

# PRELIMINARY REPORT ON THE E-COMMERCE SECTOR INQUIRY

Federation of German Consumer Organisation's comments and recommendations

18. November 2016

## Impressum

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# I. INTRODUCTION

**E-Commerce** has become **increasingly important for consumers** in the European Union. The Preliminary Report (PR) on the E-commerce Sector Inquiry of the European Commission<sup>1</sup> underlines this in many of his findings such as the strong increase of e-commerce compared to bricks and mortar shops. It also shows that retailer and manufacturer use the online channel to a greater extent and that new business models develop (such as platforms and marketplaces). These new channels and business models potentially enable a wider product choice and better prices for consumers. According to a recent study, a fully integrated Digital Single Market could generate total welfare gains for European consumers of €154 Billion each year.<sup>2</sup>

The PR finds that in 2015 already 53% of individuals aged 16 to 74 have ordered goods or services over the internet (p.9), with online sales seeing exponential growth rates compared to bricks and mortar shops. Cross-border purchases, in comparison remain rather modest compared to the overall level of e-commerce. The relatively lower number of consumers shopping cross-border is due to several factors:<sup>3</sup> language skills; trust in cross-border delivery; trust in return and replacement of a defective good; and structural problems relating to the discrimination of consumers in the Internal Market.

By definition, e-commerce is not bound to a specific national or specifically circumvented territory. However **retailers use a number of techniques in order separate national markets** through geoblocking techniques. Nevertheless, the Preliminary Report shows that already today 20% of search inquiries to marketplaces come from other EU member states than the origin of the marketplace (p.115). Also, retailers use the cross-border nature of e-commerce in order to compare prices and products on a European scale (p.166).

With regard to digital content services consumers are clearly showing a strong **growing demand** across the EU. However they also report about a number of difficulties when accessing, or trying to access, those services. The Preliminary Report shows that the artificial division of the European market into temporal and territorial exclusive markets stands in the way of the Digital Single Market.

Right holders often split up their rights in several components and monetarise each of them separately. So rights are licensed by using combinations of technology related rights, release windows and territories and attach exclusivity on them. The result can be the creation of absolute territorial and temporal monopolies for specific marketing channels. As a result about half of the licensing agreements grant some degree of exclusivity (p. 256), while more than half of the online audio-visual operators' licences contain exclusive rights.

In the following the Federation of German Consumer Organisations (vzbv) would like to highlight some of the findings in light of the Geoblocking Regulation and e-commerce in digital content.

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<sup>1</sup> Commission Staff Working Document, Preliminary Report on the E-commerce Sector Inquiry, 15.09.2016, SWD(2016)312 final.

<sup>2</sup> Simonelli, Felice (2016): Combating Consumer Discrimination in the Digital Single Market: Preventing Geo-Blocking and other Forms of Geo-Discrimination, September 2016, on the request of the European Parliament's IMCO committee, p.6.

<sup>3</sup> See i.a. Civic Consulting (2011): Consumer market study on the functioning of e-commerce and Internet marketing and selling techniques in the retail of goods, p.12/13.

## II. E-COMMERCE AND CROSS-BORDER TRADE (GEOBLOCKING REGULATION)

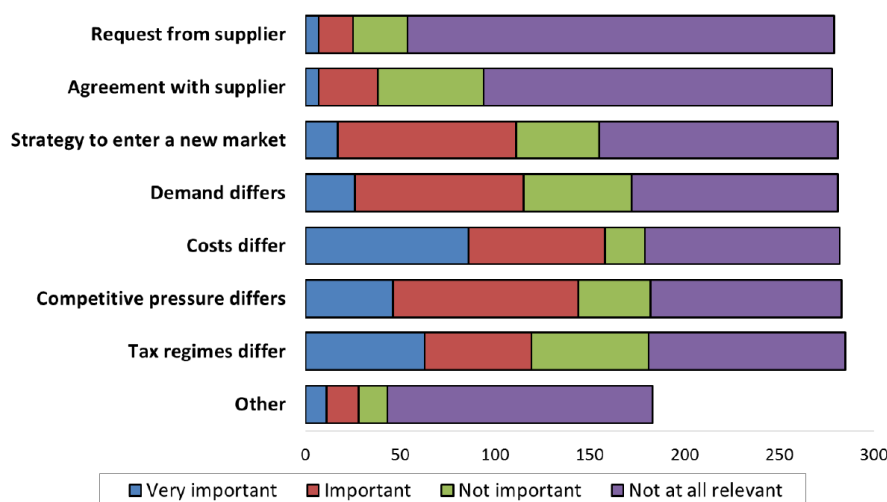
Despite the potentially vast opportunities for consumer and businesses, consumers hit national borders too often when aiming to shop across national borders in the EU. This not only contradicts the promises of the Internal Market but also diminishes EU consumer welfare overall. The Preliminary Report underlines these difficulties.

