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Stephen Kinsella OBE and Hanne Melin

Sidley Austin LLP

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The on-going review of the Vertical Restraints Regulation (“VRR”)¹ has brought to the surface a conflict between traditional retail models where the consumer takes a back seat and modern ways of retailing where the consumer is given greater freedom to select the right product at the right price.

So far, the important debate about how vertical restraints should be regulated, particularly in the context of online selling, has been rather hijacked by the concerns of the luxury goods industry. Luxury goods manufacturers present the issue as being whether the internet, as a distribution channel, is suitable for the delivery of a package of services dictated by those manufacturers.

However the real issue is consumer choice. The internet makes it possible for consumer demand to drive competition in terms of product offering and price. There is no

*Stephen Kinsella OBE is partner and head of the EU competition law practice of Sidley Austin LLP based in Brussels, where Hanne Melin is an associate. The authors have assisted eBay on EU law matters but the views expressed in this article are their own—not those of Sidley Austin LLP or eBay. This article has been prepared for academic purposes only and does not constitute legal advice.

¹Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L336/21, 29.12.1999. The VRR expires on May 31, 2010 and the Commission is currently reviewing it with a view to replacing it.

doubt that “[c]onsumers have everything to gain from the Internet.”²

The fundamental principle that EU competition policy exists to help create a single EU market and serve the consumer is ignored by some interested parties, despite being constantly repeated by the Commission.³ The purpose of this article is to steer the debate back to what is at the heart of competition policy—consumers’ interests.⁴ This requires an understanding of how vertical restraints are regulated in the EU and how online restrictions fit into that framework.

I. LEGALLY STRAIGHTFORWARD

We have a system of EU law where, in principle, contractual provisions are prohibited that harm competition and limit free trade without providing obvious benefits to consumers. This is set out in Article 81 EC Treaty by way of a two-step analysis: Article 81(1) contains a clear and general prohibition against agreements, including vertical agreements, restricting competition. Article 81(3) contains an exemption to this prohibition where it can be shown that a restriction is indispensable to the attainment of clearly defined pro-competitive efficiencies *and* that consumers demonstrably receive a fair share of the resulting benefits.

As a derogation from this system, the VRR provides a safe harbor for a limited class of agreements where it is felt safe to presume that those agreements will produce

²See statement by Consumer Commissioner Meglena Kuneva, Commission press release of March 5, 2009, IP/09/354, “Online shopping increasingly popular in the EU, but development ‘held back’ by barriers to cross border trade.”

³See, e.g., speech by Competition Commissioner Neelie Kroes at 2nd Lisbon Conference, November 15, 2007: “In particular, we all agree on one basic and fundamental fact: competition policy is first and foremost there to serve the consumer. But it requires constant commitment and constant efforts to get the best out of free but fair markets, and pass these benefits to our citizens.”

⁴See, e.g., speech by Commissioner Kroes at BEUC dinner, 22 April 2008: “Defending consumers’ interests is at the heart of the Commission’s competition policy.”

sufficient countervailing benefits. This safe harbor is a privilege: It exempts agreements from the Article 81 two-step analysis. Where it applies, companies no longer bear the normal burden of explaining how their restrictive agreements bring about efficiencies that benefit consumers.

The VRR intervenes in the functioning of Article 81 by way of simplified presumptions. In practice, this means that it deprives consumers and others of the protection they are granted by Article 81 EC Treaty, offering instead a presumption of legality. This intervention is minimized only by ensuring that the VRR correctly reflects the principles of Article 81(3), i.e. that the agreements it exempts produce countervailing consumer benefits. (This is of course essential, as Article 81 is a Treaty provision which cannot be derogated from by secondary legislation.)

As a safeguard to ensure that Article 81(3) is correctly implemented, the VRR black-lists certain so-called hardcore restrictions.⁵ These are severe anticompetitive restraints which fall within Article 81(1) and which experience shows will only in rare circumstances satisfy the conditions of Article 81(3) and can therefore not be presumed to create positive effects to the benefit of consumers.⁶

The consequence of the black list is that the privilege of the VRR is taken away. We are back to the status quo ante: The Article 81 two-step analysis comes into play and the creator of the restrictive agreement must show that it meets the conditions for exemption under Article 81(3).

