

client alert

E-COMMERCE | EU |

4 OCTOBER 2016

SUMMARY OF THE EUROPEAN COMMISSION'S PRELIMINARY REPORT ON THE E-COMMERCE SECTOR INQUIRY

On 15 September, the European Commission published its Preliminary Report on the E-commerce Sector Inquiry. As a reminder, the Commission had decided on 6 May 2015, as part of its Digital Single Market strategy, to launch a sector inquiry to assess and collate elements that could help identify potential barriers to competition in the e-commerce sector. To this end, the Commission sent highly detailed questionnaires to various market players active in the sector and in particular to manufacturers of branded products, resellers (*pure players* or not) and marketplaces.

Well aware that competition conditions may vary from one product category to another, the Commission purposefully sent its questionnaires to market players operating in various product categories in order to integrate this variable in its preliminary report. Product categories concerned are (i) clothing, shoes and fashion accessories, (ii) consumer electronics, (iii) electrical household appliances, (iv) computer games and software, (v) toys and childcare articles, (vi) media, (vii) cosmetics and healthcare products, (viii) sports and outdoor equipment and (ix) house and garden products.

After conducting an in-depth analysis of competition conditions in the e-commerce sector (I.) and resulting changes to the organisation of distribution patterns (II.), the Commission reviews certain restrictions inherent to these markets, such as physical point of sale criterion, the use of marketplaces, price comparison tools and recommended retail pricing (III.).

Simultaneously, the Commission organised a public consultation to enable interested stakeholders or professional organisations to send their comments about the preliminary findings of the sector inquiry presented in the Preliminary Report. The deadline for submitting such contributions is set at 18 November 2016.

I. HOW COMPETITION WORKS IN THE E-COMMERCE SECTOR

The main features of competition in the e-commerce sector

The Commission is reviewing the main elements driving competition between the various actors of the distribution chain. This review shows that, depending on their position in the production and distribution chain, economic players will not make the same efforts to differentiate themselves from their competitors.

The results of the inquiry indicate that, for manufacturers, the most important parameters of competition are: product quality, brand image, the novelty of the product and thus the renewal of ranges and innovation, as well as safety and design.

For distributors, the key element of competition is price, followed by wide product range and the availability of the latest models. For marketplaces, the key elements that drive competitiveness are wide product range, image and reputation of the marketplace, ease of use and price.

The review of the Commission highlights the fact that price is not the only competitive and differentiating factor, for both offer and demand. Indeed, manufacturers consider that their differentiating items are rather the renewal of product ranges, innovation and the quality of their products, and direct their efforts and investments towards these objectives in order to meet the expectations of consumers. It is therefore essential to uphold the capacity of major brands to innovate and improve the quality of their products.

Price transparency

The Commission observes the existence of high price transparency in e-commerce. It is inherent to online commerce and has a significant impact on the behaviour of consumers, who can immediately compare prices online and very easily move from online to offline channels, and vice versa.

Price transparency is emphasised by the IT tools used by distributors. The Commission states that over half of distributors say they monitor their competitors' prices and adapt their own pricing accordingly (up to several times a day for certain types of goods).

As regards dual pricing, only a small minority of cross-channel market players admit to applying different prices for online and offline sales. Some explain this difference by the intensity of competition on online prices. Others explain that dual pricing can be justified by the lower costs of e-commerce (no operation costs of a physical POS, no pre-sales costs).

II. BRANDS' RESPONSE TO THE DEVELOPMENT OF E-COMMERCE

Manufacturers develop their own retail website and open up to pure players

Price transparency, quick price erosion and difficulties for major brands to maintain a consistent brand image online and offline, have together affected manufacturers' distribution strategies. To meet the threat of the development of e-commerce, the Commission observes that big brand names have launched their own retail website and/or have opened up the distribution of their products to pure players.

As regards the development of retail websites by brands, the Commission notes that the phenomenon has led to the vertical integration of distribution by the brands. This is particularly true in the cosmetics and sportswear sectors, where over 80% of manufacturers are present at a different level in the production/distribution chain. This integration, which constitutes one of the strongest reactions to the development of e-commerce, has, according to the Commission, enabled brands to benefit from the development of e-commerce while at the same time increasing their control over the distribution of products, including on quality and price.

