CHAPTER 14

SELECTIVE DISTRIBUTION AND ONLINE SALES AFTER THE *PIERRE FABRE* DECISION OF THE CJEU

IOANNIS APOSTOLAKIS[1]

SUMMARY

The treatment of vertical restraints under Article 101 TFEU by the European Commission and the Courts has traditionally been criticized as overly formalistic. A recent example is the *Pierre Fabre* judgment of the CJEU, where the Court ruled that an overall ban on Internet sales within a selective distribution network constitutes a restriction of competition by object and cannot, therefore, benefit from the exemption provided for by Regulation 330/2010. What is indeed very surprising about this decision is, as we shall examine in the following text, the absence of any economic arguments, as well as the obscurity of any legal reasoning put forward by the Court.

1 Ph.D. Candidate, University of Glasgow, School of Law.

I. INTRODUCTION

Article 101(1) of the Treaty on the Functioning of the European Union (hereinafter TFEU) prohibits

> all agreements between undertakings… which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.

The article is applicable not only to restrictive arrangements between competitors ('horizontal agreements'), but also to vertical relationships between undertakings, namely to agreements for the sale and purchase of goods and services which are entered into between undertakings operating at different levels of the production and distribution chain in relation to the contracted goods or services.

It is in every manufacturer's best interest to have its products as more widely disseminated as possible. To this purpose, the options that are available to the manufacturer can be divided in three broad categories: (a) vertical integration, (b) commercial agency, and (c) distributorship agreements. The main difference of these three methods lies in the degree of control exercised by the manufacturer (the 'upstream firm') over its dealers (the 'downstream firms') and it ranges from full control, in the case of vertical integration, to partial control, in the case of distribution agreements.

This partial control is essentially established through the assumption of various obligations on the part of the dealer (or occasionally the supplier), which limit – to a lesser or larger extent – the parties' freedom of action. Single branding agreements, exclusive and selective distribution schemes, as well as franchise networks all fall within this category and are restrictive of competition. Nevertheless, vertical restraints, as they are often called, are generally likely to result in enhancing efficiency and consumer welfare, and this likelihood is inversely related to the degree of market power enjoyed by the parties on either level of the distribution chain. Thus, the European Commission's treatment of vertical restraints tends to be much more lenient in comparison to its approach to restrictions of competition between direct competitors. To this purpose it has issued Regulation

330/2010[2], the so-called Vertical Restraints Block Exemption Regulation (along with its predecessor, Regulation 2790/1999[3]), so that any vertical agreement that meets the requirements set out by the Regulation falls outside the scope of the application of Article 101(1) TFEU. It is only the 'hardcore' restraints that cannot benefit from the Block Exemption Regulation[4], the most important of which are minimum resale price maintenance and absolute territorial protection.

II. SELECTIVE DISTRIBUTION IN GENERAL

Unlike in the case of exclusive distribution, a selective distribution agreement consists in the establishment of a distribution network, in which the number of dealers is restricted not on the basis of the number of territories, but rather on the basis of 'selection criteria linked in the first place to the nature of the product'[5]. Additionally, in the context of a selective distribution system, goods and services can be sold only to other members of the distribution network as well as end users; in other words, the manufacturer is free to prohibit any sales to non-authorised dealers[6]. Another difference between exclusive and selective distribution is that, in the case of the latter, the supplier cannot prohibit members of the network to actively sell to end users. The concept of 'active sales' refers to the active approaching of individual customers or of a specific customer group through various means, such as advertisement, promotions, unsolicited e-mails, etc[7]. By contrast, a sale is 'passive' when it consists in the dealer's response to unsolicited requests of individual consumers[8]. Any such clause would amount

2 Regulation 330/2010 on the Application of art. 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices [2010] OJ L 102/1.
3 Regulation 2790/1999 on the Application of art. 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices [1999] OJ L 336/21. These Guidelines expired on 31 May 2010.
4 *Supra* note 1, art. 4.
5 See Guidelines on Vertical Restraints [2010] OJ C130/01 (hereinafter: Vertical Guidelines), at para. 174.
6 *Ibidem*.
7 *Ibidem*, at para. 51.
8 *Ibidem*, at para. 52.

to a 'hardcore' restriction of competition, which would trigger the application of Article 101(1) TFEU. Moreover, the parties to the agreement will not be able to benefit from the respective Block Exemption Regulation[9], even though they can seek individual exemption under Article 101(3) TFEU.

