



# Vertical Restraints in the Internet Economy

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# **Table of Contents**

A.	I	Introduction	4
В.	E	Economic and legal background	4
ı		Classification of vertical restraints in economic theory	4
	1	1. Possible efficiency gains from vertical restraints	5
	2	2. Typical damages caused by vertical restraints	8
I	l.	Legal framework for vertical restraints	9
	1	1. Article 101 (1) and (3) TFEU	10
	2	2. Vertical Restraints Block Exemption Regulation	12
C.		Development and challenges of the internet economy	13
I		Characteristics of the internet economy	13
	1	1. Economic significance	14
	2	2. Implications for competition	15
I	l.	Relation between online and offline trade	16
I	II.	. Internet platform markets	18
D.	(	Case practice relating to the internet economy and current issues	19
I		Classic resale price maintenance and the pressure exerted to implement it	19
ı	l.	Dual pricing	20
I	II.	. Hindrance of online sales in selective distribution systems	21
I	V.	. Price parity clauses used on platform markets	24
E.	5	Summary	26
F.	L	List of questions	27



#### A. Introduction

The fast-growing internet economy and its new models of business are leading to a more efficient production and distribution of goods, with a trend towards lower prices. At the same time the internet increases transparency and rapidity of response within the distribution systems. This intensifies competition, challenging more established distribution structures. It also opens up new possibilities of co-ordination and control. Against this background competition authorities have to focus their attention on identifying and if need be prohibiting any excessive restraints of competition, both caused by and targeted against innovative distribution concepts. This is already being done in current proceedings on vertical resale price maintenance and in the examination of specific restrictions to online sales in selective distribution systems. Such restrictions concern, inter alia, the use of third party platforms and virtual marketplaces which are of great importance for the online sale of products. On the other hand, the operators of these platforms to some extent try to secure and expand their established position in the market with price parity clauses and similar restraints.

A key role in the assessment of vertical restraints plays the Vertical Restraints Block Exemption Regulation (VRBER)<sup>2</sup>, which was amended three years ago. However, even after its amendment, the regulation offers no specific guidelines on online distribution. The situation is different in the case of the Guidelines on Vertical Restraints, which were amended at the same time.<sup>3</sup> Here, efforts have been undertaken to specify in concrete terms the significance of hardcore restrictions which do not qualify for exemption under the VRBER for the use of the internet.<sup>4</sup> In practice this raises many issues relating to the application and interpretation of the regulation, which give reason to pursue in greater depth the issue of vertical restraints in the internet economy and their assessment under competition law.5

#### В. **Economic and legal background**

#### ı. Classification of vertical restraints in economic theory

The effects of vertical restraints on competition are often less obvious than those caused by horizontal agreements between competitors on the same level of the value chain. The specific market and competition conditions thus play a significantly greater role in the assessment of such restraints. The main reason for this is that individual vertical restraints taken on their own initially only affect a product-based value chain and directly restrict intrabrand competition. However, in order to be able to adequately define and assess the competitive effects of vertical restraints on markets, the intensity of competition beyond product-based value chains and hence inter-brand competition is also of key importance.



In the discussion on vertical restraints, another area of focus remains the type and possible extent of their potential efficiency effects. In comparison to a scenario in which companies are integrated vertically at as many levels of the value chain as possible, the development of and exchange between different levels of market and value chains is often the more efficient solution. However, in contrast to vertically integrated structures, coordination problems can arise between the individual sections of the value chain, for example, due to differences in interest and information within the chain. These coordination problems lead to inefficiencies for the distribution chain as a whole because it fails to maximize its total profit from the sale of the respective product by selling an optimal volume at an optimal price or to minimize the costs involved or losses in quality.

Vertical restraints can relieve or solve these coordination problems and so generate positive efficiency effects. 6 In economic theory maximizing the profit of the distribution chain does not harm the end consumer of the product if there is sufficient inter-brand competition from other suppliers of comparable products. Under these conditions and in the overall picture the vertical restraints maximize not only the welfare of the members of the distribution chain but also the overall welfare of all parties concerned. However, these positive effects are undermined and competition problems occur if companies in a distribution and value chain gain market power. Market power in this context can also be a direct result of strong consumer preferences for a specific product. The underlying product differentiation, for instance brought about by different brand images, reduces inter-brand competition. Companies can also gain market power for follow-up business as a result of (not anticipated) switching costs (so-called lock-in effects).

#### 1. Possible efficiency gains from vertical restraints

In economic literature a whole range of coordination problems in a vertical market and value chain are discussed which can be solved or at least alleviated by vertical restraints.8 The relevant problems can be attributed to vertical or horizontal external effects and the guarantee of sufficient incentives for product specific and contract specific investments. The argument in favour of protecting an established "brand image" still holds a certain prominence.

## Vertical and horizontal external effects

The best-known example of "vertical external effects" is the problem of double marginalisation. 9 Two companies at different market levels of a distribution chain which by virtue of their market power have the scope to set prices, calculate their sales prices in such a way that they maximise their individual profit. The company at the upstream level of the



market cannot prevent the company at the next level from adding a mark-up to its own sales price which exceeds the actual costs incurred, accepting a possible reduction in the quantity of sales as a result. However, this reduction in quantity also directly affects the upstream level. Vertical restraints can help to alleviate or completely eliminate (i.e. internalize) these vertical effects. For example, an agreement on a maximum sales price at retail level would solve the problem of too little sales for the distribution chain as a whole and raise the overall amount of profit achieved.

The best-known example of "horizontal external effects" which is often quoted in practice is "free riding" on services which are performed prior to the sale of a service or good and which cannot be priced individually. 10 This problem is also related to the phenomenon of external effects of individually optimal decisions. The individual profit calculus of companies on the upstream and downstream levels of a market can in this case lead to low and consequently inefficient levels of service and sales efforts at the retail level. The retailer in his capacity as advisor or advertiser incurs costs which also result in a higher retail price. On the basis of their own individual profit calculus, other retailers could be tempted to save these expenses by offering interested parties which have already been advised the respective product at a lower price. As the investments of the retailer who has provided consultancy and advertising services cannot be amortisized because his profits decrease correspondingly, there is less incentive to offer such services, although from the perspective of the distribution chain as a whole, it would be desirable.

Further forms of horizontal externalities can arise if a dealer invests in a high quality reputation, which in the eyes of the customers is conferred on the products he offers. Competitors of the dealer also offering these products could then take advantage of this reputation without having made the necessary investments. 11 As a consequence, the corresponding investments will either be reduced or not undertaken at all for lack of incentives. The situation could also arise where a manufacturer dispenses with advisory and other services carried out by its dealers if its competitors with their rival products can also directly benefit from such investments. 12

## Exploitation of contract-specific investments

The second case group which offers scope for efficiency gains through vertical restraints relates to the problem that the launch of a specific product can involve costs and in some cases risks which are very difficult to calculate. For example, in order to market a new product or one which has already been established elsewhere in a sales region not yet covered, shelf space has to be cleared by removing a product earning a predictable amount of profit, without any sufficient predictability, however, about the sales and profit-making prospects of the new product. This is the starting basis for opportunistic behaviour by the



manufacturer, referred to in economic literature as the "hold-up problem". This problem arises in particular if a retailer has to make product specific and contract specific investments in order to sell the product in question: If a retailer has to make advance investments into a network of stores and the training of staff, he will only do this if the prospects of his investments being worthwhile are good. Once the retailer's investments have been made and the introduction into the market has proved successful, the manufacturer in its own profit calculus could have an increased interest in generating a high turnover with a lower retail price and for example becoming active itself in the distribution of the product. For example, in opening up new markets by way of a franchise system, where the franchisee makes advance investments into a retail outlet and builds up a customer basis, the franchisor could, if the business is successful, be tempted to replace the attractive retail site with one operated by himself. In anticipating the risk of what in his view would be opportunistic behaviour on the part of the manufacturer, the retailer could avoid investment. Ultimately, fewer or even no retailers would be found to sell the product, resulting in negative consequences for product diversity or for the regional market penetration of a product. 13

## Brand image

A controversial subject of discussion is to what extent investments in a brand image create efficiencies and have to be protected by vertical restraints. 14 The key argument in favour of the assumption of efficiencies is that a brand image can act as a quality signal in the case of so-called "experience goods" (goods, whose quality can only be assessed after purchase) or in the case of so-called "credence goods" (goods, whose quality cannot be reliably assessed (especially by a non-expert) even after purchase): In particular, high advertising costs should guarantee a constantly high quality because they would be ineffective if the commitment to quality were not kept and this became known. If it were not possible to overcome the problem of information asymmetry, the end consumer would only be prepared to pay the price for experience or credence goods he would have to pay for low quality and not the price which would be required for producing the high quality he desires. 15

Another argument presented is that an image which in the extreme case stands for a purely fictitious high level of quality, can itself be a product characteristic, the acquisition of which will benefit a customer and which is therefore an added value worthy of protection. <sup>16</sup> This is conceivable in the case, e.g. of products which serve as status symbols.<sup>17</sup> Mandatory retailer standards can help to build up a positive brand image and enhance the attractiveness of the product for the end consumer and in this way increase its sales. 18 However, the latest case law of the European Court of Justice in the Pierre Fabre case takes a critical view of this



argument and represents the view that the aim of protecting the prestige image of a product cannot be a legitimate aim for restricting competition.<sup>19</sup>

#### 2. Typical damages caused by vertical restraints

The possible efficiencies and therefore pro-competitive effects of vertical restraints must be weighed against potentially negative effects on competition. <sup>20</sup> Whereas the discussion about the potential efficiencies of vertical restraints focuses on the individual value chain and intrabrand competition, the main focus in the various damage scenarios is more on marketrelated inter-brand competition. With the damage they cause to inter-brand competition, vertical restraints can increase wholesale and retail prices and reduce the choice of offer, quality or innovation efforts.