As regards pure players, the Commission notices that, although major brands open distribution of their products to retail websites that do not have any physical points of sale, certain pure players face a refusal of access to certain products because of their low price policy.

Additionally, the Commission notes that, despite the development of e-commerce, a number of manufacturers, especially luxury industry players, stress the importance of selling their products in physical points of sale. Luxury industry players consider that the traditional

purchase experience in a sales environment that is specific to luxury, with an additional service during the sale, is essential in the positioning of their products and in meeting the expectations of consumers. In this context, some market players of the luxury industry indicate that the launch of retail websites for certain luxury brands and products was disappointing, with consumers preferring the purchase of high-price products in a luxurious and traditional shopping environment.

Lastly, although major brands have adapted to the development of e-commerce and benefit from it, half of those manufacturers who answered the Commission's inquiry consider that marketplaces could have a negative impact on their business.

An increasing use of selective distribution

19% of manufacturers admit to having put in place a selective distribution system to counter the development of e-commerce, while 67% of manufacturers have introduced new selection criteria, in particular via the creation of an "internet addendum". The development of e-commerce may have led to an increasing use of selective distribution and/or to an adaptation of quality criteria to the e-commerce context.

The Commission is conducting an interesting analysis of the various reasons put forward by manufacturers, and observes that the reasons highlighted are not very different from one product category to another. They include: protection of market positioning, preservation of the brand's image, sales environment that reflects the brand's image, preservation of the prestige and perception of the brand's luxury image, delivery of pre-sale and after-sale services and provision of quality and/or professional advice, personalised advice, technical advice from a specialist, etc.

In addition, the Commission is conducting an in-depth analysis of the various selection criteria applied either to both online and offline channels, or to just one of the two channels. For further information, please refer to pages 82 to 86 of the Preliminary Report.

The Commission notes that, although as a general rule the selection criteria applied may vary significantly from one channel to another, the development of e-commerce has led to the implementation of more stringent selective distribution and quality criteria.

Although major brands justify this stringency by the need to ensure a high level of quality in the distribution of their products, the Commission considers that certain selection criteria go beyond what is necessary and is conducting an in-depth analysis of certain restrictions, such as the physical point of sale criterion, the ban from using marketplaces, price comparison tools and the instauration of recommended retail prices.

III. COMPETITION RESTRICTIONS REVIEWED

The physical point of sale criterion

The Commission observes that the physical point of sale requirement is usually driven by the need to ensure proper advice to customers by qualified staff; the possibility to demonstrate the operation and technical specificities of the product; the possibility for customers to visualise the product; the luxury contextual sale environment ; the special shopping experience, with tailored care and attention given by the staff; or the need to provide safety guidelines.

As regards the validity of the physical point of sales criterion, the Commission recalls that such a qualitative criterion indicated in a selective distribution agreement that links a manufacturer

and a retailer whose market share does not exceed 30% and that does not contain a hardcore restriction, benefits from the exemption provided for by the exemption regulation no. 330/2010. However, it also recalls that when the characteristics of a product do not require a selective distribution network or the application of certain selection criteria, and if the restriction(s) in question generate anti-competitive effects on the market that are not likely to be counterbalanced by efficiency enhancing effects, the benefit of the Block Exemption Regulation may be withdrawn, in line with article 29 of regulation 1/2003.

In this regard, the Commission finds that selective distribution has increased considerably these last few years for a wide range of product categories. It then considers that the obligation for retailers to operate a physical point of sale, when it is generally covered by the exemption regulation, could require further examination in certain individual cases when, for certain product categories or product lines, pure players could be approved on the basis of equivalent criteria. The Commission concludes that the criterion of a physical point of sale could, in some cases, go beyond what is necessary to maintain a high quality of distribution.

Since the Commission suggests that the physical point of sale criterion may not be justified for some product categories, it may nonetheless be justified for the other product categories.

It thus seems that the Commission will not review its position on the physical point of sale criterion for products that have always been the object of a selective distribution whose justification was recognised by the Commission and EU courts, and for which the investments in pre-sale services, such as personalised advice, the *touch and feel* as well as the sales environment, are essential in maintaining the quality and good use of the product, the brand's image and/or its luxury or premium positioning on the market.

