

The European Commission's Preliminary Report and Public Conference on the E-commerce Sector Inquiry

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On September 15, 2016, the European Commission published its Preliminary Report on the ongoing e-commerce sector inquiry. The report is based on the input from nearly 1,800 companies operating in e-commerce of consumer goods and digital content and has analyzed around 8,000 distribution contracts. The report confirms the fast growth of e-commerce in the EU and identifies business practices that may restrict or distort competition.

On October 6, 2016, the Commission held a Public Conference in Brussels to discuss the Preliminary Report.

The e-commerce sector inquiry was launched on May 6, 2015 and forms part of the Commission's Digital Single Market Strategy, one of the main pillars of which is to ensure better access for consumers and businesses to goods and services online across Europe. The aim of the sector inquiry is to obtain an overview of the prevailing e-commerce market trends and to identify possible restrictions or distortions of competition, in particular in relation to cross-border e-commerce. The Preliminary Report is the second step in the ongoing e-commerce sector inquiry, after the Commission already published its Initial Findings on geo-blocking on March 18, 2016, which noted that geo-blocking is a widely used practice throughout the EU for both consumer goods and digital content.

Findings of the Preliminary Report in Relation to Consumer Goods

In relation to consumer goods, the Commission found that there are a number of market features which have a substantial effect on the distribution strategies adopted by manufacturers which, in turn, may raise competition concerns.

A. Market Features

1. Price Transparency and Price Tracking

The Commission found that the high degree of online price transparency and price tracking is the feature which most affects the behavior of market players and customers. Fifty-three percent of the respondent retailers track the online prices of their competitors, and sixty-seven percent of them use automatic software programs to do so. Seventy-eight percent of the retailers who use software to track prices subsequently adjust their prices based on the ones of their competitors. Online price transparency leads to an increase in

price competition but may have drawbacks for competition on other parameters than price, such as quality, brand image, and innovation.

2. Free-riding

The Commission found that there is a high degree of free-riding with many customers using the pre-sales services offered by one sales channel but then purchasing the product through another sales channel. The free-riding was not all one way, however: although brick and mortar shops provide product demonstrations and personal advice, online services provide product information and reviews. Recouping the costs of brick and mortar pre-sales services is a major concern for many manufacturers and retailers.

B. Practices Adopted by Manufacturers in Response to the Growth of E-commerce

Manufacturers have responded to the growth of e-commerce and to these market features by adopting a number of practices in order to better control the distribution of their products and the positioning of their brands.

1. Increased Direct Retail Activities by Manufacturers

The Commission found that 64 percent of the respondent manufacturers started their own direct retail activities in the last 10 years, competing with their existing distributors.

2. Expansion of Selective Distribution

There has been an expansion of selective distribution with, in the last 10 years, around one in five respondent manufacturers introducing selective distribution systems for the first time and 67 percent of those who already used selective distribution introducing new selection criteria, in particular for online sales. Almost half of the manufacturers using selective distribution reported that they do not allow pure online players to join their selective distribution network. The Preliminary Report notes that, following the sector inquiry, the Commission may scrutinize certain clauses restricting online sales in selective distribution agreements.

3. Increased Use of Contractual Sales Restrictions

Manufacturers have also responded to the growth of e-commerce by using contractual sales restrictions regarding the distribution of their products. The Commission found that these restrictions may take various forms, such as cross-border sales restrictions (geo-blocking), marketplace restrictions, pricing restrictions, and restrictions on the use of price comparison tools.

a. Cross-border Sales Restrictions (Geo-blocking)

The preliminary findings show that 38 percent of the retailers use geo-blocking in order to restrict cross-border online sales. While the majority of the geo-blocking measures are based on unilateral decisions by retailers, nearly 12 percent of the retailers report that they are contractually required by the right holders to geo-block for at least one of the product categories they offer. Geo-blocking can take the form of a refusal to deliver abroad, refusal to accept cross-border payment, and, to a lesser extent, re-routing and website access blocking.

b. Marketplace Restrictions

Online marketplaces allow smaller retailers to become visible and sell products to a large customer base and in multiple Member States with limited investments. The preliminary results show that sales via marketplaces generate a high share of the online revenues of smaller retailers which use both their own website and marketplaces to sell goods online. An own online shop remains important for most retailers and more than half of the respondent retailers sell via their own online shop only. The Commission further found that 39 percent of the respondent retailers use marketplaces for their sales, and only 4 percent of the retailers responded that they sell exclusively via marketplaces.

