EUROPEAN COMMISSION'S PRELIMINARY REPORT IN THE E-COMMERCE SECTOR INQUIRY: HIGHLIGHTING RISK AREAS FOR SUPPLIERS OF BRANDED GOODS

Date: 11 October 2016

European Regulatory / UK Regulatory Alert

By: Dr. Annette Mutschler-Siebert, M. Jur. (Oxon), Gabriela da Costa, Francesco Carloni

In September, the European Commission published its much-awaited Preliminary Report in the e-Commerce Sector Inquiry, launched last May 2015. Although the primary focus of the Commission's Inquiry is on restrictions limiting the cross-border online resale of goods in the European Union, its preliminary findings go significantly further than this, addressing a number of areas which have for some time been in a state of flux and caused significant uncertainty for brands trading in Europe. These helpfully include the extent to which suppliers can rely on their brand image to restrict who sells their products online, or whether they can ban the resale of their products through online marketplaces. Although the Commission's statements are not binding on national competition authorities or the European Courts, the findings provide the most comprehensive statement of the Commission's current position on these points, and thus some helpful direction pending the implementation of more concrete legal rules.

The Commission's preliminary findings also provide an indication of the sectors and the specific contractual clauses that are most likely to attract legal scrutiny going forward. These indications may enable companies to better identify key risk areas in their business models or agreements and take steps to minimise their exposure. The Commission has stated that *"the report should be a reason for companies to review their current distribution contracts and bring them in line with EU competition rules if they are not",* and has indicated that it may open investigations into specific companies to ensure compliance with EU rules on restrictive business practices.

COMMISSION'S POSITION ON BRAND PROTECTION AND MARKETPLACE RESTRICTIONS

The Commission's preliminary findings present a detailed factual examination of the commercial drivers underpinning distribution strategies and terms. The Inquiry is understood to be the largest ever conducted by the Commission, with its preliminary results based on questionnaire responses received from over 1050 retailers, almost 260 manufacturers, 37 online marketplaces, 89 price comparison tools, and 17 payment system providers active across Europe. These also derive from a review of around 8,000 distribution agreements collected by the Commission.

Certain statements can be drawn from the Commission's assessment of these responses which should be welcomed by suppliers of branded products.

©2005-2026 K&L Gates LLP. All Rights Reserved.

First, the Commission deliberately acknowledges that intra-brand competition should not solely be based on price

The Commission's findings illustrate how the incentives of suppliers and retailers are often misaligned when it comes to building and maintaining a brand image and quality reputation. Whilst the great majority of supplier respondents consider product quality and brand image to be of greatest importance in attracting customers; price is most often identified as being of greatest importance to retailers.

The Commission helpfully recognises that this possibility of misaligned incentives may lead suppliers to legitimately seek to protect their brand image and reputation by means of contractual obligations in distribution agreements. For example, it acknowledges that suppliers "might find it necessary" to introduce selective distribution systems for certain products or introduce detailed selection criteria.

The Report further highlights that in addition to adopting a selective distribution model, the most common reaction of suppliers to the growth of e-commerce over the last 10 years has been to open their own consumer-facing online shops, thereby competing in many cases with their own independent retailers. Of interest and assistance to suppliers will be the fact that, whilst the Commission recognises that such vertical integration may reduce the number of independent retailers (and thus intra-brand competition), it can also streamline the incentives of the manufacturing and the retail level. It may for example actually lead to lower retail prices (because supplier and distributor decisions are coordinated with a view to maximising their joint profits) and could also lead to better coordination of pre-and post-sale services. Subject to some implications that certain selective distribution systems and criteria may go too far (discussed further below), the Commission's general recognition of the importance of competition based on non-price parameters such as quality is likely to be welcomed by premium brands in particular.

Second, the Commission maintains its view that online marketplace bans are not hardcore restrictions

Perhaps one of the "hottest topics" regarding online distribution in Europe today is whether and to what extent a supplier can prevent resellers from selling its products on online marketplaces.

The Commission's Guidelines on Vertical Restraints ("Vertical Guidelines"), which were published in 2010, provide that *"where 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."*

This has generally been relied upon by suppliers to justify marketplace bans. However, some recent decisions of the French and German competition authorities and courts have found such bans to be serious violations of European competition law and thus cast considerable doubt on how far a company can rely on the Vertical Guidelines in designing its distribution system. The question has now been put to the Court of Justice of the European Union for resolution with respect to luxury products in a case concerning the selective distribution system of perfume manufacturer Coty Germany GmbH.

