

## ALERT MEMORANDUM

# European Commission signals Antitrust Enforcement Actions in the E-Commerce Sector

September 26, 2016

In May 2015, the European Commission (the “**Commission**”) launched an inquiry into the e-commerce sector in the European Union (“**EU**”) (the “**Sector Inquiry**”). On September 15, 2016, the Commission published a Preliminary Report (the “**Report**”) setting out its initial findings. The Report identified a number of potential competition concerns, including: (i) in relation to consumer goods, geographic sales restrictions, bans on sales via marketplaces such as eBay and Amazon, pricing restrictions, and online sales and advertising restrictions; and (ii) in relation to digital content, geo-blocking, exclusivity of rights and content, bundling of online rights in licensing, and the long durations of some licensing agreements. The Commission warned that businesses operating in the EU should review their business practices in light of the Report and that it might commence enforcement proceedings against individual businesses on the basis of its findings to date.

The EU is the world’s largest e-commerce market, with over 53% of individuals aged between 16 and 74 having ordered goods or services over the internet in 2015. Despite this, only 15% of EU consumers shopped online from a seller based in another Member State. Similarly, around half of the EU citizens accessed or downloaded digital content in 2014, but more than 50% of them have experienced problems when trying to access digital content cross-border.<sup>1</sup> In May 2015, the Commission adopted the Digital Single Market (“**DSM**”) strategy outlining key actions under policy areas, or “pillars”, through which the Commission seeks to create a DSM within the EU. One of these pillars is to improve access to digital goods and services for consumers and business across the EU. Under this pillar, the Commission has put forward legislative proposals in a number of areas, including the harmonisation of contract rules for the supply of digital content and online sales of goods, rules addressing “unjustified geo-blocking”, and copyright reforms. In parallel, the Commission launched the Sector Inquiry, with the aim of gathering information on the conduct of companies active in e-commerce and investigating barriers to cross-border online trade in goods and services erected by companies. This alert memorandum summarises the findings of the Report in respect of the online sale of consumers goods and digital content, and discusses the implications for businesses operating in the EU.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

**LONDON**  
 City Place House  
 55 Basinghall Street  
 London EC2V 5EH, England  
 T: +44 20 7614 2200  
 F: +44 20 7600 1698

**Maurits Dolmans**  
 +44 20 7614 2343  
[mdolmans@cgsh.com](mailto:mdolmans@cgsh.com)

**Paul Gilbert**  
 +44 20 7614 2335  
[pgilbert@cgsh.com](mailto:pgilbert@cgsh.com)

**BRUSSELS**  
 Rue de la Loi 57  
 1040 Brussels, Belgium  
 T: +32 2 287 2000  
 F: +32 2 231 1661

**Antoine Winckler**  
 +32 2 287 2018  
[awinckler@cgsh.com](mailto:awinckler@cgsh.com)

**Francisco Enrique González-Díaz**  
 +32 2 287 2117  
[fgonzalez-diaz@cgsh.com](mailto:fgonzalez-diaz@cgsh.com)

**Thomas Graf**  
 +32 2 287 2003  
[tgraf@cgsh.com](mailto:tgraf@cgsh.com)

<sup>1</sup> 2015 Eurostat data; Eurostat Community Survey on ICT usage in households and by individuals 2014; and Flash Eurobarometer 411 (2015).

## I. E-Commerce Sector Inquiry

### Background.

On May 6, 2015, the Commission launched the Sector Inquiry, with the aim of “*identifying possible competition concerns affecting European e-commerce markets*”, particularly “*potential barriers erected by companies to cross-border online trade in goods and services where e-commerce is most widespread*”.<sup>2</sup> The Sector Inquiry covers both online sale of consumer goods and digital content.

The Sector Inquiry complements legislative proposals designed to improve access to digital goods and services by EU consumers adopted within the framework of the Commission’s DSM Strategy.<sup>3</sup>

### EU Sector Inquiries.

Article 17 of Regulation 1/2003<sup>4</sup> empowers the Commission to “*conduct its inquiry into a particular sector of the economy or into a particular type of agreements across various sectors*” where there are suggestions that competition may be restricted or distorted within the common market.

Unlike proceedings under Article 101 or Article 102 of the Treaty on the Functioning of the EU (“TFEU”),<sup>5</sup> sector inquiries do not target specific businesses but are aimed at investigating a sector as a whole, in order to gain a better understanding of market characteristics and trends, the competitive dynamic, and identify possible competition concerns.

In the course of a sector inquiry, the Commission may (i) send requests for

information (“RFIs”) to businesses; (ii) take statements from natural or legal persons; and (iii) carry out inspections. Significant fines may be imposed on businesses that supply incorrect or misleading information.

