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**LVMH submission**

**Concerning the review of the Community competition rules applicable to  
vertical restraints.**

EU Registration number: 16094042309-21

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## **INTRODUCTION**

1. In the context of the public consultation, launched on 28 July 2009, LVMH wishes to present the following observations to the Commission, concerning the draft proposal of the Block Exemption Regulation No 2790/1999 (the “Regulation”) and its accompanying Guidelines (the “Guidelines”). The main goal of the current review process is to adapt selective distribution systems to market developments since 1999.
2. Summary of LVMH’s comments:
  - Selective distribution is at the heart of the luxury goods industry’s business model. Selective distribution brings four benefits to consumers: service, experience, choice and protection.
  - In addition to meeting consumer expectations by providing the highest quality of authentic luxury goods, selective distribution greatly contributes to the long-term sustainability and survival of the industry.
  - Undoubtedly, e-commerce offers new opportunities for luxury brands as it provides an additional distribution channel to the traditional physical shop (brick and mortar network).
  - LVMH views e-commerce activities as complementary to brick and mortar, since online sites provide a link to traditional sales networks. Internet sites may increase visibility and ease access to brands, their universe and their products.
  - However, the unregulated expansion of e-commerce would definitely weaken the viability of the physical network to the detriment of the consumer. Priority should be given to those who manage high-quality internet sites for online sales of luxury brands, but the vast majority of consumers still require a connection to a network of physical shops. Therefore, quality criteria and standards must be determined according to the means of the distribution channel.
  - Selective distribution provides the consumer with the necessary assurance and trust they expect. It is therefore of paramount importance for the luxury goods industry that the criteria on selective distribution in traditional retailing also apply to ecommerce, taken into account the different nature of the internet as a distribution channel, .

LVMH’s comments on the draft proposal open to public consultation are based on an analysis of the business model of the luxury sector. LVMH tries to convey that its business model responds to customers’ expectations (I), and analyses the conditions under which selective distribution and e-commerce can coexist under the draft Regulation and Guidelines (II).

## **I. A BUSINESS MODEL THAT RESPONDS TO CONSUMER AND GENERAL PUBLIC EXPECTATIONS**

3. ***LVMH's business model.*** The LVMH group's main activities include the design, production and marketing of luxury goods. LVMH business model provides consumers worldwide with extremely high-quality products that meet consumer demand for excellence. LVMH's business model applies to all of the brands of the group, which include Louis Vuitton, Celine, Kenzo, Givenchy, Christian Dior, Guerlain and Chaumet in France; Fendi, Pucci, Stephanobi and Rossi Moda in Italy; Donna Karan and Marc Jacobs in the United States; Loewe in Spain; Thomas Pink in the United Kingdom; Tag Heuer, Zenith and Hublot in Switzerland. Moreover, the group counts other prestigious brands in wines and spirits, among them Don Pérignon, Ruinart, Veuve Clicquot, Krug, Yquem, and Cheval Blanc. Consumers are willing to pay more for luxury goods because the brand, product and accompanying services are of the highest quality from a technical, aesthetic and exclusivity viewpoint.
4. ***The business model of the luxury goods industry in general.*** LVMH's business model is not different from those of its main competitors. Like LVMH, industry players rely on the services of exclusive designers and continual investment in innovation. Moreover, industry players invest in the latest manufacturing technologies to equip stylists with new design tools that allow for the most thorough and meticulous production processes. Equally, the industry sources the highest quality materials for their products and dedicates the manufacturing to craftsmen that possess the necessary skills and expertise. In addition, the industry employs the greatest artists for designing luxury goods advertising, fashion shows, window displays and other communication and marketing materials. Moreover, industry players, like LVMH, invest massively in the physical presence of brick and mortar (traditional shops) to sell their goods. These shops, often located in city centres, add to the urban prestige and attractiveness of cities. These shops employ highly trained and skilled staff and the jobs are sustainable, valuable and highly prestigious. Thanks to the industry's focus on training, employees are able to present a brand's complete range of products and custom-made services to customers seeking this high level of service. Based on these flagship brick and mortar shops, industry players aim to develop integrated distribution networks (e.g., Louis Vuitton), or selective networks. Selective distribution offers independent distributors the possibility of marketing the brand's products, under the condition that they invest in the brick and mortar (or physical) shops that meet quality criteria defined by the manufacturer.
5. ***The role of selective distribution.*** Achieving excellence in the distribution and the sale environment of luxury goods is essential to the success of luxury goods industry. The distribution model contributes to the value of luxury products. In that respect, the luxury goods market cannot be compared to mass-market consumer goods. In order to ensure that the distribution of luxury products answers customers' expectations, manufacturers select their distributors based on strict qualitative criteria. The growth, competitiveness and vigour of the luxury goods industry in Europe are the best proof

that our business model is effective. It implies that this model is favourable to competition in the interest of consumers, and that it is objectively justified.

