

**PHYSICAL & VIRTUAL
SELECTIVE DISTRIBUTION
IN THE EU COMPETITION LAW**

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I. Introduction

Selective distribution constitutes a case, in which vertical restraints are imposed in order the manufacturer to promote and sell his products/services in the market. The manufacturer has undoubtedly the leading role setting freely –within the context of the laws regarding competition- his own criteria under which the distribution network shall operate. However, the development of the Internet has set new legislative challenges, since the autonomous operation of on-line distribution has proven to cause imbalances in the rest of the distribution system. Therefore, raises the question, if it is possible selective distribution and autonomous on-line distribution to co-exist. And that question will stand as the topic of the following analysis. However, in order our analysis to be methodologically sound, firstly we will analyze the current situation, its problem and its ratio and then we will proceed to a recommendation of a solution.

II. Current situation: Setting physical restrictions in a virtual world

The current legislative framework (Regulation 330/2010) has introduced various provisions regarding on-line distribution, but yet has not found an answer to that issue. More specifically, article 4 (b) concerning territorial restrictions states at first a general prohibition: vertical agreements are prohibited if, directly or indirectly, lead to a “restriction of the territory into which – or of the customers to whom- a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services”. Price discrimination from territory to territory¹ is the target for the party trying to impose such restrictions: Consumers in high income territories, who are therefore considered as richer, will pay more than the consumers in low income territories for the same goods. That means that borders, barriers have to be put in order to prevent arbitrage² or in other words to prevent the natural human tendency of making the most advantageous choices; in terms of healthy competition conditions, finding and buying where prices are low and reselling where prices are high.

Nevertheless, except from this general prohibition, the provision further states four exceptions from the hardcore restriction in article 4 (b), from which the first and most important to us exception concerns the restriction of active³ sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer⁴.

However, nowadays almost every dealer uses the **Internet** and controls a webpage along with his premises. Considering how vast the Internet is, it proves to be a complex issue implementing this general prohibition and its parallel exceptions. Particularly, every issue when regulated has mainly three parts; a technical, a legal and an economical one. And here is actually the big mistake of the Commission persisting to implement the same technical, legal and economical regulations for on-line distribution as well as for distribution through physical networks⁵.

Undoubtedly, every distributor has the right to use the Internet in order to promote and sell his products. At this context, the recent judgment of the Court of Justice in the case of Pierre Fabre⁶ is of a significant importance. Particularly, the ECJ ruled that in a system of selective distribution⁷, the restriction of requiring the presence of a qualified pharmacist for selling cosmetics/personal care products within a physical space resulting in a ban on using the Internet for such sales, amounts to a restriction by object and therefore must be considered as a restriction of the 101(1) TFEU, which isn't enlisted in the content of the R. 330/2010.

¹ New guidelines on Vertical Restraints, para 50

² *Motta, Rey, Verboven, Vettas*, p. 4; *Abbott*, Parallel Importation: Economic and social welfare dimensions, International Institute for Sustainable Development, available at: <http://ssrn.com/abstract=1915395>, p. 7

³ The motif “active versus passive sales” is very common in the regulations concerning vertical agreements (New guidelines, para 51). «Active» sales mean actively approaching individual customers by for instance direct mail, including the sending of unsolicited e-mails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in the media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. «Passive» sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers.

⁴ Ar. 4 (B) (I)

⁵ *Themelis*, After Pierre Fabre: the future of online distribution under competition policy, International Journal of Law and Information Technology, Vol. 20, No. 4, doi:10.1093/ijlit/eas017, pp. 346-369, p. 347 & p. 356, where it refers to “dual commercial dimension”; There are different opinions expressed especially in the US, *Velez*, Significant changes to the Block Exemption on Vertical Restraints, p. 218

⁶ C- 439-09 *Pierre Fabre Dermo-Cosmetique*

⁷ It is generally thought though that it has general power for the e-commerce.

Besides it can be considered as a restriction of the freedom of movement as well as a restriction of the consumers' freedom to shop from wherever they are situated⁸. Therefore, the Commission considers having a website a form of passive selling, since it is a reasonable way to allow customers to reach the distributor⁹. Besides it is unfair and insane to blame the distributor for the potentials that the new technologies have and it is even worst to try to restrain these technologies and consequently block the evolution of trade and consumer welfare.

