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Online Sales in Context of Selective Distribution

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Contents

Summary	3
1 Introduction	4
1.1 Research Background	4
1.2 Purpose	5
1.3 Method	5
1.4 Material	6
1.5 Delimitation	6
1.6 Outline	6
2 Online Sales as Distribution Channel	7
2.1 General Considerations	8
2.1.1 Encouraging Competition	8
2.1.2 Consumers' Benefits	8
2.1.3 Single Market	9
2.2 'Selective' Concerns	10
2.2.1 Matching Problem	10
2.2.2 Free Riding	11
2.2.3 Protecting Brand Image	12
3 Recent Changes in Online Sales Regime	13
3.1 Passive Nature of Online Sales	13
3.2 New Hardcore Restrictions	15
3.2.1 Website Re-routing	15
3.2.2 Credit Card Data Issue	17
3.2.3 Limiting Proportion of Online Sales	17
3.2.4 Dual Pricing	19
3.3 Acceptable Restrictions	20
3.3.1 Restrictions on Active Sales	20
3.3.2 Brick and Mortar Requirement	21
3.3.3 Quality Standards	22
3.3.4 Third Party Platforms	23
4 Pierre Fabre Landmark	25
4.1 Procedure before the Court	25
4.1.1 Factual Background	25
4.1.2 ECJ Findings	26
4.1.3 Advocate General Findings	28
4.2 Case Outcome and Consequences for Online Distribution	30
4.2.1 A Clear Message	30
4.2.2 Single Market Need	31
4.2.3 Restriction by Object	32
4.2.4 Objective Justification	33
4.2.5 Free Movement or Competition	35
4.2.6 Legitimate Aim	38
4.3 After-Fabre Experience	40
4.3.1 Factual Background and Decision	40
4.3.2 Argumentation for Appeal	41
4.3.3 Being Reasonable	42
5 Conclusion	44
Bibliography	46
Table of Cases	49

Summary

This thesis is devoted to integration of online sales into selective distribution system. Particularly, it evaluates regulatory documents, case law and doctrinal studies concerning online sales in order to make a prospective analysis of future development of online distribution and its coherence with selective distribution aims and realities.

The world has changed significantly due to development of technologies and Internet. The first Block Exemption Regulation and the accompanying Guidelines adopted in 1999-2000 did not provide sufficient regulatory basis to control online sales. Their amendment in 2010 in fact meant the beginning of the new age for vertical agreements in the European Union. Together with the relevant case law they serve as guidelines for manufacturers in organizing their selling networks.

However, the law can never satisfy everybody's interests. While the European Commission fights the European market partitioning, manufacturers using exclusive and selective distribution and other vertical restrains do not seem ready to introduce their products into the one-click distribution channel. The new provisions on online sales due to their controversial nature were seriously disapproved at their draft stage from the side of the companies owning luxury brands and most of law firms. Unfortunately, there exists no case law yet to assess the new rules in practice. The Pierre Fabre case decided on the basis of the old regulatory documents demonstrates both the producers' need to protect the image and the quality of their goods and the Commission's and the European Court of Justice's motivation to establish the single market. This opposition is likely to remain in the nearest future.

Therefore, a compromise decision shall be found in order to balance interests of producers, distributors and consumers taking into consideration political aspects.

1 Introduction

1.1 Research Background

The European Competition Law besides the objective to maintain an efficient competition as such has always been aiming to create the single market integrating all the Member States. Thus, vertical restrains had been regarded as an impediment to this supreme aim until the very end of 20th century, when the Commission was heavily criticised for ignoring possible pro-competitive character of vertical restrains.

Thus, in 1997 the Commission issued the Green Paper declaring a new approach towards vertical restrains. As a result, Regulation No 2790/1999¹ and the accompanying Guidelines² provided a new more economic based approach in assessing effects of vertical restrains on competition. However, in spite of such a big step forward these documents lost their relevancy very soon after their adoption.

The reason of their falling behind is the fast development of the Internet and online shops. Internet distribution has appeared as a separate distribution channel and has attracted many market players. At the same time, the Commission has recognised an integrative power of online sales; therefore, the Internet has become an important instrument for new markets penetration.

Before the expiry of Regulation No 2790/1999 and its Guidelines the Commission issued the Draft Regulation³ and the Draft Guidelines⁴ and opened public consultations. Plenty of documents were submitted before the Commission for

¹ Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (“Regulation No 2790/1999”) [1999] OJ L 336/21

² Commission Notice, Guidelines on Vertical Restraints [2000] OJ C 291 (“the old Guidelines”)

³ Draft Commission Regulation on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (“Draft Regulation”) <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/draft_regulation_en.pdf>

⁴ Draft Commission Notice - Guidelines on Vertical Restraints (“Draft Guidelines”) <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/draft_notice_en.pdf>

the analysis. Finally, it adopted the new Block Exemption Regulation⁵ and the accompanying Guidelines⁶ in 2010.

The new documents contain many provisions on online sales, which interpretation is rather controversial, especially in the context of selective distribution. As follows from the comments to the Pierre Fabre case⁷ – the only existing judgement on online sales on the European Union level, manufacturers of luxury goods and high-quality products may disfavour the established rules on Internet selling and argue for its detrimental effect on some products.

Future development of the case law will demonstrate whether the Commission's approach towards online sales is too strict, like it was with the vertical restraints, or the Commission follows the right direction.

1.2 Purpose

The thesis aims to examine the relevant documents, such as the VBER and the Guidelines, as well as the relevant case law in order to reveal the existing status of online sales, particularly in the context of selective distribution, its benefits, drawbacks and possible development. The questions to answer are if the current regime is appropriate for effective competition and if there could be more reasonable solutions in terms of consumer welfare.

1.3 Method

The method chosen for this paper is a traditional legal dogmatic method. The traditional method includes describing and systematic analysis of the applicable legislation, case law, doctrinal studies and research articles. The outcome of traditional method application is to reveal the status of online distribution in competition law of the European Union, its virtues and shortcomings and attempt to find possible solutions to the existing problems.

⁵ Commission Regulation 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (“the VBER”) [2010] OJ L102/1

⁶ Commission Notice, Guidelines on Vertical Restraints [2010] OJ C130/1 (“The Guidelines”)

⁷ Case C-349/09 *Pierre Fabre Dermo-Cosmétique SAS v Président de l’Autorité de la concurrence* [2011]

1.4 Material

The material for this research contains the Vertical Block Exemption Regulation and the accompanying Guidelines together with their draft versions and the relevant case law, such as the Pierre Fabre case and the Decision of French Competition Authority on the Bang & Olufsen case⁸. Doctrinal studies, research articles and contributions submitted before the Commission as public consultations are also of great value for the thesis.

1.5 Delimitation

This thesis covers the key issues on compatibility of the new online sales regime with the well-established principles of selective distribution. The main problems of interest concern safeguarding of brand image and other inherent features of selective distribution, such as a need to offer professional advice and to ensure the products' proper usage, when operating online distribution channel. Possible detrimental influence of Internet selling on producers of luxury and high-quality goods is emphasised.

1.6 Outline

The thesis consists of five chapters, where two of them are introduction and conclusion. The second chapter describes the theoretical aspects of online sales, especially in combination with selective distribution. The third chapter contains the analysis of the current regulatory basis of online sales; its comparison with the provisions offered in draft documents and describes possible consequences of such regime in practice. The fourth chapter examines the relevant case law and discusses its positive and negative issues.

⁸ République Française Autorité de la concurrence, *The Autorité de la concurrence fines Bang & Olufsen for prohibiting its approved distributors from selling its products online*, Press releases 2012, English version
<http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=418&id_article=2009>

2 Online Sales as Distribution Channel

In recent decades the Internet has developed dramatically and therefore the substantial share of commerce has expanded to the online space, which has become a significant part of everyday life. As a separate distribution channel Internet selling has its own peculiarities that influence competition in a specific way.

Before looking deeply into main features of online distribution and its legal regulation, it is worth explaining the position, from which all the following findings will be assessed, namely, whose benefits competition law aims to ensure.

Legal doctrine considers two main concepts as the aims of the EU competition law – consumer welfare and total welfare. Consumer welfare constitutes consumer surplus, however, it is not limited to the price, but also includes quality, range and service related to the price⁹. Consumer welfare can also be found in creating of incentives for manufacturers to innovations and inventions. Total welfare consists of consumer and manufacturer surplus. In other words, total welfare is economic efficiency, providing maximizing of consumer welfare and optimal allocation of resources¹⁰.

Nevertheless, the concept of total welfare is rather controversial and is often criticised for difficulties in practical implication and finding total welfare standard. Thus, competition authorities do not seem to adhere to it. The case law interpretation of the competition rules supports such position. Article 101(3) TFEU provides a possibility for an agreement to be exempted inter alia given it allows consumers fair share of the resulting benefit; and the European Court of Justice has recently confirmed that principle¹¹. Alternatively, competition rules and the case law do not contain any lead to manufacturers' welfare.