6. ***A flagship of the European industry.*** The luxury goods industry is of strategic importance for Europe. Its high-quality goods are sold under prestigious brand names. These brands provide an aura of exclusivity and promote values in quality and craftsmanship, underlined by know-how of the best artisans in Europe. The luxury goods industry is also of major importance to the European economy. Thanks to its creativity, quality products and to the meticulous standards of its distribution channels the industry employs approximately 800 000 in Europe with an annual turnover of approximately €170 billion. The industry manufactures the majority of its goods in Europe and is an export champion (notably to China) outside European borders.
7. ***A model overwhelmingly supported by public opinion.*** European citizens share this appreciation of luxury goods. Contrary to what was recently affirmed:<sup>1</sup>
  - 72% said that, in their view, luxury items should be sold through specific outlets, with the brands' own sales staff at hand, or online through the brands' own websites;
  - And 65% of all respondents agreed that offering such goods in hard discount stores or internet platforms would be detrimental to their reputation.
8. ***Online commerce within the framework of selective distribution.*** E-commerce offers new opportunities for luxury brands as it provides an additional distribution channel. However, distribution channels must remain as selective and prestigious as in physical outlets. This concerns the presentation and the environment in which products are sold, the information and the personalised advice provided to clients as well as delivery and after-sale service. Selective distribution must be applied in a rigorous a manner to online commerce as to business through a physical network.
9. ***The position of LVMH in online commerce.*** The LVMH group has fully embraced the internet as a distribution channel. For each of its major brands, LVMH has online sales sites whose identity has been inspired by its physical boutiques. In addition, LVMH's authorised distributors are allowed to create online commerce sites on condition that they already operate a physical outlet and that they respect the quality criteria defined by the brand. Some of these distributors belong to the marketing networks of the LVMH brands and have made the necessary investments to create high-quality internet sites, often with a pan-European or global appeal, which offer users an experience with new and interactive purchases.
10. ***The deregulation claimed by the free riders.*** Some 'pure players' on the internet criticise the business model of the luxury products industry, claiming that they could sell luxury goods online at a lower price provided selective distribution standards do not apply to online sales. Such a claim is misleading because it would tend to allow

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<sup>1</sup> See the TNS Sofres survey conducted at the request of the Comité Colbert, the Fondazione Altgamma and the Walpole British Luxury, "*European perceptions of the luxury goods industry*", September 2009, attached as [Annex 1](#). The survey was conducted in Germany, Italy, France, Spain and the UK, with a representative sample of the population from 18 years old and above – Questions n°2 and 3.

‘pure players’ to benefit unduly from the massive investments made in the physical outlets by brands and authorised distributors (*e.g.*, purchase or rental of top class advertising spaces in city centres, storage (stocking) of extended ranges of products, presentation and attractive decoration, merchandising, trained and competent staff, personalised services for consumers, after-sale service). An unregulated development of e-commerce would seriously undermine the networks of physical outlets and would cause irreparable harm to the aura of luxury brands. Furthermore, such deregulation would allow counterfeiting and fraud to prosper as well as pose risks to health and to consumer security.

11. ***The simple principle of “brick and click” is not sufficient.*** Some ‘pure players’ declare themselves ready to respect the criteria imposed by the luxury brands for internet distribution of its products; but, at the same time, they do not intend to invest in the physical outlets. They are against every rule, which would oblige them to balance the sales they make in physical outlets and online sales. In reality they are thinking of the short-term benefit of increased traffic to their sites and forgetting the long-term harm to the luxury goods industry, and subsequently its disappearance.

Although less aggressive than a claim for total deregulation, such a request does nothing less than to parasitize physical networks by making the most, without return, of the significant investments carried out by the physical distributors to make their brands and products even more attractive. The main arguments commonly used by certain ‘pure players’ are the following:

- a. *“the physical distributors would only have to do the same as pure players”*, that is to say, create internet sites in order to take their share of online business. The problem would be that in the absence of a quantitative rule imposing a minimum relative level of sales in brick and mortar outlets, online players could invest a minimum amount in a brick and mortar outlet, and then sell massively on the online channel. Moreover, given the strength of certain platforms or online business sites, with powerful search engines, gigantic data sources, as well as advertising and international payment services, one understands immediately that these ‘pure players’ would have quickly dominated the online distribution of luxury goods. As a result, the viability of the physical networks would be put at risk.
- b. *“the development of e-commerce could never discourage consumers from wanting to visit the physical outlets”*. This argument conceals crucial economic data: the difference in the cost of distribution between physical outlets and internet. Take, for example, the case of perfumes and cosmetics in a physical shop, for a product bought from a manufacturer for €65, the cost of distribution is around €35 that is a production cost of €100. On the internet, the cost of distribution is, for the same product, around €10, the production price is therefore €75. With a margin of 5%, the physical distributor would sell at €105 what the platform would offer for €80 that is a difference of more than 30%. The real problem is that the financial structure of brick and mortar networks, with high fixed costs and relatively small margins, is very fragile. It would be enough for a small fraction of customers of brick and mortar to be lost, for the brick and mortar network to be unprofitable. All of the simulations show that, with such a price difference, a good number of consumers end up choosing in a physical shop, and then

ordering online. This means that if an e-commerce distributor could concentrate online demand on his site, while the physical outlets would be *de facto* hived-off to traditional distribution, all of the network of physical outlets would soon be annihilated, and the luxury product industry, losing its business model, would soon find itself threatened out of existence.

