both meet the specific objectives identified above, namely ensuring effective competition law enforcement and remedies against vertical restraints linked with the exercise of market power by buyers and preventing such vertical restraints from distorting competition to the detriment of consumers. In particular, their deterrence effects are much stronger than those of Option 3 (the baseline scenario), which only takes into account the supplier's market share. Options 1 and 2 thus ensure that contractual arrangements between suppliers and distributors eventually benefit European consumers. As explained in Chapter 6, Option 1 may provide for a more precise methodological tool in this respect.

172. In addition to being effective, Options 1 and 2 are also efficient: based on a relatively high market share of 30% they leave a comfortable safe harbour in which both suppliers and buyers without significant market power are free to develop contracting models to their convenience, while only agreements where the supplier's market share and/or the buyer's market share exceeds 30% fall outside this safe harbour. This also allows the Commission, the national competition authorities and the courts to concentrate their resources on the agreements that are most likely to result in consumer harm, without entailing any deterring increase in administrative their costs.

173. Option 2 involves much less compliance costs for firms than Option 1. It alleviates to a large extent the concerns expressed during the public consultation regarding the costliness and impracticability of Option 1. This makes Option 2 preferable to Option 1. It does not remove all compliance costs, however, but this is the price to pay for a policy that will better deter and sanction anticompetitive conduct. Given their pervasiveness, there are many thousands of vertical agreements in Europe, at all levels of the supply and distribution chain, and in all sectors. It is obvious that the Commission and the national competition authorities cannot investigate all of them. The Treaty intends Article 101 to have direct effect on the market, i.e. companies have to abide by it. Where firms have significant market power, it cannot be

presumed that their agreements will comply with Article 101, which would be necessary for them to be covered by a block exemption regulation.

174. To help companies assess their agreements, the Guidelines include new sections providing guidance on how to treat certain new categories of buyer induced vertical restraints. In addition, it is proposed that if the market share threshold: is exceeded after the entry into force of the proposed rules, the benefit of the block exemption will still apply during two years where the 30% buyers' market share is exceeded by less than 5% and during one year where it is exceeded by more than 5%.[42] This makes Option 2 efficient (costs effective) on the whole.

175. Finally, Option 2 is entirely coherent with the wider objectives of EU policy, unrestricted and undistorted competition being a pillar of the internal market. Option 2 also brings further coherence between competition law instruments since the latest block exemption regulation, which concerns technology transfer agreements, already introduced market share thresholds relating to both sellers (licence holders) and buyers (licensees). Similarly, the market share thresholds in the Commission's *De Minimis* Notice refer to both that of suppliers and buyers[43].

b) Policy options related to internet sales

(i) Delineation between active and passive sales for the internet

176. With Option 1 and Option 2 it would be possible to apply exclusive distribution in the online context as suppliers would be allowed to restrict active selling of their dealers into the territories of other dealers while consumers and companies would still be able to shop wherever they want in the EU. It follows from this impact assessment that these policy options reconcile better than Option 3 (which would restrict the possibility to have exclusive distribution in the online context) the interests of the suppliers with no significant market power to protect the investments of their distributors from free riding or to achieve other efficiencies, and the consumers' and companies' interests to fully take advantage of the internet to overcome geographic barriers.

177. In addition, Option 1 and Option 2 are better than Option 3 in terms of compliance costs for the SMEs and impact on public administration. However, by refining the distinction between active and passive sales Option 2 scores higher than Option 1 (baseline scenario) in terms of legal certainty and less compliance costs for companies. Therefore, the favoured policy option is Option 2.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

178. Option 1 (baseline scenario) would continue to block exempt the requirement to have a brick and mortar shop. This option would allow suppliers with no significant market power to organise their distribution systems as they feel appropriate, in order to avoid free riding between the chosen dealers. Consumers would not be hurt since anticompetitive foreclosure of online-only retailers seems to be unlikely below the

[42] See Article 7 of the draft Regulation.
[43] See footnote 10 above.

market share threshold while competition between authorised dealers would be preserved by the existing rules on resale restrictions. This Option is better than Option 2, which provides for an additional limitation of the proportion of overall online sales, since it allows suppliers with no significant market power to limit possible free riding by excluding internet-only suppliers from their distribution network, without however limiting the online activity of their selected dealers.

179. Option 3 would not block exempt the requirement to have a brick and mortar shop. Option 1 is also better than Option 3 because the latter may lead to a negative impact on consumer welfare and competition, compliance costs for companies and public resources while Option 1 leads to a positive impact on all of these dimensions. Therefore, the favoured policy option is Option 1.

9. MONITORING AND EVALUATION

180. The consultation exercise that led to the adoption of the draft Regulation and Guidelines was very extensive. Public consultations and a series of other consultations with stakeholders at Member State and Community levels, including public authorities and prominent practitioners from the private sector, have contributed greatly to the analysis and evaluation of the relevant issues.

181. The Commission will continue to monitor the operation of the Regulation and Guidelines based on market information from stakeholders. This will provide the Commission with opportunities to receive feedback from representatives from industry, consumer associations, law firms and economic consultants.

182. The Commission is also engaged in a continuous dialogue with the national competition authorities on the application of Articles 101 and 102, primarily through the European Competition Network. The ECN has various working groups, including a working group on vertical restraints. Given that the enforcement of Article 101 as regards vertical agreements mostly takes place at the national level, this dialogue is a very important tool for the Commission not only to monitor, but also to evaluate the functioning of the proposed rules in practice.

183. In its monitoring and evaluation, the Commission will pay particular attention to the functioning of the new buyers' market share threshold and the appropriateness of its level. In the same context, the Commission will also pay particular attention to the possible inclusion of the motor vehicle sector within the scope of the Regulation on vertical restraints.

184. The proposed Regulation will expire twelve years after its entry into force. However, the Commission will amend or repeal the Regulation and the Guidelines earlier, if the Regulation and the Guidelines, or some of the provisions thereof do not respond any longer to market conditions in the EU, and lead to anticompetitive practices with no proper efficiency reason, which may not justify the exemption any longer.

185. Before the Regulation has reached half of its maximum duration (i.e. within 6 years of its entry into force) the Commission services will consider the need for an intermediate review, basing themselves on their experience and that gained in the European Competition Network (NCAs), in particular in the area of internet sales.

