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Ban on online sales: a crime of lese-majesty?! (Judgement of the CJEU dated October 13, 2011)

As mentioned in our May 2011 e-newsletter, legal practitioners and leaders of selective distribution networks eagerly awaited the decision of the Court of Justice of the European Union (hereinafter "CJEU") in response to a request for a preliminary ruling that had been referred to it on November 10, 2009 by the Paris Court of Appeals in the Pierre Fabre Dermo-Cosmétique case (hereinafter "PFDC"). The question was worded as follows:

"Does a general and absolute ban on selling contract goods to end-users via the Internet, imposed on authorized distributors in the context of a selective distribution network, in fact constitute a "hardcore" restriction of competition by object for the purposes of Article 81(1) EC which is not covered by the block exemption provided for by Regulation 2790/1999 but which is potentially eligible for an individual exemption under Article 81(3) EC?".

We could legitimately expect a clear answer to this question on October 13, 2011 when the CJEU rendered its decision[1]. Yet, unfortunately, this decision left us somewhat unsatisfied…

Indeed, the CJEU seemed to overlook the true issue, in practical terms, associated with the request for a preliminary ruling. Even the theoretical response provided by the CJEU is far from being completely satisfactory and, intellectually speaking, leaves us with a feeling of frustration.

As a matter of fact, the CJEU failed to serve as a "guide" and leaves the Paris Court of Appeals with the difficult task to settle alone the question of the lawfulness of the clause prohibiting online sales imposed by PFDC. The stakes are momentous and it is not exaggerated to say that the fate of selective distribution

networks lies in the hands of the referring jurisdiction.

As a result, we just have to wait, again, for the forthcoming judgment of the Paris Court of Appeals…

After recalling the terms of the decision of the *Autorité de la concurrence* (French Competition Authority) dated October 29, 2008[2] that found the clause inserted by PFDC in its general terms of sale[3] to be a "*restriction of competition violating Article 81 TEC and Article L.420-1 of the French Commercial Code*", the CJEU decided to respond to the Paris Court of Appeals' request for a preliminary ruling in a three-stage reasoning process, just like the Advocate General did in his opinion.

1) First stage: Does the ban on online sales imposed by PFDC in its general terms of sale constitute a "hardcore restriction" within the meaning of Article 101§1 TFEU (formerly Article 81 TEC)?

As a preliminary remark, the CJEU corrected the wording of the request for a preliminary ruling referred to it by the Paris Court of Appeals by recalling that the concept of "hardcore" restriction exists neither under Article 101 TFEU nor under Regulation 2790/1999 on block exemptions. These EU texts only refer to the concept of restriction of competition "by object" *(*as opposed to a restriction of competition "by effect").

This semantic correction being made, the CJEU, on the issue of the qualification of "restriction of competition by object", recalled that its role is limited to providing points of interpretation of European Union law and that, in any event, "*it is for the referring court to examine whether the contractual clause at issue prohibiting de facto all forms of internet selling can be justified by a legitimate aim" (#42 of the CJEU's judgment).*

While the CJEU did not concretely rule on the relevant clause, it seems that this clause does not stand a chance: the reference to European Union law appears to be solely aimed at convincing the Paris Court of Appeals that the clause imposed by PFDC constitutes a restriction of competition "by object" (which is, by essence, one of the most serious forms of restriction of competition).

Even though it considered that "*under Pierre Fabre Dermo–Cosmétique's selective distribution system, resellers are chosen on the basis of objective criteria of a qualitative nature, which are laid down uniformly for all potential resellers*" (#43 of the CJEU's judgment*),* the CJEU, however, implied that clauses 1.1 and 1.2 of PFDC's general terms of sale (prohibiting *de facto* online sales) were disproportionate with regards to what is required for the protection of the quality of the relevant products and the proper use thereof.

To support its reasoning, the CJEU referred to two decisions concerning the sale of non-prescription medicines[4] and contact lenses[5] under which it did not accept "*in the light of the freedoms of movement, arguments relating to the need to provide individual advice to the customer and to ensure his protection against the incorrect use of products*" (#44 of the CJEU's judgment*).*

On this specific point, it seems a bit strange to ground the rejection of arguments intended to establish that the restriction of competition pursues legitimate aims "*in the light of the freedoms of movement"!* Does the

preservation of the freedoms of movement within the EU territory necessarily follow the same criteria as the protection of competition? We can reasonably doubt it.

In addition, the CJEU considered that maintaining a prestigious image of the products was not a legitimate aim for restricting competition.

As such, the CJEU used a cryptic formula to try and drive the Paris Court of Appeals into considering that the clause in question was constitutive of a "restriction of competition by object", unless "*following an individual and specific examination of the content and objective of that contractual clause and the legal and economic context of which it forms a part, it is apparent that, having regard to the properties of the products at issue*" that clause is objectively justified (#47 of the CJEU's judgment).