- c. *"the consumer would, to a large extent, benefit from the disappearance of physical outlets because he could buy at lower prices"*. This presentation is completely biased. The real issue is that brick and mortar shops address a specific segment of consumer demand that is not addressed by cheap online sales. The risk is that these consumers would not be served in the future since the brick and mortar selective distribution model as a whole would not be in a position economically to survive.

12. ***The attachment of the public to physical outlets.*** Other than their central role in the business model of the luxury goods industry, physical outlets of major brands occupy an important space in the urban world, as well as in the memory and conscience of European citizens. The survey carried out by TNS-SOFRES confirms the social and cultural role of these outlets.<sup>2</sup> Indeed, the results of the survey show that, for the vast majority of persons questioned, the luxury goods industry, its products and its outlets, play an important role:

- In the prestige and attractiveness of city centres (76%);
- In the cultural aura of Europe around the world (73%);
- In the preservation of craftsmanship (71%);
- In the creation of employment and maintenance of economic competitiveness of Europe in relation to the rest of the world (69%).

13. ***Conclusion on the business model.*** Based on the above, it can therefore be said that:

- The business model of the luxury goods industry has allowed the industry to grow steadily, to resist the current crisis and to ensure an important financial, social and cultural contribution to Europe;
- The luxury goods industry has grown competitively with a high level of innovation improving non-price competition factors such as services and quality;
- The business model of the luxury goods industry is based on selective distribution to fulfil consumer expectations regarding how to reach our products;
- In the luxury products sector, the network of physical outlets is the means of creating brand awareness and prestige;

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<sup>2</sup> See the TNS-Sofres survey mentioned above, "European perceptions of the luxury goods industry » - Question n°1, attached as [Annex 1](#).

- Consumers, like the public in general, are very attached to the survival of luxury product outlets;
- The only way to keep these outlets in existence is to allow each physical distributor a fair share of online commerce, provided that the right criteria can be applied to recreate a luxury experience on line.

14. ***Business model and regulation.*** It would be paradoxical that under EU law, while a non-dominant supplier would remain free to decide whether or not to sell, a distributor would be in practice forced to sell in all circumstances on the internet. This would introduce an unjustified discrimination between integrated and non-integrated players. In the understanding of LVMH, competition rules should not have as their object to impose on manufacturers of luxury goods a specific type of business model. The manufacturers of these products must, on the contrary, be able to keep the freedom to choose their business model under their own responsibility, in particular in order to assure that online sales portray their brand image and their products in good light, as well as ensuring that they neither alter the image nor the physical outlets network. At the very least, it appears necessary that the rules on competition law do not condemn a business model, which, under the current regime of the Regulation, was able to prove its ability to meet consumers' needs and those of the public.
15. ***The limits in regulating competition.*** The business model of LVMH and, in a general manner, that of the luxury goods industry is not anticompetitive. All of the brands of the LVMH portfolio are sold online, either via approved websites, or on integrated sites. For example, Sephora has been a pioneer of online sales, and is currently struggling to build an EU-wide site due to the current constraints on pan European payment systems and discordant consumer protection laws in Europe. Provided luxury brands, through their business model, do not pose an obstacle to the internet as a distribution channel, nothing justifies questioning either the selective distribution system in itself, or the existence of physical outlet networks to which the public is very attached and without which the luxury product industry would not survive.

LVMH considers that the current review of the Regulation and the Guidelines must improve the competition rules, but it should not alter the business model allowed by Regulation No 2790/1999, which itself allowed over the last ten years for the needs of consumers to be met, as well as contributed to the prosperity of Europe and to the influence of its culture having been validated by jurisprudence all along.

## **II. THE BUSINESS MODEL OF THE LUXURY BRANDS AND THE REVISION OF THE BLOCK EXEMPTION REGULATION**

16. **General observations.** On the whole, the draft Regulation and its Guidelines are inspired by the need to give suppliers the freedom to choose their business model and, notably, to have recourse to selective distribution if they believe it to be useful.

The LVMH group can only applaud the maintaining of this principle of freedom. However, it believes it useful to ask for clarifications on a certain number of points, while, in relation to others, it requests that certain inconsistencies between the draft proposals and the business model of the luxury product industry be resolved.

The main submissions of LVMH relate to:

- The prolongation of the system of selective distribution and the rule of “brick and click”, which allows the approval of an online distributor to be subject to the operation of a physical outlet (A);
- The need for a certain balance, within a distributor’s business, between sales in the physical outlet and online sales (B);
- The necessary reference to the notion of objective justification (C);
- The need for greater legal certainty (D).

### **A. The prolongation of the selective distribution system**

17. **The double goal of LVMH’s proposals for changes to the current draft.** LVMH’s proposals only seek to obtain clarifications on the following issues:

- The interpretation of Article 4(b), third indent, of the draft Regulation (1°),
- And the principle of "brick and click" (2°).

