

THE NEW EU RULES FOR ONLINE SALES

Competition Law360

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5/24/2010

On April 20, the European Commission published new rules governing “vertical” agreements, such as distribution and supply agreements. The new rules are set out in the Vertical Restraints Block Exemption Regulation and the related Guidelines. They will become effective as of 1 June for new agreements and as of June 1, 2011 for existing agreements.

Compared with the last revision of these rules in 2000, the recent revision is relatively modest. In 2000, the Commission issued rules that reflected an entirely new approach to the assessment of vertical agreements, jettisoning a formulaic, rule-based approach in favor of one that focuses on the real-world economic effect of agreements in the market. While many initially missed the certainty of the old approach, most now agree that the economics-based approach has worked well in practice and has given companies greater flexibility in structuring their distribution agreements.

To a large degree, the recent revisions introduce changes at the margins aimed at addressing some largely technical problems under the old rules. However, there are a few areas where the changes have been more significant. Below, we highlight these key changes and their practical impact on companies operating within the European Union. The principal substantive changes concern the promotion and sale of products online, as the new Guidelines clarify how the general rules apply in the online context. Additionally, suppliers must now consider the market shares of their customers, as the new rules address the anticompetitive effects caused by strong buyers. Finally, suppliers now have more options to specifically tailor their distribution systems to their needs, due to the additional clarity and sophistication of the new rules.

Online Sales

Much of the debate leading up to the adoption of the new rules concerned online sales, in particular whether suppliers may limit online sales by their distributors, and whether suppliers may protect exclusive distributors from online sales and promotion by distributors in other territories.

Regarding limits on online sales, the Commission reached a compromise. Under the new rules, suppliers may not place either proportionate or absolute limits on the number of online sales made by their distributors, but they may require them to have one or more brick-and-mortar stores and to make a minimum number of sales through their brick-and-mortar sales channel. These requirements allow suppliers to both ensure that their distributors do not focus exclusively on Internet sales and prevent pure e-tailers from entering their distribution networks.

For suppliers of luxury products, these requirements were considered important to combat free riding by e-tailers, which do not provide the pre-sales advice and customer services provided by retailers in brick-and-mortar stores. The new rules are not, however, a complete victory for suppliers of luxury or branded products. In particular, under the new rules, as long as a distributor makes the minimum sales required in its brick-and-mortar store, it can, at the same time, sell large quantities of products online. Further, the rules would not seem to prevent large e-tailers, such as Amazon or eBay, from acquiring or opening a brick-and-mortar store for the sole purpose of entering a supplier's network, and then proceeding to devote their energies to online sales. While suppliers may try to prohibit such companies from entering their systems or limit the level of supplies available to them or the locations from which they may operate, it is not clear how effective such measures will be.

Further, distributors must not be required to pay a higher price for products intended to be resold online (when compared to the price of products intended to be resold offline). However, this does not preclude the supplier agreeing with the buyer a fixed fee to support the buyer's offline or online sales efforts (as long as the fee is not variable with a link to offline turnover, since this may well indirectly amount to dual pricing).

Regarding the protection of exclusive distributors from sales coming from outside of their territories, the Guidelines seek to clarify the distinction between the types of online conduct that represent "active" sales into an exclusive distributor's territory (which may be restricted) and "passive" sales into its territory (which may not be restricted). In relation to online activity, the Commission interprets the two concepts as follows:

- "active" sales mean actively approaching customers, using unsolicited email or advertisements or other promotions specifically targeted at customers in a territory;
- "passive" sales mean responding to unsolicited requests from individual customers, general advertising or promotion (in media or on the Internet) that reasonably reaches customers outside an exclusive territory.

The Commission is keen to promote online sales and, thus, the Guidelines provide that a distributor's use of its website is generally not considered to be a form of active selling, since it is a reasonable way to reach every customer. Ease of access from outside a territory is a characteristic of the technology. When a customer visits a website located in another member state, contacts the distributor, and makes a purchase, this amounts to a passive sale. The language used on a website plays no role in differentiating between active and passive sales. Thus, even though a UK distributor with a website in French could be said to be targeting customers in France and Belgium, this is still not considered to be active selling.

The Guidelines further make it clear that suppliers may not attempt to restrict cross-border online sales by requiring a distributor to do any of the following:

- prevent customers in another territory from viewing its website;
- automatically reroute such customers away from its site; and
- terminate consumers' transactions over the Internet once their credit card data reveal an address not within the distributor's territory.

