

# RESPONSE TO PUBLIC CONSULTATION

## PRELIMINARY REPORT ON THE E-COMMERCE SECTOR INQUIRY

### 1. Introduction

#### 1.1. Cosmetics Europe

Cosmetics Europe – The Personal Care Association (‘Cosmetics Europe’) here below provides its comments to the European Commission’s Preliminary Report on the E-Commerce Sector Inquiry (‘the Preliminary Report’). Cosmetics Europe is the trade association representing Europe’s cosmetic, toiletry and perfumery industries since 1962. Today, the sector is worth €77 billion. Cosmetics Europe membership includes international companies and national associations of the European Member States and beyond. Cosmetics Europe represents directly and indirectly the interests of approximately 4600 companies ranging from international cosmetics manufacturers to small family-run businesses operating in niche markets. Cosmetics Europe is based in Brussels, Belgium and registered in the EU Transparency Register (No: 83575061669-96). The national associations in France (FEBEA), Spain (STANPA) and Italy (Cosmetica Italia) have been closely associated in the drafting of the below comments and fully endorse the document.

Cosmetic products are regulated by a European-wide regulation<sup>1</sup>. The nature and the specificities of the products necessarily lead to the application of a stringent regulatory regime that organises traceability and cosmetovigilance<sup>2</sup>, which remain under the strict responsibility of the manufacturer. A cosmetic product is defined by the regulation as any substance or mixture intended to be placed in contact with the external parts of the human body or with the teeth and mucous membranes of the oral cavity with a view exclusively or mainly to cleaning them, perfuming them, changing their appearance, protecting them, keeping them in good condition or correcting body odours.

#### 1.2. Initial comments on general findings in the Preliminary Report

- Cosmetics Europe welcomes the balanced approach of the Preliminary Report and the clear confirmation that selective distribution systems are covered by the Vertical Block Exemption Regulation (VBER). Cosmetics Europe also refers to the long-standing case-law of the Court of Justice according to which certain categories of cosmetics products, due to their luxury or

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<sup>1</sup> Regulation (EC) No 1223/2009 of the European Parliament and of the Council of 30 November 2009 on cosmetic products, OJ L342, of 22.12.2009.

<sup>2</sup> Cosmetovigilance is the system put in place to detect adverse effects of cosmetic products, and to prevent adverse effects by taking appropriate measures.

technical nature, deserve the protection of selective distribution in all circumstances (see section 2 below).

- Cosmetics Europe stresses that selective distribution as a mode of distribution should not be considered as contrary to e-commerce. Cosmetics selective brands operate in an omnichannel environment. E-Commerce is part of their commercial strategies with the aim to ensure, across all distribution channels, the most consistent purchasing journey for their consumers. The VBER provides that absent market power, companies are free to choose how to best structure their selective distribution system, including the requirement of a physical sales point if necessary.
- Cosmetics Europe notes the growth of e-commerce as well as the statement in the Preliminary Report that 64% of manufacturers questioned in the sector inquiry have been opening their own e-shops. Indeed, brand manufacturers totally embrace the opportunities offered by digital, including opening their own e-shops. By setting up e-shops, in addition to the commercialisation of their products, the brand owners apply and interpret themselves the laid down quality criteria, which enable them to better accompany their authorized distributors' efforts to create a unique shopping experience for the customers.
- Cosmetics Europe agrees with the findings that restrictions linked to the use of market places are not to be considered as restrictions by object. Cosmetics Europe welcomes that the Commission does not consider marketplaces as separate distribution channels but rather as complementary means to sell on-line.
- Cosmetics Europe notes that the preliminary findings did not find any indications of market power of suppliers in any of the sectors investigated, and that moreover, the sectors examined do not appear highly concentrated. This is certainly the case for the cosmetics industry which is highly competitive with numerous small brands constantly emerging on the market.
- By contrast, Cosmetics Europe notes the European Commission's remark regarding the restrictions imposed by marketplaces on the ability of the retailers to present themselves prominently on the marketplace and establish a direct relationship with the customer. This notably relates to the concerns, reportedly expressed by some manufacturers, regarding the strong bargaining power that may already be enjoyed by some marketplaces.
- Cosmetics Europe agrees with statements made by manufacturers that price is not the only criteria between brands to attract customers. Indeed, when it comes to inter-brand competition, quality, innovation, creativity and brand image will constitute the most important criteria. Companies will adapt their commercial strategies to best preserve the consistency of the brand image.