#### **1° The interpretation of Article 4(b), third indent, of the draft Regulation**

18. **The sentence in question.** The Commission’s current draft of Article 4(b), third indent, of the Regulation provides that a territorial restriction on sales would be regarded as “hardcore” except as regards *“the restriction of sales by the members of a selective distribution system to unauthorised distributors in markets where such a system is operated.”*

19. **Primary meaning.** It is understood that the additional wording underlined above is intended to target the situation where a supplier sells products using a selective distribution system in some EU Member States, but in other Member States sells products to distributors who do not comply with the selection criteria (*i.e.*, unauthorised distributors). The intention appears to be to ensure that, in such a situation, authorised dealers may be prevented from selling to unauthorised distributors only in the territories where the supplier (i) uses selective distribution; or (ii) sells its products through its own outlets; or (iii) does not at all commercialise its products. On the contrary, it would not be permissible to restrict sales to unauthorised

distributors in the territories where the supplier itself sells its products to unauthorised distributors.

20. **Possible ambiguity.** As LVMH understands it, this additional wording is not intended to undermine the principle of selective distribution. However, LVMH fears that the new wording, as currently drafted, could be misinterpreted to mean that in a territory where a selective distribution system is not, or has not yet been put in place in relation to a certain product, a supplier may no longer prevent an authorised retailer from selling to an unauthorised retailer in that territory. Take, for example, a situation where a luxury goods supplier – perhaps a smaller company – sells by selective distribution in say 10 Member States of the Community, but has not yet set up any distribution network for its brand in the other 17 Member States. LVMH's fear is that, one way of reading Article 4(b) would mean that, in those circumstances, the supplier could not prevent its authorised distributors in those 10 Member States from selling to unauthorised distributors in the other 17 Member States where it had not yet established a distribution system. Similarly, where a supplier has exclusively reserved certain territories for its own direct sales to the final customers, LVMH fears that this new wording could be misunderstood as allowing an authorised dealer to sell to an unauthorised dealer in a territory exclusively reserved to the supplier itself.
21. **Practical uncertainty.** Such interpretations would entirely undermine the principle of selective distribution. The supplier would be prevented from insisting on selective distribution merely because its brand was not sold in all Member States of the EU. In effect, the selective distribution networks of brands, which are not distributed throughout the whole of the EU, would no longer be secure and could be undermined. That would pose particular risks for smaller brands, new brands and new players who could not fully protect their goods through selective distribution systems. Similar problems could arise merely because the supplier had reserved certain territories to itself.
22. **First proposal for clarification.** LVMH does not believe that such results are intended by the Commission. It is at the core of selective distribution that a supplier may prevent an authorised retailer from selling to an unauthorised retailer, wherever the latter may be situated. However, to avoid any misunderstanding, LVMH suggests that the Commission should revert to the previous wording of the present Regulation and omit the words “*in markets where such a system is operated.*”
23. **Second proposal for clarification.** A second possibility would be to insert a clarification in the text or by way of a footnote to paragraph (55) of the Guidelines:

“*The purpose of the phrase “in markets where such a system is operated” (which did not exist in the former Regulation) is to exclude the possibility of restricting sales to unauthorised distributors with respect to territories where the supplier itself distributes its products through non-selective distributors. Its purpose is not to exclude the possibility of restricting sales with respect to territories where the supplier sells its products through its own outlets or does not have any distribution network.*”
- 2°) **Selective distribution of luxury goods: the principle of “brick and click”**
24. **The purpose of selective distribution.** A key element in the success of luxury goods businesses is a distribution network which supports and preserves the image of the

products, provides a prestigious and high quality selling environment, and fulfils the expectation of the consumer who is purchasing not just the physical product, but also “the aura of luxury” and a superior sales and after-sales service.

25. ***A purpose recognised by the case law.*** It has long been established in case law and commercial practice that luxury goods may be legitimately sold through selective distribution systems. For example:
- The Court of Justice in *Copad/Christian Dior*<sup>3</sup> recently decided that: “*the quality of luxury goods such as those at issue in the main proceedings is not just the result of their material characteristics, but also of the allure and prestigious image which bestows on them an aura of luxury. Since luxury goods are high-class goods, the aura of luxury emanating from them is essential in that it enables consumers to distinguish them from similar goods. Therefore, an impairment to that aura of luxury is likely to affect the actual quality of those goods.*”<sup>4</sup> and
  - The principle of selective distribution for luxury goods has been consistently recognised by the Commission and Courts at both European and national level<sup>5</sup>.
26. ***The principle.*** In LVMH’s view, and as supported by the new draft Regulation, suppliers should have the right to oblige retailers selling luxury goods to follow this approach as far as possible so that, for the customer, online shopping is a seamless extension of the physical shopping experience found in the “up-market” retail outlets selling luxury goods.
27. ***The survival of physical networks in an age of online commerce.*** As regards, more particularly, the physical networks for the distribution of luxury goods, the requirement to maintain a properly presented brick and mortar outlet is no more than a justified qualitative requirement aimed at preserving the luxury aura of the goods, and providing the service which the customer rightly requires<sup>6</sup>. The cost of creating and maintaining a physical network is generally much greater than the cost of establishing and operating a website. If the owner of the website does not have to invest in creating the same “luxury aura” or trained staff as is required of the physical outlet, and if the online sales can be made without the seller having any physical outlet at all, it is clear that authorised retailers would be less prepared to invest in maintaining the

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<sup>3</sup> Case C-59/08, *Copad SA v Christian Dior couture SA and others*, [2009] ECR 00000

<sup>4</sup> See Case C-59/08, *Copad SA*, paras. 24-26.

