ONLINE SALES AND COMPETITION LAW CONTROLS

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Many franchisors may welcome the use of the internet by their franchisees as a means of reaching a wider range of customers and increasing sales revenue. Others may wish to control or limit the extent or way in which their franchisees use the internet. In either case, EU and UK competition rules impose strict limits on the extent to which a supplier can prevent its franchisees and other retailers from selling the franchise or contract products online. Both franchisors and franchisees need to know the extent to which restrictions on online selling infringe the rules. A franchisor should avoid a situation in which restrictive clauses in the franchise agreement are not valid or enforceable against franchisees.

Various decisions by the Office of Fair Trading ("OFT") and related UK competition law developments in 2013 and 2014 have demonstrated the importance attached under competition law to unimpeded internet selling. The Competition and Markets Authority ("CMA"), the successor to the OFT, is carrying out an economic research project monitoring how online trade is working, and is in particular gathering information about how makers of branded clothes and luxury goods are restricting internet retail platforms from selling products online.

On 6th May 2015 the European Commission announced a sector enquiry under EU competition law into the e-commerce sector. The sector enquiry will focus on potential barriers caused by commercial operations to cross-border online selling in the EU, for products for which e-commerce is most used, with electronics, clothing, shoes and digital content given as examples. The knowledge gained from the sector enquiry will probably be used in competition law enforcement, including individual anti-trust cases. Also on 6th May 2015, the European Commission launched a Digital Single Market Strategy, under which a wide range of legislative measures will be proposed to deal with obstacles to cross-border e-commerce trading in the EU. The competition law sector enquiry complements this Digital Single Market Strategy.

So online selling is currently under the spotlight of the EU and UK competition authorities.

The EU competition law position

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distributor must be allowed to use the internet to sell products. For this purpose, the term "distributor" must be regarded as embracing all resellers, including franchisees.

EU law, under Article 101 TFEU, treats selling on the internet as "passive" as opposed to "active" sales. Generally, under the EU competition law regime for vertical agreements, restrictions on active sales can be permitted under the exceptions criteria of Article 101(3) whilst restrictions on passive sales are almost always prohibited. For these purposes, active selling means actively approaching individual customers or potential customers to make sales, whilst passive selling means responding to unsolicited requests or orders from individual customers. The European Commission takes the view that whilst the use of a website may have effects beyond a distributor's or franchisee's own territory, these effects result from the technology that allows easy access to a website from everywhere. Where a customer visits a franchisee's website, contacts the franchisee and makes a purchase, it is considered passive selling from the perspective of the franchisee.

Restrictions on passive sales are regarded as hardcore restrictions or restrictions by object as opposed to by effect. This means that a restriction on passive selling, including a restriction on internet selling, is treated as by its nature infringing the competition rules, without needing to demonstrate that it actually has anti-competitive effects. Restrictions on passive selling are black-listed in the European Commission's block exemption Regulation for Vertical Agreements so that the inclusion of such a clause in an agreement will prevent the exemption that could otherwise apply where all the criteria of the block exemption Regulation are fulfilled. This position was confirmed by the European Court of Justice in a case involving the selective distribution system of Pierre Fabre. Pierre Fabre's selective distribution agreements concerned cosmetics and personal care products and required all sales to be made in a physical space in the presence of a qualified pharmacist. This was held to be a ban on internet selling and was a restriction by object within the meaning of Article 101(1) TFEU and thus infringed the competition rules. The ECJ also stated that the aim of maintaining a prestigious product image was not a legitimate purpose and could not be relied upon to provide any objective justification for such a clause.

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4 Ibid. 
6 Case C-439/09.
The European Commission's current e-commerce sector enquiry will focus on contractual barriers to cross-border e-commerce sales of products and digital content, especially in distribution contracts, which can be taken to include franchise agreements. The Commission has also indicated that geo-blocking of access to websites will be an important aspect, so clauses requiring a reseller to geo-block certain data products or services are likely to come under scrutiny.

**Indirect restrictions on online sales contrary to EU law**

The principles of EU competition law are expanded as they apply to internet selling, in the European Commission's *Guidelines on Vertical Restraints*. These Guidelines indicate that any of the following obligations on a reseller shall be considered to be hardcore restrictions on passive selling, and in a franchising context, a reseller can be taken as referring to a franchisee:

- obligations to prevent customers located outside an allocated territory from viewing its website;
- obligations automatically to reroute customers to the manufacturer's or another franchisee's website;
- obligations to terminate consumers' internet transactions where their credit card data reveal an address outside an allocated territory;
- limits on the proportion of overall sales that may be made on the internet; and
- requirements to pay a higher price for products intended to be resold online than for products intended to be sold offline.

