

Clarifying Competition Law:

Distribution Agreements and Product Pricing: Part 1: EU and France

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The logo for Bryan Cave, featuring the text "BRYAN CAVE" in a blue, sans-serif font. A green curved line is positioned below the text, starting under "BRYAN" and ending under "CAVE".

Speakers



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Anita Esslinger has a general corporate and commercial practice relating to international business transactions. In addition, she practices in the areas of international regulatory issues, including EU and UK competition law. Ms. Esslinger is dual-qualified as an English solicitor and an American lawyer. At the beginning of 2014 she returned to the Washington DC office, where she is now resident, after spending almost twenty years in the London office. She continues her UK and EU practice from Washington DC.

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Kathie Claret is a partner in the Transactions, Labor and Employment and European Competition client service groups. Mrs. Claret has practiced law in France for more than 30 years, focusing mainly on corporate and commercial transactions and contracts, including mergers and acquisitions (M&A), means of representation and channels of distribution, and French employment issues.

In addition, Mrs. Claret regularly advises on restrictive trade practices and the regulatory, products liability, consumer law and intellectual property issues unique to retail distribution and licensing.

Agenda

- The Basics
- Pricing
- Exclusive Distribution, and Territorial and Customer or *Clientèle* Restrictions
- Selective Distribution
- Internet Sales

The Basics

- EU competition law
 - Article 101(1): Prohibition on restrictive agreements that affect trade between EU member states
 - In this webinar, we will consider anti-competitive agreements and business practices between suppliers and their distributors, including wholesalers and retailers (vertical agreements)
 - Commission Regulation No 330/2010 – The Vertical Agreements Block Exemption (valid through May 31, 2022) and Vertical Guidelines – effects analysis
 - Safe harbour – provided conditions of the block exemption are complied with, certain restrictions will be valid and enforceable even if they would otherwise be caught by Article
 - Only applies if the market share of each party of their relevant market or markets in the EU (or national markets if more applicable) does not exceed 30%
 - And there must be no “hard-core” restrictions present.
 - If the Block Exemption does not apply, need to consider whether restrictions qualify for an individual exemption under Article 101(3)
 - Must contribute to improving production or distribution or promoting technical or economic progress while allowing consumers a fair share of the benefit – parties must self-assess, courts are the final arbiter

“Hard Core” Restrictions

- Certain categories of restrictive agreements are treated as having the “object” of restricting competition – these generally will be in breach of Article 101(1) regardless of the effect on competition
- Examples:
 - Resale price maintenance
 - Restrictions on “passive sales” in exclusive distribution agreements
 - Restrictions on cross-supplies between members of a selective distribution arrangement
 - Restrictions on sales by buyers at the retail level to end-users

The Basics

- French competition law
 - Article L. 420-1 of the French *Code de commerce* provides essentially the same prohibitions as Article 101(1) with respect to restrictive agreements and applies to all activities of production and distribution of goods and services that affect only trade in France
 - L.420-4 provides for an exemption very similar to 101(3), but there are no express block exemptions. But in practice the French authorities may look to the EU block exemption by analogy
- Enforcement
 - The European Commission has enforcement power in relation to Articles 101 of the EU competition law
 - Since May 2004, EU member state national competition authorities have the power to apply Article 101 in its entirety, including imposing fines, accepting commitments and ordering interim measures
 - Thus the French competition authorities and French courts can enforce both EU and French competition law
 - Framework for cooperation between the Commission and national authorities with respect to EU competition law

Dangers of non-compliance

- Restrictions in violation of Article 101(1) that are not exempt under Article 101(3) or a block exemption are automatically void and unenforceable
- Potential for heavy fines
- Private and collective damages actions
- Bad publicity

Fines

- EU

- Potentially up to 10% of worldwide turnover – Guidelines on method of setting fines
- Commission fines in the tens of millions of Euros in the past
- Parent liability where decisive influence is exerted (presumed for wholly owned subsidiaries)

- France

- Number of fines imposed is decreasing due to use of the commitment procedure, the average amount has increased significantly
- French Supreme Court has held that a simple rebuttable presumption of liability of whole groups of companies for violations arises with respect to wholly-owned subsidiaries (6 January 2015)
- Although Article L. 464-2 of the French *Code de commerce* allows the French Competition Authority to adjust the amount of fines according to the scope of the practice, its impact on the economy, the gravity of the facts, their reiteration, the economic situation of the company/group, the Supreme Court held that:

“the fines imposed on the basis of article L. 464-2 of the Code de commerce must be motivated and determined individually for each punished company or organization; this requirement excludes the automatic increasing of the fine as a result of its mere membership in a group” (22 October 2014)