# Vertical restraints as obstacle to market entry and expansion

Vertical restraints can be used to raise the costs of market entry and expansion for potential or actual competitors ("raising rivals' costs"). The clearest example of this is the binding of particularly efficient manufacturers or retail companies to exclusivity agreements. Actual or potential competitors on both market levels then have to do without these companies and resort to weaker market participants. Price parity clauses can also act as an obstacle to market entry and expansion if platforms even out price differences on one side of the market and in this way prevent competitors from quickly attaining a critical mass on the same side of the market by offering lower prices (see following under C.III and D.IV).

On the other hand, platforms and marketplaces enable smaller retailers to enter the internet market without incurring sunk investment costs on a large scale. If the use of such platforms and marketplaces is prohibited or hindered, this makes market entry difficult (see following under D.III).

## Facilitation of collusion and curbing of competition

Vertical restraints can also facilitate the enforcement of explicit or implicit collusion. In vertical distribution structures manufacturers' selling prices are generally relatively intransparent and the adherence to implicit or explicit collusion at this level of the distribution chain is therefore very difficult to monitor. If retailers are tied to a specific endconsumer price by means of vertical resale price maintenance, this also reduces the incentive for the manufacturers to reduce their prices as they can no longer expand their profits. Manufacturers can monitor the price discipline of internet shops in a fully automated process by means of search programmes (crawlers or search bots). Vertical resale price maintenance thus facilitates or stabilizes explicit or implicit collusion at the manufacturer level of the distribution chain. Price parity clauses can also help to even out cost differences



on the purchase side and so facilitate the implementation of agreements. This makes it possible to react very quickly to price deviations. A price recommendation on the downstream level, for example, which is permissible in principle, can serve as an orientation for coordination to achieve collusive market equilibrium, which would not be possible without this reference point because there are many conceivable points of equilibrium. Exclusive areas can also facilitate or strengthen implicit or explicit market sharing.

The effects of vertical restraints leading to and stabilizing collusion are most prominent in a market environment in which (1) there are several overlapping supply relationships ("interlocking relationships"), i.e. most of the manufacturers are listed with (almost) all retail companies, and (2) a network of vertical restraints has been established.<sup>21</sup> It can be shown, for example, that e.g. vertical resale price maintenance can induce all the value chains in a market to increase their market power over the end consumer as a whole and jointly to such an extent that, in spite of the existence of several suppliers at the manufacturer and retail level, this leads to a market result comparable with a monopoly situation.

Vertical restraints which do not reach this extreme or the level of explicit or implicit collusion can still curb competitive activity. They can be used at least to credibly signalize that there is no intent to engage in aggressive competition towards rival market players. One plausible situation in this respect is the credible commitment to abstain from any aggressive price competition by setting up a selective distribution system or distribution via exclusive retailers, which diminishes inter-brand competition at the retailer level. At the same time this reduces the pressure exerted by retailers on manufacturers to produce more efficiently and lower their selling prices, enabling lower retail prices. Once more it can be assumed that these competition-dampening effects are all the stronger the more widespread such agreements are in a market.

# Vertical restraints reduce consumer welfare

The damages theories illustrated all have a reduction of (potential) competitive activity as a common theme. With less pressure on competition, endeavours towards innovation and increased efficiency generally decline. Apart from the overall loss of welfare, a redistribution of welfare often occurs away from the (end) customer to (intermediate) dealers and producers. This is particularly true in the case of vertical resale price maintenance which the Bundeskartellamt has often had to deal with in the past. Due to the fact that a dealer is barred from offering a product at a lower price than recommended, the customer has to pay a higher price. This is particularly true of markets on which there is a certain degree of product differentiation.

#### II. Legal framework for vertical restraints



Apart from the general requirements of Article 101 TFEU and the interpretation of this regulation in case law (especially in respect of selective distribution systems), the Vertical Restraints Block Exemption Regulation (VRBER) is of key importance for the legal assessment of vertical restraints.

#### 1. Article 101 (1) and (3) TFEU

## Basic structure

The prohibition of anticompetitive agreements and concerted practices listed under Article 101(1) TFEU and Section 1 GWB covers horizontal as well as vertical restraints of competition.<sup>22</sup> In spite of their generally less obvious effects, it is recognized that individual forms of vertical restraints can have an anticompetitive object, if under consideration of the specific circumstances of the individual case and the economic and legal context, they are regarded by their very nature as harmful to the proper functioning of normal competition. <sup>23</sup> In all other cases the effects on competition should be examined in the individual case in order to determine any restriction by effect. In accordance with the "theories of harm" presented under section I.2, these are likely to be found in the creation of barriers to market entry, the dampening of competition or the facilitation of collusion. If a restriction of competition either by object or effect is determined, the theoretically conceivable efficiency gains illustrated under section I.1 can be used to gain exemption under Article 101(3) TFEU. However, it is not sufficient for the efficiencies to be merely conceivable. Instead, these have to be presented in concrete terms and substantiated in their extent and probability of occurrence.<sup>24</sup> In addition, the further requirements of Article 101 (3) TFEU must be cumulatively fulfilled. The criterion of indispensability requires that both the agreement itself and the individual restrictions resulting from it are necessary in order to generate these efficiencies.<sup>25</sup> The agreement has to allow consumers a fair share of the resulting benefit for it not to be detrimental to the demand side. The fourth requirement serves to maintain competition in respect of a substantial part of the products in question.. In accordance with Article 2 of Regulation 1/2003, the companies which invoke Article 101 (3) TFEU bear the burden of proof.

The case is completely different where the VRBER applies. The VRBER is based on the empowerment of the Commission to stipulate a general application of Article 101(3) TFEU to categories of agreements and corresponding concerted practices which fall under Article 101(1) TFEU.<sup>26</sup> Accordingly, the VRBER defines a category of agreements which "normally satisfy the conditions laid down in Article 101(3) TFEU."<sup>27</sup> The block exemption will only be granted to vertical agreements, "for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 101 (3) of TFEU". 28 Accordingly, the objective of the BER



is to filter out those vertical agreements which are likely to have overriding benefits for competition and the consumer and which therefore justify a general exemption. If a vertical agreement falls under the VRBER, a "presumption of legality" <sup>29</sup> applies as long as the benefits from the regulation are not withdrawn in a special procedure. Under Article 29 Regulation 1/2003 an agreement prohibited under Article 101 (1) TFEU which falls under the VRBER and does not satisfy all the conditions for exemption under Article 101 (3) TFEU can be denied protection under the BER. 30 In this case, however, the competition authority bears the burden of proof that the effects of the agreement in question are not compatible with Article 101 (3) TFEU.31

# Classification of selective distribution

Selective distribution systems play a particular role in the case law on Article 101 TFEU. According to the legal definition of the VRBER selective distribution systems<sup>32</sup> are characterised by the fact that suppliers are obliged to supply the goods or services in question only to dealers authorised according to specified criteria and the dealers are obliged not to sell them on to non-authorized dealers.<sup>33</sup> Such distribution systems are primarily used to distribute branded products.<sup>34</sup> There is an ongoing discussion about whether the design of such distribution systems is compatible with the principles of competition; recently the ECJ dealt with this form of distribution in its decisions "Auto 24" (2012) and "Pierre Fabre" (2011).35

The ECJ had already decided relatively early that selective distribution systems in the form of so-called purely qualitative selective distribution systems do not fall under Article 101(1) TFEU since there is no competitive restraint.<sup>36</sup> This is the case if resellers are selected according to objective criteria of a qualitative nature, as long as these criteria are uniform and applied in a non-discriminatory manner. Moreover, the characteristics of the product in question must require such a distribution network to maintain its quality and ensure its proper usage and the criteria must not go beyond what is necessary.<sup>37</sup> It is generally acknowledged that restricting price competition in favour of other competition factors can be justified in such a case.<sup>38</sup> In the opinion of the Court of the European Union, consumer interests should be considered when assessing an objective justification.<sup>39</sup> However, in the consumers' view, suppressing price competition in favour of extra services is not necessarily desirable. In the absence of an objective justification, selective distribution systems are to be considered as restraints of competition by object, which necessarily affect competition in the Common Market. 40



#### 2. **Vertical Restraints Block Exemption Regulation**

Based on the consideration that many forms of vertical restraints are only problematic in the case of market power on at least one level of trade, the VRBER focuses in its assessment in particular on the market shares of the companies concerned. If the market share thresholds laid down in the regulation are not reached, the agreements are generally exempted irrespective of their content and can only be taken up if the exemption is withdrawn. Another approach is necessary, however, for the important group of so-called hardcore restrictions, which are assumed to be harmful to competition irrespective of the extent of market power of the companies concerned.

