Selective Distribution Under Article 101 TFEU
- Devaluation of Brands?

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## Selective Distribution Under Article 101 TFEU – Devaluation of Brands?

**Abstract:** The Internet has revolutionized the distribution of both information and products. The online sales platform has a special meaning within the context of the European Union, as it conveniently enables consumers to make purchases from distributors established in different Member States. Parallel trade, lower consumer prices, and the promotion of a seamless Single Market are inviolable concepts for EU authorities, such as the European Commission. As the Internet can indubitably enhance the achievement of these objectives, EU competition law is in result reluctant in permitting restrictions to online retail.

This study argues that certain forms of Internet sales limitations might be necessary for manufacturers in brand image protection. The issue is most relevant for products distributed through selective distribution networks with means to ascertain that consumers perceive them in a special way. The online sales environment differs from the physical and stirs brand owner unrest over the effects which Internet sales might have upon product reputation. The current legal framework appears to neglect such concerns and paves the way for a limitless online marketplace for branded products.

The current legal framework is unbalanced and a more market-determined approach might be needed to achieve long-term consumer welfare maximization. Limited restrictive measures, such as on-/offline sales volume proportionality, not constituting outright bans, might facilitate product exclusivity and heterogeneity, brand promotion, and inter-brand competition in ways warranting the existence of a restriction.

**Keywords:** Article 101 TFEU, Regulation 330/2010, selective distribution, vertical agreement, competition law, block exemption, Internet retail, brand image, trademark
CONTENTS

LIST OF ABBREVIATIONS

1 INTRODUCTION

2 AIM OF THE STUDY

2.1 Research question

2.2 Structure

2.3 Demarcations

2.4 Motives for the study

3 COMPETITION AND LAW

4 TRADEMARKS AND SELECTIVE DISTRIBUTION

4.1 The functions of a trademark

4.2 Selective distribution

5 ONLINE SALES – A SOLUTION AND A PROBLEM

5.1 Towards the new BER

5.2 Lower prices

5.3 ‘Aura of luxury’

5.4 Court concerns

5.5 Free-riding

5.6 Equivalence

5.7 Special treatment

5.8 Skepticism on inter brand competition

5.9 Case Pierre Fabre

5.10 Online sales under Article 101(3)

6 CONCLUSIONS

7 SUGGESTIONS FOR FURTHER RESEARCH

REFERENCES
Leenalle ja Ramille
**LIST OF ABBREVIATIONS**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AG</td>
<td>Advocate General</td>
</tr>
<tr>
<td>BER</td>
<td>Block Exemption Regulation</td>
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<tr>
<td>CFI</td>
<td>Court of First Instance</td>
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<tr>
<td>CJEU</td>
<td>Court of Justice of the European Union</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
</tr>
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<td>EGC</td>
<td>General Court</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>MS</td>
<td>Member State of the European Union</td>
</tr>
<tr>
<td>MSs</td>
<td>Member States of the European Union</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
</tr>
<tr>
<td>US</td>
<td>The United States of America</td>
</tr>
<tr>
<td>VABER</td>
<td>Vertical Agreements Block Exemption Regulation</td>
</tr>
<tr>
<td>YSL</td>
<td>Yves Saint Laurent</td>
</tr>
</tbody>
</table>
1 INTRODUCTION

Imagine yourself hearing someone mentioning the name “Louis Vuitton” or “Chanel”. Then contemplate on your very first thoughts associated with these aforementioned brand names. Although the thoughts and perceptions of different individuals may range from the farthest corners of the spectrum between positive and negative, a vast majority of these views most likely have one characteristic in common: these brands are viewed as something quite extraordinary in comparison to the range of more conventional substitutes found on the market. Some might view products sold under these brand monikers to be lavishly overpriced when considering their physical features, while others see these products as bearing a strong association with the feeling of exclusivity and a concept of luxury. Regardless of a perception positive or negative, any consumer is likely to acknowledge a deviating product positioning related to these luxury products.

The essence and influence of a luxury product are founded upon a brand base carefully built and the brand’s graphical depiction, the manufacturer’s trademark, speaks a silent language comprised of strong mental images in the mind of the consumer. Indeed, it could easily be argued that the trademark of a luxury good brand, and the product bearing this mark in itself, benefit largely from the existence of the mental image which they create. While many individuals, and marketing professionals especially, strive to educate themselves with the skills to build the next successful megabrand, some might turn to think about the delicacy of the mental images brands use in their communication with the public. In other words, one might focus on the various threats which could devaluate a brand and, consequently, create a change in the mental image which a branded product emanates. After all, the light in which the consumer perceives a manufacturer’s trademark is a key element in creating a demand for any product in the first place.

The value of a successful trademark is not perpetual and it could be reduced, if not altogether lost, should the mark and its associated products suffer a decline in the image which they enjoy among consumers. Trademark reputation could be regarded as the lifeblood for luxury goods specifically. Without a reputation, there is no product luxury. Consequently, without a luxury feature, we have only another product among all the others.
Brand owners (trademark proprietors) have long recognized the sensitive nature of product image and have therefore undertaken measures to safeguard it. One dimension in fostering the image which a product enjoys on the market is controlling the concept and setting requirements for the circumstances under which a given product is distributed therein. Establishing such framework for distribution means implementing, namely, selective distribution, which is widely used by manufacturers of branded goods in the dissemination of their products.

The development of the information society and the evolution of online sales and electronic commerce within the European Union have created a tension between the restrictions applied in selective distribution agreements and the convenience of purchasing via the Internet. While on the one hand the selling of luxury goods through the Internet is perceived as undesirable regarding the exclusive image of certain products, on the other hand unrestricted Internet sales and purchases are viewed as a fundamental right of the distributor and consumer with a special relevance within the context of the European Union and its ideal of a Single Market between Member States.

A debate exists between whether or not restrictive measures implemented by manufacturers in the distribution of their products via the Internet should be viewed to restrict competition and violate EU competition law. The need for brand owners to protect product image has gained a certain level of support from European courts in the past. However, the existing case-law and the findings therein appear to have only a limited influence for relevant regulation in the modern Internet era.

The current legal framework governing selective distribution agreements is benevolent towards sales on the Internet and reluctant towards permitting restrictions pertaining to them. While the European Commission’s inmost aim of maximizing consumer welfare is, indubitably, a noble one, the contemporary legal framework might fail in delivering this objective. A more market-determined policy, based on more autonomous brand owner distribution practices, might provide a better outcome in the long run. Sacrificing a degree of manufacturer autonomy in pursuit of creating a limitless platform for the selling of luxury products might not serve best the interests of the relevant consumer. Furthermore, the issue of whether the imposing of certain restrictions on distribution within a supplier’s selective distribution system creates anti-competitive effects in the first place is wide open for debate.
2  AIM OF THE STUDY

The aim of this study is to investigate the debate involving distributor sales made through the Internet and the reluctance of brand owners to permit such activity. On the one hand, this study aims to chart up and analyze the reasons why it is viewed as important for online sales to remain rather unsegregated, while on the other hand the aim is to investigate the rationale behind leaving the permitting of Internet sales as a decision made by the manufacturer in respect of his autonomy as a trader. Furthermore, the study aims to draw conclusions on the potential market effects and consequences that these diverse approaches might create, with an objective in providing arguments on how the restriction of Internet sales within a selective distribution network should be appropriately interpreted in the light of Article 101 of the Treaty of the Functioning of the European Union1.

2.1. Research question

The research question of this thesis reads as follows:

“How should Article 101 TFEU be interpreted in correspondence to the restriction of Internet sales within a selective distribution network?”

2.2. Structure

Chapter 1 provides the reader with a brief introductory overview on the study topic. Chapter 2 sets the study’s research aims and demarcations together with the primary research question. Chapter 3 familiarizes the reader with the basic concepts of competition and the role of competition law within the European Union. After the introduction of these concepts and the relevant market context, Chapter 4 proceeds to elaborate the functions of a trademark and the concept of selective distribution together with applicable competition law. Chapter 5 investigates various arguments, issues, and views to the debated research topic, including the author’s own thoughts and ideas on the matter. Chapter 6 draws conclusions from the findings in the previous Chapter, summing up the work and providing an answer for the research question. Chapter 7 is a section dedicated for suggestions of further research in topics which the author came across when writing this study.

2.3. Demarcations

This study does not concentrate in the analysis of whether or not the product of a specific company fulfills the legal criteria required to operate a legitimate selective distribution system. The study discusses these criteria, but presupposes that those companies which are analyzed, and which currently operate a selective distribution network, fulfill the requirements for this practice. In other words, the study concentrates on the restriction of Internet sales within selective distribution networks and does not, for the sake of clarity, attempt to question the initial legitimacy of any networks used as examples.

Furthermore, this study focuses on the legal and territorial context of the European Union and hence will not construct a comparative legal analysis between various markets. The study will include and discuss certain concepts from United States’ antitrust law for reference, yet the objective is not to compare these regimes in the form of a comparative legal study.

2.4. Motives for the study

The author became interested in studying this topic due to its inherent juxtaposition of brand owner interests and the Single Market ideal. On the one hand, we have the investment and autonomy of product manufacturers, while on the other hand we have consumer welfare through Internet purchasing in an unrestricted EU market, which both are concepts worth protection. However, these concepts seem at least partially as mutual exclusive. Neither one can be fostered without sacrificing a degree of the other. Policy decisions herein may have significant effects on both businesses and the European consumer, therefore requiring proper justification.

The Internet has revolutionized the distribution of both products and information. This development has led to a series of fundamental legal problems related to intellectual property rights and confidentiality. Distribution of copyrighted material through p2p networks, free-ride of trademark reputation, and violation of privacy, among other issues, create a plethora of questions pending for solutions. Therefore, the author views that every impact which the Internet might have upon traditional practices is worth studying from a legal point of view.
3 COMPETITION AND LAW

Competition can be defined as the simultaneous endeavor of individuals, groups, companies, or any other entities with the objective of achieving something which all competing parties will not ultimately be able to achieve. Competition, in the context of the marketplace, exists between firms striving to overcome other firms, i.e. their competitors, in order to obtain a stronger position in the market. The stakes in market competition are, in principle, rather high. A firm’s long term objective could, in fact, be reduced to mere survival. While a successful company might be able to conjure high revenue streams, the fate of an unsuccessful venture could be heavy debt, going out of business, and leaving the market. Due to the callous nature of competition, firms must constantly fight for their position and, as a result, might have an interest in limiting the competitive environment and restricting the competition they have to engage in.

As its founding principle, competition law regulates the behavior of firms in the marketplace with the aim of preserving competition and guarding consumer welfare. Competition between firms is generally perceived to create benefit to consumers as it precludes firms the possibility of charging artificially high prices for their products, provides them with an incentive to develop new and better goods, and ensures that there is a sufficient supply of products available to meet consumer demand. Competition can be viewed as a continuum where firms are challenged to excel the achievements of others and which ultimately creates societal benefit through technological and economic advances.

Competition law aims to ensure that consumers can purchase the products they want with an affordable price determined by the market mechanism. Competition law sets limitations on the ways companies are allowed to do business and the content of the agreements they make with each other in order to protect this mechanism, which

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2 Mikko Alkio and Christian Wiik, Kilpailuohikeus (2nd rev edn, Talentum 2009) 42
4 Alkio & Wiik 13-15
6 Petri Kuoppamäki, Uusi kilpailuohikeus (WSOYpro 2006) 2
7 This study focuses on vertical agreements, which are agreements entered into by companies from different ladders of the distribution chain, e.g. a manufacturer and a distributor. The concept of vertical agreements shall be elaborated in more detail in subsequent chapters.
requires an unrestricted interaction of supply and demand to operate efficiently. When this condition is fulfilled, the market functions properly and its mechanism determines the ‘right’ price for a product.

Although a common market economy paradigm holds that competition works best the more freely competitors are able to compete with each other, economic history implies that the creation of a workable competitive environment requires at least a certain degree of regulatory intervention, as the most efficient level of competition will not be realized without some fine-tuning. In theory, the highest level of consumer welfare would be achieved under ‘perfect competition’, which is a theoretical model used to explain, among other things, the pricing of products. As this concept is merely theoretical, the goal of competition policy has been set to promote ‘workable’ or ‘effective’ competition.

A threat to effective competition on the market rises when a certain firm is in a position from where it can exercise market power i.e. operate more or less independent from competition, and thus might be able to raise product prices, maintain an artificially high price level, and reduce its total output of products without a threat of competitors satisfying consumer demand with lower priced substitutes. Competition law concerns the regulation of this power. Should a company use its market power to distort the functioning of the market, it is in the interest of both consumers and other firms that these anticompetitive practices are legally intervened. However, estimating and determining market power is a complicated process and excess intervention by authorities might have detrimental effects on a specific field of competition. A short-sighted policy aimed to protect customer interests might, in the long run, decrease the number of firms competing at a given field of business, which ultimately has a negative

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8 Alkio & Wiik 13, 46
9 Ibid 14
10 Kuoppamäki 2. The opposite of market economy would be a controlled economy, in which the role of competition law is less significant (for further reference, see Alkio & Wiik 3)
11 Alkio & Wiik 12
12 MacQueen et al 891-892; Alkio & Wiik 46. Perfect competition is a theoretical model requiring certain explicit conditions, such as consumers’ perfect knowledge of market conditions and the complete nonexistence of barriers to entry and exit. The model is merely theoretical and is not plausible in reality.
13 Kuoppamäki 6
14 MacQueen et al 892
15 Alkio & Wiik 88. In basic, the more market share a firm has the more potential market power it might be able to exert (for further reference see Alkio & Wiik 89-91)
16 Alkio & Wiik 89
17 MacQueen et al 892
18 Ibid 45
19 Alkio & Wiik 89-91
influence on both competition and the welfare of consumers. Therefore, competition law requires input from both lawyers and economists to correctly address commercial practices within a legal process. In principle, when a company is not in a position from where it will be able to exercise market power, it will not be able to affect the functioning of the market. Thus, there should be no legal intervention to the practices of this particular company.

The objectives of EU competition policy can be characterized as the protection of effective competition on the European market, the protection of consumers as well as small firms, and the facilitation of a Single Market between EU Member States. The Union’s competition policy seeks to abolish any territorial barriers restricting the realization of a seamless Internal Market. The context of the EU, comprised of 27 independent MSs, requires a rather unique approach from a competition law point of view. The achievement of EU goals essentially requires that competition law complements these aims. The antitrust law of the United States and the competition law of the EU, synonyms to each other, take different approaches in the treatment and evaluation of distribution and licensing agreements despite a degree of late convergence in some areas.

The Single Market idea is central from a Community standpoint and constitutes the most important principal of its economic rationale. In order to attain this market ideal, Community law prohibits national rules restricting or hindering cross-border trade of goods originating from other EU Member States. Cross-border trade includes parallel trade, referring to the importation of given goods sold by their proprietor in the market of a given MS from another MS in which he sells this product. While on the one hand parallel trade is argued to benefit the consumer in the form of lower prices, on the other hand it can be argued that the maintenance of price differences between

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20 Alkio & Wiik 14
22 Alkio & Wiik 17
24 Alkio & Wiik 16
25 Josephine Steiner, Lorna Woods and Christian Twigg-Flesner, EU Law (9th edn, Oxford University Press 2006) 571
26 James Hanlon, European Community Law (2nd edn, Sweet & Maxwell 2000) 216
27 Alkio & Wiik 19
28 Craig & de Búrca 604
29 Ibid 605-606
territories is a crucial need from a business strategy point of view. Regardless of the right answer it is certain that Internet sales, due to the nature of the distribution channel itself, form a central bone of contention in the debate concerning EU cross-border trade principles. The Single Market aim has been clearly visible in both the decisions made by the European Commission and the jurisprudence of the Court of Justice of the European Union. The aims of promoting market integration and abolishing barriers to it necessarily affect the conditions which EU competition law sets upon cross-border distribution agreements, specifically. Distribution agreements are, by nature, bound to fall under strict scrutiny, as an objective of EU competition law is to minimize the possibility of firms to restrict or divide the Internal Market with their agreements and practices.

The cornerstone of EU legislation, in relation to competition and rules applying to undertakings, is Article 101 of the Treaty of the Functioning of the European Union, under which anti-competitive agreements are controlled and made unenforceable.

Article 101 TFEU, comprising three paragraphs, reads as follows:

1. The following shall be prohibited as incompatible with the internal market; all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;

   (b) limit or control production, markets, technical development, or investment;

   (c) share markets or sources of supply;

   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

   (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

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30 MacQueen et al 856
31 Alkio & Wiik 17
32 Ibid 18
33 Ibid
34 Article 101 TFEU is de facto identical to its predecessor, Article 81 of the Treaty Establishing the European Community (see e.g. Consolidated Versions of the Treaty on European Union and of the Treaty Establishing the European Community [2006] OJ C321 E/1 ), which is ex-Article 85 of the Treaty of Rome. This study refers to this Article both as 101 and 81 in order to avoid a confusion in the publication years of artic-les and books which, depending on the year of their publication, refer to this Article with either number
35 TFEU (n 1)
2. Any agreements or decisions prohibited pursuant to this article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

The Commission lists protecting competition, enhancing consumer welfare, and ensuring efficient resource allocation as the main objectives of Article 101. Market integration, the pursuit of an open single market, is viewed as a key development to the realization of these objectives.