⁹ Pieter Kalbfleisch, *Aiming for Alliance: Competition Law and Consumer Welfare*, Journal of European Competition Law & Practice, 2011, Vol. 2, No. 2, p. 111

¹⁰ Paul Craig and Gráinne de Búrca, *EU Law: Texts, Cases and Materials, 5th Edition*, Oxford New York : Oxford University Press, 2011, p. 959

¹¹ Case C-501/06P *GlaxoSmithKline Services Unlimited v Commission of the European Communities* [2009] ECR I-9291

As follows from the aforementioned considerations, the concept of consumer welfare is prevalent and is used to decide competition cases, thus, it will be also adhered to in this thesis.

2.1 General Considerations

2.1.1 Encouraging Competition

As the efforts and sunk costs of establishing an online outlet are considerably lower than those for brick and mortar shops, the number of Internet resellers is constantly growing, thus, facilitating competition on the market.

Mostly it concerns intra-brand price competition. Internet transparency allows customers searching for better deals; therefore, price has become the decisive factor for a purchase. Nevertheless, non-price incentives are still high, since besides competing with each other online distributors have to compete with retailers operating physical outlets. The large number of competitors on the market consequently leads to improving of purchase terms and conditions and lower prices.

The same argumentation remains valid also for inter-brand competition. In fact, the Internet is merely a new space for distributing goods; hence, it is subject to relatively similar fair trade rules. Furthermore, in case many producers apply similar restrictions on online sales, this could cause cumulative effects, resulting in distortion of competition. Subsequently, such collusive practice might lead to maintaining artificially high prices and limited consumer choice in online stores¹².

2.1.2 Consumers' Benefits

Along with lower prices, convenience of online shopping is the most valuable aspect for many consumers.

The obvious advantage is a fast access to a large variety of stores in different countries. Despite online market fragmentation is still high¹³, some products are

¹² Viktoria H.S.E. Roberston. *Online sales under the European Commission's Block Exemption Regulation on vertical agreements: Part 1*, European Competition Law Review 2012, 33(3), pp. 132- 137.

¹³ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Cross-

available only in foreign online outlets, thus, the consumer can spend several minutes to buy a product via the Internet, which otherwise could be purchased only while visiting a particular state. Some online distributors offer a pre-order of goods not available at the moment, which is not typical for physical outlets.

Transparency of Internet shops appears very significant for consumers' choice. Firstly, customers can easily get almost all information about the product they are interested in and even take a look at other customers' feedbacks. The price transparency is of special value, since it allows consumers making better-informed choices and, hence, saving money. It is worth noticing that there exists a great amount of price-compare sites, which are able to compare not only prices, but also delivery costs and find the cheapest options.

The last point on online shopping convenience to present here is that "consumers should have the choice"¹⁴. This actually means that customers shall be free to decide on their own if they want to enjoy services of brick and mortar shops and, consequently, pay for them while paying for the product, or make a purchase online without such assistance yet at a lower price. However, customers could enjoy both services and low price, as it will be discussed further.

2.1.3 Single Market

Internet selling is perfectly suitable for development of the single market in the European Union. Unlimited access to the site from anywhere and developed postal and delivery services allow every online shop trading all over the European Union. However, there exist practical impediments for Union-dimension sales. As it has been stated in the Commission's report¹⁵ there are many reasons why online market remains fragmented. In particular, they are connected with customers' perception issues and lack of trust to online shops established in other Member States. While the

Border Business to Consumer E-commerce in the EU, COM(2009) 557 final <http://ec.europa.eu/consumers/strategy/docs/COM_2009_0557_4_en.pdf>

¹⁴ D. Waelbroeck, Partner Ashurst LLP, *Internet Distribution and Vertical Restraints* <http://www.ucl.ac.uk/laws/conferences/verticals/UCL_verticals_03_waelbroeck.pdf>

¹⁵ Commission Staff Working Document, Report on cross-border e-commerce in the EU, SEC(2009) 283 final <http://ec.europa.eu/consumers/strategy/docs/com_staff_wp2009_en.pdf>

Commission can hardly control consumers' preferences, it absolutely can take care of eliminating certain restraints on Internet selling, like it was done in 2010.

2.2 'Selective' Concerns

Online sales freedom is detrimental for manufacturers of certain products. While some producers aim to get rid of goods and to gain profit from every sold item, others have to care about prestigious image of their products as well.

2.2.1 Matching Problem

Complicated nature of some products and a need in professional advice may undermine sales of such products through the Internet. In case of luxury goods, the distribution channel shall be able to provide customers with 'product matching' services¹⁶. In physical outlets customers can try out the product in real light, feel its texture, compare the match with their image and also get individual advice. Physical proximity and a feedback provided by sales personnel is essential for some types of goods, thus, their availability in online stores might cause the problem of 'bad experience'. 'Bad experience' occurs when a person who has bought an unsuitable product may never buy goods of this brand again, even though his or her 'perfect product' is available in the product line, thus, the 'bad experience' of one product will be attributed to the brand as whole¹⁷.

On the other hand, not every type of products sold via selective distribution system experiences matching problem when selling online. Regarding computers, mobile phones, household appliances and other devices it should be noticed that it is even easier to find an appropriate product using Internet. Products' appearance and tactile perception are less important in this case. These products can be compared on the basis of objective characteristics and matched with actual customers' needs. Therefore, online distribution is beneficial for such products.

¹⁶ Cristina Caffarra, *An Economic Report for Chanel, Selective Distribution of Luxury Goods in the Age of E-Commerce*, (2008), p. 16
<http://ec.europa.eu/competition/consultations/2008_online_commerce/chanel_report.pdf>

¹⁷Ibid., p. 18

Nevertheless, online sales can be beneficial regardless of the type of goods. It happens given the product is bought by a repeat purchaser¹⁸. Repeat purchasers got advice in the past; hence, they cannot face a matching problem when shopping online. Apparently, online stores shall not discriminate against non-experienced customers; thus, this idea unfortunately cannot be implemented in practice.

2.2.2 Free Riding

At the end of the day, the most significant detrimental effect of Internet sales is free riding.

While some dealers reach lower prices and, thus, bigger demand via parallel imports into some state, and consequently, free ride only on official shops in this particular area, online stores with low prices potentially free ride on every authorised shop in all the states where they deliver to. Considering difference in standards of price and distribution costs in different countries, such practice could dramatically damage brick and mortar distributors. Online shops are limited in the ability to provide their own matching services and consequently they free ride on the services provided in brick and mortar outlets. Customers could try out a product and get consultation in a physical outlet and finally buy a product from an online shop, enjoying low retail price. As a result, a physical retailer's efforts are not paid for and an online reseller gets a customer and hence profit.

Theoretically the problem could be resolved if dealers charged for pre-sale services separately¹⁹. It would allow physical outlets being refunded for services provided for the customer even if he or she did not buy the product after being consulted. However, practical implication of such scheme is very complicated. Customers could pay for a certain period of time when services are provided. Though there is no guarantee that a sales employee's efforts are hard enough to justify the payment. The second option could be that the customer pays only when a successful 'match' is found. In this case, the customer could intentionally refuse appropriate products to avoid services payment and then buy the product online.

¹⁸ Ibid., p. 20

¹⁹ Ibid.

Nevertheless, there exists an example of a services fee. Recently Vera Wang bridal boutiques in Shanghai have started to charge approximately 500\$ for 90-minutes try-on²⁰. This new policy is aimed to protect intellectual property rights of the designer, since Chinese market has many counterfeit producers copying Vera Wang dresses. As the fee is deducted from the product price in case of purchase, customers who are intended to buy a dress will not spend extra money²¹.

2.2.3 Protecting Brand Image

Producers of luxury and technically sophisticated goods, besides investing in quality, also invest into the brand name and aura of luxury.

Luxury manufacturers' concerns are mostly connected with the customers' perception of online shops. If case they are seen as equal to high-class physical stores, online distribution is not to negatively influence the brand image. Alternatively, in case online shops are perceived as similar to discount outlets, this undermines the prestige of the brand.

In that consideration, the design of the website is of great importance. Trivial site environment and incorrect product presentation, such as inappropriate colours not associated with the brand, poor quality photos, insufficient description, etc., might destroy aura of luxury ascribed to the brand. Therefore, manufacturers tend to develop special 'Internet sales module' software²² in order to provide a uniform website image for every distributor.

Taking into account all the said above, it appears extremely important to find a balance between interests of producers, distributors, and certainly consumers in order to facilitate efficient competition on the market.

²⁰ Melanie Lee, Reuters, *Vera Wang scraps \$500 try-on fee in Shanghai*, (2013) <<http://www.nbcnews.com/business/vera-wang-scraps-500-try-fee-shanghai-2B9101156>>

²¹ Alexis Lai, Lucrezia Seu, *Vera Wang makes fashion faux pas at first China store*, (2013) <<http://edition.cnn.com/2013/03/28/business/china-vera-wang-discrimination>>

²² Caffarra, p. 19

3 Recent Changes in Online Sales Regime

The old Guidelines on Vertical Restraints of 2000 did not contain comprehensive provisions on online sales and treated the Internet as the means of advertisement rather than selling. The new Guidelines in paragraph 52 explicitly state that, "in principle, every distributor must be allowed to use the Internet to sell products".

The examples of the Internet restrictions provided in the Guidelines and other relevant issues are to be discussed below. It is important to mention that during the elaboration of the final versions, Commission received 164 documents²³ with comments on Draft Regulation and Draft Guidelines. Such contributions help to assess a problem from different points of view and will be used in the following discussion.

