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COMMISSION STAFF WORKING DOCUMENT

SUMMARY OF THE 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) 413}

1. BACKGROUND

1. The competition rules applicable to vertical agreements are set out in 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] ('the Regulation' and 'the Guidelines').

2. The Regulation provides for a block exemption for vertical agreements where the market share of the supplier does not exceed 30%. The benefit of the block exemption does not, however, extend to agreements containing a so-called 'hardcore restriction' listed in Article 4 of the Regulation.

3. In 2008, the Commission initiated a review of the Regulation and the Guidelines because the former will expire on 31 May 2010. This resulted in the Commission adopting a draft revised Regulation and Guidelines in July 2009 for the purposes of launching a public consultation. Following the public consultation and after consulting the national competition authorities ('NCAs'), the Commission services carried out an impact assessment and proposed to the College an amended Regulation and Guidelines.

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

4. Two major developments have marked the ten-year period following the adoption of the current rules, namely increased attention to, and evidence of the possible negative effects of buyers' market power and an increase in the use of the internet as a sales vehicle.

5. **Regarding buyer power**, under the current Regulation, the benefit of the block exemption depends on the supplier not having a significant degree of market power, i.e., on its market share being below 30%. However, in the last ten years, it has increasingly been recognised that in reality, vertical restraints need not generally be supplier-led. Partly due to the political attention that it has attracted, the focus of economic research has mostly been on buyer driven vertical restraints in the retail sector, but NCAs have also been confronted with such restraints in a number of other sectors.

6. **Regarding online sales**, vertical agreements concluded by companies may be used to prevent European consumers from accessing products online. At the same time, the development of the internet as a distribution channel that makes it easier for distributors to reach customers from a wide geographic area may affect the operation of distribution models such as exclusive and selective distribution that can lead to substantial efficiencies for European consumers.

7. The Commission has therefore been asked to provide guidance as to the treatment of the restrictions that suppliers may impose on their distributors' use of the internet,

[1] [1999] OJ L 336, 21–25
[2] [2000] OJ C 291, 1–44

bearing in mind that under the current Regulation suppliers can restrict active, but not passive sales to areas where they operate an exclusive distribution system. The Commission has also been asked to clarify whether a supplier may require its distributors to have a physical outlet to allow consumers to experience the product, thereby excluding internet-only distributors from their distribution network.

3. OBJECTIVES – THE "WHAT"

8. The **general objective** of EU competition rules is to make markets function for the benefit of consumers, including through undistorted and effective competition in European supply and distribution.

9. Regarding buyer power, the **specific objective** of the review is to allow the Commission, the NCAs and the courts to address effectively agreements containing anticompetitive vertical restraints concluded by buyers that hold significant market power and to deter parties from concluding such agreements. Regarding online sales, **the specific objective** is to strike the right balance to allow on the one hand European consumers and companies to fully take advantage of the internet to overcome geographic barriers in the broader context of promoting the internal market and on the other hand to allow manufacturers to achieve efficiencies and to improve the distribution of their products for the benefit of consumers.

4. POLICY OPTIONS – THE "HOW"

10. In view of the overall positive experience of the Regulation, the broad support from stakeholders and NCAs to keep a block exemption regulation, the **baseline scenario** is keeping rules based on the Regulation and Guidelines as they currently stand. Also, neither the public consultation, the jurisprudence of the European Courts nor the case practice of the Commission/NCAs give support for having a Regulation without any hardcore restrictions.

11. For the market power of buyers the following **policy options** have been identified:

   – In addition to the suppliers' market share, making the benefit of the block exemption depend on the buyer's market share in the <u>downstream market</u> (Policy Option 1);

   – As Policy Option 1 but considering the buyer's market share in the <u>upstream market</u> (Policy Option 2);

   – Keeping the benefit of the block exemption depend on the supplier's market share only (Policy Option 3).