As stated in paragraph 1, Article 101 TFEU covers those agreements which are severe enough to potentially restrict trade between Member States. Trade between MSs must be affected to an appreciable extent. The national legislation of MSs includes provisions stating that Article 101 shall be applied when an agreement might affect trade between MSs. Following Regulation 1/2003, national competition authorities and courts are obliged to apply EU competition law to such agreements where Community trade might be affected to an appreciable extent. In a case where this

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36 MacQueen et al 897
37 Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C101/08 para 13. It is important to note that these Commission Guidelines are without prejudice to any views that the CJEU, EGC, or Community courts might take (for reference, see para 7). The Guidelines are to be considered as soft law and explaining the views and aims of the Commission.
38 MacQueen et al 898
41 Ibid Art 3(1)
threshold is not reached, national legislation may be applied. Should both national and EU law be applicable, the latter has priority over the first. In other words, the outcome of German law, for example, shall not contradict with EU law. Distribution agreements, especially those restricting Internet sales, should be regarded as such which may easily affect trade between Member States and are thus rendered a regular subject of scrutiny under Article 101.

Like mentioned earlier, Article 101 includes three paragraphs. The first one forbids certain types of agreements, decisions, and concerted practices made by undertakings or associations of them. The Article includes a list of those types of provisions which are specifically viewed to be anti-competitive. An agreement might fall within 101(1) if it restricts trade within the meaning of the paragraph i.e. if the agreement may affect trade between MSs and has, as its object or effect, the prevention, restriction, or distortion of competition within the Internal Market. Should it be established that an agreement is anti-competitive by its object, there is no need to analyze the economic effects of the agreement in such case. In other words, such a restriction is illegal per se and the market effect of the agreement is irrelevant to determine.

If an agreement is not intended to restrict competition by object, then its economic effects have to be analyzed in order to find out whether it falls within the prohibition laid down in Article 101(1). The interpretation of Article 101 is the central element in determining the borderline between legitimate and illegal provisions included in agreements. Agreements falling within Article 101(1) are automatically void and unenforceable under the subsequent Article 101(2).

The provisions laid down in Article 101(1) can, however, be declared inapplicable under Article 101(3) stating the cumulative conditions which, when fulfilled, exempt an individual agreement from falling within 101(1). Article 101(3) does not distinguish

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43 Maria Held 'The more lenient approach of German courts towards prohibition of distribution via internet auction platforms – recent developments’ [2010] 31(9) ECLR 343, 343
44 Held 343
45 'Concerted practice' refers to an ‘agreement’ which is not based upon a made contract, but which is carried out by undertakings through mutual understanding (for additional reference, see MacQueen et al 898 ; Tritton para 8-036). A case where one party engaged in concerted practices is forced, due to the strength of the other party, to implement these practices, refers to ‘tacit acquiescence’
46 Agreements, which aim to restrict competition as their objective, are referred to as ‘restrictions by object’
47 MacQueen et al 897
48 Ibid 896
between agreements restricting competition by object or effect.49 Therefore, an exemption is granted for all agreements fulfilling the conditions of 101(3).50 The purpose of 101(3) is to weigh the pro- and anti-competitive effects of an agreement with each other. When the pro-competitive effects of an agreement outweigh its anti-competitive effects, the agreement shall be regarded as pro-competitive and thus compatible with EU competition law.51 When the cumulative conditions of Article 101(3) are fulfilled, the agreement enhances competition in a manner where the pro’s outweigh the con’s “[...] because it leads the undertaking concerned to offer cheaper or better products to consumers, compensating the latter for the adverse effects of the restrictions of competition”.52 Indeed, it would be illogical not to allow agreements remaining in the positive, and therefore an agreement with outweighing pro-competitive effects should not be prohibited by competition law.53

Effectively, those agreements, decisions, and concerted practices which fall within Article 101(1) and do not satisfy the conditions of Article 101(3) are prohibited in all circumstances with no prior decision required to that effect.54 It follows that those agreements, decisions, and concerted practices that fall within Article 101(1), but satisfy the conditions of Article 101(3), shall not be prohibited without any prior decision to that effect being required.55 It is worthwhile to note that Article 101(3) becomes relevant only when an agreement restricts competition within the meaning of Article 101(1), i.e. 101(3) may be invoked as a defense for alleged anti-competitive behavior.56

In the past, exemption under 101(3) was granted exclusively by the Commission57 through an application process.58 Regulation 1/2003,59 referred to as the ‘Modernization Regulation’, eased the administrative burden of the Commission and granted both national competition authorities60 and courts61 the right to apply Article 101 in its entirety. The competition authorities and courts are, however, obliged to

49 Guidelines for Art 81(3) para 20
50 Ibid
51 Guidelines for Art 81(3) para 33
52 Ibid para 34
53 MacQueen et al 900
54 Reg 1/2003 Art 1(1)
55 Ibid Art 1(2)
56 Guidelines for Art 81(3) paras 40-41
57 Tritton para 8-058
58 MacQueen et al 902
59 See(n 40)
60 Reg 1/2003 Art 5
61 Ibid Art 6
inform or consult the Commission whenever applying Article 101 for consistency reasons.\footnote{Reg 1/2003 Art 11(3) ; Art 15(2)} Furthermore, if an agreement has been subject to a prior decision by the Commission, national courts and competition authorities may not give contradicting decisions and are also required to avoid decisions contrary to a contemplated Commission decision in initiated proceedings.\footnote{Reg 1/2003 (n 34) Art 16(1-2)} Regulation 1/2003 made Article 101(3) directly applicable, meaning that under the new system firms may self-assess whether their agreement falls within the prohibition of 101(1).\footnote{MacQueen et al 902} A ruling on the legality of an agreement is needed only in the case of dispute or complaint.\footnote{Ibid}

One might immediately see from the wording of Article 101 that restrictions in distribution agreements can be rather problematic from an EU competition law point of view. First and foremost, they are rather easily likely to affect trade between MSs, thus making Article 101 applicable. This threshold is in practice reached with relative ease, as agreements ostensibly restricting competition within a single MS are often perceived to have anti-competitive repercussions expanding to the Common Market.\footnote{Tritton para 8-040} It should be regarded that such repercussions are nothing short of unavoidable in the case of limiting sales made through the Internet. Second, these limiting provisions in distribution agreements might restrict trade within the meaning of Article 101 in the particularly addressed illegal forms, such as indirect fixing of trading conditions, limiting markets, sharing markets, and subjecting distributors to supplementary obligations not connected to the primary subject of a contract.

Notwithstanding an agreement restricting trade within the meaning of Article 101(1), it can be provided an individual exemption under Article 101(3), should it satisfy the four cumulative conditions laid down therein. In order to benefit from this exemption, an agreement must therefore improve the production or distribution of goods or promote technical or economic progress. In doing this, the consumer is to receive a fair share of the benefit resulting from the arrangement. Furthermore, the restrictions of the agreement must be indispensable in reaching these objectives and the contract parties

\begin{itemize}
  \item \footnote{Reg 1/2003 Art 11(3) ; Art 15(2)}
  \item \footnote{Although the Commission strives to build an effective and decentralized competition law regime within the Community, at least a certain degree of central administration is needed in reducing the risk of inconsistent judgments between MSs which could lead to legal uncertainty and be untenable in light of a harmonized approach to competition law}
  \item \footnote{Reg 1/2003 (n 34) Art 16(1-2)}
  \item \footnote{MacQueen et al 902}
  \item \footnote{Ibid}
  \item \footnote{Tritton para 8-040}
\end{itemize}
shall not be afforded the possibility to eliminate competition for a substantial part of the products in question.

Should a distribution agreement restrict trade within the meaning of Article 101(1), it must be granted an exemption either under Article 101(3) as indicated above, or under a block exemption regulation specifically tailored for the type of agreement in question in order to be compliant with EU competition law. The purpose of a block exemption regulation is to aid undertakings in the self-assessment of the legality of their agreements. A block exemption regulation lays down specific conditions which, when fulfilled, will exempt an agreement from falling within Article 101(1). In other words, an agreement is automatically valid and enforceable when it fulfills the conditions laid down in a BER concerning it. Stating briefly, the rules of a BER have been tailor-made to comply with the requirements of Article 101(3) and provide companies a form of simplified guidelines for the evaluation of, for example, their agreements concerning product distribution. Should an agreement fall outside a BER due to a provision noncompliant to its requirements, such an agreement may still benefit from exemption under Article 101(3) and does not fall automatically within Article 101(1).

For the purposes of this study, the relevant BER to consider is the block exemption regulation on vertical restraints, which sets out the required conditions for selective distribution networks. The concept of selective distribution and its relevant legal framework shall be discussed as part of the following Chapter. The interrelation between an agreement restricting competition, exemption under a BER, exemption under Article 101(3), and a violation of Article 101(1) can be illustrated as below:

68 MacQueen et al 907
69 Ibid 903
70 Ibid
72 Prior to selective distribution being included under a block exemption regulation, legal boundaries for this form of distribution were based on the case-law of the Court of Justice and the Court of First Instance and decisions made by the Commission. A list of the most significant court rulings and Commission decisions concerning selective distribution can be found in the Commission’s Green Paper on Vertical Restraints in EC Competition Policy (1997, footnote 35), accessible at http://europa.eu/documents/comm/green_papers/pdf/com96_721_en.pdf
## AGREEMENT

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<td>ART 101(3)</td>
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<td>&lt;</td>
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<td>Violation of Art 101(1)</td>
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4 TRADEMARKS AND SELECTIVE DISTRIBUTION

It follows from the concept of competition that the presence of several competing undertakings is required in order for a field of business to be competitive. When there are plenty of firms competing within one given industry, all manufacturers face a challenge in differentiating their product from the offerings of others. A product can be differentiated through the creation of a brand. A brand can be developed and applied to an entire undertaking or its individual products and services73, and can be defined as ‘[t]he intangible sum of a product’s attributes: its name, packaging, and price, its history, its reputation, and the way it’s advertised’.74 A brand has also been defined as ‘a collection of intangible values as perceived by a consumer which are attributed to a name, symbol, or design used to identify a product or group of products or services’.75

Although the conceptual borders of a brand remain an issue of discussion,76 a trademark, if not constituting its complete synonym,77 indisputably comprises at least a part of one. Trademarks are symbols referring to a particular company or a branded product produced by that company, thus forming an integral and essential part of a brand. A trademark can be a word, symbol, or other signifier distinguishing the goods produced by one manufacturer from those of other undertakings.78 In other words, a trademark is the key in connecting a given product to its brand image in the mind of the consumer, and may thus be regarded valuable for both the brand owner and the customer.79

The intangible values of a brand, such as reputation, quality, and exclusivity are fragile components which could be affected negatively through various forms of misuse. Should the value of a brand, which is based upon consumer perception, be devaluated, then it could be reasoned that the message conveyed by the trademark will also be affected as a result. This means that the trademark would be associated with less valuable products in the minds of the consumers, effectively leading to a decrease in the reputation of the trademark.

73 MacQueen et al 575
74 Ibid, citing Ogilvy at <http://www.ogilvy.com>
75 Ibid, citing L’Oréal and others v Bellure and others [2006] EWHC 2355 (Ch) para 79
76 Ibid
77 Landes and Posner use ‘trademarks’ and ‘brands’ as synonyms to each other in their book The Economic Structure of Intellectual Property Law (see following footnote)
79 Tritton para 3-001
Very importantly, the latter equation on brand value could function also the other way around. In practice, this means that inflation of trademark reputation could consequently decrease brand value. It could be argued that brand devaluation through a decrease in trademark reputation is, in the case of certain products, the most plausible of different threats to brand value. The value of a luxury good brand could immediately be affected should the manufacturer’s trademark be associated with, for example, discount stores or other distribution outlets inferior to the quality of distribution premises normally used in the distribution of the trademarked products. Considering this, one might turn to think what would then be the effect of selling special or luxury goods over the Internet?

Brand value is an abstract concept which might, aside from undesirable distribution, be devaluated through various other forms of negative association such as tax fraud, sweat shops, or any discriminatory acts to name a few examples. However, the aforementioned are all threats which companies can combat through different internal policy measures. Their hands are far more tied in protecting brand value when they use external distributors in the distribution of their products.

The exclusive rights conferred by a trademark provide a trademark owner an incentive to develop, promote, and invest in the mark and the products sold under it. Trademark proprietors, fearing the undermining of their efforts made to build brand and trademark image, namely goodwill, are eager to control the way in which their products are presented and sold to customers. This concern might warrant the view suggesting that the quality of distribution channels forms an important component in brand goodwill protection. Trademark proprietors, having made heavy investments in the creation of goodwill, have strong reasons to protect the acquired reputation of a mark.

4.1. The functions of a trademark

Customers utilize trademarks in both purchasing and characterizing products made by different manufacturers. On the way to work, one might stop by Wayne’s Coffee to enjoy another cup of coffee produced by a manufacturer whose products have pleased him in the past. Another one might, from the wide range of alternatives offered, prefer

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80 The example charts up threats external to a branded product itself. Naturally, deficiencies in the products themselves, e.g. a decrease in product quality, would have strong negative consequences also
81 Tritton para 3-001
82 MacQueen et al 856
to buy a Lacoste shirt not only due to the material features of the product itself, but also due to a certain message conveyed by the small crocodile sewed onto the shirt.

The cases above provide two basic examples of several trademark functions. In the first case, the trademark imprinted on the paper cup guarantees the consumer that the coffee contained within is the same exquisite product which he has enjoyed earlier. In the latter case, the consumer bases his choice of purchase upon both perceptions on a level of quality and a certain message, which the product of this particular manufacturer, in his opinion, does inherently possess.

Trademarks indicate the origin of goods and services sold under the mark and, serving as badges of origin, perform an origin function. The trademark messages to the consumer that all products bearing a certain trademark originate from the same manufacturer. By doing so, the trademark enables customers to differentiate between products originating from different undertakings. A trademark could be viewed to equal the producer's identity, although the mark does not make a direct reference to this company. As in the coffee example above, the trademark assures the consumer that the product purchased originates from the same manufacturer whose coffee he has purchased earlier. Under trademark law, others may be prohibited from using the same mark for their products, and this can also be viewed to have aims in the protection of consumers.

A consumer is, however, often more interested in the quality of a product rather than merely its source. Trademarks, performing their origin function, relate certain products to one particular manufacturer. As a good originates from only one manufacturer, it becomes more likely that the goods can be produced in uniform quality. A consumer hopes that the products made by different manufacturers will all have their own consistent qualities, be they more or less good, and thus a trademark becomes an indicator of product quality. In other words, a consumer assumes that a certain source produces goods of a certain quality. A trademark's indication of

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83 MacQueen et al 572-573
84 Tritton para 3-001
86 Ibid, 409-410
87 Tritton para 3-001
88 Ibid
89 Maniatis 407
90 MacQueen et al 574, citing Case C-10/89 SA Cnl-Sucal NV v Hag GFAG [1991] FSR 99 at 129 30
product quality is not an absolute, nor a legal one\footnote{MacQueen et al 574, citing Wagamama Ltd v City Centre Restaurants Plc [1996] ETMR 23}, and the trademark proprietor has the right to alter the quality of his products.\footnote{Tritton para 3-001} However, a trademark proprietor has an economic incentive in producing goods of uniform quality, and thus in maintaining a stable level of quality.\footnote{Maniatis 407} Consistency of product quality is necessary in order to maintain consumer loyalty,\footnote{Ibid} and therefore any changes in product quality may pose a risk of financial repercussions to the manufacturer.\footnote{Ibid}

Thirdly, trademarks perform a function related to advertising. A trademark works as an advertisement for products sold under it, and therefore proprietors make heavy investments of time, effort, and money in building a trademark capable of capturing the attention of the public.\footnote{Ibid} The advertising function of a trademark is the cumulative result of a product’s origin, quality, and any other possible features of the relevant brand.\footnote{Maniatis 408} As a result of successful branding, a trademark may have advertising power, goodwill, which stands independent from the reputation of the actual products.\footnote{Ibid} In other words, ‘[…] the mark has an inherent economic value which is independent of and separate from that of the goods or services for which it is registered’.\footnote{Tritton para 3-001} Having, for example, Coca-Cola sponsoring a sports event could be viewed as much more than mere advertising of soft drinks. The goodwill of the Coca-Cola trademark could have an effect on, for example, how special and significant the event is perceived by the public.

Every brand can be considered to communicate a unique story, a psychological message, for the part of its relevant products.\footnote{Tritton para 3-001} The market has changed vastly from a long past era where material characteristics, not brands, were the dominant determinant behind purchase choices.\footnote{MacQueen et al 574, citing Wagamama Ltd v City Centre Restaurants Plc [1996] ETMR 23} In the older market, consumers used trademarks to distinguish between goods originating from different sources, but their choice of purchase was more based upon product characteristics than their manufacturers.\footnote{Ibid} Today it is increasingly harder for companies to differentiate through product characteristics, so brand owners effectively invest and trust in brands to act as
purchase determinants. Thus, product brands have become an increasingly valuable tool for differentiation on the market.