However, the new Guidelines on Vertical Restraints, in order to prevent cases of free riding through the Internet, allow the manufacturer to require brick-and-mortar stores as a selection criterion¹⁰. The complementarity between virtual and physical trade is besides the core of the Commission's policy¹¹. In this way the manufacturer can ensure that through online sales, the distributor will also promote the product and the brand through a physical environment in which the product can be offered under topnotch conditions¹². For example, in such a way explanations that the specialist trade of selective distribution, pre-sale and after-sale services require cannot be available online¹³. This precondition is also enforced by the distributor's obligation both virtual and physical distribution methods to be the same¹⁴. Nevertheless, setting the establishment of a brick and mortar store as a precondition for online distribution raises many concerns. The commission actually admits the practical problems born from this regulation¹⁵. However the philosophy of selective distribution and the leading role of the manufacturer, who actually trusts his products to the distributors under his own conditions, have put aside any discussions regarding the reconsideration of that policy.

Nevertheless, bullying cannot be permitted and limits have to be set, in favor of the use of Internet. The New Guidelines mention four cases- agreements, which cross the red-line and thus are regarded as hardcore¹⁶:

- 1) More specifically, any agreement is forbidden that results in the block of the distributor's webpage for the consumers who are located in another exclusive territory. As equally harsh are considered agreements which reroute automatically the consumers to the manufacturer's or another distributor's webpage. However, links to the manufacturer's or another distributor's webpage on the distributor's webpage are permitted.
- 2) Unacceptable are also agreements terminating the consumer's transactions, if the consumer is not located in the distributor's territory. This process will be operated with the help of the consumer's credit card, which will reveal his location.
- 3) Any restriction, which leads to the limitation of the distributor's proportion of overall sales made over the Internet, is also prohibited. But in these cases some exceptions are allowed.

⁸ New Guidelines, para 38

⁹ New guidelines, para 52

¹⁰ New Guidelines, para 54; IP/02/916, *B&W loudspeakers*; E-bay's response proved quite the opposite For an example of a study conducted to investigate the nature and scale of the benefits enjoyed by customers of a particular online marketplace, see Frontier Economics, *Economic Study of the Consumer Benefits of eBay*, September 2008, London, available at <http://ec.europa.eu/competition/sectors/medialebay-frontierjreport.pdf> [Accessed September 17, 2009].

¹¹ France was the pioneer at implementing the combination of virtual and physical commerce, (Decision of the Conseil de la concurrence no. 06-D-24 of 24 July 2006 *Festina France*) *Sain-esteben, Billard, Jouvensal*. Online reselling and selective distribution networks: what can be learnt from the French experience?, *Journal of European Competition Law & Practice*, 2010, doi:10.1093/jeclap/lpq009, available at: <http://jeclap.oxfordjournals.org/content/early/2010/03/01/jeclap.lpq009.full.pdf>

¹² *Baker and McKenzie*, Response to the European Commission's Consultation on "The Opportunities in Online Goods and Services" (2008), p.5, available at http://ec.europa.eu/competition/consultations/2008_online_commerce/brandowners_contribution.pdf [Accessed March 15, 2011]

¹³ *Velez*, 'Recent developments in selective distribution', *European Competition Law Review*, Issue 05, 2011, p. 244

¹⁴ New Guidelines, para 54

¹⁵ New Guidelines, para 54; Themelis, p. 357

¹⁶ New guidelines, para 52

- First, the supplier can require that the buyer shall sell at least a certain absolute amount of the products – based on value or volume- off-line to ensure an efficient operation of its premises. This amount can be the same for all buyers or determined individually for each buyer. Here comes again the problem that was mentioned above; physical and virtual commerce are two completely different sectors. In this way, the manufacturer can set a relatively high border (what is high shall be considered ad hoc) in order to practically neutralize his distributor's webpage, since it is nowadays a common truth that e-commerce¹⁷ has way far greater potentials than physical commerce. This requirement does not directly restrict Internet sales, but it does so indirectly.

However, it is a fact, that without this restriction free riding phenomena can occur. Particularly, the distributor can maintain a small store with low operating expenses in order to fulfill this requirement and at the same time his main sales can be operated through Internet¹⁸. That cannot also be acceptable. A balance is needed. And considering the leading role of the manufacturer in selective distribution, this restriction is necessary. The next step should be made through the definition of the objective criteria.

- Second, the supplier has the right to make sure that the online activity of the distributor remains consistent with the supplier's distribution model. This exception is totally correct, since it preserves the main core of the selective distribution's philosophy. In particular, a manufacturer can well set quality standards for the use of the internet site by the distributor in order to accept him as a member of his distribution network, just like for the trade in a physical environment¹⁹. This regulation does not constitute a discrimination against the Internet. It is rather discrimination between free trade and trade under a selective distribution's system. And that is acceptable.

4) The last case, which is considered as hardcore –as an exception to the passive sales category- is setting different prices for the distributor to buy his products; higher for the products distributed online and lower for the products distributed off-line. An exception from this prohibition is the agreement for a fixed fee, stable for all products, in order to support the latter's off-line or online sales efforts.

