



International Distribution Institute



**IDI CONFERENCE 2018**  
**MANAGING AND CONTROLLING DISTRIBUTION**  
**AT THE RETAIL LEVEL**  
**8-9 JUNE 2018**  
**(FLORENCE)**

**LIMITING FREE RIDING WITHOUT BREACHING COMPETITION**  
**RULES**



PROF. AVV. ALDO FRIGNANI

*Professor of EU Competition Law, University of Turin*

[www.studiofrignani.com](http://www.studiofrignani.com)

Torino – Milano – Roma –  
Bologna



## Intrabrand v. interbrand competition

Why in the EU so great emphasis is put on intrabrand competition ? Need to achieve the single market: integrationist purpose (which is absent in the USA).

Any distribution network organized on a territorial basis needs to warrant a **reasonable protection** of its members against competition from their colleagues and at the same time to permit **reasonable “intrabrand” competition** within the network.

Services are a device for the manufacturers to win interbrand competition by rendering the distribution more efficient

“Once deprived of the opportunity to cut prices [below cost plus reasonable profit], dealers can win sales only by providing services” (AREEDA, HOVENCAMP, VIII, § 1611).

Free riding depresses the “full service dealers’ return on their investments in promotion and services, perhaps so much so that they become unwilling to provide the services at all (AREEDA HOVENCAMP, *ibidem*)

Free riding concerns intrabrand competition; what matters in the market is rather interbrand competition.

To solve a free rider problem is **one of the positive effects** of vertical restraints



The **Guidelines on vertical restraints of 2010** say § 107

- “ *One distributor may free-ride on the promotion efforts of another distributor....Exclusive distribution or similar restrictions may be helpful in avoiding such free-riding. In particular:*
  - *by allocating an exclusive territory*
  - *by imposing a non-compete obligation*

Hence the distinction between active sales (which can be prohibited) and passive sales (which should be left to the free choice of distributor).

- The advent of e-commerce has **disrupted the precarious balance** reached previously in the brick and mortar shops based distribution economy.
- **Online sales increase the output**, generating (in the words of judge BORK) an efficiency for the manufacture. But it is not always so, therefore manufacturers dislike it, because **they cannot monitor the distributors**, like in offline system, especially with luxury goods, branded goods or technically complex goods which need services.
- The Guidelines devote to on-line sales a **certain number of paragraphs** (from 52 through 64) . Online sales must be free for the distributor with these limitations. Taking the example of franchising:





## **To sum it up, it is lawful in franchising agreement for the franchisor to stipulate that: (part 1)**

1. the franchisee's website offers in addition a number of links to websites of other franchisees and/or the franchisor;
2. the franchisee sells off-line at least a certain absolute amount (in value or volume) of the products;
3. the franchisee's online activity remains consistent with the franchisor's **distribution model**;
4. a fixed fee will be paid to support the franchisee's off-line or on-line sales efforts;
5. the franchisee refrains from on-line advertisement specifically addressed to certain customers;
6. the franchisee in its website does not insert territory based banners on third party websites;



## **To sum it up, it is lawful in franchising agreement for the franchisor to stipulate that: (part 2)**

- VII. paying a search engine or online advertisement provider to have advertisements displayed specifically to users in the territory reserved to another franchisee is prohibited;
- VIII. the franchisee respect quality standards for the use of internet sites to resell its goods just as the requirements of quality standards for shop or for selling by catalogue or for advertising or promotion in general. Therefore, it is lawful in a franchising agreement to impose the observance of “*quality standards*” for the use of the internet site which are totally consistent with the networks uniformity .
- IX. To fix a percentage on the on-line sales would be prohibited ( although the German judges allowed it: BGH 4 November 2003, *Depotkosmetik*, in *GRUR*, 2004).
- X. As we understand it the Commission here refers to a participation of the franchisee to the costs of franchisor’s publicity or promotion, which will benefit all franchisees network either for their off-line sales or for on-line sales.



## TPP AND COTY CASE

The coming into the market of “**pure internet players**”, third party platform or TPP, particularly those who sell “goods of all kinds” (including low quality goods, second hand goods, out of season, counterfeited products) has **exacerbated the problem** since they undermine the reputation of the trademark or brand.

This aspect triggered the Coty case.

### FACTS

Coty Germany, a luxury cosmetics producer, asked their selective distributors not to sell through third-party platform (TPP): one of them (Parfümerie Akzente ) refused to sign such clause, claiming that it was contrary to BER n. 330 and its interpretation, particularly Pierre Fabre judgment of October 30, 2011, which condemned a selective distribution system (SDS) for dermocosmetics requiring the presence of a doctor, implicitly precluding the e-commerce sales.