Consumer purchase choice in the market today is affected by factors based in both product characteristics and consumer psychology. The first-mentioned covers product price, quality, and supply, while the latter is not based upon the product itself but rather the image of the associated brand. The public is very image-conscious, so brand image might be of paramount importance to product characteristics for manufacturers engaged in certain market sectors, such as luxury items. Luxury goods are not bought solely due to their material features, but also because of the exclusivity they emanate. The image of a brand can convey luxury, freedom, power, youth, or exclusivity among various other attributes. The Lacoste example in the beginning of this Chapter illustrated this two-tier effect on consumer purchase choice. There the consumer based his purchase upon both the physical characteristics and the image of a shirt.

The psychological side connected to brands and trademarks might therefore be regarded as an important vehicle in product differentiation and an integral part of product identity alongside origin and quality. Combined with the physical side of products, competition between undertakings may be perceived to exist in two parallel frontiers - mental and physical. One part of manufacturers might invest more on the psychological side, while another part might prefer focusing on physical characteristics. Both parties, however, pursue a common aim in differentiating their products. They might have different means, yet their objective is the same. In respect to this, one might question whether legislation accommodates equally both these sets of means.

Brands are important concepts in the market today and companies allocate an abundance of resources in building consumer awareness for a particular mark. In fact, a trademark might well be considered an investment. Therefore, it is of small wonder that trademark proprietors are increasingly willing to protect the complex and delicate image of their brands in the market.

103 Tritton para 3-001
104 Ibid
105 Ibid
106 Ibid
107 MacQueen et al 575, citing Mülhens GmbH & Co KG v OHIM [2008] ETMR 69 para 36
108 Ibid 574
4.2. Selective distribution

Selective distribution can be defined as:

‘[…]a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors within the territory reserved by the supplier to operate that system’.\textsuperscript{109}

In other words, selective distribution means that a manufacturer (supplier) sells his products only to such distributors who fulfill certain criteria. Furthermore, these selected distributors shall not sell the products to any distributor who is not part of the distribution network. Selective distribution networks are used by a range of different manufacturers and, in particular, often by those supplying technically complex, design, or luxury goods.\textsuperscript{110}

The rationale behind favoring selective distribution, from the manufacturer’s point of view, has its foundations in brand value protection. The supplier may, under freedom of contract, select those distributors which he prefers.\textsuperscript{111} This selection may be done through qualitative criteria\textsuperscript{112} based upon the qualifications of the distributor, his staff, trading premises, supplied services, and so forth.\textsuperscript{113} By requiring certain criteria, brand owners wish to influence the outlets from which their products are sold to the public.\textsuperscript{114}

The interior of trading premises and a high quality sales environment in general are used to promote the status of the goods in the eyes of the consumers.\textsuperscript{115} Requiring a certain level of quality from distributors might be justified, as sales from inferior outlets could devaluate the value and image of the manufacturer’s products.\textsuperscript{116} These requirements, in other words, aim to preserve the perception of product exclusivity in consumer minds.\textsuperscript{117} Brand owners often wish to promote the value of their goods by

\textsuperscript{109} Reg 330/2010 Art 1(e)
\textsuperscript{110} Kuoppamäki 141-142
\textsuperscript{111} Ibid 142
\textsuperscript{112} Quantitative criteria, as another option, would relate to a strategy in limiting the amount of distributors appointed to different areas. Quantitative criteria are generally regarded more anti-competitive than qualitative criteria, and thus more likely to fall within the prohibition laid down in Art 101(1) TFEU
\textsuperscript{113} Kuoppamäki 141
\textsuperscript{114} Korah 272
\textsuperscript{115} Kuoppamäki 142
\textsuperscript{116} Ibid
\textsuperscript{117} Philip Marsden and Peter Whelan, ‘Selective distribution in the age of online retail’ [2010] 31(1) ECLR 26, 28
requiring distributors to provide specific sales services in their outlets. In *Metro II*, the ECJ held that certain products might require ‘[…] sales service and after-sales service specially adapted to their characteristics and linked to their distribution’.  

Selective distribution should not be confused with franchising, although these two modes of distribution do have some characteristics in common and are both governed by the same block exemption regulation. In general, a franchise requires an entrepreneur to sell specific products under a specific concept in which product brand plays a central role. In selective distribution, a distributor is not obliged to follow a particular concept to the same extent as in franchising. Products from different manufacturers might often be sold side by side and the trademarks of all these manufacturers may be used in advertising, as the requirements for selective distribution are limited to the suitability of sales premises, qualifications of personnel, and so forth. A simple example of a franchise could be McDonald’s, while one for selective distribution could be Stockmann Beauty.

Once entering into a selective distribution agreement with a manufacturer, a distributor basically agrees to sell products under a set of criteria established by the supplier. One might then ask how far the suppliers can go with these criteria. Can a supplier legally require distributor compliance to any requirement he might be willing to set? EU competition law’s answer to this question would be a ’no’. Certain provisions in selective distribution agreements might restrict competition, rendering them illegal under competition law. Selective distribution criteria are thus not borderless and are governed through particular regulation.

Prima facie, selective distribution could be seen as an act of discrimination towards different kinds of distributors. How may one distributor be privileged to benefit from the sales of a certain product, while another one may not? Indeed, selective distribution systems are viewed as restraints having possible anti-competitive effects. These systems have a negative effect upon price competition between authorized distributors through limiting the number of potential distributors in the market and, as a result, consumers might end up paying a higher price for their goods. The effects of selective and exclusive distribution agreements have been a major issue of debate in the past, for

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118 Case 75/84 *Metro SB Großmärkte GmbH & Co KG v Commission of the European Communities* [1986] ECR 3021 para 54
120 Kuoppamäki 142
example with regard to agreements made within the EU motor vehicle business sector.\textsuperscript{121}

However, selective distribution has been established to create outweighing pro-competitive effects in factors other than price.\textsuperscript{122} Selective distribution is perceived to be a legitimate requirement in the provision and maintenance of specialist trade, meaning high quality and high technology in particular, capable of justifying a reduction in price competition through the increase of competition in other forms, and thus compliant to Article 101 TFEU.\textsuperscript{123} In \textit{Metro I},\textsuperscript{124} the ECJ acknowledged that competition might take many forms and although selective distribution might have a negative impact on prices, this effect shall not be the sole focus of the competition law analysis.\textsuperscript{125} It follows that selective distribution agreements and practices do not per se contradict with competition law.\textsuperscript{126} Despite restricting price competition, selective distribution may have a positive impact upon quality competition between authorized distributors, thus catalyzing the provision of better services for the consumer.\textsuperscript{127}

Brand owners argue that selective distribution is needed in order to guarantee that their products are sold together with sales services and consumer advice mandatory for the proper utilization of the products.\textsuperscript{128} These services are, in other words, needed to guarantee that a consumer purchases the most suitable good and is able to utilize it to its full extent. Not all products are, however, such which would require selective distribution. The relevant characteristics of a product shall be analyzed to establish whether they ‘necessitate the existence of a selective distribution system in order to preserve its quality and ensure its proper use’.\textsuperscript{129} A product may not necessitate a selective distribution system, should it be already sufficiently protected by national rules governing trade and the conditions of sale for the product in question.\textsuperscript{130} In jurisprudence, products such as perfumes, hi-fi, and televisions have commonly been

\textsuperscript{121} Kirsty Middleton, 'The legal framework for motor vehicle distribution – a new model?' [2001] 22(1) ECLR 3, 3 et seq
\textsuperscript{122} Kuoppamäki 142
\textsuperscript{123} Korah 272, citing Case 107/82 Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v Commission of the European Communities [1983] ECR 3151, para 33 et seq
\textsuperscript{124} Case 26/76 Metro SB-Großmärkte GmbH & Co. KG v Commission of the European Communities [1977] ECR 1875 para 21
\textsuperscript{125} Marsden & Whelan 28
\textsuperscript{126} Roger J Goebel, 'Metro II's Confirmation of the Selective Distribution Rules: Is This the End of the Road?' [1987] 24(4) CML Rev 605, 610
\textsuperscript{127} Kuoppamäki 142
\textsuperscript{128} Ibid 141
\textsuperscript{129} Case 31/80 NV L’Oréal and SA L’Oréal v PVBA ”De Nieuwe AMCK” [1980] ECR 3775 para 16
\textsuperscript{130} Ibid
viewed to reach a threshold justifying a selective distribution network.\textsuperscript{131} Or, as the Commission puts it, selective distribution is ‘almost always used to distribute branded final products’.\textsuperscript{132}

When a product can be seen to necessitate selective distribution by nature, the manufacturer is allowed to establish qualitative distribution criteria which, when purely qualitative, are primarily perceived to fall outside the scope of Article 101(1) for the lack of anti-competitive effects.\textsuperscript{133} The ECJ has held selective distribution as permissible under EU competition law,

‘[…]
provided that resellers are chosen on the basis of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and his staff and the suitability of his trading premises and that such conditions are laid down uniformly for all potential resellers and are not applied in a discriminatory fashion’.\textsuperscript{134}

Selective distribution agreements are considered as vertical agreements,\textsuperscript{135} which are made between undertakings operating at different levels of production and distribution chains and relate to the conditions under which the contract parties may purchase, sell, or resell particular goods and services.\textsuperscript{136} Suppliers and distributors, for example, are undertakings operating on different ladders of trade. Manufacturers enter into vertical agreements with external distributors mainly due to a lack of resources required for vertical integration, where the manufacturer would operate the distribution of products by itself.\textsuperscript{137} Using external distributors might not be lucrative only financially, as external distributors’ knowledge of local market structures and conditions could have high value to the brand owner.\textsuperscript{138}

Contrary to horizontal agreements, potential cartels, vertical agreements are not perceived to have an undesirable effect on competition should there be sufficient

\textsuperscript{131} Marsden & Whelan 28
\textsuperscript{132} Guidelines on Vertical Restraints [2010] OJ C130/01 para 174
\textsuperscript{133} Ibid para 175
\textsuperscript{134} Metro v Commission, para 20
\textsuperscript{135} Horizontal agreements, for their part, are agreements entered into by companies operating at the same level of production and distribution. Horizontal agreements are viewed to have severe negative effects on competition and the parties to a horizontal agreement might be forming a prohibited cartel aiming to fix market prices and affect trading conditions
\textsuperscript{136} Reg 330/2010 Art 1(a)
\textsuperscript{137} Mario Velez, ‘Significant changes to the block exemption on vertical restraints’ [2011] 32(4) ECLR 212, 212
\textsuperscript{138} Ibid
competition between competing undertakings.\textsuperscript{139} This leads to the division of intra and inter brand competition. Intra brand competition refers to competition between distributors of the same brand,\textsuperscript{140} for example all distributors selling Yves Saint Laurent. As all these distributors sell the same products, they sell products of the same quality, and must therefore compete through other factors, such as price, availability, or other sales conditions\textsuperscript{141} including pre-sales services. Inter brand competition refers to competition between distributors of different brands,\textsuperscript{142} for example Adidas and Puma. Here the consumers are interested in comparing also the quality of the products among the other affective factors.

Selective distribution has effects on intra brand competition; the competitive environment concerning a particular branded product. It may lead to higher prices, collusion, and a decrease in intra brand competition,\textsuperscript{143} while also foreclosing certain distributors.\textsuperscript{144} The limitations are, however, needed in maintaining the integrity of the distribution system.\textsuperscript{145} Like stated above, the decrease in intra brand competition is often outweighed by sufficient inter brand competition. If the price of one brand rises while its availability declines, consumers might be willing to turn to those brands providing substitutes for the first products. A lack of inter brand competition would mean that consumers are unable to buy any substitutes and would thus be unable to persuade a manufacturer into reconsidering the pricing and distribution of his products. When there is sufficient intra brand competition on the market, the ECJ has held that selective distribution of certain goods, such as luxury cosmetics,

\begin{quote}
‘[...] improves competition in the interests of consumers, in particular by contributing to the preservation of the “luxury” image of the products compared with similar products which do not enjoy such an image, so that Article 85(1) of the Treaty does not apply to certain qualitative criteria which have that objective.’\textsuperscript{146}
\end{quote}

Vertical agreements made between suppliers and distributors are governed by Regulation 330/2010, the block exemption regulation on vertical agreements. The role of the VABER is to lay down a specific set of rules which, when satisfied, will provide

\textsuperscript{139} Reg 330/2010 Recital 7
\textsuperscript{140} MacQueen et al 895
\textsuperscript{141} Ibid
\textsuperscript{142} Ibid
\textsuperscript{143} Mario Velez ‘Recent developments in selective distribution’ [2011] 32(5) ECLR 242, 242
\textsuperscript{144} Guidelines on Vertical Restraints para 175
\textsuperscript{145} Kuoppamäki 141
\textsuperscript{146} Case T-88/92 Groupement d'achat Édouard Leclerc v Commission of the European Communities [1996] ECR 1961 para 173
any selective distribution agreement an exemption from the prohibition of Article 101(1) TFEU. The VABER aims to exempt those vertical agreements, which are perceived to have pro-competitive effects outweighing their negative ones. Effectively, the BER should not exempt any vertical restrictions which are likely to restrict competition, harm consumer welfare, and are not indispensable in the pursuit of pro-competitive effects.\textsuperscript{147}

It is stated that certain vertical agreements may improve economic efficiency in production or distribution and, importantly, lead to an optimization of investment levels.\textsuperscript{148} The Commission, rightfully, perceives that the possible anti-competitive effects of vertical agreements grow stronger with the more market power a contract party has.\textsuperscript{149} Effectively, the Commission introduced to the VABER a relevant market share threshold of 30\% for both the supplier and buyer parties of an agreement.\textsuperscript{150} With the establishment of this threshold, companies able to exercise market power are deprived from BER exemption, as it is increasingly unlikely that the pro-competitive effects of an agreement by such parties would outweigh the negative ones.\textsuperscript{151} It is perceived that should neither contract party have market power, vertical agreements generally lead to increased efficiency in production and distribution allowing consumers a fair share of the resulting benefit, should the agreements not contain provisions severely restrictive to competition.\textsuperscript{152}

Such provisions severely restricting competition are referred to as ‘hardcore restrictions’ within the VABER. Hardcore restrictions compose the Regulation’s ‘black list’ of unacceptable conditions. Should an agreement contain a provision which amounts to a hardcore restriction, it will not benefit from an exemption under the BER. Article 4 VABER, providing a list of the hardcore restrictions, reads as follows:

\textit{The exemption provided [...] shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:}

(a) the restriction of the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price,
provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

(b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services, except:

(i) the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer,

(ii) the restriction of sales to end users by a buyer operating at the wholesale level of trade,

(iii) the restriction of sales by the members of a selective distribution system to unauthorised distributors within the territory reserved by the supplier to operate that system, and

(iv) the restriction of the buyer’s ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier;

(c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment;

(d) the restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different level of trade;

(e) the restriction, agreed between a supplier of components and a buyer who incorporates those components, of the supplier’s ability to sell the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods’.

The emphasized lines in the Article above state that an exemption under the VABER will be withdrawn from agreements which have as their object the restriction of territories or customers into or to whom buyer parties (distributors) may sell given products and services, excluding sales made to unauthorized distributors by members of a selective distribution system. Furthermore, the active and passive sales efforts of members of a selective distribution system may not be restricted under the BER, with the sole exception being sales made from an unauthorized place of establishment.

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153 Emphasis added
The inability of manufacturers to restrict territories or customers into or to whom their distributors may sell the contract products, stated in Article 4(b), has clear foundations in the Single Market program. As a restriction on territories or customers amounts to a hardcore restriction, it is de facto guaranteed that manufacturers will not be able to divide markets and segregate customers into different groups under benefit from the VABER. Effectively, parallel trade from one MS to another may not be barred, as the manufacturers may not prevent a distributor from selling products or services to customers residing in other EU territories.

ECJ jurisprudence has long condemned territorial restrictions, especially agreements resulting in absolute territorial protection, whereby distributors are protected from both parallel imports and sales made by any other distributor. In Consten & Grundig,154 a landmark case, the Court stated that Article 85(1) forbids agreements through which manufacturers grant exclusive territories for distributors. There Grundig, a German manufacturer of radios, obstructed parallel trade of its products from Germany to France in order to make Consten a sole distributor of its products in the French market.155 A hardcore restriction in territorial protection shall be allowed only in exceptional cases and for strictly limited periods of time to, for example, enable distributors to enter new markets successfully.156 The ECJ recognized the need to protect licensee investment in new products157, and, in Nungesser, distinguished between ‘open’ exclusive licenses and ‘closed’ ones.158 Open exclusive licenses, which do not affect the position of third parties such as parallel traders or foreign licensees, were viewed to fall outside Article 81(1).159 Closed licenses, where the position of third parties is affected, as in Consten & Grundig, are to fall within the prohibition of this Article.