<sup>5</sup> See e.g. ECJ /CFI: Cases T-19/92, *Leclerc v Commission* (“*Yves Saint Laurent*”) [1996] ECR II – 1851; T-88/92 *Leclerc v Commission* (“*Givenchy*”) [1996] ECR II – 1961; C-372/02, *Metro v Cartier* [1994] ECR I-15 – European Commission: Commission Decision 92/33/EEC of 16 December 1991, *Yves Saint Laurent Parfums*, OJ 1992 L 12/14, Press release IP/01/713; B&W *Loudspeakers*, Press release IP/02/916 of 24 June 2002 – Paris Court of Appeals: *Bijourama v Festina France* 2006/17900, *Pacific Creation v PMC Distribution* - 2007/04360 – French Competition Council: Decision n° 06-D-28 of 5 October 2006 relative to practices implemented in the sector of selective distribution of Hi-fi and home cinema equipment; Decision 07-D-07 relative to practices implemented in the sector of cosmetic and personal hygiene products (“*Cosmetics*”) and – Bundeskartellamt: *Lancaster Group GmbH v Beauty Net AG* KZR 2/02.

<sup>6</sup> See also e.g. Conseil de la Concurrence – *Festina* – Decision No. 06-D-24, *Bose / Focal Triangle* – Decision No. 06-D-28, *Cosmetics* – Decision No. 07-D-07, Cour d’Appel de Paris – *PMC Distribution v Pacific Creation* 2007 / 04360, *Pierre Fabre* 2008 / 23812, Bundesgerichtshof – *Lancaster Group GmbH v Beauty Net AG* KZR 2/02, OLF München – *Amer Sports U(K)* 4842/08.

physical outlet, or the technical advice and personal service in the shop which the customer of luxury goods legitimately expects. This, in turn, is likely to lead to a decline in standards in the physical network, and to a progressive deterioration of the “luxury aura” of the goods, with consequent damage to the brands. None of that would be in the ultimate interest of the consumer.

28. ***Paragraphs (54) and (57) of the draft Guidelines.*** LVMH therefore warmly welcomes paragraph (54) of the new draft Guidelines which makes it clear that “...under the block exemption the supplier may require its distributors to have a brick and mortar shop or showroom before engaging in online distribution.” Similarly, LVMH fully supports the principle that the criteria for online sales by authorised retailers should pursue the same objective as those required for off-line sales, as appears to be recognized in paragraph (57) of the new draft Guidelines: “[t]his does not mean that the criteria imposed for online sales must be identical to those imposed for off-line sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes.”
29. ***The case of token outlets.*** LVMH also considers that an ancillary restraint which seeks to prevent the brick and mortar shop in question from being merely a token outlet for an online business, is fully compatible with Community law:
- “If, without the restriction, the main operation is difficult or even impossible to implement, the restrictions may be regarded as objectively necessary for its implementation.”<sup>7</sup>*
30. ***The effective implementation of the ‘brick and click’ principle.*** Thus, in the luxury goods sector, provisions which ensure that online sales are balanced compared to the aims in view, which include maintaining the image of the brands, and a stable and effective brick and mortar network, in the consumer interest, should be recognized as fully compatible with the Regulation. Indeed, since the Commission has recognized the principle of brick and click as legitimate, it is essential that that principle not be undermined or evaded.
31. ***The need for freedom to organise the business model.*** LVMH therefore submits that suppliers of luxury goods should be free to organize their business models as they see fit, in particular, through selective distribution networks. The Commission should not seek to “micro-manage” how those models should develop in the future. There is no evidence of consumer detriment in this flagship European industry which leads the world in innovation, design and the production of high quality, technically complex craftsmanship products.

## **B. LVMH’s proposals to amend Paragraphs (52) and (57) of the draft Guidelines**

### **1° Paragraph (52) of the draft Guidelines**

32. ***Proposal to suppress the “hardcore” classification.*** LVMH considers that the word “hardcore” should not be applied to a provision in a selective distribution agreement for luxury goods requiring a certain balance of sales to be made through a brick and

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<sup>7</sup> Case T-112/99, *Metropole television (M6) and others v. Commission* [2001] ECR II-02459 at para. 109.

mortar outlet. Given that it is highly doubtful whether such a provision is a restriction of competition at all, and that the Bundesgerichtshof accepted such a provision as fully justified in the *Lancaster* case, LVMH proposes that the Commission should drop entirely the third indent of paragraph (52) of the draft Guidelines.