ANNEX 1: The competition rules applicable to vertical agreements

1. Annex 1 first provides an overview of the regulatory framework applicable to vertical agreements, and then explains how the current rules work in practice.

1. EVOLUTION OF THE REGULATORY FRAMEWORK APPLICABLE TO VERTICAL AGREEMENTS

2. The early jurisprudence of the Court of Justice of the European Union confirmed that Article 101 of the TFEU (former Article 81 of the EC Treaty) applies to vertical agreements[44]. In particular, if used by companies with significant market power, vertical agreements may restrict competition within the meaning of Article 101(1) of the TFEU thereby creating obstacles to market integration and harming consumers.

3. The case law also recognises that vertical restraints may also have positive effects. They may for instance help a manufacturer to enter a new market, achieve economies of scale, enhance brand image, or avoid a situation in which one distributor 'free rides' on the promotional efforts of another distributor. In these circumstances, agreements which restrict competition may nonetheless be exempted under Article 101(3) of the TFEU, provided that a sufficient share of the benefits arising from the agreement is passed on to consumers.

4. Vertical agreements therefore require an assessment aimed at establishing whether they are caught by Article 101(1) and if so, whether they comply with all the conditions set out in Article 101(3) so as to benefit from the legal exemption provided for therein. Agreements falling under Article 101(1) which would not comply with Article 101(3) are null and void pursuant to Article 101(2) of the TFEU.

5. The first Council Regulation 17/62 implementing Articles 85 and 86 of the Treaty (later Article 81 and 82 EC, now Article 101 and 102 TFEU)[45] gave the Commission an exclusive competence to grant exemptions under Article 85(3) EC and set up a system of notification to the Commission of agreements for which an exemption was sought. The notification system gave rise to a "mass" problem with almost 30,000 notifications concerning vertical agreements[46]. Since the Commission was unable to adopt many formal decisions, an approach of "block exemptions" was adopted.

6. Under the enabling Council Regulation 19/65[47], the Commission is empowered to adopt block exemption regulations which define certain categories of vertical agreements which generally fulfil the conditions of exemption under Article 101(3). Under this regulation the Commission adopted in the 1980s block exemption regulations in the field of distribution, in particular relating to exclusive distribution[48], exclusive purchasing[49], and franchising[50].

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44 Joined cases 56/64 and 58/64, *Consten and Grundig v. Commission*, [1966] ECR 299
45 [1962]OJ 013/204
46 *First Report on Competition Policy 1971*, point 48
47 [1965] OJ 36/533
48 [1983] OJ L 173/1
49 [1983] OJ L 173/5
50 [1988] L359/46

7. Against the background of a growing feeling of unease in the mid 1990s with the effectiveness of the competition policy towards vertical agreements, the Commission started a thorough review of its policy in this field by adopting in 1997 a Green Paper on Vertical Restraints in EU Competition Policy[51]. A number of points became clear during the consultation process that followed the publication of the Green Paper. The block exemption regulations were too legalistic and form based and created an unnecessary compliance burden, especially for companies without significant market power such as SMEs. It became clear that the new policy would require a more economic approach, analysing vertical agreements in their market context and making the assessment dependent upon their effects on the market.

8. The Commission subsequently sketched in a White Paper a new policy approach towards vertical agreements[52]. This was followed by the adoption in 1999 of the current block exemption regulation 2799/1999 (hereinafter "the Regulation") and in 2000 of the Guidelines on vertical restraints (hereinafter "the Guidelines").

9. Contrary to previous block exemption regulations, the Regulation applies to all types of vertical agreements. It covers all the sectors of the economy with the exception of the car distribution[53], which is covered by a sector specific block exemption regulation. In addition, contrary to previous block exemption regulations, the Regulation also covers vertical agreements entered into by more than two parties.

10. The Regulation and the Guidelines formed the first package of a new generation of block exemption regulations and guidelines inspired by a more economic and effects-based approach. The Regulation and the Guidelines are based on the principle that for a proper assessment of a vertical agreement it is necessary to analyse its likely effects on the market, both negative and positive[54]. The same approach was subsequently introduced in other block exemption regulations and guidelines regarding the application of Article 81 EC, such as those concerning technology transfer agreements and horizontal cooperation agreements[55]

11. The basic aim of the Regulation and Guidelines was to simplify the rules applicable to supply and distribution agreements and to reduce the regulatory burden, especially for companies lacking market power like SMEs, while ensuring a more effective control of agreements entered into by companies holding significant market power.

12. Therefore, for vertical agreements the Regulation provides for a "safe harbour" on condition that the market share of the supplier does not exceed 30%. Beneath this threshold vertical agreements are block exempted: it is presumed that these vertical agreements will either not have negative effects or, if they do, that the net balance

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[51] COM (96) 721 final

[52] COM (98) 544 final

[53] Commission Regulation 1400/2002, [2002] OJ L 203/30

[54] In general, an effects-based approach implies that likely effects have to be assessed both for the application of Article 101(1) TFEU, where the authority must show that the agreement in question has actual or likely negative effects, and for the application of Article 101(3) TFEU, where the firm must show that the agreement causes actual or likely positive effects, which then have to be weighed against the negative effects.

[55] Commission Regulation 772/2004, [2004] OJ L 123/11 (technology transfer agreements); Commission Regulation No 2658/2000, [2000] OJ L 304/3 (specialisation agreements); Commission Regulation 2659/2000, [2000] OJ L 304/7 (research and development agreements)

will be positive. The relevant competition authority can withdraw the benefit of the block exemption regulation for the future if the negative effects resulting from a particular agreement are not outweighed by its positive effects, but below the market share threshold such a negative balance is considered unlikely and withdrawal decisions were thus rarely taken in practice.

13. The benefit of the Regulation does not, however, extend to agreements containing a so-called "hardcore restriction", such as minimum resale price maintenance and some resale restrictions, such as restrictions on passive sales and parallel trade, listed in Article 4 of the Regulation. The direct consequence of including a hardcore restriction in an agreement is that the agreement cannot benefit from the block exemption. In addition, the competition authority will assume that the agreement will have actual or likely negative effects. There is a presumption that such effects will result from the agreement. It is also considered unlikely that a hardcore restriction will have positive effects or that, where efficiencies are likely to result, these will be passed on to consumers and/or that a hardcore restriction is indispensable for creating these efficiencies. In other words, there is a presumption that the agreement will not fulfil the conditions of Article 101(3) TFEU. Lastly, there is a considerable chance that the authority will impose a fine.

