Bundeskartellamt

Case summary 27 May 2014

Call for refusal to supply by WALA Heilmittel GmbH, Bad Boll/Eckwälden

Sector:	Natural cosmetics
Ref.:	B2-52/14
Date of decision:	6 May 2014

On 6 May 2014, the Bundeskartellamt decided to terminate proceedings against WALA Heilmittel GmbH, Bad Boll/Eckwälden ("WALA") which were initiated on account of its call for the refusal to supply after WALA had discontinued the conduct concerned.

WALA's operations include the manufacture and sale of cosmetic products under the "Dr. Hauschka" brand name. Sales of the products concerned take place within a closed distribution system, i.e. the products are sold exclusively to authorised retailers who in turn are only allowed to sell these products to final customers or to other authorised retailers. The sale to final customers takes place via a number of different retail channels, such as natural cosmetic specialist stores, pharmacies, health-food shops and organic supermarkets. Retailers are supplied either by WALA itself or via wholesalers.

In the second half of 2013, WALA prepared to introduce the newly-designed "face care and regeneration care" product line. To this end, WALA made efforts to encourage retailers to acquire a so-called "initial stock" package. This "package" was a range of initial stock for the newly-designed "face care and regeneration care" product line. On 1 March 2014, WALA adjusted its supply of "face care and regeneration care" products to the new product line. Retailers who had previously bought the initial stock package continued to receive individual supplies of WALA products. Retailers who had not acquired an initial stock package by 1 March 2014, on the other hand, were placed under a temporary supply stop by WALA. This meant that those retailers were unable to obtain any WALA products from WALA between 1 March 2014 and 15 May 2014, either from the newly-designed "face care and regeneration care" product line or from the unchanged "body care" product line. Deliveries of WALA products were not resumed until the retailer concerned had acquired the initial stock package.

In order to enforce the supply stops effectively, WALA called on its wholesalers not make any deliveries to "banned retailers" either, and transferred "blacklists" to wholesalers for this purpose.

If a “banned retailer” purchased the initial stock package, it was “cleared” by WALA for supply again, also via wholesalers, which were informed to this effect by WALA.

After the Bundeskartellamt became aware of these procedures, it launched investigations and came to the following – provisional – assessment of WALA’s conduct under competition law:

A manufacturer is free to decide in principle which products it wishes to sell within the context of a selective distribution system and may also define who is allowed to sell these products if this selection of sales partners is made in accordance with competition law. However, in view of the fact that WALA had not terminated existing distribution agreements in this case and that the retailers that were not willing to acquire the “initial package” thus continued to be part of WALA’s selective distribution system, the measures taken to enforce the product adjustment appear to be problematic from the point of view of competition. This is because the provisions on facilitating cross-deliveries (under 1 below) and the prohibition on calls for boycott (under item 2 below) are to be observed within the existing selective distribution system

1. Limiting cross-deliveries

In limiting the number of authorised distributors and issuing the instruction to sell goods only to final customers or other authorised distributors, WALA is establishing a so-called “selective distribution system” for the sale of its products[1]. Such selective distribution agreements may fall under the prohibition of Article 101 (1) TFEU or Section 1 of the German Act against Restraints of Competition (German Competition Act, GWB), but in many cases are exempt under competition law. So-called purely qualitative selective distribution is not covered by the prohibition of Article 101 (1) TFEU if the nature of the product concerned requires selective distribution, the resellers are selected without discrimination on the basis of objective quality criteria and the defined criteria are necessary[2]. Even if a selective distribution system does not fulfil these criteria,

[1] Cf. para. 174 of the “Guidelines on Vertical Restraints” of the European Commission (“vertical restraints guidelines”), Official Journal C 130/1 of 19 May 2010.

[2] Cf. para. 175 of the vertical restraints guidelines with references to the relevant decision-making practice of the European courts.

the so-called "vertical block exemption regulation"[3] assumes that this is only problematical if there is market power at one level of trade. If the market share of the manufacturer and the retailer is below 30%, the distribution system is generally exempt from prohibition under Article 101 TFEU.

An exemption on the basis of the vertical block exemption regulation is not possible under Article 4 of the vertical block exemption regulation, however, if the selective distribution agreement contains so-called hardcore restraints. If a hardcore restraint exists, it is assumed that the agreement falls under Article 101 (1) TFEU and the conditions of Article 101 (3) TFEU are probably not fulfilled.[4] A hardcore restraint of this kind exists under Article 4 d) of the vertical block exemption regulation when the manufacturer imposes a restriction on cross-deliveries between distributors within the selective distribution system. This also applies in particular when the distributors concerned are operating as wholesalers or retailers at different trade levels. The freedom to make cross-deliveries within a network primarily serves to strengthen "intra-brand" competition on price within the distribution system[5]. The non-exemption of the restriction of deliveries within the system limits the manufacturer's possibility, inherent in the design of selective distribution systems, of limiting competition at distributor level by selecting authorised distributors.

