Selective distribution systems in practice
Consequences of and justifications for selective distribution together with effects of the new Block Exemption Regulation

Bachelor’s thesis within business law (European competition law)

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Abstract

On 1 June 2010, a new Block Exemption Regulation (BER) and new Guidelines that affect the practical use of selective distribution systems enter into force. The BER exempts vertical agreements, such as selective distribution agreements, from the prohibition of Article 101 (1) TFEU. It is significant for individual market players to obtain knowledge of what impact the new BER and the new Guidelines have for the practical use of selective distribution systems.

The Commission has amended the new BER and the new Guidelines in the light of the development the last decade. Two main changes are noticed that affect the content of the new legislative documents. Firstly, it is established that many distributors have obtained larger market shares. Secondly, it is stated that Internet sales have increased largely. The basic principles of the new versions of the BER and the Guidelines are identical with the former versions but the present changes are although noticeable for companies and their selective distribution systems.

The new BER contains a new market share rule that is more restrictive than the corresponding rule in the former BER. However, the new market share rule is not an expression of a less tolerant approach towards selective distribution systems; rather an amendment necessary due to the development of distributors’ market shares.

The growth of distribution in the Internet the last ten years is reflected in the new Guidelines. The Commission’s approach towards the Internet as a distribution method seems in general to be positive. It is noticeable that the Commission wants that parties of selective distribution agreements shall be able to benefit from all the positive effects of online sales at the same time as the Commission tries to preserve the positive effects of selective distribution.

This thesis describes and examines the practical use of selective distribution systems. Different reasons for companies to use selective distribution systems and effects of the new BER and Guidelines are in particular examined.
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**Abbreviations**

BER  
Regulation 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 (Block Exemption Regulation)

CJ  
Court of Justice of the European Union

EC Treaty  
Treaty establishing the European Community

e.g.  
exempli gratia; for example

EU  
European Union

EUR  
Euro

Guidelines  
Guidelines on Vertical Restraints

Ibid.  
Ibidem; exactly the same as cited directly above

TFEU  
Treaty on the Functioning of the European Union
1 Introduction

1.1 Background

The aim of European Union (EU) competition law is to protect undistorted competition in the internal market. Undistorted competition includes enhanced welfare for consumers and more efficient allocation of resources.\(^1\) Competition law is an instrument to achieve integration on the single market.\(^2\) The basis of EU competition law is arranged in the Treaty on the Functioning of the European Union (TFEU)\(^3\).

A central piece of legislation in EU competition law is Article 101 of the TFEU which corresponds to the old Article 81 of the Treaty establishing the European Community (EC Treaty)\(^4\). The article is the main tool for controlling anti-competitive behaviour such as an agreement between two market players in which the parties split the current market or the situation when two market players cooperate to gain as much profit as possible at the expense of other market players.\(^5\)

The aim of Article 101 TFEU is to secure effective competition within the internal market.\(^6\) Article 101 (1) TFEU prescribes that agreements between independent parties, which may affect trade between Member States, shall be prohibited as incompatible with the internal market if they can prevent, restrict or distort competition within the internal market. Article 101 (2) TFEU states that such agreements shall be automatically void while Article 101 (3) TFEU sets out that the prohibition according to Article 101 (1) may be declared inapplicable to an agreement if certain criteria are fulfilled. In short terms, Article 101 (1) TFEU can be declared inapplicable if the beneficial outcome of an agreement outweighs the restrictive aspects.\(^7\)

Article 101 TFEU applies, among other things, to vertical agreements.\(^8\) Vertical agreements are agreements between two undertakings which are active on different levels of the distribution or production chain.\(^9\) Selective distribution systems are vertical agree-

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\(^1\) Communication from the Commission, Notice, Guidelines on the application of Article 81 (3) of the Treaty, OJ C 101, 27.4.2004, paragraph 33.


\(^8\) Ibid., page 101.

ments that are able to restrict competition within the internal market and are therefore a matter of EU competition law.

The Commission has been given the ability to declare Article 101 (1) TFEU inapplicable to certain categories of agreements.\footnote{Regulation No 19/65/EEC of the Council of 2 March 1965 on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices, OJ 36, 6.3.1965 as amended by Council Regulation (EC) No 1215/1999 of 10 June 1999 amending Regulation No 19/65/EEC on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices, OJ L 148, 15.6.1999.} Through the Regulation 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 (Block Exemption Regulation, BER)\footnote{Former version: Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336, 29.12.1999. New version: Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101 (3) of the Treaty of the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L 102, 23.4.2010.} the Commission exempts vertical agreements and concerted practices from the prohibition of Article 101 (1) TFEU. The BER embraces, among other things, selective distribution systems which are agreements where the supplier (the seller) undertakes to sell the goods in question only to distributors (buyers) selected on the basis of specified criteria and where the distributors undertake not to sell the goods further on to unauthorised distributors.\footnote{Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101 (3) of the Treaty of the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L 102, 23.4.2010, Article 1 (1) (e).} Selective distribution systems are commonly used by companies which e.g. distribute branded final products.\footnote{European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 174.}

To facilitate for a company to assess whether or not their agreements should be regarded as exempted from the prohibition laid down in Article 101 (1) TFEU the Commission publishes Guidelines\footnote{Former version: Commission Notice, Guidelines on Vertical Restraints, OJ C 291, 13.10.2000. New version: European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010.} which are more detailed than the BER and which purpose is to help companies to assess their vertical agreements according to EU competition law.\footnote{European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 3.} The current BER and Guidelines expire on 31 May 2010 and it is significant for individual market players to obtain knowledge of what impact the new BER and the new Guidelines are going to have for vertical agreements as selective distribution systems.\footnote{Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336, 29.12.1999, Article 13.}

### 1.2 Purpose

The aim with this thesis is to describe and examine the practical use of selective distribution systems foremost according to the BER and the Guidelines by answering the following questions:

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\footnotesize{13} European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 174.


\footnotesize{15} European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 3.

1. What are selective distribution systems and how are they regulated?
2. Why do companies use selective distribution systems and what practical consequences have those systems?
3. How will selective distribution systems be affected by the new BER and the new Guidelines?

1.3 Method and materials

The methods used for this thesis are a descriptive method and a problem oriented method. To find an answer to the first question of the purpose, which is answered in chapter 2, it is necessary to apply the descriptive method where selective distribution systems are described and presented on the basis of EU legislation.

For the second question, answered in chapter 3, the descriptive method is used to some degree but the main method is the problem oriented method. Meant by problem oriented method is that subjects are discussed through analyses rather than through presentations and explanations of principles that already are established.

The third question, discussed in chapter 4, is considered through the problem oriented method solely. The BER and the Guidelines that both expire on 31 May 2010 are compared with the new versions of the BER and the Guidelines. This comparison is the basis of the discussion regarding question number three and the focus is to observe changes that affect selective distribution.

Throughout the thesis a practical example is used to assist the reader to understand the complicated and theoretical characteristics of selective distribution. The fictive example is composed of supplier X, the branded product Y and a number of distributors. The example occurs in connection with explanations which become easier to understand when connected to a practical situation.

The materials used are valued differently depending on what legal source respective material is based upon. Materials such as treaties, regulations and other legislative documents are valued higher than articles published in journals and other literature. The selection of materials depends, to some extent, on the dissimilar characteristics of the questions in the purpose.