Apart from all the above, the use of the Internet sometimes can be considered as active selling and therefore prohibited. The Commission for example considers online advertisement specifically addressed to certain customers or territory based banners on third party websites or even paying a search engine/ online provider to have advertisement displayed specifically to users in a particular territory as a form of active selling²⁰.

In any case, a Regulation regarding Internet sales is under transformation and is to be published in 2015²¹, focusing, apart from other, to the application of the future regulations on selective distribution²².

¹⁷ It will be interesting to view the commission reactions to this new reality, see Commission Communication COM (2011) 942, A Coherent Framework For Building Trust in the Digital Single Market for E-commerce and Online Services (2012)

¹⁸ Velez, 'Recent developments in selective distribution', European Competition Law Review, Issue 05, 2011, p. 246

¹⁹ New regulations, para 54

²⁰ New regulations, para 53

²¹ The 'Communication' (n 2); the Commission Staff Working Papers, 'Online Services, Including E-commerce, in the Single Market' http://ec.europa.eu/internal_market/e-commerce/docs/communication2012/SEC2011_1641_en.pdf accessed 4 June 2012, and 'Bringing E-commerce Benefits to Consumers' http://ec.europa.eu/internal_market/e-commerce/docs/communication2012/SEC2011_1640_en.pdf accessed 4 June 2012; Commission Communication COM (2011) 206, Single Market Act: Twelve levers to boost growth and strengthen confidence: 'Working together to create new growth' (2011) <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0206:FIN:en:PDF>> accessed 4 June 2012; Commission Communication COM (2010) 245, A Digital Agenda for Europe (2010) <http://ec.europa.eu/information_society/digital-agenda/documents/digital-agenda-communication-en.pdf> accessed 4 June 2012; see also further <http://ec.europa.eu/information_society/digital-agenda/index_en.htm> accessed 4 June 2012.

²² Themelis, p. 366

III. Need for reconsideration- Proposed solution

It was mentioned above, that every issue has its technical, its legal and its economical aspect. And it has to be acknowledged that the Commission has taken serious steps towards the legislative adaption of selective distribution in the new virtual conditions. Yet in the dilemma “selective distribution or expansion of on-line distribution” the Commission has taken a clear decision; selective distribution, even if it means the sacrifice of the whole potentials of on-line distribution. Besides, from a legal point of view that seems to be the most reasonable decision, in order to prevent the rise of free riding phenomena.

However, there is yet a solution: having said that the Commission restricts autonomous on-line distribution in order to prevent free riding phenomena, leads us to the conclusion that the only way to allow such an autonomy without having such consequences to face, is to eliminate all the relevant motives that a distributor may have when choosing between physical and virtual selective distribution. And the only way to eliminate such motives is the manufacturer to apply a dual-pricing model, in order to make the distributor indifferent between the two options he has. In other words, since physical distributors face larger costs, because of the operation of their premises, the manufacturer should be allowed to apply higher prices for online distributors, in order to reduce the marginal-cost differences that physical and virtual distributors have, so that both types of distributors apply more or less the same prices for the same product when reaching the consumer.

At this point, one could argue that such solution cannot be applied, since the Commission prohibits this model of dual pricing. However, the answer to this argument is that the aforementioned prohibition has a different ratio, since its main concern is to prevent the distributor from being bullied by the manufacturer. But actually true bullying is when the Commission allows the manufacturer to restrict autonomous online distribution for the abovementioned reasons.

Therefore, allowing dual pricing will result in the elimination of the distributor’s motives that cause free riding and the elimination of the manufacturer’s motives that cause bullying, and thus a legislative revision of that point is recommended towards an autonomous online distribution.

IV. Conclusion

As this work comes to an end, there is one conclusion, which needs to be stated. And this has to do with e-commerce. Many express serious doubts concerning whether or not competition law can control e-commerce and the new virtual selective distribution. As it is proven above, there should not be such a doubt. Regulation 330/2010 has already adapted selective distribution in a great extent to the latest market trends. However, more steps have to be made towards that goal, requiring not a pure legal, but also economical approach to this issue.

One last observation should be noted. Selective distribution is going through a process, which will result to the complete reformation of its characteristics. That is inevitable, because of the Internet's positive impact on the market. However, this reformation may need one last sacrifice; competition itself. A new competition approach and policy is necessary. Consumer welfare has to take the leading role, when regulating such matters. The maintenance of the manufacturer's leading role in the distribution's chain must not exceed the importance of consumer welfare, especially when there can be no negative consequences regarding the operation of the distribution system. Otherwise, there will always be barriers blocking the development of Internet sales and ultimately the development of selective distribution itself in the name of competition. Another paradox? Probably.

V. References

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