## Market share threshold

The VRBER lays great emphasis on the criterion of market power in vertical restraints. 41 The key criterion for exclusion is therefore a market share of more than 30% for suppliers and buyers on the market relevant for their transaction. 42 The market share of a company therefore serves as an approximate indicator for its market power. Whereas extensive investigations are necessary to determine explicit market power, it is generally easier to measure the market share of a company and this can be a good indicator for the possible existence of market power. Any large deviation in these values in an individual case can be considered in an individual assessment of the case. In particular, vertical restraints with a market share above the 30% threshold are not presumed to have overriding anticompetitive effects.<sup>43</sup>

The question of whether the chosen level of 30% is appropriate cannot be answered empirically and is likely to be influenced by the market characteristics of the individual case. In view of the collusion-facilitating effect of vertical restraints, the question arises as to what extent a constellation in which three companies with an almost 30% share of the market use similar vertical restraints, is sufficiently likely to lead to a pro-competitive outcome.

## Hardcore restrictions

In a number of vertical agreements it is presumed that, irrespective of the market power of the companies concerned, anti-competitive effects will arise and that these negative effects will generally outweigh any efficiencies or that the restraint is not indispensible or does not allow consumers a fair share of the resulting efficiency gains. 44 These cases are categorised in the group of hardcore restrictions under Article 4 and in the group of excluded restrictions under Article 5. Hardcore restrictions are, for example, restrictions of the possibility of the buyers to freely determine their sales prices (resale price maintenance) or restrictions of the



territories or customer groups which are to be served (see excerpt from the VRBER attached).

If a hardcore restriction is identified, the contract as a whole is excluded from the scope of application of the VRBER. 45 As even in the case of hardcore restrictions constellations are conceivable which fulfil the exemption criteria of Article 101(3) TFEU, the exemption of such restrictions is still possible on a case by case basis. There is therefore no per se prohibition.

# Withdrawal of exemption

Whereas with the market share criterion and hardcore restrictions the VRBER offers a very rough framework for generally classifying the probability of pro-competitive effects outweighing the restraints in question, the withdrawal of exemption allows for an assessment of the individual case. If contrary to the assumption under the VRBER a vertical agreement has effects which are incompatible with Article 101(3) TFEU, the legal benefit which it enjoyed under the Block Exemption Regulation can be withdrawn. A withdrawal decision has the effect that the exemption of the agreement lapses once the withdrawal becomes effective (ex nunc). 46 The right of the authorities of the Member States to intervene is limited to the territory or a part thereof of the Member State in question, so far as it has all the characteristics of a distinct geographic market.<sup>47</sup>

A possible withdrawal constellation mentioned in the VRBER is the possible anti-competitive effect of parallel networks of similar vertical agreements. 48 In particular, the cumulative use of qualitative criteria could foreclose more efficient dealers or categories of distributors (e.g. discounters). 49 This risk is acutely present in selective distribution systems. 50 Another constellation mentioned is the use of selective distribution systems for products unsuitable for this form of distribution or with inappropriate selection criteria. <sup>51</sup> Initially, selective distribution systems fall under the protection of the VRBER, irrespective of the type of product and type of selection criteria if thresholds of 30% are not reached and there is no hardcore restriction.<sup>52</sup>

#### C. Development and challenges of the internet economy

#### Characteristics of the internet economy I.

The current preoccupation with vertical restraints is influenced by the rapid development of the internet economy and the resulting impetus to competition. The internet economy is to be understood as business activity in which goods and services are distributed and sold at a distance using the Internet.



#### 1. **Economic significance**

# Development of infrastructure and user numbers

The number of people in Germany buying goods on the internet has steadily grown in recent years. At the end of May 2012, 57 million people in Germany had used the internet at least once in the previous three months.<sup>53</sup> 74% of these (42.3 million people) had either bought or ordered products for their private use (period of reference: the last 12 months). 54 Purchase via the internet has therefore been accepted by a wide sector of the population. In view of a population of 80.3 million people<sup>55</sup>, a further increase in demand for online transactions is to be expected.

Only fast internet connections make a large number of e-commerce offers attractive because, e.g. product presentation films are relatively data-intensive. In the past years the share of households with fast broadband connections has grown considerably, from 30% in 2006, over 50% in 2008 and 70% in 2010 to 75% in 2012. 56 The fast expansion of the user base in the last years was therefore an important pre-condition for the growth in ecommerce.

The mobile internet is still of minor but increasing significance: In 2012 10% of online shoppers used a smartphone or other handheld device to order or buy products.<sup>57</sup> The potential for the future lies in the fact that the mobile internet can connect online trade with offline trade because it will be possible e.g. to compare offers on the spot.

## Development of turnover

Total expenditure by end consumers on the internet (goods and digital services such as tickets for air travel or concerts) amounted to 37.3 billion Euros in 2012, an increase of approx. 25% over 2011.<sup>58</sup> In goods sales alone the total amount in 2012 was 27.6 billion Euros, an increase of 27.2 per cent over the previous year. <sup>59</sup> In 2012 Amazon alone, the most important online distributor on the German market, achieved a turnover of 6.6 billion Euros. 60 For 2013 a growth of 21.3 per cent in turnover achieved with the sale of goods is expected, increasing this amount to 33.5 billion Euros. 61 On another basis for calculation, ecommerce in Germany was estimated at 19.67 billion Euros in 2012 and an annual growth of approx. 10% to 28.39 forecast for the period 2013 to 2016. 62 In spite of the large deviations in absolute values due to different underlying definitions and the related varying growth forecasts, strong growth is generally expected in the coming years. A driving force could be lower end consumer prices in online trade in a number of sectors. In 2012, for instance the Autorité de la Concurrence found substantially lower prices in France in the three sectors which it examined, i.e. electrical household appliances, cosmetics and body care products.<sup>63</sup>



#### 2. Implications for competition

The internet economy provides significant stimuli to competition, which can be categorized into three areas: Reduction of search costs for the buyer, expansion of the "geographic" reach of the distributor and reduction of distribution costs. This enables manufacturers to enter into direct contact with end consumers and distributors to offer a wider selection of goods or services. 64

## Reduction of the transaction costs for the end consumer

The internet raises market transparency and in doing so reduces transaction costs for the end consumer: Firstly, it offers distributors as well as manufacturers the possibility of extensive and detailed product presentation with the aid of written, photo and film illustrations, which can go beyond the possibilities of a typical sales talk in a brick-andmortar store. Secondly, comparing different offers is less time and cost intensive for consumers in the internet than in the brick-and-mortar trade. 65 This is due to the easy searchability of offers of distributors through search engines, price comparison sites and third party platforms which often enable a direct comparison between the different retail offers. Price comparison sites and third party platforms in particular help to intensify intrabrand competition. 66 The internet can also help to reduce the information asymmetry between end consumers and distributors or manufacturers on the quality of an offer, since end consumers have the possibility to exchange their assessments of and comments on the product in internet fora, marketplaces or shops. The internet also facilitates access to professional evaluations and tests.