The Federation of German Consumer Organisations (vzbv) finds that it is necessary to find a **balance between the right of establishment of companies and the interest of consumers** to participate in the Internal Market on an equal footing.

Against this background, the proposal for a Regulation to tackle unjustified geoblocking in the Internal Market<sup>4</sup> is an important stepping stone in order to reconcile the consumer with business interests.<sup>5</sup>

The sector inquiry shows that retailers mostly regard the following factors as an obstacle to cross-border trade in the European Union: Diverging production and delivery costs; a different competition environment; and diverging tax systems (p.124). These **potential problems to cross-border trade**, as they are seen by retailers for cross-border commerce, are however **not part of the scope of the Geoblocking Regulation**.

Figure B. 51: Number of retailers indicating the level of importance of pre-defined options for charging different prices when selling cross-border<sup>215</sup>



Source: Preliminary Report, p. 124

Since the Commission proposal only addresses the “**shop like a local**” scenario, the questions of delivery, diverging tax systems or a different competitive framework are not addressed. From vzbv’s perspective, this argument similarly holds for questions of customer service and consumer advice which, under the rules of the Geoblocking Reg-

<sup>4</sup> Regulation No. 2016/289

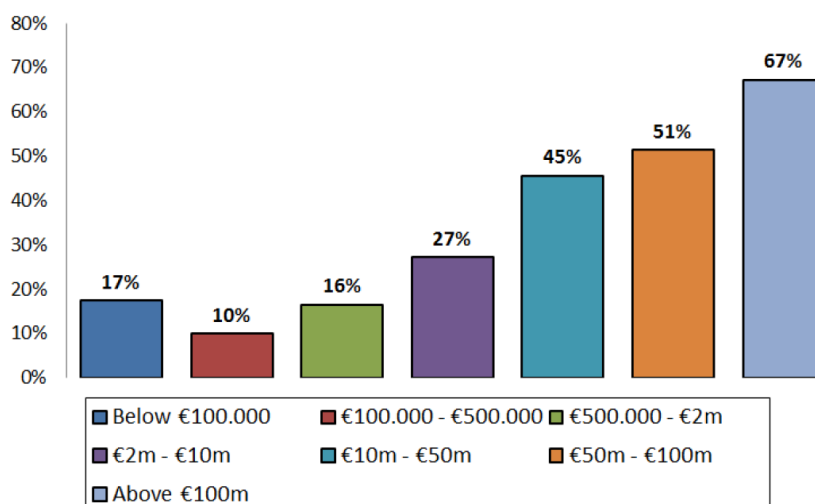
<sup>5</sup> See also vzbv’s position paper on the Geoblocking Regulation.

ulation, should not create additional burdens to retailers. These services can still be directed to a specific national market, however, without discriminating consumer based in other member states which want to purchase the respective good in the form of an unsolicited request (passive sale). Furthermore, since the respective national rules of the trader remain valid there are no diverging warranty periods or divergent demands for general terms and conditions.<sup>6</sup>

The sector inquiry furthermore finds that most **decisions from retailers to discriminate** customers on the basis of their nationality or their place of residence by and large originate from **big companies with an annual turnover of more than 100 Mio. €** (p.122).

**Geoblocking** is thus usually **not performed by small and medium-sized companies** that fear the costs and efforts of cross-border trade but by large retailers that use the right of establishment to partition markets along national borders.