14. However, the above does not mean that Article 101(3) TFEU cannot apply to an agreement containing a hardcore restriction. It is always possible for the firm in question to come forward with substantiated claims that the hardcore restriction will bring about efficiencies. The moment that the firm brings forward convincing evidence of efficiencies, the authority must show the likely or actual negative effects. If the efficiencies outweigh the negative effects, and the other conditions of Article 101(3) TFEU, such as the indispensability test, are also fulfilled, the agreement is not prohibited.

15. Council Regulation 1/2003[56], which formed another major step in EC competition law (the so called "modernisation"), abolished the notification system established by the previous Council Regulation 17/62.

16. Following the adoption of Council Regulation 1/2003, it is for the parties to carry out the assessment of their agreements under Article 101 TFEU. Individual assessment can entail expenses for parties to an agreement. The Block Exemption Regulation applicable to vertical agreements relieves the contracting parties from the need for an individual assessment by creating a "safe harbour" below the 30% market share threshold. The Regulation allows therefore market players, in particular SMEs, to enter into agreements they can assume to be *ex ante* in line with EU competition law, enabling them to flexibly conclude or adjust them, while reducing their compliance

[56] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ L 1, 04.01.2003, p.1), as amended by Council Regulation (EC) No 411/2004 of 26 February 2004 repealing Regulation (EEC) No 3975/87 and amending Regulations (EEC) No 3976/87 and (EC) No 1/2003, in connection with air transport between the Community and third countries (OJ L 68, 6.3.2004, p.1) and Council Regulation (EC) No 1419/2006 of 25 September 2006 repealing Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport, and amending Regulation (EC) No 1/2003 as regards the extension of its scope to include cabotage and international tramp services (OJ L 269, 28.09.2006, p. 1), hereinafter "Regulation 1/2003".

costs, enhancing legal certainty and contributing to the coherent application of EU competition rules across the EU. Agreements not covered by the block exemption are not presumed to be illegal, but instead have to be assessed individually. The Guidelines provide for a framework for companies to undertake such an assessment.

17. In addition, the Commission gave up its exclusive competence to grant exemptions under Article 101(3) TFEU. Council Regulation 1/2003 empowered the national competition authorities ("the NCAs") to apply Articles 101 and 102 TFEU ("decentralisation"). National courts can also apply these provisions directly, for instance in case of actions for damages brought before them.

2. PRACTICAL APPLICATION OF THE CURRENT RULES

18. As explained above, companies no longer need to notify their vertical agreement to the Commission to obtain an exemption under Article 101(3). This means that they are responsible for assessing and ensuring the compliance of the agreement with Article 101. Failing to do this they bear the risk that if a complaint is lodged before the Commission (or an NCA) or if the Commission (or an NCA) takes enforcement action on its own initiative, they can be sanctioned by the relevant competition authority for behaviour violating the competition rules. In such case the agreement will be void and the companies can face a fine. There may also be private actions for damages before the national courts launched by the victims of illegal behaviour.

19. The self-assessment of a company consists of the following steps:

– Check whether the agreement at hand is a vertical agreement (the Commission's Guidelines on vertical restraints assist it in this task). This is because agency agreements for example are not caught by the rules on vertical restraints, and horizontal agreements are covered by their own rules.

– In the case of a vertical agreement, check whether the agreement contains a hardcore restriction. If it does, it is presumed to have negative effects that are not outweighed by positive effects, but this presumption can be rebutted in individual cases.

– Check whether the agreement contains a restriction, such as a non-compete obligation longer than 5 years, which is excluded from the benefit of the block exemption under Article 5 of the Regulation. The company will have to assess both the negative and positive effects of such a restraint with the assistance of the Commission's Guidelines on vertical restraints.

– If there are no hardcore and/or excluded restrictions in the agreement, check if it contains another restriction. If there is no restriction, the agreement will not fall under Article 101.

– If the agreement contains a restriction, check the market share. If it is below 15%, under the *De minimis* Notice it will be presumed that the agreement does not have an appreciable effect on trade between the Member States or on competition, in which case Article 101 does not apply.

– If the market share is below 30%, the agreement will be covered by the Block Exemption Regulation, i.e. it will be presumed compatible with Article 101(3).

– If the market share is above 30%, assess the negative and positive effects of the agreement, with the assistance of the Commission's Guidelines on vertical restraints.

– If the Commission (or a national competition authority) took enforcement action against the agreement, try to show that (contrary to what the authority claims) the agreement does not lead to actual or likely negative effects and/or that those negative effects are outweighed by efficiencies. Indeed, while the burden of proof that a restriction infringes Article 101(1) lies with the enforcer[57], the burden of proof that the agreement meets all the conditions to benefit from an individual exemption under Article 101(3) lies with the company.

20. Since companies no longer have to notify their agreements to the Commission (or the national competition authorities) to get an individual exemption, the Commission will look into such agreements when it considers that a complaint lodged before it[58], or market information it may get or possess (e.g. though sector enquiries, but also information provided by market participants, consumer organisations or other stakeholders) warrant enforcement action.

21. What the Commission then has to do:

   – Follow the same steps as those described above. It is for the Commission to show the negative effects, while it is up to the companies to bring evidence about positive effects outweighing the negative effects, and it is only after these two steps are completed that the Commission will decide whether or not the balance effectively tends towards the agreement being compatible or incompatible with Article 101.

   – It should be added that the Commission has the power to withdraw the benefit of the block exemption if a vertical agreement, considered either in isolation or in conjunction with similar agreements enforced by competing suppliers or buyers, comes within the scope of Article 101(1) and does not fulfil all the conditions of Article 101(3).

22. National competition authorities will by and large follow the above steps and also have the possibility to withdraw the benefit of the block exemption if the agreement leads to negative effects in the territory of a Member State which have all the characteristics of a distinct geographic market. The cooperation between the Commission and the national competition authorities in the application of Articles 101 and 102 of the Treaty is governed by the above-mentioned Regulation 1/2003.