The latter point means that it is virtually an automatic infringement to price-discriminate against a franchisee selling mainly on the internet as compared with a franchisee selling through a physical outlet. Generally speaking, price discrimination in the Article 101 context will only infringe Article 101 if actual harm to competition is shown, but in the internet context such price discrimination automatically infringes.

In addition, whilst there has not yet been a specific decision to support the point, it is thought likely that restrictions on the purchase or use of search engine adwords are in many cases likely to infringe Article 101 TFEU. Such restrictions can likewise be regarded as constituting an appreciable impediment to selling products on the internet.

By contrast, there are certain steps which, according to the European Commission's Guidelines, can be taken to control sales via the internet:

First, a franchisor can require that a franchisee sells at least a certain amount of products offline (measured in either value or volume) to ensure an efficient operation of a "brick and mortar" shop. In this way, a franchisor can prevent a franchisee being an "internet only" reseller. However, as mentioned, the franchisor cannot limit the proportion of sales to be made by the franchisee over the internet.

Second, a franchisor can generally prevent a franchisee using active sales techniques across the internet, notwithstanding the general position that internet selling is passive selling. A franchisor can generally prevent its franchisees advertising the products online in a manner specifically addressed to certain customers, for example using territory-based banners on third party websites, or paying a search engine or online advertisement provider to have advertisements displayed specifically to use in a particular territory. Restrictions on such active selling can come within the exceptions criteria of
Article 101(3) where an assessment of the agreement overall shows that the Article 101(3) criteria are fulfilled.

Third, a franchisor can require that the franchisee's website shall also offer links to websites of the franchisor and/or other franchisees. This is provided though that there is no automatic rerouting to such websites and no obligation for such rerouting.

Fourth, a franchisor may impose quality standards for the use of an internet site for the resale of its products, in the same way that a franchisor or supplier may require quality standards to be observed in a physical outlet or for advertising and promotion in general. It is implicit in this, however, that any such quality controls imposed must be proportionate taking into account the nature of the products. The Commission's Guidelines also go further and state that a supplier may limit its distributors' use of third party platforms to distribute the contract products by requiring that they use third party platforms only in accordance with standards and conditions agreed between the franchisor and its franchisees for the franchisees' use of the internet.

Fifth, and by way of example of the previous point, the Guidelines state that where a reseller's website is hosted by a third party platform, the supplier may require that customers do not visit the reseller's website through a site carrying the name or logo of the third party platform. This provision is taken to allow restrictions preventing sales via an internet platform such as Amazon or eBay. However, this provision should be followed with a degree of caution, because there are indications that some national competition law authorities within the EU are taking a stricter approach. It is understood that the German Federal Cartel Office considers that platforms such as Amazon may be the only means by which a small retailer can gain any recognition when selling on the internet, especially in relation to consumers using search engines to find sellers. Such competition authorities may therefore treat this point in the Commission's Guidelines, written in 2010, as no longer valid.

**Internet selling under UK competition law**

The UK competition authority, the CMA, was established by means of a merger of the OFT and the Competition Commission into a unitary authority with effect from 1 April 2014. Like the OFT, the CMA attaches high priority to ensuring unimpeded internet sales, because the internet is seen as an important enabler of choice and therefore competition. The Government's Strategic Steer for the CMA 2014-17, a high level policy document issued for the inception of the CMA in 2014, referred to the need for the CMA to take full account of longer term dynamic competition through new business models. This was reflected in the CMA's 2014 Strategy Statement, which set out a focus on emerging sectors and models, including online.

The general EU policy on restrictions on internet selling, was confirmed under UK competition law in two cases under Chapter I of the Competition Act 1998 in the mobility aids (mobility scooters) sector. The first of these cases, an infringement decision against Roma Medical Aids Limited in August 2013, not only condemned contractual prohibitions on online selling by Roma's retailers (as well as restrictions against selling below a recommended retail price), but this case and also a subsequent...

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8 For example, in the B&W Loudspeakers case, the European Commission required B&W Loudspeakers not to withhold its consent for internet sales other than on criteria concerning the need to maintain the brand image and presentation of the products, on a comparable basis to the criteria for sales from a traditional retail outlet, in order to enable Commission approval for a selective distribution system; European Commission press release, IP/02/916, 24 June 2002.

