Competition law aspects of distribution in the online world

Corporate Counsel Forum

Nelson Jung  Director, Office of Fair Trading
Elisabetta Rotondo and Rachel Iley,  Kemp Little Competition Law Group
What we’re covering today

please note: Chatham House rules apply

09.10 – 09.35: Elisabetta Rotondo and Rachel Iley
- Impact of the Internet on distribution
- Introduction to vertical agreements, EU and UK approaches

09.35 – 09.50: break

09.50 – 10.15: Nelson Jung, Director, Office of Fair Trading
- Vertical agreements online

10.15 – 10.30 Questions

10.30 – session ends
Impact of the Internet on competition law (1)

The Internet has a profound impact on distribution law

- Raising general questions of how competition law and other rules apply to distribution online
- Competition regulators have had to adapt existing rules on ‘vertical’ agreements to fit the online world: 2010 new vertical Guidelines reflect the impact of the Internet

“Consumers have everything to gain from the Internet. It expands the size of the market they operate in and gives them access to more providers and more choice. It makes it possible to compare products, suppliers and prices on an unprecedented scale. Internet use for retail shopping is destined to become pervasive.”

Impact of the Internet on competition law (2)

Although regulatory activity has focused primarily on adapting current rules to the online world, e-distribution is also creating new pressure points.

- New types of competition law infringement
  - e.g. European Commission investigation into Google’s alleged abuse of alleged dominance in online search

- New business models which may not fit neatly within traditional distribution competition law
  - Both European Commission and the OFT have recognised this and OFT is researching potential models and how the law applies to these

"Consumers have everything to gain from the internet. It expands the size of the market they operate in and gives them access to more providers and more choice. It makes it possible to compare products, suppliers and prices on an unprecedented scale. Internet use for retail shopping is destined to become pervasive."

Meglena Kuneva
Consumer Protection Commissioner,
5 March 2009
Assessing distribution under EC/UK law: the framework for vertical agreements (1)

- **Same rules apply to the online world as do to the offline world:**

- **Article 101 TFEU/Chapter I CA98 prohibits anti-competitive agreements, i.e.**
  - have object / effect of preventing, restricting or distorting competition
  - have an effect on trade between Member States / in the UK

- **Distribution is typically achieved through ‘vertical’ agreements**
  - Parties operating at different levels of the supply chain e.g. supplier and ‘buyer’/distributor (NB not consumers)
  - Non-reciprocal agreements between actual/potential competitors where both supplier and distributor compete downstream but not upstream
Key points about vertical agreements

- Vertical agreements are generally regarded as less harmful than horizontal restraints and may even be pro-competitive

most vertical agreements may be exemptible under Article 101(3)TFEU/Part 9 CA1998 if they provide pro-competitive efficiencies

unless….

- either party has market power or
- agreements contain hard core restrictions:
  - RPM (limiting distributor’s ability to set its own prices)
  - territorial / customer restrictions
  - foreclosure of competitors
  - certain restrictions in a selective distribution network

- >40% consider issues of dominance
  - unilateral conduct will not fall foul of competition law unless there is dominance
    - Article 102/Chapter II CA98 may apply
1. “the territory into which or the customers to whom the buyer or its customers may sell the contract goods or services”

Application to online distribution

“in principle, every distributor must be allowed to use the Internet to sell products” (Vertical Guidelines)

- **Supplier can restrict active sales into other exclusive territories/customer groups**, e.g.
  - actively targeting a group of customers on its website
  - sending unsolicited emails
  - territory based banners on third party websites
  - specifically targeted adverts/promotions e.g. via a search engine
Hard-core restrictions and the Internet under EU law (1b)