⁵See Article 4 of the VRR and section 3 of the Verticals Guidelines.

⁶See Recital 10 to the VRR.

II. ONLINE CHALLENGE

There are different ways of preventing retailers from using—or effectively using—online channels. Indeed, some suppliers have been very creative in this area. Retailers can be outright prohibited from setting up an online shop; they can be allowed to use the internet provided they charge the recommended retail price (RRP); they can be required to make no more than a set percentage of turnover from online activity or limit the number of units they sell to a single online customer; they can be prohibited from setting up their webshop on an online platform; they can be required to comply with certain conditions which make online selling too expensive or too difficult to actually engage in, etc.

The objective behind all these attempts to restrict online selling is basically to keep markets artificially segmented and to control retail prices. In the offline world, such aims are more easily achieved simply because of practicalities such as distance. The global nature of the internet and the accessibility offered by online selling challenge the possibilities of suppliers to adopt those strategies. Simply put, online retailing has dramatically widened consumer choice and awareness of commercial opportunities. It also has the potential to increase the competitive pressure on traditional retailers; the internet has changed the way consumers approach their shopping decisions. Consumers increasingly compare both price and quality online before taking a purchasing decision. “Window shopping” is much more convenient online whether the consumer finally shops online or offline.⁷

⁷See section 4 of Commission Staff Working Document, Report on cross-border e-commerce in the EU, SEC(2009) 283 final, 5.3.2009 (Commission Report on e-commerce).

Imposing an absolute prohibition upon retailers making use of the internet for sale and/or promotion therefore constitutes a hardcore restriction under the VRR and is not presumed to carry any consumer benefits.⁸ It falls within Article 81(1) leaving the supplier to demonstrate countervailing efficiencies from which consumers receive a fair share.

III. AN ELEMENT OF COMPETITION?

One class of agreements that is exempted under the VRR is selective distribution systems. The reason is that in certain circumstances selective distribution is considered an element of competition; it promotes competition on other factors than price such as sales conditions, pre-and after-sales services, etc. This has been seen as beneficial to consumers, in particular in relation to high-quality and technically complex consumer goods.

Before going further, it is important to take a step back and recognize that those suppliers who are particularly concerned about the image and service components of their products can choose to distribute their products themselves. That gives them full control of how their products are sold. Then again, because of factors such as cost, local knowledge, etc., suppliers often decide to use third party distributors. But when doing so the potential for anticompetitive harm increases and, as a result, competition law dictates that the suppliers must yield some control over what retailers can do with goods that have become their property.

⁸Article 4(a)-(c) of the VRR; and ¶ 51 and 53 of Commission Notice—Guidelines on Vertical Restraints, OJ C291/1, 13.10.2000 (Verticals Guidelines). *See also* Commission press releases of 17 May 2001 (IP/01/713), December 6, 2000 (IP/00/1418) and June 24, 2002 (IP/02/916) on the selective distribution systems of YSL Perfume and B&W Loudspeakers.

The general principle governing the rules on selective distribution is that the supplier should be able to control the quality of distribution—this is supposed to be the element that counterbalances the restriction of competition, in particular as regards price, inherent in selective distribution systems.⁹ To this end, the supplier can elect to appoint only those retailers who satisfy certain qualitative, objective, and proportionate criteria, and it can prevent non-authorized retailers from trading in the products.

But if the supplier goes further, the conditions of Article 81(3) are unlikely to be satisfied. This would, for example, be the case if the supplier used selective distribution for products that do not objectively necessitate it or laid down criteria that are disproportionate to the objective of ensuring efficient distribution.

Also, since the main risk with selective distribution is so apparent, the VRR establishes safeguards to prevent brand owners from excessively restricting intra-brand competition. One example is a prohibition on restrictions on sales within the selective distribution system: All members of the system must be free to sell actively or passively to each other and to any consumers wherever located in the EU.

