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What Is Stopping Brands from Adopting Selective Distribution? Three Common Myths Dispelled

Selective distribution offers brands a ready-made and well-established means of ensuring that their products are sold in a consistent and high-quality sales environment across Europe. It does so by limiting sales of a brand's products to a network of resellers that meet its specified selective distribution criteria, with all others placed on the other side of the network's protective moat. Resellers who commit to support a brand, for example through investment in point of sale materials, marketing spend, or staff training, are rewarded, while access to products by less committed retailers is cut off. As a result, the brand's products are presented in the best light and competition between brands is enhanced.

By creating an enforceable prohibition on sales to unauthorized resellers, selective distribution enables brands to take direct legal action against authorized resellers that divert sales in this manner. Significantly, it may even enable brands to take legal action directly against unauthorized resellers (including those selling online in a manner that damages the brand), whether on the basis of tortious interference in contractual relations or under national laws that are designed to protect the integrity of selective distribution networks.

Although these benefits mean that selective distribution is becoming an increasingly popular means of controlling distribution in Europe, especially to protect a brand's online presence, some brands remain reluctant to adopt it. While this may be for perfectly legitimate commercial reasons, our experience is that some brands may be deterred on the basis of misconceptions as to certain legal and commercial issues surrounding selective distribution. This article is intended to dispel some of the most common selective distribution myths:

1. Selective distribution is only available for luxury products;
2. Selective distribution requires the brand to apply criteria uniformly and to admit anyone who meets the criteria; and
3. Selective distribution is too rigid and difficult to implement and manage.

Before addressing these in detail, it is important to understand the overall legal framework for selective distribution.

Selective distribution has two essential requirements:

- a brand commits to sell products only through a network of authorized resellers that meet its specified selection criteria; and
- all network members are prohibited from selling to unauthorized resellers.

Since selective distribution prohibits sales to unauthorized resellers, it inherently limits competition between them and authorized resellers. As such, the agreements implementing a brand's selective distribution system are potentially vulnerable to challenge under EU and national prohibitions of anticompetitive agreements. Historically (*i.e.*, before 2003), any agreement that restricted competition in Europe was potentially unlawful, regardless of its benefits, unless it was individually notified to the European Commission and exempted by a specific decision. As notifications were relatively rare, and exemption decisions even rarer, it was usually desirable for parties to ensure that their agreements fell outside competition law altogether to guarantee enforceability.

This was the context for the development of the concept of "purely qualitative selective distribution." This form of selective distribution, which is not caught by competition law at all, has three essential requirements:

- the product concerned must fall into a category that *requires* selective distribution (typically, because it is a high quality or technically complex product);
- members must be admitted by reference to qualitative criteria that are applied in a uniform and non-discriminatory manner; and
- the criteria applied do not go beyond what is objectively necessary.

While it remains the case that a selective distribution system that meets these conditions is entirely immune from legal challenge, and hence the safest form of selective distribution, it certainly does not follow that a system that does not meet these conditions is unlawful.

This is because EU competition law provides a legal safe harbor for common forms of distribution agreement, by means of the Vertical Agreements Block Exemption Regulation (VBER). As long as an agreement falls within this safe harbor, it cannot be challenged before a court and can only be attacked by a competition authority if it is first expressly removed from the safe harbor.

The VBER safe harbor is available to protect any selective distribution agreements, as long as:

- neither the brand nor any individual reseller has a market share of more than 30%; and
- the agreement does not contain any hardcore restriction of competition, such as a restriction on the ability of resellers to set their own resale prices or a ban on sales between network members.

As long as the VBER safe harbor applies, brands have a substantial degree of freedom over the design of their selective distribution system. This is illustrated by reference to the following selective distribution myths.

a. Myth 1—"Selective Distribution Is Only Available for Luxury Products"

The VBER does not specify any limitation on the products that can be distributed under a selective distribution agreement that is protected by the safe harbor. This is confirmed by the European Commission's Verticals Guidelines, which state that the VBER "exempts selective distribution regardless of the nature of the product concerned". As one leading commentator has noted, this means that a brand is perfectly entitled to create a selective distribution network for the sale of its lollipops, should it wish. All that is required is that the brand accepts the basic principle that its products should be sold in a particular way and that the sale of its products should be limited to resellers that can meet that standard.