3.1 *Passive Nature of Online Sales*

The Guidelines expressly say that "in general, where a distributor uses website to sell products that is considered a form of passive selling, since it is a reasonable way to allow customers to reach the distributor"²⁴. Consequently, restrictions on online sales imposed by the supplier to its dealers are considered as hardcore restrictions and, hence, preclude a safe harbour of the VBER.

Nevertheless, one can argue the Commission's approach towards the nature of online sales. The current distinction between active and passive sales was useful prior to the development of Internet selling. Thus, the main criterion of passive sales is the existence of search costs for customers²⁵.

²³ The European Commission, Review of the competition rules applicable to vertical agreements, Public Consultations [webpage], (2013) <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html>

²⁴ The Guidelines, para 52

²⁵ European Competition Lawyers Forum (ECLF), *Comments on the Draft Block Exemption Regulation and Guidelines on Vertical Restraints* ("European Competition Lawyers Contribution") p. 13 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/europeancompetitionlawyersforum_en.pdf>

However, nowadays it is obvious that consumers' search costs to find the site of the local retailer or the site from abroad are not different. Moreover, customers are not aware of such distinction and do not aim to become a part of passive sales mechanism. Development of Internet shops has encouraged invention of price-compare sites and third party platforms that collect information on available goods. Typing the name of the product customers are interested in, they do not care from which part of the European Union they will get the item as long as the price and conditions are reasonable. In this regard, the Commission's statement that "offering different language options on the websites does not, of itself, change the passive character of selling" becomes undermined. In practice search engines find the relevant sites by matching the information typed by the user and the content of sites, subsequently, the spelling and the language of the site are of significant importance.

In abstract from such details it is worth saying that the Commission's approach is rather inconsequent. It tries to be progressive and draws a lot of attention to the Internet as to "a powerful tool to reach a great number and variety of customers than by more traditional sales methods"²⁶. However, the Commission does not consider online space as parallel to the real one, but more as complementary. Apparently such complementary nature has lead to the passive character of online sales. On the other hand, if Internet distribution channels and offline channels are parallel to each other, they must be supported by equal regulatory policy and, furthermore, with the policy on their interaction. Considering online sales within selective distribution, "it is simply another distribution channel and suppliers should be free to put restrictions and qualitative criteria on online distributors that achieve the same objectives as with brick and mortar distribution"²⁷.

Moreover, it appears that the Commission while considering online sales as passive sales implicitly admits that operation of an Internet shop may constitute the main activity of the distributor. Thus, as a 'bonus' to selective distribution according to the Guidelines²⁸ the supplier may require distributors to have at least one brick and

²⁶ The Guidelines, para 52

²⁷ A S Watson Europe, *Response to the Commission's review of the Block Exemption Regulation and Guidelines on vertical restraints*, p. 7<
http://ec.europa.eu/competition/consultations/2009_vertical_agreements/aswatson_en.pdf>

²⁸ The Guidelines, para 54

mortar shop. In this respect the useful example is provided in one of the contributions submitted before the Commission²⁹. Thus, the dealer of luxury goods could operate a small brick and mortar shop, for instance, in Malta, while distributing the goods via the Internet all over the European Union. Is it still true that its small shop in Malta is the active sales point and the EU-delivery online store is an additional passive business? One more example could be distributing of the software, computer games, music and movies through the Internet, particularly via such platforms as App Store, iTunes, Google Play, Marketplace, Amazon, Spotify, Steam etc. Obviously due to the digital nature of some products it makes almost no sense to buy them from offline shops. The same question arises – is it still ‘passive distribution’ – and the answer seems to be totally opposite to the Commission’s view.

As it has been mentioned above the Commission is interested in development of the single market. Internet sales as “a powerful tool to reach a great number and variety of customers” shall encourage such development. This may be the reason why the Commission protects online sales so carefully. Having given them the notion of ‘passive sales’, the Commission, therefore safeguards online sales from vertical restraints, since general prohibition of passive sales is the hardcore restriction under the VBER. However, the development of the single market through the system of passive sales seems to be a logical mistake in this complex idea.

3.2 New Hardcore Restrictions

3.2.1 Website Re-routing

The first example of the hardcore restrictions on passive selling is preventing customers located in another territory from viewing the distributor’s website or automatically re-routing customers from this site to manufacturer’s or other distributors’ websites.³⁰ Having appeared in the Draft Guidelines without any additional explanations this clause was argued in the contributions submitted before

²⁹ Clifford Chance LLP, *Response of Clifford Chance LLP to the European Commission’s Consultation on the Review of the Competition Rules Applicable to Vertical Agreements*, (“Clifford Chance LLP Contribution”), p. 7 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/cliffordchance_en.pdf>

³⁰ The Guidelines, para 52

the Commission. In particular, it is discussed that re-routing does not aim to partition the market, though to be sure that customers are provided with the sufficient level of services.

The main argument is that the customers shall be advised in the language that is intelligible to them. The example provided is that if the user intends to buy a hair colorant, which might cause allergic reaction, he or she must be informed of that³¹. Furthermore, automatic re-routing does not prevent the customer from buying the product from the initial website he is visiting or any website he wishes, though “the supplier must be allowed to ensure he has been properly informed beforehand”³².

Others insist that re-routing can be beneficial for end-customers in terms of consumer protection. Thus, “web re-routing may serve to address legitimate concerns regarding disparate legislative systems and trading conditions, but also to minimise free-riding risks and to provide for adequate liability structures”³³. At the same time, prohibition of re-routing could compromise the efficiency of the distribution network structure through eliminating competitive online and offline dealers. However, further argumentation has not been provided.

As it is seen from the Guidelines the Commission has not changed the approach. Nevertheless, the initiatives on customer friendliness have been heard, because the offer of the relevant links to the manufacturer’s or other distributors’ websites is not regarded as hardcore restriction³⁴. The Commission’s decision seems very reasonable, since if producers care about the level of services and the language of the site, they could offer to visit the other webpages through the pop-up window,

³¹ The European Cosmetics Association Colipa, *Comments by Colipa on the Proposed Review of Competition Rules for the Distribution Sector*, p. 4 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/eucosmeticsassocolipa_en.pdf>

³² Ashurst LLP, *Response to DG Competition’s Draft Revised Block Exemption and Guidelines for the Assessment of Vertical Agreements under EC Competition Law*, p. 3 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/ashurst_en.pdf>

³³ Estée Lauder Companies, *Consultation on The Proposal for a Vertical Restraints Block Exemption Regulation and its Guidelines*, pp. 21-22 (“Estée Lauder Companies Contribution”) <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/esteelaudercompanies_en.pdf>

³⁴ The Guidelines, para 52

for example. Automatic re-routing appears to be a hard selling practice that is simply impolite towards customers.

3.2.2 Credit Card Data Issue

The next hardcore restriction is termination of consumers' transactions over the Internet once their credit card data reveal an address that is not within the distributor's territory³⁵. This novelty was not criticised by its meaning, though the current wording is not absolutely clear.

Nowadays the possibility to pay with the card everywhere means a lot for customers and the Internet is not an exception. Free movement of persons as one of the main freedoms of the European Union creates situations where people live out of the territory where their bankcards are registered. Obviously, such people shall not be deprived from online shopping in the region where the online shop delivers to, because of the card data. It seems that the Commission's intention was to cover not only credit cards, but also debit cards by such restriction, otherwise, an explanation shall be provided. Some customers prefer using paying systems, such as PayPal, Moneybookers etc., since they provide high-level data securement. Nevertheless, the current wording can hardly be interpreted as to cover paying systems as well. The Commission shall take that inaccuracy into account when amending the Guidelines in the future.

3.2.3 Limiting Proportion of Online Sales

Limiting the proportion of distributors' overall sales made over the Internet is another hardcore restriction. The Guidelines add that this does not preclude the supplier from requiring its distributors to sell at least a certain absolute amount (in value or volume) of the products offline to ensure an efficient operation of its brick and mortar shop. This absolute amount can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location³⁶.

³⁵ Ibid.

³⁶ Ibid.

This clause was intensively criticised especially in connection with the supplier's right to require its distributors to have at least one brick and mortar shop³⁷. Thus, some authors³⁸ believe that if there is a condition to operate a physical point of sale it is consistent to impose a reasonable proportion between online and offline sales. Otherwise, distributors could circumvent such requirement by operating a 'sham-shop'³⁹ and mostly sell goods online.

Thus, the most relevant problem for selective distribution is free riding. Limiting the proportion of Internet sales will create incentives for dealers to invest into offline shops, hence, maintaining retail environment and the level of services that are so important for selective distribution. In its contribution Estée Lauder tried to draw the Commission's attention to the problem of free riders in luxury goods industry and the need to limit online sales. It stated, particularly, that in case 'the prestige cosmetics and fragrances industry' is wrong about importance of the current issue, the consequences for competition on the market could be not significant, on the contrary, if the industry is right about detrimental effect of such provision, the harm could be significant in terms of "of lost revenue, jobs, innovation and consumer choice and loss irremediable"⁴⁰. Moreover, the good example is that such practice was supported in Germany. The Federal High Court considered that "it is neither discriminatory nor unjustified within a selective distribution system to tie supply to the condition that at least 50% of all sales must be made through the brick and mortar store"⁴¹.