A non-restriction on sales territories and customers has gained additional relevance in the context of modern online purchasing. The Internet enables consumers from all parts of the EU to reach any desired distributor that is established within the Common Market. For example, a consumer residing in Finland may contact a Greek distributor of Chanel products online and buy a certain Chanel product from him without legal interference from the manufacturer. According to Article 4(b) (iii), the manufacturer

154 Joined cases 56 & 58/64 Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission of the European Economic Community [1966] ECR 299
156 Guidelines on Vertical Restraints para 61
157 MacQueen et al 901
159 Ibid
can interfere only should a distributor, who is part of his selective distribution system, sell products to unauthorized distributors within the territory reserved for the manufacturer to operate this system.\textsuperscript{160} Consumers are obviously not to be regarded as distributors, so suppliers may not restrict sales made to them regardless of where within the EU they might reside. Thus, the Internet shifts distributor-consumer relationships onto a truly Community-wide level.

Article 4(c) VABER prohibits manufacturers from limiting active or passive sales made by members of their selective distribution systems to end users, with the only exception covering sales made from unauthorized places of establishment. The dichotomy of ‘active’ and ‘passive’ sales, present in the wording of the preceding VABER\textsuperscript{161} also, created interpretation problems and forced the Commission to define their meaning more clearly through a set of examples for the purposes of the BER in force today. ‘Active’ sales are defined in the VABER Guidelines as follows:

“Active’ sales mean actively approaching individual customers by for instance direct mail, including the sending of unsolicited e-mails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory”.\textsuperscript{162}

‘Passive’ sales, for their part relevant to selective distribution,\textsuperscript{163} are defined in the following way:

\textsuperscript{160} The wording ‘territory reserved for the manufacturer to operate this system’ is rather problematic. If Chanel would not be operating a selective distribution network in Finland, a Greek distributor might, according to the wording of Article 4(b) (iii), not be legally prohibited from selling to any distributors in Finland, as the manufacturer has not ‘reserved’ this territory for a selective distribution system and thus there could not be ‘unauthorized’ distributors. To simplify the provided example, we consider that Chanel has ‘reserved’ Finland for selective distribution and thus a foreign distributor may sell only to Finnish end consumers and authorized distributors.


\textsuperscript{162} Guidelines on Vertical Restraints para 51

\textsuperscript{163} A precise definition for ‘passive’ sales is required for exclusive distribution, specifically. The dichotomy per se is not as important in selective distribution, as either alternative may not be restricted. In exclusive distribution, the manufacturer has to be able to regulate distributors’ active sales in order to maintain the integrity of exclusively assigned territories, which the Commission rightfully acknowledges in Art 4(b) (i) VABER; exclusive distribution may not be combined with selective distribution, as this would inevitably lead to a hardcore restriction of active or passive sales (see Guidelines to Vertical Restraints para 57).
‘Passive’ sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion [...] is considered passive selling.164

Article 4(c) VABER thus prohibits manufacturers from restricting both solicited and unsolicited sales made by their selected distributors, meaning regardless of whether customers approach the distributors or vice versa. The combination of active and passive sales therefore constitutes ‘sales’ in a very broad meaning of the word which is not limited to handing a product over the counter, but covers also various forms of advertising. As in the case of non-restrictions for sales territories and consumers, the effects of unrestricted active and passive sales are magnified by the Internet. The Commission underlines that selected distributors should be free in selling both actively and passively online.165 As manufacturers shall not prohibit these sales, their distributors may freely use the Internet in approaching customer groups from various territories and are, on top of the sales resulting from these endeavors, to enjoy also any unsolicited sales made. The broadness of this distributor liberty is very important to understand. In practice, a manufacturer may not limit the online sales of his selected distributors in any way. Enigmatically, the VABER entitles him to require quality standards for the use of Internet sites166 in a manner which shall not exceed what is ‘equivalent to the criteria imposed for the sales from the brick and mortar shop’.167 Any standards may, however, never limit the online sales of a distributor.168 The manufacturer may not establish any sales quota for products sold online, as the Commission has specifically stated that any limitation on online sales volume equals to a hardcore restriction.169 Effectively, manufacturers face the threat of practically a limitless amount of product sales shifting into the online environment, where and through which the reputation of their products may suffer a considerable decline.

A vertical agreement including a hardcore restriction, such as a limit on online sales, is not only excluded from the scope of the VABER, but is also presumed to fall within Article 101(1) TFEU and unlikely to fulfill the exempting conditions of Article 101(3). A hardcore restriction might be allowed as part of an agreement only in exceptional cases where such provision is ‘objectively necessary’ to, for example, enable new market entry

164 Guidelines on Vertical Restraints para 51
165 Ibid para 56
166 Ibid para 54
167 Ibid para 56
168 Ibid para 54
169 Ibid para 52(c)
or safe supply of dangerous substances.\textsuperscript{170} Therefore, the possibility of brand image protection amounting to objective justification in the eyes of the Commission seems rather unlikely. According to certain views, the concept of an ‘objective justification’ should be interpreted narrowly so that it better serves the welfare of consumers rather than the integrity of selective distribution systems.\textsuperscript{171}

The Commission views the Internet as a ‘powerful tool to reach a greater number and variety of customers’ in comparison to traditional sales methods.\textsuperscript{172} In principle, every distributor must be allowed to take advantage of selling through the Internet.\textsuperscript{173} This approach, lenient to online sales, should be regarded as a continuation of a long standing Commission policy instead of a recent turn take. The previous VABER and its respective Guidelines contained very similar provisions already more than one decade ago.\textsuperscript{174} It would, therefore, appear that the Commission’s view towards the Internet has not changed amidst the development of this distribution channel during the past ten years.

\textsuperscript{170} Guidelines on Vertical Restraints para 60
\textsuperscript{171} Marsden & Whelan 33
\textsuperscript{172} Guidelines on Vertical Restraints para 52
\textsuperscript{173} Ibid
\textsuperscript{174} Guidelines on Vertical Restraints [2000] OJ C291/1 paras 50-51
5 ONLINE SALES – A SOLUTION AND A PROBLEM

5.1. Towards the new BER

Vertical restraints have traditionally been viewed rather skeptically in EU competition law.\textsuperscript{175} Already long before the era of the Internet and the information society, vertical agreements have posed an intrinsic threat of dividing markets and hindering European market integration.\textsuperscript{176} Prior to the current VABER and its predecessor, vertical agreements were approved or disapproved by the Commission on a case-specific basis. The drafting of block exemption regulations began in order to ease up the administrative burden piled upon the Commission. With the BERs in force, those agreements compliant to relevant provisions do not require an individual approval from the Commission anymore.\textsuperscript{177} The first BER to include selective distribution, Regulation 2790/1999, was followed by the current Regulation 330/2010.

Block exemption regulation 2790/1999 created controversy and interpretational problems during its time in force. In order to receive feedback and determine the developing needs of various industries, the Commission arranged consultations on the draft for the succeeding VABER during the autumn of 2009.\textsuperscript{178} The consultation took place during July and August with its target group consisting of organizations, industry associations, and consumer interest associations with direct experience to assess vertical agreements and the regulation concerning them. The Commission stated that the aims of the new VABER would be the reduction of the regulatory burden upon undertakings not possessing market power and the introduction of an effects-based assessment scheme for vertical agreements. Evolution of Internet sales was recognized as a major development since the enactment of the earlier BER and the Commission specifically wanted to invite comments on its proposed policy towards the restriction of online sales; this resulted in an abundance of replies.\textsuperscript{179} Online commerce was not a significant factor during the time when the previous VABER was drafted, so that Regulation did not cover Internet sales in any particular way.\textsuperscript{180}

\textsuperscript{175} Kuoppamäki 143
\textsuperscript{176} Ibid
\textsuperscript{177} Ibid
\textsuperscript{178} Information on the public consultation, as well as all contributions received, can be accessed at <http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html>
\textsuperscript{179} Jean-Michel Coumes and Katharine Wilson, ‘New rules on supply and distribution agreements: main changes of the new system’ [2010] 31(11) ECLR 439, 439
\textsuperscript{180} Velez (n 136) 215
Despite receiving an abundance of critical feedback from enterprises and players across industries, the current VABER left a whole range of manufacturers’ questions without answers once coming into force. Once again, the Commission had been obliged to make drastic policy decisions both in between the seemingly diverse needs of consumers and brand owners and the weighing of economic argumentation versus the Single Market aim. For selective distribution, the current BER provides some clarity and solution yet simultaneously creates considerable problems for brand owners willing to protect investment in their brands. The current legal regime appears to offer a hybrid of both solution and problem for the needs of a competitive European product market in the Internet era.

The Commission’s lenient view towards Internet sales can be regarded as a logical chapter in its long-standing perception of competition law aiming to prohibit those vertical agreements that curtail the welfare of European consumers and establish private barriers to trade between MSs.\textsuperscript{181} Consumer welfare has a primary focus in the interpretation of Article 101 TFEU and could be regarded as the ultimate aim of this provision in the Treaty.\textsuperscript{182} Price reductions, increased selections of products, and products and services of better quality are all consumer benefits that enjoy un leveled importance, and thus it could be claimed that the position of the European consumer has never been stronger than what it is today.\textsuperscript{183} The Commission has stated the VABER to have its objectives in the enhancement of online sales, consumer freedom of choice, and price competition.\textsuperscript{184} Furthermore, the number and influence of vertical agreements has been perceived as significant and it is important that they are updated to serve the mechanisms of the contemporary market.\textsuperscript{185}

5.2. Lower prices

Online retail can inarguably provide enormous benefits to consumers. When not restricted, the Internet enables customers and distributors from all parts of the EU to reach and make transactions with each other. Using the Internet, consumers enjoy the possibility of purchasing from the widest range of products and services offered by countless manufacturers and are, additionally, able to retrieve all the information

\textsuperscript{181} Guidelines to Vertical Restraints para 7
\textsuperscript{182} Marsden & Whelan 26
\textsuperscript{183} Ibid
\textsuperscript{184} Olli Wikberg, ‘Jakelu- ja toimitussopimuksia koskevat Euroopan komission uudet kilpailusäännöt’ [2010] 2010/4 Defensor Legis 491, 491
\textsuperscript{185} Ibid 492
needed for easy price and product comparison.\textsuperscript{186} Not only does the Internet create added value for consumers through providing a convenient connection to distributors, but it also enables them to purchase the exact products desired at the most affordable price.

It is quite easy to argue that unrestricted Internet sales serve best some of the greatest interests of the consumers, especially their desires for lower product prices and convenience in purchasing. The consumers may now pursue the very best of deals from their home computers without being bound by the opening hours of a physical shop.\textsuperscript{187} Therefore, in tandem with the EU’s fundamental aim in creating a seamless Single Market, decision-makers’ preference for unlimited online sales seems logical. The Internet enables a consumer to benefit from lower product prices for two reasons. First, on a domestic level, the online price of a product might be cheaper compared to the store price due to the seller accruing fewer costs. Second, if the online price level of products in, say, Finland, is not lucrative to a Finnish consumer, he can always contact a Spanish distributor who can sell the same product to him with a better price.

Like introduced earlier,\textsuperscript{188} brand owners wish to foster product image and exclusivity and may legally require selected distributors to offer desired kinds of sales services for the customers. These services could consist of, for example, a recommendation on a product most suitable for the needs of an individual consumer and a demonstration on its features or use. The provision of these services, however, inevitably accrues costs for the distributor. These costs are never a real problem, as the distributor can compensate all pre-sale costs through the final sales price of the product. When a distributor sells a product through the Internet, he accrues fewer costs in selling this product. Every sale he makes online is a sale for which he does not need to ensure that there are sufficient qualified personnel available in the store to provide pre-sales services for a consumer. Therefore, he might be able to sell products cheaper online and consumers effectively benefit from a lower price. In other words, the distributor’s ability to cut total sales costs results in a better price for consumers.

This lower sales price benefits consumers in their subsequent product purchases. When for the first time buying a branded product which, due to its inherent nature in usability or complexity, might require advising services, a consumer might be willing to visit the

\textsuperscript{186} Marsden & Whelan 29-30
\textsuperscript{187} Ibid 30
\textsuperscript{188} See text to n 116
physical shop of a selected distributor. The shop’s higher product price would not be a problem for him as it is hopefully compensated by the service he is provided with. However, once obtaining the guidance he needs, the consumer may then make his subsequent purchases through the Internet for a lower price.\textsuperscript{189} He does not benefit from pre-sales services anymore, so he might rather choose to buy the product from where it is sold cheaper.

Importantly, in such a case, the customer does not need to pay a higher price for a product because of the existence of services he does not need or want.\textsuperscript{190} The street presence and pre-sales services of the brick and mortar shop create rent and staff costs unavoidably raising the cost of a sold product, but it should not be the consumer’s burden to suffer from paying multiple times for something he obviously does not need more than once.\textsuperscript{191}

Not only do Internet sales create a potential price benefit for consumers, but the online environment may also provide an enhanced shopping experience for a part of the public. Some customers might be more intimidated than delighted by the presence and approaches of sales staff in physical stores and would rather make their purchases in peace and undisturbed.\textsuperscript{192} The Internet has also evolved into a medium for modern ‘window shopping’,\textsuperscript{193} which enables, besides mere purchasing and ordering transactions, consumers to browse conveniently through wide selections of products from various manufacturers without ever having to leave the warmth of their homes.\textsuperscript{194}

It should be noted that all the previously mentioned consumer benefits, mainly price reductions and convenient distance purchasing, are created through bypassing pre-sales services, i.e. at their expense. In other words, this means that the mentioned consumer benefits are created only when products are sold under circumstances not necessarily satisfying the criteria for the circumstances which the manufacturer has intended his products to be sold under. Products are thus taken outside a context which their manufacturer has desired to be a part of their purchase. An immediate question might concern whether the moving of a good from one sales context to another might

\textsuperscript{189} Marsden & Whelan 30
\textsuperscript{190} Ibid 31
\textsuperscript{191} Ibid
\textsuperscript{192} Ibid 30
\textsuperscript{194} Marsden & Whelan 30
have an impact on how people perceive this given product. Is it possible that the reputation of a branded product could devaluate in a change of sales context?

Although consumers might benefit from a better price, it should be asked whether this result indeed brings about the maximization of consumer welfare. The consumer might have to pay less for his goods; yet when choosing to do so, he simultaneously disregards a range of services available at a physical shop. Such services could have convinced the consumer that he, indeed, benefits more from another product choice or he could have received education for making better use of whatever product he ultimately chooses to purchase. This information, importantly, could have an impact on how he ultimately values the product he purchases. The central question is whether this price reduction brought by online sales compensates the loss of services for the consumer. This question, obviously, is a subjective one. One consumer might prefer to purchase products from a brick and mortar shop as it enables him to benefit from a range of services and promotes the image of the product he purchases. Another consumer might be purely in pursuit of cheap prices and thus reluctant to paying extra for any services offered. Unrestricted online sales can thus be seen to provide a desirable solution for a portion of consumers, particularly those who do not need pre-sales services and those after the most lucrative price.

When analyzing whether brand owners should have a right to limit the Internet sales of their distributors, one question requiring an answer is whether the sales services provided are important enough to justify an obligation for all consumers to pay extra for their products.\footnote{Marsden & Whelan 36} If the answer is ‘no’, meaning that a majority of consumers would prefer purchasing online rather than from physical shops, then the sales made through the Internet could be viewed as devouring an unnecessary portion of a product’s sales price and be thus a desirable phenomenon regardless of any concerns that the brand owner might have. Moreover, competition resulting from Internet sales could be argued to determine the real value, or market price, for branded products where no deadweight for consumers is included. However, the consideration above would go beyond merely estimating a value for sales services provided, as it would actually be questioning the rationale for selective distribution systems from a fundamental perspective. Do brand owners really have a legitimate need to apply selective distribution criteria as practically any distributor today will be able to conduct online sales? It is clear that some provided services are unable to follow products into the online realm but is this,
however, a problem should the consumers still be eager to make their purchases online due to a lower price?