9 OFT press release 57/13, 5 August 2013; Decision of the OFT, CE/9578-12, 5 August 2013.
Infringement decision against Pride Mobility Products Limited in March 2014\(^{10}\), condemned clauses prohibiting online advertising of prices by retailers. All of these restrictions were restrictions by object and hardcore infringements. The restrictions on online advertising were specifically concerned with advertising by retailers of prices below recommended retail prices. Thus internet minimum advertised pricing clauses were regarded as infringing competition law in a similar way to outright restrictions on internet selling.

The restrictions on internet advertising were considered not only to prevent internet sales but also to prevent competition in physical outlet sales by advertising to a wider audience using the internet. These restrictions made it more difficult for the retailers to use the internet as a channel to win new customers and therefore restricted the customers and territories to which they could sell.

It should be noted that, in the Roma case, the restrictions were not formally set out as contractual clauses, but were rather contained in circulars sent by Roma to its retailer network. Roma monitored retailer compliance and threatened retailers with cessation of supplies if they did not comply. The infringements were found to exist even though not all of the retailers complied all of the time. For competition law purposes, this constituted an infringing agreement or concerted practice.

The affected retailers as well as the supplier were in each case held to have infringed the competition rules. The OFT’s infringement decision in the Roma case was addressed to Roma and seven online retailers, some of which also operated physical shops, and its infringement decision in the Pride Mobility case was addressed to Pride Mobility and eight online retailers, some of which also operated physical shops.

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The CMA is also re-examining restrictions on the advertising of prices on the internet, in a rather different context, concerning online travel agents, in the Hotel Online Booking case. The OFT investigated agreements between InterContinental Hotels Group and each of Expedia and Booking.com which prevented Expedia and Booking.com, online travel agents, from offering discounts on hotel rooms. The case was originally settled by means of commitments given to the OFT in January 2014\(^{11}\) requiring InterContinental Hotels to allow discounting by the online travel agents for room-only bookings up to the amount of their commission earned for the relevant hotel. However, as a condition of the commitments, the online travel agents could only offer such discounts to end users using “closed group” schemes such as membership or loyalty schemes, who had made at least one prior undiscounted booking. Outside of such schemes, for example on price comparison websites and meta-search sites, the online travel agents could only publicise the availability of discounts, but were not allowed to publicise a specific level of discounts.

These restrictions on online advertising of specific price or discount information caused concern to Skyscanner, a price comparison or meta-search site operator, and it appealed successfully to the

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\(^{10}\) OFT press release 23/14, 27 March 2014; Decision of the OFT, CE/9578-12, 27 March 2014

\(^{11}\) OFT press release 06/14, 31 January 2014; Decision to accept commitments to remove certain discounting restrictions for Online Travel Agents, OFT 1514dec, 31 January 2014
Competition Appeal Tribunal ("CAT") against the CMA decision to dispose of the case by accepting such commitments. The CAT found that, in allowing restrictions on the disclosure of specific price information, the OFT had limited the availability of the kind of information used by meta-search and other price comparison websites to enable consumers to make direct and immediate comparisons of actual prices of available hotel rooms. The CAT accepted Skyscanner’s claim that the ease of access for consumers to specific price information will have substantially worsened as a result of the commitments. The CAT annulled the OFT’s decision and referred it back to the CMA to reconsider the matter, in effect requiring the CMA to re-assess the case taking full account of the objective for price transparency through the internet and in particular through price comparison or meta-search sites. This shows the importance attributed under competition law to price comparison websites in facilitating price competition.

Price parity agreements

Price parity clauses have been a prominent feature of EU and especially UK competition cases concerning the internet. Price parity clauses are also known as "most favoured nation" clauses. They do not set absolute price levels, but typically they require a supplier to make a corresponding reduction in price to the dealer if the supplier sells at a lower price on another platform or website. Thus, in the online world, the beneficiary of such a clause is the internet platform which acts as a channel to the ultimate buyer. In a franchising context, such clauses may be unlikely to arise unless the franchisee were operating an internet platform and had sufficient bargaining power to impose such a clause on the franchisor.

Whether or not price parity or most favoured nation clauses infringe competition law depends on the circumstances. One factor is the degree of price transparency and the internet provides such transparency, which makes price monitoring easier. This makes it more likely that such clauses will infringe the competition rules in an online environment than offline.