12. For the delineation of active and passive sales for the internet the following **policy options** have been indentified:

   – Keeping the distinction between passive and active sales for the internet as it is in the current Guidelines (Option 1);

– Keeping and refining the distinction between passive and active sales in the context of the internet (Option 2);

– Stating that all restrictions on the use of the internet are hardcore restrictions (Option 3);

– Block exempting all restrictions on the use of the internet (Option 4).

13. For the requirement for distributors to have a brick and mortar shop the following **policy options** have been identified:

– Block exemption of the requirement for distributors to have a brick and mortar shop (Option 1);

– Block exemption of the requirement for distributors to have a brick and mortar shop and to limit the proportion of overall sales made over the internet (Option 2);

– No benefit of the block exemption for the requirement for distributors to have a brick and mortar shop (Option 3).

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

5.1. Economic impacts: impact on effective competition

14. The impact of Option 1 would be to allow the Commission, the NCAs and the courts to effectively remedy anticompetitive agreements where the buyer's market share in the market where the buyer sells the contract goods or services exceeds 30%. In such a case the parties to the agreement would have to assess whether the agreement complies with Article 101. This should deter anticompetitive conduct.

15. Option 2 would essentially have the same impact as Option 1 in terms of empowerment of the Commission, the NCAs and the courts. The difference with Option 1 is the market that is taken into consideration in determining the market share of the buyer. 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. However, buyer power in the procurement market is often closely linked with market power on downstream markets, and hence the upstream market share is a reasonable proxy for the buyer's market power downstream. Therefore, Option 2 would also allow effective enforcement and deter anticompetitive conduct.

16. In contrast to Options 1 and 2, under Option 3 the only way the Commission or a NCA could address anticompetitive restraints linked with buyers' market power would be to withdraw the benefit of the block exemption with respect to the agreement. This option is not available to courts, however. Also, 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.

5.2. Impact on companies

17. Where an agreement is not covered by the block exemption, the parties must make a self-assessment of its compliance with Article 101. Introducing a buyer's market share threshold (Options 1 and 2) thus entails certain compliance costs. However, SMEs are unlikely to possess market shares of such a level, and 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 do such a self assessment.

18. Option 2 would undoubtedly also involve compliance costs, but compared with Option 1, those costs are likely to be 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 agreements.

19. Option 3 would not change the current situation with regard to compliance costs and is therefore more favourable to companies from this point of view.

5.3. Impact on consumers

20. Options 1 and 2 allow protecting more effectively consumers from the adverse effects of the anticompetitive exercise of market power by buyers. Under Option 3 the Commission and the NCAs could not effectively remedy and sanction anticompetitive practices which harm consumers.

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

6.1. Economic impacts: impact on effective competition

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

21. Option 4, which would define all online sales as active sales, would block exempt most restrictions on the use of the internet. This would lead to more market segmentation/price discrimination to the detriment of the consumers and would seriously undermine the single market. Furthermore, such a policy option would not be compatible with established case law.

22. Option 3 would not allow any restriction on online activity of the dealers and would therefore undermine the very rationale of exclusive distribution and the efficiencies thereof even in the absence of significant market power of the parties.

23. Options 1 and 2 would maintain the distinction between active and passive sales in the context of the internet and allow suppliers to restrict active sales into territories exclusively allocated to other distributors. In view of the low risk of harm to competition stemming from exclusive distribution networks set up by parties with no or limited market power, these options best accommodate the interests of the parties who may want to set up exclusive distribution systems and the interests of the European consumers and companies to fully take advantage of the internet to overcome geographic barriers.

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

24. Option 3 would not block exempt the requirement to have a brick and mortar shop imposed by suppliers with no or limited market power. This option would reduce the freedom of suppliers to organise their distribution system as they feel appropriate to solve potential free riding problems. Yet the competition risk of anticompetitive foreclosure is remote. This option would thus fail to solve efficiently the problem of free riding between distributors. This could lead to a suboptimal provision of those services to the detriment of the final consumer.

