

## **Selective distribution for cosmetics and EU competition rules on online sales**

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### **Summary**

On March 3 2011 the European Court of Justice (ECJ) Advocate General Ján Mazák issued a non-binding opinion on *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la Concurrence and Ministre de l'Économie, de l'Industrie et de l'Emploi* (Case C-439/09). In it, Mazák argues that selective distribution agreements which impose a general and absolute ban on the sale of cosmetics and personal care products by selected (authorised) distributors to end users on the internet may conflict with EU competition rules.

According to EU law, distributors are free to sell within a selective distribution system, both actively and passively, to all end users and in both the online and offline environments.

### **Facts**

Pierre Fabre Dermo-Cosmétique SAS (PFDC) manufactures and markets several ranges of pharmaceutical, homeopathic and pharmaceutical-related products. It has a number of subsidiaries, including the cosmetics laboratories Avène, Klorane, Galénic and Ducray.

Like most companies operating in its sector, PFDC has opted for a system of selective distribution: its products are sold only through authorised distributors (such as pharmacies) which are chosen on the basis of the quality of their sales outlets, the professional qualifications of their staff and their commitment to ensuring the presence of a pharmacist, which the company regards as

necessary when dispensing such products. Moreover, distributors are prohibited from selling the products in question to unauthorised distributors.

PFDC's distribution agreements for the Avène, Klorane, Galénic and Ducray brands include a clause that requires each distributor to:

sell the products in question only from physical (ie, non-virtual) premises; and  
supply evidence that a qualified pharmacist will be present at its outlet at all times.

PFDC justified such requirements - which necessarily excluded any form of online sale - on the basis of the specific nature of the products in question which, it claimed, should be sold only where advice from a qualified pharmacist was available, as they had been developed as healthcare products.

On October 29 2008 the French Competition Authority found that PFDC, by prohibiting the online sale of its products, had infringed competition rules - specifically, Article L420-1 of the French Commercial Code and Article 81 of the EC Treaty (now Article 101 of the Treaty on the Functioning of the European Union).

In the authority's opinion, PFDC had harmed consumers' interests by preventing them from enjoying the competitive effects that might be expected from the online sale of products distributed through a selective network. An internet distribution system allows consumers to compare prices more easily and offers them services that conventional outlets cannot provide. Home delivery and real-time availability of product-specific documentation, in any location, serve to stimulate price competition while giving distributors an incentive to provide more services in order to attract or retain customers. Moreover, the authority considered that PFDC had restricted the commercial freedom of its authorised distributors by depriving them of a marketing channel with strong growth potential.

PFDC was ordered to remove any provision in its selective distribution agreements that effectively prohibited internet sales of its cosmetics and personal care products. The authority fined PFDC €17,000.

The decision followed a decision of March 8 2007 by the same regulator in which 10 companies operating in the personal care products and cosmetics sector agreed to modify their selective distribution agreements to allow their distributors to sell their products online.

On December 24 2008 PFDC brought an action before the Paris Court of Appeal for the annulment - or, in the alternative, the amendment - of the decision, claiming that:

the decision was unfounded in respect of anti-competitive purpose; and

the purpose of the selective distribution agreements was not to restrict competition but, on the contrary, to ensure a satisfactory level of service for consumers by enabling them to request and obtain specialist advice on the most appropriate product at all times.

Moreover, PFDC argued that the practice in question was exempt either under a block exemption permitted by the EU Vertical Agreements Block Exemption Regulation (2790/1999)<sup>i</sup> (now EU Regulation 330/2010),<sup>ii</sup> or individually under Article 81(3) of the EC Treaty (now Article 101(3) of the Treaty on the Functioning of the European Union), allowing for the agreements' contribution to economic development to be taken into account.