Price parity clauses were an important feature of the e-books case, in which the European Commission took action against an unusual most favoured nation retail price clause imposed by Apple on various book publishers in relation to the price of e-books on the i-Bookstore website platform. The clause was contained in agency agreements between each publisher and Apple, and the Commission stated that the clause was intended to ensure that the publishers would compel other retailers to switch to the agency model. The publishers would then be able to exercise greater influence over the retail prices of their books (retail price maintenance being illegal outside the agency model), so that the publishers could thereby avoid the most favoured nation clause biting so as to reduce the price of their publications on the i-Bookstore. The case was settled by means of commitments by the publishers, including commitments to terminate the agency agreements and to offer retailers other than Apple the opportunity to terminate any agency agreement for the sale of e-books that restricted or limited the retailer’s ability to reduce the retail price, and further commitments not to enter into similar restrictive agreements for specified periods and (as regards continuing agency agreements) to allow retailers to offer discounts not exceeding the annual commissions paid by the relevant publisher to the retailer.

Amazon operated a price parity policy which restricted its sellers from offering lower prices on other online sales channels (not just their own websites). This was investigated by the OFT, and also in parallel by the German Federal Cartel Office. Amazon settled the case in August 2013 by agreeing with the OFT to discontinue its price parity clauses across the EU. It agreed to remove price parity clauses from its click-through agreements in the EU

12 Skyscanner Limited v CMA [2014] CAT 16, judgment of 26 September 2014
and to discontinue enforcement of price parity clauses.\textsuperscript{14}

Price parity provisions or most favoured nation clauses concerning price comparison websites were a feature of the CMA’s market investigation of the private motor insurance market, which was concluded in 2014.\textsuperscript{15} The CMA found that price comparison websites enabled new motor insurance providers to enter the market by providing internet access to potential customers. The CMA found that "wide" most favoured nation clauses reduced competition between price comparison websites. 

"Wide" most favoured nation clauses require a supplier to ensure that its product will be made available on a given platform at a price which is no higher than the price on any other website or platform. The CMA decided to make an order requiring motor insurers and price comparison websites to stop entering into or using such "wide" clauses. Where a "wide" most favoured nation clause is in place, a price comparison website does not face the possibility that a retail customer may find the same insurance policy more cheaply on another price comparison website. Such clauses also make it more difficult for a new entrant to gain a foothold in the market by offering a cheaper insurance product. As a result, motor insurance premiums were found to be higher where wide most favoured nation clauses apply.

The CMA distinguished "narrow" most favoured nation clauses, which require that the price quoted through a price comparison website to consumers will always be competitive with the price on the insurance provider's own website, without reference to the price quoted on other price comparison websites. The CMA concluded that such "narrow" most favoured nation clauses are a legitimate tool used by price comparison websites to engender consumer trust, and that without them there would be a risk that consumers might use price comparison websites less. The CMA concluded that the ability of the price comparison websites to offer prices that are the same as those available online directly from the insurer, is part of the essential, customer attracting proposition of a price comparison website.”

The same as those available online directly from the insurer, is part of the essential, customer attracting proposition of a price comparison website. This again shows the importance attached by UK competition law to price comparison websites as enablers of competition.

\textbf{Conclusions}

Despite the EU (and UK) competition rules, it is not uncommon in practice to find restrictions in commercial agreements on internet sales. However, it is clear that restrictions on internet selling, restrictions on advertising products and prices on the internet, internet minimum advertised pricing clauses, and resale price maintenance obligations (for online as well as offline sales) are all incompatible with, and likely to infringe, competition law. Such restrictions will generally constitute restrictions by \textit{object} meaning that there will be no need to demonstrate a restrictive \textit{effect} to establish an infringement. Where restrictive effects do need to be shown in order for restrictions on internet selling to be considered to infringe competition law (for example in relation to price parity or most favoured nation clauses), the price transparency enabled by the internet will in many cases be an important factor.

Some suppliers are more ready than others to accept that the internet is a fact of business life and to embrace the fact that it can result in an increased

\textsuperscript{14} OFT press release 60/13, 29 August 2013

\textsuperscript{15} Private motor insurance market investigation, CMA, Final report, 24 September 2014
customer base and greater overall sales. Some suppliers and franchisors seek to control the quality of internet selling insofar as they can legitimately do so, rather than to exclude internet selling. The technology available for internet use has now developed to an extent that a virtual presentation of a product, including detailed close-ups, can be achieved almost as effectively as in a shop. Such possibilities can provide a basis for the use of quality criteria, that a franchisor or supplier might require its franchisees or resellers to follow, when selling on the internet. This can be combined with obligations to safeguard the goodwill and reputation in the franchisor’s brand name and products by ensuring that its name and products are presented on a website in a manner which meets equivalent requirements to those which are acceptable in relation to trade marks in the physical world.

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