Since the first question is more based on concrete facts than the other two the materials used for answering the first question are the wording of Article 101 TFEU, case law to some extent, important sections of the BER and the Guidelines as well as literature on the subject matter.

The second question is discussed in particular on the basis of provisions in the Guidelines. The provisions in the Guidelines that treat positive and negative aspects of vertical agreements, such as selective distribution agreements, are formulated generally and from the perspective of the market as such. Those provisions are interpreted in the perspective of companies using selective distribution. Additionally, conclusions made in literature are used to obtain entirety of the chapter.

The materials used for the third question are primary the wording of the new BER and Guidelines as well as the wording of the former versions. Although, the changes are discussed with some guidance both from the first drafts of the new BER and the new
Guidelines, which were published in July 2009, and from public consultations consisting of comments on the drafts made by persons working with competition law.

The references in chapters 1, 2 and 3 refer to the new versions of the BER and the Guidelines as far as possible. Several provisions are identical in the new and the former versions and since the new versions enter into force soon after this thesis is published the references refer to the new versions. Although, when a matter is discussed that exists in the former versions but not in the new it is referred to the former versions. The terminology in chapter 4 distinguishes from the other chapters, due to the different aims of the chapters, and chapter 4 includes therefore references both to the former and the new versions.

1.4 Delimitation

In spite of the fact that the BER embraces several types of vertical agreements this thesis only considers selective distribution agreements. The reason for this delimitation is that selective distribution agreements are commonly used, especially for goods which are technically advanced and when the brand is significant, and thereby affecting a large number of companies.\(^{17}\) Considerations of all vertical agreements embraced by the BER would require much more space than offered by this thesis.

Even though selective distribution systems apply likewise to goods and services this thesis only mentions selective distribution of goods. This is to facilitate for the reader. However, the reader should bear in mind that what is said about goods applies to services as well.

Since the purpose with this thesis is to discuss selective distribution systems with focus on selective distribution in practice and forthcoming developments the content in Article 101 TFEU is examined only briefly. The BER and the Guidelines determine selective distribution more extensively and constitute the primary source of law, for companies and other, when considering the status of certain selective distribution agreements; the focus is therefore on those two legislative documents. Decisions by the Commission can be used, parallel with e.g. regulations, to examine selective distribution but are disregarded by reason of this thesis’ limited space.

The circumstance that a selective distribution agreement can be concluded between three or more independent parties is disregarded in this thesis. The terms used are merely supplier, for the party of the agreement that sells, and distributor, for the party of the agreement that buys, even though different synonyms exist.

\(^{17}\) Westin, J. *Europeisk konkurrensrätt*, page 96.
2 The concept of selective distribution systems

2.1 Chapter introduction

The aim of this chapter is to determine what a selective distribution system is and how this type of agreement is regulated. This chapter provides essential information that is necessary to assimilate before the discussions and analyses of chapter 3 and 4.

The chapter begins with a description of selective distribution together with a practical example. It continues with selective distribution in relation to Article 101 TFEU, the BER and the Guidelines in due order.

2.2 Explanation of selective distribution systems

A selective distribution system is a distribution system where a supplier chooses distributors on the basis of specified criteria. Selective distribution is created through an agreement between a supplier of goods and a distributor where the supplier undertakes to sell the goods only to distributors that fulfil the criteria. The distributor on the other hand is prevented from selling the goods further to other distributors that do not fulfil the criteria laid down in the agreement.\textsuperscript{18} In other words, the distributor may only sell the products to other distributors within the same selective distribution system or to end-users.

Since selective distribution is formed through agreements between suppliers and distributors selective distribution need to imply some beneficial effects for both parties or else the party which does not benefit from the agreement will not accept it. The supplier and the distributor are free-standing and act as two independent parties. Selective distribution systems are commonly used by suppliers towards distributors when the supplier intends to distribute branded final products.\textsuperscript{19} At first sight it might seem that selective distribution is advantageous only for suppliers. The system makes it possible for the supplier to ensure high standard of reselling of the products.\textsuperscript{20} This is usually very important when the products are branded and where the supplier considers high quality of resellers very important to maintain a good reputation.

The benefit for the distributor who joins a selective distribution system is that the distributor only has to compete with other distributors within the same distribution system who are selling the same type of product. Put that way the competition within a brand decreases since the number of distributors reduces.\textsuperscript{21}

The criteria related to selective distribution systems are numerous. It is for the supplier and the distributor to arrange the selective distribution and to agree upon which and how many criteria the distributor must fulfil. The selected criteria can be formulated in


\textsuperscript{19} European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 174.


\textsuperscript{21} European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 175.
any way as long as they are sufficiently specified. The criteria can be of both qualitative and quantitative nature. Examples of qualitative criteria are demands of trained staff in shops where the goods are sold, obligations towards the distributor to offer the customers pre- or after sales services and requirements of the manner in which the goods are presented to the customers in the shops. Examples of quantitative criteria are requirements of maximum or minimum levels in sales and limitations in number of possible authorised distributors.

To enable a link between theoretical explanations and selective distribution in practice an example which can arise in reality is now presented. This is the starting point for the example of supplier X and product Y which returns several times in this thesis.

Selective distribution is most likely an important issue for supplier X which produces the branded item, product Y, in which supplier X commits a large amount of resources. The supplier aims to create and maintain a good reputation of the product among end-users and chooses therefore to create a selective distribution system. According to this selective distribution supplier X only sell product Y to distributors that fulfil the criteria which the supplier includes in the agreement. Firstly, supplier X requires the distributors to design and dedicate at least five shelves, each of a fixed size, in the shops where product Y is going to be sold. Secondly, the supplier demands the distributors to be able to provide the buyers of product Y some pre- and after sale services. To perform this requirement the distributors must possess a special tool and at least one person of the distributors’ staff must have a specific certification. Supplier X considers the services to be important since end-consumers may associate offered and well functioning pre- and after sales services with high-quality products. As already mentioned supplier X’s purpose is to maintain a good reputation of product Y. Finally, product Y is only sold to distributors which sell at least 100 examples of the product each year. The quantity will be based on the sale from previous calendar year. Until the parties have practiced the agreement during one year supplier X will estimate the probable amount of sold products together with each distributor.

The distributors A, B and C, each which fulfils the criteria, enter into selective distribution agreements with supplier X since they all believe that they will benefit by selective distribution. Distributor B, for example, estimates that the beneficial effects will be that its clientele will increase if the number of distributors that sells product Y reduces. The distributors D and E do not fulfil the criteria laid down in the selective distribution agreement and are therefore not allowed to distribute product Y. Supplier X will not conclude any agreement until these distributors carry out the measures needed to fulfil the criteria. It is also possible that distributors D and E do not want to distribute product Y. Some distributors, that actually fulfil the criteria, may choose not to conclude any agreement with supplier Y because they consider that the advantages with the selective distribution are too small.