On October 29 2009 the Paris Court of Appeal asked the ECJ for a preliminary ruling on whether:

a general and absolute ban on selling products to end users on the Internet, imposed on authorised distributors in the context of a selective distribution network, has the object of restricting competition for the purposes of Article 81(1) of the EC Treaty;

such a restriction can benefit from the block exemption in EU Regulation 2790/1999; and

if the restriction in question cannot benefit from the block exemption, whether it may benefit from an individual exemption pursuant to Article 81(3) of the treaty.

## **Relevant provisions**

In order to assess whether PFDC's general and absolute ban on internet sales infringed competition rules and regulations, the authority and the Paris Court of Appeal referred to the following EU provisions.

Article 81(1) of the treaty prohibits 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.”

EU Regulation 2790/1999 provides for a block exemption for distribution agreements which fulfil certain criteria. It also contains a list of hardcore restrictions that cannot benefit from the block exemption.

Article 81(3) of the treaty provides an exemption - on certain conditions - for agreements that improve the distribution of goods or promote economic progress.

## **Advocate general's opinion**

The advocate general considered that a general and absolute ban on online sales in the context of a selective distribution network is a restriction by object for the purposes of Article 81(1), since it goes beyond what is objectively necessary in order to distribute goods in an appropriate manner in light of their material qualities, aura and image.

According to ECJ case law, the anti-competitive object of an agreement may not be established solely on the basis of an abstract formula. Attention must be paid to other factors, including the content of the provisions of the agreement, the objectives that it seeks to attain and its economic and legal context.<sup>iii</sup>

The advocate general opined as follows:

PFDC's claim that the prohibition was justified on public health grounds, as its products required the advice of a pharmacist in order to be used correctly, was objectively unfounded. Such products are not medicines and there is no regulatory requirement that would mandate their sale only in a physical space and in the presence of a qualified pharmacist.<sup>iv</sup>



PFDC had claimed that the prohibition was justified in order to prevent the threat of counterfeiting and the risk of free riding, which could lead to the disappearance of the services and advice provided in pharmacies, as the owners of websites could free-ride on the investments of distributors without websites. This claim was considered unfounded. Detrimental effects resulting from internet sales could be counteracted by adequate security measures. Moreover, creating and operating a high-quality website entails costs; therefore, it could not be presumed that internet distributors would be free riding on the investments of distributors that operated from a physical outlet.<sup>v</sup>

The ECJ had previously found that selective distribution agreements may be justified in order to preserve the aura and image of the goods in question, as in *Copad SA v Christian Dior couture SA, Société industrielle lingerie*.<sup>vi</sup> The advocate general also accepted that cosmetics and personal care products are, in principle, appropriate for selective distribution agreements and that the presence of a pharmacist may enhance the image of such products. Nevertheless, the general and absolute prohibition of internet sales could be proportionate only in exceptional circumstances.<sup>vii</sup> A manufacturer could impose appropriate, reasonable and non-discriminatory conditions on internet sales, thereby protecting the aura and image of its products. This possibility is expressly referred to in Paragraph 51 of the European Commission Guidelines on Vertical Restraints,<sup>viii</sup> which states that:

“a supplier may require quality standards for the use of the internet site to resell [its] goods, just as the supplier may require quality standards for a shop or for advertising and promotion in general.”

The same provision is set forth in the recently adopted guidelines on vertical restraints.<sup>ix</sup> The advocate general suggested that the national court should examine whether information and advice could be adequately provided online. Moreover, he noted that a prohibition on internet sales would eliminate a modern means of distribution which would allow customers outside the catchment area of a physical outlet to buy these products; this, combined with the increase in price transparency that internet sales would provide, would enhance intra-brand competition.<sup>x</sup>

The advocate general noted that PFDC’s ban on internet sales restricted both active and passive sales and thereby constituting a ‘hardcore restriction’ within the meaning of Article 4(c) of EU Regulation 2790/1999,<sup>xi</sup> which states that an agreement is ineligible for exemption under the regulation if it seeks to restrict:

“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.”