5.3. ‘Aura of luxury’

In fact, there might be a problem here, and it has been partially recognized and addressed in the jurisprudence of the ECJ. In *Copad*, the Court held that the quality of luxury goods is not merely the result of their material characteristics, but is similarly comprised ‘of the allure and prestigious image which bestows on them an aura of luxury’.\(^\text{196}\) This was not the first time that a European court identified the special nature of luxury goods. In *Leclerc*, the CFI perceived that the concept of characteristics in luxury cosmetics:

‘[…] cannot be limited to their material characteristics but also encompasses the specific perception that consumers have on them, in particular their ‘aura of luxury’. […] [Such] products […], on the one hand, are of a high intrinsic quality and, on the other, have a luxury character arising from their very nature’.\(^\text{197}\)

The CFI found that the luxury character and exclusive image of such ‘sophisticated’ products is important in the eyes of the consumers and that there is, in the consumers’ minds, only a low degree of substitutability between luxury cosmetic products and competing products from other segments of the cosmetics sector.\(^\text{198}\) Furthermore, the Court viewed that consumers enjoy products with a luxury image and appreciate the opportunity of purchasing luxury.\(^\text{199}\)

Therefore, an evaluation of luxury goods shall not be limited to cover only the physical features of such products, as their true breadth reaches far beyond. In *Copad*, the Court continued stating that a trademark proprietor can invoke his trademark rights to prohibit licensed distributors from selling his products to discount stores should such sales damage the allure and prestigious image which bestows on those goods an aura of luxury.\(^\text{200}\) Furthermore, the Court viewed that the conditions and characteristics, i.e. restrictions, of selective distribution systems can preserve product quality and ensure a

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\(^\text{196}\) Case C-59/08 *Copad SA v Christian Dior couture SA*, Vincent Gladel, as liquidator of Société industrielle lingerie (SIL), Société industrielle lingerie (SIL) [2009] para 24

\(^\text{197}\) *Leclerc v Commission* para 109

\(^\text{198}\) Ibid para 108

\(^\text{199}\) Ibid

\(^\text{200}\) *Copad v Christian Dior* para 60(1)
proper use of these goods. In the buildup to Copad, Dior granted a license for SIL to manufacture and distribute Dior products. SIL, despite rejections from Dior, sold these products to the discount store chain Copad. Following this, Dior brought forth a trademark infringement action. It follows from Copad, that trademark proprietors may prevent a distributor from selling to discount stores where such sales would impair the product’s aura of luxury and also any subsequent resale made by these stores where this resale would undermine the reputation of the branded goods. The judgment supports the argument of certain distribution channel restrictions being appropriate and legitimate measures in the protection of brand image.

In general, distribution restrictions made in order to foster the luxury image of a product are not to be deemed as inherently anti-competitive. In Leclerc, the CFI considered that:

"[...] it is in the interests of consumers seeking to purchase luxury cosmetics that the luxury image of such products is not tarnished, as they would otherwise no longer be regarded as luxury products. The [...] segmentation [...] between luxury and non-luxury cosmetics reflects the varying needs of consumers and thus is not improper in economic terms."

5.4. Court concerns

It is, without doubt, true that a case such as Copad, where a distributor sold products to an external reseller, is quite different from what is happening with online sales within selective distribution networks. First, VABER Article 4(b) (iii) specifically allows manufacturers to restrict any sales made by the members of a selective distribution network to unauthorized distributors. Second, any online sales made by a manufacturer’s selected distributor are not, anyway, made by an unauthorized one. However, the important point here is that the Court’s reasoning in Copad suggests that the ECJ perceives a need to make distinctions between different kinds of distribution channels and that distribution channels might be inherently different from each another. The ECJ, in other words, would seem to justify that brand owners have legitimate interests in excluding certain distribution channels due to an impact which

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201 Copad v Christian Dior para 28
202 Held 346-347
203 Bill Batchelor & Melissa Healy, ‘European Court of Justice gives brand owners new remedies against unauthorised resellers’ [2009] 30(9) ECLR 470, 470
204 Leclerc v Commission para 114 (emphasis added)
they could have upon product image.\textsuperscript{205} Moreover, the ECJ’s judgment in \textit{Copad} implies that brand owners’ concerns over trademark image may permit the exclusion of certain distribution channels.

Brand owners might have a desire in prohibiting, or at least limiting, the Internet sales of their distributors, as these sales might be perceived to have a negative effect upon the exclusive nature and reputation of the products sold.\textsuperscript{206} Elements integral to certain products, such as the experience of purchasing luxury, the feeling of exclusivity, the benefits of pre-sales services, among others, all suffer a decline in the online sales environment.\textsuperscript{207} The concerns of brand owners have gained support especially in German courts. In \textit{Lancaster},\textsuperscript{208} the \textit{Bundesgerichtshof} ruled that a manufacturer of brand perfumes was allowed to terminate a distribution agreement when online sales exceeded 50\% of total sales in order to protect the exclusivity of the products.\textsuperscript{209}

With this decision, the Court thus recognized a legitimate need in adjusting the online and offline sales volumes for branded goods. Furthermore, this judgment implicitly suggests that online distribution may indeed be capable of harming product reputation. Chanel, in its contribution to the consultation for the new VABER, correctly noted that the discussed drafts for the new VABER and its Guidelines, which directly forbid the limitation of online sales volumes, contradicted the judgment made by the German Supreme Court.\textsuperscript{210} It is of little wonder that Chanel, being a major brand in luxury goods, would have preferred the \textit{Bundesgerichtshof}'s findings in \textit{Lancaster} to have more influence upon the Commission’s future policy decisions. Chanel was not the only consultation participant noticing the deviation between the approaches of the \textit{Bundesgerichtshof} and the Commission, as \textit{Lancaster} was frequently cited and viewed to justify a need for brand owners to impose reasonable conditions upon online sales volumes in order to prevent product devaluation.\textsuperscript{211}

\textit{Lancaster} is not a judgment standing completely alone, as it would appear that sales made through the Internet do not enjoy such a holistic ‘safe haven’ as one could first

\begin{itemize}
\item \textsuperscript{205} Held 347
\item \textsuperscript{206} Ibid 343
\item \textsuperscript{207} Ibid
\item \textsuperscript{208} KZR 2/02 4 November 2003
\item \textsuperscript{210} Chanel, contribution in the consultation for Reg 330/2010 para 43
\item \textsuperscript{211} European Competition Lawyers Forum, contribution in the consultation for Reg 330/2010 para 78
\end{itemize}
imagine after reviewing the tight wording of the VABER and specifically the Guidelines for its interpretation. Courts have taken the view that the Internet may not be regarded as one single distribution channel and that it should instead be divided into a series of different sub-channels. A manufacturer’s ability to restrict the selling of its products through auction websites, as an example, has been legitimised through case-law.

The Higher Regional Court of Karlsruhe ruled\(^\text{212}\) that the prohibition of sales through the auction website eBay does not constitute a restriction of competition within the meaning of Article 101(1) and that manufacturers shall be able to prohibit such sales due to their negative effects upon brand image.\(^\text{213}\) The District Court of Berlin had earlier taken the view that an overall prohibition on eBay sales is non-legitimate and that an outright auction website ban is a disproportionate criterion for the purposes of selective distribution.\(^\text{214}\) The Oberlandesgericht Karlsruhe did not hold either of these findings in the appeal proceedings. In Amer,\(^\text{215}\) the Higher Regional Court of Munich ruled that a prohibition of eBay sales was permissible under the old VABER. The prohibition of such sales was viewed as merely a requirement for sales quality comparable to the ones concerning sales made from a brick and mortar shop, advertising, or promotion in general.\(^\text{216}\) The Court, however, took the view that an outright ban on Internet sales would have amounted to a hardcore restriction under the former VABER.\(^\text{217}\)

The rulings of these German courts, with Lancaster in particular, demonstrate that a distinction between different distribution channels is well established in the jurisprudence of European courts. As the Internet has necessitated its dissection into different sub-channels of distribution, restrictions on certain forms of Internet retail have been far from unlawful throughout the past decade. Although selling through web auctions is very different from online sales made by distributors within a selective distribution network, the judgments of the German appeals courts underline the complexity and broad influence of sales within the web environment. Considering that the treatment of online sales is currently suffering from a lack of precedents, it is rather unfortunate for brand owners that Lancaster was not given greater weight by the

\[^{212}\] Case 6 U 47/08 25 November 2009
\[^{213}\] Held 345-346
\[^{214}\] Ibid
\[^{215}\] U(K) 4842/08 2 July 2009
\[^{216}\] Held 346
\[^{217}\] Ibid
Commission. Perhaps the Commission, biased through their Single Market aim, was unable to perceive the reasoning in this case objectively enough.

5.5. Free-riding

Despite some incongruity with modern online retail, it is important to remember that selective distribution systems are, in the first place, both legitimate and desirable structures because of the pro-competitive market effects that they bring. In AEG, the ECJ specifically held that these systems are a legitimate requirement in specialist trade, including complex and luxury goods in particular, where the provision of specific services might be required to accompany a sold product. There the Court confirmed that provisions in selective distribution agreements are compliant with Article 85(1) of the Treaty of Rome ‘in so far as they aim at the attainment of a legitimate goal capable of improving competition in relation to factors other than price’. Consequently, following the Court’s reasoning in Metro I, the qualitative criteria imposed upon distributors has to be ‘objective’ and may not go beyond what is necessary in ensuring that given products are suitably presented for sale. The criteria laid down may thus not be borderless and a reduction in price competition has to be compensated with an increase of competition in another area, such as the quality of services provided. This is the most central idea in selective distribution. In brief, a legitimate selective distribution system warrants its closed and controlled nature through its pro-competitive effects outweighing any anti-competitive ones.

However, unrestricted online sales may have the effect of undermining the integrity upon which this central idea is built and challenge the very foundations of legitimate selective distribution systems. Online sales, when remaining unrestricted, undermine these systems by providing a wide possibility for distributors to free-ride the promotional efforts of others. The Commission, despite recognizing a potential risk here, appears to grossly ignore the scope of this phenomenon as possibly detrimental for brand image. Selective distribution has traditionally been a system ensuring that the purchase of certain products is accompanied by a set of sales services offered in a

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218 AEG v Commission para 33
219 Ibid
220 Metro v Commission para 20
221 Leclerc v Commission para 117; L’Oréal v De Nieuwe AMCK para 16
222 Frances Dethmers and Pier Posthuma de Boer, ‘Ten years on: vertical agreements under article 81’ [2009] 30(9) ECLR 424, 434
specific environment. Physical presence, such as sales premises and qualified staff, can be seen as a hallmark in luxury product distribution. The aforementioned presence is important for luxury goods and complex products as pre-sales services cannot be offered in the online environment. The brick and mortar shopping experience is essential for the brand image of these products as product exclusivity may suffer if it is not provided. Limitless Internet retail may not only shift sales of branded products into the online realm where the sales services are unable to follow, but the possibility it offers for distributors to free-ride each other’s efforts may lead to a gradual decline in the quality of the sales service offered in physical shops. Such decline in service quality might, in result, lead to brand devaluation.

How can distributors then free-ride the investments of each other? As suggested in Chapter 5.2, products can be sold online for a lower price as fewer costs are accrued by the distributor. This cost saving is achieved through not needing to invest in pre-sales services for sold products. Effectively, Internet retailers might be able to ‘steal’ the customers of brick and mortar shops by being able to offer a better price for them. However, this would mean that these retailers get the maximum benefit with a minimal investment. Customers might visit the brick and mortar shop of one distributor and, after taking advantage of the pre-sales services offered, make the actual purchase from an online distributor for a lower price. As a result, the physical shop gets no reward for the services offered while the online one benefits for not having them. Consumers might strongly facilitate this free-riding of service investments, as they have the possibility to enjoy pre-sales services practically for free and might belittle their conduct as having only the minor importance of small individual cases.

This form of free-riding could reduce the incentive for brick and mortar distributors to invest in the quality of their services and advertising. What use is there for a distributor to make investments in brand image if another distributor reaps what he sows? How could it be feasible for a business to invest in the promotion of something if the resulting sales revenues flow into the pockets of others? A reduction of investments

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223 Velez (n 142) 242
224 Anders Gahnstrom and Christopher Vajda, ‘E.C. competition law and the Internet’ [2000] 21(2) ECLR 94, 104
225 Velez (n 142) 244-245
226 See page 34
227 Chanel, contribution in the consultation for Reg 330/2010 para 21
228 Dethmers & de Boer 439
229 Velez (n 142) 245
to brand promotion could result in a decline of product reputation in the longer run.\textsuperscript{230} Thus, limitless online sales may potentially create a situation where no one is willing to invest in brand promotion, which, ironically, is the founding purpose for selective distribution networks. Consequently, we face the awkward question of why should a branded product not as well then be sold from a discount retail outlet, if it can be sold via the Internet where fine premises or trained personnel correspondingly are not available.\textsuperscript{231}

One should recognize that certain distribution arrangements, such as selective distribution, and promotional efforts aim to maintain and strengthen a specific image of products in the minds of the consumers. Branded goods benefit from an image which attracts customers into buying them. It could therefore be argued that the aforementioned practice creates a demand for a certain product in the first place. Internet retailers, taking advantage of a lower sales price, could thus be viewed to roughly exploit product goodwill and demand, which are the results from endeavors conducted by others. What could, then, happen to this demand if promotional endeavor and brand investment suffer a substantial reduction? Moreover, what effect might this have upon a brand in the long run?

The scenario of Internet retailers free-riding the promotional effort made by brick and mortar distributors is not limited by national borders. In fact, the scope of this maneuver is magnified by parallel trade. Not only may Finnish online distributors benefit unfairly from the promotional endeavors of their domestic brick and mortar rivals, but a benefiting distributor may easily be established outside Finland also. Parallel trade could further increase consumer incentive to purchase online. Due to a difference in price levels between EU MSs, the most lucrative option for a Finnish consumer would be to purchase the product from a foreign distributor selling online. While on the one hand the possibility for consumers to take advantage of different price levels within the Internal Market can bring great benefit, on the other hand it seems rather problematic from a distributor’s point of view under these circumstances.

Online retail can thus create a considerable threat to the integrity of selective distribution systems. The Commission, however, did foresee a possibility for such profiteering and opportunism taking place. Therefore, the VABER Guidelines lay down that manufacturers have the right to require their distributors to operate one or more

\textsuperscript{230} Velez (n 142) 245
\textsuperscript{231} Gahnstrom & Vajda 103-104
brick and mortar shops. This brick and mortar requirement effectively does solve a worst case scenario where purely online based companies, ‘pure players’, would parasitize brick and mortar shops. However, the ability to impose this requirement could prove to be insufficient in combating the free-rider phenomenon. Although a distributor would agree to operate a brick and mortar shop in order to gain admission into a selective distribution system, he might not have sufficient incentive in promoting brand image as he might be attracted to pursuing lower costs and higher revenues through concentrating in online sales. This would in practice mean, that distributors open ‘alibi’ shops in order to be eligible for a part of the real deal. They could easily make the bulk of their sales online, while operating their physical shop and promoting brand image only in an auxiliary fashion. While this might be completely rational from a distributor’s financial viewpoint, it may have a deteriorating effect on product reputation and thus certainly be against the initial desire of the brand owner. In the long run, as the brand is milked dry, it could be possible that there is no goodwill left to exploit in such a way.

The brick and mortar requirement seems insufficient for brand value protection largely because online sales simultaneously may not be limited. The area of influence covered by a physical shop simply does not match that of a website. Simply by opening an alibi shop somewhere downtown, a distributor is capable of embracing the whole range of revenue streams flowing in the web. In the case of distributors based in MSs with lower price levels compared to other states, this opportunity is further increased by potential profits through parallel trade. A manufacturer could, naturally, increase distributors’ incentive to focus in physical sales by requiring them to operate several brick and mortar shops as a condition for becoming member to the distribution system, but what rational distributor would enter into a contract so non-lucrative?

According to the Guidelines, a manufacturer may not limit the amount of online sales made by its distributors, but is allowed to require that they sell at least a certain absolute amount of products offline in order to ensure the efficient operation of brick and mortar shops. This ‘absolute amount’ can be determined individually for

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232 Guidelines to Vertical Restraints para 54
233 Gianni De Stefano, ‘The new EU "Vertical Restraints Regulation": navigating the vast sea beyond safe harbours and hardcore restrictions’ [2010] 31(12) ECLR 487, 489
234 Chanel, contribution for the consultation of Reg 330/2010 para 5(a)
235 Velez (n 136) 218
236 Guidelines to Vertical Restraints para 52(c)
different distributors depending on their size or their geographical location.\textsuperscript{237} Although the ability to determine an offline sales quota might relieve a brand owner from the worst of fears, it still does not provide a possibility to either limit online sales or tie them up with offline sales. The quota has to be absolute and not proportionate. The Commission, interestingly, did not provide any practical example of such a quota.\textsuperscript{238} A brand owner might gain only a small benefit from setting minimum offline sales quotas for distributors, if their online efforts may not be controlled in proportionate fashion.\textsuperscript{239} Internet sales can be made throughout the Community and those distributors more focused in selling online may still free-ride the investments made by more dedicated physical outlets. Some large brand owners view that a desirable degree of proportionality will not be achieved should online sales not be limited.\textsuperscript{240} From the perspective of brand owners, it is rather unfortunate that the precedent in \textit{Lancaster}\textsuperscript{241} ultimately twisted into this form of policy. Especially in the case of luxury goods, a proportionality requirement might be necessary in order to ensure that online retailers contribute in brand promotion sufficiently enough.\textsuperscript{242} Otherwise, the temptation to take advantage of product reputation might grow too strong. It would truly require dedication and commitment to the long-term prosperity of a brand to sustain a high level of active brand promotion instead of pursuing more opportunistic and short-term profit maximization strategies.

