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Vertical Restraints

CPI COMPETITION POLICY INTERNATIONAL

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LETTER FROM THE EDITOR

Dear Readers,

In this edition of the CPI Antitrust Chronicle, we look at the topic of Vertical Restraints. Generally speaking, within competition law, a vertical restraint is an agreement undertaken at different levels of production, distribution, or supply (e.g. an anti-competitive agreement between a manufacturer and distributor).

Vertical restraints are a well-known and much-written about area within antitrust, but there are new developments. In September 2020, the European Commission published the Staff Working Document on its review of the Vertical Block Exemption Regulation ("VBER") and is in the process of revising its VBER and Vertical Guidelines, which expire in 2022.

A main focus of this Chronicle addresses where things stand in this evaluation and revision process in Europe. For instance, will there be changes to the list of hardcore restrictions contained in the rules – those agreements typically treated as having the object of restricting competition under EU competition law?

Many of the past cases, and economic literature on Vertical Restraints, have focused on the physical world of manufacturers and distributors. Authors in this Chronicle also consider what's new and different about the digital world that matters for the antitrust analysis of vertical restraints.

With perspectives from the EU, UK, and U.S., we hope this edition of the Chronicle furthers the discussion and debate on Vertical Restraints.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

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SUMMARIES

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VBER Review: Overview of the Evaluation Phase

By Andrea Amelio, Isabel Pereira Alves & Marion Carbo

On September 8, 2020, the European Commission published the Staff Working Document on its review of the Vertical Block Exemption Regulation ("VBER"). During the evaluation phase, the European Commission gathered a large body of evidence on the functioning of the VBER from several sources. Overall, the evaluation has shown that the VBER and the Vertical Guidelines are useful tools for the European Commission, NCAs, national courts and businesses. Nevertheless, the evaluation has also identified a number of issues, in particular as regards the clarity of the rules and their ability to address new market developments. Based on these findings, in October 2020 the European Commission has launched the impact assessment phase.

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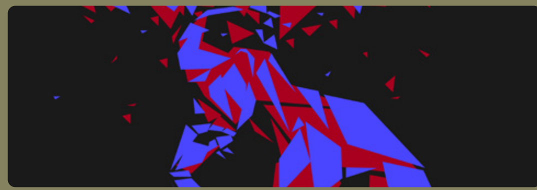

Rethinking the EU's *by Object* Approach to Vertical Restrictions

By André Pretorius & Alex White

The EU is in the process of revising its Vertical Block Exemption Regulation and Vertical Guidelines, which expire in 2022. As part of this process, the European Commission has carried out an evaluation identifying a number of issues with how the current rules have functioned since their adoption in 2010, primarily due to the significant changes wrought to distribution markets by the growth of e-commerce. But it has concluded that the list of hardcore restrictions contained in the rules – those agreements typically treated as having the object of restricting competition under EU competition law – are generally appropriate. This article challenges that conclusion, and particularly how the *by object* approach has been applied to vertical agreements in the context of online selling. In our view a more coherent and rigorous approach to defining *by object* vertical restrictions is called for and will be critical to ensuring that the rules achieve their ultimate aim of improving legal certainty.

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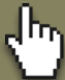

Economic Principles and the Reform of the European Commission's Approach to Vertical Agreements

By Peter Davis, Gerhard Dijkstra & Vikram Kumar

The European Commission recently published its evaluation results from a consultation on the Vertical Block Exemption Regulation ("VBER") and accompanying Vertical Guidelines. The consultation identifies several aspects of the rules governing vertical agreements as warranting greater clarity and/or more specific guidance, with many areas of potential revision motivated by examples arising from the growth of e-commerce. First, we consider the key messages in the Working Document. Second, we outline five economic principles that we believe should guide the Commission's revision of VBER and its Vertical Guidelines. We then illustrate the application of such economic principles by considering in more detail the economic analysis of two specific types of vertical agreements, resale price maintenance and most-favored nation clauses.

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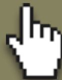

Vertical Restraints in a Digital World

By David S. Evans

The subject of vertical restraints is well-trod territory in antitrust. Most of the cases, and economic literature, have focused, however, on the physical world of manufacturers and distributors. This paper considers what's new and different about the digital world that matters for the antitrust analysis of vertical restraints. Cases and economic learning from the physical world remain highly relevant. What makes the digital world different is the prominence of intermediaries, most of which are multisided platforms, and the implications of the Internet and other information technologies for these intermediaries and the businesses that rely on them. After describing key features — including critical mass, multi-homing, and platform governance regimes — this paper considers important aspects of analyzing vertical restraints in the digital world. It then considers several applications involving platform rules, exclusive contracts, and MFNs for digital intermediaries.

SUMMARIES

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Vertical Agreements Under the UK Competition Act 1998: Past, Present, and the Post-Brexit Future

By Alison Jones

This paper charts the development of UK competition law and policy towards vertical agreements over the 20 years since the Competition Act 1998 came into force. It traces how UK policy has evolved and notes that although many UK cases initially focused on resale price maintenance, a number of more recent cases have analyzed vertical restraints affecting online selling, which have proliferated since 2000 with the rapid growth of e-commerce. The paper also considers how the law could, or should, develop in the future, especially after the transition period following the UK's departure from the EU ends. In particular, whether, post-Brexit, the UK authorities should continue to follow EU competition law in this sphere, which has in significant respects been influenced by internal market considerations, or whether it should take a different course.

WHAT'S NEXT?

For January 2021, we will feature Chronicles focused on issues related to (1) **GDPR v. CCPA**; and (2) **Telecommunications**.

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CPI ANTITRUST CHRONICLES FEBRUARY 2021

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Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.

VBER REVIEW: OVERVIEW OF THE EVALUATION PHASE

BY ANDREA AMELIO, ISABEL PEREIRA ALVES & MARION CARBO[1]

1 Andrea Amelio, EU Delegation to UK. Isabel Pereira Alves, DG COMP, European Commission. Marion Carbo, DG COMP, European Commission. The content of this article does not by any means reflect the official position of the European Commission. Responsibility for the information and views expressed here lies entirely with the authors.

I. INTRODUCTION

On September 8, 2020, the Commission published the Staff Working Document ("SWD")[2] on its **review of the Vertical Block Exemption Regulation ("VBER")**.[3] This publication marked the end of the first phase of the two-stage review process that will result in the adoption of the new vertical rules that should come into force when the current rules expire on May 31, 2022.

The Commission launched the review process of the current VBER and the Vertical Guidelines[4] on October 3, 2018. In this so-called evaluation phase, which ended with the publication of the SWD, the Commission aimed at gathering evidence from stakeholders on the functioning of the VBER together with the Vertical Guidelines. In the ongoing second phase, called the impact assessment phase, launched in October 2020, the Commission proposes the policy options for revising the current rules.

During the evaluation phase the Commission carried out various consultation activities to gather evidence on the functioning of the VBER together with the Vertical Guidelines, such as a public consultation that took place during the first half of 2019, a dedicated stakeholder workshop held in November 2019, and an external evaluation support study.[5]

The SWD reflects the evidence on the functioning of the VBER, together with the Vertical Guidelines, gathered during the evaluation phase, and will help the Commission decide whether the VBER should be lapsed, renewed under its current form, or revised.

This article will describe the legal framework of the VBER, the framework of the review that led to the adoption of the SWD, the methodology followed during the evaluation process, and the main findings of the evaluation.

II. LEGAL FRAMEWORK[6]

Article 101(1) of the Treaty on the Functioning of the European Union ("the Treaty") prohibits agreements (including those concluded between undertakings operating at different levels of the supply and distribution chain, or "vertical agreements") that restrict competition, unless they contribute to improving the production or distribution of goods, or to promoting technical or economic progress while allowing consumers a fair share of the resulting benefits, in accordance with Article 101(3) of the Treaty.

In order to assess whether a vertical agreement complies with Article 101 of the Treaty, the Commission first needs to check whether said agreement restricts competition (Article 101(1) of the Treaty), and second, to determine whether it produces pro-competitive effects that outweigh the restrictive effects on competition (Article 101(3) of the Treaty).

To facilitate the enforcement work of the Commission, the Council adopted Regulation 19/1965,[7] which empowers the former to define, by way of regulation, certain categories of agreements that generally fulfil the conditions for exemption under Article 101(3) of the Treaty. Therefore, vertical agreements that fall within the scope of such a block exemption regulation ("BER") benefit from a presumption of legality (so-called "safe harbor") and no longer require an individual assessment.

2 Commission staff working document of the Vertical Block Exemption Regulation, Brussels, 8 September 2020, SWD (2020) 173.

3 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, OJ L 102, 23.4.2010, p. 1.

4 Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, p. 1.

5 See staff working document, pages 22 to 27.

6 See staff working document, pages 7 to 13.

7 Regulation No 19/65/EEC of 2 March of the Council on application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices, OJ 36, 6.3.1965, p. 35, as amended by Council Regulation (EC) No 1215/1999 of 10 June 1999, OJ L 148, 15.6.1999, p. 1.

The current VBER adopted in 2010, together with the Vertical Guidelines, is based on the premise that the efficiency-enhancing effects of vertical agreements outweigh any anti-competitive effects, depending on the degree of market power of the companies involved and the competition they face on the market.[8] In line with this approach, the VBER exempts agreements in which the market share of the supplier and the buyer do not exceed the 30 percent thresholds and which do not contain certain types of severely anti-competitive restrictions ("hardcore restrictions").[9]

The VBER, together with the Vertical Guidelines, aim to facilitate the enforcement work of the Commission and, in view of the decentralized enforcement system, the work of the national competition authorities ("NCAs") and national courts as well, by providing them with a common analytical framework to assess vertical agreements. It also aims to help businesses to self-assess the compliance of their vertical agreements with Article 101 of the Treaty, thus reducing costs.

III. FRAMEWORK OF THE EVALUATION

The Commission conducted the evaluation of the VBER, together with the Vertical Guidelines, in all EU Member States.[10] According to the Better Regulation Framework,[11] it did so in an open, transparent manner, informed by the best available evidence and backed by the comprehensive involvement of stakeholders.

The Commission evaluated the VBER, together with the Vertical Guidelines, against five criteria: effectiveness, relevance, efficiency, EU added value, and coherence.[12] More specifically, the Commission tested whether the objectives of the VBER were met during the period of its application (effectiveness), continue to be appropriate (relevance), and whether the VBER, taking account of the costs and benefits associated with applying it, was efficient in achieving its objectives (efficiency). It also considered whether the VBER, as legislation at the EU level, provided added value (EU added value) and is consistent with other Commission documents providing guidance on the application of Article 101 of the Treaty and related legislation with relevance for vertical agreements (coherence).[13]

In order to properly carry out the evaluation and to assess each criterion, the Commission identified a benchmark for the analysis. The main point of comparison was the hypothetical situation of not having a VBER and Vertical Guidelines in place. The evaluation therefore looked at the functioning of the VBER, together with the Vertical Guidelines, as compared to a situation where the assessment of whether vertical agreements comply with Article 101 of the Treaty would have to be done only in light of other Commission documents that help self-assessment, i.e. relevant case law at EU and national level, as well as the enforcement practices of the Commission and the NCAs.[14]

In order to properly conduct the evaluation, the Commission designed a methodology of analysis aiming at gathering an extensive set of information. The sources of information included a public consultation, a targeted NCA consultation, a stakeholder workshop, an evaluation support study, spontaneous stakeholder submissions, and evidence gathered through other Commission initiatives. For each of the sources, the Commission identified the appropriate information to be gathered for informing the assessment of the five criteria.[15]

The public consultation generated 164 contributions submitted through the online questionnaire, and 13 position papers submitted without the online tool. With this public consultation the Commission aimed at gathering the different positions of stakeholders directly involved in the application of the VBER and the Vertical Guidelines on all five criteria.[16] Likewise, the targeted consultation of NCAs generated 20 con-

8 1999 VBER, recital 7.

9 For completeness, the VBER also fit into the procedural framework of analysis of EU competition rules. In the 2000s, Council Regulation 1/2003 abolished the pre-notification of agreements to the Commission as established by the previous Council Regulation 17/62. Businesses therefore can no longer notify their agreements to the Commission in order to benefit from immunity from fines. They have to self-assess the compliance of their agreements with Article 101 of the Treaty. In addition, Council Regulation 1/2003 decentralized the application of Article 101(3) of the Treaty by empowering national competition authorities and national courts to apply both Article 101(1) and Article 101(3) of the Treaty, which in the past was a prerogative of the Commission only.

10 Since the VBER has been fully applicable in the United Kingdom during the period under review, the evaluation includes evidence gathered from stakeholders in the UK, in particular from the UK's Competition and Markets Authority.

11 https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

12 Commission staff working document, Better Regulation Guidelines, Brussels, July 7, 2017, SWD (2017) 350.

13 See staff working document, pages 20 to 22.

14 See staff working document, page 20.

15 See staff working document, page 25.

16 See staff working document, page 22.

tributions, including one from one of the EFTA States. The information provided by NCAs contributed to the assessment of all five evaluation criteria.[17] Building on the outcome of the public consultation, the Commission carried out a stakeholders workshop to gather additional evidence about the functioning of the VBER, together with the Vertical Guidelines.[18] The Commission also relied on an extensive evaluation support study ("the support study") with a particular focus on the evaluation criteria of effectiveness, efficiency, and relevance. Through the support study the Commission aimed at gathering qualitative and quantitative information, notably by surveying stakeholders, carrying out econometric analyses to evaluate the effects of certain restrictions, and reviewing NCAs' enforcement practices.[19] The Commission also received several spontaneous submissions from stakeholders who had either not participated in the public consultation or who wanted to supplement their contribution to the public consultation with additional evidence.[20] These included studies carried out by stakeholders to provide the Commission with additional evidence. Lastly, the Commission also relied on information gathered through other Commission initiatives, like the sector inquiry into the electronic trade of consumer goods and digital content in the EU, its own enforcement and policy briefs.[21]

IV. FINDINGS OF THE EVALUATION

The findings of the evaluation can be grouped into three main categories. The first group of findings relates to the main market trends and developments to which the VBER and the Vertical Guidelines were subject to. The second group contains the high-level findings on the functioning of the VBER and the Vertical Guidelines. The third group refers to the specific findings on the functioning of specific provisions of the framework.

A. Market Trends and Developments[22]

Since the adoption of the VBER and the Vertical Guidelines, the development with the biggest impact on distribution models has been the growth of online sales and online marketplaces. The findings of the support study show that, overall, the share of individuals purchasing online has increased by 100 percent since 2008. As for the use of online intermediaries, such as search engines, online marketplaces, and price comparison tools, they are particularly important for consumers purchasing online.[23]

The growth of e-commerce has reshaped distribution models and strategies. As e-commerce facilitates buyer's access to sellers outside their territory, distribution systems which rely on territorial sales restrictions, such as exclusive distribution, have become less attractive. By contrast, selective distribution, which provides suppliers with a tighter control over their distribution networks, is prominently used. The development of online channels has also fostered an increase in direct sales. More suppliers are now offering their goods to consumers online, therefore directly competing with their distributors. Moreover, new types of vertical restrictions, most of which are related to online sales, are being applied to distributors.

The growth of online sales also has an influence on consumer's purchasing behavior. Today's consumers expect a seamless experience throughout their purchasing journey, which should be a fluid omni-channel process in which consumers change easily within and in between online and offline channels. If consumers tend to make a complementary use of several sales channels, online channels now play a major role in the process, especially in its information and evaluation phase. Search engines have become the most used channels for product discovery. To meet consumer's expectations, suppliers have increased the number of channels they use to distribute and promote their products, and have adopted a more prevalent multi-channel sales approach. Such a multi-channel environment better serves consumers' needs, but it also raises discussion about free riding between the different sales channels.[24]

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17 See staff working document, page 23.

18 See staff working document, page 23.

19 See staff working document, pages 23 to 24.

20 See staff working document, page 24.

21 See staff working document, pages 24 to 25.

22 The Commission took into account various sources, notably the results of the e-commerce inquiry of 2017 (see https://ec.europa.eu/competition/antitrust/sector_inquiries_e_commerce.html. the evaluation support study and the consumer purchasing study (see https://ec.europa.eu/competition/consultations/2018_vber/index_en.html).

23 See staff working document, pages 33 to 34.

24 See staff working document, pages 35 to 43.

B. General Findings

The evidence gathered in the evaluation suggests that the VBER, together with the Vertical Guidelines, is a useful instrument overall that increases legal certainty, compared to a situation without the VBER and the Vertical Guidelines. However, the identification of lack of clarity, difficulty of application or rules no longer adapted to recent market developments, as well as gaps, pointed to possible improvements in the framework. The existence of diverging interpretations by NCAs and national courts also pointed towards a need to strengthen the common analytical framework that the VBER provides for these institutions.[25]

It was also found that, overall, the VBER, together with the Vertical Guidelines, meets the objective of avoiding false positives, i.e. it generally does not exempt agreements for which it cannot be assumed with sufficient certainty that they satisfy the conditions of Article 101(3) of the Treaty, and of avoiding false negatives, i.e. it does not fail to exempt agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 101(3).[26]

The evaluation also indicated that the costs borne by stakeholders in applying the VBER, together with the Vertical Guidelines, are proportionate and would be higher in its absence. The estimation remained qualitative, however.[27]

With regard to relevance, the rules proved not to be sufficiently well adapted to the current market environment, as they do not entirely take into account the abovementioned market developments that have taken place since their adoption.[28]

The coherence of the VBER and the Vertical Guidelines and a general exemption at EU level were found to be satisfactory overall.[29]

C. Some Specific Findings

The evaluation collected a large body of evidence on all the areas of the VBER and Vertical Guidelines that are not functioning well, or not as well as they could, as well as the underlying reasons. This article will only illustrate a small subset, notably seven issues including dual distribution, market share thresholds, non-compete obligations, exclusive distribution, retail price maintenance, parity clauses, and certain online restriction.

Dual distribution refers to scenarios in which a supplier not only sells its goods or services through independent retailers, but also sells them directly to end customers, and therefore is competing with its distributors at retail level. Dual distribution, which is generally exempted under Article 2(4) of the VBER, constitutes an exception to the general rule that agreements between competitors are not covered by the VBER and have to be assessed under the horizontal rules.[30]

The evidence gathered during the evaluation indicated that stakeholders perceive a qualification of dual distribution as a vertical relationship, that its exemption from the prohibition in Article 101(1) of the Treaty is adequate, and should therefore remain part of the VBER.[31] However, the evaluation has also shown that the rules do not adequately reflect a number of issues. Among these, it is worth mentioning that the support study has shown that suppliers use online channels to increase their market presence at the retail level. Therefore, the dual distribution exception initially meant to cover scenarios where suppliers were using direct sales to get an understanding of the market and foster brand recognition (e.g. through the operation of a flagship store) may now be too broad, and exempt situations where horizontal issues are no longer negligible.[32]

As for the use of **market share thresholds** set for the application of the VBER, they are based on the premise that the likelihood of efficiency-enhancing effects outweighing any anti-competitive effects that result from restrictions contained in vertical agreements depends on the degree of market power held by the parties to the agreement. In line with this approach, Article 3 of the VBER contains 30 percent market share caps for both the supplier and the buyer, above which the block exemption does not apply.