Following a sector inquiry, the Commission typically publish a report on the results of its inquiry. It may also launch enforcement proceedings against individual businesses on the basis of its findings at any time.

The subjects of the Commission’s previous sector inquiries include the energy, financial services, and pharmaceutical sectors. Previous sector inquiries gave rise to a number of enforcement proceedings and legislative actions in the relevant sectors.

### Fact-finding exercise and initial findings.

The Commission sent RFIs to a large number of businesses. In connection with consumer goods, responses were received from almost 1,500 retailers, marketplaces, price comparison tools, payment service providers, and manufacturers/suppliers. In connection with digital content, a total of 340 content providers, VPN and IP routing services, and right holders submitted information, including over 6,700 licensing agreements.

On March 18, 2016, the Commission published an Issues Paper presenting initial findings that geo-blocking is widely used in e-commerce across the EU. The Report published on September 15, 2016 identified further potential competition concerns.

### Next steps.

The Commission has launched a public consultation on the initial findings presented in the Report and stakeholders are invited to submit their comments by November 18, 2016. The Final Report is expected to be published in the first quarter of 2017. The Commission may also launch enforcement proceedings against individual businesses on the basis of its findings to date.

<sup>2</sup> “Antitrust: Commission launches e-commerce sector inquiry”, Commission press release, May 6, 2015, available at [http://europa.eu/rapid/press-release\\_IP-15-4921\\_en.htm](http://europa.eu/rapid/press-release_IP-15-4921_en.htm)

<sup>3</sup> The DSM Strategy was adopted by the Commission on the same day as the launching of the Sector Inquiry.

<sup>4</sup> 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

<sup>5</sup> Article 101 regulates agreements and concerted practices which have as their object or effect the prevent, restriction or distortion of competition within the EU. Article 102 prohibits the abuse of a dominant position by businesses.

## II. Findings On Consumer Goods

### Market characteristics and trends.

The Sector Inquiry covers a wide range of consumer goods, including clothing, shoes and accessories, consumer electronics, computer games and software, toys, books, cosmetics, and sporting equipment.

The Commission observed that none of the sectors investigated appeared to be highly concentrated at either manufacturing or retail level. This suggests that most distribution agreements fall within the market share thresholds under the Commission's Vertical Agreements Block Exemption Regulation ("VBER").<sup>6</sup> The absence of evidence of dominance also led the Commission to focus on potential Article 101, rather than Article 102, concerns.

In reaction to the growth of e-commerce, there has been an increasing trend of manufacturers opening their own online shops, although most continue to sell via independent distributors in parallel. For the minority of vertically integrated manufacturers that now exclusively sell via their own online shops, any potentially restrictive measures they adopt are unilateral and fall outside competition law.<sup>7</sup>

The Commission also noted that there had been a considerable expansion of the number of selective distribution systems. It expressed doubts whether some of the relevant products required selective distribution or the applied selective criteria at all. In particular, it considered that the requirement by a large majority of manufacturers for retailers to operate at least one brick and mortar shop (and thereby excluding all pure online players) may go beyond what is necessary for the products in question. Further, there appears to be a lack of transparency and objectivity of selection criteria used by some manufacturers.

### Potential competition concerns.

The Commission identified a number of potential competition concerns, the most significant of which are discussed below.

#### 1) Geographic online sales restrictions.

The Commission found that 36% of retailers do not sell cross-border and 38% use geo-blocking measures to restrict cross-border sales. However, the decisions of the vast majority of retailers not to sell cross-border at all or to customers in certain Member States are unilateral and therefore fall outside competition law.<sup>8</sup>

Only 12% of the retailers reported the existence of online sales restrictions in agreements with manufacturers. Such restrictions ranged from outright cross-border online sales bans to indirect measures such as a requirement to translate the retailers' websites into the languages of Member States before the products could be sold to such Member States. The restrictions are sometimes communicated orally or structured as requirements whereby approval by the supplier is needed before cross-border sales are permitted.

Specific problematic contractual restrictions identified include: (i) general restrictions limiting retailers' ability to sell to customers outside their Member State of establishment or to customers located in certain Member States; (ii) restriction of active sales by retailers outside a designated territory, irrespective of whether other territories have been exclusively allocated to other distributors; (iii) restriction of passive sales into territories exclusively allocated to other distributors; and (iv) in a selective distribution system across Member States, limitation of authorised distributors' ability to actively or passively sell to end customers within those Member States.<sup>9</sup>

<sup>6</sup> Commission Regulation (EU) 330/210. The Commission has published detailed Guidelines on Vertical Restraints ('Guidelines') to assist parties in the assessment of the legality of vertical agreements.