The online sales of distributors may not be discouraged and limited through unfavorable pricing policies either. The Guidelines state that an agreement in which a distributor pays a higher price for products intended to be sold online amounts to a hardcore restriction.\textsuperscript{243} Different pricing is acceptable only in special cases where selling online would lead to substantially higher costs to the manufacturer compared to selling offline.\textsuperscript{244} However, enigmatically and without any elaboration, a manufacturer may agree a fixed fee with the distributor to support the latter’s online or offline sales.\textsuperscript{245} The fee may not be a variable one as such compensation would per se lead to dual pricing.\textsuperscript{246} The possibility to negotiate a fixed fee in order to support offline sales,
when not more properly defined, may lead to legal uncertainty with manufacturers facing a complicated task in implementing fee policies with the risk of violating Article 101 TFEU. Should a brand owner simply do nothing and decide not to tackle online sales through offline sales support fees, he might run into the risk of brand devaluation, leaving him caught between a rock and a hard place.

It is noteworthy that the possibility for distributors to free-ride the investments of each other has its foundations in price competition. The distributor offering the best price is strong in attracting customers. Basically, the more unrestricted online sales remain the lower prices consumers will be able to enjoy. However, like reasoned earlier, this might be untenable from the perspective of brand value. Therefore, the Commission would seem to have a preference for price over all other competitive aspects, such as product and service quality. It would seem that the aim in lower price justifies a whole range of different means. However, this should not necessarily be the case, as it is well established case-law through Metro I that an analysis of competition shall not solely be based upon the element of price.

The Commission, in the Guidelines for the VABER, strongly encourages competition on price within selective distribution networks. Neither ‘active’ nor ‘passive’ sales may be prohibited in such networks, although ‘active’ selling is regarded to contain effort which ‘is only attractive for the [distributor] if it […] reaches a specific group of customers or customers in a specific territory’. In other words, it is recognized that this form of selling has a special intention of luring customers from outside a more conventional area of influence, yet it still shall remain free within selective distribution systems. Although the Commission’s view can be regarded to promote parallel trade, which has its beneficial effects, the implications which this standpoint has upon brand value protection and competition factors other than price should perhaps be granted more consideration.

The Single Market aim and the resulting reluctance of EU authorities to allow restrictions upon the online sales regime may thus pursue a valuable aim, but arguably not the best possible result in terms of market competition. The Commission might be wrong in believing that low cost distribution, made through utilizing the Internet, benefits the consumer the most, as in reality the simultaneous distortion caused to

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247 Dethmers & de Boer 438-439
248 See page 24
249 Guidelines to Vertical Restraints para 51
selective distribution systems might force brand owners to decrease output, which ultimately deprives consumers from an increase in product choice and quality.\textsuperscript{250} The free-rider problem might embody a symptom resulting from the inability of the current regulatory framework to strike the right balance between the seemingly competing interests of brand owners, distributors, and the consumers. On the one hand, brand owners should not be allowed to use exclusivity and pre-sales services as an excuse for unreasonably high product prices, while on the other hand price competition based upon a reduction in product exclusivity and the availability of services might have long-term negative effects.

The price of luxury products seems to have a rather unique nature. Although the price for such products might seem ridiculously high in light of their physical features, customers do purchase them for some perceived reason and, meanwhile, their manufacturer is making good business. Supply and demand can thus be seen to meet and the price for the luxury good is determined by the market. It is quite unclear whether the strict approach of the VABER is truly needed to influence this setting. The current regulatory framework could instead be seen to provide distributors an escape valve from using resources to pursue such objectives which are legitimate requirements for brand promotion in the brick and mortar environment.\textsuperscript{251} Price competition at the expense of services and exclusivity might not serve best the market for value goods in the long run. Therefore, the Commission should find a proper balance between enabling consumers to make Community-wide purchases and protecting suppliers as well as promotionally active distributors from excessive online opportunism.\textsuperscript{252}

\section{5.6. Equivalence}

The Guidelines grant brand owners a degree of influence over the online sales environment of distributors. The manufacturer is entitled to require quality standards for the use of a website ‘just as [he] may require quality standards for a shop […] or for advertising and promotion in general’.\textsuperscript{253} The quality criteria set for a sales website shall not exceed what is overall equivalent to the criteria imposed for sales from a brick and mortar shop.\textsuperscript{254} Consequently, any nonequivalent criteria which dissuade
distributors from utilizing the Internet amount to hardcore restrictions.\textsuperscript{255} The Commission further elaborates:

\textit{[Equivalence] does not mean that the criteria imposed for online sales must be identical to those imposed for offline sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes.}\textsuperscript{256}

The setting of ‘equivalent’ criteria for Internet sites is, especially in light of the Commission’s elaboration above, highly problematic for brand owners. First, a restriction on online sales within selective distribution systems will still amount to a hardcore restriction. Second, the setting of equivalent criteria for two vastly different distribution channels might, in reality, be a mission impossible. The concept of equivalence remains very unclear and may create legal uncertainty. Companies are discouraged from establishing the most beneficial combinations of online and offline sales, as an uncertainty over achieved equivalence leaves them facing the risk of implementing a hardcore restriction.\textsuperscript{257} The Commission’s approach has rationale in intended brand owner protection, but the equivalency requirement might hinder development in the successful integration of the online and offline sales platforms.

Not all of the criteria that may be legally required by the brand owner for the brick and mortar sales environment can be transferred into the online realm. The prestige of sales premises and offered pre-sales services, for example, are unable to follow online in their full forms. Therefore, it seems impossible to construct a website which would be correspondent to a brick and mortar shop. In \textit{Leclerc}, the CFI found that:

\textit{[…] having a person in the retail outlet capable of giving consumers appropriate advice or information is in principle a legitimate requirement for the sale of luxury cosmetics and an integral element in the proper presentation of those products.}\textsuperscript{258}

Obviously the presence of a sales person, within the meaning of this passage, will not exist online. How could two very different kinds of distribution channels pursue the same objectives in a manner where they achieve comparable results if the sales made through the other are far less unrestricted? In the light of \textit{Leclerc} above, should not

\textsuperscript{255} Guidelines to Vertical Restraints para 56
\textsuperscript{256} Ibid (emphasis added)
\textsuperscript{257} Velez (n 142) 245
\textsuperscript{258} \textit{Leclerc v Commission} para 126
unavoidable absence of sales personnel rather grant brand owners the possibility to reject online sales on the basis that a difference between the two distribution modes renders the achieving of comparable results impossible, thereby justifying deviating criteria?

The possibility to require equivalent quality criteria for distributor websites could therefore be considered, in addition to being difficult to interpret, as insufficient in protecting brand image online. Legitimate quality requirements imposed for the selling of luxury goods from brick and mortar shops should de facto legitimize a stronger restriction of online sales, as they simply are impossible to repeat for the online environment. In fact, these requirements could even be viewed to somewhat justify an outright ban on web sales. The equivalence requirement is a paper tiger not enabling an actual limitation on online sales volumes and not serving the innermost need of brand owners to maintain the most desirable environment for the sale of their products.

Proponents of the equivalence requirement point out that the operation of a website compliant to a series of quality standards requires significant investment and intellectual resources.259 A distributor needs to invest time and effort into designing and maintaining its website in the best possible fashion, as potential customers are always just one click away from a competitor’s website.260 Even the brick and mortar shop requirement is considered as overly excessive by some, as it excludes those distributors who would be willing to distribute according to the set Internet standards but do not have a desire to open a physical shop.261 Although these arguments might appear valid, they seem to miss the fundamental point in the debate. The key issue, in the writer’s opinion, does not focus in the comparative costs of operating brick and mortar versus online shops, but rather the fact that, regardless of cost structures, the online environment is unable to offer the desired range of services that contribute to brand image and create a demand for products in the first place. Web sales, inherently, may have negative effects upon the reputation of a certain product. The cost structures of eager Internet retailers, albeit seemingly lucrative, should not override manufacturer autonomy in deciding how products are distributed, presented, and sold.

In support of online sales, it has been argued that the equivalence requirement, in combination with the brick and mortar requirement, aids brand owners to structure the

259 European Competition Lawyers Forum, contribution for the consultation of Reg 330/2010 para 82
260 Ibid
261 Ibid
distribution of their products in a way which maximizes their sales while adequately preserving brand image and tackling free-rider problems. In other words, the additional coverage brought by the Internet leads to more sales and the requirement of a brick and mortar shop guarantees additional brand street visibility while deterring the most ruthless of opportunists. If this arrangement truly would maximize long-term revenue streams, then it would be in the greatest interest of brand owners to establish. However, this does not seem to be the case. Brand owners have all incentive to find the best market-driven ways to maximize their revenues, and the Commission should not interfere and cause distortion with competition regulation failing to recognize the particular needs of different kinds of products and industries. The manufacturers operate closer to the market and might thus be more aware of its characteristics and the ways through which it works best for them.

5.7. Special treatment

The Commission has been criticized for favoring the Internet and lifting it above all other distribution channels. Although the Commission’s preference for the Internet can be partly reasoned through the increase in Community trade brought by this distribution channel, its lenient policy could distort the market for certain branded goods. In practice, the current VABER obliges manufacturers to permit the sales of their products online unconditionally.

The Internet seems to enjoy special treatment, as it is de facto unconditionally unlawful to prohibit sales made through it. Back in 1991, the Commission made a decision where Yves Saint Laurent was allowed to implement an outright ban on the traditional mail ordering of its perfumes. The selling of luxury goods under optimal circumstances was perceived to necessitate a direct contact with the customer and thus the banning of mail ordering was a viewed as a legitimate measure in ensuring that products are presented to the public in a homogeneous way. Furthermore, the Commission viewed that YSL’s mail order ban did not amount to an appreciable restriction of

262 Velez (n 142) 244
263 Ibid 246
264 Ibid
265 Ibid
266 Dethmers & de Boer 433
268 Gahnstrom & Vajda 105
Although this Decision is no longer recent, it seems rather peculiar that during the time of traditional mail ordering this form of distribution could be prohibited to protect product image, but the same reasoning does not seem to apply in the online era to the case of the Internet. Although an Internet site may be able to provide more information on products in comparison to mail order catalogues, it still seems quite irrational that mail ordering may be restricted while its online correspondent may not. After all, in both these forms of distribution, the purchasing process skips a desired sales environment and the product is delivered as a package to the local mail office.

Special treatment for the Internet might have been more justified and understandable during the early years of e-commerce, when the online distribution channel was still in its Jurassic period. Back then, stronger incentives were required for companies to start investing in the developing online sales platform. However, the Internet, being a massive channel of distribution today, has matured during the past decades, suggesting that continuing special treatment towards it should be considered differently within the modern context. Legislation favoring unrestricted online sales might well be a measure overprotective. The current legal regime holds the restriction of online sales per se to be illegal, while a self-assessment of positive and negative effects made by parties to a vertical agreement might, in some cases, be a more reasonable and commensurate approach.

Overprotective measures for the Internet seem to lack the support of solid economic justification. A scarce number of their decisions, together with nearly non-existent case-law, constitute a very limited experience for the Commission to comprehend the desirable sphere for e-commerce. Therefore, as the VABER has no empirical evidence in support of its restrictions, its provisions regarding online sales might suffer from over-reaching leniency. Without evidence proving otherwise, brand owners should be allowed to pursue a uniform distribution policy throughout all distribution channels. In practice, this would enable any channel to be excluded, should it not be capable of sufficiently fulfilling the distribution criteria set by a manufacturer. This could well be a

269 Gahnstrom & Vajda 105
270 Velez (n 142) 246
271 Ibid
272 Dethmers & de Boer 435
273 Velez (n 136) 218-219
274 Ibid
275 Ibid
potential approach, as the current one does not benefit from any firm evidence or experience suggesting otherwise. Instead, the current policy is only a blind punch based upon an assumption that lower prices will ultimately lead to the maximization of consumer welfare, i.e. justifying all means. Ironically, unfounded regulatory intervention could distort the market and may easily lead to the opposite result.276

Increasing brand owner autonomy might be a well-found approach considering that some restricting arrangements, which the current VABER considers as hardcore restrictions, might have outweighing pro-competitive effects.277 Brand owners might be, for example, able to differentiate their products more effectively should they have more influence upon the modes through which product distribution is made. If any such arrangement would start turning consumers towards the products of competitors, then the brand owner would be forced to reconsider his policy.

The Commission seems to justify the strong position of online sales through the Single Market aim rather than economic rationale. The VABER Guidelines state that the foreclosure of Internet distribution would reduce the possibility for consumers to take advantage of a range of benefits in the form of lower price, increased transparency, and wider access.278 US case-law treats online and offline sales in a more uniform fashion compared to the EU approach and differences between the regional contexts of these two regimes might be one reason explaining this deviation.279 Although the Internet plays an important part in the proper functioning of the European Single Market, there are arguments supporting a more neutral regulatory approach towards online sales. Parallel trade, fuelled by the current VABER, may decrease the R&D incentives of brand owners should their sales prices and profits be driven low.280 Community-wide trade is thus a delicate issue and should not dominate the debate over Internet sales unchallenged. Furthermore, the safeguarding of parallel trade at all costs should not be considered as the ultimate aim of the EU.281

The Commission should maybe remain more neutral in regulating online sales and should instead let the market participants decide the best market-driven ways to

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276 See pages 47-48
277 Velez (n 142) 246-247
278 Guidelines to Vertical Restraints para 178
279 Velez (n 136) 218
281 Ibid 396
establish their distribution networks, as introduced earlier. Brand owners have the incentives to find those solutions which maximize output. The current legal framework, through offering special treatment to online sales, might have the effect of upsetting the balance between distribution efficiencies and the interests of suppliers. According to brand owner views, it should be considered whether regulatory intervention can have better results than the market itself in the context of selective distribution networks. Unnecessary regulation should be avoided, as any intervention not based upon solid economic rationale could effectively distort the development of dynamic markets.

Regardless of whether online sales continue to benefit from special treatment in succeeding VABERs, it is important to remember that the argument labeling the Internet as ‘just another distribution channel’ applies differently from two perspectives. On the one hand, one distribution channel should not be elevated above others. This would be an unfair policy towards different kinds of distributors, not to mention the diverse particularity of industries. On the other hand, the existence of a plethora of distribution channels means that the Internet, constituting only one of them, will never be able to ‘steal’ the entire consumer base of a product. Although a lower price might be one key factor in purchase decisions, a part of the public will still want to buy a product under the circumstances it most prefers and disregards small price deficiencies. Therefore, online sales might never render selective distribution systems obsolete.

5.8. Skepticism on interbrand competition

It has been established earlier that reduction in intra brand competition is not a problem as long as there is sufficient inter brand competition in the market. Indeed, the VABER Guidelines state that ‘the loss of intra-brand competition can only be problematic if inter-brand competition is limited’ and reiterate that ‘the reduction in intra-brand competition is easily outweighed by sufficient inter-brand competition’. Intra brand agreements are not viewed to have anti-competitive effects unless the parties can exercise market power. As the new VABER excludes this possibility by depriving BER benefit from agreements where the market share of the buyer or the

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282 See page 51
283 Velez (n 136) 217
284 Chanel, contribution to the consultation for Reg 330/2010 para 8(1)
286 Guidelines to Vertical Restraints paras 177-178
287 Velez (n 136) 213
seller party exceeds 30%, what is then the need for heavy regulation concerning restrictions of online sales in those agreements where the BER remains applicable? Why is there suddenly a new concern for anti-competitive behavior even in the absence of market power?

The Commission suddenly appears to be skeptical over the possibility of inter brand competition prevailing over the negative effects of intra brand agreements, contrary to what is generally perceived to be the case. Even when there would be fierce inter brand competition, and there is no evidence that this would not be the case in e.g. luxury cosmetics, the Commission stands negative towards restrictions on Internet sales although competition on quality and brand reputation are keys for product differentiation, i.e. competition between brands.

The Commission and EU courts have both, in the past, indicated that even hardcore restrictions may fall outside Article 101(1) TFEU should there be no distortion of competition. Product differentiation through quality and exclusivity may enhance inter brand competition and, regardless of any restrictions on online sales, have pro-competitive effects. As the VABER effectively deprives its benefit from agreements made by parties with market power, it seems somewhat illogical that brand owners are not given the possibility to differentiate through product positioning. Why should a brand owner not be allowed to require only brick and mortar sales if this serves his product differentiation aims and, more importantly, if he can afford it?

The writer does not believe that all brand owners are in the position to say ‘no’ to Internet sales. On the contrary, many might be more than willing to embrace online distribution and the additional sales revenue it might bring. However, this is their choice of product positioning and differentiation. Why should another brand owner, whose highly invested product image is capable of luring enough consumers to purchase his products from brick and mortar shops, be punished and forced online? He might well perceive that the preservation of the exclusivity of his product, guaranteeing long-term demand, necessitates sales to be physical. If he and his distributors are able to make profitable business through brick and mortar sales only, what is the real problem here? Distributors might often be willing to sell increased amounts of products, yet their approach focusing more in shorter-term profit maximization should

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288 See page 27  
289 Dethmers & de Boer 438-439  
290 Ibid 426
not override the long-term prosperity of a branded product as perceived by the manufacturer. After all, a reduction in product image might not only hurt the brand owner, but all of his distributors as well.

Closely related to this view, it should be remembered that when there is sufficient interbrand competition, brand owners have no reason to restrict the volume of their products sold.\textsuperscript{291} They only want the sales volume to be sold under specific circumstances. These are, fundamentally and truthfully, two different issues. Undertakings should have more freedom in determining and designing the distribution systems which they perceive to serve them best. The market will ultimately determine the fate of any restriction that is implemented by a party without market power.