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[57] For hardcore restrictions, there is a double presumption that the agreement breaches Article 101(1) and does not meet the conditions set out in Article 101(3); therefore, for these types of restrictions the order in which evidence is brought is that the authority merely has to establish the existence of a such a hardcore restriction (but not its negative effects) while the company has to bring forward evidence that the agreement fulfils the conditions of Article 101(3). In case the undertakings substantiate that likely efficiencies result from including the hardcore restriction in the agreement and that in general all the conditions of Article 101(3) are fulfilled, this will require the Commission to effectively assess the likely negative impact on competition before making the ultimate assessment of whether the conditions of Article 101(3) are fulfilled.

[58] Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty (OJ C 101, 24.04.2004).

ANNEX 2: Competition policy on resale restriction over the internet in the context of the review of the rules on Verticals Restraints

1. Annex 2 explains the current competition policy on resale restrictions (I) and how this general policy is currently applied in the context of the internet (II). It also explains the changes in the draft Regulation and Guidelines which were subject to public consultation (III).

1. CURRENT COMPETITION POLICY ON RESALE RESTRICTIONS

1. Pursuant to Article 4(b) of the Regulation, resale restrictions of the territory into which, or of the customers to whom, the buyer may sell the contract products are hardcore restrictions. Therefore, in most vertical (distribution) agreements, restrictions on how, where and to whom the distributor sells the product infringe in principle the competition rules.

2. There are two specific types of distribution system that include resale restrictions which are in certain circumstances block exempted under the current competition rules. These are (a) exclusive distribution and (b) selective distribution systems.

Exclusive distribution

3. In an exclusive distribution agreement the supplier agrees to sell his products only to one distributor for resale in a particular territory. A more nuanced approach towards resale restrictions is applied in the case of exclusive distribution where efficiencies - such as preventing free riding between distributors and economies of scale - can be expected to arise from resale restrictions (including those over the internet).

4. When the manufacturer's market share is below 30%, the Regulation, in particular Article 4(b), first intend, covers protecting an exclusive distributor against active sales (i.e. actively approaching customers)[59] by another exclusive distributor. However, regardless of the suppliers' market share, any restriction on passive sales (i.e. unsolicited sales at the initiative of the customers)[60] is a hardcore restriction.

5. The possibility to make passive sales outside allotted territories is currently seen as a safety valve for protecting the internal market. It is considered that if price differences between Member States become excessive, then customers will start to exploit the possibilities of arbitrage. The possibility to make passive sales is also

[59] According to current Guidelines (point 50), «Active» sales mean actively approaching individual customers inside another distributor's exclusive territory or exclusive customer group by for instance direct mail or visits; or actively approaching a specific customer group or customers in a specific territory allocated exclusively to another distributor through advertisement in media or other promotions specifically targeted at that customer group or targeted at customers in that territory; or establishing a warehouse or distribution outlet in another distributor's exclusive territory.

[60] According to current Guidelines, "passive" sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion in media or on the Internet 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 non-exclusive territories or in one's own territory, are passive sales.

seen as necessary to protect consumers', companies' and their agents' possibilities to purchase products wherever they want in the EU. In this context, the prohibition of absolute territorial protection is also a means to achieve more market integration which is one of the fundamental goals of the EU. The Guidelines state that "*companies should not be allowed to recreate private barriers between Member States where State barriers have been successfully abolished*" (point 7).

6. The current policy on the one hand allows suppliers to use exclusive distribution to achieve efficiencies, and on the other hand prevents market partitioning by protecting the possibility of arbitrage from customers if price differences between territories become excessive.

Selective distribution

7. To help to create a brand image, a manufacturer can choose to distribute its product through a selective distribution system where he can reserve sales only to distributors who fulfil his selection criteria. In such a system, the manufacturer can reject supplying companies which do not fulfil the selection criteria and restrict sales to non-authorised dealers, leaving only appointed dealers and final customers as possible buyers. Selective distribution is block exempted up to 30% market share of the supplier. However, regardless of the suppliers' market share, resale restrictions imposed by the manufacturer on the selected distributors beyond not being allowed to sell to non-authorised distributors are a hardcore restriction. Pursuant to Article 4(c) and (d), both restrictions on active and passive sales to end users, and restrictions of cross-supplies between authorised distributors are hardcore restrictions.

8. It is worth concluding that exclusive and selective distribution systems - which by their very nature imply some resale restrictions - are widely used by companies in the EU and can lead to substantial efficiencies for EU consumers. The Regulation covers exclusive and selective distribution as long as companies do not have significant market power (i.e. market share below 30%). This is because, in the absence of significant market power, anticompetitive effects stemming from exclusive and selective distribution are unlikely and, if they lead to anticompetitive effects, efficiencies are likely to outweigh the possible anticompetitive effects. The philosophy of the Regulation is that it should be left to the market to sort out the most effective way of distribution, in particular as long as companies do not have significant market power and there is a certain degree of competition.

2. CURRENT COMPETITION POLICY ON RESALE RESTRICTIONS APPLIED IN THE CONTEXT OF THE INTERNET

9. The Guidelines provide for an interpretation of the current competition policy on resale restrictions in the context of the internet.

10. Since the internet allows distributors to reach customers in different territories, restrictions of the use of the internet by distributors are considered to be hardcore restrictions. In this regard, current EU competition policy towards vertical agreements is very supportive of internet sales. Restrictions on the distributors' use of the internet – having a website, using various languages on that site, sending e-mails

to individual customers – as a general rule infringe Article 101(1) of the Treaty on the Functioning of the EU (former Article 81(1) of the EC Treaty). The Guidelines make it clear that *"every distributor must be free to use the internet to advertise or to sell products"* (point 51).

11. On the basis of the general policy, some resale restrictions are covered by the Regulation in the context of exclusive and selective distribution.

Exclusive distribution

12. When the manufacturer's market share is below 30%, the BER covers protecting an exclusive distributor against active sales of another exclusive distributor via the internet, such as e-mails directly addressed to customers in the exclusive territory or other techniques specifically targeting those customers. However, regardless of the suppliers' market share, any restriction on passive sales over the internet is a hardcore restriction. In general, for the purposes of applying Article 101 to vertical agreements the use of the internet is not considered a form of active sales since it is a reasonable way to reach every customer. For example, a distributor cannot be prevented from having a website in different languages and responding to spontaneous requests from customers located in other territories than in the one allocated to that distributor (a supplier cannot prohibit the exclusive distributor A from responding to a request from a consumer located in the exclusive territory of distributor B).

