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Restrictions on Selective Distribution Systems on the Internet

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I. INTRODUCTION

The growing significance of the internet as a channel of distribution has made it the subject of increasing scrutiny from both competition authorities and courts across the EU. This is, in particular, the case for various forms of restrictions of distribution through the internet. This article considers the stance of competition authorities, including the European Commission (“EC”), the German Federal Cartel Office (“FCO”) and the U.K. Office of Fair Trading (the “OFT,” recently replaced by the Competition and Markets Authority, the “CMA”) as well as the EU and German courts on the issue of distribution restrictions through the internet in systems of selective distribution.

In general, a system of selective distribution involves a supplier who undertakes to sell the contract products only to distributors meeting certain selection criteria; these distributors then undertake not to resell the products to distributors failing to meet the criteria.² Selective distribution is usually used to distribute branded final products,³ in particular luxury and technically sophisticated goods.

II. APPLICABLE LEGISLATION

When assessing compliance of systems of selective distribution with requirements of EU competition law, the EC and EU courts take into account provisions of Art. 101 TFEU as well as Regulation 330/2010 of 20 April 2010 on the application of Art. 101(3) TFEU to categories of vertical agreements and concerted practices (the “VABER”). The latter is accompanied by the Guidelines on Vertical Restraints (the “Guidelines”).

Considering that systems of selective distribution confined to only a single Member State can be found to have an effect on trade between Member States, the above set of EU legislation is also applied by competition authorities of Member States and national courts in addition to provisions of their respective national competition laws, whereas EU laws take priority. Strictly speaking, the Guidelines are only binding upon the EC, but in practice they are widely applied and referred to at the national level.

The Guidelines categorize online sales as a form of “passive” selling, which results from the character of the relationship between the distributor and the customer, whereby it is the customer who normally reaches the distributor’s website to make a purchase. Only where the

¹ EU & Competition Solicitor, London.

² Guidelines, ¶ 174.

³ VABER, Art. 1(e).

distributor actively approaches the customer by means of unsolicited emails or targeted online advertising campaigns can sales resulting from such activities be categorized as “active.”

The distinction between “passive” and “active” sales has no practical relevance in the context of selective distribution. This results from the provision of Art. 4(c) VABER, which specifies that any restriction of active and passive sales to end customers constitutes a hardcore restriction and as such removes the benefit of the block exemption under VABER from the agreement in its entirety.

This is confirmed by the Guidelines, which make it clear that “in principle, every distributor must be allowed to use the internet to sell products.”⁴ In the context of systems of selective distribution, “the dealers should be free to sell, both actively and passively, to all end users, also with the help of the internet.”⁵

The Guidelines allow imposing certain criteria for online sales, but require that these should be equivalent to the criteria for sales from the brick-and-mortar shop, pursue the same objectives, and achieve comparable results. Any difference between the criteria “must be justified by the different nature” of these two means of distribution.⁶

III. PURELY QUALITATIVE SYSTEMS OF SELECTIVE DISTRIBUTION

A system of selective distribution is, by its very nature, capable of restricting competition in breach of Article 101(1) TFEU and equivalent provisions of national competition laws of Member States. However, under principles established in the decision of the European Court of Justice (the “ECJ”) in *Metro*,⁷ purely qualitative systems of selective distribution are presumed not to contravene Article 101(1) TFEU. Such systems cumulatively satisfy the following three conditions:

- the characteristics of the products in question necessitate the use of selective distribution in order to preserve their quality and ensure their proper use,
- distributors have been chosen on the basis of objective criteria of qualitative nature laid down uniformly for all potential resellers and not applied in a discriminatory fashion, and
- the criteria do not go beyond what is necessary to protect the quality of the products in question.

IV. OUTRIGHT PROHIBITION OF DISTRIBUTION THROUGH THE INTERNET

A. *Pierre Fabre*

The question of what is necessary to protect the quality of the products in question (condition #3) in the context of sales on the internet remained open until the ECJ’s decision in *Pierre Fabre*.⁸ The case was referred for a preliminary ruling by a French court. It arose from the absolute and general prohibition of internet sales of cosmetics and personal care products. The

⁴ ¶ 52.

⁵ ¶ 56.

⁶ *Id.*

⁷ Case 26/76.