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23 European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 175.
2.3 Selective distribution and its regulations

2.3.1 Selective distribution and Article 101 TFEU

Article 101 (1) TFEU applies to agreements that have effects on trade between Member States.\(^\text{24}\) The Court of Justice of the European Union (CJ) has, for the assessment of whether or not an agreement has this effect, appointed a broad test. According to this test Article 101 (1) TFEU is applicable even though the agreement merely has an indirect or potential effect on trade between Member States.\(^\text{25}\) Because of the wide scope of this test agreements with no effect on trade are unusual.\(^\text{26}\)

Selective distribution infringes in general the undistorted competition because the exclusion of non-authorised distributors affects intra-brand competition.\(^\text{27}\) Intra-brand competition is competition between operators of the same level of the market in relation to a certain brand while the opposite, inter-brand competition, is competition between brands of a certain product.\(^\text{28}\) Conclusively, Article 101 (1) TFEU applies to selective distribution agreements.

Even if selective distribution in general affects trade between Member States each selective distribution system does not infringe Article 101 (1) TFEU. According to the CJ a selective distribution agreement does not hinder the free competition as long as the distribution system is created in a certain way. The selective distribution must be regarded as necessary for the nature of the product which is assumed when the product is technically advanced, luxury or branded. Furthermore, the criteria included in the distribution agreement must be of qualitative nature and applied equally for all distributors. Finally, the criteria shall not go beyond what is necessary to obtain the positive effects of selective distribution for the product in question.\(^\text{29}\) As long as the selective distribution system fulfils these conditions it is not in conflict with Article 101 (1) TFEU.

The selective distribution system implemented by supplier X will probably infringe Article 101 (1) TFEU. Product Y is definitely branded so selective distribution shall probably be regarded as necessary for product Y but the criterion which require the distributors to sell a minimum amount of products each year is of quantitative nature and therefore infringes the present selective distribution system Article 101 (1) TFEU.

Selective distribution agreements which shall be prohibited as incompatible with the internal market according to Article 101 (1) TFEU, e.g. because the agreement consists of quantitative criteria, can however be exempted from the prohibition by Article 101 (3) TFEU. To be declared exempted from the prohibition the selective distribution system needs to fulfil the four requirements of Article 101 (3) TFEU. The anti-

\(^{24}\) Article 101 TFEU is accessible in Appendix 1.


\(^{26}\) Craig, P and De Búrca, G, EU law: Text, Cases and Materials, page 975.


\(^{28}\) Ibid., page 1277.

competitive effects of the agreement are considered outweighed by the beneficial as-
pects when the requirements are fulfilled.\textsuperscript{30}

Firstly, the agreement has to contribute either to improvement of production or distribu-
tion of the goods or promote technical or economic progress. This is thus about effi-
ciency gains and it is necessary to examine the connection between the gain and the
agreement.\textsuperscript{31}

Secondly, the efficiency with the agreement must allow a fair share to the consumers. If
the anti-competitive agreement for example leads to higher prices for consumers the
second requirement demands that the consumers get compensated through higher qual-
ity of the product or similar.\textsuperscript{32}

Thirdly, the restrictive agreement shall be proportionate to the efficiencies it results in;
the agreement must be adequate.\textsuperscript{33} Fourthly and lastly, the agreement may not attain a
possibility for any of the contracting parties to eliminate competition in a substantial
part of the goods concerned.\textsuperscript{34}

Accordingly, selective distribution agreements are accepted either if the requirements,
for example the condition that the criteria included in the agreement must be of qualita-
tive nature, laid down by the CJ are fulfilled or if the selective distribution, admittedly
infringing Article 101 (1) TFEU, fulfils the conditions of Article 101 (3) TFEU.

2.3.2 Selective distribution and the BER

The regulations in which the Commission exempts groups of agreements from the pro-
hibition of Article 101 (1) TFEU facilitate the appraisal of the legality of the agree-
ments. The regulations exempt whole categories of agreements which admittedly fall
within the prohibition of Article 101 (1) TFEU but which, according to the Commissi-
ion, regularly fulfil the conditions of Article 101 (3) TFEU.\textsuperscript{35} The BER is one of the
group exemption regulations and exempts vertical agreements such as selective distribu-
tion systems. Consequently, the Commission considers that selective distribution sys-
tems have beneficial consequences that prevail over the anti-competitive aspects.

According to the Commission vertical agreements, as defined by the BER\textsuperscript{36}, can im-
prove economic efficiency by making the cooperation between the contracting under-
takings work smoother. Moreover, the Commission states that this increased coopera-


\textsuperscript{31} Communication from the Commission, Notice, Guidelines on the application of Article 81 (3) of the

\textsuperscript{32} Ibid., paragraph 86.

\textsuperscript{33} Ibid., paragraph 73.

\textsuperscript{34} Ibid., paragraph 105.

\textsuperscript{35} Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101 (3) of
the Treaty of the Functioning of the European Union to categories of vertical agreements and concerted
practices, OJ L 102, 23.4.2010, preamble (3).

\textsuperscript{36} Ibid., Article 1 (1) (a).
tion can lead to lower transaction- and distribution costs. For an agreement to be treated as a selective distribution system by the BER, and by that means exempted from Article 101 (1) TFEU, the agreement must prevent the supplier from selling the product to other distributors than those who fulfil the specified criteria just as the agreement must prevent the distributors from selling the product to unauthorised distributors.

Selective distribution systems are accepted and exempted, from the prohibition of Article 101 (1) TFEU, by the BER as long as the market share of the supplier on the market on which the product is sold is below 30 percent. The reason for this threshold is that the anti-competitive effects of selective distribution are presumed to outweigh the positive features when the market share of the supplier exceeds 30 percent. The decrease of intra-brand competition, which is a consequence of unauthorised distributors, has larger impact on trade if the inter-brand competition is low. Inter-brand competition decreases in proportion to an increasing market share of the supplier.

For the selective distribution agreement implemented by supplier X this market share rule means that if the market share of supplier X is, for example, 12 percent the BER is applicable to the selective distribution agreements between supplier X and the distributors A, B and C respectively. If the market share of supplier X instead is 33 percent there is a lesser degree of inter-brand competition between product Y and competing products of other brands. A lesser degree of inter-brand competition implies that the effects supplier X’s selective distribution system has on intra-brand competition are more substantial than if the market share was lower. Consequently, the BER does not in this latter situation exempt, from Article 101 (1) TFEU, the selective distribution system of supplier X.

The BER contains a number of criteria which, if some of the criteria are included in the agreement, result in that the BER does not apply to the agreement. These criteria are called hardcore restrictions and are declared not indispensable to the general positive consequences of vertical agreements. The selective distribution agreement, as well as other vertical agreements, may not contain for example restrictions of minimum sale prices or restrictions of to whom and in which territory the distributor may sell the product. Despite these hardcore restrictions, a supplier of a selective distribution system is allowed to prevent authorized distributors from selling the product to distributors that are unauthorized. Furthermore, a selective distribution agreement may not consist of a

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40 Ibid., preamble (8-9).


42 Ibid., preamble (10).
clause that restricts an authorized distributor’s reselling to end-users or that restricts the possibility to sell and buy between distributors within the same selective distribution system.\footnote{Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101 (3) of the Treaty of the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L 102, 23.4.2010, Article 4.} Important to notice is that a selective distribution system that contains a hardcore restriction is not banned as such. The consequence is solely that the BER does not apply on systems containing hardcore restrictions.