## *Increase of distributor reach*

With the elimination of travel and time costs for the consumer, the (theoretical) reach of the distributors which sell via the internet increases. Theoretically, it is possible for each online store to be discovered worldwide. However, due to the large number of similar businesses<sup>67</sup>, this is usually only possible with targeted expenditure on advertising, offline e.g. by means of TV advertising and online e.g. by means of banner and search engine advertising. Not only for this reason, national borders still play an important role. This is confirmed by the fact that 98% of online buyers in Germany<sup>68</sup> order from sellers within Germany, 14% (also) from sellers within the EU and 8% (also) from sellers outside the EU (e.g. Switzerland, USA).<sup>69</sup> These figures also show that the cross-border online trade within the EU still has significant growth potential and can further increase competitive activity. The reasons for the concentration on the "home market" can be delivery costs and times, confidence in law enforcement and cultural preferences. There are, for example, indicators which point to local or regional preferences of the end consumers.<sup>70</sup>



## Reduction of transaction costs of dealers and manufacturers

The internet also leads to a reduction in the transaction costs of manufacturers and dealers. In many cases it is only through the internet that manufacturers gain the possibility to enter into direct contact with end consumers via so-called social platforms like Facebook, their own homepage or online shops and sell their products directly. This possibility is complimented to some extent by so-called flagship stores in which a manufacturer can present and sell his products in his own elaborately designed brick-and-mortar stores. In turn, retailers are less limited in their product range by restrictions in terms of exhibition and storage space. As a result of the wider geographic reach it can also be profitable for them to offer niche products and build up specific know-how for these products. 71 This increase in product variety for the end consumer is in itself a potential source for increasing consumer welfare.<sup>72</sup>

In conclusion, it can generally be stated that the internet leads to a significant reduction of distribution costs and an intensification of competition at both the manufacturer and retailer level. The end consumers are likely to be the main beneficiaries of these developments in terms of falling prices or increased quality and product variety or improved service. However, the most perceived changes are likely to be at the dealer level, which is directly affected by the increasing pressure on competition exerted by the revolution in online distribution. At the same time it cannot be denied that increased transparency and rapidity of response generated by the internet can create new opportunities to restrict competition. For example, they can encourage concerted market behaviour or help to secure a powerful position.

#### II. Relation between online and offline trade

The online turnover of 37.3 billion Euros is somewhat put into perspective when compared to the overall turnover of the German retail trade, which amounted to approx. 428 billion Euros in 2012.<sup>73</sup> Correspondingly, online sales of goods so far account for less than 10% of total sales.<sup>74</sup> If the so-called fast moving consumer goods (such as food and drugstore products) are excluded, the proportion of online sales rises and amounts to about 14%. 75

## Proportion of online sales is sector-dependent

The relevance of online trade varies significantly from sector to sector: For example, online sales account for a high proportion of total sales in the areas of "consumer electronics" (approx. 17% in 2012) and "fashion and accessories" (16.8%). 76 In the area "DIY and gardening", on the other hand, online sales only account for 2.6% of total sales. 77 It is expected that the amount of online sales will increase further, in some sectors possibly up to



a proportion of 50% of total sales<sup>78</sup>. This fact combined with a limited growth in total sales means that a loss in turnover of more than 10% already exerts significant pressure on offline distribution concepts.

In a survey on the online and offline purchasing behaviour of consumers in Germany conducted in November 2012<sup>79</sup> (which was based on 84,000 transactions, or 2 million Euro turnover), 7% of the transactions were made on the internet and the turnover generated with these accounted for nearly 16% of all purchases included in the survey. The purchases were largely made in specific sectors. For example, 27% of the sum that was spent on online purchases was spent on electronic goods, followed by a 22% which was spent on fashion. An analysis of shopping cart contents as indicated in the transaction data suggests that it is more common in the over-the-counter retail trade to purchase different product categories together than it is in the online trade.

# Research and customer advice both online and offline

The question of how the different channels are used and combined in the overall process of product search, pre-sale advice, selection and purchase decision is of interest to both, the design of distribution systems and the legal assessment of restraints. In the survey mentioned above, about 20% of the online purchases were researched offline and 17% of the offline purchases were researched online. Due to the significantly higher turnover volume generated in the brick-and-mortar retail trade, the purchases that were researched online and executed offline generated an eleven times higher turnover than those that were researched offline and purchased online.

## Consumer preferences for distribution channels

While the survey showed a tendency of younger, high-income consumers to shop more often online than older or low-income consumers, another differentiation of customer groups is possible which is based on purchasing behaviour and online shopping preferences.

According to the survey, the choice of the purchasing channel usually depends on whether a customer wants to take the product directly home or have it delivered. Any other incentives, such as the sales price, are secondary to this. Both sales channels have their specific advantages which is why there is a tendency of online distribution channels merging with offline sales channels ("multi-channelling"). Not only are previously exclusively brick-andmortar retailers increasingly using online sales channels, but also purely online retailers are contemplating setting up retail outlets, at least in the large metropolises.<sup>80</sup>



#### III. Internet platform markets

So-called platform or two-sided markets are market models common for the internet. One example is the platform operated by eBay, which is open to commercial and private sellers and allows sales via auctions and via fixed sales prices. Amazon also operates a so-called Marketplace which is fully integrated into its internet shop and on which independent commercial dealers can sell their products to customers. Search engines such as those operated by Google or Microsoft ("Bing") are also platform markets: Search enquiries from one market side are linked to advertisements from the other market side. Platform markets are, however, not a recent internet phenomenon. Credit cards, for example, bring together independent sellers and potential buyers in their choice of means of payment. Another example are newspapers that link advertising customers with potential buyers of their products.

An internet marketplace (i.e. a platform market where suppliers that are independent of the platform operator offer goods or services to third parties) becomes the more interesting for independent dealers the more potential customers are active there. Vice versa, the market place will be more attractive for customers if many dealers are active on it because this leads to stronger competition between dealers and a bigger range of products to choose from. A reciprocal positive externality which only affects one and the same market is called network externality. One example is the telephone market where each owner of a telephone (marginally) enhances the attractiveness of the telephone for all other network users. By analogy, the positive externality across market sides as outlined above is referred to as "indirect" network externality.81 For network effects to be noticeable and to generate a positive feed-back, often a certain "critical mass" is required. 82 If this critical mass is achieved, network effects in conjunction with economies of scale can lead to a strong, almost invincible market position of the platform which might even take the form of a socalled natural monopoly. This, however, depends on a range of factors, such as the homogeneity of demand: It is, for example, possible for one customer group with a preference for high-quality services to favour a certain platform despite its higher prices, while another customer group whose sole interest are low prices will favour a different platform. Another significant factor is the emergence or absence of negative economies of scale which, at a certain point, can have the effect that costs will rise again (increased coordination efforts due to increasing complexity, e.g. delays in responding to customer enquiries).83

In principle, on each market there is a demand side and a supply side that interact to exchange goods or services. A market is a two-sided or platform market if this exchange is



made easier (through reduced transaction costs) by an intermediary and the intermediary can influence the volume of transactions processed by him not only by the amount of fees charged on both market sides but also by their allocation to the two sides.<sup>84</sup> Usually, the allocation of fees takes into account the demand elasticity of the respective market side, its options to use more than one platform ("multi-homing" 85) and the respective strength of the indirect network externalities mentioned above. The costs incurred by the platform on the respective market side are secondary in this calculation. For example, online search engines such as Google finance themselves via the market side that runs advertisements, whereas the market side that posts search enquiries, thereby generating significant costs, only contributes to the maintenance of the business model by providing meta data on search patterns. Hotel reservation sites and market place operators also often offer their services for free to end consumers but demand a commission from the suppliers (hotels or dealers) if a contract is concluded with a customer. Of course, this commission is indirectly also paid by the end consumer.

#### D. Case practice relating to the internet economy and current issues

#### I. Classic resale price maintenance and the pressure exerted to implement it

The Bundeskartellamt's past case practice on vertical restraints focused to a great extent on cases of resale price maintenance. As restrictions of competition by object they usually violate Article 101(1) TFEU and they do not fall under the VRBER, because they deliberately restrict the possibility of customers to set their sales prices themselves and therefore constitute a hardcore restriction within the meaning of Art. 4(a) VRBER. Individual exemptions are possible but companies usually do not even claim that the prerequisites for an individual exemption are fulfilled.

Recently, there have been a number of cases were companies tried to counter the price pressure which has emerged because consumers buying via the internet save on search and travel costs, which in turn has intensified competition. According to the Bundeskartellamt's findings, two dominant suppliers (namely Phonak GmbH, a major supplier of hearing devices<sup>86</sup> and CIBA Vision Vertriebs GmbH, the market leader in the market for contact lenses<sup>87</sup>) tried with illicit measures to maintain a certain sales price level of independent retailers which had come under pressure from sales over the internet and the internet's transparency.