The Commission’s strict policy in the VABER can be viewed to exaggerate the negative effects of intra brand agreements not exercising market power to correspond with those of horizontal cartels.\textsuperscript{292} The Commission’s reluctance in disallowing Internet sales is rather strange especially when it simultaneously claims to acknowledge that vertical agreements entered into by firms lacking market power are not perceived to have significant effects upon the competitive environment. The influence and effect of interbrand competition seems to be underestimated already from the very beginning. Obviously, the Single Market aim constitutes one major reason why the Commission might not dare to leave online sales unregulated. From an inter brand competition point of view, the pursuit of market integration might once again be seen to conflict with economic rationale in product differentiation – to the detriment of brand owners and ultimately the consumer.

\textbf{5.9. Case Pierre Fabre}

Although the treatment of online sales and their restriction can be seen to suffer from the lack of jurisprudence at the moment, a potentially important future precedent is currently in process. Case \textit{Pierre Fabre}\textsuperscript{293} involves issues which address the quarrel between brand owners and online sales par excellence. In 2007, the French competition authority, \textit{l’Autorité de la Concurrence}, opened proceedings against Pierre Fabre Dermo-Cosmétique, a domestic manufacturer of cosmetics and personal care products. Pierre Fabre and its various subsidiaries manufacture products sold under

\begin{itemize}
\item \textsuperscript{291} Velez (n 142) 246
\item \textsuperscript{292} Dethmers & de Boer 439
\end{itemize}
Klorane, Duncray, Galénic, and Avène brands, and in 2007 the Pierre Fabre group held a 20% share of the relevant French market. The main issue in the proceedings concerned a contractual clause in Pierre Fabre’s selective distribution agreements. Pierre Fabre required from its distributors that the sales of the company’s products must be made exclusively in physical space and in the presence of a qualified pharmacist capable of providing consumers with advice on the correct use of products and recommending the most suitable product for the needs of an individual customer. Pierre Fabre further stated these requirements to be important in maintaining the prestigious image of the products at issue. The problem was that the brand owner’s requirement de facto excluded all forms of Internet selling.

L’Autorité de la Concurrence ultimately ordered Pierre Fabre to remove this contractual clause from agreements on the basis of it restricting competition ‘by object’ within the meaning of Article 81(1), while not benefiting from an exemption under Article 81(3). Pierre Fabre brought an action for the annulment of this decision before the cour d’appel de Paris, which referred to the CJEU for a preliminary ruling on the following question:

‘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 which is not covered by the block exemption provided for by Regulation No 2790/1999 but which is potentially eligible for an individual exemption under Article 81(3) EC [Article 101(3) TFEU]?’

Advocate General Mazák viewed that this question may be divided into three parts. First, whether a ban on online sales constitutes a restriction of competition within the meaning of Article 101 TFEU. Second, whether such a ban effectively falls outside the exemption provided by the VABER. Third, whether such a ban, despite restricting trade

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294 Pierre Fabre v l’Autorité de la Concurrence (CJEU, 13 October 2011) paras 9,11
295 Ibid para 12
296 Ibid paras 12-13
297 Ibid para 45
298 Ibid para 14
299 Ibid para 27
300 Yann Utzschneider and Alexandre Glatz, ‘France: anti-competitive practices – pharmaceutical products’ [2009] 30(2) ECLR N17
301 Pierre Fabre v l’Autorité de la Concurrence paras 29-30 (emphasis added) ; Please note that the proceedings of Pierre Fabre started during the time that the old VABER, Regulation 2790/1999, was still in force. However, the contested provision of this BER, Article 4(c), is identical to Article 4(c) of the current VABER. This change of BERs in force has therefore practically no effect on discussion.
302 Pierre Fabre v l’Autorité de la Concurrence, Opinion of AG Mazák, para 18
within the meaning of Article 101(1) TFEU and being ineligible for BER benefit, may still be exempted under Article 101(3) should it fulfill the conditions therein.

Pierre Fabre argued that the contractual clause does not aim to restrict competition but rather ensures a consistent level of service to consumers.\(^{303}\) In order for a consumer to obtain the best possible advice, a pharmacist must directly view the skin, hair, and scalp of the consumer.\(^{304}\) The company underlined that the broad coverage provided by its large number of existing selected distributors, together with a resulting high level of intra brand competition on the French market, imply that the company is not aiming to restrict product supply.\(^{305}\) In their view the ban improved distribution, avoided free-riding,\(^{306}\) and guaranteed that pre-sales services would not disappear from physical sales outlets\(^{307}\) while its abolishment would not lead to increased competition or reduced prices.\(^{308}\) The brand owner viewed that the competition authority made an error in law when deciding that his contractual clause restricts competition ‘by object’ within the meaning of Article 101(1).\(^{309}\) Like introduced earlier,\(^{310}\) should it be established that an agreement restricts competition ‘by object’, then there is no need to examine any economic efficiency or market effect which the agreement might have. Thus, the competition authority would not need to prove the anti-competitive effect of the agreement and the burden of proof in proving fulfillment of Article 101(3) conditions would fall upon Pierre Fabre.

Pierre Fabre stated that CJEU case-law recognizes, through cases such as Copad,\(^{311}\) the value in certain restrictions to distribution, which could mean that an objective justification for an Internet sales ban might stretch further than any plain safety and public health concerns related to given products.\(^{312}\) AG Mazák viewed that any private voluntary measures, which limit the sale of goods online, must pursue legitimate objectives of a more public law nature in order to be objectively justified and therefore the protection of brand image, based upon more private interest, does not constitute a

\(^{303}\) Pierre Fabre v L'Autorité de la Concurrence, Opinion of AG Mazák para 14
\(^{304}\) Ibid para 19
\(^{305}\) Ibid paras 10,13
\(^{306}\) Pierre Fabre v L'Autorité de la Concurrence paras 23,26
\(^{307}\) Pierre Fabre v L'Autorité de la Concurrence, Opinion of AG Mazák para 38
\(^{308}\) Ibid para 14
\(^{309}\) Ibid
\(^{310}\) See page 12
\(^{311}\) See pages 38-39
\(^{312}\) Pierre Fabre v L'Autorité de la Concurrence, Opinion of AG Mazák para 31
form of such. AG Mazák viewed brand image protection to be a valid concern for manufacturers, yet did not perceive this to justify an outright ban on online sales, as, in the AG’s view, a brand owner is permitted to impose proportionate and nondiscriminatory conditions on Internet sales in order to avoid free-riding. The AG opined that the setting-up and operation of a website accrue costs in the process, suggesting that ‘the very existence of free-riding by Internet distributors on the investments of distributors operating out of a physical outlet cannot be presumed’. These views from the Advocate General seem rather debatable. AG Mazák’s opinion seems to differ from the ones of many legal academics, and he could be guilty of overestimating the costs of operating a website as corresponding to those of operating a physical store and oversimplifying the very difficult issue of setting ‘equivalent’ conditions for online and offline sales.

The CJEU stated that according to its settled case-law the analysis of whether an agreement restricts trade ‘by object’ within the meaning of Article 101(1) requires that the precise purpose of the agreement, including the content of the clause and the objectives sought, must be considered in the economic and legal context in which it is to be applied. The Court did not see Pierre Fabre’s contractual clause to pursue legitimate objectives in a proportionate manner as laid down in Metro and L’Oréal, although the company’s selective distribution system fulfilled other set criteria. The need to provide individual advice to customers does not objectively justify a ban on Internet sales, meaning that such a requirement extends beyond proportionality and what is necessary. The Court pointed out that Pierre Fabre’s products are not classified as medicines and that their distribution is thus not governed by any specific legislation for medicinal products. Furthermore, the CJEU viewed that the aim of protecting brand image does not constitute such a legitimate aim that would prevent a restriction of competition from falling within the prohibition of Article 101(1) TFEU. The Court thereby ruled that an agreement, which bans online sales, restricts competition ‘by object’ within the meaning of Article 101(1) TFEU should it not be objectively justified.

313 Pierre Fabre v L’Autorité de la Concurrence, Opinion of AG Mazák para 35
314 Ibid para 40
315 Ibid
316 Pierre Fabre v L’Autorité de la Concurrence paras 34-35
317 See page 25
318 See page 42
319 Pierre Fabre v L’Autorité de la Concurrence para 44
320 Ibid para 24
321 Ibid paras 45-46
The Court viewed that an exemption through the VABER cannot, due to a contradiction with its Article 4(c)\textsuperscript{322}, apply to Pierre Fabre, as the online sales ban ‘at the very least has as its object the restriction of passive sales to end users wishing to purchase online and located outside the physical trading area of the relevant member of the selective distribution system’.\textsuperscript{323} The Court did not hold that the Internet would constitute an ‘unauthorized place of establishment’ referred to in Article 4(c) VABER, as this concept refers only to outlets where direct sales take place.\textsuperscript{324}

The Court had insufficient information to give guidance concerning the application of Article 101(3) into the present case\textsuperscript{325} and left for the national court to examine whether Pierre Fabre fulfills the conditions of this Article.\textsuperscript{326} All in all, the Court thus ruled that Pierre Fabre’s contested selective distribution agreement clause restricts trade within the meaning of Article 101(1) TFEU in a manner rendering it ineligible for exemption under the BER yet eligible for an individual exemption under Article 101(3).

Through Pierre Fabre the boundaries of online sales prohibitions have become somewhat clearer. According to the preliminary ruling of the CJEU, agreements including de facto online sales bans for products which are not classified as medicines are excluded from the VABER. However, these agreements might still benefit from an exemption under Article 101(3). The judgment later given by the referring court, cour d’appel de Paris, will most likely become a precedent for similar cases in the future, regardless of what the French court might ultimately decide.

The CJEU’s judgment contains several strict policy measures, which are more likely to be welcomed by online sales proponents than opponents. First, the legitimate requirement of having a sales person present in the retail outlet, laid down by the CFI in Leclerc,\textsuperscript{327} does not seem to enable the limitation of sales made online. Thus, the finding of the CFI appears not to stretch into the form of ‘having a person present in the retail process’. Instead, the Court’s view in Leclerc is seemingly curtailed to plainly mean that it is not forbidden by law for a brand owner to require that a shop, selling his products, employs personnel actually aware of what they are selling. Second, the judgment of the CJEU explicitly states that the aim of maintaining a prestigious brand

\textsuperscript{322} See page 28; the Article is identical in both Reg 2790/1999 and Reg 330/2010
\textsuperscript{323} Pierre Fabre v L’Autorité de la Concurrence para 54
\textsuperscript{324} Ibid para 56
\textsuperscript{325} Ibid para 50
\textsuperscript{326} Ibid para 48
\textsuperscript{327} See page 49
image does not constitute a defense for restricting competition. This particular finding of the CJEU is likely to be frequently referred to in the statements of competition authorities and distributors battling sets of different qualitative criteria in selective distribution agreements. Rather unfortunately, the CJEU did not consider the effects which Pierre Fabre’s clause would have had upon parallel trade, despite recognizing that the ban effectively restricted sales made to customers residing outside the physical trading area of a particular distributor. It would, however, be logical to consider that the CJEU’s views in the judgment would only strengthen should the aforementioned restriction of sales increase in scope.

5.10. Online sales under Article 101(3)

Even though a vertical agreement would fall outside the VABER, this might not necessarily be the end of the story. What happens after is what the French court will be required to do in case Pierre Fabre – an analysis of whether the agreement may benefit from an individual exemption under Article 101(3). As online sales restrictions within selective distribution systems under this are currently facing a lack of precedent cases, an analysis of the Article’s possible application to such restrictions must be made following the Commission’s Guidelines on applying the Article. The Guidelines are merely a soft-law instrument and are without prejudice to any views that European courts or competition authorities may take. Nevertheless, they provide an insight into the intentions of the Commission and serve as one tool when analyzing the lawfulness of agreements.\footnote{De Stefano 487} The Guidelines may be considered as the effective ‘law’ in this area as long as contradicting judgments are absent.\footnote{Marsden & Whelan 33}

The burden of proving fulfillment of the cumulative conditions laid down in this Article is upon the party claiming its benefit.\footnote{Reg 1/2003 Art(2)} In order to benefit from an exemption under Article 101(3), an agreement must contribute in:

1. ‘[…]
   improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and [shall] […]not:

2. (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

3. (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question’.

\footnote{328 De Stefano 487} \footnote{329 Marsden & Whelan 33} \footnote{330 Reg 1/2003 Art(2)}
Although it might be a very difficult task for brand owners to convince courts that their restrictive distribution policies, being rejected by the VABER, do fulfill the cumulative conditions of Article 101(3), this Article might have some room for the need to protect brand image due to the pro-competitive effects that such practice can possibly create. After all, it has been established that the creation of a branded good, say a luxury good, is a long process where a certain product image first needs to be created.\textsuperscript{332} Once an image, a brand of prestige, has been created in the eyes of the public, a manufacturer has to have certain influence over how the goods are distributed on the market in order to foster this image.\textsuperscript{333} Several forms of manufacturer influence have been viewed as legitimate in the jurisprudence of European courts. Strong product brands, together with inter brand competition, have been viewed to create pro-competitive effects which legitimize the existence of selective distribution networks in the first place. The potential problem for brand owners might be in proving that a restriction on online sales does not ‘impose on the undertakings concerned restrictions which are not indispensable’ in pursuit of brand image protection.

The first condition of Article 101(3) requires that the agreement either improves the production or distribution of goods or promotes technical or economic progress. The Guidelines to the application of Article 101(3) state that only objective benefits may be taken into account when assessing whether an agreement fulfills this provision.\textsuperscript{334} Effectively, it is not enough that an agreement creates efficiencies from the subjective view of the party claiming benefit. A link must be established between the agreement and the claimed efficiency before analyzing its value.\textsuperscript{335} Analysis in the first condition is based upon the nature of the efficiency, the link between the agreement and this efficiency, the likelihood and magnitude of the efficiency, and how and when it will be achieved.\textsuperscript{336}

Claimed efficiencies may include quality-based qualitative efficiencies, which can be of equal or even paramount importance to cost efficiencies.\textsuperscript{337} Distribution agreements, in particular, have been recognized to create qualitative efficiencies.\textsuperscript{338} In this respect, it

\textsuperscript{331} TFEU Art 101(3)
\textsuperscript{332} Simone Aicardi and Claude Lebel, ‘Legal aspects of selective distribution of luxury products in France’ [1990] 12(7) EIPR 246, 246
\textsuperscript{333} Ibid
\textsuperscript{334} Guidelines for Art 81(3) para 49
\textsuperscript{335} Ibid paras 49-50
\textsuperscript{336} Ibid
\textsuperscript{337} Ibid para 69
\textsuperscript{338} Ibid para 72
could be argued that a restriction on online sales within selective distribution systems may, in some cases, create qualitative efficiencies through preserving brand image, maintaining the integrity of legitimate distribution networks, and motivating distributors to provide high quality services. Preservation of brand image has been viewed to increase inter brand competition, which may promote economic progress. The sales restriction might protect the integrity of distribution networks through reducing the possibility for distributors to free-ride the promotional efforts of others, thereby potentially improving the distribution of given goods. Motivating distributors to invest in service quality through decreasing the aforementioned free-riding phenomenon could be argued to promote technical progress, for its part.

The second condition of Article 101(3) requires that consumers are allowed a fair share of the benefit created by the agreement. ‘Consumers’ are defined as the customers of the contract parties and their subsequent purchasers.339 In the case of selective distribution, the consumers would mainly be the end consumers, meaning individual customers. The ‘fair share’ referred to in the Article means that the positive effects of the agreement must outweigh the negative ones.340 The limiting of Internet sales could be argued to create such outweighing benefits to consumers. Through abolishing their fear of free-riding and requiring that more sales be made through physical outlets, distributors would be motivated to promote the brands they sell and to provide services of the highest quality in order to gain competitive advantage over each other. In result, the consumers would benefit from better services. It has been particularly recognized in the Guidelines that consumer pass-on can take the form of qualitative efficiencies, such as the creation of sufficient additional value to consumers in compensation of negative effects.341 Should an agreement lead to higher prices, consumers must be fully compensated through an increase in quality or other values.342 This requirement could arguably be fulfilled should distributors, as a consequence from an online sales restriction, provide higher quality services for consumers.