In this respect, the advocate general disagreed with PFDC’s assertion that online sales should be classified as sales from an unauthorised virtual establishment. Although Article 4(c) makes no reference to internet sales,<sup>xii</sup> he considered that the Internet is not a virtual establishment, but rather a modern means of communicating and marketing goods and services.

An anti-competitive agreement which restricts competition and would, in principle, be prohibited by Article 81(1) of the EC Treaty may, in principle, benefit from the exemption provided by Article 81(3). The advocate general considered that in order to determine whether this exemption applies, a referring court must determine whether the agreement in question fulfils the four cumulative criteria in the article, in that:

it contributes to improving the production or distribution of the goods in question or promotes economic or technical progress;



consumers are allowed a fair share of the resulting benefit;

it does not impose unnecessary restrictions on the parties to the agreement; and

it does not allow for the possibility of eliminating competition.

Moreover, an undertaking that claims the benefit of Article 81(3) bears the burden of proving that all such conditions are met.<sup>xiii</sup>

As there is insufficient evidence in the file before the ECJ in this respect, the advocate general considers that the ECJ cannot provide more specific guidance on this point.

## **Comment**

The advocate general's opinion is not binding on the ECJ. However, the court generally follows such opinions.

According to the guidelines on vertical restraints, every distributor must be free to use the Internet to advertise or sell its products. The new guidelines further acknowledge that “the Internet is a powerful tool to reach a greater number and variety of customers than by more traditional sales methods”.<sup>xiv</sup>

In any event, the supplier may require that quality standards be applied to the use of an internet site to resell its goods. The criteria imposed for online sales may differ from those imposed for offline sales, as long as they pursue the same objectives and achieve comparable results, and that the difference between the criteria is justified by the differences between the two modes of distribution.<sup>xv</sup>

In view of the PFDC case, and in accordance with the advocate general's opinion, a manufacturer may protect the aura and image of its products by imposing appropriate, reasonable and non-discriminatory conditions on internet sales. In particular, individualised information and advice on cosmetics and personal care products could be adequately provided to online users, who could submit questions on the products without needing to go to a pharmacy.

The new EU Regulation 330/2010, which entered into force on June 1 2010, provides for a one-year transition period to enable enterprises to comply with the new requirements. Agreements already into force on May 31 2010 are not subject to the new regime until May 31 2011.<sup>xvi</sup> It is advisable to review current agreements in order to ensure that they comply with the new regulation.



## Endnotes

<sup>i</sup> Commission regulation of December 22 1999 “*on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices*”.

<sup>ii</sup> Commission regulation of April 20 2010 “*on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices*”. Regulation 330/2010 entered into force on June 1 2010 and effectively replaced Regulation 2790/1999 which expired on May 31 2010. Regulation 330/2010 is not relevant to the main proceedings at this time.

<sup>iii</sup> Joined Cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P, October 6 2009, *GlaxoSmithKline Services Unlimited v Commission of the European Communities*, paragraph 58.

<sup>iv</sup> Paragraph 37 of the advocate general’s opinion.

<sup>v</sup> *Id.*, Paragraph 40.

<sup>vi</sup> C-59/08, April 23 2009.

<sup>vii</sup> Paragraph 54 of the opinion.

<sup>viii</sup> October 13 2000. According to Paragraph 4, the guidelines are not binding on the ECJ.

<sup>ix</sup> May 19 2010, Paragraph 54.

<sup>x</sup> Paragraph 56 of the opinion.

<sup>xi</sup> *Id.*, Paragraph 62.

<sup>xii</sup> Article 4(c) of EU Regulation 330/2010, which makes no reference to internet sales.

<sup>xiii</sup> See Article 2 (entitled “Burden of Proof”) of Regulation 1/2003 of December 16 2002 “*on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty*”.

<sup>xiv</sup> Paragraph 52 of the new guidelines.

<sup>xv</sup> *Id.*, Paragraph 56.

<sup>xvi</sup> Article 9.

