

Competition - Switzerland

Competition Commission issues guidance on online retailing restrictions

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[Introduction](#)

[Content of amicable settlement](#)

[Reasoning](#)

[Other guidance on purely qualitative selective distribution](#)

Introduction

On July 11 2011 the Competition Commission closed its investigation into Electrolux AG and V-Zug AG in connection with restrictions on online retailing of household appliances (ie, white goods) by reaching an amicable settlement. The commission held that the prohibitions on sales from online stores were unlawful in principle, and that internet sales should be restricted only under certain strict conditions. This procedure allowed the commission to establish guidelines on restrictions on online retailing, drawing on the practice of the European Commission⁽¹⁾ and certain EU member states' national authorities.⁽²⁾ The decision also provides guidance on the commission's practice in relation to selective distribution systems.

Content of amicable settlement

The investigation opened on September 15 2010. Electrolux had completely forbidden its distributors (whether members of its selective distribution network or not) from selling household appliances online, while V-Zug had imposed various restrictions on its distributors regarding online sales. Based on an amicable settlement entered into with the commission at the end of the investigation procedure, Electrolux and V-Zug made a commitment to allow retailers which were members of their selective distribution network to trade online, and also (in principle) to do so under a different domain name from that used for physical sales points. However, the commission authorised Electrolux and V-Zug to impose specific qualitative requirements on online retailing and to oblige their online retailers simultaneously to operate from a physical sales point. The commission also allowed Electrolux and V-Zug to oblige their approved retailers to set up their website so as to ensure that their contact details (ie, the company name and full address), as well as the addresses of their physical points of sale, appeared clearly on the site and could be viewed at 'first glance'.

Reasoning

The commission considered that the bans imposed by Electrolux and V-Zug amounted to unlawful agreements affecting competition, despite the fact that such bans appeared to be the result of measures unilaterally imposed by the two manufacturers. It is unnecessary under Swiss law to have a binding agreement between the parties involved in order to find the existence of an "agreement affecting competition" according to Article 4(1) of the Competition Act. Rather, it is sufficient to prove the existence of some kind of conscious and intended cooperation that may objectively affect competition on the market. In this respect, the commission highlighted the fact that had the ban on online sales announced by Electrolux and V-Zug been implemented, it would have been adhered to by 'mixed' retailers (ie, those that trade both on the Internet and from physical points of sale), since their refusal to respect the announced prohibitions would have resulted in the cessation of deliveries and, subsequently, a considerable decrease in turnover.

The commission denied that the contemplated ban on online trading could fall within the scope of Article 5(4) of the act, which forbids the setting of fixed resale prices (ie, retail price maintenance) and the granting of territories to the extent that sales by other distributors into these territories are not permitted (ie, absolute territorial protection). The commission indicated in this respect that a restriction on online trading could be likened only to the setting of fixed resale prices in qualified circumstances, notably

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when the ban on online sales is combined with price recommendations or with agreements that influence the price policy of retailers, or when – in addition to forbidding or restricting the online business – the supplier threatens to exert or actually exerts pressure on the retailers (through threats, intimidation, warnings, sanctions, delay or suspension of sales) so as to ensure that they apply a certain price level. Besides, the commission reiterated that, according to Paragraph 10 of its Notice on the Competition Law Treatment of Vertical Agreements (June 28 2010), online sales must be regarded as passive sales. Thus, a ban on these sales will fall within the scope of Article 5(4) if:

- the manufacturer agrees with its exclusive retailer to prevent access to its website to customers from outside the designated territory;
- the retailer commits to introducing on its website a system that automatically redirects such customers to the manufacturer's or another retailer's website; or
- the retailer commits to blocking any online transaction whenever the credit card of a customer is registered at an address outside the designated area.

The commission then examined the question of whether the ban on online trade could be considered a significant restriction of competition under Article 5(1) of the act, which could not be justified on grounds of economic efficiency pursuant to Article 5(2). Based on certain recent economic studies, the commission first pointed out the fairly substantial price differences that can usually be observed between goods sold online and those sold at physical points of sale. The commission then indicated that internet sales significantly increase price transparency, in particular by reducing costs and by cutting the time required for a consumer to find a retailer willing to sell the desired goods. According to the commission, it is also because of this transparency requirement that market participants should be forbidden from taking measures that would make the publication of online product prices more difficult. Such transparency, combined with lower prices, has a disciplinary effect on the prices adopted at physical points of sale and indirectly puts pressure on the prices and margins of the manufacturers themselves.

The commission – in consideration of the fact that an outright prohibition or restriction on online sales affects price competition, and after reiterating that a ban on internet sales must be construed as a limitation of passive sales pursuant to the Notice on Competition Law Treatment of Vertical Agreements (Sections 3 and 12(2)) – held that such a ban amounted in this case to a qualitatively significant restriction of competition within the meaning of Section 12(2) of the notice. From a quantitative point of view, the contemplated ban appeared to be significant: with a cumulative market share of about 50% of the large household appliances market, Electrolux and V-Zug clearly exceeded the threshold at which restrictions of competition are considered to become significant pursuant to Section 13(1) of the notice (ie, the absence of a significant restriction of competition when none of the undertakings participating in the agreement has a market share in excess of 15%, unless there are several similar parallel vertical distribution networks, in which case the market share threshold is reduced to 5%). Moreover, both companies were envisaging – more or less at the same time – implementing limitations on online sales, with a similar aim.