25 See staff working document, pages 89 to 90.

26 See staff working document, pages 89 to 90.

27 See staff working document, page 90.

28 See staff working document, pages 90 to 91.

29 See staff working document, page 90.

30 See Vertical Guidelines, paragraph 28.

31 See staff working document, page 156.

32 See staff working document, pages 156 to 159.

The evidence gathered during the evaluation indicated that some stakeholders consider the current market share thresholds as generally working well. Nevertheless, they raised some issues related to the lack of clarity and consistency of the rules with regard to the definition of the relevant market, and to the fact that the 30 percent market share thresholds may be too high, in particular when applied to online intermediaries, while other stakeholders took the view that the market share thresholds are too low.[33]

Non-compete obligations of an indefinite duration or exceeding five years are excluded from the benefits of the VBER and therefore require an individual effects-based assessment under Article 101 of the Treaty. Non-compete obligations that are tacitly renewable beyond a period of five years are deemed to have been concluded for an indefinite duration. The evaluation has indicated that the broad exclusion of non-compete clauses from the benefit of the block exemption may result in false negatives, by covering non-compete obligations that satisfy the conditions laid down in Article 101(3) of the Treaty.[34]

In particular, the exclusion of tacitly renewable non-compete obligations is considered by some stakeholders as unjustified, to the extent that the buyer can terminate or renegotiate the agreement at any time with a reasonable notice period and at reasonable cost. The overly broad scope of the exclusion could also result in an unnecessary administrative burden and additional transaction costs for businesses, since it forces them to periodically renegotiate their contracts despite there being a willingness on both sides to continue the contractual relationship beyond five years.[35]

Exclusive distribution refers to a distribution model in which the supplier agrees to sell its products for resale to only one distributor in a particular territory. Pursuant to Article 4(b)(i) of the VBER, provided that the market shares of the parties to the exclusive agreement do not exceed the 30 percent thresholds, the supplier can prevent other exclusive distributors from actively selling in territories which are either reserved for itself or allocated to other exclusive distributors.[36]

The evidence gathered during the evaluation indicates that the rules on exclusive distribution have generally worked well. The support study, however, found that exclusive distribution is not a widespread practice, with only a limited number of stakeholders reporting the use of this distribution model. This could be due to the fact that exclusive distribution does not enable suppliers to sufficiently protect investments in the context of the growth of online sales. The main concern raised in the context of this practice is in relation with selective distribution. Notably, the evaluation pointed to some issues, such as a lack of clarity regarding the possibility to combine selective and exclusive distribution in different territories. Some stakeholders also consider that there is insufficient guidance on the circumstances in which exclusive and selective distribution may be combined in the same territory, but at different levels of the supply chain, without raising concerns under Article 101(1) of the Treaty.[37]

Regarding **retail price maintenance**, i.e. restrictions to the buyer's ability to determine its sales price, which are considered as hardcore violations, the evaluation indicated that the majority of respondents to the public consultation consider that Article 4(a) of the VBER and the related paragraphs of the Vertical Guidelines generally provide an appropriate level of legal certainty. However, a significant number of respondents to the public consultation pointed to a slightly low level of legal certainty.[38]

Among the findings, it is worth noticing that respondents and other stakeholders have stressed a lack of legal certainty due to limited guidance on the circumstances under which recommended or maximum resale prices could amount to RPM and as regards the conditions under which RPM can benefit from the exemption of Article 101(3) of the Treaty.[39]

Regarding **parity clauses**, the evaluation recognized that these have become more common over time, and that the VBER and the Vertical Guidelines do not provide sufficient guidance on how to assess their compatibility with Article 101 of the Treaty. Furthermore, the evaluation found a divergent treatment of retail parity clauses by NCAs and national courts, notably regarding the treatment of narrow parity clauses in the hotel booking sector.[40]

33 See staff working document, pages 159 to 165.

34 See staff working document, page 185.

35 See staff working document, page 186.

36 See Vertical Guidelines, paragraph 151.

37 See staff working document, pages 188 to 192.

38 See staff working document, pages 168 to 169.

39 See staff working document, pages 168 to 175.

40 See staff working document, pages 180 to 185.

Lastly, regarding **certain online restrictions**, the evaluation has indicated that the assessment of these restrictions is one of the areas in which the VBER and the Vertical Guidelines are perceived to lack clarity and not be up to date in light of recent market developments.[41]

In this context, stakeholders point to a number of issues regarding indirect measure that make online sales more difficult.

Some stakeholders consider that the qualification of *dual pricing* (i.e. charging the same distributor a higher wholesale price for products intended to be sold online than for products to be sold offline) as a hardcore restriction is no longer adapted to the current business needs. This derives from the fact that, as some stakeholders pointed out, online sales have developed during the last decade into a well-functioning sales channel that no longer needs special protection. Moreover, brick-and-mortar stores are facing increasing pressure from online sales. This situation has been exacerbated (at least for now) due to the pandemic, during which online sales experienced an unprecedented peak. Both suppliers and offline-focused retailers have therefore called for more flexibility to allow them to support brick-and-mortar stores in an appropriate manner. It has also been mentioned that the underlying logic of the Vertical Guidelines on dual pricing, which only allows suppliers to apply different wholesale prices to pure online players and pure offline players, is not in line with the current commercial trend, which aims to provide an omni-channel experience to consumers.[42]

Some stakeholders also expressed a need for clarification regarding online advertising, and more specifically the use of trademarks and brand names in the context of online advertising. All stakeholder groups highlighted the importance of using trademarks and brands names in the context of online advertising.[43] As indicated above, the support study indicated that search engines have become the most used channels for product discovery, and brand names can play a significant role as search terms used by consumers. However, there is no consensus among stakeholders on how restrictions on the use of trade marks in advertising and restrictions to bid for trademarks with certain search engine should be assessed.[44]

V. CONCLUSION

The evaluation has shown that the VBER and the Vertical Guidelines are useful tools that significantly facilitate the enforcement work of the Commission, NCAs and national courts, and help businesses to self-assess the compliance of their vertical agreements with the Treaty. Nevertheless, the evaluation has identified a number of issues, in particular with regard to the clarity of the rules and their ability to address new market developments.

In light of the findings, the Commission has launched the impact assessment phase, which will look into different policy options for a possible revision of the rules in the areas identified during the evaluation as not functioning well. Like the evaluation phase, the impact assessment will include several consultation activities to gather the views of stakeholders in this regard.

41 See staff working document, pages 208 to 209.

42 See staff working document, pages 211 to 215.

43 See staff working document, pages 218 to 219.

44 See staff working document, page 221.

RETHINKING THE EU'S *BY OBJECT* APPROACH TO VERTICAL RESTRICTIONS

BY ANDRÉ PRETORIUS & ALEX WHITE[1]

1 Alex White is a senior associate and André Pretorius a partner at Herbert Smith Freehills, London. They would like to thank Kristien Geeurickx and Alberto Martinazzi for their comments, and Kyle Johnson and Evi Gkaidatzi for their research assistance.

I. INTRODUCTION

The EU is in the process of revising its rules on vertical agreements as contained in the Vertical Block Exemption Regulation (VBER) and Vertical Guidelines, which expire in May 2022.[2] Ahead of further consultations and the publication of draft revised rules, the European Commission (Commission) published in September a staff working document evaluating how the current rules have functioned since their adoption in 2010 (the Evaluation), as well as a short Inception Impact Assessment, concerning potential policy options in a limited number of areas.[3]

The Evaluation, the outcome of two years of consultation and evidence gathering, finds that the VBER and Vertical Guidelines are still relevant and useful tools to facilitate the self-assessment of vertical agreements. But it also finds that distribution markets have changed significantly due to the growth of e-commerce and new market players, such as online platforms. These developments have led to considerable changes in distribution models, generally increasing the range of distribution channels used by suppliers, but also in the range of vertical restrictions used to regulate distribution in and across such channels.

In light of these changes, the Commission concludes that the EU's vertical rules, whose aim has been to improve legal certainty, are no longer meeting that objective. Various rules lack clarity, give rise to diverging interpretations, or are no longer applicable to the current business environment. In other places, the Commission recognizes that gaps have emerged, including in the range of vertical agreements deserving exemption under article 101(3) of the Treaty on the Functioning of the European Union ("TFEU").

But the Commission finds that the list of hardcore restrictions included in the rules – those agreements typically treated as having the object of restricting competition under article 101(1) TFEU – to be generally appropriate.

This conclusion raises questions. What the Evaluation fails to recognize, as we seek to show in the remainder of this article, are certain fundamental problems with the Commission's approach to hardcore/by object restrictions, and particularly in how that approach has been applied to vertical agreements in the context of online selling.

II. WHAT IS WRONG WITH THE EUROPEAN APPROACH TO RESTRICTIONS BY OBJECT IN VERTICAL AGREEMENTS?

Defining certain agreements as having the object of restricting competition relieves competition authorities of the burden of demonstrating that the agreement has had anti-competitive effects before finding an infringement.[4] As such they are intended as a tool of procedural efficiency, lessening the evidential burden on competition authorities, but they also aid businesses by providing legal certainty. As they are typically reserved for the most serious types of infringements, and companies ought to know better, they are also typically subject to the heaviest fines.

This approach to enforcement is however only workable and proportionate if the category of agreements to which the by object characterization applies is carefully and strictly defined. Where exactly to draw the line between by object and 'by effect' restrictions has been a matter of debate, including pronouncements of the Court of Justice of the European Union ("CJEU") on a number of occasions over the past decade – a point not reflected in the Commission's Evaluation. Perhaps the most seminal case of this period, and which narrowed what had been seen as an undue expansion of the concept of restriction by object, is *Cartes Bancaires* (2014). The approach in the *Cartes Bancaires* judgment can be summed up by reference to the words of Advocate General Wahl in that case, that the by object category should be reserved for "*conduct whose harmful nature is proven and easily identifiable, in the light of experience and economics*."[5]

In our view, *Cartes Bancaires* marks a departure from the position underlying the current vertical rules adopted in 2010, but it has also not always been fully reflected in subsequent decisional practice. The issue with the current vertical rules in particular lies in part with the basic way in which they apply the elements of article 101 TFEU. For example, the Vertical Guidelines proceed on the basis that certain vertical agree-

2 Commission Regulation 330/2010 OJ 2010 L102/1 and the Vertical Restraints Guidelines OJ 2010 C130/1.

3 Commission Staff Working Document: Evaluation of the Vertical Block Exemption Regulation SWD(2020) 172 final, September 8, 2020, and Commission, Inception Impact Assessment, Ref. Ares(2020)5806566, October 23, 2020.

4 By object restrictions are nonetheless distinct from *per se* infringements under U.S. antitrust law, in that they are in principle always open to justification under article 101(3) TFEU. A by object analysis will also involve consideration of the economic and legal context of the agreement in question (whereas such matters may more typically fall under a rule of reason approach in the U.S.).

5 C-67/13 P *Cartes Banciares* EU:C:2014:1958, para. 56; C-67/13 P *Cartes Bancaires* EU:C:2014:2204, paras. 51-53.

ments have the object of restricting competition under article 101(1) TFEU, whilst leaving open that they could nonetheless have pro-competitive effects.[6] (A similar approach is also reflected for example in the Commission's 2018 *Guess* decision, as we discuss further below.) Those pro-competitive effects are however left to be assessed under article 101(3) TFEU as part of an efficiency defense, only once a presumption of illegality has arisen and the burden of proof shifted to the allegedly infringing firm.

If competition authorities following these rules are routinely able to conclude that an agreement has an anti-competitive object, and at the same time leave open that it may have pro-competitive effects, there is a real risk of reaching false positives. Or, adapting the colorful analogy of AG Bobek in *Budapest Bank*, there is a risk that the Commission looks at something that superficially resembles a fish and disregards the fact that it smells like a lily.[7] That risk is then heightened by the reality that in practice, when faced with a presumption of illegality and bearing the burden of proof, many companies are not prepared to challenge an authority's by object finding, but instead opt for settling and not contesting those findings in order to obtain a reduction in their fine.

As a result, the reasoning underlying many competition authorities' by object findings is rarely tested, leaving any potential flaws in the approach unchecked and becoming embedded in decisional practice. The risk of this occurring is also greatest in our view when the by object approach is applied to markets as changing and complex as vertical markets in their current stage of development.

III. THE EXAMPLE OF *PING v. CMA*: FAR FROM A HOLE IN ONE

The rare occasions when an authority's by object reasoning is challenged, however, afford an opportunity to see how coherent the approach really has been. A good example of this is the recent *Ping* case in the UK. Ping, the U.S. golf club manufacturer, had required the members of its selective distribution network in the UK to only sell its custom golf clubs after an in-store custom-fitting. In its 2017 infringement decision, the UK's Competition and Markets Authority ("CMA") considered Ping's online sales ban to have the object of restricting competition, as it restricted the ability of its resellers to sell custom golf clubs and to compete in and across online/offline distribution channels. Ping was accordingly fined £1.45 million.[8]

Ping challenged the decision before the Competition Appeal Tribunal (the Tribunal) in 2018, and in turn before the Court of Appeal, which handed down its judgment in January 2020.[9] Whilst both appellant courts ultimately upheld the CMA's decision, what is striking is the CMA's and the courts' struggle to find a clear and coherent explanation for the by object finding. To highlight a number of key points:

- Before the CMA and on appeal, Ping argued that its online sales ban was not intended to restrict competition but to promote in-store custom fitting. Custom fitting was an integral aspect of its brand; could only properly take place in-store; and online selling of its custom clubs would risk disincentivizing its resellers from investing in in-store custom fitting for fear of free-riding by online sellers.

- The CMA actually accepted that in-store custom fitting was a legitimate objective for Ping to pursue. But at the same time, it considered the online sales ban to have an anticompetitive objective. The way the CMA sought to overcome this apparent contradiction was to consider that the ban went beyond what was necessary to achieve its legitimate aim, so that in effect, the legitimate objective could not be taken into account.[10]

- On appeal, the Tribunal considered that the CMA had committed an error of law. It should not have considered proportionality as part of its assessment of the object of the rule, but only once its object had been established, as part of an article 101(3) TFEU assessment.[11] The Court of Appeal was unsure who was right between the CMA and Tribunal, but found the law to be "*frustratingly untidy*" on this issue and in need of clarification by the CJEU.[12]

6 See Vertical Guidelines, paras. 47 and 122.

7 Case C-228/18 *Budapest Bank* EU:C:2019:678, para. 51.

8 CMA, Case 50230 *Online sales ban in the golf equipment sector*, August 24, 2017.

9 *Ping v. CMA* [2018] CAT 13, and *Ping v. CMA* [2020] EWCA Civ 13.

10 CMA, Case 50230 *Online sales ban in the golf equipment sector*, August 24, 2017, para. 4.165.

11 *Ping v. CMA* [2018] CAT 13, para 94-100. The Tribunal also accepted that objective justification could be considered at the prior stage in applying the *Metro* test (by which selective distribution measures can fall outside of article 101 TFEU altogether *inter alia* if they are necessary for non-price competition) but considered this was also distinct from assessing the object of a measure, and from a proportionality assessment under article 101(3) TFEU.

12 *Ping v. CMA* [2020] EWCA Civ 13, paras. 71-75.

- The Tribunal went as far as to say that it was "*prima facie counterintuitive that the internet ban, adopted by Ping with the intention of ensuring that customers purchase correctly fitted clubs, thereby enhancing their enjoyment of the game, …should be found to have had as its object the prevention, restriction or distortion of competition resulting in the imposition of a quasi-criminal fine.*"[13] If this was the case, it is difficult to see how the online sales ban conforms with *Cartes Bancaires* in terms of the harmful nature of the ban being "*proven and easily identifiable, in the light of experience and economics.*"

- The Tribunal appeared to overcome this by not actually applying *Cartes Bancaires* but the earlier and wider "*real (non-fanciful) potential to restrict competition*" test from the CJEU's 2011 *Allianz* judgment.[14] On appeal the Court of Appeal was then at pains to explain that *Allianz* had not actually been the test applied by the Tribunal.[15]

- The Court of Appeal followed *Cartes Bancaires* more closely, but it struggled to apply it in a convincing way. It could not point to any economic literature to support why the internet ban should be treated as a by object restriction, whilst it could only point to a limited body of experience. It referred to the CJEU's 2011 *Pierre Fabre* judgment in which the CJEU had held that an online sales ban was liable to restrict competition by object. But the ban in *Pierre Fabre* – far more clearly on the facts – had no alternative pro-competitive/legitimate rationale to explain it, whilst the judgment is primarily notable for its lack of detailed reasoning.[16] The Court of Appeal also cited the CJEU's 2016 *Coty* judgment, but that case concerned a different restriction (a ban on resellers using online marketplaces) and did relatively little to elaborate on the reasoning applicable in *Pierre Fabre*.[17] It also cited two other CJEU cases that had been relied upon in *Pierre Fabre* but which concerned not competition law but the free movement of goods and services.[18]

- In turns, the CMA and appellant courts each relied on the CJEU's 2008 judgment in *BIDS* as establishing the principle that an agreement can have the object of restricting competition even if it serves other legitimate objectives.[19] But this overlooked that *BIDS* concerned a very specific context: a horizontal cartel. As one commentator has noted,[20] horizontal cartels are the one area of competition law that rarely if ever have an alternative *pro-competitive* objective to explain them.

- The same cannot necessarily be said for other areas of competition law, and especially not for vertical agreements. Vertical agreements are in fact distinctive in being the one area of competition law where the CJEU long ago recognized that a restriction of price competition can potentially be off-set by the pro-competitive elements of a vertical agreement on non-price parameters, such as to even result in the agreement falling outside of the scope of article 101 TFEU altogether (under the *Metro* test).[21] This cautions against any simplistic read-across of *BIDS* outside of the context to which it applied.

13 *Ping v. CMA* [2018] CAT 13, para. 147.

14 *Ibid*. para 142, citing Case C-32/11 *Allianz Hungária* EU:C:2013:160, para. 38.

15 *Ping v. CMA* [2020] EWCA Civ 13, para. 116.

16 C-439/09 *Pierre Fabre* EU:C:2011:649, paras. 34-47.

17 C-230/16 Coty EU:C:2017:941. The CJEU focused on explaining why a ban on the use of online marketplaces could fall outside article 101(1) TFEU under the *Metro* criteria because, in contrast to the absolute sales ban in *Pierre Fabre*, resellers would remain free to sell via their own online stores or non-marketplace third party sites.

18 Case C-322/01 *Deutscher Apothekerverband* EU:C:2003:664 and Case C-108/09 *Ker-Optika* EU:C:2010:725.

19 C-209/07 *BIDS* EU:C:2008:643, para. 21.

20 See Pablo Ibáñez Colomo "*On Ping: the CAT reinvents economics in a paragraph – will cartels now be allowed?*," Chillin'Competition, 11 September 2018.

21 C-26/76 *Metro* EU:C:1977:167, para. 21.

IV. WAY FORWARD?

With cases marred by as many difficulties and complications as *Ping*, it can be difficult to see how a more coherent approach to defining a by object restriction in the context of vertical agreements can be struck. Fortunately, two CJEU judgments from this year provide helpful further direction. These are *Paroxetine* and *Budapest Bank*, in which the CJEU reached the view that an agreement should not be treated as a by object restriction if an alternative plausible pro-competitive or neutral rationale casts "reasonable doubt" as to whether the agreement reveals a sufficient degree of harm.[22] This would imply a significant change in the basic approach to applying article 101 TFEU. Plausible pro-competitive rationales should obtain a fair hearing before an authority concludes on the anti-competitive objective of an agreement, rather than being relegated to an article 101(3) TFEU assessment, only once a legal presumption of illegality has arisen and the burden of proof shifted to the alleged defendant.

But, unfortunately, these case-law developments and their implications for the VBER and Vertical Guidelines are not discussed in the Commission's Evaluation. To address this, we consider the impact of this case-law, together with a number of other issues, in relation to five key vertical restrictions: RPM, dual pricing, selective distribution, online marketplace bans, and brand bidding restrictions.

A. RPM

The Evaluation finds that retail price maintenance (RPM) has been the most enforced vertical restriction by European competition authorities over the past decade, representing 210 of 351 vertical infringement cases. The Commission see this statistic as confirmation that the classification of RPM as a by object restriction continues to be appropriate.[23]

However, this statistic to the contrary could be a sign that something is amiss. If by object cases are supposed to be reserved for restrictions that are "*proven and easily identifiable*," why are so many companies committing them?[24] At the same time, could it also have something to do with the difficulties, discussed above, that companies face in challenging by object findings? Could there also be novel features to more recent RPM cases (such as the fact that many have involved RPM in relation only to online selling) which have resulted in their being overlooked due to the by object approach?