Selective distribution

13. The supplier cannot, in principle, restrict the online sales of its distributors since a restriction of the use of the internet is a hardcore restriction. However, the supplier may require quality standards for the use of the internet, just as the supplier may require quality standards for a shop or promotion in general. The manufacturer can exclude from online sales companies which do not fulfil the selection criteria (while a luxury product manufacturer cannot restrict online sales of his appointed dealers A, B and C, he can exclude (online) sales by company D which does not fulfil the manufacturer's selection criteria). For instance, the manufacturer may require, as a selection criterion, its distributors to have a brick and mortar shop or showroom to allow consumers to taste/feel/experience the product. This may exclude internet-only-shops from the distribution network. The current regime does not generally interfere with the selection criteria the producer with a market share below 30% applies to select its dealers since selective distribution is covered by the Regulation.

3. CHANGES IN THE DRAFT REGULATION AND GUIDELINES SUBJECT TO A PUBLIC CONSULTATION

14. The draft Regulation does not change the scope of the current policy on resale restrictions. Resale restrictions are in principle hardcore restrictions except in the context of exclusive and selective distribution.

15. With regards to internet, the draft Guidelines maintains the general principle that restrictions of the distributors' use of the internet are hardcore restrictions.

Exclusive distribution

16. Based on experience, in particular at the national level, the draft Guidelines elaborate further on the criteria used for the distinction active/passive sales with the aim to identify the most common practices to be considered as restrictions of passive sales which infringe Article 101(1). In particular, the draft Guidelines (point 52 *in fine*) make clear that some practices which directly or indirectly limit the dealers' possibilities to use the internet are hardcore resale restrictions. The Commission regards for instance the following as hardcore restrictions of passive selling:

– requiring a (exclusive) distributor to prevent customers located in another (exclusive) territory from viewing its website or requiring the distributor to put on its website automatic re-routing of customers to the manufacturer's or other (exclusive) distributors' websites;

– requiring a (exclusive) distributor to terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's (exclusive) territory;

– requiring a distributor to limit the proportion of overall sales made over the internet;

– requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line.

Selective distribution

17. The draft Guidelines maintain the current policy.

18. In addition, the draft Guidelines explicitly state that suppliers may require, under the block exemption Regulation, their distributors to have a physical presence before engaging in online sales, thereby excluding online only retailers from the distribution system.

19. Furthermore, to ensure an efficient operation of the physical outlets, the draft Guidelines also provide that suppliers may require their dealers to sell off-line at least an absolute amount (in value or volume). In the same time, the draft Guidelines provide that this requirement may not limit the online sales of the distributor and must be determined on the basis of objective criteria such as the buyer's size in the network (footnote 29 under point 52 of the draft Guidelines).

20. The Guidelines also clarify that suppliers may offer theirs distributors a fixed fee in order to ensure an efficient operation of their physical outlets (footnote 30 under point 52 of the draft Guidelines).

21. For a more detailed discussion on the context and *rationale* underlying the amendments proposed in the draft, and the alternative options, please refer to Chapters III, IV and V of this Report.

ANNEX 3: Stakeholder consultation

Introduction: General comments on the Commission's proposed approach

1. The public consultation on a revised Block Exemption Regulation and Guidelines took place between 28 July and 28 September 2009. In this context, 162 submissions were received. The Commission also received contributions from some organisations/companies prior to the launching of the public consultation, which did not differ from the thrust of the contributions in that context.

2. As the national competition authorities consulted through the European Competition Network and the Advisory Committee for restrictive agreements and dominant positions, the stakeholders expressed a striking support to maintain in force a system of block exemption and accompanying Guidelines, which is considered as having worked very well or globally well in practice.

3. Only a handful of stakeholders questioned the need to keep such a system, noting that companies are now used to self-assessing the compliance of their agreements with Article 101 of the Treaty on the functioning of the European Union ("TFEU") (former Article 81 of the EC Treaty), and/or considering that a case by case approach is more in line with the effects based approach to enforcement that the Commission has been increasingly promoting. However, this is generally not the position of companies, who consider that the current system has given them flexibility (to organise their system as they best see fit) and legal certainty, notably through the "safe harbour" provided by the 30% market threshold. Therefore, companies welcomed the Commission's "evolution, not revolution" approach.

4. In the light of the focus and content of the contributions received, the areas where the Commission is proposing to up-date and/or clarify the rules, namely the market power of buyers and the increasing use of the internet as a distribution channel seem to have been well chosen.

5. Beyond these two themes (which are dealt with in more detail below and in the body of the Impact Assessment Report), many stakeholders also welcomed the clarifications brought by the Commission that also hardcore restrictions may in some circumstances benefit from an individual exemption under Article 101(3). The comments received with respect to these three themes are summarised in more detail below.

6. Some other critical general comments were also submitted, whether in relation to the functioning of the current rules and/or the Commission's proposals. Firstly, the Commission's approach to selective distribution was seen as either not taking sufficient account of the positive effects of that particular type of distribution (value added services, investment incentives), or too lenient towards it. Indeed, conflicting calls were made for the Commission on the one hand to more generally acknowledge the legitimacy of selective distribution and on the other hand to only allow selective distribution to be block exempted based on public qualitative selection criteria linked to the nature of the products concerned. Secondly, a handful of requests were made that the Commission elaborate specific rules for franchising. Thirdly, some statements were also made explicitly and implicitly about the current rules being applied in an inconsistent manner across EU jurisdictions, which should be remedied

by the review. Finally, a handful of stakeholders generally considered that the current rules have not worked well for their particular sector, either because they are too lenient or too restrictive of business freedom.

1. Comments on the proposal to introduce a buyer's market share threshold

7. Many stakeholders commented on the proposal to introduce a buyer's market share threshold (as a proxy for market power) in addition to that of the supplier to determine the applicability of the Block Exemption Regulation. While some stakeholders expressly welcomed the proposal or found it neutral, most stakeholders voiced concerns about the legal and practical consequences of introducing such threshold, in particular the perceived increased compliance costs for companies.

8. In the absence of case law and perceived evidence that buyer power has led to negative effects in the past, a number of stakeholders questioned the underlying reasons and the need to introduce such a threshold. Others, however, explicitly recognised that market power exercised in vertical agreements can result in anticompetitive foreclosure and that introducing a buyer's market share threshold could address such concerns.