A selective distribution system can be either 'purely qualitative', namely in the cases where dealers are selected on the basis of objective criteria dictated by the nature of the product, or 'quantitative', if a specific limit in the number of dealers is set by the supplier[10].

In its seminal judgment in the *Metro* case[11], the CJEU held that only a purely qualitative selective distribution system can be found to be compatible with Article 101(1) TFEU. And this can happen only where three requirements are satisfied. First, the nature of the product in question must necessitate a selective distribution system. Second, the criteria used for the selection of dealers should be of qualitative nature, laid down uniformly for all potential dealers and should not be applied in a discriminatory manner. Finally, the criteria should not go beyond what is necessary for the product in question.

With regard to the first condition, i.e. the nature of the product, it has been established from the Court's case law that the products the nature of which would justify a selective distribution network can be divided in two broad categories: technically complex products and luxury products. More specifically, products which have been held to meet this requirement are: televisions[12], hi-fis[13], cameras[14], personal computers[15], clocks and watches[16], gold and silver products[17], perfumes[18], dinner services[19], and cars[20].

9 See art. 4(b) of Regulation 330/2010.
10 Vertical Guidelines, at para. 175.
11 Case 26/76, *Metro-SB-Grossmärkte GmbH v. Commission (no. 1)* [1977] ECR 1875.
12 Case 75/84, *Metro v. Commission (no. 2)* [1986] ECR 3021.
13 *Grundig* [1985] OJ L 233/1.
14 *Hasselblad* [1982] OJ L 161/18.
15 *IBM* [1984] OJ L 118/24.
16 *Junghans* [1977] OJ L 30/10.
17 *Murat* [1983] OJ L 348/20.
18 *Parfums Givenchy* [1992] OJ L 236/11; *Yves Saint Laurent* [1992] OJ L 12/24; *Groupement d'Achat Edouard Leclerc v. Commission* [1994].
19 *Villeroy & Bosch* [1985] OJ L 376/15.
20 *BMW* [1975] OJ L 29/1.

More specifically, in its judgment in the *Leclerc* case[21], a landmark case concerning a selective distribution network for cosmetic products, the General Court held that such a distribution system fell outside Article 101(1) TFEU since it was a legitimate requirement in order for the prestige image of the brand to be preserved, as well as in order for the consumers' perception of the products as prestigious to be safeguarded. The only condition set out by the Court was that the qualitative criteria for the selection of retailers of luxury cosmetic products do not go beyond what is necessary to ensure that those products are suitably presented for sale.

III. ONLINE SALES

The rapid invasion of the Internet into the everyday lives of billions of people worldwide has brought about a real revolution to practically every aspect of our lives, and distribution of goods and services was no exception. E-commerce – the 'mercantile face of the Internet'[22] – changed the pattern of trade in most industries and, consequently, many antitrust law scholars have been concerned with the future of the application of the competition rules in this new environment.

Undoubtedly, e-commerce is not only here to stay, but has also become an ever developing alternative to the traditional patterns of commercial transactions. In the UK, almost 80% of the companies use the Internet as a distribution channel[23], whereas in 2012 online retailing accounted for 13.2% of all retail sales, increasing by 14% in comparison to 2011 (the EU average is 8.8% of all retail sales, 16.1% higher than the year before)[24].