“[Unless it can be proved that] the parent companies of the Vinci and Eiffage groups have exercised a decisive influence on their subsidiaries’ behavior, in particular in the definition of their commercial policy, [...] they shall not be charged with the infringing conduct of their subsidiaries” (22 February 2014)

Pricing

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The Pricing Prohibition – Resale Price Maintenance

- Any agreement or restrictive practice that has as its direct or indirect object the establishment of fixed or minimum resale prices of a buyer – resale price maintenance or RPM – is viewed as a “hard-core” infringement of competition law
- It is not covered by the block exemption and is unlikely to qualify for an individual exemption under Article 101(3)
- The European Commission has imposed serious fines – in the tens of millions of Euros for RPM
- Even though in the US, resale price maintenance is now analysed under a rule of reason (*Leegin*) and not viewed as *per se* violation, this is generally not the case under EU competition rules

Limited Time Exception – RPM

- The 2010 Guidelines on Vertical Restraints recognise that companies may plead an efficiency defence to RPM under Art 101(3) and for the introductory period for new products, RPM may induce distributors under ‘competitive pressure’ to make the launch of a new product a success to the benefit of consumers.
- We’ve yet to see a test case for this introductory pricing and the language is sufficiently vague to deter its use

What amounts to RPM?

- Fixing the distributor's **margin**;
- Fixing a **minimum resale price**;
- Setting a **maximum discount** which a distributor must apply;
- Making **rebates or promotional costs** (or other supply benefits) conditional upon adherence to a given price level;
- **Linking** the resale price to that of competitors' products;
- Obliging a buyer to apply a **most favoured-customer clause** in resales
- Using threats, intimidation or warnings to **coerce a buyer** to comply with the supplier's recommended resale prices;
- **Indirect pressure** linked to mechanisms to identify instances of discounting
 - **certain monitoring of the prices** of distributors, and
 - obliging retailers to **report** other **distributors deviating** from the "recommended" price level.

Resale Price Maintenance

- You may not enforce an RPM policy by indirect means outside the terms of the contract by imposing penalties or sanctions for non-adherence to the policy
- These sanctions can take many forms such as refusing to deal or imposing longer lead times for product deliveries or terminating your distributor's agreement to reinforce the requirement to resell at a fixed or minimum price
- Nor may you provide incentives such as bonus payments or allowances for compliance with minimum or fixed resale price restrictions, however they are dressed up

Maximum and Recommended Resale Prices

- Suppliers may impose a maximum resale price or recommend a resale price , as long as it does not have the effect of a fixed or minimum resale price, as for example, as a result of pressures from or incentives by the supplier
- Exercise caution when putting prices on product packaging
- Unilateral instructions by the supplier should not form the basis of an anti-competitive agreement unless there is express or implied acquiescence by the distributor – but beware, as it may not be difficult to find an “agreement”

French Developments in RPM

- Resale Price Maintenance consistently reaffirmed as anti-competitive, with a certain leniency where no retaliation against distributors who did not comply with imposed pricing
- Article L. 442-5 of the French *Code de commerce* provides for criminal penalties in case of imposed retail pricing (fine up to € 15 000)
- Widespread case law in France reflects broad interpretation of what constitutes “enforcing” RPM.

French RPM Cases

Nestlé Purina Petcare - Royal Canin

In 2012, the French *Autorité de la Concurrence* fined Nestlé Purina Petcare and Royal Canin up to € 19 million and € 11.6 million for, among other things, imposing resale prices in the entire French territory during 5 years. It was established that the suppliers directly negotiated the prices and uniform tariff conditions with the “*purchasing organizations*”, and would transmit a document entitled “*summary of the applicable tariffs*” to wholesalers who were thus not free to propose different resale prices to the same organizations. The practice was deemed to affect the free competition between wholesalers, increasing prices, and was therefore detrimental to the economy. The decision was upheld by the Court of Appeal in 2013.

The “perfume case”

In 2012, after 6 years of procedure, a global fine of € 40.71 million was imposed on several luxury brands including Chanel, Hermès Parfums, YSL, for enforcing the “*indicative public price*” communicated to their distributors as well as a “**maximum discount rate**” authorized. Compliance with fixed prices was carried out by controls and threats of reprisals (threats of breach of contract and late delivery among others); but also by **the conditioning of certain discounts on the observance of resale prices**. Those practices were judged to increase the average level of the products prices, which was detrimental to consumers and amounted to RPM. Sanctions were partially upheld in 2014.