Conclusively, as long as the supplier’s market share is lower than 30 percent and as long as the selective distribution agreement contains no hardcore restrictions it does not matter, for the BER to be applicable, whether the criteria included in the agreement are of qualitative or quantitative nature and the nature of the product does not matter.\footnote{Commission Notice, Guidelines on Vertical Restraints, OJ C 291, 13.10.2000, paragraph 186.} The main principle with the BER is that it provides the presumption that all selective distribution agreements are legal.\footnote{European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 23.}

\subsection*{2.3.3 Selective distribution and the Guidelines}

The BER and the Guidelines both consider the exemption of vertical agreements; however the Guidelines provide more details. The Guidelines should be read in conjunction with the BER.\footnote{Mendelsohn, M and Rose, S, \textit{Guide to the EC Block Exemption for Vertical Agreements}, page 11.} The Guidelines provide comments on the different articles of the BER as well as they provide examples and explanations.\footnote{Ibid., page 69.} The aim of the Guidelines is to help companies assess their individual selective distribution agreements to establish how the agreements should be treated according to EU competition law.\footnote{European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 3.}

There is a difference in EU law between hard law and soft law. Article 101 TFEU and the BER constitute hard law while the Guidelines constitute soft law. The importance with this statement is to consider that the Guidelines are not legally binding and in a situation of conflict the BER will prevail over the Guidelines.\footnote{Wijkmans, F, Tuytschaever, F and Vanderelst, A, \textit{Vertical Agreements in EC Competition Law}, first edition, Oxford University Press, Oxford 2006, page 36-37.} Nevertheless the fact that the Guidelines constitute soft law they have an important function in the field of selective distribution systems and other vertical agreements since they set out the principles for the assessment of vertical agreements as defined in the BER.\footnote{European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 1.}

The Guidelines are off and on subject for critique because they might appear to be too hard to use for companies that make use of vertical agreements such as selective distribution systems. The value of the Guidelines should not however be underestimated; they are very important for lawyers and other persons versed in competition law.\footnote{Mendelsohn, M and Rose, S, \textit{Guide to the EC Block Exemption for Vertical Agreements}, page 70.}
3 Selective distribution systems in practice

3.1 Chapter introduction

The aim of this chapter is to determine why companies choose to use selective distribution; in other words the aim is to establish what the reasons are for suppliers to establish selective distribution and for distributors to accept selective distribution including the limitations which it results in. The underlying reasons for selective distribution are strongly connected with what practical consequences selective distribution systems have so these two issues are determined together.

The chapter starts with a brief survey of different distribution alternatives and continues with a more extensive examination of a number of reasons for and consequences of selective distribution. Distributors and suppliers may have widely differing reasons to apply selective distribution and this examination does not claim to be exhaustive. To be able to determine why selective distribution systems are used it is although necessary to establish some justifications which probably are used frequently.

3.2 Different distribution alternatives

It is important both for suppliers and distributors to consider different alternatives of how to organize the distribution of a particular product. Different types of products require different distribution solutions. Other factors, than the characteristics of the products, such as the nature of the market and the size of resources obtainable for the supplier and the distributor respectively can be decisive in the selection of distribution method.\(^{52}\)

A supplier that manufactures a product, which is consumed in large quantities and on daily basis, needs to find a suitable distribution method for the product so that consumers easily can buy it while a product that is not consumed on a daily basis instead requires another distribution method. This distinction appears to be obvious when considering for example how food products, e.g. bread, are distributed compared to the distribution of a branded and exclusive espresso machine. Consumers in general want to purchase food products to prices as low as possible while the same consumers probably regard pre-sale services and satisfactory information about the product more important when purchasing an espresso machine.

Basically there are two different ways of organizing the distribution of goods. The supplier can choose to manage the distribution function itself or engage an independent party to operate the distribution function. Selective distribution agreements belong to the latter alternative. Suppliers commonly prefer to engage free-standing parties to handle the distribution. Distributors in general know more about the market and are probably better enabled to enter markets quickly and effective.\(^{53}\) Both suppliers and distributors need to consider different distribution methods to maintain an efficient and suitable distribution method which maximizes sales and profits.\(^{54}\)


\(^{53}\) Ibid., page 597.

\(^{54}\) Craig, P and De Búrca, G, *EU law: Text, Cases and Materials*, page 990.
It is essential to understand that the reasons for companies to use selective distribution are economic and practical. Selective distribution may improve economic efficiencies both for suppliers and distributors. Selective distribution systems can facilitate the coordination between a supplier and a distributor at the same time as the system can lead to reduced transaction- and distribution costs. The decision to conclude a selective distribution agreement with an opposite party is like all decisions concerning business a question of assessing favourable effects.

3.3 Reasons for and consequences of selective distribution

3.3.1 Why certain products in particular need selective distribution

Suppliers that manufacture either technically advanced products or branded products often introduce selective distribution systems in relation to its distributors. There are probably several reasons that justify the suppliers’ use of selective distribution but one reason is simply that the suppliers consider that selective distribution is crucial for the products they manufacture. The suppliers’ view is that the characteristics of the product require a distribution method that is controlled to a, for the supplier, satisfactory degree. A selective distribution system can assist a supplier to create and protect an image of a brand and thereby make the product more attractive to end-users.

Consider for example supplier X that manufactures the branded product Y. Supplier X wants to maintain and develop the value of the brand. If product Y would be distributed negligently by all possible distributors, including discount stores, the brand would fairly quick lose its value. Supplier X believes that consumers would not associate product Y with desirable exclusiveness and high quality if product Y were not distributed under controlled methods.

3.3.2 Solution to the free-rider problem

Selective distribution systems hinder so called free-riders from taking unfair advantages of other suppliers’ or distributors’ efforts. The prevention of free-riders is beneficial both for suppliers and distributors within selective distribution systems. Free-riding distributors are distributors that take unfair advantages of other distributors’ efforts.

The Guidelines state that a real free-rider problem only arises in relation to promotion activities and services which distributors provide its customers before a purchase. One example of this free-riding problem is when one distributor provides customers with some kind of pre sale service while another distributor does not. The distributor which provides service is compelled to charge its customers more for a product which is sold


57 European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 107 (i).

58 Ibid., paragraph 107 (a).

59 Ibid.
to a lower price by the distributor that does not provide any service. In such cases customers tend to go to the service-providing distributor to get the wanted information about the product but afterwards turn to the distributor that has the lower price to actually buy the product. This latter distributor is the one that gets the profit but at the expense of the service-providing distributor; the latter distributor free-rides on the service-providing distributor.

The problem with free-riders can be solved by selective distribution. Selective distribution agreements are advantageous in this regard directly for distributors and indirectly for suppliers. Selected distributors of selective distribution systems are permitted to sell the product only to other selected distributors of the same system and to end-users; no distributors will be able to sell the product as long as they do not become a party to the agreement. Further, this means that all distributors that sell the product must use some of its resources to attain the different criteria and no distributors will be able to sell the product to a lower price just because of the absence of these costs. Distributors may consider the prevention of free-riders, as a consequence of selective distribution systems, so valuable that it is worth the efforts laid down to become a part of a system. In other words, the prevention of free-riders benefits distributors of selective distribution systems directly.

Suppliers benefit, although indirectly, from the consequence that selective distribution prevents free-riders. It is already stated that suppliers consider the requirements of its selective distribution necessary for e.g. maintaining a good reputation of the brand of a product. The consequence that selective distribution agreements prevent free-riders is beneficial for suppliers since not many, if any, distributors would accept to fulfil the requirements in an agreement unless the agreement would result in a prevention of free-riders. Selective distribution agreements would probably not exist to any large extent if the agreements were not able to prevent free-riders. Conclusively, what is good for one party of a selective distribution agreement is in this regard good also for the other party.