The increasing significance of e-commerce is indeed not surprising at all if we take into account the important benefits that consumers are presented with. Never before had shopping been so quick and efficient: consumers have

21 Case T-19/92, *Groupement d'Achat Edouard Leclerc v. Commission*.
22 P. Kirch, 'The Internet and EU Competition Law' (2006) 5 J.I.T.L.&P. 18–35, 20.
23 Robertson, V, *'Online Sales Under the European Commission's Block Exemption Regulation on Vertical Agreements: Part 1'* (2012) 33 E.C.L.R. 132–137, 133.
24 Centre for Retail Research, 'Online Retailing: Britain and Europe 2012', available at http://www.retailresearch.org/onlineretailing.php [access: 2.03.2013].

the chance to choose from a wide variety of products that are being made available on numerous online outlets that are merely a couple of clicks away from each other. Moreover, access to these outlets is available 24/7, unlike the limited opening hours of the so-called 'brick-and-mortar' shops. The Internet also offers consumers the unique opportunity to check and compare prices for the same product on websites based in different countries, prices which, additionally, are usually lower online than in brick-and-mortar shops (due to the lower costs incurred by the online retailer). Last but not least, consumers can take advantage of the different customer-orientated websites in order to read reviews of products or find out about the best deals before making a purchase. As a result, e-commerce can be said to increase consumer welfare by offering lower prices, convenience in shopping and a broader selection of goods and services to customers in comparison to traditional sales methods.

IV. THE *PIERRE FABRE* CASE[25]

Pierre Fabre Dermo-Cosmétique was a manufacturer of cosmetics and personal care products which were sold mainly through pharmacists on both the French and the European markets. In 2007, *Pierre Fabre* had a market share of 20% on the respective market for France and was selling its products through a selective distribution network. The respective distribution agreements stipulated that the goods should be sold exclusively in a physical space and in the presence of a qualified pharmacist, thus imposing a ban on the online sales of Pierre Fabre's products.

Following an investigation, the French Competition Authority (*Autorité de la Concurrence*) ruled that the aforementioned practice infringed both Article L. 420-1 of the French Commercial Code and Article 101(1) TFEU, and, more specifically, held that an overall prohibition of Internet sales amounted to a restriction of competition by objet, unable to benefit from the Vertical Agreement

25 Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v. Président de l' Autorité de la Concurrence*.

Block Exemption Regulation (then Reg. 2790/1999). The French Competition Authority further found that the agreements were not eligible for an individual exemption under Article 101(3) TFEU, since the four requirements of the said provision were not met.

Pierre Fabre challenged this decision before the Paris Court of Appeals (*Cour d'appel de Paris*), which decided to file a reference for a preliminary ruling by the CJEU under Article 267 TFEU. It asked whether a general and absolute ban on Internet sales in the context of a selective distribution network constitutes a 'hardcore' restriction of competition for the purpose of the application of Article 101(1) TFEU, whether a selective distribution contract containing such a clause may benefit from the block exemption, and whether Article 101(3) TFEU could be applicable when the Block Exemption Regulation is not.

The Court started by noting that

> [f]or the purposes of assessing whether the contractual clause at issue involves a restriction of competition 'by object', regard must be had to the content of the clause, the objectives it seeks to attain and the economic and legal context of which it forms a part[26].

It then pointed out that, in the context of a selective distribution system, agreements that *de facto* prohibit a method of marketing products that does not require the physical movement of the customer are to be considered as restrictive of competition by object, unless the restriction can be objectively justified[27].