IV. QUALITY ONLINE

As described, appointed resellers within a selective distribution system cannot be prevented from selling to consumers *wherever* they are situated in the EU. To reinforce that point, the VRR and the Verticals Guidelines stipulate that appointed retailers cannot be prevented from making use of the internet to sell and/or advertise.

However, this does not mean that suppliers cannot control the quality of online

⁹See, e.g., ¶ 112 of Case T19/92, *Edouard Leclerc v Commission*, [1996] ECR-II 01851; ¶¶ 33-34 of Case 107/82 *AEG Telefunken v Commission*, [1983] ECR 3151.

distribution. They are able to impose reasonable and objective quality criteria to govern internet sales in the same way that they can insist on criteria for product presentation and shop appearance in the high street stores. Such criteria do not amount to online restrictions as long as they are proportionate and non-discriminatory and are clearly designed in the interests of consumers. But if they were to go beyond what is necessary (to e.g. ensure proper product presentation on the website), they are in principle anticompetitive under Article 81(1). This is, for instance, the case where a criterion prohibits *per se* an entire online channel, such as third party online platforms, without subjecting the particular retailer's webshop (set up on that online platform) to an individual appraisal against the supplier's quality criteria.

V. SO WHO'S AFRAID OF THE INTERNET?

Though it is clear in principle that appointed retailers within a selective distribution system must be allowed to use the internet, this is not being adhered to in practice. Some brand owners argue that their products—be they lawnmowers, sports shoes, children's toys, or “luxury goods”—cannot properly be sold online. The arguments seem to be that online retailers cannot provide certain services (sometimes described as a “matching service”¹⁰) and that it is uncertain whether brand image can be preserved online.

Let's start with the argument that consumers greatly prize the “matching services” offered by brick-and-mortar stores and that those services cannot be offered online. Proponents of that view then move to insist that online selling must therefore be curbed

¹⁰See CRA Economic Report for CHANEL, *available at* http://ec.europa.eu/competition/consultations/2008_online_commerce/chanel_report.pdf

to prevent online retailers from “free-riding” on these brick-and-mortar services.

The first flaw in this argument is a simple and logical one—if the physical point of sale services was so prized by consumers, or by enough of them, there would be no question of a competing online sales channel succeeding in competing with brick-and-mortar stores or free-riding on their investment.

Another fundamental flaw of this argument is that it looks at online retailing as an inherently imperfect way of selling goods to consumers—as being inadequate in itself and dependent on or a second-class substitute for traditional retailing. Online retailing is measured by reference to how far it can provide consumers with the identical experience to traditional retailing. This is the wrong way to look at it, and it will inevitably result in discrimination against online channels, just as supermarkets and department stores were once discriminated against. Rather, online retailing must be viewed on its own merits. Having said that, online and offline channels are of course interdependent and many retailers do not draw a distinction between them: As the European Commission has itself pointed out, consumers may “window shop” online before purchasing in a brick-and-mortar shop, though nobody seriously suggests that the high street is “free-riding” on the investment of the online channels.¹¹

Consumers generally look online for something—a product or a service—they do not easily find on the high street where they live or work. For instance, they look for a brand they cannot find around the corner; a different product, model, color, or size of a brand present on the high street; a better price/service combination; better or more

¹¹See §6.3 of Commission Report on e-commerce. Indeed, many successful retailers operate a multichannel strategy combining offline and online channels.

objective information about a product, which can include feedback from other purchasers; more convenience by not having to visit the shop but have the products delivered to the door; more time to reflect on whether to purchase; better consumer rights (in many cases, distance shopping laws lead to more generous online refund/return policies).

Going beyond that, those who argue that online retailing is inferior to traditional shopping seem not to have been shopping in the high street recently. In the vast majority of cases, shopping involves walking into a store, selecting a product from the shelf without guidance, carrying it to the till, and having your credit card swiped. The only “sales support” you are likely to get is the question whether you require a bag in which to carry your purchase home.