The Commission found that, across the EU, 18 percent of the retailers report marketplace restrictions in their agreements with suppliers. The marketplace restrictions encountered by the Commission range from absolute bans to restrictions to sell on marketplaces that do not meet certain quality criteria.

c. Pricing Restrictions

Across the EU, 42 percent of the retailers responded that they experience some form of pricing restrictions or recommendations and 80 percent of the manufacturers responded that they recommend certain re-sale prices to their distributors. Almost 30 percent of the manufacturers indicate that they systematically track the prices of their products sold via independent retailers. Others do so in a targeted manner, i.e., for certain products or in certain markets. Almost a third of the retailers indicate that they usually comply with the price indications given by the manufacturers, while slightly over a quarter of the retailers say that they never comply.

d. Price Comparison Tool Restrictions

The Commission found that the use of price comparison tools is widespread with more than a third (36 percent) of the retailers reporting that they supplied data feeds to price comparison tool providers in 2014. Around one in 10 retailers (9 percent) report that the agreements with their suppliers contain some form of restriction in their ability to use price comparison tools. While certain manufacturers consider price comparison tools as beneficial for their business because they increase the visibility of their brands, a substantial number of them view price comparison tools rather critically because they enhance competition based on price, rather than on other features. Price comparison tool restrictions range from absolute bans to restrictions based on certain quality criteria.

Findings of the Preliminary Report in Relation to Digital Content

The Commission found that the availability of licenses from right holders is essential for digital content providers and a key element of competition in the digital content markets. The availability of rights for online transmission depends on the precise scope of the rights as defined in the licensing agreements. There are several factors which determine to what extent rights for online distribution of content are available, including the technological, territorial, and temporal scope of the rights, the duration of the licensing agreements, and the

fact whether the rights are licensed on an exclusive basis. The preliminary results of the sector inquiry show that contractual restrictions, in relation to the licensed transmission technologies, timing of releases, and licensed territories, are the norm in digital content markets.

A. Geo-blocking and Restrictions in Terms of Service

In line with its Initial Findings published on March 18, 2016, the Commission found, in addition to the fact that rights are often licensed on a national basis, that about 70 percent of the respondent digital content providers geo-block users from other Member States. Almost 60 percent of the respondent digital content providers are contractually required by the right holders to geo-block. Many licensing agreements allow the right holders to monitor the use by content providers of geo-blocking measures or their compliance with territorial restrictions and to impose sanctions and ask for compensation if such measures or territorial restrictions are not complied with.

Furthermore, many licensing agreements also require digital content providers to include access and use restrictions in their terms of service. Eighty-seven percent of the respondent digital content providers note that their terms of service contain restrictions as to the users' possibility to access content in certain Member States. Thirty-seven percent of the providers require the user to supply accurate address data when signing up for an account or a subscription while 17 percent of the providers restrict the user's right to play downloaded content in certain territories. Lastly, 10 percent of the providers restrict the user's right to access content through a VPN or a similar service. Most importantly, 83 percent of the content providers are required by their licensing agreements to include at least one restriction in their terms of service. The most frequently occurring restriction is the one restricting the Member States in which the user can access the digital content, with 93 percent of the respondents indicating that they are required by their licensing agreements to include such restriction in their terms of service.