<sup>7</sup> Note however the Commission is proposing legislation to prevent what it views as "unjustified geo-blocking", including through the use of the non-discriminatory requirements established under the Services Directive (Directive 2006/123/EC).

<sup>8</sup> But see footnote 7. Commenting on the Report, the Director-General of Competition at the Commission, Johannes Laitenberger, also noted: "*If you have a non-dominant firm taking unilateral decisions, that is not a competition matter.*"

<sup>9</sup> Each of these restrictions are considered "hardcore" and fall outside the VBER. There is a presumption that an agreement which contains a hardcore restriction will restrict competition and cannot be justified on an individual basis.

## 2) Bans on sales via online marketplaces.<sup>10</sup>

A high proportion (32%) of retailers in Germany reported having marketplace restrictions, followed by France (21%), the Netherlands, Austria, Spain, and the U.K. (15%-17%). *De facto* marketplace bans include requiring the retailer's website to appear under a domain name which contains the name of the retailer's business or requiring the website to be operated by the retailer.

Manufacturers put forward essentially the same reasons for marketplace bans as they did in the run-up to the adoption of the current VBER and Guidelines in 2010: (i) to protect the image and positioning of their brands; (ii) the failure of marketplaces to combat sale of counterfeit products effectively; (iii) to ensure sufficient pre- and post-sale services; (iv) to prevent free-riding; and (v) that marketplaces prevent retailers from establishing a direct customer relationship with customers.

In response, the Commission noted the efforts by marketplaces to increase the quality and image of their sites and services, including through offering sellers the ability to design their own seller shop within a special area of the marketplace, and the availability of take-down procedures in relation to counterfeit products. It did not, however, form a view on whether these were sufficient. By contrast, the Bundeskartellamt – the German competition authority – which takes a strict approach against marketplace bans, considered in recent cases that online platforms have evolved since 2010 such that they can no longer be automatically associated with products of inferior quality.

The permissibility of having marketplace bans as a qualitative criterion is currently before the European Court of Justice ("ECJ"),<sup>11</sup> after a series of diverging decisions in Germany.<sup>12</sup> However, based

on the Report's findings, consistent with its Guidelines,<sup>13</sup> the Commission concluded that in its view marketplace bans do not constitute hardcore restrictions. In particular, absent evidence that marketplace bans *de facto* amount to a total ban of online sales,<sup>14</sup> the Commission concluded that marketplace bans or restrictions concern "*how the distributor can sell the products over the internet and do not have the object to restrict where or to whom distributors can sell the products.*"

## 3) Bans on use of price comparison tools.

9% of retailers reported having agreements that restrict their ability to use price comparison tools to promote their products.

Manufacturers justify such restrictions by reference to price comparison tools' exclusive focus on prices at the expense of other important factors such as quality, features, and style. They also pointed to the potential of such tools to have a negative effect on brand image and the downward pressure on prices and margins they foster.

Although price comparison tools offer retailers the ability to increase the exposure of their product offerings and generate traffic to their own websites, they are not a distinct online sales channel. For this reason, bans on use of price comparison tools do not restrict online sales as such.

Further, the Commission acknowledged that manufacturers operating selective distribution systems are in principle allowed to require quality standards in relation to the promotion of their products on the internet. This includes banning the use of price comparison tools by authorised distributors.

## 4) Pricing restrictions.

Whilst manufacturers may recommend a resale price, the restriction of a retailer's ability independently to

<sup>10</sup> Examples of online marketplaces include eBay, Amazon, Etsy, Shopify, and WooCommerce.

<sup>11</sup> Coty, Case C-230/16.

<sup>12</sup> Bundeskartellamt decision of August 26, 2015, case B2-98/11 (*Asics*); Bundeskartellamt decision of June 27, 2014, case B3-137/12 (*Adidas*); Bundeskartellamt, case summary of October 24, 2013, case B7-1/13-35 (*Sennheiser*); KG Berlin judgment of September 19, 2013, case 2 U 8/09 Kart (*Scout school bags*); and OLG Schleswig judgment of June 5, 2014, case 16 U 154/13 (*Casio*). Cf., OLG Munich judgment of July 2, 2009, case U (K) 4842/08 (*Adidas*); and OLG Karlsruhe

judgment of November 25, 2009, case 6 U 47/08 Kart (*Scout school bags*).

<sup>13</sup> Guidelines, para. 54 ("[W]here the distributor's website is hosted by a third party platform, the supplier may require that customers do not visit the distributor's website through a site carrying the name or logo of the third party platform.").