In fact, a recent survey commissioned by the Commission shows that consumer satisfaction online is, on average, higher than for other channels. Consumers are not only more satisfied overall, they are also more satisfied about the quality/price combination and the quality of services they are offered on the internet.¹² Consumers are more satisfied online mainly because of the wider range of offers in terms of innovation, price, and quality; the ability to see and compare prices; and the ease of purchase with totally flexible opening hours.¹³

¹²See §5.1 of Commission Report on e-commerce. The survey looked at two consumer product categories considered representative for assessing consumer satisfaction with the internet as a retail channel—namely, Entertainment & Leisure products and Information & Communication Technology products.

¹³Looking at Entertainment & Leisure products, consumer satisfaction was higher online as regards **overall satisfaction** (85.9 percent of consumers online compared to 75.8 percent of consumers on average for all sales channels); **quality & price** (80 percent vs 67.3percent); and **quality of services** (75.3 percent vs. 72.7percent). Satisfaction is also higher for online purchases with regard to innovation, ease of

Having said that, there will clearly be consumers who prize point of sale service for some goods and will be prepared to pay for it. Equally there is nothing to prevent the supplier from assessing what value such services bring to his brand and sales as a whole and rewarding the retailer for providing such services, by way of marketing support or some other incentive method. All businesses which rely on third party distribution have to make such calculations. Of course life might be easier if one could simply fix the resale price across all outlets and not worry about competition between retailers, but such a disproportionate and consumer-harming response is precisely what competition law exists to prevent.

The inevitable conclusion is that the “free-riding” argument is a smokescreen for fear of competition from a retailing method which apparently delivers effective services appreciated by consumers. This fear is, for example, the reason suppliers require that appointed retailers have a brick-and-mortar shop to be allowed to set up an online shop. All such a requirement does is protect traditional retailing from competition from online retailing.¹⁴ By requiring online retailers to also operate offline, unnecessary costs are loaded onto the online customer and the full potential of online retailing is effectively held back. Retailers who are perfectly capable of satisfying quality standards but do not have the means, possibility, or desire to operate on the high street are foreclosed. Consumers are not able to fully exercise choice in terms of what services they need and are happy to pay for.

purchase, opening hours, price transparency, affordability, choice of qualities, price comparability, range of prices, and fulfillment of delivery. (See figures 6-15 of Commission Report on e-commerce.)

¹⁴See, e.g., ¶ 122 of Case T19/92 *Edouard Leclerc v Commission*; and ¶¶ 73-74 of Case 107/82 *AEG Telefunken v Commission*.

It is also argued that consumers appreciate brand image and that brand image cannot be preserved on the internet. The reality is that the value placed on brands varies greatly from one brand to another and among consumers. It cannot be used as a blanket justification for restrictive distribution rules, and case law has confirmed that criteria within a selective distribution system cannot be justified merely on the grounds of seeking to protect brand image and marketing policy.¹⁵

Moreover, whether brand image can be preserved on the internet depends upon the ambition of suppliers and retailers. It is about deciding on design, additional features, service level, etc.—just as suppliers and retailers must do for brick-and-mortar shops or department store corners.

It is hard to avoid the suspicion that “brand image” is often simply a pretext for preventing price competition. That is, for example, the reason why some suppliers exclude *per se* certain online channels, such as online platforms. This practice is discriminatory, excessive, and falls within Article 81(1): It bans *a priori* an entire distribution channel (which is perfectly capable of being used to sell products in appropriate conditions), rather than allowing individual retailers to satisfy objective quality criteria.

