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LEGO forced to adjust its discount system for online sales

LEGO has recently agreed to amend its retail discount system, after the German Federal Cartel Office ('Bundeskartellamt') initiated proceedings against it over concerns that retailers could only obtain the highest possible discount from LEGO if they sold LEGO products offline. This latest proceeding by the Bundeskartellamt over dual pricing marks an escalation in the Bundeskartellamt's approach.



The German Federal Cartel Office ('Bundeskartellamt') has terminated antitrust proceedings against LEGO following LEGO's undertaking to amend its retail discount system¹. In particular, LEGO has undertaken to enable online retailers to obtain the same level of discounts as retailers operating brick-and-mortar stores. The Bundeskartellamt had initiated the proceeding in reaction to complaints from retailers. Under LEGO's previous discount system, retailers could only obtain the highest possible discount if they sold LEGO's products offline because several criteria of its discount policy applied exclusively to offline sales. For instance, certain criteria associated discounts to the numbers of metres of shelf space available for LEGO products. Consequently, even retailers who met all of LEGO's conditions for online sales in some cases obtained lower discounts than other retailers exclusively active in offline sales.

LEGO and previous cases

The LEGO case is the latest in a string of so-called dual pricing cases pursued by the Bundeskartellamt. However, this time the Bundeskartellamt seems to have gone a step further.

In a system of dual pricing, a retailer is granted different purchase prices or discounts, depending on whether the retailer intends to sell the product online or offline. A dual pricing strategy resulting in higher prices or lower discounts for online sales may violate Article 101(1) TFEU (and Section 1 of the German Act against Restraints of Competition). Such a system can restrict intra-brand competition because it provides a competitive disadvantage for retailers using online sales channels *vis-à-vis* retailers using offline sales channels. Further, dual pricing systems may be incapable of benefiting from the European Commission's Vertical Block Exemption Regulation ('VBER'). As the Commission's Guidelines on Vertical Restraints explain, dual pricing systems may be hardcore passive sales restrictions pursuant to Article 4b of the VBER². However, relevant agreements may benefit from an individual exemption pursuant to Article 101(3) TFEU, depending on the circumstances.

The Bundeskartellamt has pursued several cases in this area in recent years. In 2010, it forced Dornbracht, a manufacturer of luxury bathroom

fittings, to modify agreements granting wholesalers considerable rebates if they sold Dornbracht fittings to installers that fulfilled service requirements and certain levels of quality (e.g., professional installation) *vis-à-vis* customers³. Dornbracht had expressed publicly its intention to restrict online sales. This proceeding later served as the basis for a successful claim for damages brought by an online retailer against Dornbracht⁴.

Similarly, the Bundeskartellamt made Gardena, a manufacturer of gardening tools, and Bosch Siemens Hausgeräte ('BSH'), a manufacturer of household appliances, change their rebate systems in 2013⁵. Gardena had introduced functional rebates tying the rebate level to the type of the distribution channel used. Only offline sales could qualify for the full rebate. Similarly, BSH's rebate system had linked the rebate for BSH's hybrid retailers, i.e., retailers selling products both online and offline, to the percentage of their online sales. Under this system, the more sales BSH's hybrid retailers generated online, the less rebate they received.

The Bundeskartellamt viewed these dual pricing systems as restrictions of competition by object, i.e., hardcore restrictions having by their very nature the potential to restrict competition. Such restrictions are presumed to have negative effects. This presumption implies, without the Bundeskartellamt having to show anti-competitive effects, that the restriction falls within Article 101(1) TFEU. Further, the Bundeskartellamt considered that these systems were incapable of being exempted under the VBER or pursuant to Article 101(3) TFEU.

What makes the LEGO case different?

What makes the LEGO case different from the previous ones is the following: The discount criteria applied by LEGO did not differentiate between online and offline sales. Rather, they differentiated only within offline sales on the basis of relevant criteria. However, the Bundeskartellamt identified a 'structural disadvantage' for online sellers because they were not entitled to the same possible maximum discount. As a remedy, LEGO will need to introduce alternative or additional discount criteria for online sales, which, if met, allow for the same maximum discount as offline sellers are entitled to. For LEGO it may become a challenge to come up with equivalent criteria for online sales. While

certain criteria, for instance relating to shelf space, make sense in an offline world, they may not in the context of online shops. Further, it is hard to see how criteria applying only to offline sales can be seen as a restriction by object because they discriminate against online sales. An effect-based analysis appears to be more appropriate for such situations. At least, the Bundeskartellamt should have considered whether there was an objective necessity for the relevant criteria. It is also doubtful whether a 'structural disadvantage' in relation to online sales is what the authors of the Guidelines on Vertical Restraints had in mind.

Implications

The Bundeskartellamt is taking a very strict approach when it comes to possible discrimination of online sales. Suppliers with activities in Germany may wish to review their rebate schemes and ensure that retailers using online sales channels can qualify for the same level of discounts as retailers selling offline. Depending on the circumstances, dual pricing systems can benefit from an individual exemption from the application of Article 101(1) TFEU. The availability of such an exemption should be assessed with great care. As the Commission's Preliminary Report on the e-commerce Sector Inquiry makes clear⁶, one of the key considerations in relation to different discounts offered to different channels is whether the discount is offered to compensate for higher costs incurred by the manufacturer as a result of retail sales in one channel and not in the other. The granting of a fixed fee compensating for higher costs of one channel as compared to another is one possibility to compensate for such costs, contrary to variable fees which are considered as liable to incentivise sales via one channel.

1. Bundeskartellamt, press release of 18 July 2016, available at: <https://www.bundeskartellamt.de>
2. See paragraphs 52 (d) and 64 of the Guidelines on Vertical Restraints.
3. Bundeskartellamt, case B5-100/10 (Dornbracht).
4. Oberlandesgericht Düsseldorf (Düsseldorf Higher Regional Court), judgment of 13 November 2013, VI-U (Kart) 11/13. The complaint by the defendant was rejected by the Bundesgerichtshof (German Federal Court of Justice), judgment of 7 October 2014, KZR 88/13.
5. Bundeskartellamt, cases B5-144/13 (Gardena) and B7-11/13 (BSH).
6. Commission Staff Working Document, Preliminary Report on the E-Commerce Sector Inquiry, 15 September 2016, available at: <http://ec.europa.eu/competition/antitrust>