<sup>14</sup> The Commission found that own online shops remain the most important online sales channel for retailers. Even among smaller and medium-sized retailers, the proportion of retailers that sell only on marketplaces is relatively low.

determine the final resale prices – resale price maintenance (“**RPM**”) – is a hardcore restriction identified in the VBER.<sup>15</sup>

At least a third of the retailers received some form of pricing recommendations from manufacturers. Of these, some reported being provided with a discount range, instructions to apply the same retail price online and offline, indications of what minimum price they should apply or what advertised price they should use.<sup>16</sup> Others reported being threatened with retaliatory measures, such as loss of discounts, delayed supplies, severance of contracts, or expulsion from the distribution network, if they failed to follow the manufacturers’ pricing indications.

Where “recommended” prices translate into actual prices being applied, such practice likely constitutes RPM. On the basis of its findings, the Commission concluded that certain pricing arrangements may merit investigation on a case-by case basis.

### **5) Online sales and advertising restrictions.**

Some manufacturers impose criteria for online sales which are overall more onerous than those imposed for offline sales or even restrict online sales altogether.<sup>17</sup> Such clauses constitute hardcore restrictions under the VBER.<sup>18</sup>

Other manufacturers limit retailers’ use of manufacturers’ trademarks/brand names for online advertising or search engine optimisation irrespective of whether such usage could amount to a trademark violation.

The Commission advanced the theory that, since search engines are so important for attracting

customers to the retailers’ website, a limitation on retailers’ ability to bid on trademarks in order to get a preferential listing on search engines’ paid reference services (such as Bing Ads and Google AdWords) will restrict retailers’ ability to attract online customers and *prima facie* raise concerns under Article 101.

This is a novel theory. The Commission in effect equated a limitation that prevents a retailer from achieving a prominent position on search engines’ sponsored areas as a restriction on online sales. This seems unwarranted, in circumstances where manufacturers are generally permitted to place restrictions on how authorised distributors may advertise the products, as the Commission acknowledged in relation to the use of price comparison tools. Further, retailers’ websites will still appear on the general search results page, and there are many other ways through which traffic can be directed to a retailer’s website, *e.g.*, through direct URL, online marketplaces, price comparison tools, and mobile apps.

## **III. Findings On Digital Content**

### **Methodology and scope.**

In order to distribute digital content online, a content provider must obtain a licence from holders of copyrights in such content. The Sector Inquiry focuses on potential restrictions in agreements between right holders and providers of online digital content services (licensees).

The Sector Inquiry covers the following digital content: (i) films; (ii) sports; (iii) children TV; (iv) TV fiction; (f) non-fiction TV; (g) news; and (h) music. In order to avoid duplication with the ongoing Pay-TV Investigation,<sup>19</sup> the provision of pay-TV services in relation to film content has been expressly excluded from the scope of the Sector Inquiry. That said, the Commission did examine licensing agreements covering films provided by digital content providers (but not right holders).

<sup>15</sup> VBER, Article 4(a).

<sup>16</sup> E.g., in May 2016, the U.K. Competition and Market Authority imposed a fine of £2.3 million on a commercial fridge supplier, for operating a “minimum advertised price” (“**MAP**”) policy that prohibited resellers from advertising the products below a specified MAP. Earlier that month, it imposed a fine of £0.8 million on a manufacturer of bathroom fittings for introducing a “recommendation” to resellers that online prices should be no lower than 25% of in-store recommended retail prices.

<sup>17</sup> E.g., in the 2016 Lego case, the Bundeskartellamt challenged Lego’s trade discount system under which retailers only obtain the highest possible rebate if they sold Lego products offline. The Bundeskartellamt found that Lego’s practice put online retailers at a “structural disadvantage”.

<sup>18</sup> VBER, Articles 4(b) and 4(c).

<sup>19</sup> Case AT.40023, Cross Border Access to Pay-TV Content (“**Pay-TV Investigation**”). The Commission’s preliminary position is that the contractual restrictions between each of six major US film studios and Sky UK that prevent consumers located in other Member States from accessing, via satellite or online, pay-TV services available in the U.K. and Ireland infringe Article 101.

### Potential competition concerns.

The Sector Inquiry has a particular focus on geo-blocking given its potential to impede cross-border online trade. The Report built on findings on geo-blocking set out in the Issues Paper published in March. The Report also expressed concern that other prevalent features of licensing agreements – including (i) exclusivity of content, rights, and bundling of online rights; (ii) the long duration of licensing agreements; and (iii) payment structures that disadvantage smaller operators – may impede entry and expansion.