3.3.3 Increased profits

Selective distribution systems can lead to increased profits for companies. Selective distribution can for example minimize distribution costs for suppliers since the suppliers’ resources can be used more effectively through selective distribution systems. Selective distribution can also increase sale profits for distributors. Normally, products that are either technically advanced or branded are distributed through selective distribution systems. Distributors that sell branded or technical products of high quality are most


likely regarded as attractive by consumers and an increased attractiveness may result in increased sale profits. Whether or not profits actually increase depend on different factors in each case. However, selective distribution agreements in general minimize distribution costs and increase sale profits.

Selective distribution may also be profitable, both for suppliers and distributors, since local selected distributors often have better knowledge about which the customers on the local market are and what those customers demand regarding for instance information about products.\textsuperscript{64} Selected distributors may basically be better suited to make the most of the resources laid down in the distribution of a certain product.

3.3.4 Less intra-brand competition

Selective distribution systems result, among other things, in reduced intra-brand competition. Less intra-brand competition is regarded as a disadvantage for the internal market but is at the same time one common justification for suppliers to establish selective distribution systems and for distributors to accept the same.\textsuperscript{65}

Suppliers probably consider this consequence, decreased intra-brand competition, as beneficial since selective distribution in this regard results in fewer distributors and consequently better chances to uphold a desired degree of control of the distribution chain. Selective distribution becomes a legal tool for suppliers to limit intra-brand competition. Moreover, selective distribution systems may prevent distributors as discount stores from distributing a certain product; this is a consequence which many suppliers would say is an advantage of great importance. Selective distribution is an appropriate method to avoid pressure from price discounters.\textsuperscript{66}

Supplier X wants the branded product Y to be distributed by high qualitative distributors and especially not by large discount stores that are parts of nationwide chain stores. Supplier X assumes that both the price and the reputation of product Y would decrease if discount stores were able to distribute the product. Supplier X’s purpose of its selective distribution system is to maintain the good reputation of product Y; it is therefore essential for supplier X in its decision-making that intra-brand competition decreases as a result of the system.

Distributors regularly compete with each other by offering reduced sale prices to customers. Less intra-brand competition implies a lower degree of competition between distributors, which distribute a product organized by selective distribution, which in the long run results in that it becomes less necessary for the distributors to compete against each other by reduced prices. It is beneficial for a supplier if its distributors do not have to compete with each other through low prices. A supplier’s brand may be affected unfavourably by unstable and reduced prices since consumers might regard that brand as less exclusive.

\textsuperscript{64} Marsden, P and Whelan, P, Selective distribution in the age of online retail, European Competition Law Review 2010, 31 (1), page 27.

\textsuperscript{65} European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 100.

\textsuperscript{66} Ibid., paragraph 178.
Authorized distributors of selective distribution systems consider the effect of less intra-brand competition as beneficial as suppliers do. Conclusively, the fact that selective distribution results in less intra-brand competition may function as a justification, both for suppliers and distributors, which motivates employment of selective distribution.

3.3.5 Possibility to open up new geographical markets

Selective distribution agreements are beneficial for suppliers that want to enter new geographical markets with its product. Entrance on a new market most likely requires some extra investments from suppliers that need to find distributors that are willing to distribute but also from distributors that endeavour to distribute at the new market. It is probably necessary for a supplier that aims to enter a new market with its product to be able to provide potential distributors the beneficial consequences of selective distribution. Not many potential distributors are prepared to invest resources in distributing a product on a new market unless they are guaranteed some protection.

The possibility to open up new markets, which is a consequence of selective distribution, motivates for sure suppliers to introduce selective distribution systems. However, this effect of selective distribution is beneficial also for distributors that want to enlarge its distribution area.

3.4 A selective distribution system as a win-win situation

Selective distribution systems become beneficial for suppliers and distributors respectively when they manage to cooperate within an agreement. One party of a selective distribution system will not benefit if the other party does not. This is why selective distribution can be regarded as constituting a win-win situation.

The selective distribution system of supplier X, which aims to maintain the good reputation of its branded product Y, would not be very successful for any party if distributors A, B and C would not benefit as much as they regard necessary. If distributors A, B and C consider that the system does not imply enough advantages they will in all probability terminate the agreement as soon as they are permitted. Therefore, it is crucial for supplier X to formulate its system, including the criteria, in a way that gain the distributors as much as necessary for them to stay within the agreement. Supplier X is dependent on distributors A, B and C and the distributors are dependent on supplier X.

Vertical agreements, such as selective distribution agreements, are in general less harmful to the market than other agreements concluded between undertakings that operate at the open market. One reason why selective distribution agreements are regarded as less harmful is because the parties are dependent upon each other. In other words, there is no cause for one party of the agreement to act anti-competitively towards the other party. This is another way to express the reciprocal relation between a supplier and a distributor that have concluded a selective distribution agreement.

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67 European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 107 (b).
68 Ibid., paragraph 98.
3.5 Final remarks regarding selective distribution in practice

The practical use of selective distribution systems is widespread amongst suppliers that manufacture final branded products. Suppliers which sell final branded products to distributors through selective distribution agreements can by that reason presuppose that its competitors also apply selective distribution. Furthermore, when a supplier in a certain industry applies selective distribution it might be assumed that more suppliers that manufacture the same type of product apply the same distribution method. This means that also suppliers that manufacture other types of products, than final branded ones, through selective distribution may assume that its competitors apply selective distribution systems. These statements indicate that selective distribution in general is a commonly used distribution method.

Vertical agreements, such as selective distribution agreements, tend to be more pro-competitive and positive from an efficiency aspect rather than just anti-competitive. There is nothing that indicates that the practical use of selective distribution systems will decrease. Suppliers and distributors will probably henceforth derive advantages from the use of selective distribution systems.

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4  The new BER and the new Guidelines

4.1  Chapter introduction

The aim of this chapter is to analyse how selective distribution will be affected by the new BER and the new Guidelines which enter into force 1 June 2010. In other words, the aim is to determine how companies that use selective distribution in its businesses will have to change its selective distribution systems to comply with the new set of rules.

The chapter starts with a brief presentation of selective distribution in a historical sense. This is to give the reader a short introduction of how selective distribution has developed. The chapter continues with an examination of the new BER and the new Guidelines. The different changes that modify the use of selective distribution are examined particularly. The position on selective distribution in general is analysed in the end of the chapter.

4.2  Selective distribution in a historical sense

Selective distribution systems were block exempted from the prohibition laid down in Article 101 (1) TFEU first time when the former BER entered into force on 1 January 2000. Before that time selective distribution agreements were exempted one by one through decisions made by the Commission. A more economic and effects-based approach to selective distribution was adopted through the former BER. When the former BER entered into force the treatment of selective distribution became less formalistic and the burden of proof for companies that used selective distribution systems diminished. The Commission admits in the former BER the positive economic effects of vertical agreements, such as selective distribution agreements, and states that it is likely that the positive effects of vertical agreements outweighs the anti-competitive effects.

Ten years has gone since the new economic approach to selective distribution was introduced and even though the former BER has been successful a revision is necessary. Vertical agreements exist in huge numbers and it is of importance both for business and consumers that the rules are being revised.