B. Duration of Licensing Agreements and Exclusivity

The preliminary results show that right holders tend to have relatively long-term and often exclusive licensing agreements with digital content providers. Of the agreements submitted to the Commission, four out of five had a duration of at least two years and almost one out of 10 had a duration of over 10 years. Furthermore, a substantial number of licensing agreements include clauses which facilitate the prolongation of the agreements, such as first negotiation clauses and automatic renewal clauses. As a result, digital content providers (or new entrants) seeking to enter a certain market or to expand their current commercial activities in a market may face difficulties to secure licenses that are the object of long-term exclusive licensing agreements between their competitors and the right holders.

C. Payment Structures

The Commission found that the widespread use of advance payments, minimum guarantees and fixed/flat fees (per bundle of programs, or independent of the number of programs) results in smaller digital content providers or new entrants having to pay the same amount as larger incumbents for equivalent rights, which may put them at a competitive disadvantage. However, for some types of products and release windows, revenue sharing and performance-based payment mechanisms (e.g., where payments are proportionate to

the number of subscribers or users accessing the content) seem to be more widely used which favors competition downstream, increases choice for users and makes use of the possibilities offered by online transmission.

Next Steps

Sector inquiries are investigations carried out by the Commission into certain sectors and do not target specific companies. Hence, the Commission will not be entitled to fine companies as a result of the e-commerce sector inquiry. However, if the sector inquiry brings to light certain unlawful practices, the Commission may, following the inquiry, decide to open case-specific investigations regarding these practices to ensure compliance with the EU antitrust rules.

The Commission reiterates in its Preliminary Report that the restrictive practices it found may, under certain circumstances, breach EU antitrust rules and that this needs to be assessed on a case-by-case basis. The Commission also notes that the Preliminary Report should encourage companies to revise their current distribution agreements, if necessary. In a speech given on September 22, 2016, the Director-General for Competition at the Commission, Johannes Laitenberger, stated that the Commission may take enforcement action in the e-commerce sector and that “producers, retailers and content providers do not need to wait until the end of the [e-commerce] consultation to incorporate guidance from the Preliminary Report on what they can do to stay on the right side of EU competition rules”.¹ During the Commission’s conference in relation to the Preliminary Findings on October 6, 2016, Commissioner Vestager said that many companies have already taken the opportunity to check that they are complying with the EU antitrust rules and that she hopes that by the end of the inquiry every company involved in e-commerce will do the same. This suggests that the Commission believes that a number of the arrangements they have seen during the inquiry do in fact need modification to a greater or lesser degree, and that enforcement action in respect of some cases is likely.

The conference did not provide any real indication as to the Commission’s upcoming priority areas, and the Commission avoided giving a substantive answer to several questions from the floor, indicating that the purpose of the conference was to continue the discussion on the report, not to indicate future areas of Commission activity. For example, asked whether the greater use of selective distribution identified in the report would lead to the Commission reconsidering its current guidance, the Commission merely noted that the agreements were becoming more “sophisticated.”

Nevertheless, the Commission is clearly coming under pressure to act in some areas. However, Monique Goyens, the Director-General of BEUC, the European Consumer Organization, for example, asked for consumers to be able to buy online content across-borders, at least where that content was not available in the consumer’s home territory. That could not, in her view, undermine investments in territorial exclusivity, because the rights had simply not been made available in the consumer’s home state.

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It is notable that that is a lesser request than full passive sales for online content, where—at least in line with traditional passive sales rules—such sales would be possible even if the rights were being made available in the consumer’s home state.

The Preliminary Report is now open for public consultation for a period of two months (until November 18, 2016). The Commission’s Final Report is scheduled for the first quarter of 2017.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Antitrust/Competition practice:

Kevin Coates
Miranda Cole
Wesley Lepla

+32 2 549 52 32
+32 2 549 52 64
+32 2 545 75 11

kcoates@cov.com
mcole@cov.com
wlepla@cov.com

¹ See <http://globalcompetitionreview.com/news/article/41886/laitenberger-dg-comp-may-enforce-e-commerce/>.

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