Although the Verticals Guidelines go on to say that the Commission will consider removing an agreement from the VBER safe harbor if the characteristics of the product concerned do not require selective distribution, it will only do so if there is evidence of "appreciable anti-competitive effects". In practice, this has proved to be a rather empty threat, as the Commission has never done it.

It is also important to remember that only the Commission or a National Competition Authority can remove an agreement from the VBER safe harbor. As a result, in the absence of intervention by a competition authority, a protected agreement remains completely immune from the challenge before a national court.

b. Myth 2—"Selective Distribution Requires the Brand to Apply Criteria Uniformly and to Admit Anyone Who Meets the Criteria"

As noted above, while purely qualitative selective distribution does require that criteria are applied uniformly, this is unnecessary if the VBER is available. In order for a brand's selective distribution system to be classified as such under the VBER, it simply needs to apply "specified criteria" to select network members. In other words, it must apply some sort of criteria to determine whether to admit a reseller and these criteria must in some way be "specified," in the sense that the brand needs to be able to show which criteria were applied when it decided whether to admit a specific reseller.

As long as the VBER applies, there is no need for the brand to be consistent in applying the criteria, and different criteria can be applied for different channels, territories, products or, indeed, individual resellers. As the Verticals Guidelines confirm, the VBER is available "regardless of the nature of the selection criteria". A brand is also perfectly entitled to apply a numerical limit on the number of resellers it admits to its selective distribution network, whether on a national or EU-wide basis, as long as all resellers remain free to sell across the whole area covered by the network.

The main caveat is that a brand cannot apply criteria that amount to hardcore restrictions, for example by specifying as a criterion that the reseller cannot discount products or sell outside its national territory. It is also advisable for the brand to maintain a degree of coherence in the application of criteria, to avoid selection being viewed as entirely arbitrary (or, worse, a means of enforcing a hardcore restriction, such as resale price maintenance) or the system breaking down to the extent that it can no longer be meaningfully described as selective distribution at all (for example, if a brand waives most of its criteria to allow sales through a supermarket chain, while maintaining them for other retailers). This can be particularly important if the brand relies on its distributors to apply criteria to admit resellers. Online criteria should also be defensible and broadly equivalent to the brand's brick and mortar

criteria, to avoid any accusation that they are being used by the brand as a *de facto* restriction of online sales.

c. Myth 3—"Selective Distribution Is Too Rigid and Difficult to Implement and Manage"

As should now be clear, the VBER provides brands with significant flexibility to craft their selective distribution system in a way that works best for them, as long as the basic requirements of selectivity by reference to specified criteria and prohibition of sales to unauthorized resellers are maintained.

A selective distribution system does require an enforceable legal foundation, in the form of contracts between the brand and its authorized distributors. Selective distribution also requires a degree of organization on the part of the brand when rolling out and maintaining its network.

A brand can choose between a single-level distribution system, under which it sells to authorized resellers, who sell on to end customers (or each other), or a multi-level system, where distributors sell to resellers who sell on to end customers. In the latter system, the brand can continue to be responsible for admitting resellers or it can rely on its distributors to apply its admission criteria for selecting authorized resellers. As long as the brand ensures that its distributors are adhering to their contracts, for example by applying the brand's criteria, ensuring an enforceable contract is put in place with authorized resellers, and keeping a record of who they admit, then no issues should arise.

Distributors can be prohibited from selling directly to end customers or be free to do so, as long as sales adhere to the standards specified by the brand. Similarly, the brand is free to sell directly to end customers itself or to limit sales to its distribution channel. A brand may prohibit sales through third-party marketplaces, permit all such sales or authorize sales only through marketplaces that meet its quality standards. As long as resellers remain able to sell online, the choice rests with the brand.

As long as a brand is prepared to commit to a minimum level of up-front organization and ongoing oversight, backed by targeted enforcement, selective distribution, therefore, offers an attractive and flexible means of distribution for a wide variety of products.

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