Despite reiterating that the operation of a selective distribution system is compatible with Article 101(1) TFEU, as long as dealers are selected on the basis of objective criteria of a qualitative nature, and notwithstanding the fact that it accepted that in the present case this requirement had in fact been met[28], the Court went on to examine whether 'whether the restrictions of competition

26 *Ibidem*, at para. 35.
27 *Ibidem*, at paras. 38–39.
28 *Ibidem*, at paras. 41 and 43.

pursue legitimate aims in a proportionate manner'[29]. The CJEU underlined that, in the light of the freedoms of movement, it has not accepted in previous cases arguments relating to the need to provide individual advice to the customer and to ensure his protection against the incorrect use of products put forward to justify a ban on internet sales. The Court further rejected the Pierre Fabre's argument that the prohibition was essential for the maintenance of the prestigious image of its products:

> [t]he aim of maintaining a prestigious image is not a legitimate aim for restricting competition and cannot therefore justify a finding that a contractual clause pursuing such an aim does not fall within Article 101(1) TFEU[30].

In the light of these assumptions, the CJEU concluded that, for the purposes of the application of Article 101(1) TFEU, in the context of a selective distribution system, an overall ban on online sales will be held to restrict competition by object, unless the relevant clause is objectively justified.

Finally, the Court confirmed that, as a hardcore restriction of competition, a general ban on Internet sales cannot benefit from the Vertical Agreements Block Exemption Regulation. It could, however, be exempted, on an individual basis, under Article 101(1) TFEU, if the referring court finds that the conditions laid down in that provision are met.

V. COMMENTARY

It has been argued that *Pierre Fabre* could be interpreted as meaning that the aim of preserving a luxury image is not sufficient to justify the use of a selective distribution system in the first place[31]; thus, essentially, the CJEU overruled the General Court's previous decision in *Leclerc*, and limits the categories of goods the nature of which would render a selective distribution network essential. We

29 *Ibidem*, at para. 43.
30 *Ibidem*, at para. 46.
31 See J. Knibbe, 'Selective Distribution and the ECJ's Judgment in Pierre Fabre', (2012) 33 E.C.L.R. 450–451, 451.

believe that a more accurate approach would be that the Court, committed to promote the use of the Internet as a means for the strengthening of interstate trade, regards e-marketplaces as a valuable opportunity in the service of the 'single market imperative'.

Nevertheless, *Pierre Fabre* is undoubtedly susceptible to criticism from a competition law standpoint. The Court's treatment of bans on Internet sales is almost frustratingly formalistic. The essence of the Court's reasoning is given in – literally – five sentences, without any reference to economic theory whatsoever. But even so, reading through the decision one would almost struggle to identify the legal arguments behind the classification of the prohibition on Internet sales as a 'hardcore' restriction of competition, so that it now falls in the same category of restraints as horizontal price fixing, horizontal market sharing and bid rigging, namely restraints that are by their very nature detrimental to competition. But is it the same case with the prohibition of Internet sales in a selective distribution system?

In order to answer this question, a distinction between the two types of competition with regard to its pattern should be made: *inter-brand* and *intra-brand*. Inter-brand competition refers to the competition between suppliers or dealers selling different brands of the same or equivalent goods. By contrast, intra-brand competition is the competition between distributors of the same supplier's products. Competition law scholars have traditionally argued that antitrust enforcers should focus on the protection of inter-brand competition, and be much more lenient with regard to the restrictions of intra-brand competition, which not only are considered by economists as less harmful to the consumer, but have been found to be a means for the promotion of the competition between suppliers.

The main argument in favour of restrictions in intra-brand competition was formulated in 1960 by Lester Telser in his seminal article 'Why should manufacturers want fair trade?'[32] Telser argued that vertical restraints may be employed by the manufacturer as a solution to the 'free rider' problem. More specifically, Telser argued that sales at the retail level depend on both the

32 (1960) 3 J. L. & Econ. 86.

product's price and the product-specific services provided by the retailer. Customers value the additional services, but, given the chance, they would rather buy the product at a lower price. In the absence of vertical restraints, retailers offering those special services would inevitably charge more than those who do not, due to the higher costs that the former incur. As a result, it is highly likely that a customer will be convinced to purchase a certain product by taking advantage of the pre-sales services provided by one retailer, but will eventually buy the product at a lower price from a competing dealer that offers no such services. Accordingly, fewer or no dealers will provide pre-sale services, which in turn will cause a reduction in the sales. Thus, the manufacturer can ensure that all dealers will provide the necessary tangible pre-sale services, which in turn will result in a raise in output, and, accordingly, in the stimulation of inter-brand competition.