The third condition for Article 101(3) to apply requires that a restriction for online sales would not be an indispensable measure in obtaining the claimed efficiencies. In practice, this requires that no other economically practicable and less restrictive means

339 Guidelines for Art 81(3)para 85
340 Ibid para 85
341 Ibid para 102
342 Ibid para 86
for achieving these efficiencies are available.\textsuperscript{343} Undertakings are not obliged to consider hypothetical alternatives and the Commission states that it will not intervene in vertical agreements unless it is reasonably clear that there are other less restrictive alternatives available.\textsuperscript{344} A restriction shall be considered indispensable if its absence would eliminate or significantly reduce a claimed efficiency.\textsuperscript{345} However, hardcore restrictions of competition are perceived unlikely to qualify as indispensable measures.\textsuperscript{346}

In light of this, one could argue that the brand owner having the right to restrict online sales at least to a certain degree constitutes an indispensable measure within the meaning of Article 101(3). After all, such restriction does not necessarily have to mean an outright ban on web sales, but could instead be limited into tying up distributors’ online and offline sales volumes. A proportionality requirement for online sales, despite contradicting the VABER, might be indispensable in securing the integrity of legitimate selective distribution networks for two reasons. First, it could limit the possibility of distributors to exploit the reputation of products by shifting sales online in pursuit of higher profits. Like argued before, such maneuvering is not only made at the expense of provided services and brand image, but also facilitates free-riding of promotional efforts made by brick and mortar distributors. Thus, the shifting of sales into the online environment is untenable for both the brand owner and his promotionally active distributors in the long run. Second, as a proportionality requirement could decrease the temptation of increasing sales volume online, it might motivate a distributor to invest more in his services and the brand image of the sold products which ultimately enable him to better compete for customers.

A proportionality requirement could thus increase the incentive for distributors to compete through higher quality rather than lower price. Competition through a higher level of quality might be seen to better serve the nature and purpose of branded goods in particular. A branded product benefits from qualitative efficiencies, such as an increase in quality, but is less likely to benefit from a lower cost per se. Although an outright ban on online sales might exceed what is ‘indispensable’ within the meaning of Article 101(3), a proportionality requirement for online and offline sales might constitute a necessary and reasonable requirement in ensuring distribution integrity.

\textsuperscript{343} Guidelines for Art 81(3) para 75
\textsuperscript{344} Ibid
\textsuperscript{345} Ibid para 79
\textsuperscript{346} Ibid
and a high level of services in the long run. The Guidelines specifically state that different forms of restrictions, with consideration to the context in which they are to be applied, might be indispensable in the correct alignment of contract party incentives and in ensuring that these parties concentrate in implementing their part of the agreement.\textsuperscript{347} This states, ad penem litterae, \textit{precisely} the reason why brand owners are desperate for an additional degree of influence over online sales and why their concerns should have room under Article 101(3).

The fourth and final condition of Article 101(3) requires that an exempted agreement shall not have the effect of substantially eliminating competition in the relevant market. The analysis of whether an agreement has this effect shall be based on the analysis of existing competition on the market and the impact which the agreement has upon this level of competition.\textsuperscript{348} Restrictions in intra brand agreements have been established to have no significant effects upon the competitive environment when there exists sufficient inter brand competition. For a large part, the market for many branded products can be viewed as highly competitive, as rarely might there be a case where any product truly has no competing substitute. Although consumers might be reluctant in substituting the branded products which they prefer, this does not imply that actual substitutes would be non-existent, as this reluctance is a result of successfully built brand image which has been fuelled by the existence of inter brand competition and a dire need for the manufacturer to differentiate from his competitors in the very first place. Thus, in the presence of competitive pressure, selective distribution agreements might rather unlikely amount to substantial restrictions on trade.

The Commission, however, states that the fourth condition will not be fulfilled if an agreement eliminates an important ‘expression’ of competition related to price or innovation.\textsuperscript{349} Any restriction on online sales might run into problems through its inherent restriction on potential price competition, should this approach be followed narrowly. However, competition authorities and courts should always weigh the increases and decreases between different expressions, like price and quality, against each other and permit those agreements where the positive effects outweigh the negative ones. Restrictions on online sales might thus be able to fulfill the fourth condition of Article 101(3), should this fundamental principle be kept in mind.

\textsuperscript{347} Guidelines for Art 81(3) para 80
\textsuperscript{348} Ibid para 108
\textsuperscript{349} Ibid para 110
Certain forms of vertical agreements, which de facto restrict online sales within selective distribution networks, might have some room within Article 101(3). Much depends on the weight that courts are willing to give to the potentially gained qualitative benefits against reductions in price competition and sales area coverage. Should Pierre Fabre, for example, be exempted by virtue of Article 101(3), such a finding could necessitate imperative changes for the VABER. If an agreement, such as Pierre Fabre, satisfies the conditions of Article 101(3), then it is clear that restrictions on online sales may have pro-competitive effects within the meaning of Article 101 TFEU, which would effectively establish that the current VABER excludes vertical agreements with pro-competitive effects. This might suggest that the VABER provisions do not serve the market in the best possible way and might instead deprive benefit from a range of potentially pro-competitive agreements and create legal uncertainty for brand owners. If online sales restrictions would gain foothold in being perceived as pro-competitive, brand owners would benefit significantly from a better drafted BER taking notice of such findings, as the burden of proving BER violation is upon authorities whereas benefit under Article 101(3) needs to be proven by the party claiming its exemption. Moreover, what justice would there be in a BER that does not consider economically supported, legitimate arguments from manufacturers?

350 The Commission has, however, stated in Recital 5 in the preamble for Regulation 330/2010 that the VABER is to exempt only vertical agreements ‘to which it can be assumed with sufficient certainty that they satisfy the conditions of Article 101(3) of the Treaty’. Therefore, the BER does not aim to exempt all agreements which could later be proven to have pro-competitive effects under Article 101(3).
CONCLUSIONS

The ultimate problem in combining selective distribution with online retail appears to be the fact that these two concepts, instead of complementing each other, partially cancel each other out. Services and premises, which are vital elements in the protection of brand image, are unable to follow sales transactions online. This unavoidable and indisputable fact creates a structural problem into the setting and so far this outcome, together with its potential repercussions, appears to be underestimated in EU legislation.

Although the needs of brand owners are recognized in case-law, these rulings appear to have insignificant value in the context of online sales. In other words, the rationale in the protection of brand image and product exclusivity does not seem to apply within the modern context involving the Internet. The Commission has imposed a tight regulatory framework in order to address the online retail issue. It could be argued that this framework, negative towards online sales restrictions, has not been established upon economic rationale, but rather upon a concern that any restrictions might contradict with earlier existing concepts, such as the Single Market aim. It remains yet unclear, whether this strict regulation will ultimately lead to consumer wealth maximization or to something very different instead.

The current regulatory framework, de facto prohibiting any restrictions on online sales volumes, can be seen to create tension through juxtaposing several mutually exclusive factors. The more the other factor is supported, the more the other is unavoidably undermined. The illustration below portrays a series of factors which are, either explicitly or implicitly, supported by the current legal framework (Unlimited online sales) and their opposites, which might get additional protection under a legal framework permitting some forms of online sales limitations within selective distribution systems (Limited online sales).

<table>
<thead>
<tr>
<th>Unlimited online sales</th>
<th>Limited online sales</th>
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<tbody>
<tr>
<td>Low price, convenient purchase</td>
<td>Product exclusivity</td>
</tr>
<tr>
<td>Product homogeneity</td>
<td>Product heterogeneity</td>
</tr>
<tr>
<td>Free-riding</td>
<td>Brand promotion</td>
</tr>
<tr>
<td>Short-term brand benefit</td>
<td>Long-term brand benefit</td>
</tr>
</tbody>
</table>
One key issue would appear to be that competition on price serves better the short-term than long-term objectives in the context of branded goods. Internet sales make possible a wide utilization of existing brand goodwill without sufficient contribution to its maintenance and compensation for a potential reduction in brand image. Although lower prices for consumers may bring great benefit, it is well-established case law through *Metro I* that an agreement’s effect on price level shall not be the only and decisive competitive factor analyzed, as the aim of competition law is to allow any agreements which bring outweighing benefits regardless of whether they raise product price level or not. Unlimited online sales within selective distribution systems, albeit pursuing valuable aims in market integration and customer convenience, may inherently damage the ecosystem which makes possible the success stories behind branded products, with luxury products in particular.

The threat herein is that an entire, independent layer of competing products will be wiped away. Luxury goods, in particular, should be considered as their own field of products which are unable to comply with a one-size-fits-all regulatory framework in the long run. Product image is everything for a luxury good and the online retail context unavoidably alters it. Luxury good brand owners might perceive a need to refuse the selling of their products online as this distribution channel, despite being capable of reaching a larger number of consumers and creating higher revenue streams, does not serve the long-term prosperity of the goods. Higher temporary revenue streams are worth nothing if product image and exclusivity undergo an inflation which decreases demand in the long run. In the past, well-known luxury product manufacturers were allowed to refuse mail ordering in defense of their product differentiation and brand image. Now this same rationale does not apply for the Internet. Decades ago these companies had the possibility to differentiate and build brand image without the threats which today’s newcomers need to face. What might happen now, if unlimited Internet sales are equally the future for both products sold by H&M and Louis Vuitton? If the ‘old’ luxury brands are devaluated, while the birth of new ones is simultaneously made impossible, the result could be the eradication of one independent genre of products. What would remain is a slightly larger base of products sold, generically, through the Internet.

The Commission and the Advocate General in *Pierre Fabre* seem thoroughly convinced that manufacturers are able to require equivalent sales criteria for both online and

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351 See page 24
brick and mortar sales. However, neither party has cared to further elaborate this statement. Moreover, brand owners appear to be very reluctant in concurring with their finding. The reaction of brand owners is quite understandable, as these two sales environments are very different from each other. Luxury cosmetic companies, for example, could try to build chat-based platforms for customer-personnel interaction on websites, but would such solution, or any other in web-based form, be truly equivalent to the physical world?

What might be needed is a legal framework where the market plays a larger role in deciding the fate of distribution agreements. The market should decide what agreements succeed in differentiating products profitably and whether heavily branded goods, as a genre of products, can justify their existence through sustaining a level of demand. If the question of ‘Should the restriction of Internet sales be allowed?’ is answered with a ‘no’, then the market might suffer losing a degree of product exclusivity and an increase in product homogeneity. If this answer would be a ‘yes’, then brand owners would have the possibility to apply the most market-driven distribution and differentiation policies. Although a manufacturer would be allowed to restrict online sales, potential distributors would always have the option of not entering into distribution agreements with him. If a manufacturer implements a distribution policy with excessive restrictions, he would be unable to sign distributors, which would effectively force him to a) integrate vertically b) retreat from excessive restrictions or c) prove that his products will sell and that business is good even under these strict restrictions. If he succeeds in alternative c), then demand for the product has warranted the existence of any distribution restrictions. Should he correspondingly fail, his distribution policy might require refinement. In both cases, the market can be seen to benefit from the result. A more market oriented policy would also gather empirical evidence from the true market effects of online sales restrictions. If these effects should prove to substantially restrict competition, the provisions of future VABERs could naturally address and tackle this proven restrictive effect.

Although not providing an option completely flawless, the possibility for manufacturers to establish a certain proportionality requirement for sales made from physical shops and online might be the best solution in aligning the interests of brand owners and distributors. A mere offline sales quota, as in the current VABER, is insufficient should Internet be limitless. An online sales restriction policy based upon different sales prices, as an alternative, would be full of illogicalities, mainly as a distributor would be
required to sell such products which accrue the lowest costs for him for the highest price. A restriction policy based upon higher online sales prices might also cause a threat of distributors withdrawing from online selling altogether, which is not a desirable scenario in the context of the modern Internet society. There are, however, many unanswered questions in a proportionality requirement. How strict or lenient should the ideal and legitimate proportion be? Does it have to be the same for different kinds of branded products? Although these questions are hard to answer, the extreme alternatives of outright bans and unrestricted sales both seem to be untenable answers. Therefore, a workable solution might necessarily have to be found midway. Once again, the market itself might be capable of providing guidance in finding the best possible solution.

The quarrel between online sales and brand owner interests can be seen as a new chapter in the constant tension between competition law and intellectual property rights. It should be remembered that definitely not all manufacturers wish to limit online retail. The ones who are most concerned are those manufacturers, whose product brands and trademarks have acquired a certain reputation. They fear that online selling might devaluate the reputation of their brand, the intellectual property that makes their product something more than the sum of its parts. This ‘additional element’ has been very difficult for the regulation on vertical agreements to address. The exclusivity of a product, for example, does not better the physical characteristics of the product, nor does it have an effect on its actual functioning. Thus one could argue that the protection of product exclusivity, being something intangible and abstract, does not amount to an objective reason to prohibit or limit online sales. Following this logic, luxury bags would still be the same bags regardless of whether they are purchased online or from a physical shop. One could go further and claim that Internet retail is most feared by those manufacturers who know that this form of retail would eat out their product exclusivity, which is nothing but an artificial element capable of raising sales prices and thus worth fortunes to them.

However, there can be a perception radically deviant from the one above. Reducing products to their physical features, or bare bones, is a perception rather negative towards the intellectual property of brands and trademarks. After all, the ‘aura of luxury’, which certain products emanate, has been recognized to be a concept both valuable for consumers and worth legal protection. Product branding and differentiation through various sets of means, including the selection of particular
channels for product distribution, are generally viewed as pro-competitive endeavors. Such issues are not a concern for the part of more conventional products, whose manufacturers most likely have nothing against expanding their sales platform online. The current regulation for selective distribution agreements, which does not address the potential threat that unlimited online sales might have upon product image, might therefore be an unsatisfactory one-size-fits-all solution for the part of certain branded products, as it could result in the devaluation of their brands. It is therefore a regime rather unfavorable from the perspective of intellectual property. The current VABER allows only limited means for brand goodwill protection, and brand owners need to defend their distribution policies under Article 101(3) TFEU, which could be very difficult and uncertain.

The competitive market and the end consumer might benefit more from a versatile range of products instead of a more homogeneous offering. Those manufacturers wishing to compete through product exclusivity should be allowed more freedom to do so just as those ones opting to compete through lower price should be allowed to pursue their respective strategy. These approaches should not be unduly combined, as in the current regulation, since this might inevitably lead to the detriment of the manufacturers pursuing the first-mentioned strategy. Unlimited online sales force these two strategies into a common mold, which does not create equal benefits for both sides. Legislation should not force products to be sold via specific distribution channels especially should this be against the legitimate preferences of manufacturers. Furthermore, legislation should neither force these manufacturers to integrate vertically as a result of them not being able to establish sufficient sales criteria upon third party distributors.

Fundamentally, the pursuit of a more competitive European market might require interpreting Article 101 TFEU in a way which leaves more autonomy for brand owners in their online sales policies. Although an outright ban might easily be an overreaching measure, a regime where Internet sales reign limitless seems excessively lenient from the perspective of businesses within certain industries. Limited restrictions to online sales within selective distribution systems might be essential in maintaining the brand image and competitiveness of products in the long run. After all, the nature of branded products can legitimately warrant selective distribution and there is no indisputable evidence suggesting that qualitative conditions therein should step aside from obstructing sales made through one particular distribution channel. A reasonable
solution could be in the introduction of a possibility for manufacturers to establish, at least, a proportionality requirement for the online and offline sales made by their selected distributors in the succeeding VABER. As the current VABER is in force until 2022, brand owner interests should be given the corresponding additional weight in individual applications of Article 101(3) TFEU. Although the Single Market aim and lower consumer prices do constitute goals worth striving for, the overriding of economic rationale in their pursuit might not create the best possible results in the long run. It would be hard to build a true and sustainable competitive market upon an ignorance of facts and competition rationale. Consumer welfare is not created solely through lower prices, but also through a wider range of products made available in the market. Selective distribution agreements, which, in a competitive market, have only a remote effect on competition, might thus deserve more lenience than what is available for them under the current legal framework.
7 SUGGESTIONS FOR FURTHER RESEARCH

During the course of this study, the writer identified some issues and questions which might benefit from independent further research. First and foremost, an empirical study on the concrete implications which unrestricted online sales carry for branded products should be made. Field research in this matter would be imperative in order to objectively comprehend the scope of threat that online selling may impose on the reputation of branded goods. A study could include, for example, a quantitative analysis on how consumers perceive online sales to affect their perceptions of different brands, or a case study on the views and sales volumes of selected manufacturers. Such a study would importantly provide some long-awaited concrete and factual evidence into the debate between online sales and brand image protection.

While the present study concerned online sales within selective distribution networks under Article 101 TFEU, a corresponding legal study could be made on exclusive distribution networks. These networks are facing very interesting times in the future, as manufacturers are allowed to restrict the ‘active’ sales efforts of their exclusive distributors. The Commission has taken a very interesting policy in the active/passive sales dichotomy, wherein a website primarily constitutes only ‘passive’ sales, and the resulting implications upon manufacturers operating exclusive distribution networks might easily be worth a study. Such a study could be complemented by empirical research in the topic area later on.

A comparative legal study on the potential differences between approaches of EU and US competition law towards the restriction of online product sales might also be valuable. The regional contexts of these legal regimes unavoidably influence the content of the legislation enacted, and it would be interesting to know whether differences in legislation create different kinds of benefits and problems within the topic area.

Aside from the actual topic area of the present study, the concepts of trademarks and brands could be worth researching. The essences of these two concepts still remain somewhat unclear. A brand indisputably covers a trademark, its graphic depiction, but a trademark, on the other hand, does not capture the whole essence of a brand. A brand might already be covered in EU legislation as a ‘trademark with a reputation’, but a more in-depth analysis of these two concepts, and what they encompass, could be a very interesting read.
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