75 IP/10/445, Antitrust: Commission adopts revised competition rules for distribution of goods and services, Brussels, 20 April 2010.
4.3 Selective distribution systems after the revision

4.3.1 The amendments in general

The Commission has amended the new BER and the new Guidelines in the light of the development the last decade.\(^{76}\) Two main changes are noticed that affect the content of the new legislative documents. Firstly, it is established that many distributors have obtained larger market shares and thereby increased its buyer powers. Secondly, it is stated that Internet sales have increased largely. These two observations are two main reasons for the modification of the new BER and Guidelines as compared to the corresponding former versions.\(^{77}\)

The basic principles of the former BER and Guidelines remain the same in the new BER and Guidelines.\(^{78}\) Even though the new BER and Guidelines in many aspects are identical to the former versions the present changes are noticeable for several companies and their selective distribution systems.

4.3.2 Overall clarifications

It seems like the new BER and the new Guidelines seek to clarify different principles and definitions which were more unclear in the former legislative documents. The different definitions are gathered in one place in the new BER instead of spread into different sections of the regulation as it was in the former BER.\(^{79}\) For example, the definition of vertical agreements was, in the former BER, given after and in another article than the definition of selective distribution. It is fundamental to understand that selective distribution agreements are concluded vertically. The BER is not at all applicable to agreements that are not considered as vertical. The clarification in the new BER may facilitate this basic understanding.

An additional clarification is a sentence that is added in the preamble to the new BER and that elucidates that there is no presumption that agreements that fail to fulfil the market share rule shall be regarded as prohibited according to Article 101 (1) TFEU or that these agreements shall be deemed unable to fulfil the requirements of Article 101 (3) TFEU.\(^{80}\) This statement involves nothing new but it clarifies the relation between Article 101 TFEU and the new BER.

\(^{76}\) IP/10/445, Antitrust: Commission adopts revised competition rules for distribution of goods and services, Brussels, 20 April 2010.


\(^{78}\) IP/10/445, Antitrust: Commission adopts revised competition rules for distribution of goods and services, Brussels, 20 April 2010.


\(^{80}\) Ibid., preamble (9).
The Commission has got some criticism for the length and the many details of the former Guidelines.\(^81\) The critic composes of opinions on for example the practical examples which the Commission has included in the Guidelines. It is said that the Guidelines sometimes confuse more than explain. The Commission has not changed the general impression of the new Guidelines so the criticism will most likely continue to exist. However, the overall clarifications probably make the new BER easier to understand.

### 4.3.3 Market share rule

The former BER consists of a market share rule which states that the market share of the supplier must be lower than 30 percent on the relevant market in order for the vertical agreement, in which the supplier is a contracting party, to be exempted from the prohibition of Article 101 (1) TFEU.\(^82\) Many distributors’ market shares have increased during the last decade and this is the reason why the market share rule in the new BER differs from the rule in the former BER. The exemption provided for in the new BER applies, from 1 June 2010, to selective distribution agreements, as well as other vertical agreements, as long as the market share of the supplier is below 30 percent of the market on which the goods are sold and as long as the market share of the distributor is below 30 percent of the market on which the distributor purchases the goods.\(^83\) Thus, the new BER consists of a limitation on the market share of the supplier as well as a limitation on the market share of the distributor.

It is assured that the market share rule is amended due the fact that many distributors are more powerful today, than ten years ago, but the underlying meaning of why the rule is modified as a consequence of this is not clarified. The following is although a possible explanation of the modification of the rule.

Whether or not the negative anti-competitive consequences of selective distribution, such as the reduction of intra-brand competition, shall be regarded as outweighed by the positive consequences depends, according to the former BER, on the level of market shares held by the supplier. As long as the conditions set out in the former BER are fulfilled the Commission presumes that the positive consequences prevail over the negative aspects.\(^84\) Although, the reduction of intra-brand competition, which selective distribution agreements lead to, impact trade to a larger extent in cases where inter-brand competition is low. The negative consequences with selective distribution dominate irrespective of which party of a selective distribution agreement that has large market shares. Consequently, the Commission states in the new BER that the likelihood that the positive effects of selective distribution dominate is due to the level of market shares of

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either party of the agreement. There was, when the former BER entered into force, simply no rationale for this wider market share rule which now has become necessary because of the current development of many distributors.

To return to the example of supplier X and product Y; the market share rule in the new BER affects the selective distribution agreement between supplier Y and the distributors A, B and C respectively since the exemption of each agreement from the prohibition laid down in Article 101 (1) TFEU depends on the market share that each distributor holds as well as the market share of supplier X. As regards the market share of the distributors it is their market shares on the market on which they purchase product Y that is decisive.

The former Guidelines state that vertical agreements such as selective distribution agreements may have effects on the market downstream of the distributor. The market downstream of the distributor is the market on which the distributor sells the products to its customers. The opposite, the market upstream of the distributor, is the market on which the distributor buys the product from the supplier. It is apparent that selective distribution systems have effects on the market upstream of the distributor since the essential feature of selective distribution is that some distributors are selected and some distributors are not allowed to distribute. The whole concept with selective distribution is to affect the relationship between a supplier and the possible distributors. However, the Commission comments in the former Guidelines that the simplified approach of the former BER, to consider merely the market share of the supplier, makes the application of the block exemption easier and increases legal certainty. The Commission moreover explains that the market downstream of the distributors is affected only to a limited extent where the market share of the supplier is no more than 30 percent. Consequently, selective distribution may have effects on the market downstream of the distributor but a block exemption that is easy to apply and the high level of legal certainty are to be considered so fundamental that the small effects on the market downstream of the distributor shall be disregarded.

The draft of the new BER, which was published in July 2009, proposed a more restrictive market share rule than both the rule in former BER and the market share rule implemented in the new BER. According to the draft both the supplier’s and the distributor’s market share should be decisive for an exemption of the agreement. This more restrictive formulation in the draft made no distinction between the markets upstream or downstream of the distributor. In other words, it was suggested that the exemption provided for in the BER should not apply to agreements where the market share of the

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87 Ibid.

distributor, either on the market in which the distributor acts as a buyer or on the market in which the distributor sells the products, was higher than 30 percent.

The proposal in the draft regarding the market share rule has been seriously criticized in submissions written by persons and organizations working with competition law. A common opinion is that a market share rule that considers both the upstream and the downstream market share of distributors would be far too complex and give rise to practical problems. The practical problems would consist of difficulties in defining the market between the distributor and the customers.\(^89\)

Several submissions declare that the market share limit according to the former BER was justified and in general accepted by suppliers and distributors that make use of selective distribution systems. Several submissions also declare that that reason cannot be used to defend the market share rule in the draft. It was suspected that the restrictive rule should not have been accepted by suppliers and distributors. Another common opinion in the submissions is that such a formulation, as occurred in the draft, would be in opposition to the practical and economic approach which the Commission adopted through the former BER.\(^90\)

It is likely that the Commission modified its position towards a less restrictive approach of the market share rule in the new BER, compared to the suggestion in the draft, because of the large quantity of submissions that noticed the possible complications. One legitimate question to ask in connection to this is if the Commission considered to abandon the view that a simplified approach of the market share rule is motivated because it leads to high level of legal certainty and a block exemption that is easy to apply. The section of the former Guidelines in which the Commission states the value of easy applicable rules and high legal certainty is deleted in the new Guidelines. This indicates that the answer to the question if the Commission might consider to abandon this view should be in affirmative. Although, the concept of easy applicable rules is very fundamental and it is not very likely that the idea is totally neglected.

