

Newsletter, 27 May 2014

## Most favored nation clauses under scrutiny

### German Federal Cartel Office prohibits best price clause of online hotel portal HRS

In its recently published decision of December 2013 the German Federal Cartel Office (“FCO”) prohibited the hotel booking platform HRS from continuing to apply its best price clause vis-à-vis hotels<sup>1</sup>. The decision will, eventually, be one of many decisions of national competition authorities in Europe concerning similar sets of facts. Investigations on best price clauses of hotel booking platforms were also initiated in the UK, Hungary, Sweden, France, Switzerland and Italy. In view of, *inter alia*, its HRS decision the FCO claims to be the “international pioneer” for setting the rules for e-commerce. As the European Commission (“Commission”) is not taking a stand, the FCO decision hence triggered a controversial discussion about the role of national enforcers within the European Union. Are there indeed reasons to worry?

#### Facts of the Case

HRS - Hotel Reservation Service (“HRS”) provides brokerage services to hotels by offering accommodation on its online hotel portals ([www.hrs.de](http://www.hrs.de) and [www.hotel.de](http://www.hotel.de)). While hotel customers may search and book hotel rooms directly on HRS’s portals free of charge, hotels have to pay a commission to HRS for the brokerage services on the value of rooms booked through HRS. The brokerage contracts between HRS and hotels contained clauses which ensured that the price offered through HRS for a room would never be higher than the price the hotel offered through other online distribution channels, i.e. other hotel or travel portals or the hotel’s own webpage. The hotels were also obliged to treat HRS no less favorably than other online distribution channels in relation to room availability and other booking and cancellation conditions (all most favored nation clauses used by HRS together referred to as “best price clause”). Hotels which did not comply with the best price

clause were taken off the HRS booking system. HRS furthermore intended to extend the application of the best price clause from online to offline channels by prohibiting the hotels to offer better rates at the reception desks than HRS. In the course of the proceedings, which were triggered by a competitor’s complaint in January 2010, HRS unsuccessfully offered to temporarily suspend the best price clause.

#### Reasoning of the FCO

The FCO argues that the best price clause has anticompetitive effects on the market concerned and thus constitutes a violation of Sec. 1 German Act against Restraints of Competition (“ARC”) and Art. 101 Treaty on the Functioning of the European Union (“TFEU”), namely by restricting competition between (i) online hotel portals and (ii) the hotel operators. The FCO also held that the use of the best price clause constitutes an abusive conduct by HRS vis-à-vis small and medium size hotels in violation of Sec. 20 (1), 19 ARC.

The FCO states:

- HRS was not a commercial agent to whom Sec. 1 ARC/Art. 101 (1) TFEU does not apply. The distribution of the economical risk between an online hotel portal and its hotel partners could not be compared to the usual risk distribution in case of a commercial agent.<sup>2</sup>
- The best price clause restricted competition between online hotel portals. Other portals had no economic incentive to offer lower commissions to the hotel partners of HRS in order to encourage those hotels to offer rooms at cheaper prices as HRS would automatically benefit from the same price without lowering its own commission.<sup>3</sup> Also, the best price clause hindered the

<sup>1</sup> FCO, case no. B 9 - 66/10 - [HRS](#), decision of 20 December 2014.

<sup>2</sup> FCO, case no. B 9 - 66/10, para. 147.

<sup>3</sup> FCO, case no. B 9 - 66/10, para. 155 *et seq.*

introduction of new sales strategies and thus the access of new online hotel portals to the market.<sup>4</sup>

- The competition between hotels was limited by the best price clause as it restricted the hotels' flexibility to adjust their prices and the distribution channel they use.<sup>5</sup>
- The brokerage contracts between HRS and its hotel partners constituted vertical agreements within the meaning of the Vertical Restraints Block Exemption Regulation No. 330/2010 ("VBER"). The exemption provided by Art. 2 (1) VBER did not apply because HRS's market share on the relevant market exceeded 30%.<sup>6</sup> The market affected by HRS's behavior was the market for the provision of brokerage services via hotel portals regarding accommodations located in Germany. Other distribution channels in the wider online hotel booking sector (e.g. hotel websites, specialized portals, online travel agencies, meta search engines and tour operator portals) did not compete with online hotel portals such as HRS, Expedia and Booking.com. It could thus be left open whether the best price clause also constitutes a hardcore restriction within the meaning of Art. 4 a) VBER.
- An individual exemption under Sec. 2 (1) ARC/Art. 101 (3) TFEU did not apply. HRS's argument that the best price clause caused efficiency gains for costumers whereas price competition would lead to the reduction of quality was not accepted. Product quality was an important criteria and would not loose its relevance due to strong price competition.<sup>7</sup> Even if the best price clause had been assumed to cause efficiency gains the exemption would not have applied because the clause was neither indispensable nor did it allow customers a fair share of these efficiency gains.
- The use of the best price clause also constituted an abuse of HRS's market-strong position vis-à-vis its small and medium size hotel partners.<sup>8</sup> These hotels were particularly dependent on the marketing of their rooms by online hotel portals as they were less well known to potential hotel customers than bigger hotel operators and could not stand up to the online hotel portals and major hotels in the ranking on the search engines. This assessment should apply despite the strong