The Paris Court of Appeals is thus not much further ahead today than it was at the time it raised the request for a preliminary ruling…

2) Second stage: In the event the relevant clause constitutes a restriction of competition "by object", can it benefit from the block exemption?

In this respect, the CJEU recalled that pursuant to Articles 2 and 3 of Regulation 2790/1999, the leader of a selective distribution network may be eligible to a block exemption insofar as its market share does not exceed 30%. Precisely, the CJEU, in #11 of its judgment, specified that PFDC held a market share of 20%.

Yet, the CJEU pointed out that, in any event, the relevant anti-competitive practice did not fall within the clauses referred to in Article 4 of Regulation 2790/1999, such so-called "black" clauses entailing automatically the exclusion from the benefit of the block exemption, irrespective of the market share held by the company that applied such practice.

"Black" clauses include clauses that, under Article 4(c) of Regulation 90/1999, "*have as their object the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorized place of establishment*".

When developing its argumentation, PFDC tried to show that prohibiting de facto online sales ought in fact to be regarded as prohibiting members of the selective distribution system from operating out of an unauthorized place of establishment, which is tolerated under Article 4(c) of Regulation 2790/1999.

The CJEU rejected this interpretation and considered that the expression "*out of an unauthorized place of establishment*" only concerned "*outlets where direct sales take place*". Yet, the CJEU was not as radical as the Advocate General who had considered in his opinion that the Internet was not an "*establishment*" but rather a "*means of marketing goods and services*". The CJEU held that "*the question that arises is whether that term can be taken, through a broad interpretation, to encompass the place from which internet sales services are provided*" *(#56* of the CJEU's judgment*).*

However, fearing having to make a further analysis on this question, the CJEU dodged the issue and considered that, since companies have the option to assert, on an individual basis, the applicability of the individual exemption provided for in Article 101(3) TFEU, "*it is not necessary to give a broad interpretation to the provisions which bring agreements or practices within the block exemption*".

As such, it concluded that "*a contractual clause, such as the one at issue in the main proceedings, prohibiting de facto the Internet as a method of marketing, cannot be regarded as a clause prohibiting members of the selective distribution system concerned from operating out of an unauthorized place of establishment within the meaning of Article 4(c) of Regulation 2790/1999" (# 58* of the CJEU's judgment*).*

3) Third stage: Can the relevant clause benefit from an individual exemption under Article 101§3 TFEU?

Here again, considering that it was not in a position to verify whether the requirements set forth in Article 101§3 TFUE[1] were met in this specific case to allow an individual exemption, the CJEU indicated that it did "*not have sufficient information before it to assess whether the selective distribution contract satisfies the conditions in Article 101(3) TFEU*" and that it was "*unable to provide further guidance to the referring court*" *(# 50* of the CJEU's judgment*).*

It is therefore up to the Paris Court of Appeals to make all useful researches to grant, as the case may be, to PFDC the benefit of the individual exemption.

As a result, the referring court will, alone, rule on the lawfulness of the *de facto* ban on online sales imposed by PFDC.

In any case, there are growing fears that PFDC will ultimately be ordered to accept the sale of its products online by its distributors… which could be a severe blow to selective distribution networks as a whole because it would only leave them with a residual possibility to restrict the conditions of online sales.

What will be the ruling of the Paris Court of Appeals – especially since it had indicated, in its decision of October 29, 2009, that PFDC had raised "serious arguments" to defend its position?

Will the Paris Court of Appeals be able to resist the pressure imposed by the French Competition Authority, the European Commission and now the Court of Justice of the European Union, all of them suggesting that a clause banning online sales within a selective distribution network should be considered as a breach of Article 101 TFEU and Article L.420-1 of the French Commercial Code?

The suspense is at its peak…

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[1] CJEU, case C-439/09 concerning a reference for a preliminary ruling under Article 234 EC from the Paris Court of Appeals, made by decision of October 29, 2009, received at the CJEU on November 10, 2009, in the

proceedings.

[2]French Competition Authority's decision n°08-D-25.

[3]As a reminder, Article 1.1 of the general terms of the distribution contracts requires each distributor "*to supply evidence that there will be physically present at its outlet at all times during the hours it is open at least one person specially trained … to give on-the-spot advice concerning sale of the [PFDC] product that is best suited to the specific health or care matters raised with him or her, in particular those concerning the skin, hair and nails. In order to do this the person in question must have a degree in pharmacy awarded or recognized in France*". Article 1.2 states that the products concerned may be sold only "*at a marked, specially allocated outlet*".

[4] Deutscher Apothekerverband judgment, C-322/01, December 11, 2003.

[5] Ker-Optika judgment, C-108/09, December 2, 2010.

[6]As a reminder, are likely to benefit from an individual exemption agreements and concerted practices that "*contribute 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 (i) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (ii) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question*".