Figure B. 49: Retailers that gather location information for geo-blocking purposes for each 2014 turnover category<sup>211</sup>



Source: Preliminary Report, p. 122

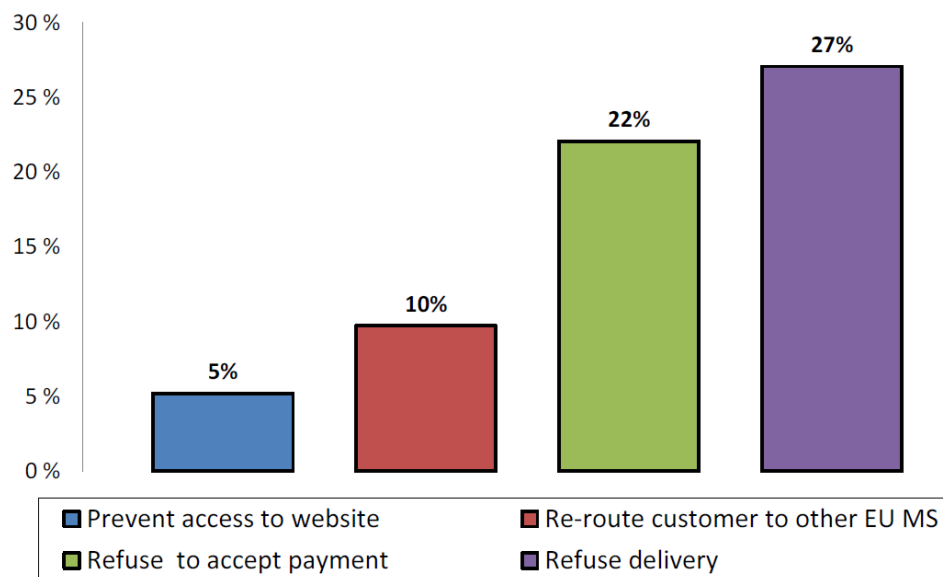
In the course of a further rise of significance of e-commerce, **manufacturers** increasingly use the digital environment to **set-up their own online shops** and to use direct marketing for their goods (also through marketplaces) (p.64). From vzbv's perspective, the Geoblocking Regulation particularly opens opportunities for these manufacturers to make their products available in the Internal Market and to gain new customers from EU member states especially through platforms or marketplaces.

With regard to the discrimination of consumers in the Internal Market, **two practices of geoblocking** stand out: The refusal to accept payments and the refusal to deliver products cross-border (p.120).

<sup>6</sup> Even if warranty periods are not altered through this regulation, it has to be underlined that a recent vzbv-commissioned study nevertheless confirmed that diverging warranty rules in the European Union have no impact on the prices of products. vzbv (2016): Studie zur Gewährleistung: Längere Fristen, gleiche Preise, September 2016,

While the proposed Geoblocking Regulation foresees clear rules for enabling a Europe-wide use of payment services,<sup>7</sup> the **delivery of goods** is not part of the Geoblocking proposal. For consumers the self-organisation of cross-border deliveries is more costly and time consuming and brings with it questions of liability if consumer have to entrust a third party with the delivery of a good.<sup>8</sup>

**Figure B. 47: Retailers that gather location information for each geo-blocking purpose – EU 28**



Source: Preliminary Report, p. 120

### vzbv recommendation to the Commission

- ❖ The **European Commission** needs to ensure that in the long run, consumers have their **goods delivered in the Internal Market in an uncomplicated and low-cost manner** where the burden of proof is not disproportionate on the consumer side. Furthermore the rights and duties of platform operators that handle these additional services should be spelled out in more detail.

The Preliminary Report equally underlines that the rules of the **EU competition framework** are not fully sufficient in order to tackle the current restrictions of consumer access and choice in the Internal Market due to geoblocking practices. The decision by specific retailers to restrict consumer access to their tangible goods and services is often a unilateral decision of non-dominant retailers (p.127). Therefore competition law

<sup>7</sup> Although it has to be noted too that the Payments Services Directive II has eased most conflicts in this respect but still needs to be properly implemented and enforced.

<sup>8</sup> In this case, bringing in a further service provider apart from the trader and the customer puts the consumer in a less favorable position. While in cases where the trader is responsible for sale and delivery of a good, the passing of risk occurs at the moment where the good is handed over to the consumer. With a third party service provider in charge of the delivery, the passing of risk occurs at the moment the trader hands over the good to the service provider. If the consumer receives a defective good, the burden-of-proof to determine at what point of the delivery the good has been damaged lies with the consumer.

and rules on vertical agreements, more specifically, do not apply to all cases of geo-blocking.<sup>9</sup>

The Geoblocking Regulation is needed in order to address those cases that do not fall under competition law **through legislation horizontally covering all retailers** in the European Union.

As regards **geoblocking practices for digital content** the report underlines that 74% of the licensing agreements for fiction TV require content providers to employ geoblocking measures, (66% with respect to licensing agreements for films, p. 237). Licenses often allow right holders to impose sanctions for non-compliance. As a consequence technical geo-blocking measures are widely used in the EU with 70% of the digital content providers employing such measures (p. 233). The disappointing result for European consumers is limited availability of content and unsatisfied demand for digital contents like audio-visual services or music services.