## Holding of the Court in the Coty case

- a) A TPP ban in a distribution of luxury goods complies with art. 101.1 TFUE, which does not preclude such clause provided that METRO case conditions (objective criteria for selection, non discrimination, proportionality) are met  
*[paragraph 29]*
- b) TPP bans are not prohibited by arts. 4 a) and 4 b) of Reg. 330/2010:
  - i) no restriction of customers[ *impossible to circumscribe, within the group of online purchasers, TPP customers:par.66* ] ;
  - ii) no restriction of passive sales[ *customers could find online offers of authorized distributors through online search engines and advertisement:par.67* ]



International Distribution Institute

## **Critical considerations and future of on-line sales**

### **THE EU COMMISSION IS HAPPY**

The EU Commission has welcomed Coty judgment because it provides «*more clarity and legal certainty to market participants*» and facilitates «*a uniform application of competition rules across the EU*»[statement of Dec.8,2017 confirmed in Competition policy brief April 18,2018]

### **BundesKartellAmt's position**

Coty is not a “*carte blanche*” for the use of platform bans[branded goods outside the luxury area are not covered by Coty].





## **CRITICAL CONSIDERATIONS**

### **THE BUSINESS COMMUNITY IS PARTIALLY HAPPY AND PARTIALLY DISAPPOINTED**

The business community, while welcoming the application of the rule of reason and in practice the repeal of Pierre Fabre, is partial unhappy because the holding of Coty does not solve all problems outside the luxury goods, besides the fact that the requirements going back to METRO case (1977) are inadequate for modern distribution. The great majority of these subtle categories are unknown to the USA literature.

**COTY ESTABLISHES A DUAL STATUS: ONE FOR LUXURY AND THE OTHER FOR NON LUXURY GOODS** - but without setting out the legal definition of the two categories, which is an impossible task

a) For example, most cosmetics do not pretend to be luxury goods notwithstanding that Coty products are.



## CRITICAL CONSIDERATIONS

b)The admissibility of certain restrictions in distribution based on the “nature” of the goods is a non sense[it seems more appropriate to opt for the “*characteristics*” criterion: whenever the consumer before buying a branded good needs the servicing of instructions how to use it(technical products) or demonstration (perfumes or cosmetics) or testing (champagnes or wines)a TPP ban should be admitted]

c)From an economic perspective, the strength of the Coty holding would be substantially diminished if were not applied also to non luxury goods.

d)The disappointment of the either business community or antitrust scholars(e.g. PARDOLESI) comes from the choice of the ECJ to solve a 2017 problem relying on categories set out in an very old economic scenario (where e-commerce was not yet conceived by the business men) without feeling the necessity of setting out new categories in order to meet the needs of a world of internet economy.

## Geoblocking regulation and franchising

- On **February 28, 2018** the European Union passed a regulation prohibiting unjustified geographical blocking based on nationality, place of residence, place of establishment.
- Although art.6 provides that
  - *Without prejudice to Regulation (EU) No 330/2010 and Article 101 TFEU, this Regulation shall not affect agreements restricting active sales within the meaning of Regulation (EU) No 330/2010 or agreements restricting passive sales within the meaning of Regulation (EU) No 330/2010 that concern transactions falling outside the scope of the prohibitions laid down in Articles 3, 4 and 5 of this Regulation.*

we may sum it up as follows:





## **we may sum it up as follows:**

- It is applicable also to franchise distribution;
- Most provisions apply from 3 December 2018 onwards;
- Implications for businesses:
  - i) Substantial extension of the prohibition of territorial restrictions:
    - a) applies to distributor's unilateral behavior (unlike vertical BER, which only applies to bilateral or multilateral behavior)
    - b) restrictions on active sales remain admissible: distributors do not need to implement websites in foreign languages;
    - c) restrictions on passive sales. Dealers must offer delivery in member States that are addressed by the dealer's business activity. With regard to other member States there is an obligation to cooperate by means of implementing a collection point or participation in the delivery organized by the customer;
    - d) conclusion of contract with customer must not be denied on the basis place of establishment, place of residence or nationality (there are some legal exceptions).
  - ii) Business should adapt their behavior to the new rules.

Elimination of barriers on foreign customers' access to websites including automatic re-routing. Adaptations of online forms, so that foreign customers can enter their contact data.



International Distribution Institute

*Thank you for the attention!*

**Prof. Avv. Aldo Frignani**

aldo.frignani@studiofrignani.com



[www.studiofrignani.com](http://www.studiofrignani.com)

Torino – Milano – Roma – Bologna