The solution of the market share rule in the new BER is probably suitable since it would impact too much on trade to exempt selective distribution agreements from the prohibition of Article 101 (1) TFEU regardless the market shares of the distributors. The new market share rule is most likely a good compromise between the requirement of a block exemption that is easy to apply and the demand of undistorted competition.

The modification of the market share rule affects selective distribution agreements in practice. Suppliers and distributors that already use selective distribution must estimate not only the market share of the supplier but also the market share of the distributor. The change is although not entirely negative for companies on the market. The new rule is for example beneficial for smaller distribution companies since it might be regarded


as convenient for a supplier to conclude selective distribution agreements with distributors whose market shares clearly are lower than 30 percent.

### 4.3.4 Increased online sales

The growth of distribution on the Internet the last ten years is reflected in the new Guidelines. The Commission deals in the new Guidelines with the effects of this development in connection with the survey of hardcore restrictions. The approach towards the Internet as a distribution method seems in general to be positive. The Commission regulates the relation between selective distribution systems and distribution on the Internet through details of which criteria in selective distribution systems that shall be regarded as allowed and which criteria that shall be regarded as hardcore restrictions.

The wording of the new BER is not affected by the new and changed provisions of the new Guidelines. Nevertheless, the meaning of the new BER is affected by the changed provisions since the function of the Guidelines is to provide more information about selective distribution systems and other vertical agreements. The Guidelines is of great importance to the treatment of selective distribution and that is furthermore also an explanation of why the meaning of the new BER is affected by the new Guidelines. The modification of the new Guidelines due to the increased online sales is significant for the practical approach to selective distribution systems.

The Commission states, in the new Guidelines, that every distributor shall remain free to use the Internet for selling. The Internet is a powerful tool for companies that perform selling activities. The new Guidelines also regulate that suppliers of a selective distribution system have, despite the assertion that every distributor shall remain free to use the Internet, a right to require quality standards from distributors which intend to distribute online. Firstly, a supplier is allowed to initiate a criterion in its selective distribution system that requires distributors to carry on trade in one or more brick and mortar shop and secondly, a supplier is allowed to initiate some requirements regarding the distributor’s website.

The new Guidelines also contain information about some criteria that shall be treated as hardcore restrictions when they restrict the distributor’s passive sales and when they limit the distributor in reaching new and various customers. Two of these restrictions apply to selective distribution. The consequence for selective distribution agreements that contain hardcore restrictions is that the BER does not apply to the agreements. The result is in other words that such agreements do not possess the benefit of the block exemption.

According to the first restriction, it is not allowed to include, in a selective distribution agreement, a clause in which a supplier and a distributor agree upon limitations of the distributor’s online sales in proportion to the overall sales. This statement does not in-

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91 European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 52.

92 Ibid., paragraph 54.

93 Ibid., paragraph 52.

clude prevention of clauses in which a supplier demands a distributor to sell minimum a fixed amount of products offline. A clause in which a supplier demands distributors to fulfil the criteria of a selective distribution system irrespective of distribution method is also allowed.\(^95\)

For supplier X this statement in the new Guidelines implies that supplier X is not allowed to initiate in its selective distribution system the demand that the distributors must sell at least 80 percent of the total amount of product Y in its brick and mortar shops. On the other hand, supplier X is allowed to introduce a clause in which supplier X requires the distributors to sell at least 80 examples of product Y in its brick and mortar shops irrespective of how many examples that are distributed online. Supplier X may also settle that the criteria in the agreement, e.g. the requirement of some pre- and after sale services, must be fulfilled by the distributors irrespective of if product Y is being sold online or offline.

According to the second restriction, a supplier and a distributor are not allowed to conclude that the distributor shall pay higher prices for products which the distributor intends to sell online compared to products intended to be resold in a brick and mortar shop. The contracting parties are however free to decide that the supplier shall support the distributor’s efforts in offline alternative online sales by paying a fixed fee to the distributor.\(^96\)

These two alternatives of the second restriction, the one prohibited and the other allowed, might appear identical. To charge a distributor higher price for each product which is intended to be sold via the Internet implies consequently that the distributor pays less for products sold in a shop. The substance of this is that the total price the distributor shall pay depends on the proportion of online respective offline sales. The restriction that is allowed contains on the contrary a fixed fee. Even if a supplier chooses to set up a clause in its selective distribution system that supports selected distributors with a fee the fee is of same value irrespective of the quantity of products that actually are sold in brick and mortar shops. The supplier must in that case support the distributor with the fee without any guarantee of the product being sold in a brick and mortar shop. The difference between these two clauses is thus that the total price of the prohibited restriction is proportional while the fee is fixed irrespective of the outcome. Presumably, a criterion in a selective distribution agreement whereby a distributor’s total cost price is dependent on the proportion of Internet sales would affect the distributor’s choice of selling method more than a criterion whereby a supplier support a distributor’s selling in a brick and mortar shop by a fixed fee.

Supplier X is not allowed to initiate a criterion in the selective distribution system meaning that distributors A, B and C shall be charged 1000 Euro (EUR) for every product Y the distributors intend to sell in its shops while the price for the same product intended to be resold online shall be 1200 EUR. The differences in cost price for the distributors have greater impact when the distributors are able to charge 1250 EUR from its customers for every product Y as compared to the situation if the selling price of the distributors is 1500 EUR. Irrespective of cost and selling prices; a criterion in which a total cost price depends on the volume of online sales has a large impact on the distribu-

\(^95\) European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 52 (c).

\(^96\) Ibid., paragraph 52 (d).
tors in its decision making and is therefore not allowed. On the other hand is supplier X allowed to support each distributor by paying each distributor 1600 EUR for its efforts in sale in a brick and mortar shop.

It is clear from the wording in the new Guidelines that the Commission regards these two restrictions as hardcore only if they restrict distributors’ passive sales. On the other hand, this means that for example a restriction to charge distributors higher prices for products which the distributors intend to actively sell online still is allowed. As a consequence of this it is necessary to examine the conception of active and passive sales. The Commission is not completely clear in its reasoning regarding this issue in the new Guidelines. The Commission admittedly describes that for example the act of contacting customers by direct mails, including unsolicited mails, shall be regarded as active selling while passive sales are for instance the responding of unsolicited mails from customers. Further, advertisement on the Internet approached to special customer groups is regarded as active selling. From e.g. articles published in journals, which consider the introduction of the new BER and Guidelines, and from the former Guidelines it becomes clear that the Commission probably anticipates sales on Internet as passive selling in general. This approach is not noticeable in the new Guidelines unless the definitions of passive and active sales are examined carefully at the same time as the reader considers that the enlarged details of restrictions which shall be regarded as hardcore would lose its importance if online sales were not considered as passive.

One interesting topic to discuss in connection to the statement that every distributor shall remain free to use the Internet for distribution is if and how different criteria of selective distribution systems may prevent the possibilities for distributors that connect to such systems to use the Internet as a distribution channel. It is established that suppliers are not allowed to completely prohibit its distributors from selling online but it is essential to examine to what extent a supplier is able to formulate a selective distribution system so that the proper possibility to sell online in reality is negligible. This matter is not, as far as is known, discussed in the new Guidelines.