To take another CMA case, *National Lighting Company (NLC)* from 2017 as an example:[25]

- NLC, a light fittings manufacturer, had imposed a maximum discount off the recommended resale price that its resellers were allowed to offer online.
- The CMA saw this as an indirect form of RPM, with the object of restricting competition as it was aimed at restricting online resellers' ability to lower their resale prices.
- NLC did not contest this finding as it admitted the infringement in order to reduce its fine under the CMA's settlement procedure. This then excused the CMA from having to consider any plausible pro-competitive effects of the online discount policy.
- However, it is at least apparent from the factual background of the case, that the discount policy stemmed in part from complaints from brick & mortar resellers who were unable to earn a margin due to undercutting by online resellers.[26] These resellers could well have had a genuine concern about free-riding. NLC's discount policy, in turn, if it sought to prevent free-riding, might have had at least a plausible pro-competitive rationale to protect resellers' incentives to invest in pre- and after-sales services. But these are all issues that unfortunately go unaddressed in the decision.

22 C-307/18 *Paroxetine* EU:C:2020:52, paras. 89 and 110-111, and C-228/18 *Budapest Bank* EU:C:2020:265, paras 82-83. See also AG Bobek's Opinion in C-228/18 *Budapest Bank* EU:C:2019:678, para. 81.

23 See Evaluation, pages 48 and 172.

24 A survey of UK businesses commissioned by the CMA in 2018 found generally a low level of awareness that RPM constituted an infringement (see ICMUnlimited, *Competition law research 2018*). Whilst lack of awareness is clearly relevant, what is not clear is the extent to which this is compounded by the infringement not being sufficiently clear and intuitive in the first place.

25 CMA, Case 50343 *Online resale price maintenance in the light fittings sector*, May 3, 2017.

26 *Ibid.* paras. 3.45 and 3.65.

The shortcomings of the CMA's decision also appear to stem from a number of additional underlying issues in the EU's approach to RPM:

- First, the Vertical Guidelines privilege online selling. The Guidelines celebrate the internet as a "powerful tool" to reach a greater number of customers and facilitate price competition[27] but they give very little attention to the challenges it presents for competition on non-price parameters. This makes it easier for competition authorities to use a similarly one-dimensional approach, and indeed the CMA uses language that closely matches the Vertical Guidelines to justify its decision.[28]

- A more balanced view is however possible and was well illustrated for example by the Commission's 2017 e-commerce sector inquiry. In the same breath as acknowledging the importance of the internet for price competition, the Commission acknowledged the challenges it presents in terms of "*addressing free-riding and maintaining the incentives for resellers to invest in high quality services*" and "*competition on parameters other than price, such as quality, brand and innovation*."[29] Free-riding had also been found to be a significant issue amongst stakeholders surveyed in the Commission's inquiry.[30] Equally, and as noted above, longstanding CJEU case-law (e.g. *Metro*) has recognized the potential trade-offs between competition on price and non-price parameters in the context of vertical agreements.

- Second, it is easy to forget that RPM primarily only concerns a restriction of *intra-brand* competition. The current Vertical Guidelines in fact acknowledge that "*the loss of intra-brand competition can only be problematic if inter-brand competition is limited*," but confusingly never reconcile this with its approach to defining practices such as RPM as hardcore/by object restrictions.

- Third, the economic evidence regarding the competitive effects of RPM is mixed, and this was in fact noted in a survey of the economic literature commissioned by the Commission as part of its Evaluation.

- Fourth, the EU's approach to RPM stands in contrast to other notable jurisdictions such as the U.S. and Australia, which take a far more balanced and reasoned approach to RPM.[31]

- Finally, if the issue in a case like *NLC* is that the discount policy in question went beyond what was necessary to achieve any putative pro-competitive aim to curb free-riding, it would seem that the Court of Appeal in *Ping* has now rendered doubtful the legality of competition authorities inserting proportionality into a by object assessment.

The Commission's Inception Impact Assessment from October 2020 suggests that the Commission has not entirely closed its mind to concerns about the current approach to RPM as it refers to conducting further discussions with businesses regarding the specific circumstances in which RPM might give rise to efficiencies under article 101(3) TFEU, and what evidence would be required in this regard.[32] But in view of the issues noted above, we are doubtful if this goes far enough.

If the Commission is ultimately unwilling to make more fundamental changes, we think it should at the very least ensure that clear alternative avenues exist for suppliers to address free-riding and other concerns presented by e-commerce, such as through dual-pricing and selective distribution (as discussed further below).

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27 Vertical Guidelines para 52.

28 CMA, "Restricting resale prices: an open letter to suppliers and resellers," June 20, 2017.

29 Commission, *Final report on the E-commerce Sector Inquiry* SWD(2017) 154 final, May 10, 2017, paras. 11-12.

30 *Ibid.* paras. 313-320.

31 See e.g. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007); and ACCC, *Statement of Reasons in respect of a notification lodged by Tooltechnic Systems (Australia) Pty Ltd for resale price maintenance conduct on Festool and Fein power tools*, July 25, 2018.

32 Inception Impact Assessment, pages 2.

B. Dual Pricing

The Vertical Guidelines treat dual pricing (suppliers charging a lower wholesale price to its resellers for their offline sales than for their online sales) as a hardcore (by object) restriction of competition.[33] It also provides for only very narrow circumstances in which it could be justified under article 101(3) TFEU.

Most stakeholders consulted by the Commission as part of the Evaluation consider that these provisions are unworkable or at least lack clarity. In particular, some argue that it fails to recognize the role dual pricing can play in compensating resellers for the higher costs that typically arise in offline selling, and curbing the risk of free-riding. We are minded to agree. Put simply, and further to the discussion above, to the extent dual pricing can have a plausible pro-competitive rationale, this needs to be considered before jumping to a by object categorization.

Notably, although not expressed in these terms, the Commission does appear to be more receptive to these concerns. The Inception Impact Assessment acknowledges that "*physical stores are facing increasing pressure*" and that the current rules may prevent suppliers from "*incentivsing [their] associated investments*," and as a result the Commission is in fact considering the possibility of ceasing to treat dual pricing as a hardcore/by object restriction.[34] This is a very welcome development.

C. Selective Distribution

The current VBER and Vertical guidelines are notable for taking a relatively permissive approach to selective distribution agreements. Such agreements are treated as falling outside of article 101(1) TFEU irrespective of the nature of the products or the selection criteria, provided the parties' market shares do not exceed 30 percent and the agreement does not otherwise contain any hardcore restrictions.

According to the Commission's Evaluation, some EU national competition authorities ("NCAs") believe this approach is too liberal and needs to be restricted. They consider that, in response to the growth of online selling, manufacturers have increasingly used selective distribution agreements purely as a way to reduce intra-brand competition and to stabilize retail prices. In our view this is not wholly fair. To the extent the internet continues to pose very real challenges to manufacturers in terms of protecting resellers' incentives to invest in non-price parameters, selective distribution should remain an option for manufacturers. It should also not be forgotten that under longstanding case-law manufacturers can seek to protect non-price competition even if this corresponds to a "*desire to maintain a certain price level*."[35]

D. Online Marketplace Bans

Respondents to the Commission's consultations as part of the Evaluation agree that the vertical rules need to be updated in light of the CJEU's 2017 *Coty* judgment.[36] In that case, the CJEU considered that a manufacturer of luxury perfumes and cosmetics could in principle restrict the members of its selective distribution system from selling on online marketplaces in order to preserve the luxury image of its goods, and such a restriction would fall outside of article 101(1) TFEU. However, opinion is not settled on how that case should be interpreted. Some NCAs, in particular the German NCA, believe that *Coty* should be confined to genuinely prestigious goods only in the context of selective distribution, whilst marketplace bans outside of this context should be treated as by object restrictions of competition.[37]

We disagree. The only legally consistent approach is that *Coty* should apply in principle to all types of products that currently justify selective distribution, which includes prestigious/luxury items, highly technical products, and all products where the companies in question meet the market share safe harbor under the current VBER/Vertical Guidelines. Moreover, outside of the context of selective distribution, it should remain possible for suppliers that adopt marketplace bans to escape a by object restriction under article 101(1) if they have a plausible pro-competitive/neutral rationale raising reasonable doubt as to the degree of harm arising from it. This could include for example, bona fide concerns about the level of pre- and after- sales service provided by such marketplaces and their impact on non-price parameters of competition.

33 Vertical Guidelines, para. 52(d).

34 Inception Impact Assessment, pages 2-3.

35 C-26/76 *Metro* EU:C:1977:167, para. 21.

36 C-230/16 *Coty* EU:C:2017:941.

37 This is the approach the German competition authority has also enforced: see e.g. decisions B2-98/11ASICS August 26, 2015 and B3-137/12 *Adidas*, June 27, 2014.

E. Brand Bidding Restrictions

Restrictions on a reseller's ability to bid on a supplier's brand name or trade mark in internet searches are not covered by the current VBER and Vertical Guidelines. Whilst the Commission's Evaluation shows that there is consensus that guidance is needed on their treatment, there is little consensus on the approach to adopt. Some argue that, further to the Commission's 2018 *Guess* decision, they should be treated as hardcore by object restrictions of competition.[38] But we caution against a simplistic reading of that case:

- Whilst the Commission in *Guess* did treat a brand bidding restriction as a by object restriction of competition, the brand bidding restriction had never been the main target of the Commission's investigation, which had looked at a range of other more standard hardcore restrictions adopted by Guess. Instead, Guess had in fact admitted the brand bidding restriction in an attempt to reduce its fine as part of the Commission's settlement procedure.

- The Commission did consider whether the brand bidding restriction could be said to have a pro-competitive/legitimate rationale, including whether it could be said to be aimed at avoiding customer confusion between Guess and its authorized resellers, or reducing Guess' advertising costs. But it did not consider either to be supportable.[39] The Commission also referred to a third possible pro-competitive/legitimate motive, whether the brand bidding restriction was aimed at preventing free-riding on Guess' brand investments. But it only raised this in the context of article 101(3) TFEU, after having concluded that the restriction had an anti-competitive object.[40] As the burden for making out an article 101(3) TFEU defense rested with Guess, and Guess had no intention of making one, this question was left entirely unaddressed.

- Why the Commission thought free-riding could only be considered under article 101(3) and not under article 101(1) along with the other two possible pro-competitive rationales is anomalous. This is also particularly so given that the UK CMA's 2017 market study into digital comparison tools considered the same three rationales, and free-riding was the one possible pro-competitive rationale that the CMA concluded might be credible, at least in the case of a narrowly construed brand bidding restriction (where the restriction relates to bidding on the brand name/trade mark alone, and not when used in conjunction with non-brand related words).[41]

This suggests that brand bidding restrictions need to be considered carefully in light of each of their possible pro-competitive rationales, and their specific context, before simplistically being added to the list of hardcore restrictions.

38 Case AT.40428 *Guess*, Commission decision of December 17, 2018.

39 *Ibid.* paras. 114-126.

40 *Ibid.* para. 164.

41 CMA, *Digital comparison tools market study*, Final report, 26 September 2017, para. 4.110.

V. HOW DOES THE EU'S SINGLE MARKET POLICY FIT IN?

Some may argue that the approach advanced in *Paroxetine* and *Budapest Bank*, to require competition authorities to pay attention to plausible pro-competitive rationales before finding an agreement has the object of restricting competition, may not neatly apply to vertical agreements. This is because the logic behind treating certain vertical agreements as by object restrictions in European competition law has not always been a purely economic one in terms of weighing anti- or pro-competitive object or effects. [42] Instead, it has at times also been motivated by a policy consideration, in terms of whether a vertical restriction frustrates the creation of the European single market, with the earliest articulation of this principle arising in *Consten & Grundig*.[43]

The problem with the single market objective, however, is that it is rarely given a clear articulation – perhaps because competition authorities tend to be uncomfortable adopting overtly political reasoning. Instead it tends to get entwined and blurred into economic principles. This only makes decision-making practice harder to understand and undermines legal certainty. *Ping* is a good example. Only after various twists in legal argument does the Court of Appeal finally land on the logic of *Consten & Grundig* to justify the CMA's by object finding.[44] The Vertical Guidelines are little better, where the single market objective only receives passing reference, leaving open to what extent it is relevant to any of the vertical restrictions discussed in the Guidelines.[45]

All this means that if the EU's vertical rules are to continue to be guided by the single market policy objective, this needs to be made far more explicit and clarified in any revised VBER and Vertical Guidelines. Conversely, the UK, after the end of the transition period, should feel free to adopt a different approach.

VI. CONCLUSIONS

To draw conclusions from the above:

- If the VBER and Vertical Guidelines are to achieve their aim of improving legal certainty, they need to take a more coherent and rigorous approach to defining by object vertical restrictions, in line with the latest CJEU jurisprudence.
- This includes ensuring that plausible pro-competitive rationales for a restriction are considered before concluding on the object of a restriction, rather than relegating such considerations to an article 101(3) TFEU assessment.
- The vertical rules need to take a more balanced approach to e-commerce, acknowledging its merits in facilitating price competition, but giving fuller weight to the challenges presented for competition on parameters other than price.
- To the extent the vertical rules continue to be guided by the single market policy objective, this must be made far more explicit and clear.

42 Colomo, P. I. & Lamadrid de Pablo, A "Court of Appeal in Ping: how market integration complicates the analysis of object restrictions" *Chillin'Competition*, April 2020; see also Colomo, P. I. & Lamadrid de Pablo, A. "On the notion of restriction of competition: what we know and what we don't know we know," in D Gerard, M Merola, B Meyring (eds) *The Notion of Restriction of Competition* (Bruylant 2017).

43 Joined Cases 56 and 58/64 *Consten & Grundig* EU:C:1966:41.

44 *Ping v. CMA* [2020] EWCA Civ 13, para. 109.

45 Vertical Guidelines, para. 7.

ECONOMIC PRINCIPLES AND THE REFORM OF THE EUROPEAN COMMISSION'S APPROACH TO VERTICAL AGREEMENTS

BY PETER DAVIS, GERHARD DIJKSTRA & VIKRAM KUMAR[1]

1 Peter Davis is a senior vice president, Vikram Kumar is a senior manager, and Gerhard Dijkstra is a manager in the London office of Cornerstone Research. The views expressed in this article are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research.

I. INTRODUCTION

In October 2018, the Commission began its evaluation of the Vertical Block Exemption Regulation ("VBER")[2] and accompanying Vertical Guidelines,[3] which expire in May 2022.[4] The results of the evaluation were published in a Staff Working Document (the Working Document),[5] where the Commission notes that, while the VBER and Vertical Guidelines provide a useful instrument that increases legal certainty, "certain provisions… lack clarity, are difficult to apply or no longer adapted to the market developments that occurred since the adoption of the VBER and the Vertical Guidelines in 2010."[6] Some of the key issues highlighted in the Working Document are as follows:

- A perceived lack of legal certainty due to divergent interpretation of the VBER by national competition authorities ("NCAs") and national courts.[7] For instance, this was raised in the context of resale price maintenance ("RPM") and most-favored nation ("MFN") clauses.[8]

- Likely practical difficulties with market definition, particularly when it comes to online platforms.[9] For instance, NCAs have sought greater clarity on whether a distribution platform's market share "should be calculated for each market on which the platform purchases the products or services offered on the platform, or for all the products or services combined."[10] Similarly, there are questions around whether sales by non-platform providers (such as in the offline world) should be taken into account when computing the market share of "supplier platforms."[11]

- The need for greater clarity on circumstances under which the use of selective and exclusive distribution simultaneously will not raise competition concerns.[12]

- The need for greater clarity on the rules around information exchange when a manufacturer engages in "dual distribution" (i.e. sells both directly to end customers via own retail arm and via a resale channel). Specifically, whether "information exchanges in dual distribution scenarios are to be treated as part of the vertical relationship and can thus be considered as covered by the VBER" and the conditions under which "information exchanges in dual distribution scenarios are admissible or instead problematic." In this regard, while some stakeholders have noted that "collecting data such as pricing data or data on consumer profiles from their distributors may allow suppliers to distribute their products more effectively and thus enhance inter-brand competition", others have "expressed concerns that exempting any type of information exchange in a dual distribution scenario may allow a supplier to require its distributors to pass on customer data that would provide the supplier's downstream retail operations with a strategic advantage and restrict the distributors' ability to compete effectively at retail level."[13]

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2 European Commission, "Commission Regulation (EU) No 330/2010 of April 20, 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," Official Journal of the European Union L 102, April 23, 2010 ("Vertical Block Exemption Regulation" or "VBER").

3 European Commission, "Guidelines on Vertical Restraints," Official Journal of the European Union C 130, 19 May 2010 ("Vertical Guidelines").

4 European Commission, "Review of the Vertical Block Exemption Regulation."; European Commission, "EU Competition Rules on Vertical Agreements – Evaluation," available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/1936-Evaluation-of-the-Vertical-Block-Exemption-Regulation.

5 European Commission, "Commission Staff Working Document – Evaluation of the Vertical Block Exemption Regulation," SWD(2020) 172 final, September 8, 2020 ("Working Document").

6 Working Document, p. 89.

7 Working Document, pp. 60, 90.

8 Working Document, p. 60. See also Working Document, pp. 169–171, 182, 184.

9 Working Document, pp. 159–162.

10 Working Document, p. 161.

11 Working Document, p. 161. The Working Document defines supplier platforms as those that provide only the infrastructure for sellers and buyers to interact and conclude a particular transaction. See Working Document, p. 130, footnotes 153, 176.

12 Working Document, pp. 92, 191. The Working Document observes that "exclusive distribution at the wholesale level and selective distribution at the retail level is commonly used" on efficiency grounds. See Working Document, p. 191.

13 Working Document, p. 157.

- Lack of clarity on the application of the agency exception to online platforms, which may be considered "an integral part of the principal's distribution system" or as an independent reseller.[14] Pertinent in this regard are "the level and type of risks that are relevant to determine whether a vertical agreement can be considered a genuine agency agreement."[15]

- The need for more guidance on "restrictions on the use of online search advertising and price comparison websites," "online sales" and "the use of online marketplaces."[16] Such restrictions have been the subject of contention in matters such as *Coty* and *Pierre Fabre*.[17]

Each of these points raises fascinating economic questions, although space constraints do not allow us to opine in detail on every one of them. Instead, we begin by discussing five economic principles that ideally should guide any revision of the VBER and the Vertical Guidelines. We then illustrate the application of those principles by exploring the economics of two specific types of vertical agreements, namely RPM and MFN clauses. We argue that uneven enforcement across NCAs and courts arises in significant part when there are tensions between economic principles and real-world applications of the VBER and Vertical Guidelines (e.g. RPM) or lack of clarity in the guidance (e.g. MFN). In its revision, the Commission should therefore seek to mitigate such issues.

II. FIVE ECONOMIC PRINCIPLES THAT SHOULD GUIDE ANY REVISION OF THE VBER AND THE VERTICAL GUIDELINES

In our opinion, the following five economic principles should guide any revision of the VBER and the Vertical Guidelines:

1. While vertical agreements may restrict competition, they may also allow firms to realize efficiencies which may not be possible absent such agreements. Thus, there is a significant degree of ambiguity in the overall economic desirability of vertical restraints according to a conventional economic analysis. Regulations and guidelines which support either under- or over-enforcement against vertical restraints involve giving up economic benefits or incurring economic costs.

2. There is a sound and clear economic rationale for the role played by the VBER provided it serves as an effective safe harbor for vertical agreements that are unlikely to have anti-competitive effects.[18] Economics suggests that a vertical agreement is likely to be socially desirable when it does not have anti-competitive effects. This will, in particular, be the case when the parties to the agreement remain subject to significant competitive constraints even once the vertical agreement is adopted.

3. Outside the VBER safe harbor, conventional economic analysis implies that a careful case-by-case assessment is required to evaluate whether the pro-competitive effects of a vertical agreement outweigh the potential anti-competitive effects.