The 'free rider' argument is also applicable in the case of the ban on Internet sales: by contrast to the members of a selective distribution network who have been chosen on the basis of objective qualitative criteria, online retailer does not offer any particular product-specific pre-sales services. It would thus be more than reasonable that a consumer would get all the necessary information about a product in a brick-and-mortar shop, say to the salesperson that he will 'think about it' on his way out, and then purchase the product online at a fraction of the price. More importantly, the free-rider problem could be, even more evident in the case of Internet sales, given that establishing an online retail outlet does not require nearly as much investment as setting up a brick-and-mortar shop.

In view of the CJEU's judgment in *Pierre Fabre*, some commentators have pointed out that the Court's objective was essentiall to 'promote the development of online distribution because it represents a new method of trading'[33]. But the question that instinctively crosses one's mind is: is in 2013 Internet in the need of any promotion in the first place? One would hardly think so… Internet is omnipresent in our everyday lives and nowadays it

33 L. Vogel, 'EU Competition Law Applicable to Distribution Agreements: Review of 2011 and Outlook for 2012'. (2012) 3 J.E.C.L.&P. 271–286, 272.

is not even only the younger generation that cannot imagine everyday life without access to it. As noted before, online sales keep increasing year after year and, even though it is hard to imagine that brick-and-mortar shops and showrooms will be rendered obsolete, the day will inevitably come when e-commerce will be a routine for everyone. Therefore, the Internet as a distribution network is nowadays already mature and this fact makes it different for one to understand how a differentiated treatment under EU competition law could be justified[34].

A final point that should be made is that it is apparent that the Court unequivocally accepted that, as long as the product is the same, the type of distribution channel is irrelevant. But is this always the case? Or do e-marketplaces constitute an entirely distinct market in their own right, separate from the traditional face-to-face commercial transactions? This is not a question that can be answered without an in-depth examination of the products and markets at issue, and definitely not a question to be – as in the present case – entirely disregarded by the enforcer. Besides, already in 1999 and in 2000, in two merger cases, *Bertelsmann/Mondatori*[35], and *UTC/Honeywell/i2/MyAircraft.com*[36] respectively, the European Commission did in fact consider the possibility that distant sales, which included *inter alia* sales via the Internet, could constitute a separate market. Notwithstanding the fact that there has not yet been a definite answer by the Commission, it is clear that the possibility of a differentiated market definition for traditional and online sales cannot be ruled out, especially in view of the potential existence of two types of customers respectively.

VI. CONCLUSION

The judgment of the CJEU in the *Pierre Fabre* case, despite introducing an overly harsh treatment of outright bans on Internet sales in the context of a selective

34 See also M. Velez, 'Recent Developments in Selective Distribution' (2011) 32 E.C.L.R. 242–247, 246.
35 Case M.1407, *Bertelsmann/Mondatori* [1999] OJ C 145/4.
36 Case M.1969 *UTC/Honeywell/i2/MyAircraft.com* [2000] C 198/06.

distribution system, could be said to introduce legal certainty with regard to the approach to such prohibitions. Nevertheless, it remains a decision that has been based on a literally non-existent economic reasoning and simultaneously on a highly questionable legal basis. Recently, the Paris Court of Appeals, in accordance with the judgment of the CJEU, upheld[37] the French Competition Authority's decision and imposed to *Pierre Fabre* a modification of its selective distribution agreement so that internet sales shall be allowed.

37 *Pierre Fabre* Dermo-Cosmétique/Autorité de la concurrence, Cour d' appel de Paris, Pôle 5, chambre 5–7, decision of 31 January 2013.