Brand owners who wish to control retail prices are concerned about any retailers who break ranks, but online channels – and in particular online platforms - are targeted more aggressively because of the particular high level of transparency they introduce and the threat they pose to differential pricing among regions and Member States. A ban on

¹⁵See ¶ 118 of Case T19/92 Edouard Leclerc v Commission; and ¶ 21 of Case 26/76 Metro v Commission [1977] ECR 1875.

online platforms prevents retailers from taking advantage of a less costly, efficient, and safe way of setting up an online operation. Consumers are deprived of the advantage offered by online platforms in terms of a transparent and highly competitive environment making it easy for consumers to access a vast amount of products and to compare prices. Putting some figures on the significant savings consumers can make by using online platforms, the Frontier Economics study estimates that consumers on eBay's European platforms benefit from individual savings of 17 percent and total savings of around EUR 1.1 billion per year. And that is only the savings on sales made; it does not take account of what could have been saved if a large volume of potential sales was not prevented.

VI. AN UPHILL TASK

So digging deeper into online restrictions—be they outright bans or excessive criteria—it is hard to come to any other conclusion than that they are motivated by a desire to prevent price competition. By suppressing the internet's potential to make the Single Market a reality to European consumers and businesses, the suppliers are trying to hang on to the pricing and market segmentation strategies of the offline world. Both the object and the effect are higher consumer prices, and this can be easily verified. Indeed, even the economic consultants employed by the brand owners to support their case acknowledge that the restraints they defend (by reference to economic theory rather than market observation) generally lead to higher retail prices. In the real world, Frontier Economics' study provides just a glimpse of the significant savings that consumers can make online.

As explained, attempts to prevent online selling cannot benefit from the privilege

of the VRR. Outside the VRR, companies must show why anticompetitive restrictions should be exempted under Article 81(3). The same burden of proof must apply to those arguing that the VRR should exempt online restrictions—restrictions that, for example, require appointed retailers to also have a brick-and-mortar shop; prohibit the use of online platforms; mandate online RPM; or cap the level of turnover that can be generated online compared to offline.

Those who want to argue that such restrictions—which effectively curb online retailing and prevent more efficient competition—are necessary to protect the intrinsic qualities of the products and, moreover, that they produce benefits to consumers, have an uphill task. They are effectively arguing for a broadened intervention by extending the scope of the VRR to cover anticompetitive restrictions for which consumer benefits cannot be presumed. This would weaken the protection afforded to consumers and others by Article 81 EC Treaty. It would deny consumers the possibility of profiting from the Single Market and exercising real choice in terms of product price and offerings. Those arguing for such a development must bear the burden of showing that it creates real value for consumers.¹⁶ It is striking that those who assert so loudly that their actions benefit consumers are unable, despite the longevity of this debate, to bring forward any empirical evidence to support it and are so opposed to being asked to prove it.

VII. CONCLUSION: IT'S ALL ABOUT CONSUMER CHOICE!

This debate is about choice, and whether the consumer can be trusted to make

¹⁶See ¶¶ 86 and 102-104 of Communication from the Commission—Notice - Guidelines on the application of Article 81(3) of the Treaty, OJ C101/97, 27.4.2004.

sensible choices rather than being forced to pay a high mark-up for a service the consumer does not want. In the end, the question is the same irrespective of whether we talk about lawnmowers, sports shoes, or luxury goods.

If a consumer really wants and needs the personal touch and point of sale advice, surely that consumer will choose those services by visiting the brick-and-mortar retailer. But why should retailers not be able to fully cater for those consumers who “care little about the ‘match’”:¹⁷ consumers who identify (better) with the online shopping experience characterized by convenience, choice, easy access, and information?

The European Commission has emphasized putting the consumer at the heart of competition policy. And technology now allows us to do so. The Commission’s research shows that consumers are extremely satisfied with the type of services they can find on the internet. This is not to say that online services cannot improve and develop, but we must ensure that the legal framework allows them to do so—allows them to flexibly adapt to consumer demand.

In the end, this is what EU competition policy is all about. It is about making market forces work properly because “consumers are the first ones to benefit: from more choice of better quality goods and services, at better prices.”¹⁸

¹⁷See CRA Economic Report for CHANEL.

¹⁸Speech by Commissioner Kroes at 2nd Lisbon Conference on Competition Law and Economics, November 15, 2007.