French RPM Cases

Kontiki (Diddl products)

The French Competition Authority found the Kontiki company to have imposed on all its retailers the signature of charters and agreements conditioning their listing on the diddl.fr website on their compliance with retail prices communicated as “recommended public prices”, or maximum prices” through price schedules, purchase order or pre-tagged products.

On the 7th of October 2014, the French Supreme Court upheld Kontiki’s € 1.34 million fine, ruling that such practices should be considered as resale price maintenance. The French Supreme Court nevertheless tempered the gravity of the infringement stating that despite the pressures to apply the imposed prices, no delisting had been implemented against the non-compliant retailers.

Most Favoured Nation Clauses

- Most favoured nation (“MFN”) or “best price” clauses established between two parties whereby one party will benefit the lowest price the other party gives to anyone
- Attractive to the buyer, but in some circumstances can raise competition issues:
 - Risk of collusion by suppliers where several suppliers enter into MFNs with buyers
 - May increase likelihood of direct or indirect exchange of pricing information
 - Risk of softening of price competition among suppliers
 - Risk of foreclosure of entry
 - “English clause” where supplier promises to match the lowest price offered to a buyer can raise similar issues
- Since 2008, the French *Code de commerce* (Article L. 442-6 II(d)) provides for the nullity of MFN clauses.

MFN Cases

On-Line Hotel Booking:

- In France, the so-called price-parity (a type of MFN) clauses imposed on hotel operators by on-line travel agencies (OTAs) – both with respect to other OTAs and the direct customers of the hotels – are currently under scrutiny by the French Competition Authority (“ADLC”). The ADLC is presently conducting market tests to assess commitments proposals from Booking.com to withdraw certain MFN clauses as regards other OTAs (as opposed to hotel operators themselves).

Exclusive Distribution and Territorial and Clientèle Restrictions

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Exclusive Distribution

- **What is an Exclusive Distribution Network?**

A distribution model where:

- Supplier undertakes to sell its products to only one distributor within a given territory. In, return, the supplier often imposes specific conditions to the distributor
- In return, the distributor frequently undertakes to buy products only from the supplier

- **Why have an exclusive distribution network?**

- Recommended to clients who wish to distribute their own brand while controlling the product's availability on the market, generally in medium/low competition territories. It also allows control of logistics costs, discount policies and follow-up of clients

- **Under French law**

Exclusivity of supply:

- Article L. 330-1 and 2 of the French *Code de commerce* provide for a maximum duration of 10 years for the exclusivity of supply to be valid

General Territorial Prohibition/Customer Exclusivity Prohibition

- In general, there is a hard-core prohibition against a supplier:
 - Restricting distributors selling into a specified territory or customer group
 - Imposing restrictions which impede the supply of goods by a distributor located in one member state to a customer located in another member state
- Market partitioning by territory or customer group
- An agreement that merely grants exclusive distribution rights but does not confer absolute territorial protection (i.e., does not prohibit passive sales) generally does not fall within the prohibition or is exemptible

Territorial Protection

- Often a major issue alongside pricing, is suppliers wishing to protect distributors in certain markets from others (and distributors wishing to be protected)
- Rarely can you provide absolute territorial protection for an exclusive distributor
- Conduct which has the effect of dividing the territory of one Member State from another can result in serious penalties
- Unique feature of EU competition rules is that they not only apply conventional antitrust rules, but also seek to promote single market integration within the EU
- France is already a single market, so no comparable public policy in France which would favour selling nationally as opposed to locally within France or prohibit dividing local markets

Types of Prohibited Measures

- Direct obligations
 - Absolute obligation not to sell or supply certain customers or territories
 - Obligation to refer orders from those customers or territories to other distributors
 - Export bans
- Indirect measures aimed at inducing compliance/monitoring
 - Refusal or reduction of bonuses or discounts
 - Termination of supply
 - Price discrimination – higher price for exported products
 - Failure to provide EU – wide guarantee service

Restrictions Permitted by Block Exemption: Active Sales Outside Territory

- Restriction on active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer
 - However, restrictions on passive sales – sales by an exclusive distributor in response to unsolicited orders outside the territory of the distributor – are not permitted
 - General advertising and promotion not directed to a specific customer or territory, including marketing over the internet are generally considered to be passive selling

Restrictions Permitted by Block Exemption

- Restrictions on both passive and active sales by wholesalers to end-users are permissible
- Restrictions on buyers of components for incorporation into their own products that prohibit active or passive resales of such components to competitors of the supplier are permissible
- France also recognizes these exemptions in connection with purely French sales

Restrictions Permitted by Block Exemption: Limited Time Exception

- Vertical guidelines issued by the Commission also recognise that there may be times when certain normally “hard-core” territorial or customer restrictions may not be caught or may be justified under an individual exemption – which must be self-assessed by the supplier, subject in the final analysis to a decision of the courts.
- For example, where substantial investments are necessary to first sell a new brand or sell an existing brand in a new territory, restrictions on passive sales by other distributors into the new territory which are necessary to permit the new distributor to recoup its investment may not be caught by the prohibition during the first 2 years.
- However, this exception has not yet been tested in the French courts or EU courts – so beware!