⁸ Case C-439/09.

manufacturer, Pierre Fabre, required that its products be sold in the presence of a qualified pharmacist, which was *de facto* tantamount to the prohibition of online sales. The requirement went, however, further than what was prescribed by the applicable French legislation, which led the ECJ to the conclusion that it was not objectively justified.

The ECJ made three important points. First of all, it rejected Pierre Fabre's contention that the ban on online sales was necessary to ensure the correct use of its products and maintain their prestigious image. The ECJ concluded that the ban amounted to a restriction of competition by object in breach of Art. 101(1) TFEU so that there was no need to consider effects of the prohibition on competition in the market.

Second, the prohibition was categorized as a hardcore restriction under Article 4(c) of Regulation 2790/1999 (which was the predecessor of the VABER), which removed the benefit of the block exemption from agreements having as their object the restriction of active or passive sales to end users by members of a system of selective distribution. As a result, the agreement fell under the prohibition of Art. 101(1) TFEU.

Third, notwithstanding the above, the ECJ indicated that it was still possible for the agreement to escape the prohibition of Art. 101(1) TFEU if it cumulatively met the criteria set out in Art. 101(3) TFEU.

B. Other Decisions

The ECJ's decision in *Pierre Fabre* laid the foundations for the stance of competition authorities and courts throughout the European Union towards an outright prohibition of sales through the internet. By way of example, following its recent market study into the U.K. mobility aids sector, on August 5, 2013 the OFT issued a decision relating to Roma-branded mobility scooters.⁹ Roma had a system of selective distribution in place, whereby it prohibited its distributors from selling its products on the internet and actively monitored compliance with that policy. The OFT found that the prohibition resulted in consumers being charged inflated prices and retailers being restricted from accessing a wider scope of consumers. The OFT concluded that the prohibition restricted competition in breach of Art. 101(1) TFEU and Chapter I of the Competition Act (the "CA") 1998.

V. RESTRICTIONS OF DISTRIBUTION THROUGH THE INTERNET

A. Quality Standards

The Guidelines provide that the supplier may require quality standards for the website used to resell its products.¹⁰ This is particularly relevant in the context of selective distribution, in which the nature of the products usually necessitates an increased level of customer service. The Guidelines provide only several examples of such admissible quality standards, for example the requirement that distributors run one or more brick-and-mortar shops or showrooms. This means that other quality requirements relating to online distribution must be considered on a case-by-case basis in light of the spirit of the Guidelines.

⁹ Case CE/9578-12.

¹⁰ ¶54.

German courts have considered some more quality requirements. The Higher Regional Court (*Oberlandesgericht*) in Karlsruhe¹¹ and the Regional Court (*Landgericht*) in Mannheim¹² have accepted a number of requirements relating to the contents of the distributors' websites and aimed at ensuring the maintenance of image of the distributed products. The accepted requirements included those to:

- make it clear on the website that online distribution merely supplements distribution through brick-and-mortar shops;
- invite visitors to the website to come to a brick-and-mortar shop to fully examine all features of the products and utilize the assistance of trained members of staff;
- clearly indicate the address and other contact details of brick-and-mortar shops of the distributor;
- mirror the ambience of a brick-and-mortar shop in the way in which the products are presented on the website;
- structure and present the website in a way corresponding with the quality of the distributed products and their image;
- ensure that the website can be quickly downloaded, has been designed to a high standard, has an easy-to-follow structure and contains comprehensive information regarding the products; and
- clearly separate products of the supplier from other products, especially those of lower quality.

B. Quantitative Caps

The Guidelines make it clear that an agreement limiting the proportion of overall sales made over the internet amounts to a hardcore restriction. However, this does not exclude the possibility of the supplier requiring that the distributor sells a certain amount of products offline, whereas the amount of such offline sales can be the same for all distributors or determined individually for each distributor on the basis of objective criteria.¹³

In its decision of November 4, 2003 in the case referred to as *Depotkosmetik im Internet*, the German Federal Supreme Court (*Bundesgerichtshof*, the "BGH") held admissible a clause permitting the supplier to terminate a license to distribute its products when the online sales reached a certain percentage of all sales or exceeded the sales from brick-and-mortar shops. The decision has lost much of its practical significance after the entry into force of the Guidelines and has not been confirmed by the BGH since then.

C. Dual Pricing

Any agreement pursuant to which the distributor shall pay a higher price for products intended to be resold online than for products intended to be resold offline amounts to a

¹¹ Case 6 U 47/08 (November 25, 2009).