It will be necessary to closely monitor the Commission's position on this precise matter, particularly in the final report that will follow the public consultation recently launched.

The use of marketplaces

48% of manufacturers that answered the Commission's inquiry consider that marketplaces have a negative impact on their business. The Commission states nonetheless that the negative impact of marketplaces on manufacturers' business depends on the characteristics specific to each of these marketplaces. Indeed, in certain cases, the marketplaces respect the identity of the brands and deliver enough information to consumers on the characteristics and qualities of the products, in such a way that these marketplaces could increase online sales of a given product without affecting their brand's image. The Commission does not issue an opinion however on marketplaces that do not respect brand identities.

The Commission then reviews the various justifications put forward by manufacturers to limit or better regulate the use of marketplaces by retailers: (i) the protection of product positioning and brand image, (ii) the protection of products against counterfeits, (iii) ensure a good level of pre-sale and after-sale services, (iv) protect existing distribution networks (free-riding), (v) the dominant position of certain marketplaces and the ambiguous relations they have with consumers. At the same time, the Commission states, relatively succinctly, that certain marketplaces have made, or are making, efforts to adapt to the qualitative criteria of brands.

The Commission observes that, beyond the absolute ban to the use of marketplaces, some qualitative criteria of manufacturers could have the same effect as an absolute ban. This may, for example, be the case if the retailer's website has to appear under a domain name which contains the name of the retailer's business, if the website on which products are sold has to be

operated by the retailer, or in case of a prohibition to sell via marketplaces that have their logo visible. In this last example, the Commission refers to the "logo clause" that sparked great debate in Germany and on which the ECJ should render a decision in the context of the Coty case.

Some manufacturers require specific approval for any marketplace via which the retailer intends to sell their products. The Commission considers that the result of such approval requirements may be the same as an explicit prohibition to sell via marketplaces. Retailers may not request such an approval and even if they do request it, a rejection of their request may follow. The Commission's position seems tough. It is based on the premise that manufacturers would systematically refuse that retailers place their products on marketplaces when the latter make a request thereto, which can evidently not be demonstrated *a priori*.

It is regrettable that the Commission is considering the instauration of incompatibility presumption for the criteria, which would require the retailer to inform its manufacturer and ask it to verify the compatibility of the platform in question with the retailer's sales standards. Such a presumption would in fact significantly reduce the manufacturer's ability to monitor the consistency of its network, in particular as regards the marketplaces used by its approved retailers.

The Commission states that the restrictions imposed by certain manufacturers may have the effect of excluding marketplaces as a sales channel. However, the fact of knowing whether a restriction leads to the exclusion of most marketplaces can only be determined on a case-by-case basis. This point has its importance since the Commission refuses to consider that such or such restriction affecting the use of marketplaces could constitute a restriction by object, requiring a concrete analysis as regards the nature of the product, the market structure and the effects of the restriction in question (which would obviously make the work of the competition authorities more complex).

There is currently a debate, in particular in some Member States, as to whether marketplace restrictions that are not linked to qualitative criteria (absolute or per se marketplace bans) amount to hardcore restrictions. A reference for a preliminary ruling is currently pending in this regard before the Court of Justice. The Commission thus seems to take note that this question will be addressed by the Court in the coming months.

The Commission then moves on to an *a posteriori* explanation of its guidelines published in 2010, and indicates that it had not considered at the time that a ban on the use of marketplaces would constitute a hardcore restriction.

The Commission then explains its appreciation to-date of the absolute ban to use marketplaces. Based on the Pierre Fabre judgment, it considers first of all that a ban on the use of marketplaces could constitute a restriction by object of passive sales in that it prevents the use of the Internet as a sales channel.

On this matter, the Commission indicates that the results of the sector inquiry do not show that absolute marketplace bans amount to a *de facto* prohibition to sell online. Marketplace bans can therefore not be treated in the same way as a prohibition to sell online. Indeed, marketplaces do not constitute the main sales channel on the Internet, and half of retailers do not today sell via marketplaces.