#### **vzbv recommendation to the Commission**

❖ vzbv demands that the **Geoblocking Regulation should incorporate non-audio-visual copyrighted services in the scope of the Regulation** and implement a swift review of the Regulation with regard to the inclusion of audio-visual services. This would **satisfy the unambiguous expectations of European consumers** to the access to digital contents in the Single Market.<sup>10</sup>

## **III. E-COMMERCE IN DIGITAL CONTENT**

### **1. LICENSING HAMPERS COMPETITION AND INNOVATION**

The Preliminary Report (PR) on the E-commerce Sector Inquiry shows, that the artificial division of the European market into temporal and territorial exclusive markets stands in the way of the Digital Single Market:

Right holders license content by using combinations technology related rights, release windows and territories and attach exclusivity on them. As a result about half of the licensing agreements grant some degree of exclusivity (p. 256). More than half of the online audio-visual operators' licences contain exclusive rights.

Territorial exclusivity is realised by contractually requiring providers to engage in geoblocking and to deny passive sales to consumers in other member states: 74% of the licensing agreements for fiction TV and 66% of the licensing agreements for films require content providers to employ geoblocking measures (p. 237). Licenses often allow right holders to impose sanctions for non-compliance. As a consequence technical geo-blocking measures are widely used in the EU with 70% of the digital content providers

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<sup>9</sup> Most significantly Art. 101 TFEU, Regulation No. 330/2010.

<sup>10</sup> This has also been underlined by a vzbv survey on the expectations of German consumers with regard to Geoblocking, where a clear majority (73%) favored not only a portability of their digital services in the European Union but also demanded access to those services in other EU member states. [http://www.vzbv.de/sites/default/files/digital\\_content\\_without\\_borders\\_factsheet\\_vzbv.pdf](http://www.vzbv.de/sites/default/files/digital_content_without_borders_factsheet_vzbv.pdf)

employing such measures (p. 233). The unfortunate result for European consumers is limited availability of content, unsatisfied demand and corresponding welfare losses.

Service providers need to secure licences to a minimum set of rights to market the content in a given territory. Therefore it is particularly worrisome from a consumer perspective that small online content providers and potential new entrants are put at a disadvantage by the prevailing licencing practises. The Commission found that **long-term exclusive licensing agreements** raise the **market entry barriers**. Contractual clauses, like first negotiation clauses, automatic renewal clauses in the licensing agreements between right holders and larger incumbent service providers, particularly hurt new entrants and smaller operators, who want to expand their activities. They are limited in their possibilities to emerge as effective competitors and serve consumers with new innovative services.

There is an additional **barrier to entry** for small potential competitors in the market for online provision of audio-visual content: About 80% of the licensing agreements for online rights are licensed on a national basis: “**Online rights** are often licensed **bundled with** rights for the distribution of content via other transmission technologies” such as rights for **terrestrial** and **satellite** transmission (p. 216). This puts small potential entrants with online-focused business models at a disadvantage as compared to incumbent telecom companies. These new business models, like streaming platforms that became increasingly popular with consumers in recent years, can deliver great value to their users.

The **vzbv** agrees with the **Commission** in that the widely employed **licensing agreements** between right holders and service providers effectively **limit competition**.

Effective competition and the threat of entry by new competitors disciplines incumbents and thereby contributes to consumer protection. The **licensing practises** of right holders and incumbent service providers artificially eliminate or reduce competition. This **hurts consumers**, through the creation of exclusive artificial territorial markets, leading to consumer welfare losses through inflated prices, lower rates of innovation and limitations in variety and quantity of supplied content.