After concluding that the contemplated agreement led to a significant restriction of competition, the commission further examined whether such a restriction could be justified on grounds of economic efficiency according to Article 5(2) of the act. Pursuant to Section 16 (4) of the notice (which clarifies Article 5(2)(c) of the act), an agreement affecting competition may be justified, among other reasons, when it appears necessary to ensure the uniformity and quality of the contractual products or to avoid inefficient levels of sales promotion measures (which can occur when some manufacturers or distributors can exploit the sales promotion efforts of other producers or distributors (ie, so-called 'free-riding')). In this respect, the commission considered that the argument regarding the fight against free-riding by online retailers at the expense of physical points of sale was not decisive. An important part of the customer base of household appliances consists of professional buyers (eg, construction companies, architectural practices and real estate agencies), which do not need specific advice when placing orders. Furthermore, the investigation revealed that Electrolux and V-Zug both had around 10 permanent showrooms spread across the Swiss territory, where customers could also obtain information about the products of these manufacturers before placing any order on the Internet.

In addition, and most importantly, recent economic studies show that free-riding is not necessarily detrimental to physical retail outlets; rather, retail outlets and online retailing appear to be becoming complementary distribution channels. The commission also pointed out that it seemed doubtful in the case at hand whether an outright ban on online sales would actually be necessary in the fight against free-riding, since suppliers could, for example, try to compensate for the additional costs referred to by retailers by paying them a fixed amount. The commission left consideration of that issue open, since the involved companies made a commitment (in the amicable settlement) to organise their distribution networks in such a way as to oblige every

approved retailer wishing to trade online simultaneously to operate a physical point of sale; such a system could ensure that the costs related to the setting up of showrooms and the provision of expert advice would be borne by all members of the selective distribution network.

Finally, the commission was not convinced by the argument put forward by V-Zug that the limitation of online retailing helps prevent faulty installation of household appliances. The commission highlighted the fact that retailers doing business exclusively on the Internet may still work with specialised installers in order to guarantee delivery of a first-class service.

Other guidance on purely qualitative selective distribution

In the course of the investigation, Electrolux and V-Zug tried to justify the contemplated ban on online sales by submitting that they had put in place a "purely qualitative" distribution system – that is, a distribution system in which the distributors were exclusively selected on the basis of objective and qualitative criteria required by the nature of the product (Section 4(2) of the notice). The commission took the opportunity to clarify its position regarding the conditions under which such a distribution system can be considered to be a lawful restriction of competition:

- The selective distribution system must be required by the nature of the product (which means that it is necessary in order to safeguard product quality and ensure its correct use);
- The retailers must be selected on the basis of objective criteria of a qualitative nature, which must be set in a uniform way and applied in a non-discriminatory manner;
- The set criteria should not go beyond what is necessary; and
- The selective distribution system must not fall within the definition of a "hardcore restriction" according to Article 5(4) of the act or contain a qualitatively significant restriction in the meaning of Section 12 (2) of the notice.

Following up on a recent case in which it fined Gaba International for banning parallel imports of Elmex toothpaste, the commission reiterated that technically complex products – in relation to which advice or assistance is often necessary – are generally well suited to purely selective distribution systems. However, the commission stressed that if a company which manufactures products under different brands wishes to distribute them through different distribution channels and to position them in different price segments, it will not then be possible to justify a selective distribution system only for those products in the highest price segments if the products of the various brands are technically similar and if the way they should be used does not fundamentally differ. If a manufacturer sells certain products through a selective distribution system in Switzerland, but sells them through a non-selective system elsewhere, this will also be considered problematic.

As far as online sales are concerned, following the commitments made by Electrolux and V-Zug in the amicable settlement, the commission did not have to address the question of whether a retailer selling products online may be excluded from a purely selective distribution system. Nonetheless, the commission noted that manufacturers which sell goods from discount stores (ie, retailers whose main selling point is price rather than product display or advice to customers) would not be permitted to exclude online retailers from their distribution networks. In addition, the commission specified that online retailers themselves need not meet the requirements of a supplier in terms of client advice, delivery, assembly work or customer service; rather, these requirements can be fulfilled through collaborations with specialist third parties.

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Endnotes

(1) See EU Guidelines on Vertical Restraints, 2010/C 130/01.

(2) See German Federal Cartel Office, September 25 2009, Decision B3 – 123/08; French Competition Council, Case 08-D-25, October 29 2008, relating to practices implemented in the sector of cosmetics and personal care products sold under the guidance of a pharmacist.

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