## 2. Comments on Selective Distribution

### 2.1 Introduction: The use of selective distribution in the cosmetics sector reflects the necessity to protect brand equity

Many cosmetics companies distribute all or part of their products through selective distribution systems in physical stores and on-line. Selective distribution enables brand owners to establish a brand environment that they can frame and that is supported by significant marketing investments to create a unique shopping experience. Customers obtain access to a selling environment that meets the customer expectations and offers an experience compatible with the values and image of a brand (such as for example luxury, high-end, innovation, sustainability, etc.). Products are accompanied by the high-quality visuals and presentation of the brand in line with its image. Professionally trained advisers focus on the consumers' specific needs and ensure advice to direct the consumers towards the most appropriate products and with explanations on their correct use (see for example dermo-cosmetics). Selective distribution systems are based on individual contracts between the brand owner/supplier and the distributor. These contracts create rights and obligations for both parties with the aim to ensure the quality of the distribution network and to guarantee the specific shopping environment that the supplier and the retailer want to enhance. An alternative scenario, which excludes the flexibility for the brand manufacturer to create a solid distribution network to support the brand image and thereby the investment in new innovative products, would inevitably lead to the commoditization of products, ultimately engendering a decrease in innovation and competition and a reduction of the consumer choice.

In the digital context, the principles of selective distribution remain the same. Brands find it essential to preserve the consistency between their distribution off- and on-line so that the consumer easily recognizes both the brand and its retailers across all channels, and has the same high-quality browsing and shopping experience, the same choice, the same services and the same constant renewal of content, visuals, presentations and products on-line as he/she would have in brick and mortar shops.

The European Courts have confirmed over the years that certain products necessitate selective distribution by virtue of their nature, and that this mode of distribution is a legitimate means of selling which increases consumer welfare. Selective distribution has been recognized as a legitimate and necessary distribution model especially for the distribution of high quality products, such as cosmetics. Competition authorities and courts have ruled that the luxury nature of cosmetic products is exceptional because it is defined not only by the material characteristics of the product, but also by its intangible aura of prestige and/or by the high level of innovation and research<sup>3</sup>.

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<sup>3</sup> See Case T-88/92, *Leclerc v Commission (Givenchy)* [1996] ECR II-1961, at paras. 113 ff.; and Case T-19/92 *Leclerc v Commission (YSL)* [1996] ECR II-1851, at paras. 119 ff as well as Case C-59/08, *Copad SA v Christian Dior* [2009] ECR I-3421, at para. 24; and Case C-337/95, *Parfums Christian Dior* [1997] ECR I-6013, at para. 45.

Cosmetics Europe's members welcome the reconfirmation by the European Commission that selective distribution systems are covered by the VBER. It notes that the observed increase of selective distribution systems should not lead to a stricter legal approach. This increase, together with the diversity of selection criterion used by companies and adapted to various product groups as well as to on-line/off-line sales (§ 215-219 of the Preliminary Report), confirm the wish of the brand owners to ensure the consistency of the brand image and its protection throughout the supply chain. This is in line with set principles of European competition law.

## **2.2 The brick and mortar requirement as an essential criterion for a selective distribution system**

Cosmetics Europe welcomes that the Commission does not question the brick and mortar as a qualitative selection criterion. We are however concerned about the comment in §228 that the brick and mortar requirement may need further assessment in individual cases when used for certain product categories or certain lines of products which pure on-line retailers might be equally qualified to sell. In Cosmetics Europe's view, such a statement, which implies a stricter approach than what is currently outlined in paragraph 176 of the Vertical Guidelines, if not further clarified, inevitably leads to legal uncertainty, leaving the interpretation to national authorities and Courts as to what product categories or even product lines within a brand may or may not justify a brick and mortar requirement. The brand owners' systems would be open to constant challenge with a significant risk of divergence of interpretation at member states level. Cosmetics Europe also reminds the principles of the VBER that state that absent market power, companies are free to choose how to best structure their selective distribution system, including the requirement of a physical sales point if necessary. Cosmetics Europe therefore encourages the Commission to further clarify its position in this paragraph.