- **Supplier must not prevent “passive” sales via the Internet:**
  - Restricting distributor using a website e.g. language options; **but**
    - quality standards
    - use of third party platforms
    - bricks and mortar shop
  - Preventing automatic updates
  - Requiring re-routing of customers *(e.g. Apple / iTunes)*; **but** can link to another distributor’s website
  - Transactions to be terminated from customers outside the exclusive territory
  - Limiting the *proportion* of overall sales over the Internet; **but**
    - consistency with supplier’s distribution model
    - certain *amount* (value/volume) of off-line sales
  - Higher prices for products resold online than for those resold off-line: “dual pricing”
    - fixed fee to support the distributor’s online/offline sales efforts
    - may be exemptible but only if online sales lead to substantially higher costs
2. “the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade”

Application to online distribution

- Selection criteria to appoint authorised dealers
  - must be “overall equivalent” to offline
- Sales to unauthorised dealers prevented
- Must allow active + passive sales by authorised retailers to end users – incl. via the Internet (Pierre Fabre)
- Distributor’s use of website is not akin to opening a new ‘brick and mortar’ outlet (which a supplier can control) (Pierre Fabre)
Hard-core restrictions and the Internet under EU law (3a):

3. “The restriction of the buyer’s ability to determine its sale price”

Resale price maintenance - what is it?

- Setting **fixed** or **minimum** resale prices – whether directly or indirectly
  - Fixing distribution margin
  - Fixing max level of discount from prescribed price level
  - Making the grant of rebates subject to observing a certain price level.
  - Linking prescribed resale price to the resale price of competitors
  - Threats, penalties, delay/suspension of deliveries/contract termination in relation to observance of a given price level.

- Reinforced by
  - Price monitoring systems
  - Most favoured customer/nation clauses
    - Retailer undertakes to set the price at which it resells manufacturer A’s products with reference to the price at which it sells the products of manufacturer B
    - Requires the seller to sell a good or service on a platform at a price that is not higher than the price the seller charges on other platforms

Regulators are encountering a high number of complaints in relation to RPM in the online space

Quasi “per se” restriction:

Previously there was a presumption that RPM agreements were unlikely to fulfil Article 101(3) criteria
Hard-core restrictions and the Internet under EU law (3b):

However….

- New appreciability test under de-minimis rules in vertical guidelines:
  - In the past no-deminimis exemption for hard core restrictions
  - New vertical agreements guidelines require hard-core restrictions (including RPM) to have an appreciable effect on competition and on trade within the EU before they will fall under Article 101/Chapter I. Provision applies to all hard-core restrictions.

- New Efficiency defences for RPM under verticals guidelines.
  - Undertakings must demonstrate the pro-competitive effects of the RPM.
  - Non-exhaustive list of defences

- Agreement will fall outside Article 101/Chapter I if it is an agency agreement:
  - Agent contracts on behalf of the principal either in their own name or in the name of the principal for the purchase/sale of goods or services by the principal
  - Selling/purchasing function of agent is part of the principal’s activities and outside Article 101
  - Agent must bear no or insignificant financial or commercial risk in relation to the activities for which appointed
## Comparison of RPM decisions in EU/UK

<table>
<thead>
<tr>
<th>OFT RPM cases since 2000</th>
<th>EU RPM cases since 2000 – only 2 actual decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Offline</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Replica Kit</strong></td>
<td><strong>Mercedes benz</strong> (2001, CFI annulled Commission decision as there was no agreement. Unilateral conduct. ECJ upheld CFI judgement)</td>
</tr>
<tr>
<td>(2003, OFT's decision upheld by CAT 2004)</td>
<td>(horizontal element)</td>
</tr>
<tr>
<td><strong>Lladro</strong> (2003)</td>
<td><strong>Volkswagen</strong> (2001, CFI annulled Commission decision as there was no agreement. Behaviour unilateral)</td>
</tr>
<tr>
<td><strong>Hasbro/Argos/Littlewoods</strong></td>
<td><strong>CD prices</strong> (2001 - no decision as no evidence of widespread RPM. Parties removed minimum prices.)</td>
</tr>
<tr>
<td>(OFT decision 2003, upheld by CAT 2004)</td>
<td>(horizontal element)</td>
</tr>
<tr>
<td><strong>Tobacco</strong></td>
<td><strong>Yamaha</strong> (2003)</td>
</tr>
<tr>
<td>(2010, appeals against judgement upheld by CAT 2011)</td>
<td>(horizontal element)</td>
</tr>
<tr>
<td><strong>Dairies</strong></td>
<td></td>
</tr>
<tr>
<td>(2011, Tesco has appealed to the CAT)</td>
<td>(horizontal)</td>
</tr>
<tr>
<td><strong>Online</strong></td>
<td></td>
</tr>
<tr>
<td><strong>E-books</strong></td>
<td><strong>Fixed book prices in Germany online</strong> (2001 no decision)</td>
</tr>
<tr>
<td>(2011)</td>
<td>(horizontal)</td>
</tr>
<tr>
<td><strong>Hotels</strong></td>
<td><strong>i-Tunes</strong> (2008, no decision as no evidence of agreement or tacit collusion between Apple and major record companies. Apple changed behaviour)</td>
</tr>
<tr>
<td>(statement of objections 2012)</td>
<td>(industry-wide?)</td>
</tr>
<tr>
<td><strong>E-books</strong></td>
<td></td>
</tr>
<tr>
<td>–(2011, commitments 2012)</td>
<td>(horizontal element)</td>
</tr>
</tbody>
</table>
Some thoughts on EU/UK approach to RPM…