The importance of marketplaces as an online sales channel differs from one Member State to another to a significant extent (while in Germany, more than 60 % of retailers reported to be selling via marketplaces, less than a quarter of retailers did so for other Member States such as

Italy, Belgium or Sweden). The importance of marketplaces as a sales channel also varies from one product category to another. Marketplace sales are more important for smaller and medium-sized retailers than for larger retailers, yet for this category of retailers, over half sell only on their own website.

The preliminary findings of the sector inquiry do not indicate that marketplace bans should be considered as hardcore restrictions within the meaning of Article 4 of the Vertical Block Exemption Regulation since they do not restrict the territory or the customers to whom the retailer in question may sell, and do not restrict active or passive sales to end users. The Commission confirms that this approach is in line with the guidelines it issued in 2010.

This does not mean that the Commission considers absolute marketplace bans in all cases compatible with European competition law. The Commission recalls that such bans may fall within the scope of article 101(1) TFEU if market shares of the parties to a distribution contract exceed 30%. The Commission or national competition authorities may also decide to withdraw the benefit of the Vertical Block Exemption Regulation pursuant to Article 29 of Regulation 1/2003. In this context, the Commission indicates that the credibility of brand protection considerations and the need for pre- and post-sale advice will be important elements in the analysis.

The position adopted by the Commission on the ban of marketplaces, which it considers to be in line with its guidelines of 2010, offers new insight since it confirms the lack of qualification of this type of clause as a hardcore restriction. Consequently, where parties to a selective distribution agreement have a market share of less than 30%, any contestation as to the validity of this type of clause would force the Commission or the national competition authorities to withdraw the benefit of the Block Exemption Regulation per category, in line with article 29 of regulation no. 1/2003. The competition authority must then establish that the ban to use marketplaces does not respect the conditions of article 101(3) TFEU. Such an analysis in particular requires the demonstration that the product concerned does not need heightened protection of its brand image and the maintenance of pre-sale and post-sale advice.

Price comparison tools

Price comparison tools allow consumers to find retailers that offer certain products, compare prices and retain the offers they consider most suitable.

According to the preliminary findings of the sector inquiry, the use of price comparison tools is widespread. 36 % of retailers reported that they supplied data feeds regarding their products to price comparison tool providers in 2014.

9% of distributors reported that they have agreements with manufacturers which contain some form of restriction in their ability to use price comparison tools, ranging from a full ban through to the imposition of qualitative criteria.

The findings show that quite a few manufacturers are critical of price comparison tools as they focus only on price, when other elements are of high importance for the attractiveness of a product, such as quality, luxurious image, design, etc.

The issues arising from the use of marketplaces and price comparison tools differ in a number of respects. Unlike marketplaces, price comparison tools redirect potential customers to the website of the authorised distributor, from which the product can be purchased, leading the customer to browse the retailer's interface that fulfils all the brand's quality criteria.

While the Commission considers that absolute bans on price comparison tools that are not linked to quality criteria may limit the ability of distributors to use this promotion method for their product and to generate traffic for their own website, it also considers that manufacturers operating selective distribution systems are in principle allowed to require quality standards in the use of these tools by their retailers.

Recommended retail prices

The Commission observes that at least one-third of retailers in each category of the products concerned receive pricing recommendations from the manufacturers. The Commission notes that, according to manufacturers, the communication of a recommended price constitutes the best way of communicating on the quality and positioning of the brand.

Some 30% of manufacturers systematically monitor the prices practiced in retail resale. Other manufacturers track the prices practiced by their retailers in a more targeted way, preferring to monitor certain products or certain key markets. Additionally, 67% of manufacturers use manual price tracking, while 40% use price-tracking software.

The Commission observes that it is now easier to detect deviations from manufacturers' pricing recommendations, which could allow manufacturers to take steps to limit such deviations. It also considers that increased price transparency that is inherent to e-commerce and the tracking of competitor prices by the retailers could reduce the incentive to deviate from the recommended retail price.

The Commission nonetheless indicates, without going into further detail, that some pricing agreements between manufacturers and their retailers may need further investigation on a case-by-case basis.

CONTACTS

ANTOINE CHOFFEL
Partner
choffel@gide.com

FRANCK AUDRAN
Counsel
audran@gide.com

You can also find this legal update on our website in the News & Insights section: gide.com

This newsletter is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide's clients and business associates. The newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee. In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communications department (privacy@gide.com).