9. Some stakeholders also suggested alternative ways to address buyer's power, such as the possibility to withdraw the benefit of the Block Exemption Regulation, to limit the applicability of the buyer's market share threshold to restrictions imposed by the buyer only, such as exclusive supply contracts, or only to apply Article 102 of the TFEU (former Article 82 of the EC Treaty) (which prohibits the abuse of a dominant position) in those cases. Some stakeholders also suggested that possible foreclosure of buyers from the source of supply could be addressed by applying a market share threshold for buyers on the upstream procurement market (rather than the downstream market share as proposed by the Commission).

10. Most critical comments concerned however the legal and practical consequences of introducing a buyer's market share threshold. Such threshold was perceived to reduce the scope of the Regulation and thus the safe harbour. In addition, the perceived difficulty for suppliers to assess their buyers' market shares, in particular to define the relevant geographic market(s) (often narrower than upstream, often regional or local) and product market(s) (often wider than upstream) was claimed to lead to legal uncertainty, increased compliance costs for companies and increased risk of litigation. Concerns were also expressed that narrowly defined geographic markets could lead to many buyers, including SMEs, being found to have market power on local markets and consequently to many existing agreement losing the benefit of the block exemption.

11. In addition to the perceived problems of monitoring buyer power in complex distribution systems with multiple relationships, concerns were expressed in relation to the practical consequences in terms of the need, should the buyer's market share exceed 30%, to review and adapt existing agreements, in particular in case of a single distribution agreement covering several different goods and/or services, where the threshold could be exceeded only with respect to some distributors and/or services of those distributors and/or in some geographic market(s).

12. Finally, most stakeholders did not comment on the level of the market share threshold. A few stakeholders, however, consider it being too high as most retailers' market share is below 30%, whereas others find it too low, suggesting to increase it.

2. COMMENTS ON THE COMMISSION'S PROPOSALS REGARDING THE RULES TO BE APPLIED TO ON-LINE SALES

13. Another aspect of the revised Regulation and Guidelines that attracted many comments is the treatment of restrictions imposed by suppliers on their distributors' use of the internet. There is a consensus that online sales provide all businesses and consumers with huge commercial opportunities. However, there is some debate in relation to business practices which limit online distribution. Two important issues were addressed by the stakeholders: (i) the delineation between active and passive sales for the internet and (ii) the requirement for distributors to have a brick and mortar shop before being accepted into the distribution system.

(i) Delineation between active and passive sales for the internet

14. Stakeholders have different views on the delineation between active and passive sales for the internet. Some stakeholders (a minority), in particular some law firms, some of the luxury industry and a competition authority, believe that the proposed rules, which make the distinction between active and passive sales are over prescriptive because they do not allow suppliers with no significant market power to restrict the online activity of their dealers. They also argued that the new rules should allow suppliers to restrict more than before the online sales of their dealers because the widespread use of the internet would encourage the free riding of distributors who do not undertake the same level of investments over the efforts of distributors who invest more in the promotion of the suppliers' products. They indicated that the internet may hinder the territorial protection of exclusive distributors and encourage free riding within selective distribution systems.

15. Other stakeholders (the majority), in particular some national business associations, a company operating an electronic platform, consumer associations and some national competition authorities supported the existing delineation between active and passive sales. These stakeholders believe that this delineation strikes a fair balance to allow, on the one hand, distributors to use the internet and consumers to benefit of the single market, and to allow, on the other hand, suppliers to prevent free riding between distributors. In addition, some of the stakeholders who agreed to keep the delineation between active and passive sales would like to better clarify when online activity of distributors results in active selling, in particular in the context of online advertisement, and the use of different languages on the websites.

(ii) Internet and the requirement for distributors to have a brick and mortar shop

16. Another point of debate concerned the exclusion of internet-only distributors from the distribution system, in particular in the context of selective distribution. A significant majority of the stakeholders, in particular some of the national business associations, the branded goods manufacturers, the luxury industry, and the law firms, and competition authorities, argued that the exclusion of online-only players from selective distribution systems, which is currently block exempted, should

remain block exempted as it currently is. It is argued that the requirement to have a physical presence before joining a distribution system may help solving a genuine free riding problem. Consumers could otherwise benefit from the pre-sales services (showroom, advice, etc) offered in the brick and mortar shops and then buy those products over the internet where those pre-sales services may not be offered and the price may be lower. This may in particular reduce the incentives for brick and mortar shops to provide a high level of pre-sale services for complex products, such as cars or high-tech products, and for so-called "experience" goods such as fine fragrances or perfumes. This could lead to a suboptimal provision of pre-sales services to the detriment of the final consumer since those services are necessary to expand demand for those products.

17. Some stakeholders, in particular the luxury industry, some brand owners and some law firms, who are in favour of excluding pure online players from their distribution system, expressed the fear that some dealers could have a "mock" brick and mortar shop and develop massive online activities similar to those of pure online dealers, which would finally allow them to free ride on the efforts of "genuine" brick and mortar retailers. They argued in particular that in order to prevent free riding between retailers by circumventing the requirement to have a brick and mortar shop, the suppliers should be allowed to limit the proportion of overall sales made over the internet or to require their dealers to pay higher purchase prices for products intended to be sold online than for products intended to be resold off-line. On the other hand, other stakeholders, in particular some brand owners, some competition authorities and some law firms, considered that the additional clarifications provided in the Commission's draft Guidelines, such as the possibility to require distributors to sell at least a certain absolute amount (in value or volume) of the products off-line or to offer a fixed fee to support distributors' off-line sales efforts, are sufficient to ensure an efficient operation of the off-line activity of the distributors without unduly limiting the online sales of the distributors. A small number of stakeholders, in particular some dealers and consumers associations and some law firms, pointed out that those additional measures may be used by suppliers to circumvent the proposed rules by indirectly limiting the online sales of the dealers.