4. The rules governing different types of vertical agreements should be suitably aligned. Specifically, economics suggests that certain types of vertical agreements may be close substitutes and result in the same or similar economic effects. For example, both MFNs and RPM agreements may help a manufacturer encourage retailers to provide a desirable level of service. Economists are ordinarily skeptical about aspects of the legal framework that have the effect of treating different vertical restraints with the same likely economic effects differently.

14 Working Document, pp. 122, 148.

15 Working Document, p. 148.

16 Working Document, p. 70.

17 Judgment of December 6, 2017 in Case C-230/16, ECLI:EU:C:2017:941, *Coty Germany GmbH v. Parfümerie Akzente GmbH*; Judgment of October 13, 2011 in Case C-439/09, ECLI:EU:C:2011:649, *Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence and Ministre de l'Économie, de l'Industrie et de l'Emploi*.

18 Embodying these safe harbor provisions through the definition of the relevant market(s) and the appropriate safe harbor market share threshold can themselves be a subject of significant debate. In both the existing VBER and the EU Non-horizontal Merger Guidelines, a 30 percent market share threshold plays a significant role. See, e.g. VBER, Articles 3(1) and 7(d). Note also that when multiple suppliers have similar RPM agreements with the same distributors, then this "network" of agreements can sometimes also be anti-competitive for reasons of coordination. See Patrick Rey & Thibaud Vergé, "Resale Price Maintenance and Interlocking Relationships," *Journal of Industrial Economics*, 2010, 58(4): pp. 928–961 at p. 952.

5. The rules governing vertical agreements should be suitably aligned with those applicable to vertical mergers. Specifically, it is worth noting that vertical agreements will ordinarily involve less direct control than a vertical merger, which may result in full vertical integration. As a result, economists are ordinarily skeptical about aspects of the legal framework that treat a vertical agreement more skeptically than an analogous full vertical merger.[19]

While the principles themselves cannot solve every point of technical detail, they nonetheless have significant force when considering the questions the Commission must answer in restructuring the VBER and Vertical Guidelines. Next, we illustrate that fact by applying these principles to two specific types of vertical agreements, RPM and MFNs.

III. RESALE PRICE MAINTENANCE

An RPM agreement is a vertical agreement wherein an upstream supplier and downstream customer agree to impose constraints on the price the downstream firm can charge its own customers. RPM can involve an upstream firm imposing (i) the downstream price entirely; (ii) a minimum downstream price; or (iii) a maximum downstream price. A fixed or minimum RPM is a "hardcore restriction" under VBER.[20] The Working Document reports that "[t]he majority of vertical cases pursued at [the] national level since the adoption of the VBER [in 2010] concerned RPM."[21]

Under the VBER, fixed or minimum price RPM does not benefit from an exemption irrespective of the market share of the parties to the agreement.[22] While in theory RPM may still benefit from an Article 101(3) exemption, according to some, it is "*de facto* a per se infringement of the competition rules."[23] Indeed, RPM agreements have "consistently been found to amount to a severe restriction of competition in enforcement actions taken by the Commission and NCAs since the adoption of the VBER."[24] Moreover, "NCAs seemed to have taken somewhat divergent approaches with regard to novel implementations of RPM [e.g. through the use of price monitoring algorithms], for which the current rules do not contain any guidance" whereby "[s]uch diverging interpretations have led to a decreased level of legal certainty."[25]

The fact that fixed or minimum RPM is considered a hard-core restriction wherein it is presumed unlikely to fulfil the conditions of Article 101(3)[26] is surprising when the economics strongly suggests that a case-by-case approach is appropriate for assessing RPM agreements.[27] Specifically, economists have identified several potential anti- and pro-competitive rationales:

19 The EC non-horizontal merger guidelines note "[n]on-horizontal mergers are generally less likely to significantly impede effective competition than horizontal mergers… [given that] the main source of anti-competitive effect in horizontal mergers is absent from vertical…mergers…*[Vertical] mergers provide substantial scope for efficiencies.*" See European Commission, "Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings," Official Journal of the European Union C 265/6, October 18, 2008, ¶¶ 11–13 (emphasis added). On the other hand, the VBER says "[t]his Regulation *should not exempt vertical agreements* containing restrictions which are likely to restrict competition and harm consumers…In particular, vertical agreements containing certain types of severe restrictions of competition *such as minimum and fixed resale-prices*, as well as *certain types of territorial protection, should be excluded from the benefit of the block exemption established by this Regulation irrespective of the market share of the undertakings concerned.*" See VBER, ¶ 10 (emphasis added).

20 VBER, Article 4(a).

21 Working Document, p. 172.

22 VBER, Article 4(a).

23 Working Document, p. 170.

24 Working Document, p. 59.

25 Working Document, pp. 170–171 and p. 60.

26 Vertical Guidelines, ¶ 47.

27 In the United States, this approach was adopted in the U.S. Supreme Court's *Leegin* decision. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, Case No. 06-480, 551 U.S. 877 (2007), Syllabus, pp. 1–2.

- Anti-competitive rationales for RPM
  RPM may (i) facilitate collusion upstream and/or downstream;[28] (ii) restrict entry or expansion upstream[29] and/or downstream;[30] (iii) soften competition upstream and/or downstream;[31] and (iv) act as a commitment device to protect monopoly rents upstream.[32]

- Pro-competitive rationales for RPM
  RPM may (i) reduce free-riding at the retail level;[33] (ii) ensure that retailers are willing to stock and promote products with unpredictable demand;[34] and (iii) promote competition upstream by providing quality certification (which is especially important for new products).[35]

Such theoretical ambiguity is also evident from empirical studies, although we would benefit from a wider empirical evidence base on the point. For example, as mentioned in the Working Document, empirical analysis of RPM in the market for books shows that the practice may have increased consumer welfare by *lowering* the price of books without any corresponding reduction in quantity sold.[36] In another classic empirical study, Ippolito and Overstreet (1996) examined the 1970s U.S. FTC *Corning Glass Works* case and found that Corning may have used RPM as a means to address principal-agent issues with distributors in order to "achieve greater distribution of its products."[37]

The *de facto* prohibition of RPM, treating it akin to a collusive price-fixing agreement, has long sat uncomfortably alongside the presence of both the pro- and anti-competitive rationales for the adoption of RPM agreements, even before the rise of e-commerce. Moreover, the available empirical evidence does not suggest that the theoretical ambiguity can be overruled on the grounds that it all points in one direction. To the extent there is a *de facto* prohibition, we should expect to incur economic costs associated with over-enforcement.[38]

28 For example, RPM may make it easier for colluding suppliers upstream to monitor deviations from price agreements. See Thomas A. Lambert, "Dr. Miles is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance," *William and Mary Law Review* 50, 2009, pp. 1937–2005 ("Lambert (2009)") at pp. 1944–1949.

29 The manufacturer may convince the retailer to not carry a competitor's product by guaranteeing high margins through RPM. See Lambert (2009), pp. 1949–1950.

30 In the presence of RPM, entrants may not be able to undercut incumbents to steal business. See Office of Fair Trading, "An Evaluation of the Impact upon Productivity of Ending Resale Price Maintenance on Books," *OFT's Economic Discuss Paper* 981, February 2008, pp. 5–6.

31 RPM may prevent retailers from undercutting each other. This may in turn sometimes reduce their incentive to negotiate lower wholesale prices. See Paul W. Dobson & Michael Waterson, "The Competition Effects of Industry-Wide Vertical Price Fixing in Bilateral Oligopoly," *International Journal of Industrial Organization* 25, 2007, pp. 935–962 at pp. 954–955.

32 Without RPM a monopolist manufacturer would maximize profits by selling to a single retailer, but in such a case, the manufacturer can increase its profits further by reneging on its agreement with the retailer and selling to an alternative retailer with lower retail prices. See Daniel P. O'Brien & Greg Shaffer, "Vertical Control with Bilateral Contracts," *The RAND Journal of Economics* 23(3), 1992, pp. 299–308.

33 Lambert (2009), pp. 1952–1955.

34 Lambert (2009), pp. 1959–1960.

35 Howard P. Marvel & Stephen McCafferty, "Resale Price Maintenance and Quality Certification," *The RAND Journal of Economics* 15(3), 1984, pp. 346–359.

36 European Commission, "Support Studies for the Evaluation of VBER: Support Study," 2020, ("EC Support Studies for the Evaluation of VBER: Support Study"), pp. 89–90.

37 Pauline M. Ippolito & Thomas R. Overstreet, Jr., "Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case against the Corning Glass Works," *The Journal of Law & Economics* 39(1), 1996, pp. 285–328.

38 The tension between current policy towards vertical agreements and economic analysis will likely be explored in court in private damages actions. For example, the UK *Pride Mobility Scooters* case involved eight retailers with RPM agreements with Pride and another 240+ retailers selling Pride that were not found to have RPM agreements. The defendants argued (with some force) that the damage from the eight RPM agreements was, if anything, relatively small. See Dorothy Gibson *v.* Pride Mobility Products Limited [2017] CAT 9.

IV. MOST FAVORED NATION CLAUSES

We now turn to applying economic principles in the context of MFN agreements.[39] As the Working Document notes, it is common for online travel agents ("OTAs"), which are online platforms, to impose MFN clauses.[40] Given the lack of guidance provided by VBER, such practices have been subject to divergent treatment by NCAs,[41] which has, in turn, "led to a decreased level of legal certainty."[42]

Like an RPM agreement, platform MFNs may also have both anti- and pro-competitive effects. In terms of potential anti-competitive effects, platform MFNs may harm competition through three key mechanisms, each of which ultimately lead to higher retail prices and thus harm consumers. Specifically, MFNs may:

- soften competition between incumbent platforms (if the platform raises its commission fees, the supplier may not raise its prices);[43]
- discourage entry by low-cost platforms (charging a lower commission fee would not translate into a lower retail price on the platform);[44]
- discourage suppliers from making investments that result in lower prices (the lower price would have to be charged on the platforms as well, thereby limiting the supplier's ability to steal sales from the platforms).[45]

In terms of potential pro-competitive effects, platform MFNs may:

- help reduce free-riding by suppliers on the services provided by platforms;[46]
- reduce search costs for consumers;[47]
- reduce negotiation costs between the contracting suppliers and platforms by reassuring platforms that they are getting the best terms possible;[48]
- ensure a platform's credibility — without MFNs, consumers might not have the confidence that the platform is a means to compare prices that are actually available and hence this undermines their willingness to use platforms;[49] and
- encourage entry of new platforms, specifically platforms with a business model similar to the incumbent's.[50]

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39 For a more extensive survey of the economics of MFN clauses see Can Çeliktemur, Gerhard Dijkstra, Alexandra Hermann & Vikram Kumar, "Most Favoured Nation Clauses in Online Platforms: The Case for Case-by-case Analysis," 2020, Mimeo Cornerstone Research, London.

40 MFN clauses are referred to as retail parity clauses. See Working Document, p. 38.

41 Working Document, pp. 182, 184.

42 Working Document, p. 90.

43 Note that this intuition does not imply that pass-through is necessarily zero in equilibrium. See Andre Boik & Kenneth S. Corts, "The Effects of Platform Most-Favored-Nation Clauses on Competition and Entry," *Journal of Law and Economics*, 2016, 59(1): pp. 105–134 ("Boik & Corts (2016)") at pp. 110, 112; Chengsi Wang & Julian Wright, "Search Platforms: Showrooming and Price Parity Clauses," *RAND Journal of Economics*, 2020, 51(1): pp. 32–58 ("Wang & Wright (2020)") at pp. 33, 46, 51, 53.

44 Boik & Corts (2016), pp. 122, 125.

45 CMA, "Private Motor Insurance Market Investigation: Final Report—Appendices," September 24, 2014, p. A8(1)-5 ¶¶ 14, 16; p. A8(1)-4 ¶ 12.

46 Wang & Wright (2020), pp. 33–35.

47 CMA, "Private Motor Insurance Market Investigation: Final Report," September 24, 2014, ("CMA Private Motor Insurance Market Investigation"), ¶ 8.104; EC Support Studies for the Evaluation of VBER: Support Study, p. 104.

48 EC Support Studies for the Evaluation of VBER: Support Study, pp. 98–100.

49 CMA Private Motor Insurance Market Investigation, ¶¶ 8.89–8.91.

50 Boik & Corts (2016), pp. 122, 125–126; EC Support Studies for the Evaluation of VBER: Support Study, p. 492.

The economic literature and NCAs (in their decisions) have distinguished between "wide" and "narrow" MFN clauses. A "wide" MFN clause requires the supplier not to set lower prices either on its own direct channel (supplier's own website) or any other competing platform. On the other hand, a "narrow" MFN clause requires the supplier not to set lower prices on the supplier's own direct channel only. Taking each potential anti-competitive effect identified above, a less permissive approach to wide MFNs appears reasonable *all else equal*:[51]

- A platform with a wide MFN has greater incentives to raise its commission than if there is only a narrow MFN. The reason is that when a platform increases its commission fee, the supplier faces a choice of either absorbing the higher platform commission or, if it chooses to raise its retail price, doing so for retail sales on all platforms because of the wide MFN clause.

- A new entrant platform may be prevented from gaining a foothold in the market when offering lower commission fees to suppliers does not result in lower retail prices for consumers. This would hold in the presence of wide MFNs by one or more incumbent platforms, since suppliers would have to offer the same lower price on all platforms and not just the entrant platform. This would not hold in the presence of narrow MFNs by incumbent platforms.

- A supplier's incentive to reduce its price on one platform is only subject to the requirement of price parity on its direct sales channel under a narrow MFN whereas the restriction is universal across all platforms under a wide MFN.

However, that is not to say that a blanket policy against even wide MFNs is justified. Since both narrow and wide MFNs may potentially have both anti- and pro-competitive effects, ultimately, the economics suggests that any such presumptions on the basis of wide or narrow MFNs should be rebuttable.

For example, a platform's ability to set high commissions with a wide MFN may be constrained if suppliers can delist from the platform (depending on the degree of competition between suppliers, the wide MFN may result in improved welfare effects for all the economic actors, including the consumers).[52] The available empirical evidence also supports the potential for both pro- and anti-competitive effects.[53]

It is striking therefore that, while some countries in Europe have banned both narrow and wide MFNs (e.g. France, Italy, Austria, and Belgium),[54] courts or competition authorities in other countries have decided to ban only wide MFNs (e.g. Germany, Sweden, and the UK)[55] on a case-by-case basis, a policy close to one that is justified on the basis of the economics. In summary, as a matter of economics overall, the welfare effects of platform MFNs are *a priori* ambiguous, such that they are ultimately best evaluated on a case-by-case basis. The revisions to the VBER and Vertical Guidelines should explicitly include the consideration of MFNs and could do so in a way likely to provide more clarity of the potential competition concerns, potential efficiencies and best-practice approach to analyzing their economic effects. If that agenda is pursued, it will help ensure a harmonized approach to the treatment of platform MFNs across Europe grounded in a proper economic analysis of their potential effects. The economics suggests that, like fixed and minimum RPM, neither wide nor narrow MFNs should be treated as hard-core restrictions.

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51 Narrow MFNs may in particular replicate the effects of wide MFNs if consumers view transacting on the supplier's own channel to be a close substitute to transacting on a platform. See Bjørn Olav Johansen & Thibaud Vergé, "Platform Price Parity Clauses with Direct Sales," Working Papers in Economics No. 1/17, Department of Economics, University of Bergen, 2017 ("Johansen & Vergé (2017)"), pp. 7, 24–25.

52 Johansen & Vergé (2017), pp. 5–7. A supplier delisting from a platform reduces its commission fees paid for part of its sales (which will be redirected to its direct channel), and hence has an incentive to reduce its price and gain a larger market share by undercutting rival suppliers. This possibility to delist disciplines the platforms' behavior and prevents them from setting high commissions. See Johansen & Vergé (2017), pp. 15–17.

53 Some empirical studies demonstrated that banning narrow MFNs may lead to reduced prices. Hunold et al. (2018) examine several countries with varying MFN legislations. See Matthias Hunold et al., "Evaluation of Best Price Clauses in Online Hotel Bookings," *International Journal of Industrial Organization*, 2018, 61: pp. 542–571 at pp. 544, 548, 558, 562–563, 566. Mantovani et al. (2020) find an insignificant overall change in hotel prices but for hotel chains separately detect a significant decline in prices with a ban of all MFNs (wide and narrow). See Andrea Mantovani et al., "Much Ado about Nothing? Online Platform Price Parity Clauses and the EU Booking.com Case," The School of Economics Discussion Paper Series, 2020, pp. 3, 6, 23.

54 France adopted the "Loi Macron" in August 2015. Austria, Italy and Belgium followed in banning all types of parity clauses with laws entering into force in 2017. See Margherita Colangelo, "Competition Law and Most Favoured Nation Clauses in Online Markets," *New Developments in Competition Law and Economics, ed. Klaus Mathis & Avishalom Tor (Cham: Springer Nature Switzerland AG, 2019), pp. 291–317, at p. 306.*

55 For the case of Germany, see Philippe Chappatte & Kerry O'Connell, "European Union – E-commerce: Most Favoured Nation Clauses," *Global Competition Review*, 15 October 2019. For the case of Sweden, see Mark-Oliver Mackenrodt, "Price and Condition Parity Clauses in Contracts between Hotel Booking Platforms and Hotels," *IIC - International Review of Intellectual Property and Competition Law* 50, 2019, pp. 1131–1143, at p. 1131. For the case of the UK, see CMA Private Motor Insurance Market Investigation, ¶¶ 62–63.

V. CONCLUSION

We believe that the desire for greater clarity and more specific guidance would be best served by ensuring the Commission's policy on vertical agreements is aligned with the central economic principles — with cases outside the VBER safe harbor evaluated on a case-by-case basis. The current framework appears to have led to a situation where some types of vertical agreements are *de facto* banned in Europe. Such a situation is economically undesirable. In particular, we believe it would be useful for the Commission to incorporate new text in relation to MFNs to provide clarity. Consistent with the European Commission's conclusion at the time of its e-commerce inquiry, we do not believe that it would be desirable to treat even wide MFNs as hard-core restrictions.[56]

The case against adopting a policy based on an assessment of economic effects is primarily that doing so involves both measurement challenges and investigatory cost. However, the one-off direct legal and economic costs incurred are best considered small in the context of a €16.4 trillion European economy.[57] In contrast, the longer lasting indirect costs incurred when either anti-competitive conduct is allowed or the efficient use of vertical agreements is prohibited should not be expected to be small. The implication is that good economic policy is likely to involve incurring the costs associated with running careful investigations of the economic effects of vertical agreements in order to reduce uncertainty about the economically correct answer. In short, there is a fundamental statistical truth that marshalling additional evidence is the only way to reduce *both* the risk of allowing anti-competitive agreements and also the risk of prohibiting the efficient use of vertical agreements, i.e. reducing the risk of both Type 1 and Type 2 errors.

56 The European Commission's e-commerce inquiry reached the same conclusion: "Should market shares exceed 30 % an individual assessment of parity clauses will be required." See European Commission, "Report from the Commission to the Council and the European Parliament: Final report on the E-commerce Sector Inquiry," May 10, 2017, ¶ 621.

57 "EU gross domestic product (GDP) in 2019 was €16.4 trillion." See European Union, "The economy," October 20, 2020, available at https://europa.eu/european-union/about-eu/figures/economy_en.

VERTICAL RESTRAINTS IN A DIGITAL WORLD

BY DAVID S. EVANS[1]

1 Co-Executive Director, Jevons Institute for Competition Law and Economics, and Visiting Professor, University College London, London and Chairman, Global Economics Group, Boston, Mass. This paper is based on my presentation at the Swedish Competition Authority's Pros & Cons 2019 in Stockholm, November 2019. I have worked, and am currently working, as an expert on antitrust cases involving vertical practices by digital platforms for both complainants and defendants and received funding for some of the research on which this article is based. I would like to thank Howard Chang for helpful comments and suggestions and Nicholas Giancarlo for excellent research help.