25. Option 1 would continue to block exempt the requirement to have a brick and mortar shop. This option would allow suppliers with no or limited market power to organise their distribution systems as they feel appropriate by requiring - if necessary - the operation of a physical outlet. Under this option, consumers would not be harmed since anticompetitive foreclosure of online-only distributors would be unlikely.

26. Option 2 would provide for the possibility to limit the proportion of overall sales made over the internet by authorised distributors. Such a limitation would be problematic since it would allow suppliers to limit the online sales of their brick and mortar distributors to the detriment of the consumers.

6.2. Impact on companies

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

27. Option 3 would undermine the effectiveness of the supply and distribution chain in cases where the competition concerns are remote or non existent. It would also entail compliance costs for companies since they would have to make their self assessment under Article 101. Option 4 would seriously undermine the internal market.

28. Options 1 and 2 would reduce compliance costs for companies by block exempting excusive distribution in the context of the internet. By giving more examples of restrictions of passive and active sales, Option 2 adds more legal certainty, thereby reducing compliance costs for companies.

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

29. Option 3 would increase compliance costs for companies with no or limited 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.

30. Option 1 would allow companies to improve the supply/distribution chain without the risk posed by Option 2, i.e., of unduly limiting the online activity of the distributors.

6.3. Impact on consumers

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

31. Options 1 and 2 would 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. Option 3 would have a negative impact on the

performance of the supply and distribution chain of companies with no or limited market power and therefore indirectly have a negative impact on consumers.

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

32. Option 1 in combination with the general principle that restrictions on online sales are not block exempted would reconcile the freedom of the manufacturers to organise their distribution system and the possibility of the chosen distributors to sell online to final consumers. Option 1 allows excluding online-only distributors, and thereby possibly limits consumers' online purchase possibilities, but allows suppliers to solve a potential free riding problem, which would overall benefit consumers. Option 2 by increasing the possibility to prohibit online sales would deprive the consumers from the possibility to buy online, thus allowing suppliers to segment the market to the detriment of the consumers. Option 3 would have a negative impact on the performance of the supply and distribution chain of companies with no or limited market power and therefore indirectly have a negative impact on consumers.

6.4. Impact on public administration, the Union budget and other impacts

33. None of the options with regard to buyer's market power nor issues related to internet sales have a direct impact on the Union budget.

34. The options that have a positive impact on effective and undistorted competition are those that best ensure long term employment opportunities The development of online retailing may have indirectly a positive impact on the environment.

7. CONCLUSION: THE PREFERRED OPTION

35. **Regarding buyer power**, it follows from the impact assessment that Options 1 and 2, which take account of the buyers' market power, meet best the specific objectives identified above, namely of ensuring effective enforcement against vertical restraints linked with the exercise of market power by buyers. In particular, their deterrence effects are much stronger than those of Option 3. Option 2 involves much less compliance costs for firms than Option 1 and thus alleviates to a large extent the concerns expressed during the public consultation regarding the latter. Therefore, the favoured option is Option 2.

36. **Regarding online sales** it follows from the impact assessment that Option 2, which refines the distinction between active and passive sales reconciles best the interests of the parties with no or limited market power to achieve efficiencies in distribution and the consumers' and companies' interests to fully take advantage of the internet to overcome geographic barriers, while at the same time providing for more legal certainty and less compliance costs for companies than Option 1. Therefore, the favoured option is Option 2.

37. Regarding the requirement for distributors to have a brick and mortar shop, Option 1 which entails that the requirement to have a brick and mortar shop would continue to be block exempted, is superior to Option 3, because the latter may lead to a suboptimal outcome for consumer welfare and compliance costs for companies. Option 1 is also superior to Option 2, which provides for an additional limitation of the proportion of online sales. Thus the favoured option is Option 1.

8. MONITORING AND EVALUATION

38. The proposed Regulation will expire twelve years after its entry into force, but the Commission may amend it earlier if the monitoring and evaluation of its operation, based on market information from stakeholders and NCAs, show that its provisions no longer respond to market conditions in the EU.