33. **Alternative proposal.** Alternatively, LVMH proposes that the Commission should move the third indent of paragraph (52), including footnote 29, and insert it at the end of paragraph (52), to read as follows:

*“The Commission regards requiring a distributor to limit the proportion of overall sales made over the internet as a potentially anti-competitive restriction. This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products off-line to ensure an efficient operation of its brick and mortar shop, nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier’s distribution model (see paragraphs 54 and 57). This absolute amount of required off-line sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer’s size in the network or its geographic location.”*

34. **Justification for LVMH’s request.** As set out above, such an approach is fully justified by the principle that restrictions which are objectively necessary to achieve the main operation – here the brick and mortar network – do not fall within Article 81(1) EC. Maintaining the integrity of the brick and mortar network is itself an integral part of maintaining both the luxury aura of the goods and the high quality service provided to the consumer.<sup>8</sup>

## 2°) **Paragraph (57) of the draft Guidelines**

35. **Hardcore and the notion of equivalence.** In light of the discussion above, LVMH considers that in any event the word “hardcore” should be dropped from the third sentence of paragraph (57). Furthermore, because of the intrinsic difference between offline and online criteria, LVMH considers that the Commission’s search for “equivalence” is impractical, and gives rise to uncertainty. In LVMH’s view, the yardstick should simply be whether the online criteria are objectively justified in support of the selective distribution system in question, having regard to the nature of the goods in question.
36. **LVMH’s proposal.** LVMH therefore proposes that the last two sentences of paragraph (57) of the new draft Guidelines should be amended to read as follows, maintaining also footnote 31:

*“Therefore, the Commission regards as a possible anti-competitive 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 or objectively justified. This does not mean that the criteria imposed for online sales must be identical to those imposed for off-line sales,*

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<sup>8</sup> As a further alternative, LVMH suggests that a footnote be included in the Guidelines to the effect that any assessment should take into account the specificities of the sector in question, in light of the jurisprudence of the Court of Justice.

*but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes<sup>36</sup>”.*

### **C. The concept of objective justification**

37. ***The necessary reference to the notion of objective justification.*** As already indicated, LVMH considers that the compatibility of the supplier’s criteria for internet sales with Article 81 EC should be assessed by reference to the principle of objective justification. The concept of objective justification is fully embedded in the case law of the Court of Justice and the Court of First Instance.<sup>9</sup> As submitted above, that is the concept to which reference should be made in paragraphs (52) and (57) of the Guidelines.
38. ***The text in question.*** This issue also arises in paragraph (54) of the draft Guidelines which provides that, “...*an outright ban on Internet or catalogue selling may be objectively necessary and fall outside Article 81(1) EC and will thus not be considered to be a hardcore restriction if it does not restrict competition that would take place in its absence given the specific circumstances in which the agreement operates, such as when its purpose is to align on a public ban on selling dangerous substances over the internet or by mail order for reasons of safety or health.*”
39. ***LVMH’s proposal.*** In the above text, the Commission has deleted the “objective justification” wording in the current version of the Guidelines (paragraph 51) and substituted the concept of “the competition that would otherwise take place” in the absence of the ban. The examples given are limited to prohibitions imposed on grounds of safety and health. LVMH suggests that this is too narrow an approach, and that the wording in paragraph (51) of the current Guidelines should be maintained.

### **D. The need for legal certainty**

40. ***The double risk to legal certainty.*** Like any proposal, the new proposal for the Regulation and the Guidelines contains certain provisions susceptible to challenge, which it would be appropriate to amend in order to render selective distribution networks more legally certain (1°);

But the biggest risk for brands lies in the extension of the concept of “hardcore” restriction (2°).

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<sup>9</sup> The notion that restrictions based on objective criteria justified by the intrinsic nature of the distribution system in question do not fall under Article 81(1) has been established ever since *Metro I* in 1977, (case 26/76, *Metro SB-Großmärkte GmbH & Co. KG v. Commission*, [1977] ECR 01875), and consistently followed by the Community courts ever since, for example in *Pronuptia* in 1986 (case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis*, [1986] ECR 00353), the *Leclerc* cases in 1996 (case T-88/92, *Groupement d’achat Edouard Leclerc v. Commission*, [1996] ECR II-01961; case T-19/92, *Groupement d’achat Edouard Leclerc v. Commission*, [1996] ECR II-01851) and *Metro / Cartier* (case C-376/92, *Metro SB-Großmärkte GmbH & Co. KG v. Cartier SA* [1994] ECR I-00015).