It is hoped the Court's much-awaited decision will be sufficiently detailed and broad to provide a robust statement of the law, which will allow businesses to know what they can and cannot do to stay on the right side of EU competition law. However, in the meantime, it is helpful to see the position taken by the Commission, which will

©2005-2026 K&L Gates LLP. All Rights Reserved.

no doubt seek to influence the Court's ruling. This is that, in its view, although marketplaces can facilitate cross-border online sales - particularly for smaller and medium-sized retailers - the preliminary findings do not indicate that absolute marketplace bans should be considered hardcore restrictions of competition as they do not have the object of segmenting markets in the internal market based on territories or customers. The Commission considers such an approach is in line with its Vertical Guidelines, which permit such restrictions as they concern the question of *how* a distributor can sell products over the Internet and do not aim to restrict *where* or *to whom* distributors can sell the products.

The Commission notes that this does not mean that the Commission considers absolute marketplace bans in all cases compatible with European competition law. However, the specific examples given by the Commission as to when it may scrutinise marketplace bans are limited to obvious scenarios: namely, where an agreement falls outside the safe-harbour of the Vertical Block Exemption, either because the parties' market share thresholds are exceeded or because the agreement contains one or more of the hardcore restrictions listed in that Regulation (such as *de facto* total bans on the use of the Internet, unlawful territorial restrictions or resale price maintenance). This limited list of express exceptions helpfully suggests that the Commission is not at this stage overly concerned with or focused on scrutinising marketplace restrictions.

Nonetheless, the Commission does somewhat “muddy the waters” slightly by keeping open the possibility for it or (more likely) the national competition authorities to withdraw the protection of the Block Exemption “if in a particular case” a marketplace ban restricts competition within the meaning of EU law and this does not result in sufficient pro-consumer benefits to outweigh the restrictions. The Commission explains that the importance of marketplaces as an online sales channel in relation to the product and geographic market in question will be an important element in this analysis. One might therefore expect the risk of national competition authorities' scrutiny to be higher in countries where marketplaces are well established and used by a significant proportion of retailers (such as in Germany, and possibly the United Kingdom, Poland, Spain and France). Other important factors noted by the Commission include the credibility of brand protection considerations and the need for pre- and post-sale advice. In this respect, the Commission warns that justifications based on brand protection considerations or on a lack of sufficient pre- or post-sale advice will be less convincing if the supplier has accepted the marketplace operator as an authorised reseller within its selective distribution system or if the supplier is itself selling on the marketplace directly to customers.

The above all notwithstanding, the extent to which the Court of Justice will follow the Commission's general reluctance to intervene in marketplace bans remains to be seen. Ultimately, it will be the decision of the Court which is determinative, since this will be binding on both the Commission and the national authorities.

COMMISSION'S FOCUS AREAS FOR FUTURE

In addition to illustrating what the Commission is not likely to focus upon in the future, the Preliminary Report provides hints as to where its focus and enforcement efforts might indeed lie.

Agreements between suppliers and retailers restricting cross-border online sales

The Commission reiterates that the territorial restrictions already regarded as hardcore in the Vertical Block Exemption Regulation or its Vertical Guidelines will continue to raise concerns and may be the subject of future

©2005-2026 K&L Gates LLP. All Rights Reserved.

investigations. These include “geo-blocking” measures designed to reject cross-border purchase requests, where these have not been unilaterally adopted by a non-dominant retailer but rather required in its contract with the supplier or otherwise required by the supplier (e.g. orally or through applying pressure). They include measures preventing a customer outside the territory from accessing the website, automatically re-routing the customer to a website targeted at another Member State, refusing payment or refusing delivery.

Concerning restrictions in selective distribution agreements

The Commission restates the legal position that agreements restricting active or passive sales to end users or other authorised resellers by members of a selective distribution system continue to be regarded as hardcore restrictions which may attract its attention.

The Commission also makes a number of additional observations suggesting that the following scenarios or clauses in the context of selective distribution might be anti-competitive and could possibly therefore lead to investigations in future.

First, the Commission notes that the number and variety of products for which selective distribution is being applied has increased considerably - thus implying that the selective distribution model might possibly be misused by some suppliers. Therefore, whilst the Commission recognises the important of intra-brand non-price competition (discussed above), this observation suggests that suppliers using a selective distribution system need to be careful to ensure the nature of their products objectively *justifies* such a system and the criteria imposed. Failing such justification, suppliers might find their distribution system being scrutinised and held to be disproportionate and unlawful.