The alternative given by the Commission for effective operation of offline shops was not supported. Conversely it was stated that the wording is rather ambiguous and demands further explanation. Thus, if it comes to absolute value of offline sales, does it refer to the sales from the supplier to the distributor or to the retail sales from the distributor to final customers? The latter option might raise retail price maintenance issues according to the American Bar Association's point of

³⁷ Ibid., para 54

³⁸ European Competition Lawyers Contribution, p.18

³⁹ Ibid., p. 17

⁴⁰ Estée Lauder Companies Contribution, p. 24

⁴¹ BGH, Az. KZR 2/02, Depotkosmetik im Internet [2004] DB 311

view⁴².

In general limiting the proportion of online sales seems to be a more reasonable solution. Adjusting the absolute amount of the products to be sold offline to the size and location distributors might negatively influence non-discriminatory manner of the supplier-distributors relations. Imposing a limit on online sales is “a much more efficient, accurate and straightforward way to prevent free-riding”⁴³.

3.2.4 Dual Pricing

The last example of hardcore restrictions provided in the Guidelines is setting a higher price for products to be sold by the distributor online than for products to be sold offline. The Commission adds that this does not exclude the supplier agreeing with the buyer a fixed fee to support the latter's offline or online sales efforts, while this fee is not a variable fee, where the sum increases with the realised offline turnover as this would amount indirectly to dual pricing⁴⁴.

As it is impartially stated in one of the submissions, the dual pricing strategy could be caused by different business and legal factors in different market areas; furthermore, “it would also be imprudent for decision makers to intervene in a company's pricing policy by actually redistributing the profits in terms of fixed fees”⁴⁵. The decision to use the system of dual pricing may be justified by the fact that producers aim to encourage their retailers to invest in brick and mortar shops. Lower purchase price allows setting higher retail margin and, hence, higher profit earning. Difference in prices could be affected by objective findings, such as average additional expenses for maintaining physical sales environment and services, average additional costs for rent, personnel training etc.

⁴² American Bar Association, *Joint Comments of the American Bar Association Section of Antitrust Law and Section of International Law on the Proposal of the European Commission for a Revised Block Exemption Regulation and Guidelines in Supply and Distribution Agreements*, p. 13 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/americanbarassociation_en.pdf>

⁴³ Clifford Chance LLP Contribution, p. 8

⁴⁴ The Guidelines, para 52

⁴⁵ Estée Lauder Companies Contribution, p. 27

The fixed fee is not able to serve the same goal, since it ignores that distribution costs differ depending on the volume of goods sold. Therefore, the distribution channel concerned can be compensated more efficiently and accurately by differential pricing policy, while fixed fees “do not make commercial sense to drive the investment sought”⁴⁶.

Having heard the public opinion, the Commission has added one more clause on dual pricing⁴⁷. It explicitly states that the agreement containing dual pricing provision may satisfy conditions of article 101(3) TFEU⁴⁸ and, thus, be exempted. In this case, the burden of proof would be on the manufacturer.

3.3 Acceptable Restrictions

3.3.1 Restrictions on Active Sales

Despite the general concept an attempt to show the possibly active character of online sales was made in the Draft Guidelines. Having presented the issue that online selling may be considered as active sales when it is specifically targeted to certain customers⁴⁹, the Commission has developed this idea further stating relevant examples⁵⁰. Thus, territory-based banners constitute the form of active selling on the territories where they are shown. Paying to search engines or advertisement providers to reach customers on a certain territory is regarded as active sales as well. Therefore, the supplier is free to prohibit such activity.

Nevertheless, it should be noticed that when customers search for something in the Internet, the high rated sites would be shown only if their content to some extent is compatible with the user’s request. At the same time the content of territory-based banners mostly depends on the previous requests of the user. Thus, such advertisement is contextual and predetermined by customers themselves.

⁴⁶ Baker & McKenzie, *Vertical Restraints – Response to Consultation*, p. 7 <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/bakermckenzie_en.pdf>

⁴⁷ The Guidelines, para 64

⁴⁸ Treaty on the Functioning of the European Union [2008] OJ C 115/47, art. 101(3)

⁴⁹ Draft Guidelines, para 53

⁵⁰ The Guidelines, para 53

Subsequently, this undermines the examples given by the Commission and even more blurs the boundaries between active and passive online sales.

However, this provision seems to be the first step for online sales to become equal to offline distribution. In the meantime, producers at least have the possibility to restrict advertisement activities of their distributors.

3.3.2 Brick and Mortar Requirement

As it has been mentioned above the Guidelines allow producers requiring its distributors to operate one or more brick and mortar shops or showrooms as a condition to be authorised dealers within a selective distribution system. The views on this novelty vary significantly.

On one hand, brick and mortar clause appears to be inconsistent with the Commission's objectives. While emphasising the importance of market integration and treating the Internet sales as a new dynamic and innovative level of distribution, the Guidelines permit such barriers to entry the distribution system. It is certainly not an obligation for suppliers to require a physical outlet, though the majority will prefer to include this clause in the criteria, thus, foreclosing some distributors⁵¹.

There for sure exist certain distributors who meet all the producer's criteria, excepting the brick and mortar one. However, it does not necessarily mean that they are potential free riders. Firstly, pure players have to invest in their virtual shops as well as physical retailers. Web-design, structure of the website, updating content, integration of paying systems according to data safety requirements, driving traffic, providing online consultations, establishing logistics system and many other demand financial, time and human recourses. Moreover, some studies reveal the other side of free-riding problem⁵². Easy access to and user-friendly environment of the online-shop allow customers to get all the information they are interested in, including approximate price, and then make a purchase from a brick and mortar shop, because they might need the product immediately. It is absolutely true that some customers

⁵¹ European Competition Lawyers Contribution, p. 18

⁵² Report on cross-border e-commerce in the EU, SEC (2009=283), 5 March 2009 and Forrester Research Report, 29 July and updated 6 August 2009, Profiling the Multichannel Consumer, by Patti Freeman Evans, cited in European Competition Lawyers Contribution, p. 19

would prefer to be consulted by the webpage than by shop assistants. Hence, in this case physical shops free ride on pure players.

On the other hand, dominance of online distribution may distort incentives of retailers to invest in brick and mortar shops and negatively influence the value of customer services up to their elimination. If customers manage shopping online without technical advice, product demonstration and possibly after-sales services, would it be any sense to invest in them? The brick and mortar requirement is a chance to safeguard ‘aura of luxury’ that is so important for producers.

However, the effect from brick and mortar requirement is significantly undermined by prohibition to combine selective and exclusive distribution systems⁵³. The Guidelines say that authorised dealers may be prevented from retailing from different premises or from opening a new outlet in a different location. However, launching website is not considered as opening the new outlet, therefore, the supplier is not entitled to impose territorial restrictions on the online store activity. This apparently might result in ‘Malta example’, where the distributor has one small physical shop in Malta and the Internet store with delivery all over the European Union.

In this consideration, the solution could be to require the distributors to have a brick and mortar shop in every state, where their online shop operates. This seems reasonable and fair, since in that regard online distributors would not free ride on someone else’s investments in a certain area, but would contribute into reputation as well. At the same time, it is quite clear that the Commission will never impede market integration in such way for the benefit of luxury goods industry.

3.3.3 Quality Standards

According to the Guidelines the manufacturer is entitled to require quality standards to use the Internet site to resell its goods⁵⁴. These standards or criteria, however, must be overall equivalent to the criteria imposed for the sales from physical outlets. Otherwise, imposing stricter requirements for authorised retailers, which dissuade them from using the Internet, is regarded as a hardcore restriction and,

⁵³ The Guidelines, para 57

⁵⁴ Ibid., para 54

therefore, prohibited. It should be noticed that criteria must not be identical, though rather pursue the same objectives and achieve comparable results, while difference in criteria must be justified by peculiarities of online and offline retailing respectively.

When reading this novelty, one might feel that even the Commission is not sure that it is possible to elaborate equivalent criteria for operation of brick and mortar and Internet shops. There are a lot of specific issues that need absolutely different approaches depending if products are sold online or offline, for instance, after-sale services, faulty product problem, security requirements for payments etc. Instead of discussing real-life examples that could occur, it shall be emphasised how the Commission treats the possible non-equivalence of standards. It basically states that dissuading distributors by imposing non-equivalent criteria is a hardcore restriction, thus, this precludes the benefit from the VBER. In the meantime, in order to be still exempted the supplier must prove that the offline and online criteria pursue the same objective and their results are comparable. Furthermore, the difference in standards must be justified by the nature of the distribution modes. As a result, if the Commission finds the criteria non-equivalent, the supplier would bear significant burden of proof to show that it does not dissuade distributors referring to such vague and estimative terms as ‘same objectives’, ‘comparable results’ and ‘distribution mode nature’.

Unfortunately, while granting a right to require quality standards for online stores, which is, by the way, obviously the main sense of selective distribution, the Commission has created a new hardcore restriction. This amendment appears to be overly harsh, since “hardcore restrictions must be limited to the most serious distortions of competition”⁵⁵.

3.3.4 Third Party Platforms

According to the Guidelines the supplier may require its distributors to use third party platforms only in accordance with conditions and standards agreed. The current provision was not included into the Draft Guidelines and, therefore, was not discussed in the submissions.