I. INTRODUCTION

Most cases and economic analyses involving vertical restraints have focused on the physical world of manufacturers and distributors. Commerce, however, is moving rapidly to a digital world populated by firms where the provision of goods and services depends heavily on Internet connections. For the analysis of vertical restraints, this digital world could involve the same principles just different facts. To a large extent that's the case. Certain features of digital businesses, however, are distinct from the physical world and will play a substantial role in matters before competition authorities and courts.

This paper provides a guide to those features and their implications for the analysis of vertical restraints. Section I describes what's new and different about digital businesses that may matter for antitrust analysis of vertical restraints. Section II provides some general principles for analyzing vertical restraints in the digital world. Section III considers examples of vertical restraints arising from the application of platform rules for participation, exclusive contracts, and MFNs to help illustrate these principles. Section IV concludes briefly.

II. WHAT'S NEW AND DIFFERENT ABOUT THE DIGITAL WORLD

The digital economy, as defined here, comprises businesses that rely substantially on the Internet to provide products and services to consumers. The products could be digital, and delivered digitally, such as video (YouTube) or search results (Google). They could be physical products that are delivered physically but are found and bought digitally (Amazon). They could be services that are delivered and consumed physically, such as a ride, but facilitated mainly over the Internet (Uber). They also comprise digital products and services that enable other digital businesses, such as mobile app platforms (Apple). By this definition, the digital economy excludes important digital products that are not provided primarily over the Internet such as payment card networks (Visa). This paper also does not consider businesses that provide the critical physical infrastructure for the digital economy, such as fixed and mobile broadband providers.

The digital economy is substantial and is likely to become an even larger portion of the overall economy. In the U.S., online firms account of almost half of the time people spend on media, 39 percent of total advertising spending, and about 10 percent of total retail commerce.[2] Expectations of future growth are partly responsible for driving up the valuations of digital businesses. As of October 1, 2019, seven of the ten most highly valued publicly traded companies made most of their profits from products and services that depend heavily on the Internet.[3] The growth of online commerce is likely to accelerate with the deployment of 5G technologies that will blanket the physical world with connected devices that can handle vast amounts of data at much greater speeds than today.

Many economically significant digital businesses operate intermediaries. In most cases these intermediaries are multisided platforms that facilitate beneficial interactions, often exchange, between distinct types of participants for which there are usually indirect network effects with other participants. In some cases, these intermediaries follow a traditional reseller model in which buyers interact directly with the intermediary rather than with sellers.[4] The main novelties in the analysis of vertical restraints in the digital world involve these digital intermediaries.

2 Data on time spent consuming media is sourced from Nielsen (2019) "The Nielsen Total Audience Report Q1 2019" at p. 4. Estimates of advertising revenue data is sourced from Interactive Advertising Bureau (2019) "IAB internet advertising revenue report 2018 full year results" at pp. 21-22. Data on E-Commerce's share of total retail sales is sourced from Federal Research Bank of St. Louis, "E-Commerce Retail Sales as a Percent of Total Sales," https://fred.stlouisfed.org/series/ECOMPCTSA#0.

3 Market capitalization data sourced from S&P Capital IQ. The top 10 firms include Microsoft, Apple, Amazon, Alphabet, Berkshire Hathaway, Facebook, Alibaba, Tencent, Visa, and JPMorgan Chase.

4 See *Matchmakers* at Ch. 7, and Hagiu, Andrei & Julian Wright (2015) "Marketplace or Reseller," *Management Science* 61(1), pp. 184-203, for a discussion of the difference between platforms and resellers. Roughly speaking a shopping mall is platform while a department store is a reseller. This paper refers to "digital multisided platforms" simply as "digital platforms" and digital intermediaries that follow a reseller model as "digital resellers."

A. Significant Digital Businesses Are Usually Multisided Platforms Based on Software

The largest digital businesses earned a substantial part of their revenues from operating multisided platforms. Table 1 lists the seven largest global digital businesses and the intermediaries that drive a large part of their revenues.[5] Many other economically significant digital businesses, such as the various ride-sharing services, operate multisided platforms. And it remains a common model for venture-backed startups.

Digital platforms rely primarily on software to provide core services such as matching, search, discovery, transactions, and communication. They also depend on the Internet to connect participants and to provide those core software-based services. The software for digital platforms typically resides on server farms maintained by "cloud providers" or in proprietary server farms.

Indirect network effects often fuel the growth of multisided platforms. More participants on one side of the platform makes the platform more valuable to participants on the other side of the platform. Rapid growth can occur as more participants join each side and thereby increase the attractiveness of the platform leading to more participants to join.

Table 1: Large Digital Businesses and Their Platforms

Company	Platforms
Microsoft	Windows, Bing, Azure,
Apple	iOS including App Development Platform and App Store
Amazon.com	Amazon Marketplace, AWS
Alphabet	Android (including Google Play), Google, YouTube
Facebook	Facebook, Messenger, Instagram, WhatsApp
Alibaba	Taobao, Tmall, AliExpress
Tencent	QQ, WeChat, Tencent Games

The Internet as well as other information technologies reduce physical constraints on expanding users and can thereby accelerate these indirect network effects. As a result, digital platforms can prove a concept locally, and then expand to many locations, using similar software and processes. They can do that more quickly than physical businesses that require more local facilities to provide services through broader physical spaces. Digital platforms and resellers now cover most sectors of the economy.

The following discussion focuses on features of digital platforms that are particularly relevant for analyzing antitrust issues involving vertical restraints. These features are the same for digital platforms as they are for physical platforms but are magnified as a result of Internet connectivity, software, and related information technologies. Although the details differ, digital resellers have similar features even though they do not facilitate direct interactions between the various groups of participants.

B. Platforms Need to Reach Critical Mass to Ignite and Grow Profitably

Digital platforms face the same chicken-and-egg problem that physical platforms often face. If they don't offer access to enough of the right participants, they don't have much to offer. This situation is different than traditional businesses which sell products rather than access. To get off the ground, a sliced-bread manufacturer needs a factory and ingredients to make bread. To get off the ground, a heterosexual dating platform must have enough men and women to offer an interesting dating product to either group.

Critical mass refers to the minimum set of members of both sides necessary for the platform to provide a sufficiently valuable service that it can keep those members on board, grow by attracting more users than it loses, and become a profitable enterprise.[6] Economists recognized the importance of critical mass for businesses that had indirect network effects in the 1990s.[7] What that literature missed was the pervasiveness of intermediaries that rely on indirect network effects and how common the critical mass obstacle is in the physical world. The critical mass problem is the same for digital platforms as for traditional ones, although the particulars of solving the challenge may differ.

5 Amazon also operates a digital platform (Amazon Marketplace) and a digital reseller (Amazon) side-by-side. Buyers see offers from both on its website and app and some sellers participate in both models. Each business model accounts for about half of its ecommerce revenue.

6 See *Matchmakers* at Ch. 5.

7 Shapiro, Carl (1999) "Exclusivity in Network Industries," *George Mason Law Review* 7(3), pp. 673-683.

How the critical mass problem gets solved in practice is a bit outside of the traditional toolkit for economists, as it is fundamentally a disequilibrium phenomenon whose details are highly dependent on the circumstances of the platform. Early adopters and expectation management are often key. Platforms need to get early adopters on board and then get enough momentum to keep them there. Participants will invest in using the platform if they expect that it will eventually reach critical mass and become valuable to them. Platforms can adopt a variety of strategies to entice more participants on board and shape expectations.[8]

Platforms may try to get "anchor tenants" — a term taken from shopping malls — to create a mass of demand from one type of participants. They can also try to use subsidies to get one or both types of participants on board subject to liquidity constraints. Contingent contracts provide another potential way to crack the chicken-and-egg problem. Participants on each side enter into contracts to join and use the platform that are triggered by other specified participants on the opposite or same side joining. For platforms in which participants on one side provide specific products or services to the other side, the platform can offer those products or services itself — that is, it can vertically integrate into one side of the platform.

Platforms that cannot achieve critical mass relatively quickly often fail. Initially, the platform gets early adopters, and others who stay with it, in expectation that it will become valuable. Some of them may drop off as they become disappointed. For the platform to reach critical mass it needs to attract more participants, on both sides, than it loses. If that doesn't happen quickly enough, the platform will start losing more participants than it gains and eventually fail. Failure is a common result in practice. The fragility of startups can provide an opportunity for established players to maintain their positions as discussed below.

Critical mass isn't just important for startups. Platforms need to maintain critical mass to remain viable. Indirect network effects can work in reverse. If participants on one side leave the platform it becomes less valuable to participants on the other side. This can lead to a death spiral as more participants desert it and it falls below critical mass. Platforms may adopt business practices to reduce the risk of that happening.

C. Consumer Ability to Use Multiple Platforms and Switch Between Them Is Key

Sometimes it is easy for participants to use several similar platforms. They could switch between them depending upon which has more relevant participants for an interaction, has better prices, or for other competitive reasons. That is known as "multihoming." People have several ad-supported media apps on their smartphones and easily switch between them. Advertisers may be able to reach the same people through different media apps.

In other cases, fixed costs, learning costs, and other costs make using several platforms inefficient so that participants standardize on one. That is known as "single-homing." Most people use a single operating system for their personal computers even though in principle they could have several running on the same machine or have desktop and laptops with different operating systems. App developers can reach those users only by writing to that operating system.

When participants on one side single-home, the platform is the only way to get access to those participants at that time. The platform is a bottleneck and an economically material one if it has captured many of those participants. Participants may still be able to switch to another platform, such as from Windows to macOS, even if they need to single-home. Thus, the competitive importance of single-homing depends on the number of participants covered and their ability to switch.

In the digital economy, platforms often sit on top of other platforms.[9] Foundational platforms are most susceptible to single-homing because they are often based on operating systems and hardware platforms that involve material switching costs. The iPhone, which relies on the iOS operating system and the App Store, provides a foundational platform for apps such as Uber. Users may be able to multi-home on app-based platforms — for example, iPhone users could have Uber and Lyft on their phones; app developers can also develop apps for both iOS and Android.

When users can easily switch between apps or websites it is possible that "competition is only a click away." Of course, the ability to click on an alternative is only one aspect of the ability to multi-home which would therefore require deeper consideration in an actual case.

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8 Microsoft's efforts to launch its X-box video game console, in competition with the dominant PlayStation console, shows the importance of expectation management, driven partly by a commitment to keeping console prices low, and vertical integration, in which Microsoft bought game publishers and produced its own games. See Evans, David & Richard Schmalensee (2007) *Catalyst Code: The Strategies Behind the World's Most Dynamic Companies*, Harvard Business Review Press, at Chapter 6.

9 See *Matchmakers*, Chapter 3.

D. Ease of Entry Influenced by Critical Mass and Multihoming

The opportunities and obstacles for entry are influenced by critical mass and multihoming considerations in the same way they are for physical platforms. For our analysis of vertical restraints in the digital economy, however, these considerations are worth calling out because of the importance of platform intermediaries and the role of technologies in fostering indirect network effects and the possibility of multihoming.

To secure critical mass, to ignite and grow, an entrant may be able to tap into a large pool of unaffiliated participants when the market is nascent. The entrant, like the incumbent, still has the challenge of convincing many prospects that the platform service has value. As the market matures, and more prospects have selected platforms, the entrant may have to persuade participants on incumbent platforms to consider its platform to build to critical mass.

Entry is easier when multi-homing is possible on both sides. The entrant may be able to get participants on other platforms to try the entrant's platform. Meanwhile, the entrant can perfect its platform and try to build critical mass. Participants on incumbent platforms may be willing to do this because they don't incur any significant switching costs. Even if there are some costs of switching over, they can gain some information on whether the move is worth it.

Entry is harder when there is single-homing on one or both sides. The entrant must convince participants on incumbent platforms to switch, which is hard before it has built critical mass and, even if it has built critical mass, may be hard given the indirect network effect scale advantages possessed by incumbents. The entrant could also tap into participants who haven't committed, which is particularly important in nascent markets where most potential participants haven't joined any platform, or ones who have exited failed platforms.

Vertical restraints, as I discuss below, could be used to convert a market that is naturally prone to multi-homing into single-homing, thereby, making it more difficult for entrants to secure critical mass and for smaller incumbent rivals to maintain it.

E. Platforms Have to Deter Participants from Behaving Badly

Platforms operate communities, in which participants interact with each other and, as in any community, participants may behave badly towards others.[10] Participants can engage in deception, fraud, bullying, hate speech, post porn or other offensive material, breach contracts, and so on. By doing so, these participants impose negative externalities on participants, on the same or other sides, and thereby reduce the value of the platform to its members. These offenses can limit the amount of activity on the platform, the interest of participants to join it, and the amount participants are willing to pay to participate. Platforms have profit incentives to deter these offenses.

Platforms do so by operating governance systems like those run by governments for communities. They have platform rules that prohibit or require certain behavior. They have detection methods, involving software and staff, to ferret out violations of these rules. They impose penalties for breaking the rules as well as screening methods for keeping bad actors off the platform. These governance systems are a distinct feature of platforms. Traditional businesses seldom have such elaborate systems. Platforms need them because of the externalities that can arise from the constant interaction of participants.

Governance systems are particularly common and sophisticated for digital platforms.[11] eHarmony, a dating site, prohibits 17 activities including sending annoying communications or providing misleading information. Amazon's marketplace has a seller code of conduct that includes prohibitions against a variety of behaviors such as trying to damage other sellers or improperly influencing consumer ratings. Google's search engine prohibits websites from many efforts to influence ranking unfairly or essentially gaming its algorithms.

Platforms, including digital ones, have more limited options for penalizing bad behavior by their communities than governments do. They typically enforce rules by excluding participants from the platform. The bans could be permanent or temporary. Google, for example, punishes websites that improperly game the system by forcing them far down the search rankings for some period. Amazon permanently bars sellers who engage in fraudulent behavior. The ban could be full or partial. Digital platforms may decide to ban some content, or apps, from a participant, but not all. Facebook may delete some content that a participant has posted but allow the person to continue to use the social network.

10 Boudreau, Kevin & Andrei Hagiu (2009) "Platform Rules: Multi-Sided Platforms As Regulators," in *Platforms, Markets and Innovation*, Gawer, ed., Edward Elgar Publishing Inc; Evans, David (2012) "Governing Bad Behavior by Users of Multi-Sided Platforms," *Berkeley Technology Law Journal* 27(2), pp. 1201-1250.

11 U.S. Congress encouraged platforms to have these systems when it passed Section 230 of the Communications Decency Act. Section 230 essentially immunized platforms from barring participants, or their content, so long as they were doing so as a good-faith application of their rules. For further discussion see Evans, David (2019) "Deterring Bad Behavior on Digital Platforms," available at SSRN: https://ssrn.com/abstract=3455384.

These governance systems are controversial now because of allegations that platforms have been too lax, thereby permitting too much bad behavior, or too restrictive, thereby preventing free speech. Most of these complaints lie outside of antitrust.[12] The core antitrust issue concerns situations in which the platform also operates a business on one side of its platform and in which the platform has allegedly used its governance system to raise rivals' costs or exclude competitors on that side.

F. Platforms Use Algorithms to Determine What Users See

To facilitate interactions between participants, platforms provide search and discovery tools for finding possible partners, as well as targeting methods to present themselves to possible partners.[13] The platform may also show connections on its own based on its predictions of participants' value from being exposed to those possible trading partners. Digital platforms, more so than others, make heavy use of software-based technologies to perform these functions. These technologies involve algorithms that use data, and statistical methods for learning from that data, to make predictive decisions. Digital platforms also rely on many other techniques. They provide reviews for users and products, tools for participants to display information, and targeted advertising.

Google, for example, uses algorithms to decide which, if any, ads to present on a search-results page following a query. The algorithms predict the likelihood that a consumer who makes that query will find the ad relevant, and useful, and click on the ad. By showing more relevant ads, Google increases the likelihood it will make money from the search engine results page it presents; making the ads more relevant to consumers increases the likelihood they will do more searches.

G. Digital Platforms Are Different from Physical Ones Mainly Because of the Technology

Digital platforms are like physical ones. Getting critical mass is a pervasive problem for platforms. The extent of single-homing is an issue for all. Platform governance systems are common. And they all help participants engage in search and discovery and many try to predict what participants want.

The combination of the Internet, software, data, and information technologies, however, dramatically lowers the cost of starting and scaling a platform, expands the capabilities for matching participants and facilitating exchanges, and increases the ability to collect and deploy data. The combination also makes many new features possible, such as posting feedback.

Of course, digital platforms themselves are highly diverse. Analyzing antitrust, as always, requires a fact-intensive analysis concerning the circumstances surrounding the complaint and the businesses implicated by it.

III. ECONOMIC ANALYSIS OF VERTICAL RESTRAINTS FOR DIGITAL PLATFORMS

There is a vast economic literature on vertical restraints as well as a long history of cases. Most of this work was developed for the physical world. There are many situations in which the literature and precedent applies directly to the digital world. There is no obvious difference between a manufacturer entering into resale price maintenance agreements with digital intermediaries versus physical distributors. Some details may differ, but they always do between matters.

There are, however, situations in which differences involving digital technologies are important. Physical retailers, for example, use data to make decisions on where to place their own and other's products. But the sophistication and power of the algorithms and the ability to vary product placements in virtually real time, over Internet connections, can make digital retail much different from physical retail.

The big difference between the digital and physical world, however, concerns the role of intermediaries and multisided platforms. Given the opportunity to develop large digital distribution platforms, cases involving manufacturers imposing vertical restraints on distributors are likely to be less important than cases involving distributors imposing vertical restraints on participants.

The economic literature on vertical restraints for single-sided firms has insights for multisided ones but one cannot assume that the models and results necessarily apply without modification. That is true for the physical platforms too. The issue becomes more important in the digital world where there are more platforms, and these platforms are powered by Internet and related technologies, and likely more cases in which this issue comes up.

12 See Evans, "Deterring Bad Behavior on Digital Platforms," *supra.*

13 Varian, Hal (2019) "Artificial Intelligence, Economics, and Industrial Organization," in *The Economics of Artificial Intelligence: An Agenda*, A. Agrawal, J. Gans & A. Golfarb, eds., University of Chicago Press.

This section runs through some of the key considerations regarding vertical restraints involving digital platforms. Similar factors apply to digital resellers, at least to some degree. These are early days, and as we get more experience with cases this list will surely grow longer and more nuanced.

A. Claims Could Involve Horizontal or Vertical Foreclosure

Digital platforms compete horizontally with other platforms to get both types of participants to join and use them. Apple's iPhone platform and Google's Android platform compete for users, beginning with buying a smartphone, and developers writing apps. A dominant platform could face claims that it has imposed vertical restraints that limit competition between the platforms. In the smartphone case, a claimant might argue that practices that limit interoperability and portability for users and developers are anticompetitive vertical restraints.

Digital platform owners may also compete with some of their participants. Google, for example, offers services on its search engine results page, such as Google Shopping, that compete with services provided by other comparison-shopping platforms which participate in Google's indexing and ranking service. The European Commission claimed that Google engaged in various practices that disadvantaged some of those websites.

There is another dimension of competition for some e-commerce properties. The property may operate an online marketplace, which is a two-sided platform for buyers and sellers, as well as an online store, which operates under a traditional reseller model. Both, of course, rely on Internet technologies, algorithms, and other innovations involving the digital economy. In addition, e-commerce properties may offer private-label products in competition with sellers on its online store and marketplace. Amazon and Walmart, which operate the first and third largest e-commerce platforms in the U.S., both do so.[14]

B. Antitrust Claims Face Usual Issues of Incentive and Ability to Foreclose Competition

Vertical restraints for digital businesses pose the same basic analytical question as for physical ones. Does the business have the ability and the incentive to engage in the practice to foreclose competition? Addressing this question for digital platforms raises the same issues as for physical platforms. The analysis, however, must account for the relevant facts some of which may be particular to the digital world. Market definition, which is not the subject of this paper, should help inform whether the digital business has the ability and incentive to foreclose competition through a vertical practice.[15]

Whether the digital platform can foreclose competition through vertical restraints will typically depend on whether it can limit access to a substantial group of participants on one or both sides of the platform. It usually wouldn't be able to do so if the platform is small relative to the overall market served or if the market is nascent, and most potential participants on both sides haven't joined, so there is plenty of opportunity for entry.[16] A ride-sharing platform may have a small fraction of the drivers and riders who have joined platforms, or it may be operating during a stage of development where there is large untapped pool of both drivers and riders.