In another case, Alessi GmbH Deutschland, a producer of high-quality design and household goods, contractually obliged its online dealers to observe its recommended retail prices. This obligation was not part of its contracts with over-the-counter retailers.<sup>88</sup>



Only recently, a proceeding against Wala Heilmittel GmbH was concluded which concerned the market for natural cosmetic products. Among other measures, the company made the participation in its selective distribution system dependent on the observation of its recommended prices. The contracts also included clauses restricting internet sales, thereby supporting the enforcement of the vertical price fixing measures.<sup>89</sup>

#### II. **Dual pricing**

Dual pricing systems can be another price-related restriction directed specifically against online sales. In a system of dual pricing, a retailer is granted different purchase prices, depending on whether he intends to sell the product online or over-the-counter. From the retailer's perspective, the manufacturers' selling prices (MSP) are variable costs that have a direct bearing on the setting of his own prices. By increasing the difference between the two prices, a manufacturer could factually gain the power to determine the retailer's choice of a sales channel for the sale of his products. With the use of an unattractive MSP for online sales he could reduce the retailer's online sales to zero or even prevent him from building up an internet distribution system in the first place. For this reason, dual pricing falls under Article 4(b) VRBER. 90 By restricting online sales, the geographic trading area of the dealer is limited, which can be regarded as a restriction of the territory into which, or the customers to whom a dealer may sell his goods. The situation is different if specific costs incurred in the brick-and-mortar trade are reimbursed in the form of fixed subsidies that are unrelated to turnover and quantities. Here, the retailer is still free in his choice of a certain sales channel, as fixed amounts usually do not influence the setting of prices. 91

In the 2011 proceeding against the manufacturer of high-quality sanitary fittings Aloys F. Dornbracht GmbH & Co. KG, the Bundeskartellamt forced the company to adapt its specialised trade agreement with wholesalers. As part of the agreement a rebate was exclusively granted for goods which were sold in a brick-and-mortar shop. As a consequence, goods that were intended for sale on the internet were sold by the wholesalers at higher prices than goods that were intended for the brick-and-mortar trade. 92 Although it is conceivable that the wholesale trade will suffer from 'free riders' benefiting from its substantial promotion efforts, compensation via a dual pricing system leads, compared to other models, to competition restraints that are not indispensable. In particular, there is a danger that a system of dual pricing would hinder a possible structural change towards online distribution.

In a different case which the Bundeskartellamt is currently investigating, retailers were granted a uniform purchase price but an annual discount on the purchase price was calculated in proportion to their online and offline sales in the previous year. In the Bundeskartellamt's view, this system generates the same anti-competitive incentives as a



system of dual pricing. Also under this system, the decision of the retailer in favour of a certain sales channel will influence his variable costs: Since in principle each sale via the internet will marginally raise the costs of all products for the following year, from a commercial perspective the retailer would have to discount the expected mark-up and calculate it into the retail prices of his current sales, differentiating between the two sales channels. In any case, this system creates incentives for the retailer to keep his online sales quota low.

#### III. Hindrance of online sales in selective distribution systems

Currently, the Bundeskartellamt is examining several selective distribution systems with regard to the design of their online distribution systems. 93 A special focus is placed on suppliers of sports shoes and clothes. But also in other sectors there is a tendency of manufacturers of branded goods reorganising their distribution systems because they feel a need to react to the growing competition and price pressure exerted by internet sales on the brick-and-mortar retail trade. 94 These reorganisation measures include in particular the introduction of selective distribution systems, also for well-established products and brands, and the tightening of specific distribution rules. In a number of cases, it seems to be the aim of such measures to replace direct vertical price recommendations with more subtle means.

## Exclusion of internet sales as a hardcore restriction

Article 4(c) VRBER contains a specific hardcore restriction which applies to selective distribution systems that fall under Article 101(1) TFEU (see above under B.II.2). Like Article 4(b) VRBER, Article 4(c) VRBER concerns the restriction of the trading territory of dealers but, as a more specific provision, it goes beyond Art. 4(b) VRBER by demanding that in a selective distribution system active sales by retailers to end consumers must always also be possible. Since sales via an internet shop are primarily passive sales, this differentiation is not particularly significant for online sales in general. According to the decision of the ECJ in the Pierre Fabre case, a contract clause prohibiting de facto the internet as a marketing method "at the very least has as its object the restriction of passive sales to end users wishing to purchase online and located outside the physical trading area of the relevant member of the selective distribution system". 95 An individual exemption under Article 101 (3) TFEU remains possible. In order to obtain this, the companies would have to explain to what extent the criteria listed under Article 101 (3) TFEU are cumulatively satisfied: In the case of a total prohibition of internet sales, even if there are efficiency gains, it will be difficult to prove that the restriction is indispensable and that consumers have been granted a fair share of the



benefits. In a recent case, the British OFT has taken up a prohibition of internet sales for electric mobility scooters. 96

Restriction of internet sales: hardcore restriction or precondition for withdrawal of exemption?

While the de facto prohibition of online sales constitutes a hardcore restriction which excludes an exemption under the VRBER, other restraints or impediments are more difficult to assess. A differentiation is particularly difficult in selective distribution systems where it is generally possible to demand very strict quality requirements from dealers. Such quality demands can naturally also be made for online sales. In particular, under the VRBER a manufacturer may demand that, in order to maintain certain customer advisory services, dealers admitted to its distribution system also have a brick-and-mortar shop. 97

The prohibition of an optimisation of search engines which (invisible to the end consumer) improves the searchability of dealers is a relatively obvious hardcore restriction (Art. 4b,c VRBER). The requirement that offline retailers that have been admitted to a selective system may only sell a product online if they have achieved a certain minimum turnover with the same product in their brick-and-mortar shop is equally restrictive. Often, however, the restrictions are more subtle. A critical level is probably reached where there are no conceivable legitimate reasons of quality to restrict online sales or where a vast number of individual requirements prevent dealers from selling their products online. Another attempt to differentiate between hardcore restrictions and other restrictions is the principle of equivalence used in the VRBER. 98 It is applied where different selective criteria are used for online and offline sales. Accordingly, if the criteria are not equivalent and their difference is so poignant that the dealers are dissuaded from using the internet to sell their products, this constitutes a violation of Article 4(c) of the VRBER. 99 In many cases, however, this can only be determined on a case-by-case basis. 100

Prohibition to use certain platforms (eBay, Amazon etc.)

A frequently discussed example of a restriction of online sales is the general prohibition for dealers participating in a selective distribution system to use independent marketplace platforms. This restriction is currently being implemented by a vast number of manufacturers of branded goods. 101 In some cases this prohibition to use independent marketplace platforms even applies if a marketplace platform is fully integrated into the online offer of an internet dealer who is also a member of a selective distribution system.



According to the EU Commission's Guidelines on Vertical Restraints, which were revised in 2010, suppliers may require that customers do not visit the website of a retailer through a site carrying the name or logo of a third party platform, as is usually the case for such marketplace platforms. 102 Consequently, such a prohibition is not regarded as a hardcore restriction by the Commission. This is a view that is also often shared in literature, in particular with regard to the prohibition of online auctioning platforms; <sup>103</sup> case law has been ambiguous in this matter. 104 The ECJ's jurisdiction in the Pierre Fabre case 105, which views competition restraints to protect a brand image critically, challenges the explanations in the guidelines on this matter. Irrespective of the scope of the hardcore restriction, the benefits of the Block Exemption Regulation can be withdrawn in cases where an 'excessive clause' has effects in a specific case that are incompatible with Article 101 (3) TFEU.

# Do platform bans generate efficiencies?

In order to be covered by the Block Exemption Regulation, a prohibition to use marketplace platforms would have to improve the production or distribution of goods, or contribute to economic or technical progress. One argument in favour of a platform ban could be to protect the brand image of the products concerned. However, after the decision in the Pierre Fabre case this argument is no longer convincing. Another argument that has been raised is the protection against free-riding on the advice and promotion efforts of other dealers. This is particular important in conjunction with an obligation to always present individual products as part of a whole range of products. Internet-based or telephone advice is, however, generally also possible for online sales.

# Doubts concerning adequate consumer participation and indispensability

If the prohibition to use platform markets generates efficiencies, consumers have to receive a fair share of the resulting benefit. In particular, consumers must not be worse off when compared to a situation where the restriction was not in place. 106 If the use of marketplace platforms is prohibited, there is a risk that possible efficiency gains will be accompanied by a reduction of intra-brand competition. Intra-brand competition can suffer from a prohibition to use platforms if the use of platforms reduces transaction costs, for example for consumers by making it easier to compare offers and for dealers by increasing their scope of sales because through a platform they can reach end consumers more easily than through their internet shop. In addition, platforms can reduce market entry costs for dealers if, for example, instead of incurring fixed costs for setting up their own internet shop and advertising measures they merely have to pay certain commissions. As a result, search costs for consumers could rise if the use of platforms is prohibited. A direct increase in retail prices is also a possible result. Both effects are unfavourable for consumers, which would have to



be balanced against possible benefits resulting from a platform prohibition, such as the exclusive presentation of products in a certain product range. How much consumers appreciate the offer of such services will by nature depend on the product. The negative effects for consumers are usually more pronounced if they cannot resort to any alternatives, and in particular if close competitors have opted for the same kind of restrictions thus creating a network of comparable restrictions.