Selective Distribution

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Selective Distribution

- **What is a Selective Distribution Network?**
 - A formal distribution model to adopt when companies wish to supply products to certain dealers who meet objective qualitative (and in some cases quantitative) criteria.
- **Why have a Selective Distribution Network?**
 - Often recommended to clients who wish to retain qualitative control over their dealers to help try and avoid their products being sold at rock-bottom prices by cut price distributors.
- **What Products are eligible?**
 - Not suitable for all products.
 - Complex or technical products e.g. computers, audio/TV, cell/mobile phones.
 - Luxury products e.g. perfumes, cosmetics, jewellery.
- **Constructing a Selective Distribution Network**
 - Nature of goods.
 - Setting qualitative criteria.
 - Criteria must not go beyond what is necessary.

Selective Distribution under French law

- Under French law, **qualitative criteria** must be necessary, objective, accurate and verifiable and non-discriminatory.
- Examples of qualitative criteria allowed under French law:
 - **qualified staff** imposed by the nature of the product, criteria subject to a proportionality test (*Cass com 24 sept 2013 n° 12-14.344. SAS Pierre Fabre Dermo Cosmétique* : imposing the presence of a qualified pharmacist as a condition to enter the network was illegal because the cosmetic products sold fell outside the pharmacist monopoly and could be used without specific medical precaution).
 - the **quality of the distributor's premises** (shop or display).
 - the quality of the **after-sales service** (compliant with product warranty).
 - ban on sale of down-market goods sold in proximity.

Selective Distribution under French law

- **Quantitative criteria:**

- The supplier may not restrict entry on a selective network solely based on quantitative criteria. Quantitative selection criteria conditional upon a certain yield, a minimal turnover or a minimum purchase were previously considered unlawful. They may, however, pass muster under an individual or block exemption (per 2010 Vertical Restraints Guidelines) if they are reasonable and proportional.
- Simply limiting the number of network distributors, in order to control the network's development, is permitted. Since the **Jaguar** case, this quantitative limitation no longer has to meet the requirements of qualitative criteria, and is non reviewable by the Courts: a "quota" of distributors can be decided by the supplier on a discretionary basis.

Selective Distribution under French Law

- **Jaguar Land Rover case:** Since Jaguar did not need a distributor in the town in which it was situated, a former distributor had been denied entry in the selective distribution network. The French *Cour de cassation* put a preliminary question to the CJUE, and conforming to its response, held that the supplier did not have to justify why it did not wish to expand its network. The French Supreme Court held that requirements governing qualitative criteria for admission to a selective distribution network do not apply to the quantitative criterion of simply limiting the number of distributors.
(Cass. com, 15 January 2013, applying CJUE, 14 June 2012 C-158/11).
- Although certain legal commentators considered this holding to apply only to the new vehicle sector, for the majority, the solution would apply to any vertical agreement in France.

Restrictions Permitted by EU Block Exemption

- Restriction on distributors in a selective distribution system selling to unauthorised distributors within the territory reserved by the supplier to operate that system (ensures a minimal protection of the network) is permitted
- Vertical Block Exemption would not cover a restriction on active selling by an authorised distributor in a selective distribution system to another authorised distributor in the system
- Selective distributors must be free to sell both actively and passively (including by internet sales) to all end-users, and to purchase from any authorised dealer
- Selective distribution cannot be combined with exclusive distribution to the extent that this would lead to a restriction of active or passive selling by the dealers
- Exclusive customer allocation may not be combined with selective distribution

Internet Sales

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Internet Sales

- In principle, distributors must be allowed to sell via the internet .
- A ban on selling on the internet is regarded as a passive sale ban, even if the use of a website may have effects beyond the territory or customer group of a distributor.
- But concerns over “free riding”, particularly for technical and luxury products – where a customer goes into the store and tries out the product, then purchases it online, as well as extra costs of bricks and mortar, continue to be raised.