#### 1) Territorial exclusivity and geo-blocking.

The vast majority of online rights (c. 80%) are licensed either nationally or for territories spanning up to four neighbouring Member States. Specifically, content types that may contain premium products, including children's TV (66%), sports (60%), films (60%), and fiction TV (56%), are more likely to be licensed on a national basis. Two-thirds of the agreements licensed for the territory of one Member State only are licensed on an exclusive basis.

Right holders indicated that their business models are built on licensing on a national basis as this allows them to optimise the distribution of their content and recoup investments. The Commission did not express a view on these justifications for (exclusive) territorial licensing.

*“Almost all respondents”* – 93% – are required by licensing agreements to include provisions in their terms of service concerning the Member States in which users may access the content. In addition, 70% of digital content providers geo-block, although only 59% of digital content providers are contractually required to do so by right holders.

In terms of categories of content, licensing agreements for fiction TV (74%), films (66%), and sports (63%) include requirements to geo-block more often than those for other digital content categories. The Commission also noted that there is a high degree of variation in the extent to which geo-blocking is required for the same category of content and there are differences in the prevalence of geo-blocking requirements in several Member States.

However, the Commission does not appear to have asked right holders why some licensing agreements did not require geo-blocking. In particular, the lack of formal geo-blocking requirements may be simply attributable to technical difficulties or a commercial decision not to impose potentially costly geo-blocking requirements on smaller content providers.

The Commission did not make reference to the ongoing Pay-TV Investigation when discussing geo-blocking. Nor does the Report indicate clearly that the Commission intends to initiate further enforcement action against geo-blocking practices. EU competition commissioner Margrethe Vestager has, however, confirmed at a press conference on the date of the Report that the Commission is continuing its investigation into “*the alleged geo-blocking of certain video games sold online for personal computers.*”

#### 2) Barriers to entry and expansion.

The Commission identified a number of barriers to entry and expansion stemming from current licensing practices.

The Commission found that exclusivity was a common feature of agreements for the licensing of transmission technology rights (*e.g.*, satellite, cable, online, mobile, and terrestrial) and usage rights (*e.g.*, catch up, multi-screen, and mobile). In addition, rights for online transmission of digital content are in the vast majority of cases licensed together with rights for other transmission technologies.

Licensing agreements also tend to be concluded for a long duration of time. 14% of the agreements were concluded for between five and ten years; and 9% were concluded for more than eleven years. In addition, some contracts contain automatic renewal, rights of first refusal, and matching offer rights.

The Commission further noted that payment structures are highly complex. In particular, the widespread use of advances, minimum guarantees, and fixed/flat fees means that new entrants and smaller operators have to pay the same amount as larger incumbents and are put at a disadvantage. At the same time, the Commission recognised that the online business models have led to experimentation with more flexible payment models including purchase on a per-product basis (such as per-stream or per-download) and revenue-sharing mechanisms.

The Commission stated that it would assess the need for enforcement action on a case-by-case basis. The Commission's assessment would take into account, *inter alia*, whether the contracting parties hold market power at either level of the supply chain. It remains to be seen what enforcement action is contemplated, absent any finding of dominance or restrictive non-compete obligations.

#### **IV. Implications for businesses operating in the EU**

Any business operating in the EU, regardless of its country of domicile, must comply with EU competition rules. In this regard, commenting on the Report, EU competition commissioner Margrethe Vestager warned that the Report should "*be a trigger for companies to review their current distribution contracts and bring them in line with EU competition rules if they are not.*"

Over the course of the Sector Inquiry, the Commission reviewed more than 2,600 distribution agreements and over 6,700 licensing agreements covering almost every category of products and digital content. As explained above, the Commission identified a number of competition concerns in relation to these agreements.

This suggests that the Commission already has in its possession information that may form the basis of any potential enforcement proceedings against individual businesses. Indeed, as explained above, the Commission has, on the basis of its findings to date, already started investigating businesses within specific sectors, such as video games.

Although the Commission's resources are necessarily constrained and specific sectors may avoid closer scrutiny for some time, e-commerce is clearly an enforcement priority for the Commission. Further, national competition authorities have competence to apply Article 101 in their respective Member States. Businesses may therefore want to review their business practices in light of the Report's findings, with the help of external advisors as necessary.

In a few areas, the Commission advanced relatively novel theories, such as in relation to online advertising and whether certain products justify the use of a selective distribution system at all. Businesses that would like to comment on these

developments have the opportunity to submit comments in response to the Commission's public consultation. The deadline for the submission of comments is November 18, 2016.

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