18. Other stakeholders have a different view on this issue. A company operating an electronic platform disagrees with the possibility to block exempt the exclusion of pure online players from selective distribution systems because the free riding justification is deemed insufficient. This company argued that in most cases a physical presence is not necessary to engage in distribution since an equivalent level of pre-sales services in terms of promotion and information may be provided online. It also pointed to a "reverse" free riding problem because in its view very often brick and mortar retailers free ride on the efforts of the online retailers. Consumers may use the internet to get the information about the products and then buy them from a brick and mortar shop. Some consumer associations argued that the current Regulation, by block exempting the exclusion of online-only distributors together with a cumulative use of this exclusion in many sectors, deprives European consumers of attractive and powerful new online distribution channels for many products. Based on the considerations above, both this company and consumer associations favour a case-by-case approach and not a general block exemption of the exclusion of online retailers from distribution systems.

3. COMMENTS ON THE COMMISSION'S PROPOSED APPROACH TO HARDCORE RESTRICTIONS

19. Many stakeholders welcomed the clarifications brought by the Commission that also hardcore restrictions may in some circumstances benefit from an individual exemption under Article 81(3). This was considered very useful to remedy the flawed perception that hardcore restrictions are "*per se*" illegal under EC competition law.

20. Setting aside the issue of on-lines sales which is discussed above, some stakeholders would have liked to see the Commission to go further in the implementation of an effects-based approach. Most of the comments on this topic however aimed at further improving or clarifying the draft rules and guidance as proposed by the Commission rather than arguing for changes in the scope of the hardcore restrictions. For example, it was requested that the Commission give more examples of the circumstances in which hardcore restrictions may be individually exempted.

21. Some stakeholders, which are however clearly a minority, nonetheless called into question the double presumption that such hardcore restrictions are generally likely to infringe Article 101(1) and generally unlikely to fulfil the conditions of Article 101(3). Some of these stakeholders, while recognising that economic literature identifies both possible anticompetitive and pro-competitive effects from the use of resale price maintenance ("RPM") and that the empirical evidence on RPM is scarce, opined that there do not seem to be significant competitive risks where the relevant firm has a small market share. Consequently, they proposed that the "*de minimis"* rules be applied to RPM (i.e. rules allowing companies with a market share below a certain threshold to use RPM).

22. It should however be noted that these calls for further relaxation mainly originated from some law firms and academia but hardly from the companies themselves or from major industry federations, which suggests that this is not a major issue for business. This can also be contrasted with the fact that other stakeholders (in particular consumer associations but also retailers and their associations, industrial associations and academia) expressly asked the Commission to retain its current cautious approach to resale price maintenance. Some stakeholders even went further urging the Commission to clarify "*not only that RPM is presumptively illegal but also that the presumption is strong and that the Commission will approach with scepticism any claim that RPM is desirable*". According to these stakeholders this is justified by the fact that when employed at retail level, RPM typically raises prices to consumers and, because of its direct impact on price, it is the vertical restraint that most easily and effectively facilitates price collusion at either manufacturer or distributor level. As regards the efficiency benefits, they argued that if any they can often be achieved through less restrictive alternatives.

ANNEX 4: Evolution of online sales in the EU and summary of the evidence used in the Report

1. Annex 6 provides some background information on the evolution of online sales in the EU in the last years as it results from the Commission's Report on cross-border e-commerce in the EU (I). It also provides a summary of the evidence on how the distinctive features of the internet may affect the functioning of some distribution systems such as exclusive and selective distribution systems (II).

1. EVOLUTION OF ON-LINE SALES IN THE EU

1.1 E-commerce compared to other retail channels

2. E-commerce is the second most commonly used retail channel. In the EU 27 in 2008, 51% of retailers made sales via e-commerce. Only direct retail sales were more common, used by 79% of retailers. It is important to note, however, that these figures relate to the percentage of retailers using a certain retail channel and do not reflect the actual percentages of sales per channel.

3. Figure 4 (Annex 1 to e-Commerce Report) of the e-Commerce Report shows the year-on-year growth rates of retail sales over the review period (2002-2007) across the different retailing channels: internet retailing was by far the fastest developing channel, growing by 45% between 2002 and 2003, though slowing in the following years to about 25% annual growth, still an impressive pace. This relative slow down in growth in recent years may be attributed to the fact that e-commerce sales started from very low levels, so the initial remarkable growth rates may have been due to catch-up effects. However, e-commerce growth rates remain in sharp contrast with the performance of other retail channels. The performance of other retailing channels has been more or less stable over the same period, with growth rates generally below 3%.

1.2 Number of online shoppers in the EU

4. Between 2004 and 2008, the percentage of individuals who had ordered goods or services over the internet for private use in the past year in the EU 25 rose significantly, from 22% to 34%. In 2008, 32% of individuals in the EU 27 had ordered online in the last year[61]. There is significant variation in the levels of e-commerce across EU Member States (Figure 1 of Annex 1, e-Commerce Report). In the UK in 2008, 57% of individuals had ordered goods or services over the internet for private use in the last year. In Denmark, Germany and the Netherlands the corresponding figure was also over 50%. In the two newest Member States, Bulgaria and Romania, however, the figure was respectively 3% and 4%. Estonia, Cyprus, Greece, Italy and Portugal saw around 10% of individuals purchasing online for private use in 2008[62]. According to the Fédération du e-commerce et de la vente à distance (FEVAD), 66% of internet users in France have made a purchase online[63].In

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61 Eurostat: Information society statistics (2009).
62 Eurostat: Information society statistics (2009).
63 FEVAD, 'Chiffres Clés vente à distance et e-commerce', 2008.

Germany in 2007, 58.3% of individuals who had used the internet in the previous three months shopped online occasionally or frequently[64]. In the Nordic countries (Denmark, Sweden, Norway, Finland and Iceland), 91% of internet users had traded over the internet in the previous six months[65].

5. According to a study by the Association de l'économie numérique (ACSEL), based on the number of online purchasers, e-commerce markets in the EU could be categorised as follows:

– A mature market in Northern Europe, including the United Kingdom, Germany, and the Nordic countries, where between 60% and 80% of internet users are online purchasers.

– A growth market in France, Italy and Spain, where the number of online purchasers is lower compared to the numbers of internet users, but where the number of new online purchasers is growing fast, signalling a strong potential for growth in the short and medium term.

– An emerging market in Eastern Europe, but for which statistical data are lacking[66].