Internet Sales

- To the extent that promotion on the internet leads to active selling into another distributor's exclusive territory or customer group, that can be restricted.
 - E.g., online ads specifically addressed to certain customers, territory-based banners on third party websites, paying a search engine or online advertisement provided displayed specifically to users in a certain territory.
- But offering different language options on a website does not, in and of itself change the passive character of such selling.

Internet – Hardcore restrictions

- Agreements that an exclusive distributor will:
 - prevent customers located in another exclusive territory to view its website or automatically routing customers to the manufacturer's or other exclusive distributors' websites.
 - terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's exclusive territory.

Internet – Hard-core restrictions

- Agreements that a distributor will limit its proportion of overall sales made over the internet
 - Although without limiting online sales, a supplier may require a certain absolute amount (value or volume) of sales in-store to ensure efficient operation of a physical shop – same for all or individually tailored.
- Agreements that the distributor will pay a higher price for products to be resold by the distributor online than off-line
 - In its most recent Opinion on internet sales (*Avis n° 12-A-20, 18 September 2012 relatif au fonctionnement concurrentiel du commerce électronique*), the French Competition Authority recalled that dual pricing could not be used in an attempt to discourage distributors to sell on-line: a supplier cannot reserve good prices or discounts only to the benefit of distributors that have a certain part of their turnover off-line.
 - However, the supplier may agree with the distributor a fixed fee (that does not vary by increase in turnover) to support off-line or online sales efforts provided that such allowance is directly related to extra costs incurred.

Internet – Quality Standards

- Particularly relevant for selective distribution
- Requiring the distributor to have a bricks-and-mortar shop alongside an internet sales site for admission to the system
- Quality standards – e.g., requiring that customers not visit a website hosted by a third party through a site carrying the name of or logo of the third party platform provider
- Under French law, the supplier may impose quality standards for the website such as compliance with a graphic design or selling the products on a dedicated page. The standards may not exceed what a supplier is entitled to impose with regard to physical outlets.

Internet – Quality Standards – French Examples

- In the leading September 2013 **Pierre Fabre dermo-cosmétique** case upholding the prohibition to forbid on-line sales, the supplier sought the benefit of an individual exemption before the French courts. He argued that the systematic presence of a pharmacist in a physical shop led to efficiency gains. The French courts refused to follow this reasoning.
- **Bang & Olufsen case** (*CA Paris, 13 March 2014, n° 2013/00714*). B&O had imposed a ban on on-line sales of all of its products to its whole network. For the Court, the ban was justified for high quality and complex products that require a demonstration in a physical outlet (Hi-Fi), but under no circumstances could it be justified for products of lower quality. The supplier was sanctioned for having imposed a general prohibition whereas a prohibition limited to highest quality and complex products could be exempted. The Supreme Court upheld this reasoning.

Can Sales on Online Marketplaces be Prohibited?

- Difference between, say, a platform provider selling in its own name, where it is a normal distributor and online marketplaces such as Ebay and Amazon Marketplace or other auction platforms
- Some companies would rather sales of their products were kept off auction websites to uphold the image and sales quality of their products
- Is the ability to do this limited to high-quality branded products that qualify for selective distribution qualitative criteria?

Can Sales on Online Marketplaces be Prohibited?

- Recent French **Competition Authority Opinion** (18 September 2012) suggests that market-place websites (e.g., Amazon) can satisfy high qualitative criteria, especially by creating “virtual” stores. Any prohibition to sell to on-line marketplaces on this ground should thus be banned. The supplier may for example impose the creation of virtual stores as well as other qualitative conditions such as access to the marketplace store via a website that does not mention the name of the platform.
- An investigation is currently underway by the French Competition Authority on this topic in connection with a complaint brought by the SARL Concurrence, a notoriously litigious French retailer, (called Concurrence!), against Samsung’s prohibition against its selective distributors selling through on-line marketplaces or un-authorized websites. In its partial decision of 23 July 2014, the French Competition Authority noted that while a supplier may condition internet sales on compliance with certain norms, the blanket prohibition against on-line marketplace sales merited its further investigation.
- While awaiting the outcome, it is recommended that suppliers seeking to limit sales via on-line marketplaces impose specific conditions (virtual store...) but avoid excluding totally those websites from their permitted channels of distribution.

Conclusion

- Distribution arrangements in the EU and France differ from those found in the United States, for example, where absolute territorial protection may be possible and resale price maintenance should be judged by rule of reason
- It is important in drafting and implementing distribution agreements to avoid the “hard-core” restrictions and to be sure that other restrictions imposed on the distributor fall within the Vertical Block Exemption, or where that does not apply, would qualify for an individual exemption under 101(3)

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