Ultimately, it is crucial that the Commission wants that parties of selective distribution agreements shall be able to benefit from all the positive aspects with online sales at the same time as it is important to preserve the positive effects of selective distribution. Online sales sometimes oppose selective distribution and vice versa. The balancing between to satisfy distributors, allow them to benefit from positive results of online sales, and to protect the good outcomes of selective distribution is complicated.

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97 European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010, paragraph 52.

98 Ibid., paragraph 51.

4.4 Final analyse of the amendments of selective distribution

The formulation of the market share rule in the new BER is probably a good solution to the development of distributors that becomes larger. For a long time it has been accepted that suppliers that have too large market shares shall not be allowed to benefit from the group exemption of the BER. Presumably, the new market share rule will be accepted basically on the same reason. Companies that have large market shares are sufficient powerful without the advantages of the BER.

Moreover, the modification of the market share rule influences e.g. the new Guidelines’ interpretation of Article 101 TFEU. The formulation of the provision, in which the relation between Article 101 TFEU and the BER is determined, was earlier that competition concerns arise when inter-brand competition is insufficient. The new Guidelines instead state that competition concerns occur when there is insufficient competition, irrespective of in which level of trade the competition is insufficient. Thus, competition concerns arise more easily according to the new interpretation. It might be presumed that this new formulation affects Article 101 TFEU but it is significant to observe that Article 101 TFEU is still applicable on selective distribution agreements as soon as the agreements, indirect or potential, affect trade between Member States. The consequence of the modified market share rule has in this regard not much effect on the interpretation of Article 101 TFEU since the Guidelines constitute soft law.

It is reasonable to say that the Commission in general holds a tolerant approach towards selective distribution systems. The new market share rule is not an expression of a less tolerant approach but rather an action necessary due to the development of distributors’ market shares the last decade.

The statements by the Commission in the new Guidelines regarding the increased online sales will probably raise different issues. One question that may arise is how the statement that every distributor must be able to distribute online shall be fulfilled when a selective distribution system contains e.g. a criterion which demands the distributor to dedicate a settled area in a shop to a certain product. It is hard to understand how that criterion shall be achievable when considering online sales.

Another aspect of the increased online sales which can raise different issues is the fact that suppliers which distribute its products by selective distribution normally want to secure that the products are sold through controlled distribution methods. Sales on the Internet are by nature harder to control than sales in brick and mortar shops. All suppliers are probably not content with the Commission’s statements about online sales and this may result in that those suppliers that deviate from the use of the Internet also deviate from the use of selective distribution. The last decade’s development on Internet sales consequently affects the use of selective distribution systems.

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It is reasonable that the Commission wants that companies, as well as consumers, shall be allowed to benefit from the advantages of online sales. Thus, online sales are effective and in many ways advantageous. It remains to discover whether or not the statements in the Guidelines will be accepted by undertakings that use selective distribution.

Well-developed and clear formulated BER and Guidelines probably result in less friction between parties of selective distribution agreements. The new BER and the new Guidelines are amended in the light of the development the last decade and additional amendments will be necessary henceforth.
5 Conclusions

The practical use of selective distribution systems is described and examined in this thesis. Firstly, the concept of selective distribution system is described. Selective distribution is formed through agreements between suppliers and distributors and might appear beneficial solely for suppliers. A supplier is e.g. able to ensure high standard of a distribution process by using selective distribution. However, selective distribution agreements need to imply some benefits for both parties of an agreement or else the party which does not benefit will not accept the agreement.

Secondly, different consequences of and justifications for selective distribution are established. Suppliers and distributors have different reasons to apply selective distribution. Justifications that probably are used frequently are that selective distribution functions as a solution to the free-rider problem, that selective distribution can minimize distribution costs and increase sale profits and that selective distribution creates a possibility for suppliers to enter new markets. Moreover, selective distribution is commonly used by suppliers that manufacture technically advanced or branded products. Suppliers in general may consider that a controlled distribution method, such as a selective distribution system, is crucial for those types of products.

Selective distribution can be regarded as a win-win situation between a supplier and its distributors. The parties of a selective distribution agreement are dependent upon each other meaning that one party will not benefit from the agreement unless the other contracting party also benefits. This characteristic of selective distribution is one reason why selective distribution agreements in general are regarded as less harmful to the undistorted competition than other agreements concluded between operators on the open market. The relation between a supplier and a distributor of a selective distribution agreement is reciprocal; there is no motive for any party to act anti-competitively towards the other party.

Thirdly and finally, the effects of the new BER and the new Guidelines that affect selective distribution systems are examined. The practical use of selective distribution systems is affected foremost by a modification in the new BER of the market share rule and changes in the new Guidelines, regarding hardcore restrictions, due to the growth of Internet sales the last decade.

The Commission proposed in the draft of the new BER a market share rule which considered the distributors’ market shares with no distinction between the markets upstream or downstream of the distributors. It is likely that the Commission modified its position and adapted a less restrictive market share rule in the new BER because of the substantial critic the proposal was exposed to. The idea that a simplified approach of the market share rule is motivated since it results in high legal certainty and a block exemption that is easy to apply is probably not totally neglected. The formulation of the market share rule in the new BER is most likely a suitable compromise. It is generally accepted that undertakings with too large market shares are sufficient powerful without the advantages of the BER. Presumably, the new market share rule will be accepted basically on the same reasons as the former market share rule.

The approach of the Commission towards online distribution seems in general to be positive. For example, the new Guidelines state that every distributor shall remain free to use the Internet for selling. Even though it is likely that the new market share rule
will confront little difficulties; the statements in the new Guidelines regarding the increased online sales will probably raise different concerns. One question is how a criterion in a selective distribution system that demands distributors to dedicate a settled area in its shops for the distribution of a certain product is achievable when considering online sales.

Another concern which the provisions, regarding Internet sales, of new Guidelines may result in is that some suppliers may deviate from using selective distribution. All suppliers are probably not content with the Commission’s statements in the new Guidelines regarding Internet sales.

To sum up, it is reasonable to say that the Commission in general holds a tolerant approach towards selective distribution systems. The amendments of the new BER and the new Guidelines do not appear as expressions towards a less tolerant approach but rather amendments necessary because of developments the last decade.
List of references

Treaties
Treaty on the Functioning of the European Union, consolidated text, OJ C 83, 30.3.2010

Regulations
Regulation No 19/65/EEC of 2 March of the Council on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices, OJ 36, 6.3.1965

Guidelines
European Commission, Guidelines on Vertical Restraints, OJ C 130, 19.5.2010
Communication from the Commission, Notice, Guidelines on the application of Article 81 (3) of the Treaty, OJ C 101, 27.4.2004

European case law

Other documents
IP/10/445, Antitrust: Commission adopts revised competition rules for distribution of goods and services, Brussels, 20 April 2010
Public Consultation, Review of the Competition Rules Applicable to Vertical Agreements, Observations submitted by the European Team of the Law Firm Contrast, available on

**Book sources**


**Article sources**


Appendix 1
Treaty on the Functioning of the European Union, consolidated text, OJ C 83, 30.3.2010

Article 101
(ex Article 81 TEC)

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.

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.