⁵⁵ European Competition Lawyers Contribution, p. 20

After the adoption of the Guidelines the wording of this provision was criticised⁵⁶. Obviously, the clause states that suppliers can impose requirements on the use of third party platforms; however, its indirect meaning is that distributors are free to choose third party platforms for operating online stores without the suppliers' consent. The European Luxury Coalition believes that such practice might be detrimental for selective distribution. In particular, the distributor could disclose confidential commercial information to a third party, such as "the stocking, logistics and marketing of products, as well as any customer relationship management"⁵⁷. In this regard a third party involvement must be minimised only to technical support of the site.

⁵⁶ Observations of the European Luxury Coalition, including Comité Colbert, Altgamma, Walpole and the Spanish Luxury Forum, on the final draft of the Commission's Block Exemption and Guidelines on Vertical Restraints submitted to inter-service consultation 18 February 2010, 1 March 2010, p. 2 <http://www.eccia.eu/uploads/media/Revision_of_the_Verticial_Restraints_Block_Exemption.pdf>

⁵⁷ Ibid.

4 Pierre Fabre Landmark

The only case that could be helpful for understanding of the current policy towards Internet sales in practice is the judgement of the European Court of Justice on Pierre Fabre Dermo-Cosmétique distribution system⁵⁸. Despite the case was decided in accordance with the old Regulation No 2790/1999, its argumentation remains in line with the VBER.

4.1 Procedure before the Court

4.1.1 Factual Background

Pierre Fabre (a member of Pierre Fabre group) is a company that manufactures and sells cosmetics and personal care products. These products are not classified as medicines and, hence, are not covered by the pharmacists' monopoly. The market share of Pierre Fabre group on the French market for those products is approximately 20%.

Pierre Fabre uses selective distribution system to sell its goods. The clause, which had drawn the interest of the French Competition Authority, was the requirement for authorised dealers that “sales must be made exclusively in a physical space, in which a qualified pharmacist must be present”⁵⁹. The Competition Authority considered that such requirement excludes *de facto* all forms of selling online and ruled that Pierre Fabre must amend the existing distribution agreements in order to enable the retailers to sell via the Internet.

The decision was contested by Pierre Fabre and, finally, reached the ECJ with the question for a preliminary ruling: “Does a general and absolute ban on selling contract goods to end-users via the internet, imposed on authorised distributors in the context of a selective distribution network, in fact constitute a ‘hardcore’ restriction of competition by object for the purposes of Article 81(1) EC [Article 101(1) TFEU] which is not covered by the block exemption provided for by Regulation No

⁵⁸ C-349/09

⁵⁹ *Ibid.*, para 12

2790/1999 but which is potentially eligible for an individual exemption under Article 81(3) EC [Article 101(3) TFEU][?]⁶⁰.

4.1.2 ECJ Findings

The ECJ started its analysis by refusing the concept of ‘hardcore restriction’, since neither article 101 TFEU nor Regulation No 2790/1999 referred to it. Thus, the objective was to determine if a ban on online sales constitutes a restriction of competition by object.

The Court stated that where the anticompetitive object of the agreement is established it is not necessary to examine its effect on competition, however, according to the case law⁶¹, “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”⁶².

The ECJ supported the referring court finding that the requirement that a qualified pharmacist must be present at physical outlets *de facto* prohibits dealers to sell goods online. Therefore, it is liable to restrict competition in cosmetics and personal care products sector, since it reduces the ability of official retailers to sell products outside their territory by excluding the method of selling, which does not require physical movement of customers.

Referring to the AEG-Telefunken v. Commission judgement⁶³, the Court assumed that despite selective distribution agreements necessarily affect price competition on the market, they may facilitate competition relating to other factors than price and, therefore, be compatible with article 101(1) TFEU. Mentioning the landmark decisions on selective distribution⁶⁴, the ECJ emphasised that to be in conformity with EU competition law, members of such networks must be chosen “on the basis of objective criteria of a qualitative nature, laid down uniformly for all

⁶⁰ Ibid., para 31

⁶¹ Case C-501/06P

⁶² C-439/09, para 35

⁶³ Case C-107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the European Communities* [1983] ECR 3151

⁶⁴ Case C-26/76 *Metro SB-Großmärkte v. Commission* [1977] ECR 1875, Case C-31/80 *NV L'Oréal and SA L'Oréal v PVBA "De Nieuwe AMCK"* [1980] ECR 3775

potential resellers and not applied in a discriminatory fashion”⁶⁵. Also the characteristics of goods must necessitate selective distribution in order to preserve their quality and ensure their proper use and, in the meantime, selective criteria must not go beyond what is necessary. The ECJ stated that Pierre Fabre undoubtedly observed the first rule, but added that the legitimate aim and proportionality of the restrictions must be determined.

Pierre Fabre presented two main arguments to justify its ban on Internet sales. Firstly, professional advice of qualified pharmacists improves the level of services customers enjoy and allow to find a product, which matches a customer best due to direct observation of his or her skin, hair and scalp. In other words, the condition at issue is justified by public health reasons. Thus, online selling lacks this advantage and consumers might buy products that are detrimental for them. Moreover, such requirement reduces risks of counterfeiting and free riding in derma-cosmetics industry. The second argument is the need to maintain a prestigious image of the brands concerned. Pierre Fabre referred to the *Copad v. Dior* judgement⁶⁶ citing that selling products from online stores (or discount stores, which are of issue in the case) “damages the allure and prestigious image which bestows on them an aura of luxury”.

Relying on its case law⁶⁷ the ECJ stated that, when it comes to non-prescription medicine, the arguments relating to personal advising and protection against inappropriate use of products cannot be accepted. Regarding the second Pierre Fabre’s argument the Court just noted that, “the aim of maintaining a prestigious image is not a legitimate aim for restricting competition”⁶⁸ without any further explanation.

Finally, the ECJ came to the conclusion that the clause at issue constitutes a restriction of competition by object.

The second part of the judgement concerns the possibility of block exemption or individual exemption under article 101(3) TFEU. In this regard Pierre Fabre

⁶⁵ C-439/09, para 41

⁶⁶ Case C-59/08 *Copad SA v Christian Dior couture SA and Others* [2009] ECR I-3421

⁶⁷ Case C-322/01 *Deutscher Apothekerverband eV v. 0800 DocMorris NV and Jacques Waterval* [2003] ECR I-14887, Case C-108/09 *Ker-Optika v ÁNTSZ Dél-dunántúli Regionális Intézete* [2010] ECR I-0000

⁶⁸ C-439/09, para 46

claimed that, “the ban on selling the contractual products via the internet is equivalent however to a prohibition on operating out of authorised place of establishment”, that is permitted under Regulation No 2790/1999. Nevertheless, the Court interpreted ‘a place of establishment’ as only an outlet where direct sales take place.

As a result, according to the ECJ, a ban on Internet sales at the very least has as its object the restriction of passive sales to final customers, who cannot purchase the product in brick and mortar shop and wish to buy it online. Thus, the agreement containing such clause cannot benefit from the block exemption. However, it still can satisfy the conditions of article 101(3) TFEU and be exempted on an individual basis.

4.1.3 Advocate General Findings

Comparing to the judgement itself the opinion of Advocate General Jan Mazák contains more profound analysis of the case. The most important issues and ideas are to be presented below.

The first thing to mention is the French Government’s consideration on anticompetitive nature of the clause at issue. While, on one hand, the French Government assumed that the ban on Internet sales may be regarded as a restriction by object, on the other, it is necessary to assess its positive and negative effects on competition, since “there is currently inadequate experience on whether the ban in question has by its very nature the object of restricting competition”⁶⁹. Thus, the ban could contribute into enhancing brand image and luxury status of the product, hence, facilitating inter-brand competition.

The next issue concerns the concept of objective justification and its interpretation. According to the French Competition Authority the objective justification concept can be applied only in two instances. Firstly, it is possible to justify a restriction, where such practice derives directly from national or EU law and aims to protect public sphere; secondly, in exceptional cases, where the agreement objectively necessitates the practice to exist. In other words, this narrow interpretation only allows justifying restrictions independent from the undertaking’s commercial choices. In the Commission’s view, “undertakings may not in principle replace the

⁶⁹ Case C-349/09 *Pierre Fabre Dermo-Cosmétique SAS v Président de l’Autorité de la concurrence* [2011], Opinion of AG Mazák, para 21

competent public authorities in establishing and enforcing the requirements concerning the safety of products and the protection of public health”⁷⁰. Therefore, Pierre Fabre’s arguments on the correct use of personal care products and public health and safety claims are objectively unfounded.

Advocate General Mazák pointed out that he would not exclude the possibility that private voluntary measures setting ban on online sales could be objectively justified due to the nature of the goods concerned or customers to whom they are sold, in exceptional circumstances. He added, that in his view, “the legitimate objective sought must be of public law nature and therefore aimed at protecting a public good”⁷¹.

The last thing here to emphasise is the context of selective distribution. Despite the Advocate General’s analysis had the same conclusion that the Court came to, it treats the ban on Internet sales as just one of the conditions of Pierre Fabre’s selective distribution system, rather than a threat to market integration. Thus, in Advocate General’s view, the products of Pierre Fabre were appropriate for using selective distribution, and, furthermore, the requirement to have a pharmacist at the outlets did not aim to restrict parallel trade, but rather to safeguard the brand name by providing high-level services and personal advice to the customers directly and immediately at the point of sale.