## 1° The risk of litigation

41. ***The need for a safe harbour.*** The principle of legal certainty is the foundation of Community law. An essential aspect of the principle of legal certainty is that the law should be clear, so that the parties concerned may conduct their affairs accordingly. In the present context, vertical agreements which fall under Article 81(1) EC and do not satisfy the provisions of Article 81(3) EC are prohibited and void under Article 81(2) EC. The overriding purpose of the Regulation is to create a safe harbour, so that there is no doubt as to the legal enforceability of the contracts defined by Article 2, subject only to the exclusions set out in Articles 4 and 5.
42. ***The removal of the notification system.*** It is thus essential that the new Regulation and Guidelines are drafted as clearly as possible. The Guidelines should not create ambiguities and uncertainties, or seek to detract from the clear scope of the Regulation itself. This is particularly important since, under the procedures established by the previous Regulation No 17/62, suppliers were able to achieve a high degree of legal certainty through the system of notification and comfort letters. This ensured consistency across the EU and ensured a secure distribution system, in consumers' interests. However, unlike the situation when Regulation No 2790/99 and the existing Guidelines were originally adopted, agreements can no longer be notified to the Commission, and national courts and national authorities across 27 Member States now have jurisdiction to apply Article 81(3) EC<sup>10</sup>. This greatly increases the scope for litigation at national level, which is time consuming, costly, damaging to investment, and, ultimately, against consumers' interests.
43. ***Ambiguities and hardcore restrictions.*** We highlight the risk of litigation since certain aspects of the current drafts are ambiguous and will have the unintended consequence of creating substantial uncertainty and provoking litigation. This is true particularly when the concept of "hardcore" is used.

## 2° Use of the concept of "hardcore"

44. ***The provisions in question.*** At paragraphs (52) and (57) of the draft Guidelines, the Commission invokes the concept of a "hardcore" restriction.
45. ***The wording of Paragraph (52).*** Paragraph (52), third indent, states that a provision requiring, "*a distributor to limit the proportion of overall sales made over the internet*" is a "hardcore" restriction, albeit that that provision is subject to footnote 34 relating to paragraph (52).
46. ***The wording of Paragraph (57).*** Similarly the last two sentences of the current draft of paragraph (57) of the Guidelines state that, "*...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. This does not mean that the criteria imposed for online sales must be identical to those imposed for off-line sales, but rather that they should pursue the same objectives and achieve comparable*

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<sup>10</sup> See e.g. Articles 5 and 6 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ 2003 L 1/1.

*results and that the difference between the criteria must be justified by the different nature of these two distribution modes.” (footnote 31 omitted for simplicity).*

47. ***The issue.*** LVMH objects in principle to the use of the word “hardcore” in these passages.
48. ***First three reasons.*** Article 4 of the Regulation contains a list of “hardcore” restrictions. First, it is not permissible to seek to add to the Guidelines further “hardcore” restrictions which are not identified as such in the Regulation. Secondly, such an approach is likely to increase the risk of litigation, given the increase in legal uncertainty, and create confusion at the level of the national courts and national authorities in 27 Member States. Thirdly, it is also inconsistent with the economics-based approach underlying the Regulation and the need to examine each case on a case-by-case basis.<sup>11</sup>
49. ***The Improper use of the concept of “hardcore”.*** Moreover, neither of the above provisions in paragraph (52) (proportion of overall sales) or paragraph (57) (equivalence of criteria) can be described as a “hardcore restriction” (“restriction caractérisée”) in the sense that term is understood in Community law. A “hardcore” restriction is a restriction which, “by its nature” has the object and effect of fixing prices or sharing markets<sup>12</sup>. Neither of the provisions in question could reasonably be described as “hardcore” in that (correct) sense: neither has the object and effect of fixing prices or sharing markets.
50. ***The absence of restriction to competition.*** In any event, it is difficult to see how either of the provisions in question can reasonably be described as a “restriction of competition” at all, let alone a “hardcore” restriction. The Commission accepts that the maintenance of a brick and mortar outlet is a permissible requirement in a selective distribution context. Indeed, for luxury goods suppliers it may be a fundamental requirement. As regards paragraph (52), third indent, of the Guidelines, it is manifest that a requirement to commit to sell a balanced quantity of products through the brick outlet is primarily designed to prevent the obligation of maintaining a brick outlet from being circumvented, for example, by a retailer mainly engaged in internet sales possessing a “sham” brick outlet. In those circumstances, a provision requiring a balanced quantity of products to be sold through the brick outlet is no more than an auxiliary restraint, objectively justified in order to implement the main operation, which is the brick and mortar network<sup>13</sup>. In these circumstances such a provision cannot reasonably be described as “hardcore.”
51. ***The notion of proportionality.*** Indeed, in the selective distribution context, a provision that is a reasonable and proportionate means of protecting the viability of the brick and mortar network should clearly be permitted. In the *Lancaster* case,<sup>14</sup>

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<sup>11</sup> See paragraph 3 in both the existing and new Guidelines: “[t]he standards set forth in these Guidelines must be applied to circumstances specific to each case. This rules out a mechanical application. Each case must be evaluated in the light of its own facts”.

<sup>12</sup> See for example Cases T-374/94 etc *European Night Services v Commission* [1998] ECR II-3141, para 136; Case T- 67/01 *JCB Services v Commission* [2004] ECR II-29, para 85, upheld by the ECJ; Case C-167/04 *JCB Services v Commission* [2006] ECR I-8935.

<sup>13</sup> See case T-112/99, *Metropole v Commission*, cited above.

<sup>14</sup> KZR 2/02, 4 November 2003

the Bundesgerichtshof held that a clause requiring at least 50 per cent of sales to be sold in the brick and mortar outlet, was not only permissible and lawful, but “modest.”