presence of Booking.com and Expedia in Germany as the dependency did not need to be limited to one company and HRS's business model was particularly attractive for small and medium size hotels.

### Comment

The FCO's decision in *HRS* is noteworthy as it provides insight into the authority's assessment of best price clauses or most favored nation clauses ("MFN") imposed on a supplier in a vertical agreement. Such restriction had not been addressed by the authority so far.

The FCO, formally, left open whether such MFN constitute a hardcore restriction pursuant to Art. 4 a) VBER. However, the FCO appears to acknowledge that a vertical MFN imposed on the supplier can simply not be brought in line with the clear wording of Art. 4 a) VBER as it is not an agreement that has the object of setting a fixed or minimum *resale price* applicable to the *buyer* of goods or services. Unlike best price clauses in horizontal agreements<sup>9</sup>- vertical MFN imposed on suppliers can hence not be considered as restrictions by object but may therefore benefit from the exemption provided by the VBER on the condition that the market share threshold pursuant to Art. 3 (1) VBER is met. The FCO - like all competition authorities - however, retains the possibility to withdraw the block exemption provided that the vertical MFN in question had certain effects which are incompatible with Art. 101 (3) TFEU. In this regard, it will be very interesting to watch the outcome of the probes into Booking.com and particularly Expedia launched by the FCO after the prohibition of HRS's clauses. Since the market share of Expedia is presumably below 30%, even on the narrowly defined market following from the *HRS* decision, it looks as if the FCO is prepared to test the route of a withdrawal procedure for the very first time.

It also remains to be seen, whether or not the European competition authorities in Hungary, Sweden, France, Switzerland and Italy that are looking into the disputed vertical clauses will follow the "lead" taken by the FCO. This is particularly interesting since the Office of Fair Trading in the UK ("OFT")<sup>10</sup> came to a different assessment than its German counterpart, when closing its investigations into the best price clauses of Booking.com and Expedia in

<sup>4</sup> FCO, case no. B 9 - 66/10, para. 158 *et seq.*

<sup>5</sup> FCO, case no. B 9 - 66/10, para. 164 *et seq.*

<sup>6</sup> FCO, case no. B 9 - 66/10, para. 177 *et seq.*

<sup>7</sup> FCO, case no. B 9 - 66/10, para. 199 *et seq.*

<sup>8</sup> FCO, case no. B 9 - 66/10, para. 235 *et seq.*

<sup>9</sup> See FCO, case no. B6 - 46/12 - [Amazon](#).

<sup>10</sup> On 1<sup>st</sup> April 2014 the Competition and Markets Authority has become the UK's lead competition and consumer body by replacing the OFT.

January 2014.<sup>11</sup> The OFT closed its investigations after Booking.com and Expedia had agreed on temporarily suspending the application of some clauses which allegedly restrained competition. Not surprisingly, HRS in the German investigation hence argued that the British regulator - unlike the FCO - has taken into account the very high dynamics in the market for online hotel booking services as well as the efficiencies of MFN in this particular industry.

The existence of incoherent national decisions in relation to the legal assessment of MFN imposed on suppliers in vertical agreements and the prospect that further divergent decisions will be taken by competition authorities across Europe raises concerns. This is particularly the case as vertical MFN are of major relevance for the rapidly growing European online business.

It is thus to be hoped that the Commission will, eventually, give up its role as a silent observer and ensure that companies can rely on a consistent approach when assessing restrictions applied on a pan-European basis.

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<sup>11</sup> See OFT, case no. CE/9320/10 - [Hotel booking sector](#).