



## European Commission - DG Competition

### Review of the competition rules applicable to vertical agreements

#### 1. Introduction

##### a) The Federation of the Swiss Watch Industry FH

The Federation of the Swiss Watch Industry FH (herein after referred to as FH), based in Biel/Bienne, Switzerland, is the leading trade association of the Swiss watch industry. The FH is a private, professional and non-profit association that currently has more than 530 members representing over 90 per cent of all Swiss watch manufacturers (including finished products, watch movements and components).

The Federation represents and protects the commercial, legal and political interests of the Swiss watch industry both in Switzerland and abroad.

##### b) The Swiss watch industry in figures

With around 50'000 persons employed in the sector, the Swiss watch industry comprises the bulk of the European watch industry. Moreover it is a major client, possibly the largest, of the European watch component supply industry.

The EU is a traditionally important market for Swiss watch exports. In 2008, the Swiss watch industry exported over 10.2 million watches with a total value CHF 4.5 billion to the Member States of the European Union.

##### c) Swiss watches and their distribution

Swiss watches are obliged to satisfy the image requirements of the individual brand name manufacturers and the "Swiss Made" label generally as well as the resultant worldwide standard of quality demanded by consumers. This applies to all the products in the sector, irrespective of the various price categories. Swiss watchmakers invest significant resources in technical research and development, which in turn produces a very high level of innovation.

Swiss watches are technically complex products that are designed for a long service life. The market presence of the brand name manufacturers is therefore not simply confined to the sale of the product itself; it also includes services such as competent sales advice and after-sales service. In this respect, the local presence of the distributor is of great



importance since he is a direct contact person for the consumer and reflects the brand image of the manufacturer.

For the above reasons, the large majority of Swiss watches are sold through "brick and mortar" shops, which are ideal for promoting customer confidence and the brand image of the individual manufacturers.

## 2. Comments on the consultation documents

### a) Selective Distribution Systems

The FH expressly welcomes the position adopted by the Commission, namely that selective distribution systems play a role in the creation of a brand image, thereby enhancing the attractiveness of a product for the end user<sup>1</sup>. It is essential, particularly in the field of technically sophisticated products such as watches, for manufacturers to establish appropriate standards to maintain quality and ensure good practice.

In highly competitive sectors, any loss of intrabrand competition is usually offset by competition among the competing brands and leads to further measures to increase efficiency<sup>2</sup>.

The FH is of the opinion that the competition authorities and legislators should not specify which precise products may be sold through selective distribution systems and therefore welcomes that Paragraph 171 of the Commission notice clarifies that the "nature of the products" should be the decisive factor. The "nature of the products" is determined by many individual factors. Hence a general rule of the Commission would impose an unjustified restriction on product manufacturers and suppliers. As long as interbrand competition is effective, and no distortion of competition apparent, the choice of a suitable distribution system should be left to the manufacturers and suppliers.

### b) Use of the Internet by authorised dealers

#### · General remarks

The internet provides the manufacturers of branded products and traders the opportunity to supply the public with general information about their products and their company. The possibility of companies to increase their "visibility" through the internet is an extremely positive aspect of this tool.

By contrast, the use of the Internet for the direct selling of certain product categories is more problematic. This is linked to the quality standards for the product described in subparagraph 1c) and above all with the related services as well.

Paragraph 52 of the draft Commission notice generally states that each dealer must be at liberty to advertise products on the Internet and to sell products by this means.

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<sup>1</sup> Paragraph 103 of the draft Commission notice-guidelines on Vertical Restraints.

<sup>2</sup> Paragraph 173 of the draft Commission notice-guidelines on Vertical Restraints; see also 1997 green Paper on Vertical Restraints in EU Competition Policy.



Restrictions may accordingly only be imposed on dealers if advertising on the Internet or selling over the Internet lead to active sales. The use of the Internet is not generally perceived by the Commission to be a form of active selling. It is also stipulated in Paragraph 57 that it should be left to the discretion of dealers in a selective distribution system to reach all end users by using the Internet as well. Therefore, the Commission regards as a hardcore restriction any obligation which dissuades appointed dealers from using the internet by imposing criteria for online sales which are not equivalent to the criteria imposed for the sales from the brick and mortar shop.