¹² Case 7 O 267/07 (March 14, 2008).

¹³ ¶52.

hardcore restriction under the Guidelines.¹⁴ The supplier can, however, agree with its distributors a fixed fee to support their offline and online sales efforts.

In December 2005 the OFT launched an investigation into a discount scheme offered by Yamaha. The discount scheme rewarded face-to-face sales as opposed to distance sales including sales through the internet. The OFT expressed concerns that the scheme restricted internet sales, but ultimately decided to close its investigation and not impose any fine on Yamaha after the company had withdrawn the scheme.¹⁵ The OFT clearly demonstrated that a discount scheme disadvantaging distribution through the internet is capable of restricting competition and that the OFT (now CMA) is willing to take on such cases.

D. Prohibitions of Sales on Internet Platforms

The Guidelines provide that the supplier may require that its distributors use third-party platforms to distribute the contract products only in accordance with the agreed “standards and conditions.”¹⁶ However, the Guidelines do not specify what sort of “standards and conditions” could be applied except for indicating that the supplier may require that “customers do not visit the distributor’s website through a site carrying the name or logo of the third-party platform.”

1. Federal Cartel Office’s Practice

The lack of clear-cut rules on what exactly is permissible with regard to distribution through third-party platforms has led to some suppliers in Germany pushing the boundaries and prohibiting their distributors outright from selling through internet platforms. By way of example, Sennheiser prohibited its retailers from operating on internet platforms not satisfying stringent quality criteria, which in practice excluded the possibility of sales on platforms such as eBay or Amazon Marketplace. This notwithstanding, Sennheiser approved Amazon as an authorized distributor of its products. The FCO abstained from launching an investigation into the matter after Sennheiser had removed restrictions of sales on Amazon Marketplace from its conditions for online sales.¹⁷

Adidas had a similar policy in place, whereby it prohibited its authorized distributors from selling on internet platforms. Following complaints by distributors to the FCO, Adidas decided to amend its conditions of sales by removing the prohibition. Adidas also expressly allowed its distributors to use search terms related to the Adidas brand for the purpose of search engine advertising such as through Google AdWords. Considering these concessions, the FCO closed its proceedings without imposing any fine.¹⁸

Even further went restrictions of online sales imposed on its authorized distributors by Asics. The company prohibited them not only from selling through online platforms, but also from supporting price comparison websites and using the names of its brands on Google

¹⁴ ¶52 (d).

¹⁵ Press release of September 8, 2006.

¹⁶ ¶54.

¹⁷ Press release of October 24, 2013.

¹⁸ Press release of July 2, 2014.

AdWords. Asics is understood to be negotiating a settlement with the FCO after receiving a statement of objections.¹⁹

Despite there still not being a decision of the FCO regarding sales through internet platforms and similar restrictions of distribution in the context of systems of selective distribution, the stance of the German regulator can be deduced from its practice. Accordingly, restrictions of sales through internet platforms are capable of restricting competition in the market and unlikely to be justifiable by reference to the nature of the product. It is also essential that the conditions of online sales be applied in a uniform fashion across the distribution network.

2. Decisions of German Courts

The issue of a ban of sales through internet platforms has also been dealt with by German courts. Despite all the relevant cases giving rise to similar issues, the courts arrived at diverging conclusions. This results, among other things, from the lack of a decision of the ECJ or the BGH on the issue, which would be binding upon courts of lower instances.

Faced with the question whether the prohibition of sales through internet platforms is anticompetitive, German courts tend to opt for one of two broad positions. According to the first one, such a prohibition is permissible under competition law as long as it is consistently applied throughout the distribution network without discriminating against any distributors. This view was taken in cases relating to distribution of Scout-branded school bags by the Higher Regional Court in Karlsruhe²⁰ and the Regional Court in Mannheim.²¹ In these cases, contrary to the terms of sales, distributors engaged in sales through internet platforms such as eBay or Amazon Marketplace, to which the suppliers responded by cutting the supplies off. To regain the supplies, the distributors took legal actions claiming that the provisions prohibiting the use of internet platforms were in contravention of competition law. The courts in Karlsruhe and Mannheim found that the suppliers were trademark owners and as such they were at the liberty to impose various conditions upon their distributors relating to the manner in which their products are distributed. These conditions could have an effect of prohibiting sales through online platforms.