- In last 10 years the OFT has issued more RPM decisions than the European Commission and has consistently investigated RPM cases throughout that period.


- Few RPM investigations by the EU Commission have reached decision stage.

- Do the lack of final decisions at EU level in recent years mark a divergence of approach with UK?

**N.B. Section 60 CA98** UK must treat competition questions arising in the UK in a manner which is consistent with treatment of corresponding questions under Community law.

- Nature of OFT cases taken on: most have horizontal element or manifest themselves as industry-wide practices…reflects appreciability requirement? Easier to prove horizontal price fixing.

- Both European Commission and OFT appear now to be focussing on vertical agreements which either affect the whole market or which have horizontal effects.
Online distribution: looking forward

- In essence, **same rules apply to the online world as they do to the offline world**
  - a pragmatic approach and sensible compromise by the Commission

- Generally **still recognition that “vertical” distribution agreements are procompetitive** but ...

- **Restrictions on active and passive sales as applied to the internet are forbidden**

- **RPM as applied in the online world is an increasing focus for regulators at EU/UK level particularly where the restrictions are**
  - Industry - wide or
  - Have horizontal effects
    - E-books (OFT and European Commission)- horizontal effects
    - *Hotels case* (OFT)- industry-wide

- Challenge for regulators will be to keep up with the rapid development of e-commerce
  - Both OFT and EU recognise that the Internet is creating different business structures which need to be assessed from a competition perspective.
    - LEAR report explores some of these...

“The best thing about the Internet is that it is open... We must also be open to different online business models. The Internet potentially offers not just new forms of content, but new ways to distribute it, new ways to make it accessible, and new ways to be rewarded for it. If we are to benefit from the Internet’s enormous innovation we must be open to new ideas here.”

(Neelie Kroes, Worldwide Web conference, Lyon, April 2012)
Consequences of breach

For the company
- Agreement / provision unenforceable
- Fines up to 10% of worldwide annual turnover
- Damages actions / injunctions
- Adverse publicity, reputational damage
- Time and costs of an investigation
- Increased risk of on-going surveillance
- Potential liability for acquirer

For individuals
- Director’s disqualification (UK) - up to 15 years
- Price fixing, market sharing and bid-rigging cartels: criminal sanctions (UK) and potential extradition
Richard Kemp
Senior Partner

ddi +44 (0)20 7710 1610
richard.kemp@kemplittle.com

Elisabetta Rotondo
Associate

ddi +44 (0)20 7710 1675
elisabetta.rotondo@kemplittle.com

Rachel Iley
Senior Associate

ddi +44 (0)20 7710 1606
rachel.iley@kemplittle.com
Kemp Little is supporting SCI to treat 40,000 children suffering from neglected tropical diseases.

Treatment costing 50p per child per year will allow them to attend school, learn more effectively & live more prosperous lives.