Another question that needs to be assessed is whether the restriction is indispensable to generate the efficiencies. An alternative could be to only allow the use of platform markets with a top-quality appearance whose logo will not harm the brand image. Another option could be to oblige dealers to either open a brick and mortar shop in a location that can be easily reached and to offer extensive pre-sale advice there, or to operate their own internet shop in addition to using the platform for their online sales. This would make 'free riding' on the pre-sale services of other dealers impossible since all dealers would have to incur comparable costs for customer advice.

#### IV. Price parity clauses used on platform markets

The Bundeskartellamt is currently dealing with two cases where platform operators have used price parity clauses: one is HRS, which operates a hotel booking site, and the other is Amazon.<sup>107</sup> In the case of Amazon, the horizontal competition restraint is more prominent, since Amazon is primarily active as a dealer itself. Both platforms demand a commission from independent suppliers if a sale or booking is made through them. In addition to Germany, other competition authorities and courts in Great Britain, Austria, Switzerland, the United States and Australia are currently also conducting proceedings to assess whether the application of a most favoured customer clause (MFCC) by internet platforms violates competition law. 108

Under the price parity clauses used in the cases referred to above, the operator of a platform obliges suppliers or dealers from one market side to offer the other market side (e.g. end consumers) their most favourable price or conditions if they sell through the platform. While most favoured customer clauses are often used on the procurement side, in this case the clause targets the final selling price, albeit still binding the service provider. 109

## Competition restraint

Price parity clauses not only restrict companies in a vertical relationship; by setting a price reference with regard to other competitors they also have a horizontal effect. Although under a price parity clause suppliers are still free to set their prices, they are no longer able



to set different prices for different sales channels in order to react to, e.g., differing distribution costs or differing levels of competitive pressure.

The fact that the providers, bound by the clauses, cannot react to competitive moves by the platforms can lead to a distortion of competition at the platform operator level: If low commission rates are not reflected in the sales prices of products offered on the platform, this can reduce the incentive for platform operators to engage in price competition. If a platform has a market position that makes it indispensable, it is able to maintain an excessive level of commissions with one market side despite cheaper sales alternatives, because the other market side cannot benefit from the cheaper offer and has therefore no incentive to switch to another platform. Price parity clauses can also restrict potential competition by making market entries more difficult: this would be the case if a newcomer depends on the possibility to place attractive offers on a platform to be able to quickly reach an economically efficient size. In addition, price parity clauses lead to a standardization of certain competition parameters, which can be conducive to collusion.

## Exemption requirements

If price parity clauses are considered exemptable under the VRBER (in other words, if they do not constitute a hardcore restriction), a withdrawal of the exemption must be considered if they actually result in anti-competitive effects. Platform parity could prevent free riding activities and thus improve the distribution of goods, thereby fulfilling the first exemption requirement under Article 101 (3) TFEU. Free riding activities by dealers or service providers that also use the services of a platform could take the following form: the dealers or providers could use the investments made by the platform, which include contract-specific investments such as the editing of their offer and unspecific investments such as the listing and sorting of offers ("bulletin board effect") and investments into the popularity of the platform which increase visitor traffic and enhance consumer trust. Before a business transaction is concluded they could induce their customers, e.g. end consumers, to go to their own internet shop or another sales channel with a lower commission, thus avoiding the payment of the commission due for the services provided by the platform. They could share the commission saved with their customers by offering them a lower sales price. Although the financing of platforms via commissions makes free riding activities possible, an argument in favour of it could be that it allows for more efficient risk allocation if a supplier only has to pay for the use of the platform if he effects a sale through the platform. This could be particularly important for less diversified suppliers. In addition, if a platform works with commissions, it has a strong incentive to promote the sales of the suppliers active on it. With a view to adequate consumer participation, these aspects need to be balanced against the negative effects for consumers resulting from the competition restraint. This includes in particular the possible restriction of potential competition because potential market entries



are prevented. Another aspect to be considered is that the free rider problem could possibly also be solved by less restrictive but equally effective measures. One possibility would be a direct payment for the use of the platform in the form of a service fee. The indispensability of the competition restraint within the meaning of Article 101(3)(a) TFEU would then have to be denied. It also has to be examined to what extent the horizontal effects of the price parity clauses eliminate competition for a substantial part of the services concerned.

#### E. Summary

The revolution in the distribution of goods and services resulting from the fast proliferation of the internet has triggered an extensive reorganisation of distribution structures which has significant effects for the retail trade in particular. The subject of vertical restraints has gained new relevance in this context.

The selective distribution of products sold to end consumers under a manufacturer's brand name is of particular relevance in this regard. The manufacturers of these products are facing increased price competition and are justifying their controversial practices by claiming that they are trying to maintain well-established specialist trade structures, specific services or a certain brand image. The interpretation of the VRBER's hardcore restrictions are of particular significance in this respect. Another issue of growing importance is the question as to what extent selective distribution is the right form of distribution for the respective products and if the selection criteria are the most suitable.

In addition, two-sided markets are becoming increasingly important in online distribution. Vertical restraints in this area and in particular the indirect network effects between the two connected market sides require a careful review of general assessments when applied to these markets.

In this dynamic market environment, the Bundeskartellamt considers it a key task to keep the markets concerned open and ensure that newly emerging competition is not hindered.



#### F. List of questions

- Does the internet economy require a re-evaluation of selective distribution systems?
- Does the VRBER with its focus on individual market shares and its narrow catalogue of hardcore restrictions offer an adequate framework for assessing vertical restraints in the internet economy?
- How should one assess the protection of brand images by means of vertical restraints? Can the prohibition of platform use be justified?
- Is the structure of the VRBER with its relatively strict requirements for the withdrawal of an exemption appropriate in respect of the intervention options for national competition authorities? Is a more active or more reserved policy of intervention by the competition authorities required?
- Under what circumstances can most favoured customer clauses for retail prices constitute a competition restraint by object? Should they be regarded as a hardcore restriction and consequently be excluded from the VRBER because under certain circumstances they can be just as anti-competitive as resale price maintenance?



## **Annex**

## **Article 101 TFEU**

- (1) The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
- a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- b) limit or control production, markets, technical development, or investment;
- c) share markets or sources of supply;
- d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
- (2) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
- (3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,
- which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
- a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives, or
- b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

## **Article 4 VRBER**

The exemption provided for in Article 2 [of the VRBER] shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

- a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;
- b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services, except:
- i) the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer,

10.10.2013



- ii) the restriction of sales to end users by a buyer operating at the wholesale level of trade,
- iii) the restriction of sales by the members of a selective distribution system to unauthorised distributors within the territory reserved by the supplier to operate that system, and
- iv) the restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier;
- c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment;
- d) the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different levels of trade;
- e) (...)