The ability of a platform to limit access would depend on the extent to which participants multi-home and, if they single home, how easily they could switch to another platform. This list isn't exhaustive. There may be other factors, including technological ones, that influence whether the platform can prevent access. A ride-sharing platform, for example, could impose an exclusivity provision on drivers but it might be difficult to monitor and enforce compliance.

Whether the digital platform has the incentive to foreclose requires weighing the benefits of foreclosure, including the likelihood of succeeding and securing profits that it wouldn't in the absence of the vertical practice, against the costs, including forgone earnings from participants subsequent to the restraint. The analysis of these issues requires the consideration of the two-sided features of the platform including

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14 eMarketer, "Digital Investments Pay Off for Walmart in Ecommerce Race," February 14, 2019, https://www.emarketer.com/content/digital-investments-pay-off-for-walmart-in-ecommerce-race.

15 The two-sided platform literature shows that profits, and thus to ability to increase those profits through higher prices, are determined at the platform level as a result of the interdependencies between the two sides and the need to balance their prices. Depending on the jurisdiction and type of platform under consideration the courts may prefer to define markets at the platform or side level. In the U.S. the Supreme Court ruled that the market should be considered at the platform level when indirect network effects are more than minor (the American Express credit card network) for a matter involving vertical restraints (rules that prohibited merchants that accepted the American Express card from then steering consumers who tried to use the card to competing card networks). *Ohio v. American Express Co.*, 138 S.Ct. 2274 (2018).

16 Digital platforms serve diverse sets of customers. Depending on the matter the relevant antitrust market, and the focus of the analysis, could be a segment of the platform rather than its entirety. To simplify the discussion this paper refers to the platform generally.

feedback between the two sides. If a vertical practice results in the loss of some participants on one side, for example, that may reduce the value to the other side, and thereby may increase the costs of engaging in the practice. As with ability, assessing whether there are incentives generally entails fact intensive inquiry, and the details will vary across platforms and practices.

Several features of a digital platform could enhance its ability and incentive to foreclose competition and therefore warrant close examination in cases. A digital platform may capture a substantial portion of potential participants as a result of indirect network effects facilitated by the Internet and related technologies. The platform does not have to be the first mover — just an early mover that got to critical mass early and grew at an accelerating clip after that. The digital platform has at least some control over access to participants on both sides. It therefore has a set of relationships that it could use to foreclose competition for existing or new platforms.

Anticompetitive strategies wouldn't be necessary if indirect network effects made it hopeless for smaller platforms to challenge dominant incumbents. Like all businesses, however, platforms can compete in the face of scale advantages by differentiating themselves. They can try to appeal to particular types of users, on either side, by catering to their different tastes (horizontal differentiation) or focus on particular degrees of quality and price (vertical differentiation). By specializing in these ways, platforms can create value that mitigates their smaller scale. In addition, when consumers can multi-home, or readily switch between digital platforms, the indirect network effects for the leading platform are not necessarily durable. Rivals could pick off participants from the leading platform. Just as indirect network effects accelerated growth for the leading platform, they can also accelerate decline.

As a result, the leading platform cannot just count on its size to keep the market to itself. It therefore may have incentives to foreclose platform rivals despite the advantages it has secured from indirect network effects. The need for rivals to achieve critical mass to attain sustainable growth may provide the leading platform the ability to act on these incentives and foreclose actual or prospective rivals. It can look for strategies that prevent these rivals from securing enough participants on one or both sides. That could include protecting itself from vulnerability arising from the ability of participants to multi-home across and switch between platforms. It could use the standard set of vertical restraints to do so.

Digital platforms could enlist their algorithms for exposing participants on one side of the platform to those on the other. A platform, for example, could condition the extent of exposure of participants on one side to trading partners on the other side based on their degree of loyalty to the platform. It could do this as part of negotiations to get participants to enter into agreements that contain vertical restraints. To obscure its strategy, it could also reduce exposure for participants that refuse to enter vertical restraints rather than refusing them to join the platform. A digital platform that offered a service on its platform that competed with a particular participant could use algorithms to reduce the exposure of that participant to the other side of platform.[17] Doing so could obscure its exclusionary strategy and make it harder to establish than simply refusing to allow the rival participant on the platform.

Digital platforms could enlist their governance systems in vertical restraint strategies. Consider the situation in which the platform also competes with a participant. It could use its governance system to exclude that participant or impose costs on that participant that it doesn't incur. These efforts may be less transparent than a direct denial of access. A platform could also enforce its governance system more strictly for participants who do not agree to vertical restraints that are designed to foreclose competition by rival platforms.

C. Vertical Practices by Digital Platform May Increase the Value of the Platform for Participants and Therefore be Pro-Competitive

The mere prospect that a digital platform could use vertical restraints to harm competition does not mean that it is necessarily doing so. As with vertical restraints generally, the platforms may have imposed the vertical restraints to enhance efficiency, such as by dealing with principal-agent or free-riding issues. The vertical restraint may foreclose competition in the sense that whenever a business offers a better product, or does so more efficiently, it secures an advantage over its rival. The challenge, as with all vertical restraint cases, involves distinguishing the pro-competitive use of vertical restraints from anti-competitive ones.

Digital platforms have profit incentives, for example, to design their algorithms to increase the value that participants on each side can secure from interactions with participants on the other side. That typically means either exposing a participant to the most suitable possible matches or providing information that enables the participant to assess their likely value. In doing so the algorithms necessarily downgrade participants who are likely to be less desirable. That can result in some participants not being presented, in effect, to other participants. Most people do not, for example, look beyond the first search engine results page and are much more likely to engage with organic search results and paid ads that are higher on the first page.

17 That was the main allegation in the Google Shopping matter. See European Commission, Case AT.39740, Brussels, June 27, 2017, C(2017) 4444 final. Available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/39740/39740_14996_3.pdf.

To take another example, as we saw above, digital platforms have profit incentives to deploy governance systems to weed out bad behavior that can degrade the platform. By doing so, they make the platform more desirable for participants. And a more desirable platform is likely to generate more indirect network effects which increases the value to all participants. Some participants may complain about the rules, because they interfere with their business models, and especially if they are expelled from the platform.

Of course, as with anticompetitive effects, assessing whether practices result in pro-competitive efficiencies, generally requires a fact-intensive analysis tailored to the circumstances of the matter. And any pro-competitive benefits need to be weighed against anti-competitive costs when the businesses engaging in the conduct has significant market power.

D. Digital Platforms Require Two-Sided Analysis to Assess Whether Vertical Restraints Harm Competition

The economic literature on two-sided platforms shows that the analysis of anticompetitive practices should account for a variety of issues that arise from platforms serving interdependent groups of users. Digital platforms raise the same issues as physical platforms, including the assessment of market definition, market power, and anticompetitive effects.[18]

An important insight of the two-sided literature is that practices that cause harm on one side could benefit the other side so that it doesn't cause an overall decrease in welfare. That is consistent with the platform adopting the practice to increase the value of the platform rather than to foreclose competition. It is also possible that the anticompetitive effects of a practice come from the interdependence between the two sides, which might not be detected from looking at each side in isolation. A platform, for example, might be able to impose exclusive contracts that fall below common thresholds used by the courts to assess anticompetitive foreclosure but by imposing these on both sides it makes it hard for an entrant to secure critical mass.

IV. EXCLUSIVE CONTRACTS, GOVERNANCE SYSTEMS, AND MFNS

This section considers three types of matters involving vertical restraints and illustrates them with public information concerning recent cases. Part A considers the use of exclusive contracts by a dominant platform to harm competition with a rival platform. It emphasizes two aspects that are particular to digital platforms: the use of exclusives to prevent rivals from securing or maintaining critical mass or the benefit of indirect network effects; and the role of algorithms in securing loyalty (single-homing) by some participants. Alibaba's use of exclusive contracts for sellers on its Tmall property in China provides an example.

Part B examines the use of governance systems by a dominant platform. It considers the sham use of rules to raise rivals' costs, or exclude, a participant on the side that competes with the platform's own service on that side. Apple's alleged use of its app developer rules to impose limitations on Spotify, which competes with Apple Music, provides an example.

Part C considers the use of MFNs by e-commerce marketplaces and resellers. It focuses on a common situation for e-commerce businesses in which they charge sellers a commission and may have MFNs that apply separately to price and commission. The UK's Competition and Markets Authority investigation of the use of price MFNs by price comparison platforms for insurance provides an example.

Throughout this section we assume that the digital platform engaging in the practice has substantial market power in a relevant antitrust market. In practice, of course, that analysis would need to assess the relevant antitrust market, accounting for two-sided considerations, and determine whether the platform has substantial market power (or is dominant) in that market.

18 Recently, high courts have considered the application of the two-sided analysis to cases. High-court decisions in the United States (*American Express*), the European Union (*Cartes Bancaires*) and China (*Tencent*) have emphasized the importance of accounting for the interdependencies between the two sides, at least in the matters before them. *Ohio v. American Express Co.*, 138 S.Ct. 2274 (2018); *Groupement des Cartes Bancaires (CB) v Commission*, C-67/13 P, EU:C:2014:2204; *Qihoo 360 v. Tencent*, Supreme People's Court of People's Republic of China, Civil Judgment No. Minsanzhongzi 4/2013, October 2014. For a detailed discussion of *American Express* see Evans, David & Richard Schmalensee, *Antitrust Analysis of Platform Markets: Why the Supreme Court Got It Right in American Express* (Boston: CPI, 2019).

A. Exclusive Contracts and the "Cat-and-Dog War" in China

The dominant platform could require some participants on one side, or possibly both, to enter into exclusive contracts for some period. These contracts would deter these participants from multi-homing during that period. That matters in practice mainly in the case in which participants would not find it in their self-interest to single home in the absence of the restraint. The contracts could also deter these participants from switching to a rival platform during that period. The contracts could target all participants on both sides, all participants on one side, or they might target large participants — anchor tenants — on one side. The exclusives could also affect a category of participants, or the platforms that service those participants, that might constitute a relevant antitrust market.

The dominant platform could insist that participants enter into these contracts to operate on the platform. It could provide rewards or penalties for divided loyalties to achieve the same results as an exclusive. The dominant platform could use its algorithms to impose penalties on participants that do not agree to formal exclusives. It could reduce the extent to which non-loyal participants on one side are exposed to participants on the other side or provide loyal participants greater levels of exposure and marketing assistance.

Key considerations for evaluating whether these exclusivity provisions could harm competition include, as is usual, the explicit or *de facto* coverage of the provisions in the relevant antitrust market, the duration of the provisions, and therefore how much of the market is contestable for rivals. This analysis, however, needs to be conducted considering the two-sided features of these platforms. In particular, the analysis should consider the extent to which the exclusivity provisions could prevent: entrants from securing critical mass; smaller incumbents from losing critical mass so that they are no longer viable; and smaller incumbents from capturing indirect network effects that could drive future growth.[19] A further issue is the extent to which participants, forced to single-home, can switch platforms.

Exclusivity agreements could also enhance efficiency. That could be the case for traditional reasons such as preventing free riding on platform efforts, preventing the loss of valuable competitive information to a rival, and aligning platform and participant incentives for mutual gain to name a few. Digital platforms could also raise specific issues that could provide pro-competitive explanations for the practices. The exclusives may help secure and maintain critical mass and thereby provide value to platform participants. Getting key participants on one side to agree to an exclusive could help persuade participants on the other side to join. There could be other reasons why preferential treatment of some participants, in return for loyalty, could increase indirect network effects or reduce negative externalities on the platform. Whether any of these efficiency explanations applies, and the magnitude of the benefits if any, would need to be evaluated.

The Great "Cat-and-Dog War" in China illustrates the potential anticompetitive use of exclusive contracts.[20] Alibaba operates Tmall, whose logo is a cat. Tmall is a B2C marketplace of buyers and sellers for consumer products. It competes with JD.com, whose logo is a dog. JD operates both a reseller model and a marketplace model that enable sellers to distribute products to consumers. Tmall is the leading B2C e-commerce platform in China and twice as large as JD.com: as of 2017 Tmall had a 57 percent share of online retail commerce and JD.com a 28 percent share. Several smaller e-commerce sites accounted for the remainder. Tmall had about an 80 percent share of apparel sales in China compared to about 8 percent for JD.com in the first half of 2017.[21]

Tmall adopted a policy known as "Choose One of Two." It asks sellers to make a choice between Tmall or other platforms. Tmall acknowledges that it has secured a growing number of exclusives but defends its policy: "Like many e-commerce platforms, we have exclusive partnerships. The merchant decides to choose such an arrangement because of the attractive services and value Tmall brings to them."[22] It didn't explain the nexus between the exclusive partnerships and the attractive services or whether additional services were provided in exchanged for the exclusives.

19 A practice that might seem innocuous in a single-sided context could be problematic in a two-sided one because of the role of critical mass in securing ignition.

20 Fox News, "At war with Alibaba: Top brands fight China e-commerce giant," April 22, 2018," https://www.foxnews.com/world/at-war-with-alibaba-top-brands-fight-china-e-commerce-giant.

21 Analysys, "Quarterly Reports of China's B2C Online Market from 2016 Q1 to 2017 Q2, https://www.analysys.cn/article/analysis/detail/1000869.

22 Fox News, "At war with Alibaba: Top brands fight China e-commerce giant," April 22, 2018," https://www.foxnews.com/world/at-war-with-alibaba-top-brands-fight-china-e-commerce-giant.

Tmall apparently does not make signing an exclusive contract a condition of operating on its platform. Instead, according to numerous merchant interviews reported in the press, and lawsuits filed against the company, Tmall retaliates against sellers that refuse to enter exclusive deals in ways that reduce their visibility and sales. Five large American consumer brands claim that they experienced a sharp drop in traffic to their storefronts on Tmall. According to one article, "Executives said that after they rebuffed Alibaba, their brand's banners vanished from prominent spots in Tmall sales showrooms and products stopped appearing in top search results."[23]

In June 2017, many apparel merchants complained that Tmall requested them to withdraw from other e-commerce platforms including JD, VIP.com and Dangdang. Some claimed they would lose 30 percent of their sales if they complied. If they refused, however, they would jeopardize the much larger volume of sales on Tmall.[24] Semir, a famous apparel brand in China, shut down its flagship store on JD in September 2017 despite having realized substantial growth on this competing platform.[25] JD.com claimed that as of early 2018 that more than 100 Chinese brands had defected in 2017.

Galanz, which sells home appliances, asserted that during the "6.18" promotional festival in 2019 Tmall attacked six of its core stores through the manipulation of algorithmic results, in retaliation for refusing Tmall's request that Galanz withdraw from the competing Pinduoduo platform. According to Galanz, Tmall excluded its stores from search results and did not display rankings that buyers relied on.[26] As a result, Galanz claims its store sales declined by between 40 to 90 percent compared to the previous year.[27]

Tmall's efforts to secure exclusives have attracted antitrust lawsuits by competing e-commerce intermediaries. JD, joined by Pinduoduo and VIPshop, have sued Tmall for abuse of dominance in Beijing High People's Court. Galanz, as a platform participant, has also sued Tmall for abuse of dominance in Guangzhou Intellectual Property Court.[28] These cases are interesting because they involve one of the largest e-commerce properties in the world, Alibaba, and concern the use of algorithmic methods to, according to the complaints, secure explicit or de facto exclusives.

While there may be pro-competitive explanations for exclusive contracts, they pose some risks for competition when they are used by dominant digital platforms. Consider the situation in which the dominant platform accounts for the preponderance of buyers in a relevant antitrust market. Sellers could lose access to most customers if they refused to agree to an exclusive. As more sellers enter exclusives, buyers will tend to see the dominant platform even more. As the smaller platform loses sellers it will lose buyers which will make it even less attractive to seller. That could further entrench the dominant platform. The smaller platform may remain viable but limited in its ability to grow and compete. Platforms that haven't reached a critical mass, and are not yet viable, may not be able to do so and, considering that, entrepreneurs and investors may decide not to enter.[29] Of course, whether the exclusives are extensive enough to cause these effects is an empirical matter.

A successful anticompetitive strategy can harm both buyers and sellers. To begin with, both lose the opportunity to multi-home on several platforms — options they would presumably have in the absence of exclusive contracts. Multi-homing intensifies competition along non-price dimensions such as service and discovery mechanisms. The exclusivity agreements can also raise prices. By limiting competition, the dominant platform can increase the commissions it charges sellers for distribution on its platform. Those sellers may pass some, or possibly all, of those increased commissions back to consumers in the form of higher prices. Depending on the jurisdiction, the competition authorities and courts may require evidence that these effects have occurred, or just that there is material risk they would occur.

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23 Fox News, "At war with Alibaba: Top brands fight China e-commerce giant," April 22, 2018," https://www.foxnews.com/world/at-war-with-alibaba-top-brands-fight-china-e-commerce-giant.

24 "Choose One of Two on '6.18': Exclusive Dealing Requested by Tmall Led Big Damage to Online Merchants," Southern Metropolis Daily, July 12, 2017, https://tech.qq.com/a/20170712/020103.htm.

25 Xie Yunzi, "Overall Increase of Semir Encumbered by its E-Commerce Business, or Due to the Closure of JD Channel," China Entrepreneur, November 7, 2017, http://www.sohu.com/a/202831895_115280.

26 Qian Lina, Shi Dan, "Galanz Fight against Tmall, Why the E-Commerce Law Failed to Regulate the Either-Or Policy," Commercial College, June 20, 2019, available at https://t.cj.sina.com.cn/articles/view/1678512213/640c105500100gwvw?from=tech&subch=internet.

27 Yang Qian, "Galanz Fight against Tmall," China Enterpreneur, June 20, 2019, http://www.iceo.com.cn/com2013/2019/0621/306237.shtml.

28 "Galanz Sues Tmall for 'Pick 1 of 2', Lawsuit Accepted by Court," NetEase Technology, November 5, 2019, https://tech.163.com/19/1105/12/ET7GGLF0000999LD.html.

29 Successful anticompetitive exclusionary conduct various categories for a platform could harm overall platform competition, to the extent for example that consumers prefer platforms that give them access to multiple categories, and thereby harm competition in categories not subject to the exclusives.

B. Governance Systems and the Music Wars

The previous example concerned the possible use of exclusive contracts to harm competition by a rival platform. A governance system provides a way for a platform that provides a service on one side of the platform to harm rivals that depend on its platform to provide their services to the other side of the platform. Participants may expend resources complying with these rules. The platform could make those costs higher for a rival — that is, engage in a raising rival's cost strategy — by applying the rules more strictly with rivals or demanding costly modifications in a discriminatory way. The platform probably has rules in place that enable it to block participants from joining the platform or to kick participants off. It could therefore simply deny rivals access to its platform. Of course, the platform could simply deny rivals access without invoking its rules, but it could cloak its motives by the sham use of governance. Rivals may not know, or be able to prove, that the platform has discriminated in applying the rules to harm them.

These cases raise the usual issues involving the use of vertical restraints to harm upstream or downstream competition. The platform benefits from the participation of firms who increase the value of the platform, including driving indirect network effects, and may provide a source of revenue. It must therefore weigh the increased profits from harming competition by the rival on one side against profits lost to the platform. That calculus depends on factors such as the extent to which customers of the rival would move to other platforms, rather than switching to the platform's competing offering.

There may be situations in which it is possible to establish that a platform has the financial incentives to harm a rival. The platform could be essential for providing access to a large base of customers for the rival and the rival could lack practical alternatives to bypass the platform. A specific category might constitute a relevant market and destroying rivals in that category might enable the platform to secure monopoly profits that more than offset its losses from these rivals.