1.3 Sectors concerned by the development of e-commerce

6. According to some estimates, the European e-commerce market was worth 106 billion euros in 2006 (an order of magnitude comparable to the size of the US e-commerce market) and 70% of turnover is concentrated in three key markets (the United Kingdom, Germany, and France)[67].The three product categories most purchased online are: "travel and holiday accommodation", which ranks first in terms of the percentage of individuals shopping online (42%), followed closely by "clothes, sports goods" (41%) and "books/magazines/e-learning material" (39%). Then come household goods (e.g., furniture, toys, etc; 35%), tickets for events (33%), films/music (29%), electronic equipment (25%), and computer software including video games (21%). It is interesting to note that half the individuals who ordered films/music, books/magazines/e-learning material or computer software (including video games) did so online[68]. Figure 3 of Annex 1 to e-Commerce Report shows the evolution of online retail sales for the review period 2002-2007 across the main product categories. The top three product categories in 2007 (in value terms) were: media products (13.2 billion euros), clothing and footwear (7.3 billion euros), and consumer electronics (6.8 billion euros). Most sectors display impressive growth rates: except for a few categories, expenditure tripled between 2002 and 2007[69].

7. The main finding of the Commission's e-Commerce Report was that while e-commerce is taking off at national level, it is still relatively uncommon for consumers to use the internet to purchase goods or services in another Member State.

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64 Bvh, 'Entwicklung des E-commerce in Deutschland (BtC)', October 2007.
65 Nordic e-trade index, May 2008.
66 ACSEL: 'Europe, An opportunity for e-Commerce' (2008).
67 Source: eMarketer (2007), quoted in ACSEL (2008).
68 See Figure 2 (Annex 1) of the e-Commerce Report.
69 Euromonitor International (2008), based on an aggregation of country statistics; product coverage and classification differs from other sources.

The main conclusion of the Report is that the gap between domestic and cross-border e-commerce is widening inter alia as a result of cross-border regulatory barriers to online trade such as consumer protection laws, intellectual property and taxation rules.

2. SUMMARY OF THE EVIDENCE USED IN THE REPORT.

2.1. The restrictions of active selling within exclusive distribution

8. The development of e-commerce does not change the economic logic of exclusive distribution, i.e., the need to protect exclusive distributors which make important investments from active selling of other distributors. This means that a stricter treatment of the restrictions on online sales as compared with off-line sales is not warranted in the context of exclusive distribution.

9. In fact, in the on-line context, there is a greater need to protect exclusive distributors from active sales by other distributors since the use of the internet may make active selling more efficient, and therefore reduce considerably the protection of the exclusive dealers' investments. Experience shows that the internet allows dealers to actively prospect, promote, and sell their products into territories which may be exclusively allocated to other dealers. For instance, an advertising technique which consists of sending electronic messages to individual customers may achieve better results than the equivalent technique in the offline world. It has been shown that click rates for targeted e-mail messages have ranged between 10-20% as compared with less than 1% for an unsolicited third class mass mailing[70]. In general, online advertisement targeted at customers based in a given territory has become an important means to reach customers. In 2007, the European online advertisement market was worth 11 billion Euros with a growth rate of 40%. For instance, in six Member States (Denmark, Germany, Netherlands, Norway, Sweden and the UK) **online advertisement** accounts for at least 10% of overall advertisement expenditure and it is expected that more than ten Member States will achieve this result by 2010[71]. In addition, the internet allows companies to track the choices of individual customers, to list their purchase habits, and process this information for the purposes of targeted advertisement and sales (the so-called "data mining").

2.2 The requirement to have a brick and mortar shop

10. The use of the internet as a distribution channel may result in a potential free riding problem when consumers use the pre-sales services (showroom, advice, etc.) offered in the brick and mortar shops, which are costly and possibly not capable of being replicated over the internet, but then buy those products over the internet where those pre-sales services are not offered and the price may, as a result, be lower. The free riding problem may lead to sub-optimal provision of pre-sales services necessary to build a demand and therefore reduce the performance of the distribution chain. To solve this free riding problem, suppliers may require their authorised dealers to have a brick and mortar shop, thereby excluding internet-only distributors from the distribution system.

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[70] Koch & Cebula, *"Price Quality, and Service on the Internet: Sense and Non-Sense"*, 2002.

[71] Interactive Advertising Bureau Europe, *Report on European Internet Advertising Expenditure in 2007.*

11. There is some support for this claim in the economic literature, empirical data and the public consultation, which shows that the free riding problem is likely to occur in some industries such as high-tech or for so called experience goods (i.e. fine fragrances or perfumes) where demand is mainly built on sales effort which are physical and costly (i.e. presentation of the products in a showroom with the possibility to test the products).

12. Carlton & Chevalier (2001)[72] demonstrated that online retailers can free ride on the promotional efforts made by brick and mortar stores, leading manufacturers to reduce sales to online-only retailers or to control the availability and pricing of their products over the internet They examined three categories of products: fragrances, DVD players, and side-by-side refrigerators and concluded that in the absence of a vertical restriction, brick and mortar shops will be vulnerable to free-riding on their sales efforts by their internet competitors if demand is mainly built on sales effort which are physical and costly; i.e., presentation of the products in a showroom with the possibility to test the products. In a more recent study, Van Baal & Dach (2005) tried to quantify the effects of the free riding[73]. Their conclusion was that "for every fourth purchase on the internet, a retailer provided unpaid information in its brick and mortar shop". According to Koch and Cebula (2002)[74], the case for free riding is stronger when: (1) the sale of a particular good or service ordinarily involves touch, taste, smell or testing, (2) the sale requires custom fitting, or, (3) the sale is usually accompanied by advice, counsel and a particular atmosphere.

13. In addition, during the public consultation, two key players from the luxury industry, Channel and LVMH, submitted two economic reports called *"Selective Distribution of the Luxury Goods in the Age of E-commerce"* and *"An Economic Analysis of the use of Selective Distribution by Luxury Goods Suppliers"*. Those studies suggest that in this industry:

– the "physical" distribution is crucial for providing pre-sales services, such as testing the products, which are necessary for building demand for the luxury products;

– pure online players may free ride on those pre-sales services and the exclusion of those players is a means of solving this free riding problem.

[72] Carlton & Chevalier, *"Free Riding and Sales Strategies for the Internet"*, 2001.
[73] Van Baal & Dach, *"Free Riding and Customer Retention Across Retailers' Channels"*, 2005
[74] Koch & Cebula, *"Price Quality, and Service on the Internet: Sense and Non-Sense"*, 2002.