10.10.2013



## **Endnotes**

- <sup>1</sup> In the following a "vertical agreement" means an agreement or concerted practice entered into between two or more companies, each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services. (see Article 1 a of the VRBER). "Vertical restraint" in the following means a restriction of competition in a vertical agreement falling within the scope of Article 101 (1) of the Treaty on the Functioning of the European Union (TFEU) (see Article 1 b VRBER)
- <sup>2</sup> VRBER: Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.
- <sup>3</sup> Guidelines on Vertical Restraints, 2010/C 130/01, 19.5,2010
- <sup>4</sup> Cf. Simon, Die neue Kartellrechtsverordnung (EU) Nr. 330/2010 für Vertriebs- und Lieferverträge, EWS 2010,
- <sup>5</sup> To improve the readability of this paper, reference will be made only to the relationship between manufacturer and retailer and consequently distribution chains, even if many of the statements made apply just as well to agreements along the production chain, one example being the purchase of primary (upstream) products. The focus will be on the VRBER.
- <sup>6</sup> For an overview of vertical restraints see e.g. Rey, Vergé, Economics of Vertical Restraints; in Buccirossi, Handbook of Antitrust Economics, MIT Press, 2008
- <sup>7</sup> Cf. Motta, Rey, Verboven, Vettas, Hardcore restrictions under the Block Exemption Regulation on vertical agreements: An economic view [Members of the "Economic Advisory Group on Competition Policy" at the GD Competition of the European Commission]; Haucap, Klein, Einschränkung der Preisgestaltungsfreiheit im Einzelhandel aus wettbewerbsökonomischer Perspektive, 2012, DICE Ordnungspolitische Perspektiven No. 22
- <sup>8</sup> Cf. e.g. Rey, Vergé, The economics of vertical restraints, in Buccirossi, Handbook of Antitrust Economics, MIT Press, 2008; Motta, Competition Policy – Theory and Practice, 2004, Cambridge University Press; paras. 106ff., **Guidelines on Vertical Restraints**
- <sup>9</sup> Cf. e.g. Spengler, Vertical Integration and Anti-Trust Policy, 1950, Journal of Political Economy No. 58
- <sup>10</sup> cf. eg. para. 107a, Guidelines on Vertical Restraints; on the significance of services, especially in respect of RPM of Schulz. Does the Service Argument justify resale price maintenance?, 2007 Journal of Institutional and Theoretical Economics 163
- <sup>11</sup> Marvel, McCafferty, Retail price maintenance and quality certification, 1984, Rand Journal of Economics, No. 15
- <sup>12</sup> Motta, Competition Policy Theory and Practice, 2004, Cambridge University Press, p.335
- <sup>13</sup> Another conceivable form of opportunistic behaviour could be that of a retailer if, for instance, manufacturers have to expand their capacities and then fully utilise them to fulfil specific contracts.
- <sup>14</sup>Cf. e.g. in support of this argument Motta, Competition Policy Theory and Practice, 2004, Cambridge University Press; Lettl, Kartellverbot nach Art. 101 AEUV, §§ 1, 2 GWB und vertikale Preisempfehlung/Preisbindung, WRP 2011; p. 735, critical: Schwalbe, Preisgestaltung in vertikalen Strukturen -Preisbindung und Preisempfehlung aus ökonomischer Sicht, WuW 2011, issue 12;
- <sup>15</sup> Cf. Akerlof, The Market for Lemons, 1970, Quarterly Journal of Economics. 84, No. 3
- <sup>16</sup> Cf. Franck, Zum Schutz des Produktimages im selektiven Vertrieb, 2010, WuW 07-08;
- <sup>17</sup> Cf. ECJ, Copad, C-59/08, 23.04.2009 (on Directive 89/104/EEC trademark law), para. 24: "(...) the quality of luxury goods (...) is not just the result of their material characteristics, but also of the allure and prestigious image, which bestows on them an aura of luxury (...)."
- <sup>18</sup> Cf. ECJ, Leclerce, T-19/92, 12.12.1996, para. 120
- <sup>19</sup> Cf. ECJ "Pierre Fabre", C-439/09, 13.10.2011, para. 46
- <sup>20</sup> Cf. e.g. paras. 100ff. Guidelines on Vertical Restraints
- <sup>21</sup> Cf. on this in particular Rey / Vergé, Resale Price Maintenance and interlocking relationships, in: The Journal of Industrial Economics, 58, 2010; cf. also para. 224 Guidelines on Vertical Restraints



- <sup>22</sup> Since according to Article 2 (2) of Regulation 1/2003, Article 101 TFEU explicitly takes precedence over Sections 1, 2 GWB in so far as trade between the Member States is appreciably affected and because these provisions of the GWB are modeled on those of the TFEU and Section 2 (2) GWB governs the applicability of BERS to national cases only, the following only refers to European law.
- <sup>23</sup> on restraints by object see para. 35ff, ECJ, Allianz Hungária i.a., C-32/11, 14.03.2013
- <sup>24</sup> Cf. para. 96, Guidelines on Vertical Restraints
- <sup>25</sup> Cf. para. 73, Guidelines on the Application of Article 81 (3) EC Regulation
- <sup>26</sup> Empowerment under Regulation no. 19/65 EEC in conjunction with Article 103 (1,2b) TFEU
- <sup>27</sup> Recital No. 3 VRBER
- <sup>28</sup> Recital No. 5 VRBER
- <sup>29</sup> Cf. paras. 23, 74, Guidelines on Vertical Restraints
- <sup>30</sup> Cf. para. 74, Guidelines on Vertical Restraints as well as paras. 48 ff., Guidelines of the European Commission on the Application of Article 81 (3) EC
- <sup>31</sup> Cf. also para. 36, Guidelines of the COM on the application of Article 81 (3) EC.
- This provision was implemented into national law under Section 32 d GWB. Fundamentally the same conditions apply for the withdrawal of exemption from Section 1 GWB under Section 2 (2) GWB as for the withdrawal of exemption from Article 101(1) TFEU under application of the BER.
- <sup>32</sup> Definition of Article 1 e VRBER
- <sup>33</sup> A discussion on selective distribution in the context of the VRBER can be found among others in Lettl, Die neue Vertikal-GVO, WRP 2010
- <sup>34</sup> Cf. para. 174, Guidelines on Vertical Restraints
- <sup>35</sup> Cf. ECJ, Auto 24 (on Regulation 1400/2002), C-158/11, 14.06.2012; ECJ, Pierre Fabre, C-439/09, 3.10.2011; discussed e.g. by Vogel, Efficiency versus Regulation: The Application of EU Competition Law to Distribution Agreements, Journal of European Competition Law & Practice, 2013, Vol. 4, No 3, p. 227-284; Schultze, BB-Kommentar: Umfassende Flexibilität bei der zahlenmäßigen Begrenzung selektiver Vertriebssysteme, BB 2012, 1883-1886; Wegner, BB-Kommentar EuGH bestätigt Leitlinien zum Internetvertrieb, BB 2011, 2956-2960
- <sup>36</sup> Cf. in particular ECJ, AEG Telefunken, C 107 82, 25.10.1983;ECJ, Metro 1, C 26 76, 25.10.1977; ECJ. Metro 2, C 75 84, 22.10.1986; ECJ, Pronuptia de Paris, C 161 84, 28.01.1986; ECJ, L'Oreal, C 31 80, 11.12.1980
- <sup>37</sup> Recently in ECJ, Pierre Fabre, C-439/09, 13. 10.2011, para. 41 with reference to ECJ. Metro 1, para. 20. and ECJ, L'Oréal, paras. 15, 16
- <sup>38</sup> Cf. ECJ, AEG-Telefunken, para. 33 recently cited in ECJ, Pierre Fabre, para. 40
- <sup>39</sup> Cf. ECJ, Leclerc / Commission, T19-92, 12.12.1996, para. 118
- <sup>40</sup> Cf. ECJ, Pierre Fabre, para. 39 with reference to ECJ, AEG-Telefunken, paras. 33 and 1. Guiding Principle: "Article 101 (1) 'TFEU is to be interpreted in such a way that in a selective distribution system a contractual clause (...) amounts to a restriction by object (...) if an individual and specific examination of the content and objective of the contractual clause and the legal and economic context of which it forms a part, it is apparent that, having regard to the properties of the product at issue, that clause is not objectively justified.'
- <sup>41</sup> Cf. Recital No. 7, VRBER
- <sup>42</sup> Article 3 (1), VRBER; para. 23, Guidelines on Vertical Restraints
- <sup>43</sup> Cf. para. 23, Guidelines on Vertical Restraints
- <sup>44</sup> Cf. para. 47, Guidelines on Vertical Restraints
- <sup>45</sup> Cf. para. 47, Guidelines on Vertical Restraints
- <sup>46</sup> Cf. para. 77, Guidelines on Vertical Restraints
- <sup>47</sup> Cf. Article 29 (2), Regulation 1/2003
- $^{48}$  Cf. recital 15, VRBER; see also para. 75, Guidelines on Vertical Restraints
- <sup>49</sup> Cf. paras. 75, 175 Guidelines on Vertical Restraints
- <sup>50</sup> Cf. para. 179, Guidelines on Vertical Restraints
- <sup>51</sup> Cf. also para. 176, Guidelines on Vertical Restraints