Moreover, Advocate General assumed that there could exist exceptional circumstances where online sale could undermine the prestigious image and the quality of goods, thus, being an objective justification for ban on online sales. In this light, the referring court (apparently while examining the possibility of individual exemption) should assess whether it is possible to adequately provide all the necessary information online and even to advise customers online answering the submitted questions.

⁷⁰ Ibid., para 33

⁷¹ Ibid., para 35

4.2 Case Outcome and Consequences for Online Distribution

As the first case on Internet selling the Pierre Fabre judgement has been actively discussed and criticised. Its perfect compatibility with the new VBER and unambiguous message in fact mean the beginning of the Internet age for distribution in the European Union. The most disputable and significant issues of the ‘pioneer’ ruling will be presented as follows.

4.2.1 A Clear Message

The main outcome of the judgement is a direct answer to the referred question. Starting with Pierre Fabre a general and absolute ban on Internet sales constitutes a restriction by object. It precludes a safe harbour of the VBER and can be possibly exempted only in accordance with article 101(3) TFEU.

Analysing the case together with the new VBER and the Guidelines, a total prohibition on ban on online sales is compensated to some extent by manufacturers’ right to require one or more brick and mortar shop, to impose conditions on online stores, which are equivalent to the conditions imposed on physical outlets, and to restrict active online promotions, etc. However, it is obvious from the contributions submitted before the Commission that luxury producers for sure cannot agree that such approach is balanced.

One more clearly declared idea is that Internet store is not treated as ‘a place of establishment’. The Court had to emphasise that, since Regulation No 2790/1999 and the old Guidelines (2000) did not contain any explanations concerning online sales in that respect. However, the Guidelines now stipulate that, “the use by a distributor of its own website cannot be considered to be the same thing as the opening of a new outlet in a different location”⁷².

⁷² The Guidelines, para 57

4.2.2 Single Market Need

As it follows from the reports on cross-border e-commerce⁷³ the Commission put serious expectations for the Internet for creation of the single market. This policy is most likely to be supported by the ECJ. The progressive economic approach, which was used successfully for amending the VBER and the Guidelines by the Commission and which showed its best in the recent GlaxoSmithKline case⁷⁴ decided by the ECJ, however, did not appear in Pierre Fabre. The Court seemed to adhere to traditional formal principles and to a certain degree neglected economic considerations. The choice of the approach is crucial for cases, like Pierre Fabre, since no precedents are available yet and this first ruling becomes a guideline for the future.

Using the traditional approach, it is sufficient to establish that a restriction at issue is a restriction by object, i.e. prohibited automatically. On the contrary, effects-based approach treats economic analysis as a dominant decisive factor of the case; hence, the effects on the competition must be assessed taking into account the parties' market shares, strength of competition on the market and other relative factors. Apparently, the outcome of the case could have been different provided the Court had used the economic approach to examine the ban on Internet sales.

Some authors⁷⁵ note that the Court, although mentioned that in order to establish a restriction by object the economic and legal context of the clause at issue must be taken into consideration, failed to follow this point. In this regard, the disproportionate manner of the ban on Internet sales established by the Court cannot serve an indisputable evidence of a restriction by object. In this particular case the Court, probably, did not pay sufficient attention (to the current) market situation. Thus, the Pierre Fabre's market share is only 20%, while its competitors do not prohibit their distributors to operate online shops. Intra-brand competition would not be reduced significantly, since on the territory of France Pierre Fabre products are sold through 23,000 pharmacies⁷⁶. In the meantime, inter-brand competition on cosmetics and personal care products is very strong as well due to a large number of

⁷³ COM(2009) 557 final, SEC(2009) 283 final

⁷⁴ C-501/06P

⁷⁵ Louis Vogel, *EU Competition Law Applicable to Distribution Agreements: Review of 2011 and Outlook for 2012*, *Journal of European Competition Law & Practice*, 2012, p. 3

⁷⁶ C-349/09, Opinion AG, para 19

manufacturers and also due to the fact that most of the products with the same status on the market as Pierre Fabre products are sold by the same distributors, in particular pharmacies, offline and online. Summing up, the effect of the Pierre Fabre's ban might not have been such detrimental as to constitute a restriction on competition. It goes without saying that the brief description of the market situation presented above cannot provide a sufficient reasoning to decide a case. However, it would have been helpful if the Court had conducted an economic analysis in order to reveal importance of online sales freedom.

In the meantime, the decision must not be considered regardless of competition policy and economic situation in the European Union as whole. The goal of European integration, including market integration, is enshrined into the TFEU. The decision that permits ban on online sales might mitigate the role of Internet distribution not only in EU scale, but also on national markets, hence, partly eliminating the new innovative distribution channel from the market. Besides, the case law of the ECJ demonstrates a tendency to correct the imperfections made in earlier judgements. Since there are variety of products and distribution modes on the market, online sales treatment can be possibly changed for extraordinary situations. Moreover, the Court clearly stated that ban on Internet sales can absolutely benefit from individual exemption under article 101(3) TFEU. Therefore, the decision is rather strict, though is necessary in order to ensure economic needs of the European Union.

4.2.3 Restriction by Object

As it is already clear the case did not lack political motivation. In this regard, it seems that the referring court formulated the question for a preliminary ruling in a very convenient for the ECJ way. Instead of quite typical question whether this or that clause violates article 101 (1) TFEU, the French court asked directly if the ban on Internet sales constitutes a restriction by object.

Concept of restriction by object is only one of the examples of application of the rule of reason⁷⁷. In order to increase procedural efficiency it is reasonable to treat certain restrictions as restrictions, which always under any circumstances have

⁷⁷ Vogel, p. 3

anticompetitive effect, i.e. restrictions by object, provided that the experience and the case law have proven that. In this consideration, such restrictions as price-fixing, market-sharing and territorial restrictions (with some exceptions) apparently have negative effects on the competition on the market, while ban on Internet sales could produce positive effects as well. Referring to the already mentioned argument of the French Government, it is worth noting that the Court has no practice on the ban on online selling and, furthermore, such a ban may cause increase of inter-brand competition on the market.

Furthermore, in the *Consten and Grundig* case⁷⁸ the ECJ rejected the Commission's argument that "an agreement intended to limit parallel trade must be considered by its nature, that is to say, independently of any competitive analysis, to have as its object the restriction of competition"⁷⁹. Alternatively, the Court conducted a competitive analysis⁸⁰, which confirmed that the agreement at issue aimed to restrict competition at the wholesale level by charging prices that were sheltered from effective competition. Consequently, before declaring that restrictions on parallel trade are restrictions by object the ECJ had assessed their possible effects on the competition on the market.

Similarly, the presumption of anticompetitive effect per se should not have been applicable in the *Pierre Fabre* case without carrying out a competitive analysis in order to find out if a general and absolute ban negatively influences effective competition on the market.

4.2.4 Objective Justification

In spite of overall strict approach to the case, the ECJ has introduced the new rule⁸¹. Thus, when discussing selective distribution agreements, the Court stated, "such agreements are to be considered, in absence of objective justification, as

⁷⁸ Joined cases 56 and 58-64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission of the European Economic Community* [1966] ECR 299

⁷⁹ Case T-168/01 *GlaxoSmithKline Services unlimited v. Commission* [2006] ECR II-2969, para 120 – interpretation of *Consten and Grundig* judgement

⁸⁰ Joined cases 56 and 58-64, pp. 342-343

⁸¹ Alexandr Svetlicinii, '*Objective Justifications' of 'Restrictions by Object' in Pierre Fabre: A More Economic Approach to Article 101(1) TFEU?*', *European Law Reporter*, No. 11, 2011, pp. 348-353, p. 351

‘restriction by object’⁸². The same idea was repeated in the operative part of the judgement, which stated that, “a contractual clause... amounts to a restriction by object... where... it is apparent that... that clause is not objectively justified”⁸³. In its previous case law the ECJ never referred to the objective justification in the context of restrictions by object. The AEG Telefunken judgement speaks of legitimate requirements, “which may justify a reduction of price competition in favour of competition relating to factors other than price” and a legitimate goal⁸⁴. In the GlaxoSmithKline case the Court emphasised that, “in order to assess the anti-competitive nature of an agreement, regard must be had inter alia to... the economic and legal context of which it forms a part”⁸⁵. Therefore, the explicit possibility to objectively justify a restriction by object and, hence, to escape prohibition of article 101(1) TFEU was introduced in Pierre Fabre.

As it follows from the opinion of Advocate General and has been mentioned above, the French Competition Authority and the Commission adhere to the narrow interpretation of objective justification that practically gives no chance to distribution agreements for products, selling of which is not covered by EU or national regulatory documents. Advocate General’s point of view is more liberal, as he acknowledges that the nature of goods or customers to whom they are sold could appear an objective justification. The relevant example, perhaps, has already been found; thus, it could be “high quality made-to-measure clothing franchise, where there is the practical need for an expert to take accurate measurements, combined with the image connected with skilled and personalised service”⁸⁶.

Summing up, the ECJ has left the door open only to those companies, products of which cannot be sold online due to public health and safety reasons, and in very exceptional circumstances to companies that are able to prove that online sales of their products would completely ruin their reputation and, maybe, business.