## 2. EXCLUSIVE TERRITORIAL LICENSING LIMITS CHOICE AND LOWERS CONSUMER WELFARE

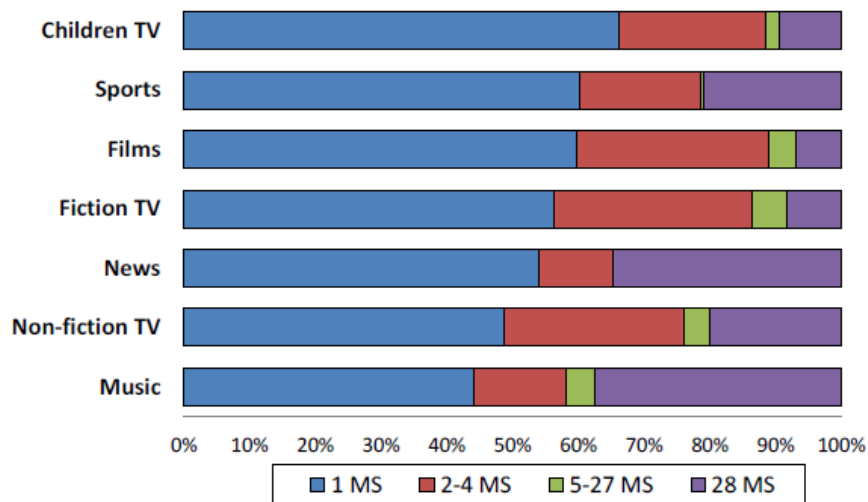
Content providers indicate that **57 %** of the licensed **online rights** for all content categories are **licensed** for the territory of **only one Member State** (25% of the licenses cover two to four Member States (p. 220-221 and Figure C 31)<sup>11</sup>.

<sup>11</sup> The number of licensing agreements that cover one Member State only are higher or similar for children TV (66 %), sports (60 %), films (60 %) and fiction TV (56 %).

The Commission should consider, that the actual number of license agreements for online transmission that are licensed for one Member State only is most likely to be higher: The Commission asked digital content providers to provide information on their 30 most important suppliers. Right holders were asked to provide information about their eight most valuable licensing agreements. This implies a bias towards high-budget content. Licenses for smaller budget audio-visual works, such as art house films could be underrepresented in the survey. It can be assumed, that smaller budget films are a) licensed in fewer Member States, as they are often distributed by small independent film distributors, operating only in one national market.



Figure C. 31: Proportion of agreements including rights licensed for a certain territorial scope – All agreements submitted by digital content providers – By product type



At the same time a study on VOD circulation by the European Audiovisual Observatory finds that **63% of European films released on VOD** are released in **only one national market**, generally the **home market**<sup>12</sup>. All too often users in other Member States cannot access these contents through digital service providers in these home markets due to restrictive licensing practices. Correspondingly the study finds that **“EU films travel less well than US films on VOD services**: On average, EU films [...] are available in 2.8 countries, whereas US films are available in 6.8 countries[...].”

At the same time there is strong demand to legally access these films across the border: The vzbv carried out a survey last year showing that over **70% of German consumers would like to be able to subscribe to foreign offers for sports, films and TV series**<sup>13</sup>. It is very frustrating for consumers when they cannot legally access the content/service of their choice. The growth in the use of VPNs (p.250) shows that a growing number of consumers wishes to purchase content from outside their home Member State. Yet, they are prevented from doing so.

From the point of view of consumers the current exclusive licensing practices are paradoxical: All too often **audio-visual works are available only in a limited number of Member States**. At the same time **consumers** from other Member States who would like to see these films but **cannot access them legally** due to licensing restrictions. This contributes to the **low audience numbers for small European Films**, which in turn is mourned by the film industry. The **most effective way to increase the circulation of European cultural works, would be to enable consumers to access these films legally across the borders**.

<sup>12</sup> European Audiovisual Observatory (2016) How do films circulate on VOD services and in cinemas in the European Union? - A comparative analysis, May 2016, [https://www.google.de/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwiW-rGuhKHQAQh-VFPRQKHSbXBqEQFggdMAA&url=http%3A%2F%2Fwww.obs.coe.int%2Fdocuments%2F205595%2F264625%2FCirculation%2Bof%2Bfilms%2Bin%2Bcinemas%2Band%2Bon%2BVOD%2Bin%2Bthe%2BEU%2B-%2BEN.pdf%2F8eae4b-b979-4a12-8667-c241a35c8cbc&usq=AFQjCNFyQzsa-k1y8mfeqE1dyRpE7O6bjA&sig2=wz7R0zS7JLh\\_WYwPzmr20A&cad=rja](https://www.google.de/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwiW-rGuhKHQAQh-VFPRQKHSbXBqEQFggdMAA&url=http%3A%2F%2Fwww.obs.coe.int%2Fdocuments%2F205595%2F264625%2FCirculation%2Bof%2Bfilms%2Bin%2Bcinemas%2Band%2Bon%2BVOD%2Bin%2Bthe%2BEU%2B-%2BEN.pdf%2F8eae4b-b979-4a12-8667-c241a35c8cbc&usq=AFQjCNFyQzsa-k1y8mfeqE1dyRpE7O6bjA&sig2=wz7R0zS7JLh_WYwPzmr20A&cad=rja)