Aside from the standard pro-competitive explanations for vertical restraints on rivals, however, it is possible that the platform is simply applying its governance rules neutrally to mitigate negative indirect network externalities. That is apparent in the case of egregious violations of rules. Even if the platform had financial incentives to harm a rival it would appear unexceptionable if it expelled a rival that engaged in fraud or facilitated sex trafficking. The difficult cases are where there is more room for judgment on whether the rival violated the rules, the seriousness of those violations, and whether the application was indeed neutral.

That brings us to the music wars. Apple has provided an app development platform for the iOS operating system for its iPhones since 2008. Developers can use that platform, including various tools, to write apps that make use of the operating systems and hardware features of the phone. Apple has also provided an exclusive distribution vehicle for those apps. Developers can make their apps available in the App Store and iPhone users can download apps from there. There is no other practical way for developers to distribute apps to iPhone users or for users to obtain iPhone apps. Developers also write apps for the Android operating system but that doesn't give them access to iPhone users unless those users switch platforms.

Apple has extensive guidelines for developers amounting to about 12,000 words that lay out what they must and must not do. There is a vetting process for accepting apps, or modifications of apps, for distribution through the App Store, which is based on these guidelines and Apple's judgment concerning the quality of the apps. There is also a set of rules for apps distributed in the App Store. Apple can remove apps from the App Store for violating these rules and expel their developers from the Apple Developer Program. There isn't much controversy that Apple's rules have enabled it to create a high-quality app ecosystem for the iPhone.

That doesn't mean, however, that Apple couldn't abuse these rules. Spotify claims that Apple has. Apple became the leading provider of downloadable music following its introduction of the iPod and the iTunes store in the early 2000s. Over the 2000s many people switched listening from CDs to downloads. When Apple launched the iPhone in 2007 it emphasized that the device combined an iPod, a phone, and a computer. It included an iPod app on the home screen.

Over the next decade, however, music streaming services such as Pandora, Spotify, Deezer, and others entered. Music consumption shifted to streaming and downloads declined sharply. Recognizing this, Apple launched Apple Music in 2015, which was a direct competitor to Spotify's premium service. It included Apple Music on the iPhone home screen and promoted it heavily to iPhone users.

Spotify filed a complaint with the European Commission in March 2019.[30] The following discussion is based on public statements it has made about this that relate, in particular to the application of Apple's App Developer rules. Spotify says that Apple "introduced rules to the App Store that purposely limit choice and stifle innovation at the expense of the user experience — essentially acting as both a player and referee to deliberately disadvantage other app developers."[31] It claims that Apple "frequently decides to interpret (and reinterpret) [its rules] in ways to disadvantage rivals like us."[32] The problems worsened after Apple launched Apple Music: "Now that Apple has Apple Music, rejections of the Spotify app start becoming more and more common and they even go far as threatening to remove us from the App Store. Those rejections seem to coincide with our promotional campaign seasons."[33] Spotify says the rules apply differently to Apple which it claims sends out the same type of promotional push notifications that rivals are barred from doing.

Apple charges a commission fee for all paid apps and for digital content purchased within apps that are distributed through its App Store. Some of Spotify's complaints concern alleged efforts to avoid the commissions for its premium service.[34] For its part, Apple accuses Spotify of seeking a free ride: "After using the App Store for years to dramatically grow their business, Spotify seeks to keep all the benefits of the App Store ecosystem … without making any contributions to that ecosystem."[35] That argument, however, cuts both ways. Spotify has benefited from distribution of its free app, on which it does not pay commissions, to iPhone users. Spotify and other apps, however, have also contributed to the iPhone ecosystem, and Apple's profits, by encouraging users to get and use iPhones. In addition to the free-riding argument, Apple denies that it blocks access for Spotify's apps and updates.

At the end of 2019, 11 years after its launch, Spotify had 100 million subscribers globally while Apple Music had 60 million, 4 years after its launch.[36] In the U.S., Apple has nudged ahead of Spotify in terms of paid subscribers. Both compete for listeners with their streaming music providers using various models. The case is particularly interesting because of the increased use of smartphones for consuming content and the battle over music listening which is a large and important category.

A successful strategy to harm competition could injure consumers who would have less choice and pay higher subscription fees and possibly music labels who would face an intermediary with greater bargaining power. An intervention into the neutral application of a governance system, that promotes platform quality and value, could also harm consumers and music labels. As a general matter, permitting the anticompetitive or prohibiting the procompetitive use of governance systems could both impose substantial harm to the platform ecosystem — the former by weaponizing the governance system to harm competition by rivals and the latter by weakening the ability of the governance system to deter bad behavior by platform participants.

C. MFNs and Price Comparison Sites

There is an extensive literature and body of caselaw involving Most Favored Nation ("MFN") clauses in contracts. Some new issues arise for digital platforms and resellers because of their widespread use of commission models. The digital intermediary charges a commission rate as a percent of the sales price, keeps the commission rate times the sales price, and pays the remainder to the seller. The commission rate is the price for distribution through the intermediary.

The contract between the digital intermediary and the seller may specify the commission rate and the price that the seller offers the product to consumers. The contract may also impose MFNs on the commission rate, to make sure it gets the highest offered fee for distribution, and the lowest price, to make sure it isn't undercut by competing intermediaries. As a general matter this does not necessarily cause any concerns.

30 Spotify, "Consumers and Innovators Win on a Level Playing Field," March 13, 2019, https://newsroom.spotify.com/2019-03-13/consumers-and-innovators-win-on-a-level-playing-field/.

31 *Id.*

32 Time to Play Fair, "A Timeline: How we got here," https://www.timetoplayfair.com/timeline/.

33 *Id.*

34 Digital apps can avoid paying commissions by having users subscribe outside of the App Store such as on a website and then using their credentials to use the app on the iPhone. Amazon, for example, does not make it possible for its app users to buy digital content, such a e-books or video, on which it would have to pay commissions, but does make it possible for its app users to buy physical goods, for which it does not have to pay commissions.

35 Apple, "Addressing Spotify's claims," March 14, 2019, https://www.apple.com/newsroom/2019/03/addressing-spotifys-claims/.

36 Digital Trends, "Apple Music vs. Spotify: Which service is the streaming king?" November 11, 2019, https://www.digitaltrends.com/music/apple-music-vs-spotify/.

It can, however, when the contract is with a dominant intermediary for a category. The problem arises when the MFNs apply to the price and commission rate separately. Suppose a smaller intermediary offers the seller a lower commission rate but in return for a lower price that, on net, provide the seller with a higher net margin on sales. The smaller intermediary does this to secure a competitive advantage over the dominant intermediary. It takes a lower margin but makes more sales. The seller and the smaller intermediary both find this deal profitable as it now stands.

Given the MFN, the dominant intermediary, however, can demand the lower price without having to agree to the lower commission. Unlike a regular MFN, it isn't getting equality with the seller — it is securing a position of superiority — resulting in an "MFN-plus." This MFN can lead to a problem for the rival intermediary as well as the seller who made the offer. The seller provides the lower price to the larger platform but without getting the lower commission rate in return and thereby incurs a financial penalty for entering into the deal with the smaller intermediary. Meanwhile, since the dominant intermediary matches the smaller intermediary's price and secures a higher margin, the smaller intermediary loses the competitive advantage it sought. The dominant intermediary, however, does earn a lower margin than it did before, when it exercises the MFN, because it earns the same commission rate but on a lower price.

The MFNs by the dominant intermediary, however, could prevent the smaller intermediary from making the offer to the seller or the seller from agreeing to take it. The MFN-Plus could deter the smaller intermediary from making the offer since it could end up taking a smaller commission rate but not getting additional sales since it would not have secured a competitive advantage. And it could deter the seller from taking the offer because it could lose substantial revenue by having to extend the low price to the dominant intermediary. Of course, the extent to which these incentives not to offer the low-priced deal depend on the facts of the matter including the size of the dominant intermediary.

The UK's Competition and Markets Authority ("CMA") encountered this situation.[37] Price comparison sites provide a marketplace in which automobile insurers can sell and automobile owners can buy car insurance. Between 55 and 65 percent of new policies are sold through these sites. The insurers set a premium and the sites collect a commission rate on the premium. The large comparison sites entered into contracts with insurers that had a price MFN but not on the commission rate.

The CMA found evidence that some price comparison sites could not get insurers to agree to lower prices in exchange for lower commissions and that the inability to adopt the lower commission/low price strategy deterred entry by price comparison sites. It also found that the MFNs reduced commission competition as well as incentives to offer valuable features, such as fraud detection, in return for lower premiums. Ultimately consumers lost from the MFNs because they didn't get the benefit of lower insurance prices. Of course, these conclusions were reached following a thorough investigation into the facts.

V. CONCLUSION

Vertical restraints in the digital world are an active area for competition authorities and private complainants and litigants. That is because of the rapid growth in the digital economy, the proliferation of digital platforms and resellers as intermediaries, the fact that some of these intermediaries also participate as sellers, and the tendency of large intermediaries to enter across many areas. If anything, this growth is likely to accelerate in the coming years as a result of the continued integration of the digital and physical economies, which will be further spurred by widespread deployment of 5G technologies.

Analyzing vertical restraints is seldom simple. It is no easier, and arguably more complex, in the digital world. There are opportunities for engaging in anticompetitive behavior especially in ways that, given the use of algorithms and governance systems, may be less transparent, and harder to prove, than in the physical world. But at the same time there are many compelling sources of efficiency which courts and competition authorities would not want to disturb. As noted above for governance systems, the costs of false positives and false negatives may both be high.

The digital world does not appear to be one in which presumptions are very powerful, aside from the usual one that anticompetitive behavior generally requires substantial market power in a relevant antitrust market. Determining whether vertical practices are anticompetitive, innocuous, or procompetitive on balance requires a fact-based analysis informed by sound economics, particularly the modern economic analysis of multisided platforms. Given possibly large and symmetric error costs the payoffs to methodical economic and empirical analysis are substantial.

37 Competition and Markets Authority, "Private Motor Insurance Market Investigation," March 2015.

VERTICAL AGREEMENTS UNDER THE UK COMPETITION ACT 1998: PAST, PRESENT, AND THE POST-BREXIT FUTURE

BY ALISON JONES[1]

1 Professor of Law, King's College London. This paper is based on a chapter prepared for publication in B Rodger, P Whelan and A MacCulloch (eds), *UK Competition Law: A Twenty-Year Retrospective*, forthcoming Oxford University Press, 2021.

I. INTRODUCTION

This paper charts the development of UK competition law and policy towards vertical agreements over the 20 years since the Competition Act 1998 ("CA98") came into force in March 2000. It notes, focusing on Chapter I of the CA98,[2] that the policy has progressed from a laissez-faire approach to a more interventionist one, closely aligned with EU law. Indeed, since 2005 UK law has closely followed EU jurisprudence, even where the latter has been significantly shaped by EU internal market considerations. UK authorities have, however, also analyzed a number of vertical restraints which have not yet received significant attention in jurisprudence at the EU level.

The paper then goes on to consider the changes that will, and could, occur in 2021 following the UK's final departure from the European Union at the end of the transition period. An important issue considered is whether, post-Brexit, the UK authorities should continue to follow EU competition law in this sphere, which has in significant respects been influenced by internal market considerations, or whether it should take a different course.

II. EVOLUTION AND DEVELOPMENT OF THE LAW

A. Enactment of the Competition Act and the Verticals Exclusion Order

At the time of the enactment of the CA98, UK authorities were rarely concerned about vertical agreements in the absence of one of the parties having market power or the existence of networks of agreements. Thus, even though the Chapter I and Chapter II CA98 prohibitions were modelled on Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU") respectively, and designed to be interpreted as far as possible consistently with EU law,[3] the government was unwilling to follow the then strict EU approach to vertical agreements.[4] As a result all vertical agreements were initially excluded from the Chapter I prohibition, other than those that had the effect of fixing resale or minimum resale prices (RPM).[5] Early CA98 vertical cases consequently focused only on RPM, hub and spoke agreements (with a horizontal element), or the scope of the Verticals Exclusion Order (see e.g. *Slack Adjusters*,[6] *Hasbro*,[7] *Lladró Comercial SA*,[8] *Toys & Games: Hasbro UK Ltd., Argos Ltd. and Littlewoods Ltd.*[9] and *Replica Football Kit*[10]).

B. Modernization of EU Law and Removal of the Verticals Exclusion Order

Disquiet about the UK approach soon began to emerge. First, there was concern about the (albeit deliberate) lack of consistency with EU law and the tension it created with the principle of supremacy of EU law,[11] especially when following EU Council Regulation 1/2003,[12] the UK's competition authority, then the Office of Fair Trading ("OFT"), now the Competition and Markets Authority ("CMA"), became obliged to apply Article 101 alongside the CA98 to vertical agreements affecting trade between Member States. Secondly, there was anxiety that the approach might be too permissive so allowing some vertical agreements creating collusion or exclusion risks to go unchecked, and creating a risk of Type II errors (or false negatives). Following consultation and an impact assessment,[13] the UK decided to repeal the exclusion order for vertical agreements with

2 Chapter I is modelled on Article 101 Treaty on the Functioning of the European Union. Broadly, it prohibits agreements etc which have as their object or effect the restriction of competition (CA98, s 2), whilst providing a legal exception for agreements which satisfy specified criteria (CA98, s 9).

3 See CA98, s 60.

4 See e.g. A. Jones, B. Sufrin & N. Dunne, *Jones and Sufrin's EU Competition Law: Text, Cases, and Materials* (Oxford University Press, 7th eds, 2019), Chapters 5 and 11.

5 See CA98. s 50(1) and Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000, SI 2000/310, Arts 2-4 (the exclusion did not apply to the Chap II prohibition).

6 DGFT Decision, *Price Fixing Agreements involving John Bruce (UK) Limited, Fleet Parts Limited and Truck and Trailer Components*, May 13, 2002.

7 DGFT Decision, *Agreements between Hasbro UK Ltd. and distributors fixing the price of Hasbro toys and games*, November 28, 2002. No fines were imposed on the distributors.

8 DGFT Decision, *Agreements between Lladró Comercial SA and UK retailers fixing the price of porcelain and stoneware figurines*, March 31, 2003.

9 DGFT Decision, *Agreements between Hasbro UK Ltd., Argos Ltd. and Littlewoods Ltd. fixing the price of Hasbro toys and games*, November 21, 2003.

10 OFT Decision, August 1, 2003. See also e.g. the CMA's no grounds for action decision in Case CE-9531/11, *Paroxetine*, February 12, 2016.

11 See, e.g. Case 14/68, *Walt Wilhelm v. Bundeskartellamt* EU:C:1969:4 and Case C-360/92 P, *Publishers' Association* EU:C:1995:6,

12 [2003] OJ L1/1.

13 See, e.g. its 2001 White Paper, A World Class Competition Regime Cm 5233, July 2001 and DTI Modernisation – A consultation on the Government's proposals for exclusions and exemption from the Competition Act 1998 in light of Regulation 1/2003, April 2003.

effect from April 2005. This change, combined with the CA98 procedure for parallel exemption from UK competition law for agreements satisfying the conditions of an EU block exemption,[14] laid the foundation for UK competition law to become aligned with the EU's, by then "modernized," approach towards vertical agreements under Article 101 (see the *Guidance on Vertical agreements*[15]). Broadly, under EU law:

- vertical agreements containing restrictions of competition by object are treated with suspicion and as presumptively illegal. Such agreements are assumed to restrict competition appreciably under Article 101(1)[16] and the European Commission's view is that they are most unlikely, and are presumed not, to satisfy the conditions of Article 101(3). Although object restraints are identified only through a flexible characterization process, jurisprudence clarifies that agreements incorporating certain established restraints – including RPM[17] (and online RPM)[18] and territorial restraints[19] – are liable in principle to pursue a restrictive objective;

- numerous vertical agreements which do not contain object restraints benefit from safe harbors, in particular agreements which:

    - have an insignificant – or *de minimis* – effect on competition (likely where the parties' market shares do not exceed 15 percent on the upstream or downstream market[20]); or

    - comply with the conditions for the group exemption from Article 101(1) set out in the Verticals Block Exemption Regulation ("VBER"), currently Regulation 330/2010,[21] which include requirements that (a) the parties' market shares do not exceed 30 percent (Article 3), and (b) the agreement does not contain specified hard-core restraints (closely aligned with object restraints), including RPM provisions and, with limited exceptions, restrictions on the territories into which, or the customers to whom, buyers can sell the product (Article 4); and

- fuller antitrust appraisal is reserved for agreements not falling within these categories.

14 CA98 s10 allows block exemptions to apply to agreements affecting trade within the UK even if they do not affect trade between Member States.

15 See OFT 419, December 2004 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284430/oft419.pdf.

16 Case C-226/11, *Expedia Inc v. Authorité de la concurrence* EU:C:2012:795.

17 See, e.g. Case 161/84, *Pronuptia de Paris v. Schillgallis* EU:C:1986:41, para. 25.

18 See, e.g. Case AT/40.465, *Asus*, September 26, 2018, IP/18/4601.

19 See, e.g. Cases 56 and 58/64, *Établissements Consten S.à.R.L. & Grundig-Verkaufs-GmbH v. Commission (Consten and Grundig)* EU:C:1966:41, Case C-439/09, *Pierre Fabre v. Président de l'Autorité de la concurrence* EU:C:2011:277 and Case AT40428, *Guess* December 17, 2018. A restraint on a distributor outside of the EU from selling into the EU is unlikely to restrict competition by object, but a broad inquiry would be necessary to determine if it might have an appreciable effect on competition in the EU or trade between Member States, see Case C-306/96, *Javico* EU:C:1998:41.

20 European Commission's Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union (*De Minimis* Notice), C(2014) 4136 final.

21 [2010] OJ L102/1.

C. Resale Price Maintenance and Online Selling Restraints

Following these changes, many UK cases have focused on agreements containing "severe" by object restraints, such as online pricing or selling restrictions. Although e-commerce has rapidly transformed distribution and retailing methods and, arguably, can exacerbate free riding risks,[22] the CMA has treated online RPM in the same way as other cases of RPM, so manifesting its concern that e-commerce can enhance the effectiveness of RPM, especially by making monitoring easier. Decisional practice establishes that the CMA generally treats online RPM, restrictions on online advertising of prices or online selling, as serious infringements of the CA98 which are likely to attract fines,[23] see e.g. *Fender Musical Instruments*,[24] *Casio Electronics*,[25] *Foster Refrigerator UK* (*Commercial Refrigeration*),[26] *Roma Medical Aids Ltd.*,[27] *Pride Mobility Products Ltd.*,[28] and *TGA Mobility Ltd.*[29]

A particularly contested case involving online selling was *Ping*.[30] In this case Ping prevented retailers from selling its golf clubs online. Ping contended that as the policy was designed to protect its brand, it did not infringe the CA98 (or Article 101). Rather, the restraints on internet selling were justified because they pursued legitimate aims – to confine sales of Ping products to brick and mortar stores that could increase club quality and consumer choice by providing buyers with custom fitting and to prevent freeriding. Further, that given the high levels of interbrand competition, customers that wished to buy golf clubs without custom fitting could easily purchase a different brand.

The CMA, whose decision was upheld by both the CAT[31] and Court of Appeal,[32] rejected these arguments finding that the prohibition of online sales restricted competition by object. It eliminated a modern means of distribution incentivizing and enabling retailers to attract, and consumers to purchase, a product outside of their normal catchment area.[33] Further, it found that the ban was not necessary and proportionate to the commercial aim of promoting in-store custom fitting – clubs could be, and were, sold online without a custom fitting. Rather, other less restrictive, technically achievable, and viable alternatives were available to meet Ping's legitimate objectives.

Although the approach adopted by both the CMA and courts in this case contained differences, they all followed, without expressly acknowledging the internal market perspective, the hardline attitude towards territorial restraints and prohibitions, or limitations, on parallel trade between Member States set out in EU law and manifest, for example, in the Court of Justice's 2011 judgment in *Pierre Fabre*.[34] Because such restraints impinge on market integration goals,[35] they are almost invariably considered to be incompatible with EU competition law, irrespective of any efficiency or other justification for the agreement. Further, the promotion of online sales is considered to be "extremely important for the internal market in Europe because it broadens the market, improves the choices for customers, and generally speaking, enhances competition."[36] Under EU law, therefore, online selling can be restricted only in exceptional circumstances.