⁸² C-439/09, para 39

⁸³ Ibid., para 47

⁸⁴ C-107/82, para 33

⁸⁵ C-501/06P, para 58

⁸⁶ Joanna Goyder, *The Pierre Fabre Case Internet Sales Bans Are Hard to Justify*, Competition Law Insight, 2012, p. 3 <<http://www.competitionlawinsight.com/corporate-issues/supply-and-distribution-agreements/the-pierre-fabre-case-46561.htm?origin=internalSearch>>

4.2.5 Free Movement or Competition

The structure and the reasoning of the Pierre Fabre case resemble more a judgement on free movement of goods, rather than competition law. The ECJ seemed to use the so called ‘proportionality test’ referring to such terminology as ‘necessity’, ‘proportionality’ and ‘objective justification’⁸⁷. Actually the Court directly declared, that it did not accept the arguments of Pierre Fabre relating to the need of individual advice and proper use of the product “in the light of the freedoms of movement”⁸⁸.

It should be noted that free movement of goods and competition cases are quite similar in their reasoning. Free movement of goods cases consist of deciding if the practice in question constitutes a restriction and, if so, of assessing suitability, necessity and proportionality *stricto sensu* in order to justify such restriction. Competition cases as a rule also detect a restriction on competition that may be exempted. Hence, both approaches pursue elimination of obstacles to internal market and fair trade development, when permitting practices, which are restrictive, though justified.

In this light the Pierre Fabre decision can be compared with the Ker-Optika judgement⁸⁹. In that case Hungarian national legislation allow selling contact lenses only in specialised shops, which also constitutes *de facto* ban on Internet selling, since consumers aiming to purchase contact lenses must be provided with medical advice in order to prevent health risks. The referring court asked inter alia if the principle of free movement of goods precludes such provision of national legislation. Summing up, in Ker-Optika a ban on online sales appeared as a restriction to customers from other Member States to make purchases via the Internet, while in Pierre Fabre it prevented distributors to operate online shops, thus, reducing competition.

Possible justification claimed by Pierre Fabre is the need to provide individual advice to the customer and to ensure his protection against the incorrect use of products. It shall be reminded that Pierre Fabre products were not medical products; hence, the requirement of pharmacist advice absolutely could not be equal to medical practitioner’s advice or prescription. In Ker-Optika Hungarian Government relied on

⁸⁷ Vogel, p. 4

⁸⁸ C-439/09, para 44

⁸⁹ C-108/09

the need to ensure protection of the health of contact lens users⁹⁰. The proportionality test carried out by the ECJ indicated that the request to sell contact lenses only in shops which specialise in the sale of medical devices is appropriate for securing the attainment of the objective pursued. However, it goes beyond what is necessary, since ophthalmologist's precautionary examinations or medical advice are not inseparable from the purchase itself. Thus, undergoing of such examinations is primarily the responsibility of each contact lens user, while the optician is responsible for merely advising⁹¹. Moreover, advising services are required only when contact lenses are first supplied, since the following purchases are made on the basis of previous experience. And, finally, advising services can also be provided via the Internet.

In order to assess the Court's position in applying free movement of goods outcomes when deciding the Pierre Fabre case, it is necessary to find out if its findings in Ker-Optika are relevant for the situation at issue.

Firstly, taking into consideration that risks of incorrect use of contact lenses are significantly more serious than those of skin cosmetics, the Court's findings in Ker-Optika are absolutely relevant for the Pierre Fabre case from the public health point of view. Therefore, the need in individual advice cannot justify the ban on online sales. It should be emphasised that consumers should also be responsible for the product's choice, otherwise, it would be risky to sell any personal care products, that might cause allergic reactions or related effects, without medical advice.

Secondly, it is worth noting that besides restricting free movement of goods, the Hungarian legislation in fact influenced competition on the market as well. By requiring selling products in physical outlets and limiting the area of sales to the territory where physical shops operate, it precluded companies from lowering prices and entering new geographical markets via Internet, hence, reducing competition (on) the market. Therefore, the ECJ's decision under article 34 TFEU was reasonable and needed both in terms of free movement of goods and ensuring effective competition.

Finally, the scale of the prohibition must not be ignored. Thus, when the Member State issues a rule de facto prohibiting online sales it inevitably covers all the

⁹⁰ Ibid., para 59

⁹¹ Ibid., para 68

distributors of the particular product within this Member State. Moreover, this creates a problem of market foreclosure for retailers, which are not able to operate brick and mortar shops. Such practice distorts competition as it prevents distributors from performing on other geographical markets, requires them to provide excessive services and forecloses pure Internet players. Consequently, all these factors taken together significantly diminish consumer welfare, since they do not contribute into reducing the price level, improving quality and innovations, though force dealers to charge customers for services, they might not enjoy.

The ban on online sales from the part of a dominant undertaking might cause the same negative effects on consumer welfare as it has been mentioned above. Nevertheless, this situation does not preclude every distributor from selling online, but concerns the distributors of the dominant company. The other distributors can, on the contrary, operate online shops and, subsequently, facilitate competition among each other and the dominant company by offering lower prices in the Internet and by entering new geographical markets. Therefore, the market would not be foreclosed as in the case with the Member State's prohibition; hence, the negative impact on consumer welfare would not be necessarily present.

De facto prohibition on Internet sales coming from the part of the sole manufacturer influences merely dealers within its distribution network (and possibly limited amount of pure-players) and aims to ensure appropriate performance of the company. Unless there is cumulative effect on the market, the ban on Internet sales may enhance brand image of the manufacturer, contribute into the services level etc., hence, improving the manufacturer's reputation and facilitating inter-brand competition as a result creating benefits for consumers.

In that regard, the Pierre Fabre situation shall not be treated as equal to the one in Ker-Optika. Thus, the Pierre Fabre case concerns selective distribution system. Its restrictive effects are proven to be outweighed by pro-competitive effects, otherwise, it would not be allowed under competition law. Thus, selective distribution aims to ensure the luxury image of goods and its proper perception by consumers. Consequently, here the requirement of pharmacist's presence is apparently aimed to prevent the problem of 'bad experience' and to the fact of providing high-class services itself.

As a result, deciding the case, where a sole company imposes ban on online sales, similarly to the one with the same prohibition from the part of the whole Member State, the Court neglected the scale of the matter, market situation and especially specifics of selective distribution mode and its overall pro-competitive nature.

Summing up, the free movement of goods experience can be helpful when deciding competition cases, though special features of organizing distribution channels must be also taken into consideration.

4.2.6 Legitimate Aim

The Court findings regarding the legitimacy of the aim to safeguard a prestigious image of the product are contradictory to the previous case law.

In the Copad v. Dior case, which Pierre Fabre referred to, Christian Dior concluded a trademark license agreement with Société industrielle lingerie (SIL) in order to allow the latter manufacturing and selling luxury corsetry goods labelled Christian Dior. The agreement contained the clause prohibiting SIL to sell the products to discount stores, as it would affect trademark reputation and luxury status. However, due to financial difficulties SIL sold Dior products to Copad, a discount network. Despite this case concerns trademark infringement, the Court's reasoning explicitly states that, "since luxury goods are high-class goods, the aura of luxury emanating from them is essential in that it enables consumers to distinguish them from similar goods"⁹² and, therefore, appearance of these goods in discount stores "damages the allure and prestigious image which bestows on them an aura of luxury"⁹³.

In the Leclerc judgement⁹⁴ Galec, the network of supermarkets, opposed the proposed Commission Decision to grant an exemption to Yves Saint Laurent selective distribution system. In Galec's view, its supermarkets were adapted to sale of luxury products, particularly, cosmetics, however, the YSL company set impossibly high selective criteria. The Court of First Instance analysed the situation very carefully

⁹² C-59/08, para 25

⁹³ Ibid., para 37

⁹⁴ Case T-19/92 Groupement d'Achat Edouard Leclerc v Commission [1996] ECR II-1851

and, finally, came to the conclusion that selective criteria of YSL met the conditions for the exemption⁹⁵ and emphasised that, “criteria aimed at ensuring that the products are presented in retail outlets in a manner which is in keeping with their luxury nature constitute a legitimate requirement of such a kind as to enhance competition in the interests of consumers”⁹⁶.

On the contrary, the aim of maintaining prestigious image was not treated as a legitimate aim for restricting competition in the context of article 101(1) TFEU⁹⁷. In this regard, the Court’s finding is ambiguous. The main paragraph of interest, paragraph 46, is not supported by any references to the previous case law and no explanation is provided why the Court considered so.

Some authors doubt if “the ECJ does indeed mean that the aim of preserving a luxury image is not a sufficient justification for using a selective distribution *at all*”⁹⁸. Such opinion seems legit, since otherwise the Court has overruled its well-established case law. On the other hand, if the Court assessed the ban on Internet sales in isolation from the selective distribution context and recognised the aim of maintaining prestigious image as not legitimate only for prohibition of online sales, then such finding, in spite of reference to article 101(1) TFEU, resembles the situation, where the ban on Internet sales constitutes a disproportionate measure in the light of free movement of goods, as discussed before.

