The European Commission sets its sights on online restrictions

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The European Commission’s preliminary report on its e-commerce sector inquiry identifies several market practices which may be subject to further scrutiny.

The European Commission (EC) launched the e-commerce sector inquiry in May 2015 with a view to identifying possible competition concerns in the e-commerce market. The inquiry forms part of the EC’s Digital Single Market strategy, which has the goal of ensuring better access to goods and services online, and focused on the e-commerce markets for consumer goods and digital content.

The EC engaged in an extensive fact gathering exercise, seeking information from nearly 1,800 stakeholders and collecting close to 8,000 distribution agreements. The preliminary report presents the EC’s initial findings following its inquiries and identifies several potential barriers to competition, which may prompt enforcement action after the sector inquiry concludes in Spring 2017.

E-commerce in consumer goods (e.g. clothing, consumer electronics, cosmetics)

The EC has identified the following features of the e-commerce market, which have affected the distribution strategies of suppliers and retailers and led to an increase in the use of particular types of contractual restrictions:

- **High degree of online price transparency**: One of the key benefits for consumers of online platforms is that they allow consumers to compare prices of many products quickly and easily. This has the benefit of lowering search costs, increasing price competition and cross-border trade. However, it has led retailers to become increasingly concerned with free-riding, such as when consumers can use bricks-and-mortar retailers for pre-sales services and then purchase the product more cheaply online.

Margrethe Vestager, Competition Commissioner

“...today’s preliminary report on the sector inquiry should also be a trigger for companies to review their current distribution contracts and bring them in line with EU competition rules if they are not.”
The emergence of online marketplaces (e.g. Amazon, eBay): These platforms facilitate access for retailers to a large customer base across multiple Member States. However, marketplaces can also cause concerns for certain suppliers that wish to protect their brand image and/or their investments in high quality pre- and after-sales services.

Suppliers have reacted to these market features in different ways - many (56% of respondents) now seek tighter control on distribution through use of selective distribution systems, or have increased their direct online sales (64% of manufacturers opened their own online retail shops in the last 10 years) which means that many retailers now find themselves competing against their own suppliers.

Through its inquiry, the EC has found evidence of the following types of restrictions, which it suggests it may investigate further:

- **Restrictions on the use of marketplaces (e.g. Amazon, eBay):** It is well established that restrictions which in effect ban the use of the internet as a method of marketing could breach EU competition law. However, whether a ban on the use of an online marketplace is anti-competitive has been subject to some debate across Europe. In contrast to the approach of other authorities, the German national competition authority has adopted decisions prohibiting marketplace bans. However, in the report the EC takes a more nuanced view that a case-by-case assessment is required, in particular, to explore possible efficiency defences such as free-riding. The question as to whether marketplace restrictions infringe competition rules is being considered by the Court of Justice of the European Union.

- **Cross-border sales restrictions (i.e. geo-blocking):** The EC notes its concerns that retailers face contractual restrictions which prevent cross-border selling online. The EC confirms that agreements which require geo-blocking by retailers - for example by blocking website access to consumers located in another Member State - may well constitute an infringement of EU competition rules.

- **Restrictions on the use of price comparison tools:** The EC raises concerns that restrictions on the use of price comparison websites may exclude an effective method for retailers to generate traffic to their website, though notes that restrictions based on objective qualitative criteria may be capable of justification. The EC considers that absolute bans, however, are more likely to be problematic. As with marketplace restrictions, the EC suggests that a case-by-case assessment is likely to be required.

- **Pricing restrictions:** The EC found that pricing restrictions are the most prevalent (42% of retailers report experiencing some form of pricing restriction) and raises concerns that price monitoring software could facilitate collusion or permit retaliation by suppliers against non-compliance with pricing recommendations.
The EC finds that these restrictions may make cross-border shopping or online shopping in general more difficult and ultimately harm consumers by preventing them from benefiting from greater choice and lower prices in e-commerce.

**E-commerce in digital content (e.g. films, TV, sports)**

The availability of licences from the holders of copyrights in content is a key determinant of competition in the market. The preliminary report finds that online distribution of content and demand for online rights has not dramatically altered the way in which right holders license their rights. The report notes a number of areas where the prevailing market features may have an impact on competition:

- **Widespread geo-blocking practices:** The EC found that agreements which require providers to apply geo-blocking measures are prevalent - nearly 60% of content providers are required by their contracts to geo-block (i.e. prevent distribution in the EU outside their licensed territory). The EC notes that contractual agreements requiring geo-blocking could breach the competition rules, though restrictions may be capable of justification in certain circumstances. The EC has already taken enforcement action in this area - in July 2016 the EC accepted commitments from Paramount TV to remove clauses from its contracts that prevent broadcasters from allowing EU consumers outside their licensed territory having to access pay-TV via satellite or online. The EC is continuing its investigation against five other studios and Sky UK.

- **Long-term exclusive licence agreements:** Licensing agreements are often complex, typically including restrictions relating to territories, technologies and release windows, and exclusivity is often attached to these licensed rights. The EC found that new entrants and smaller operators may find it difficult to obtain licenses because of the relatively long and stable exclusive contractual relationships between right holders and established digital content providers. In addition, some respondents noted that the way online rights in digital content are split up or bundled, and the prevailing payment mechanisms, can also put them at a competitive disadvantage.

The EC intends to assess on a case-by-case basis whether certain licensing practices restrict competition and whether enforcement of the EU competition rules by the EC is necessary in order to ensure effective competition.

**What does this mean for businesses?**

The preliminary report is now open to public consultation for a period of two months. Interested stakeholders may therefore wish to take the opportunity to comment on the EC’s findings and may also raise other areas of focus for the sector inquiry.

The EC expects to publish its final report in the first quarter of 2017. In the meantime, the EC will continue to scrutinise e-commerce in consumer goods and digital content. The findings of the final report are, however, likely to have implications for businesses operating in all online markets, not just those inside the current scope.

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While the EC has not made any specific recommendations for enforcement action at this stage, it is clear that such action is likely.

- Businesses should therefore review their online distribution arrangements for compliance with competition law. The EC looks likely to increase the scrutiny of selective distribution systems in the online sphere.

- Businesses should assess carefully any agreements that restrict online cross-border selling in the EU (geo-blocking).

- Attention should also be given to restrictions on pricing and the use of marketplaces / price comparison websites.

- Businesses active in the digital content field should give consideration to the extent to which their licensing practices may restrict competition, particularly in the area of geo-blocking.