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22 Especially where consumers rely on retail services – e.g. in the case of complex products, experience goods, or one-off purchases of durable goods.

23 Unless resulting from a small agreement between SMEs, CA98, s 39(3), applied in the cases of *Pride* and *Roma*, notes 27 and 28.

24 Case 50565-3, 20 January 2020. See also Case 50565-4, *Synthesizers and high-tech equipment*, June 29, 2020, Case 50565-5, *Electronic drum sector*, 29 June 2020 and 50565-6, *Digital keyboards and guitars*, July 17, 2020.

25 Case 50565-2, August 1, 2019.

26 Case CE/9856/14, May 24, 2016.

27 Case CE/9578-12, August 5, 2013.

28 Case CE/9578-12, March 27, 2014.

29 Case 50469, October 19, 2017.

30 Case 50230, August 24, 2017.

31 Case 1279/1/12/17 *Ping Europe Ltd. v. CMA* [2018] CAT.

32 [2020] EWCA Civ 13.

33 Relying on the Court of Justice's and the opinion of Advocate General Mazac in C-439/09, *Pierre Fabre* EU:C:2011:277.

34 Case C-439/09, EU:C:2011:277.

35 Removal of non-tariff barriers is not sufficient for the full development of parallel trade, arbitrage and changes in distribution across Europe. For complete success it is necessary that producers and distributors do not take actions to avoid or counteract the effects of the Single Market measures.

36 "Interview with Dr. Alexander Italianer, Director General for Competition, European Commission" theantitrustsource April 2011, 1, 6.

D. Price Relationship Agreements, MFNs and Other Distribution Agreements

One problem with the EU system's significant reliance on presumptions of illegality and safe harbors is that, although providing desirable legal certainty where applicable, little jurisprudence post-modernization has emerged to clarify the law in the scenarios where they do not apply.[37] Although case law on effects analysis does exist, it is sparse and now mainly relatively old. Not only is some of the jurisprudence (which reflects a suspicion of intrabrand restraints on rivalry between a supplier's dealers unless objectively necessary to achieve a legitimate objective) difficult to reconcile with the modernized approach reflected in Commission guidelines, but it sheds little light on how Article 101 applies to, for example, price relationship agreements and a number of newer online vertical restraints. In the UK a number of cases have focused on these issues considering: contracts that reference rivals' prices, e.g. where a supplier requires a reseller to set the resale price of its product at a price related to the price set for a competitor's product; and most favored nation clauses ("MFNs") where the supplier constrains its ability to price discriminate amongst customers by promising to treat a customer no less favorably than other customers. These cases have not, however, yet led to a particularly clear picture emerging of how such restraints are to be analyzed.

The approach taken by the OFT in both *Tobacco*,[38] and *Hotel Online Booking*[39] received some criticism for the hardline approach taken. In the former, the OFT controversially found that a series of agreements between two tobacco manufacturers and 10 retailers, under which retailers agreed to set prices for tobacco products in accordance with set "parity and differential" requirements relating to competing linked brands, restricted competition by object, even though it did not find horizontal or vertical price fixing (or other "established" object restraints). In the end, however, the CAT did not have to rule on the correctness of this finding as it set aside the decision on procedural grounds.[40] In the latter, the OFT took the provisional view that agreements between hotels and Online Travel Agents (OTAs, Booking.com and Expedia Inc.), restricting each OTA's ability to discount the rate at which room-only hotel accommodation bookings were offered to consumers, had as their object the restriction of competition in breach of Chapter I CA98 and Article 101 (through limiting price competition between OTAs and hotels). Again, however, the suitability of applying object analysis to these restraints was never fully tested, as the OFT accepted commitments from the parties to change their behavior rather than proceeding to a final decision.[41] Since then the CMA has proceeded with greater caution. A number of investigations into price parity clauses have been closed[42] or conducted in conjunction with exclusivity provisions or within the more flexible forum for market studies or market investigation provisions set out in the Enterprise Act 2002 (EA02).[43]

A handful of UK cases have also raised the compatibility of exclusive distribution, single branding and exclusivity agreements with Article 101 and Chapter I,[44] see e.g. the CMA's case closure in *ATG Media*,[45] the Scottish Outer House Court of Session's judgment in *Calor Gas Ltd. v. Express Fuels (Scotland) Ltd. & Anor*,[46] and the CAT's judgments in *Socrates Training Ltd. v. The Law Society of England and Wales*[47] and *Agents' Mutual Ltd. v. Gascoigne Halman Ltd.*[48] (in the latter it found that exclusivity rules imposed by Agents' Mutual Ltd. when it opened a new online portal, OnTheMarket, for the sale of properties (in competition with Zoopla and Rightmove) were compatible with the CA98).

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37 In particular, the Commission has not adopted either an infringement decision involving an analysis of the restrictive effects of a vertical agreement, or a non-infringement decision or published a "guidance letter."

38 Case CE/2596–03, *Tobacco*, April 15, 2010.

39 Case CE/9320-10, January 31, 2014.

40 Cases 1160–5/1/1/10 [2011] CAT 41.

41 January 31, 2014 (see CA98, s31A). Although the case was remitted back to the CMA after the commitments were quashed, in the end the CMA closed the case on the grounds of administrative priorities,16 September 2015. By this time developments were occurring in other Member States, and within the European Competition Network, see N. Varona & A. Hernadez Canales, "Online Hotel Booking," *CPI Antitrust Chronicle* May 2015 and Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities in 2016, <http://ec.europa.eu/competition/ecn/hotel_monitoring_report_en.pdf.

42 See, e.g. Case CE/9692/12, *Amazon Retail*, November 1, 2013 (investigation closed on administrative priority grounds after Amazon ended its Marketplace price parity policy and informed third party sellers).

43 See, e.g. investigation launched in November 2018 into the use of MFN clauses by comparethemarket.com https://www.gov.uk/cma-cases/price-comparison-website-use-of-most-favoured-nation-clauses, following a 2017 market study, CMA's market study into digital comparison tools, September 2017.

44 The market investigation provisions of the EA02 have also been used to investigate markets in which vertical agreements are prevalent, where access to the market appears to be foreclosed to new competitors, and where use of the CA98 is inappropriate.

45 Case 50408, June 29, 2017. See also *Street Furniture (Outside Advertising)*, 17 May 2012 (investigation into the use of long exclusivity provisions in relation to outdoor advertising closed following assurances by the parties to change their behavior).

46 [2008] ScotCS CSOH1.

47 Case 1249/5/7/16, [2017] CAT 10. See also e.g. Case 1298/5/7/18, *Achilles Information Ltd. v. Network Rail Infrastructure Ltd.* [2019] CAT 20.

48 Case 1262/5/7/16 (T), [2017] CAT 15, aff'd [2019] EWCA Civ 24.

Finally, the OFT and CMA have provided some guidance on when distribution arrangements concluded during an emergency, or a period of crisis, might be compatible with UK competition rules.[49] Indeed, during the Covid-19 pandemic the CMA made it clear that it is unlikely to enforce the CA against business cooperation – including horizontal or vertical arrangements – designed to ensure the supply and fair distribution of scarce products or services affected by the crisis to all consumers if: appropriate and necessary to avoid shortage or ensure security of supply; in the public interest; to the benefit of consumers; and, lasting no longer than necessary.[50] Specific public policy exclusion orders affecting distribution arrangements designed to prevent or mitigate disruption caused by Covid-19 were also made in the groceries[51] and dairy[52] sectors.

III. THE FUTURE

A. Changes Due at the End of the Transition Period

Under the current timetable, the UK will no longer be part of the EU competition system from the end of the transition period on January 1, 2021. Although vertical agreements concluded in the UK which affect trade between Member States will still of course need to comply with EU law,[53] from this point EU law will not be applied by the CMA, EU law will no longer have supremacy over UK law and the CMA will have principal responsibility for investigating agreements that affect trade within the UK, irrespective of whether or not the Commission is also investigating the case.

In addition, the Competition Statutory Instrument[54] amending the CA98 and EA02 will automatically come into force. This retains the VBER in UK law until its expiry on May 31, 2022. Further, the Statutory Instrument reformulates the provision for consistency between UK and EU law in a new Section 60A. This provision allows for inconsistency, and divergence, between UK and EU law in defined cases, including where necessary to reflect developments in the forms of economic activity or generally accepted principles (or the application of principles) of competition analysis.

These developments mean that, over time, the UK has scope, should it wish to do so, to diverge from EU law and practice in this area and to develop an approach more closely aligned with the interests of competition and consumers in the UK.

B. Presumption of Illegality

A first important issue is whether the strong presumption of illegality[55] currently applied to RPM, online RPM, territorial restraints[56] and online selling restraints will remain or even be extended (e.g. to certain price parity provisions such as (wide) MFNs).

Although rules or presumptions of illegality serve important ends in antitrust systems – particularly the attainment of procedural economy and the clear prohibition, and deterrence, of patently anticompetitive behavior[57] – there is some concern that the EU attitude towards vertical object restraints is overly rigid.[58] Indeed, because procompetitive justifications – and an increase in interbrand competition – could be the driving economic motivation for RPM, online sales and territorial restraints,[59] it is arguable that the application of a broad and, in practice virtually irrebuttable, presumption of illegality is unjustified. Nevertheless, the approach, heavily influenced by market integration concerns, remains entrenched in EU, and UK, jurisprudence.

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49 DGFT Decision Memorandum of Understanding on the Oil Fuels in an Emergency, October 25, 2001.

50 See https://www.gov.uk/government/news/covid-19-cma-approach-to-essential-business-cooperation.

51 See https://www.legislation.gov.uk/uksi/2020/369/made.

52 See http://www.legislation.gov.uk/uksi/2020/481/made.

53 An agreement precluding a UK distributor from selling into the EU could, in certain circumstances, affect trade and restrict competition within the EU, see, e.g. *Javico* note 19 and Case C-413/14 P, *Intel* EU:C:2017:632.

54 See the European Union (Withdrawal) Act 2018, European Union (Withdrawal Agreement) Act 2020, the Competition (Amendment etc.) (EU Exit) Regulations 2019, 22 January 2019, available at https://www.legislation.gov.uk/uksi/2019/93/contents/made.

55 Although no absolute or *per se* rule applies against object restraints, a perception has been built that they are most unlikely to be compatible with Article 101.

56 Although some territorial restraints will affect trade and competition within the UK, others may not (e.g. a ban on selling into the EU, but see note 53 and text).

57 See A. Jones & W.E. Kovacic, "Identifying Anticompetitive Agreements in the United States and the European Union: Developing a Coherent Antitrust Analytical Framework," (2017) 62(2) *Antitrust Bulletin* 254.

58 See, e.g. A. Jones & M. de la Mano, "Vertical Agreements Under EU Competition Law: Proposals for Pushing Article 101 Analysis, and the Modernization Process, to a Logical Conclusion," available at https://ssrn.com/abstract=2930943.

59 See literature reviewed in Jones and de la Mano *ibid.*

The rigidity of the approach could be mitigated in the UK, however, if the authorities were more willing to consider the purpose and the context of the agreement before concluding whether object or effect analysis is required and to accept that agreements with the potential to have mixed effects on competition should not fall within the object category.[60] RPM and online restraints should not then be found to restrict competition by object where plausibly necessary to the pursuit of a legitimate procompetitive objective. Further, new restraints should not be added to the object category unless theory or experience justifies a finding that the clauses and context reveal a high probability of anticompetitive effects.[61] This important characterization step would ensure that where, as in a case such as *Ping*, credible efficiency justifications for an agreement exist, the CMA would be required to establish and consider actual or likely anticompetitive effects, as well as proffered procompetitive justifications, prior to the practice being condemned.

C. Verticals Block Exemption or Another Safe Harbor

Another question that will have to be determined is whether a UK specific verticals block exemption should replace the VBER once it expires in 2022. Clearly the EU block exemption provides desirable legal certainty, which is highly appreciated by businesses. An alternative to adopting a specific UK block exemption, however, could be to provide a safe harbor in another way, perhaps through Guidelines explaining that vertical agreements are unlikely, in the absence of object restraints or networks of agreements, to restrict competition if the parties to the agreement lack market power (proxied, for example, by market shares of 30 percent).

Although this latter approach would lack the same legal effect and force of an exemption valued by firms, it would have some advantages over the block exemption approach from a legal coherence perspective. First, one problem with the VBER, which exempts agreements in case they restrict competition, is that they focus attention on the exemption criteria and, implicitly, indicate that an infringement of Article 101(1), and correspondingly section 2(1) CA98,[62] is likely to have occurred. Arguably this contributes to the lack of clarity shrouding the question of how Article 101(1), and Chapter I, analysis is to be conducted, especially given that many agreements satisfying the conditions of the current VBER seem highly unlikely to affect actual or potential competition to such an extent that a negative effect on prices, output, innovation, or the variety or quality of goods can be expected. Guidelines on the interpretation of section 2(1) would, in contrast, help to shed light on how effects analysis under Chapter I is to be conducted in the future. Secondly, Guidelines would be less rigid than block exemptions which provide an automatic exemption for vertical agreements that satisfy its conditions, even if they incorporate restraints that were not specifically considered at the time of the drawing up of the exemption; for example, in relation to the current VBER, restraints on selling on the internet via a third-party platform or market place[63] or price parity provisions and MFNs. Although the benefit of the block exemption can be withdrawn, this can only be done prospectively, and is rarely a priority for a competition authority. In contrast, guidance under section 2 would give the CMA greater flexibility and scope to consider a new restraint and, if appropriate, address it in a decision.

D. Greater Guidance on How Chapter I Applies to Other Vertical Agreements

Another crucial matter is whether future enforcement of the CA98 can help to ensure that the law is developed and elucidated in cases where a safe harbor does not apply. Although concern about the open-textured nature of full antitrust analysis has often led decision-takers to shy away from adopting it, and an anxiety that it will become tantamount to a rule of *per se* legality (given the difficulty it presents for claimants), the UK administrative system provides a flexible forum for the CMA to develop a workable framework for assessing vertical restraints. For example, the UK competition agency's experience with price parity agreements and MFNs under both the CA98 (and the EA02) has allowed it to build experience over time in appraising their mixed effects. If progress is advanced in this way through close analysis and decisions, which are reviewed on appeal, the law could evolve and provide greater clarity to firms.

60 See Case C-67/13 P, *Cartes Bancaires* EU:C:2014:2204.

61 See Jones & de la Mano, *supra* note 58 and Jones & Kovacic, *supra* note 57.

62 See note 2.

63 But see Case C-230/16, *Coty* EU:C:2017:941.

IV. CONCLUSIONS

Since the adoption of the CA98 UK competition law has always taken a hardline approach towards RPM. Following, the withdrawal of the Verticals Exclusion Order many more vertical agreements have been brought within the scope of Chapter I. A core focus of the CMA, and OFT, has been on object restraints. Indeed, all but one of their CA98 infringement decisions adopted in relation to vertical agreements between 2000-September 2020, related to RPM (some with hub and spoke or more serious horizontal aspects), online RPM or restraints on online selling. The other, more problematic infringement decision involved complex, vertical price relationship arrangements but was set aside on appeal (*Tobacco*).

As many other vertical agreements concluded in the UK benefit from safe harbors, relatively few other vertical agreements have been reviewed by the CMA or UK courts. Filling a lacuna left by the European Commission, however, the UK competition agency has taken a close interest in MFNs, especially when used in relation to platforms, examining them, both in the context of the CA98 and the EA02.

Post-Brexit, the UK authorities are likely to be keen to ensure that UK competition law and policy remains fairly closely aligned with EU competition rules which many firms will in any event need to continue to comply with. However, there will be scope for UK law to diverge from EU law over time, where this is thought to be beneficial and necessary to improve law and policy. It seems clear that some improvements could be made, to develop a more coherent framework for the analysis of vertical agreements under Chapter I CA98. For example, a more robust mechanism for identifying object restraints could be adopted. Further, steps could be taken to ensure that clearer guidance is provided on the question of how the restrictive effects and efficiencies of vertical agreements are to be identified and balanced against each other within the CA98 Chapter I framework.

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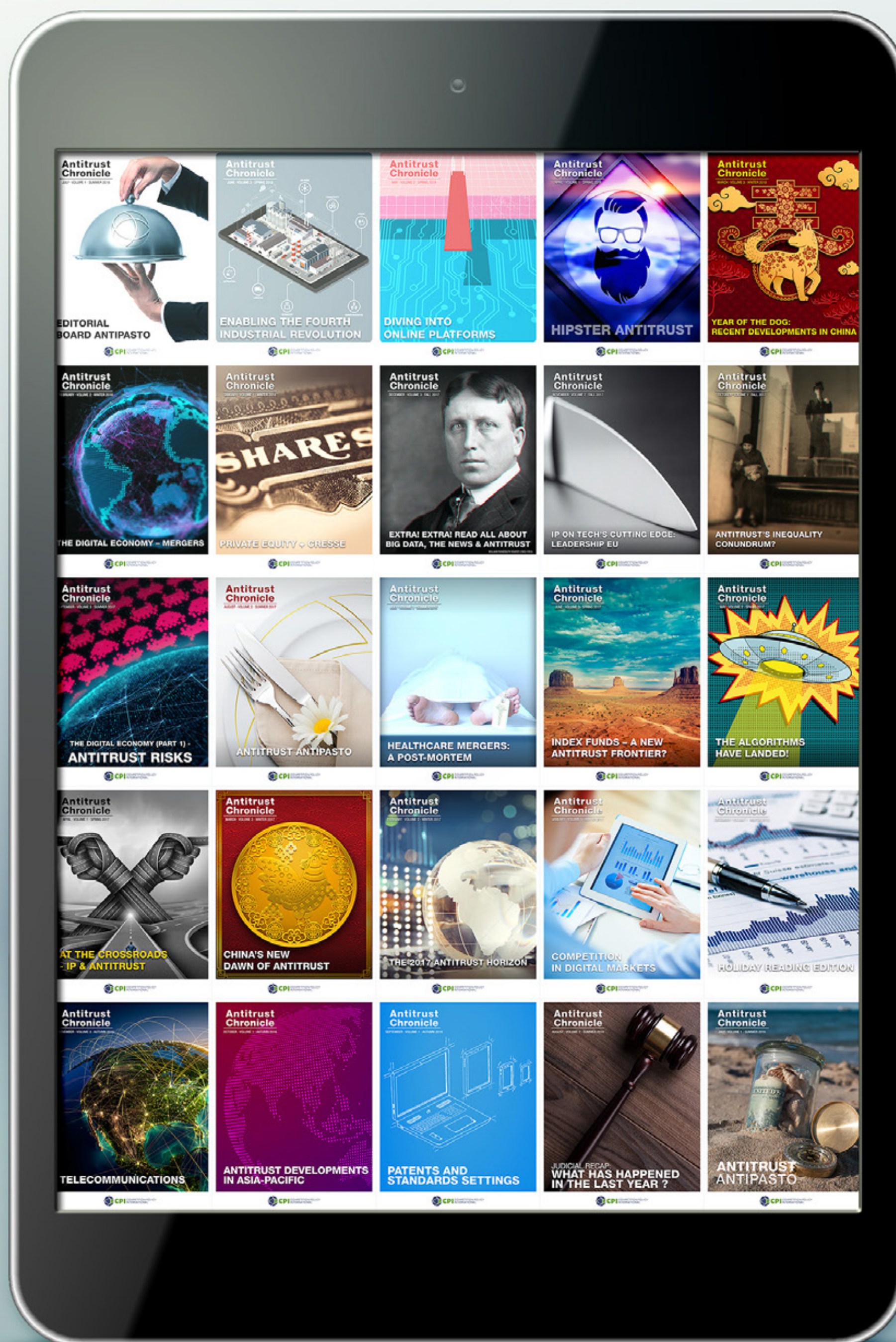

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