- <sup>52</sup> Cf. para. 176, Guidelines on Vertical Restraints
- <sup>53</sup> Cf. Federal Statistical Office, Fachserie 15, Reihe 4, IKT 2012; P4.1, p. 22
- <sup>54</sup> Cf. Federal Statistical Office, Fachserie 15, Reihe 4, IKT 2012; P4.1, p. 22, P4.4, p. 26
- 55 Cf. Federal Statistical Office, Bevölkerung und Erwerbstätigkeit; Vorläufige Ergebnisse der Bevölkerungsfortschreibung auf Grundlage des Zensus 2011
- <sup>56</sup> Cf. Federal Statistical Office, Fachserie 15, Reihe 4, IKT 2012; P4.4, p. 27
- <sup>57</sup> Cf. Federal Statistical Office, Fachserie 15, Reihe 4, IKT 2012; P4.4, p. 26
- <sup>58</sup> Cf. Press release of the German E-Commerce and Distance Selling Trade Association (BVH), "Interaktiver Handel 2012: Erneuter Umsatzrekord", 12.02.2013
- <sup>59</sup> Cf. Press release of the German E-Commerce and Distance Selling Trade Association (BVH), "Interaktiver Handel 2012: Erneuter Umsatzrekord", 12.02.2013
- <sup>60</sup> 8,732 million US Dollars according to the US Securities and Exchange Commission, Form 10-K, Commission File No. 000-22513, Amazon.com, Inc., for the fiscal year ended December 31, 2012
- <sup>61</sup> f. Press release of the German E-Commerce and Distance Selling Trade Association (BVH), "Interaktiver Handel 2012: Erneuter Umsatzrekord", 12.02.2013
- <sup>62</sup> ECO / Arthur D Little: Die deutsche Internetwirtschaft, 2012-2016 Zahlen, Trends und Thesen, p. 17
- <sup>63</sup> Cf. Autorité de la Concurrence, E-Commerce, Avis No 12-A-20, 18.09.2012
- <sup>64</sup> Cf. OECD, DAF/COMP/M(2013)1/ANN3 (not yet published) and Buccirossi, Note: vertical restraints for online sales, DAF/COMP(2013)1, Directorate for Financial and Enterprise Affairs, Competition Committee, Roundtable on vertical restraints for online sales
- <sup>65</sup> Cf. e.g. Hamburger Abendblatt, Internet Onlinehändler greifen die Optiker mit niedrigeren Preisen an. 02.08.2013, p. 1
- <sup>66</sup> Cf. Schweda, Verkaufsverbot über Online-Handelsblattformen und Kartellrecht, WRP 2013, 590-600
- <sup>67</sup> In 2011, for example, already 24% of the companies in Germany involved in the trade with, servicing and repair of motor vehicles sold products or services via a website or electronic data exchange (see Federal Statistical Office, IKT in Unternehmen 2012, 8.2, p. 28).
- <sup>68</sup> People who have bought on the internet at least once within the last 12 months (ending with 30 May 2012)
- <sup>69</sup> Cf. Federal Statistical Office, Fachserie 15, Reihe 4, IKT 2012; P4.3, p. 25
- <sup>70</sup> Cf. Hortaçsu, Martínez-Jerez, Douglas, The Geography of Trade in Online Transactions: Evidence from eBay and Mercadolibre, 2009, American Economic Journal: Microeconomics
- <sup>71</sup> Cf. e.g. Brynjolfsson, Hu, Smith, The Longer Tail: The Changing Shape of Amazon's Sales Distribution Curve, 2010, SSRS
- <sup>72</sup> Cf. Brynjolfsson, Hu, Smith. Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety at Online Booksellers, 2003, Management Science 49 (11)
- <sup>73</sup> Cf. German Retail Federation (HDE), "Der deutsche Einzelhandel", June 2013, retail turnover excluding motor vehicles, petrol stations, fuels, pharmacies; source: German Federal Statistical Office; data to some extent provisional; HDE forecast for 2013
- <sup>74</sup> The exact proportion varies according to different amounts of turnover used in the calculation, which in turn is a result of different, sometimes ambiguous definitions of online sales in publications.
- <sup>75</sup> Cf. IFH Köln, press release of 2 May 2013: "Umsatz: Online-Handel legt nochmal 15 Prozent drauf"
- <sup>76</sup> Cf. IFH Köln, press release of 2 May 2013: "Umsatz: Online-Handel legt nochmal 15 Prozent drauf"
- <sup>77</sup> Cf. IFH Köln, press release of 2 May 2013: "Umsatz: Online-Handel legt nochmal 15 Prozent drauf"
- <sup>78</sup> Cf: Focus, Schmidt, E-Commerce: Die Panik der alten Händler steigt Network economy blog, 23.07.2012
- <sup>79</sup> Roland Berger Straregy Consultants/ECE survey "Dem Kunden auf der Spur", 2013, p. 16ff.
- <sup>80</sup> FAZ, "Der Reiz der Offline-Welt", with a reference to Fab, Piperline, Warby Parker, Etsy, 27.05.2013, p. 22
- <sup>81</sup> A detailed discussion of vertical restraints on platform markets can be found at: Evans, Economics of Vertical Restraints for Multi-Sided Platforms, 2013, SSRN
- 82 Cf. Evans, Economics of Vertical Restraints for Multi-Sided Platforms, 2013, SSRN, p.5



- <sup>83</sup> Cf. Evans, Economics of Vertical Restraints for Multi-Sided Platforms, 2013
- <sup>84</sup>Cf. Rochet, Tirole, Two-Sided markets: A Progress Report, The RAND Journal of Economics, Vol 37, 2006
- <sup>85</sup> On the role of multi-homing cf. Armstrong, Competition in two-sided markets, 2006, RAND Journal of Economics Vol. 37, p. 668–691 as well as Evans, Economics of Vertical Restrints for Multi-Sided Platforms, 2013
- <sup>86</sup> Cf. Activity Report of the Bundeskartellamt 2009/2010, documentary volume, p. 104
- <sup>87</sup> Cf. Activity Report of the Bundeskartellamt 2009/2010, documentary volume, p. 98
- <sup>88</sup> Cf. Activity Report of the Bundeskartellamt 2011/2012, document 17/13675, p. 74
- <sup>89</sup> Cf. Bundeskartellamt's press release of 31.07.2013.
- <sup>90</sup> Cf. para. 52 c, d, Guidelines on Vertical Restraints; cf. also Schultze, Pautke, Wagner, VRBER, commentary, 3rd edition, para. 761
- <sup>91</sup> In those cases where online sales involve substantially higher costs for the manufacturer than offline sales, an individual exemption of a dual pricing system is possible (cf. para. 64, Guidelines on Vertical Restraints)
- <sup>92</sup> Cf. Activity Report of the Bundeskartellamt 2011/2012, document 17/13675, p. 74
- <sup>93</sup> Cf. Activity Report of the Bundeskartellamt 2011/2012, document 17/13675, p. 63
- <sup>94</sup> Cf. for example Manager Magazin online, "Schnäppchenkrieg Markenhersteller proben Aufstand gegen Ebay und Amazon", 12.12.2012; cf. Welt am Sonntag, "Adidas greift Amazon an". 17.06.12
- <sup>95</sup> Cf. ECJ, Pierre Fabre, C-439/09, 3.10.2011
- <sup>96</sup> Cf. OFT press release. "OFT issues decision in mobility scooters case". 5.8.2013
- <sup>97</sup> Cf. para. 54, Guidelines on Vertical Restraints
- <sup>98</sup> Cf. para. 56, Guidelines on Vertical Restraints
- <sup>99</sup> Cf. para. 56, Guidelines on Vertical Restraints
- <sup>100</sup> Opinion shared by Schultze,, Pautke, Wagner, VRBER commentary, 3rd edition, para.766
- <sup>101</sup> Cf. heise.online-ct, "Sportartikelhersteller untersagen Verkauf über Amazon und eBay", 01.08.2013 available at http://www.heise.de/resale/meldung/Sportartikelhersteller-untersagen-Verkauf-ueber-Amazon-und-eBay-1928424.html
- <sup>102</sup> Cf. para. 54, Guidelines on Vertical Restraints
- <sup>103</sup> Cf. for example Simon, Die neue Kartellrechtsverordnung (EU) Nr. 330/2010 for Vertriebs- und Liefervertäge, EWS 2010, 497-503; Dreyer, Lemberg, Möglichkeiten und Grenzen der Beschränkung des Internetvertriebs, BB 2012, 2004-2010; with a critical view: Schweda Rudowicz, Verkaufsverbote über Online-Handelsplattformen und Kartellrecht, WRP 2013, 590-600
- <sup>104</sup> Cf. Berlin Regional Court-16-O-412-07-Kart, Berlin Regional Court-16-O-294-09-Kart, Mannheim Regional Court-7-O-263-07-Kart, Karlsruhe Higher Regional Court-6-U-47-08-Kart, 25.11.2009, Munich Higher Regional Court, 2.7.2009, U(K) 4842/08
- <sup>105</sup> Cf. ECJ, Pierre Fabre, C-439/09, 3.10.2011, para. 46
- <sup>106</sup> Cf. Ellger in Immenga, Mestmäcker, Wettbewerbsrecht EG part 1, 4th edition, para. 234
- <sup>107</sup> Cf. Activity Report of the Bundeskartellamt 2011/2012, document 17/13675, p. 100; press release of 10.02.2012
- <sup>108</sup> Cf. Activity Report of the Bundeskartellamt 2011/2012, document 17/13675, p. 109
- <sup>109</sup> For an overview on this issue cf. LEAR "Can 'fair' prices be unfair? A Review of Price Relationship Agreements", 2012, A report prepared for the OFT; 1438 p.96, para. 6.44 ff.