Thus, the Court, perhaps, went too far in its desire to absolutely prohibit bans on online selling. The lack of motivation and inconsistent reasoning reveal the political grounds of the case. In order to prevent Pierre Fabre from ‘outright ban’, the ECJ might accept that the need in professional advise and, moreover, the aim of safeguarding the brand image were legitimate, though stating that the criterion, namely the ban on Internet sales, goes beyond what is necessary⁹⁹. However, this line of reasoning could hardly help in declaring the ban on online sales a restriction by object.

⁹⁵ Ibid., para 112

⁹⁶ Ibid., para 120

⁹⁷ C-439/09, para 46

⁹⁸ Jorren Knibbe. *Selective distribution and the ECJ’s judgment in Pierre Fabre*, European Competition Law Review 2012, 33 (10), p.450- 451.

⁹⁹ Goyder, p. 3

Two judgements presented above, along with many others, prove that the Court and the Commission have always understood the specifics of luxury market until the present Internet distribution age. Indeed, selling products through discount stores is comparable and even close to selling via the Internet in the context of luxury goods. The Court and the Commission also acknowledge that the physical presentation of luxury products contributes a lot into maintaining brand image and could be a decisive factor for a customer in his or her choice. Nevertheless, only future case law is able to demonstrate the very sense of paragraph 46.

4.3 After-Fabre Experience

The application of Pierre Fabre doctrine in practice can be seen in the Bang & Olufsen case¹⁰⁰ recently decided by the French Competition Authority.

4.3.1 Factual Background and Decision

Bang & Olufsen France is a subsidiary of a Danish manufacturer of high-quality audio and video products Bang & Olufsen A/S. The French company has a network consisting of 48 distributors in the territory of France. The agreement at issue was drawn up in 1989 and contained a clause prohibiting distance sales. Certainly, no reference was made to Internet selling, as at that time it was not developed and not considered as a separate distribution channel. In 2000 Bang & Olufsen sent a circular to all its dealers, which inter alia stated that certain category of the distributors could apply for an own page on the global website, however, they must be approved by Bang & Olufsen. According to the circular, such webpage could not contain any information concerning the dealer's activity, excepting its status of authorised distributor and ability to advise on the goods at its physical outlet. Moreover, in case the retailers operate their own websites, they are prohibited to use logos and trademarks of Bang & Olufsen.

In the French Competition Authority's view, the agreement and the circular contain *de facto* prohibition on online sales. The Bang & Olufsen global website has

¹⁰⁰République Française Autorité de la concurrence, *The Autorité de la concurrence fines Bang & Olufsen for prohibiting its approved distributors from selling its products online*, Press releases 2012, English version <http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=418&id_article=2009>

no reference to Internet sales; and the prohibition to use manufacturers' logos and trademarks makes online sales via the distributors' websites "materially impossible"¹⁰¹. Thus, prohibition of online sales reduces intra-brand competition among distributors and deprives potential customers, who live far from the outlets, of ability to buy products.

Referring to the Pierre Fabre judgement, the French Competition Authority ruled that the clause in a selective distribution agreement containing *de facto* ban on Internet sales, such as one at issue, constitutes a restriction by object, unless that clause is objectively justified.

In its decision from 12 December 2012 the Authority imposed a fine of € 900,000 on Bang & Olufsen and ordered to amend the selective distribution system within three months in order to allow distributors selling online. When determining the amount of the fine the Authority took into consideration the gravity and duration of the infringement, but at the same time admitted that the harm to the economy was very limited, as only a small number of consumers could have been affected¹⁰². Bang & Olufsen appealed the Decision, hence, now the case is pending before the Paris Court of Appeal.

4.3.2 Argumentation for Appeal

It is clear from the Pierre Fabre case that Bang & Olufsen has no chance to justify its clause. Like it has been discussed above, justification can be found only in mandatory provisions of EU or national law, regulating certain product markets, and in very exceptional situations, where online sales would 'destroy' the product's quality and image. Obviously, selling of audio systems cannot concern public safety and health issues and has no special treatment from the part of EU. It is pointless to provide arguments for maintaining prestigious brand image, since this aim is not considered as a 'legitimate aim' in accordance with the Pierre Fabre judgement. The

¹⁰¹ Van Bael & Bellis, *France: French Competition Authority Fines Bang & Olufsen € 900,000 For Banning Internet Sales*, Mondaq, 2013 <[http://www.mondaq.com/x/217644/Trade+Regulation+Practices/French+Competition+Auth
ority+finer+Bang+Olufsen+900000+for+banning+Internet+sales](http://www.mondaq.com/x/217644/Trade+Regulation+Practices/French+Competition+Authority+finer+Bang+Olufsen+900000+for+banning+Internet+sales)>

¹⁰² Hogan Lovells, *French Competition Authority fines Bang & Olufsen for prohibiting online sales*, Lexology, 2013 <<http://www.lexology.com/library/detail.aspx?g=350ba01d-c5ea-4de6-a404-4a37b9731cd1>>

need of individual advice and proper use of the product can hardly be claimed as well. The only reasonable argument seems to be a technical complexity of goods concerned. When installing audio/video system, every part of it contributes a lot into the final image or sound. Hence, certain types of acoustic systems necessitate appropriate cables and sockets. The wrong cable can significantly diminish the quality of sound even if the most innovative and expensive speaker is used. Without going deeply into details, it should be noticed that all the parts of acoustic system shall match each other and, most probably, an average consumer is not able to make an optimal choice on his/her own. However, in this regard the distributors of Bang & Olufsen could provide the guidelines on products' compatibility on the website and offer online consultations.

Therefore, the ban on Internet sales is apparently not proportionate in this case and one could hardly believe that this distribution system can satisfy requirements of article 101(3) TFEU. Nevertheless, it will be interesting to take a look at Bang & Olufsen argumentation.

4.3.3 Being Reasonable

It is worth mentioning that improvement of availability of products and consumers' choice is definitely one of the aims in nowadays competition law and practice. When fitting every company under the same rule, competition authorities should not, however, go beyond what is reasonable.

In the Pierre Fabre case intra-brand competition on the market was really strong due to the number of authorised outlets. Moreover, it is hard to imagine that anybody interested in the product lacks it because of absence of the physical retailer, since 23,000 outlets can absolutely cover the territory of France even if the product at issue is of monthly-need.

Bang & Olufsen selective distribution network has just 48 dealers. However, the products concerned cannot be treated as household appliances that, generally speaking, should be available everywhere. Bang & Olufsen acoustic systems can be used in concert halls, galleries, and clubs; hence, they are very expensive and are not demanded by most people. The company also produces home theatre audio systems and even small devices, such as earphones and computer speakers; however, it is absolutely not the leading product line. Therefore, it appears reasonable that potential

customers could drive to the nearest outlet in order to buy a home acoustic system once in 5-10 years.

It would be fair to say that such factors should also influence a decision at least when determining the amount of fine.

5 Conclusion

As it has been stated in the beginning, the purpose of this thesis is to examine the relevant documents, such as the VBER and the Guidelines, and the case law in order to reveal the existing status of online sales, particularly in the context of selective distribution, its benefits, drawbacks and possible development.

Thus, every amendment to the VBER and the Guidelines that concerns online sales has been discussed in detail. The research has demonstrated that the current regulatory documents are not perfect and need further development. Particularly, the Commission might underestimate the power of Internet selling and considers it as passive sales in the Guidelines, while doctrinal studies and even national competition authorities¹⁰³ admit that online selling constitutes a new alternative distribution channel. Other novelties reveal the Commission's ambiguous position towards online sales. For instance, the Commission acknowledges specific needs of 'selective' manufacturers and grants the right to require distributors to operate at least one physical outlet, while offering inconsistent solutions concerning dual price policy and prohibiting limiting proportion of online sales. Further, the Guidelines allow distributors imposing quality criteria on online retailers. However, such right reflects the very sense of selective distribution and introduces nothing more as a new hardcore restriction, in case criteria for online stores are not equivalent to those for physical outlets. Nevertheless, since the VBER with the accompanying Guidelines of 2010 are the first documents regulating online distribution, there is a hope that their imperfections will be corrected in the future by new amendments or by case law interpretation.

Consequently, the current approach shall be reconsidered in order to keep step with the Internet and technology development. Further development of EU competition law shall emanate from the assumption that the Internet is not a complementary way of selling goods, though an independent distribution channel. Thus, the rules on Internet selling regulating different distribution modes must be adapted to the nature and the sense of such modes with regard to previous case law and especially to economic considerations. In particular, special attention shall be

¹⁰³ French Competition Authority, C-349/09, Opinion AG, para 20

paid to far-reaching activities of online stores, their limited capacity in providing services and product presentation and their overall virtual nature in order to prevent reduced quality of goods, trade mark erosion and other negative impacts, which could result in diminishing of consumer welfare.

The main problem nowadays seems to be a tacit conflict between political needs and economic rationality in competition sphere. The big aim of establishing the single market, inter alia by means of online sales, to some extent neglects economic reasons as it follows from the discussed case law. The Commission and the Court's attempt to fit every type of agreement under the single 'online rule' does not reflect the reality. Since in fact the Internet is a new channel of selling, the distinctive requirements shall be adopted for different distribution systems. Thus, a reasonable balance shall be found between a need of separate markets integration and manufacturers' need to independently determine their trading policy, otherwise, preponderance of either necessity might negatively influence consumers by undermining producers' incentives for research and development or by markets isolation respectively.

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