The non-exemption of the restriction of cross-deliveries is therefore to be taken into account when it is a matter of whether or to what extent manufacturers are allowed to control flows of goods within the context of selective distribution, for example by requesting that wholesalers impose non-contractual limitations on deliveries to retailers:

The possibility for a manufacturer to decide freely in the first instance which products to include or not to include in a selective distribution system is legitimate and is inherent in the concept of selective distribution. In particular, the manufacturer has the possibility to exchange or redesign products or product lines within the context of selective distribution without the distributor being able to influence this. In addition, the manufacturer can control the flows of goods to the extent that it can decide by selecting a distribution partner who is allowed to sell the products in the selective distribution category as an authorised distributor as long as this selection is permissible under competition law. This decision-making independence of the manufacturer is also to be

[3] Commission Regulation 330/2010/EU of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L 102/1, 23 April 2010.

[4] Cf. para.. 47 of the vertical guidelines.

[5] Cf. *Nolte* in Langen/Bunte, Kartellrecht, Volume 2, Europäisches Kartellrecht, 12th edition, 2014, after Art. 101 TFEU, para. 539.

taken into account where the manufacturer organises its selective distribution over a number of levels of trade. The manufacturer can therefore permissibly prohibit its wholesalers from supplying distributors that are not or are no longer part of the selective distribution system as authorised distribution partners.

However, according to the Bundeskartellamt's provisional assessment, the admissible control of such "external" goods flows is to be distinguished from the control of goods flows within the system insofar as it comes under the hardcore restriction of Art. 4 d) of the vertical restraints guidelines. If, as in the present case, a manufacturer has not terminated the distribution agreements with individual distributors, so that these remain authorised distributors within the selective distribution system, such control of the goods flows (within the system) by the manufacturer is not possible. Whether the relevant distributors have a claim against the manufacturer to be supplied depends primarily on the provisions of the respective distribution agreements. That notwithstanding, the manufacturer may not agree with its wholesalers that they refrain from continuing to deliver to the retailers concerned. Such an agreement is in principle an impermissible restriction of cross-supplies within a selective distribution system.

2) Call for boycott

WALA's request that its wholesalers should not supply "banned retailers" also fulfils the elements of the offence of Section 21 (1) of the GWB. Under this provision, an undertaking may not request that another undertaking refuse to supply with the intention of unfairly impeding certain undertakings.

As the addressees of the request, wholesalers are "other undertakings" in relation to WALA within the meaning of Section 21 (1) of the GWB. The contractual involvement of an undertaking in the selective distribution of a manufacturer as a (wholesale) distributor does not lead to that undertaking losing its entrepreneurial independence[6]. The fact that the (wholesale) distributor is – permissibly - obliged on account of the provisions of the distribution agreement to supply the products only to authorised retailers whose distribution is part of the agreements between the manufacturer and the retailers, does nothing to change this assessment. With its impermissible request within the meaning of Section 21 (1) of the GWB, WALA attempted to force small

[6] On the subject of "requests" in vertical agreements within the meaning of Section 21 (1) GWB, cf. also *Nothdurft* in Langen/Bunte, Kartellrecht, Volume 1, Deutsches Kartellrecht, 12th edition, 2014, Section 21, para. 29 ff..

pharmacies that were part of the distribution system as authorised retailers to order packages containing a range of goods, which was sometimes uneconomic for them, by involving wholesalers. Such instructions by the manufacturer, based on controlling flows of goods within the system, may constitute an illegitimate call for boycott.

A preliminary assessment of WALA's request that its wholesalers should not supply the "banned retailers" suggested that it served the purpose of inadmissibly controlling the flows of goods within the selective system and also that it intended to unfairly impede retailers who wanted to reorder individual articles in line with the provisions of their contracts.

Whether a restraint is unfair has to be determined, taking into account the interests of those concerned and the law's aim to maintain the freedom of competition, within the context of an overall assessment. WALA claimed that the aim of purchasing an initial stock package was to ensure uniform product presentation. However, it should be taken into account here that even in the case of retailers who had bought the initial stock package, the parallel sale of "new" and "old" goods was not excluded. In addition, the product change only took place in the "face care and regeneration care" segment, so that it was impossible in any case for retailers to avoid the presentation of different product lines. Even if one were to ignore these aspects, however, and to recognise the manufacturer's fundamental interest in ensuring that changes to its retail product range in the context of product redesigns are made as quickly and completely as possible, it is a matter for the manufacturer to guarantee that this interest is enforced by drawing up the distribution agreements accordingly. If the relevant contractual provisions are lacking, as is the case here, the manufacturer may not enforce its economic interest in quickly and completely changing its product range by exerting economic pressure within the meaning of Section 21 (1) of the GWB. Moreover, exerting pressure in this way could be impermissible even if there is a relevant entitlement to this effect under a distribution agreement, since in principle, the manufacturer would then have to aim to enforce its claim through the civil courts. A call for boycott as a means of self-help is not justified, however.

After the Bundeskartellamt had informed WALA of the concerns specified above, WALA abandoned the conduct in question. The Bundeskartellamt then terminated the proceedings.