The Commission has also set out its thinking with respect to online promotion or advertising by distributors. In particular, the Guidelines clarify when online advertising amounts to active selling. The Commission considers online advertisements specifically addressed to certain customers to be a form of active selling to these customers. For example, banner and

search adds would be considered to be active selling to the extent they are displayed specifically to customers in a particular territory. Similarly, paying a search engine or online advertising provider to have advertisements displayed specifically to users in a particular territory is active selling into that territory. Given this, suppliers should review their distribution contracts to ensure that they have the ability to identify the territories in which distributors are buying online advertising space.

In summary, suppliers may require a distributor:

- to make a minimum number of sales through one or more brick-and-mortar stores;
- to not make active sales into the exclusive territory of another distributor or the supplier, for instance by paying a search engine or online advertisement provider to have ads, such as a banner or search ads, displayed specifically to users in that territory;
- to ensure that its website meets reasonable qualitative criteria; and
- to include links to websites of other distributors and/or the supplier.

However, distributors must be allowed to:

- sell products online without any proportional or absolute limit on such sales imposed by the supplier;
- present their website in any language;
- purchase products for resale online at the same price as products for resale offline, with the possible exception where online sales lead to substantially higher costs for the manufacturer (e.g. from more customer complaints and warranty claims); and
- advertise to customers who opt to be kept automatically informed by the distributor.

Additional Options

The new rules reflect the experience of the Commission and national competition authorities over the past ten years as well as the significant input received from industry through the public consultation process that preceded the adoption of the new rules. In many cases, this experience and input has resulted in more sophisticated rules allowing practices that previously were prohibited either out of an abundance of caution or due to imprecise drafting. The following are examples of some new options that may be available to suppliers:

- **Minimum Prices.** As under the previous rules, suppliers may generally not impose minimum or fixed resale prices. However, the Commission has acknowledged that minimum resale prices could be permissible in the following circumstances: (i) when a supplier introduces a new product, (ii) when a supplier wishes to have a coordinated short-term promotional campaign within a franchise system, and (iii) when retailers provide pre-sales services, particularly for complex products and products whose qualities are difficult to judge before use.
- **Mixed Distribution Systems.** Under the new rules, suppliers may operate more effective mixed exclusive/selective distribution systems with increased legal certainty, for example by (i) appointing selective distributors in some countries and exclusive distributors in other countries, or (ii) granting exclusive territories to wholesalers operating in a selective distribution system.

- **Location of Outlets and Warehouses.** Suppliers are now able to specify the locations of the outlets and warehouses of their wholesalers and dealers. Previously, the ability to impose such restrictions was very limited.
- **Sales by Wholesalers to Certain End-Users.** Suppliers may allow wholesalers to sell products to certain end users while prohibiting sales to all other end users.
- **Dual Distribution in Exclusive Systems.** To the extent the parties agree, suppliers may promote and sell their products alongside their exclusive distributors.

Market Share Threshold of Buyers

The Block Exemption provides the parties to a vertical agreement with a safe harbor from the application of the competition rules. Under the old rules, the supplier's market share could not exceed 30% in order to qualify for the safe harbor. According to the new rules, neither the market share of the supplier nor the market share of the buyer may exceed 30%. The new market share threshold for buyers is designed to address anticompetitive effects arising from the buyer power of large retail chains. Exceeding these thresholds does not necessarily mean that the agreement would violate the competition rules, but a more detailed analysis of the agreement and the market would be required.

While some suppliers may benefit from the new buyer threshold, particularly to avoid exclusive agreements imposed by large buyers, for other suppliers the new threshold could well constitute an unwanted burden. For example, suppliers will have to undertake additional due diligence about the downstream markets to be in a position to calculate their distributors' market shares. This would particularly be necessary where the distributor sells the products of multiple competing suppliers, as the distributor may hold a significant cumulative share of the relevant market.

Other Issues

The Commission has also introduced new guidance concerning the following practices, which are particularly relevant for suppliers using large retail outlets, such as supermarkets:

- **Upfront Access Payments.** Upfront access payments are fixed fees paid by suppliers to distributors in order to obtain access to their distribution network and to obtain certain services, such as access to prime shelf space.
- **Category Management Agreements.** Category management agreements are agreements where a retailer appoints one supplier as a "category captain" responsible for the selection, placement, and marketing of the supplier's products as well as competing products in the retailer's store.