The opposite view perceives the prohibition of sales through internet platforms as anticompetitive. In another case relating to distribution of Scout-branded school bags the Higher Regional Court (*Kammergericht*) in Berlin²² underlined that although the prohibition in question can be justified in the context of selective distribution, it must be applied in a non-discriminatory manner in order not to breach competition law. In the case before the court, the supplier banned its authorized distributors from selling on eBay to maintain the aura of quality surrounding its products, but at the same time engaged in sales of its school bags through a discount chain.

¹⁹ Press release of April 28, 2014.

²⁰ Decision of November 25, 2009 in case 6 U 47/08.

²¹ Decision of March 14, 2008 in case 7 O 267/07.

²² Decision of September 19, 2013 in case 2 U 8/09 Kart upholding the decision of the Regional Court in Berlin of 21 April 2009 in case 16 O 729/07.

The Higher Regional Court of Schleswig-Holstein arrived at a similar conclusion in its decision of June 5, 2014.²³ The case related to a system of selective distribution of Casio digital cameras, in which sales on internet platforms were prohibited. The court concluded that such a prohibition constituted a restriction of competition by both effect and object in breach of Art. 101(1) TFEU and Section 1 of the German Act Against Restraints of Competition (the “GWB”). The restriction by effect resulted from the fact that the prohibition substantially limited access to the online market by both distributors and customers. The restriction by object was due to the reduction of price pressure on Casio and its distributors and the possibility of Casio increasing its presence in the market for online sales at the expense of its distributors. Considering these characteristics, the court concluded that the prohibition resulted in the restriction of the customers to whom digital cameras could be sold and as such constituted a hardcore restriction under Art. 4 b) VABER. The court also rejected the possibility of the prohibition being justified under Art. 101(3) TFEU or Section 2 GWB.

The Regional Court in Frankfurt am Main decided along similar lines on June 14, 2014.²⁴ The case concerned distribution of Deuter-branded backpacks after the manufacturer adopted a system of selective distribution prohibiting the use of internet platforms and price comparison websites. The court found that the prohibition constituted restriction of competition in breach of Art. 101(1) TFEU and Section 1 GWB. It also qualified as a hardcore restriction falling under Art. 4 c) VABER, which prohibits restrictions of active and passive sales to end users by distributors in systems of selective distribution. Interestingly enough, the court considered that paragraph 54 of the Guidelines allowing the supplier to require that customers do not visit the distributor’s website through a site carrying the name or logo of a third party is in contravention of Art. 4 c) VABER and Art. 101(1) TFEU.

E. Advertising on the Internet

Restrictions of online sales often come hand-in-hand with restrictions of advertising on the internet. Such restrictions were imposed upon retailers of Roma branded mobility scooters. In the above mentioned decision of August 5, 2013,²⁵ the OFT underlined that the internet can make it easier for consumers to obtain price information, which should result in intra-brand competition and, in particular, price competition being intensified. The prohibition of advertising retail prices on the internet is therefore likely to eliminate incentives on the part of retailers to engage in price competition, which can ultimately lead to consumers having to pay excessive prices. The OFT found that the prohibition of online price advertising is “liable to prevent, restrict or distort competition between retailers” contrary to Art. 101(1) TFEU and Chapter I CA 1998.

The OFT reached an analogical conclusion in its (still unpublished) decision of March 27, 2013 relating to arrangements entered into by Pride Mobility Products preventing its U.K. online distributors from advertising online prices below the recommended retail price.²⁶

²³ In case 16 U Kart 154/13 (upholding the decision of the Regional Court in Kiel dated November 8, 2013 in case 14 O 44/13).

²⁴ Case 2-03 O 158/13.

²⁵ Case CE/9578-12.

²⁶ Press release of March 27, 2013.

VI. FINAL REMARKS

Despite competition authorities and courts having recently issued quite a few decisions regarding distribution through the internet in systems of selective distribution, there are still issues which remain to be fully clarified, such as admissibility of restrictions of distribution through online platforms. This leads to a deal of uncertainty in commercial practice. A number of appeals in the relevant cases are pending before national courts. It is hoped that one of the appeal courts decides to make a reference for a preliminary ruling to the ECJ so that it can have an authoritative say on the issues remaining uncertain. Until then, suppliers in systems of selective distribution operating on the internet should be advised to err on the side of caution.