Second, the Commission indicates that the requirement for retailers to operate at least one brick and mortar shop (thereby excluding all *pure* online players from the system), while generally covered by the Vertical Block Exemption Regulation, may need “further assessment in individual cases” when used for certain product categories or certain lines of products which pure online retailers might be equally qualified to sell. The Commission notes that a large majority of the supplier respondents using selective distribution exclude pure online players from their selective distribution network for at least part of their products. However, it considers that in some cases this restriction may go beyond what is necessary for the purpose of ensuring high quality distribution.

Third, the Commission identifies as a possible concern the lack of transparency and objectivity of the selection criteria used by suppliers in choosing the members of their selective distribution networks. It highlights in particular that a number of retailers that qualify themselves as "discount" retailers suggested in their responses that even if they comply with all quality criteria, suppliers will refuse their admission to the network - presumably due to their low retail prices.

The above restrictions and criteria therefore need to be looked at on a case-by-case basis to assess a supplier's possible risk exposure.

Recommended Resale Prices (RRPs)

It is a long-established European competition law principle that suppliers can recommend resale prices to resellers, provided that the retailer retains its discretion to set its own resale prices and that the RRPs are not

©2005-2026 K&L Gates LLP. All Rights Reserved.

viewed or treated as binding minimum or fixed prices. It is also well-established that the application of any sort of pressure on or attempted influence of a retailer to “comply” with an RRP could amount to unlawful resale price maintenance. This can include providing incentives to retailers to comply with an RRP, threatening sanctions (such delayed supplies, withdrawal of discounts or expulsion from the distribution network) for failure to comply, or even “friendly” inquiries as to why a retailer is deviating from the RRP.

The Commission highlights in its Preliminary Report that it is now easier to detect deviations from suppliers' pricing recommendations using software. This in turn allows suppliers to retaliate against those deviations and may possibly limit retailers' incentives to deviate from such pricing recommendations in the first place.

The Commission does not go so far as to expressly condemn recommended resale prices or price monitoring in its Report. However, against the background of retailers' questionnaire responses and the increased practical risk of pressures from suppliers, it does note that certain pricing arrangements between suppliers and their retailers “may merit further investigation on a case-by-case basis”. One might therefore expect it to be more vigilant of attempts by suppliers to try to influence retailers' advertised or sale prices, in particular online. It may also choose to open investigations into the conduct of specific suppliers regarding which it has received reports of such attempts in the course of its Inquiry.

KEY SECTORS TO WATCH

Finally, the Commission highlights in its preliminary findings the product categories in which the above concerning or potentially concerning provisions are most prevalent. These almost always include clothing and shoes, consumer electronics and sports equipment. In respect of pressures to align prices to RRPs, the Commission also mentions house and garden goods in addition to the first two abovementioned sectors. Suppliers in these sectors in particular may therefore be at greater risk of investigation and enforcement action; whilst all suppliers whose goods are sold in Europe could be regarded as having been “put on notice” by the Commission to review their practices and agreements, if necessary fix these, and provide compliance training to staff to limit their risk exposure going forward.

The Commission's Final Report, which is anticipated in the first quarter of 2017, is expected to shed more light on the Commission's enforcement priorities in this field and to give businesses further indications as to which online practices will likely invite scrutiny going forward.

WHAT K&L GATES CAN DO FOR YOUR BUSINESS

Our Antitrust, Competition and Trade Regulation team has extensive experience advising suppliers of branded products on the distribution of their products in Europe, including in particular on exclusive distribution models, selective distribution policies and e-commerce restrictions. We regularly assist clients in a wide range of sectors to best achieve their commercial objectives whilst minimising their legal risk, including evaluating, designing or refining distribution models, updating agreements, preparing distribution criteria, and implementing and monitoring effective resale strategies.

©2005-2026 K&L Gates LLP. All Rights Reserved.

KEY CONTACTS



GABRIELA DA COSTA
PARTNER

LONDON
+44.20.7360.8115
GABRIELA.DACOSTA@KLGATES.COM



DR. ANNETTE MUTSCHLER-SIEBERT, M. JUR. (OXON)
PRACTICE AREA LEADER - POLICY AND REGULATORY

BERLIN
+49.30.220.029.355
ANNETTE.MUTSCHLER-SIEBERT@KLGATES.COM



FRANCESCO CARLONI
OFFICE MANAGING PARTNER, BRUSSELS

BRUSSELS, MILAN
+32.2.336.1908
FRANCESCO.CARLONI@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.