- **Differentiation of active and passive selling in exclusive distribution agreements**

The question is whether the conventional distinction between active and passive selling in connection with the use of the Internet can be applied sensibly. The FH is of the opinion that this general approach fails to give sufficient consideration to the technological possibilities offered by the Internet. The creation and connection of a website by an authorised dealer could equally be viewed as an active measure that is designed to canvass customers and attract sales outside the allocated territory. In view of the fact that the Internet does not recognise territorial borders, the general distinction between active and passive selling is artificial and fails to give sufficient consideration to the technological development in this area.

- **"Brick and mortar" criterion**

It is very encouraging that the Commission expressly confirms the necessity of the "brick and mortar" criterion which enables the supplier to require its distributors to have a physical presence on the market before engaging in online distribution. This facilitates the exclusion of strictly "online sellers" and "free riders", who may do considerable damage to the brand image of suppliers *and* providers in the area of complex and durable goods.

- **General prohibition of the use of the Internet**

High-quality watches normally require a "touch/feel/experience" and thus depend on a direct sales consultation (which can moreover take several hours or require several contacts between the customer and the authorised dealer). The position adopted by the Commission in the draft notice could in an extreme case ultimately enable a dealer to sell a watch, which has for example been designed as a unique specimen, over the Internet without direct customer contact and without having tried it on. The argument that a customer is ultimately responsible for deciding whether he or she prefers a direct sales consultation or to buy a product on the internet does not recognize that the customer is often not aware of the technical complexity of the product and its maintenance requirements. This especially applies to mechanical watches. The dissatisfaction on the part of the customer that undoubtedly will result from such an online purchase has a direct impact on the image of the manufacturer and supplier of the product, created by the online reseller.

The watch industry is not a mass market; especially not the prestige segment. In paragraph 54 of the draft Commission notice, the Commission fails to give sufficient consideration to the different market circumstances. The justifications specified in



the text for prohibiting the use of the Internet only apply under "certain circumstances" and specifically refer to products that are potentially hazardous to health or safety. This tightening up of the current version of the Guidelines on Vertical Restraints from the year 2000, in which justifications such as the protection of the brand image and restrictions on "free-riding" are mentioned in Section 115 et seq. is difficult to understand.

In our opinion, the present narrow interpretation not only gives insufficient consideration to the problems described above in the area of technically sophisticated and complex products, it also fails to take account of the continuing problem of counterfeit products. The Internet is probably the most important distribution channel for counterfeit goods, and the problem has increased significantly again since the year 2000.

The striking proliferation of counterfeit goods on the Internet is documented by the intervention statistics of the FH. In 2008, our Federation alone arranged for over 71,000 auctions of counterfeit Swiss watches to be blocked on Internet sales platforms. They numbered 87,000 at the beginning of September 2009. With regard to actual fake websites, in 2009 to date, 2,500 Cease and desist letters were sent to web hosting companies. This is only a drop in the ocean, however, and the number of warnings could be increased to any amount if sufficient staff were available.

If these facts are borne in mind, it is not surprising that companies view the "Internet" tool with scepticism and only wish to use it sparingly to prevent disappointments at customer level.

### **3. Summary**

The judgement as to whether the use of the Internet is appropriate for manufacturers, suppliers, dealers and consumers and provides commercial benefits depends to a large extent on the product and the market on which the product is offered. It is consequently difficult to make sweeping statements about the use of the Internet in the Guidelines on Vertical Restraints.

The FH is of the opinion that the question should not be "Internet yes or no", but must be oriented towards the functioning of the relevant market instead. If interbrand competition is a market factor, it should be left to the manufacturers and suppliers to decide for themselves the extent to which they wish to use the Internet as distribution tool for their products.

We would like to conclude by stating that it is perfectly possible to view the prohibition of Internet sales by the supplier as a qualitative criterion in a selective distribution system. The prohibition in Article 81 (1) EC Treaty does not generally apply to agreements that deal with a strictly qualitative selective distribution system.