52. ***The notion of equivalence.*** Similar considerations apply to the Commission’s contention in paragraph (57) of the draft Guidelines that it is a “hardcore” restriction to adopt criteria for online sales “which are not equivalent” to the criteria imposed for the brick and mortar shop. As noted above, the question of the appropriate criteria for online/offline sales respectively is a matter quite outside the proper ambit of a “hardcore” restriction, since it is not related to either price fixing or sharing markets.
53. ***The incompatibility between the concept of “hardcore” restrictions and the sovereign assessment of the judges.*** In addition, in paragraph (57) the Commission itself accepts that the criteria do not have to be identical for online or offline sales, but should pursue the same objectives and achieve comparable results, having regard to the differences between the two different distribution modes<sup>15</sup>. In those circumstances, any alleged “non-equivalence” could be at best only a matter of degree and assessment. Again a question of appreciation of that kind falls well outside the proper scope of a “hardcore restriction” related to prices or market sharing.
54. ***“Hardcore” restrictions can only relate to anticompetitive conducts which are clear and obvious.*** Even more importantly, the introduction of the concept of “hardcore” into the question of whether criteria are “equivalent” or not, simply creates uncertainty and provokes litigation before national courts and authorities. As the Commission itself acknowledges, the online and offline modes of distribution are different, and the criteria cannot be identical. It is wrong in principle to use the words “hardcore restriction” in a context where the envisaged comparison will be one that is intrinsically difficult to make, and necessarily subjective and uncertain. Under Community law, the scope of a “hardcore” restriction is limited to a restriction of competition which is, by its nature, clear and obvious.
55. ***The limited scope of the concept of “hardcore”.*** This limitation of the scope of “hardcore” restrictions is for good policy reasons. The overriding objection to the use of the word “hardcore” in both the passages cited is the fact that the burden of proof is reversed without any legal basis or justification. As paragraph (47) of the draft Guidelines points out, describing a restriction as “hardcore” gives rise to a presumption that Article 81(1) applies, and furthermore that the provision is unlikely to fulfil the requirements of Article 81(3). However, outside the spheres of price fixing and market sharing, a reversal of the normal burden of proof is justified only in exceptional circumstances. As already submitted, there is no legal basis for attempting to reverse the burden of proof simply by means of the Guidelines. Moreover, in the present context there is no justification for doing so, either in general or in respect of the luxury goods industry in particular. As already shown, it is far from evident that a requirement to make a proportion of sales through the brick outlet is a restriction of competition at all, let alone a “hardcore” restriction, and there is no reasoning in the Guidelines to explain why such a restriction is “hardcore”. It is equally unjustifiable to introduce the notion of “hardcore” into an evaluation of the alleged non-comparability of online and offline criteria, thus placing a heavy burden

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<sup>15</sup> See para (57) of the Guidelines, last sentence, and footnote 31.

on the supplier to prove that criteria, which are by their nature different, are in fact “equivalent”. Again, that approach is not supported by any reasoning.

56. ***Increased risk of litigation.*** The Commission’s approach in these aspects of the Guidelines simply magnifies the risk of litigation, thus, to a large extent, defeats the purpose of the Regulation.

## CONCLUSION

57. LVMH welcomes the proposed reform of the Regulation and Guidelines, in particular, to the extent that the Commission strikes a balance between continued investment in “brick and mortar” shops that are essential to the selective distribution of luxury goods, and internet opportunities. As mentioned above, LVMH is however calling for further consideration on the following issues:
- the Commission, having reconfirmed the principle of brick and click as legitimate, must make sure that that principle is not undermined or evaded;
  - the risk of increased litigation which would result from the ambiguities in the draft. This would contradict the main purpose of the Regulation and Guidelines which is to create legal certainty as well as a clear and practical reference for regulators and courts;
  - the apparently favourable treatment of unauthorised dealers in areas where a supplier does not “operate” a selective distribution network. This risks jeopardizing the essence of the selective networks, as it would make a consistent control over the quality of resellers impossible in Europe. This requirement would hurt, in particular, the smaller brand/suppliers which do not necessarily have the means of to effectively operate pan-European networks; and
  - the extension of the notion of “hardcore” restriction to new contractual obligations beyond what is covered by the Regulation itself. This is likely to compound the risk of additional litigation, and force suppliers to bear the burden of proof, regardless of whether the restriction is in fact objectively justified. Because, in practice judges are unlikely to consider or accept complex economic justifications for any restriction that falls within this category, this will necessarily result in more form-based and less economically sound decisions. The extension of the concept of “hardcore” is also likely to increase the risk of diverging decisions among national competition authorities and courts and generally contradicts the economics-based, case-by-case approach underlying the Regulation.
58. The risks mentioned above are serious since they could have the effect of limiting the growth of one of Europe’s major success stories, and of chilling investment and innovation in a fragile economic environment. Rather than creating benefits for the consumers, the new VBRE and Guidelines would risk limiting the quality and the variety of the goods that are being offered, and leaving consumer expectations unaddressed.

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