<sup>13</sup> [http://www.vzbv.de/sites/default/files/digital\\_content\\_without\\_borders\\_factsheet\\_vzbv.pdf](http://www.vzbv.de/sites/default/files/digital_content_without_borders_factsheet_vzbv.pdf)

Considering the long tail of consumer demand it becomes clear that even small European films could generate a significant online audience across the EU, if consumers could legally access them across borders. If aggregated, the sum of all audio-visual content that is not consumed due to restrictive licensing and geoblocking amounts to a **substantive unsatisfied consumer demand in the long tail**. The corresponding **welfare loss hurts consumers, content service providers, right holders and film makers**.

Consumers from other member states should have the possibility to access films via service providers in the country of origin of the film. As a result the European audience of these small, culturally valuable films is most likely to increase. The currently unsatisfied demand could be supplied to a large extent, if the current licensing practise did not prevent content providers to answer to passive sales requests from consumers of other Member States.

### vzbv recommendation to the Commission

❖ The **Country of Origin principle (CoO)** in the **Online Satellite and Cable Directive** (COM (2015) 594) should be **extended to online content providers**. Hence digital content providers, had the right to sell their service to users in other Member States by securing rights of exploitation in their home market. This CoO-extension is an important step towards the creation of a truly Digital Single Market. The CoO allowed online providers to supply - until now unsatisfied - demand for specific content across borders.

The **freedom of contract** principle must **not** be **abused by right holders** and incumbent content providers to undermine the CoO principle by **creating artificial territorial monopolies** with exclusive licences and geoblocking. The freedom of contract principle is limited by the freedom of service principle: To artificially create territorial monopolies for the sake of reaping maximize profits is **inconsistent with the freedom to provide services**.

### 3. TO PROHIBIT ONLINE CONTENT PROVIDERS TO ANSWER SUPPLY PASSIVE SALES IS AT ODDS WITH EU LAW

vzbv acknowledges the possibility for right holders to offer licences on a territorial basis since this allows the development of legal offers that are better tailored to the expectations of the majority of consumers in each domestic market. But the 'freedom of contract' must not be abused by right holders and incumbent content providers in order to reap excessive economic rents by creating artificial territorial monopolies by means of exclusive licensing and geo-blocking.

The PR finds that the **right holders' rationale to license exclusive rights** (with respect to release windows (p. 251, § 806) and territory (p. 219, §696)) **is to maximise the extraction of economic rents** of the content over the entire life cycle. The same rationale is brought forward by right holders to explain, why online rights are not licensed for certain territories: Selected territorial licencing is the most profitable for right holders and the subsequent licensors. This territorially selective and exclusive licensing hurts consumers in that some content is not available in some territories at all (p. 232).

This extraction of maximal rents relies on the severe reduction or even **elimination of competition** among online service providers through the licensing agreements. Such a

**vertical restriction of competition is not covered by principle freedom of services** and it is at odds with EU law:

In its ruling in the “**Murphy case**” the CJEU made clear: **Right holders have a right to be compensated** for their effort and to earn appropriate returns. But the extraction of **maximal/monopolistic economic rents** resulting from **exclusive licensing** agreements that eliminate competition is **excessive**. Such licencing agreements are at the expense of consumers and against the basic notion of a Single Market. In the Premier League<sup>14</sup> ruling, the CJEU confirmed that contractual clauses restricting passive sales in satellite services by prohibiting broadcasters from effecting any cross-border provision of services (“absolute territorial exclusivity”) **are against Article 101 TFEU**. Such agreements, preventing passive sales, hurt competition and limit consumer choice and welfare.

**Preventing passive sales hurts competition and restricts consumer choice.**

Consumers that are interested in content and services tailored for audiences in other Member State are hurt in particular. Hence vzbv is convinced, that cross-border **passive sales should not be prevented by licensing agreements**.

**vzbv recommendation to the Commission**

- ❖ The Commission should closely monitor licensing agreements between right holders and content service providers. If passive sales are contractually prevented by agreements between service providers and right holders the Commission should consider to open new investigations in line with the ongoing cross-border pay TV case.

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<sup>14</sup> Joined Cases C-403/08 and C-429/08, Football Association Premier League and Other, §§ 139-146.