The brick and mortar criterion remains an essential criterion for the cosmetics industry. Far from being opposed, for cosmetics, physical and on-line sales points today perfectly complement each other. Cosmetics customers choose both channels, getting personalized advice in-store, with the possibility to feel and test the products, whilst appreciating the liberty of being able to compare prices, benefit from promotional campaigns and buy at any time on-line. The consumer mixes both channels and the companies adapt their marketing strategies accordingly. In a recent study made by KANTAR on the French market<sup>4</sup> it is evidenced how consumers are attached to their shopping experience in physical retail stores, whilst expecting brands to operate in a consistent and integrated omnichannel environment. The KANTAR study shows that for the French physical retail circuit, in the last year there has been an increase of 10% in the number of specialized beauty retailers (Such as for example Sephora, Marionnaud or Nocibé). The same study stresses the possibilities to obtain samples and to try the products as well as the personalized advice as the three most significant reasons for customers to visit the physical retail

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<sup>4</sup> *Les Perceptions et les attentes incontournables des consommateurs aujourd'hui*, Kantar Worldpanel 2016, See website of FEBEA with the possibility to download study, <http://www.febea.fr/fr/vos-produits-cosmetiques/actualites/communique-presse-special-evenement-du-secteur-cosmetique-la>

points. The broad range of choice and the presence of major brands at the sales points are also highlighted as important for the customer.

Moreover, as stated by manufacturers in the sector inquiry (§300), introducing a brick and mortar criterion ensures a level-playing field between retailers and helps avoiding free-riding by pure players on the in-store investments. Brand owners and authorized retailers make significant investments together for high-street services such as marketing, advertising, dedicated and knowledgeable staff and after-sale customer care. It remains the duty of the manufacturers to help protecting this relationship and these retailers' commitments.

### **2.3 Transparency and objective criteria**

Cosmetics Europe is concerned by the comments made by the Commission in §229-232 concerning the lack of transparency and objectivity of selection criteria. It must be recalled that the qualitative criteria and conditions set by brand owners for sales in a selective distribution system make part of the brands' internal commercial strategies and constitute a parameter of competition between brand owners. An unrestricted access to brands' criteria is therefore likely to undermine competition. Whilst recognizing that the qualitative criteria should be clear for potential retailers, they should remain confidential and are not to be the object of public scrutiny. Indeed, suppliers have no legal obligation to do so. Discussion on the criteria remain limited to the discussions with the retailers concerned and the objectivity of the criteria and their application are exclusively subject to judicial review by authorities and courts.

### **3. Comments on Third Party Platform Restrictions**

Cosmetics Europe welcomes the statements by the European Commission with respect to third party platform restrictions and agrees with the assessment by the Commission of the legal framework. More particularly, Cosmetics Europe agrees that marketplace restrictions do not amount to a *de facto* prohibition to sell online under the *Pierre Fabre* case law and that marketplace bans do not constitute hardcore restrictions under Article 4. The Preliminary Report makes it clear that platforms are not separate distribution channels but rather part of the overall on-line environment where they constitute one of several means to sell on-line. Cosmetics Europe further takes note of the Commission's comment on the necessity for a case-by-case assessment in certain circumstances and particularly where the 30% market share threshold is exceeded and where marketplaces are *de facto* key access routes to the market. However, these market circumstances do not appear to be present anywhere since (i) the Preliminary Report concludes on the absence of market power in any of the sectors inquired and (ii) only a very limited percentage of the retailers have indicated that they use only marketplaces for the promotion and sale of their products. To the contrary, small retailers today have a rather limited bargaining power vis-à-vis third party platforms that currently tend to get more and more concentrated with the existence of only a few large European-wide platforms.

Cosmetics Europe's members agree with the reasons (in § 444-453) put forward by brand owners as to why marketplace restrictions may be necessary. Further, the selection of an authorized retailer is *intuitu personae* and signifies that the supplier is confident that it can still frame and protect its brand and products at all stages of the purchase process, that the products will be sold in an appropriate environment (that remains consistent off and on-line) and that the retailer remains recognizable to the consumer. With respect to market places, absent any direct contractual link between the brand owner and the market place, it becomes very difficult to follow the product all the way to the consumer in the way the brand-owner and the retailer have agreed, with sometimes even an impact on the ability to comply with regulatory requirements. Moreover, paragraph 54 of the Vertical Guidelines sets out the *equivalence principle* according to which the supplier may require its authorized retailer to adhere to criteria set for on-line sales that are similar to those set for off-line sales. The *logo (enseigne) principle* included in the same paragraph is a direct embodiment of the equivalence principle, and enables companies to ensure that the retailer remains known to the customer throughout the purchasing process. It is therefore legitimate for a supplier to oppose the sale of its products on a third-party platform if that platform does not correspond to the criteria set by the brand owner, regardless of any additional services offered by the platform. The particular logo requirement is one qualitative criterion but is essential to selective distribution in that it allows brands to maintain the close relationship between the authorized retailer and the consumer.

Cosmetics Europe's members take note of the various actions given as an example by marketplaces to address quality requirements (§456-458). Many cosmetics brand owners' however still experience that several major marketplaces sell counterfeiting products and products from non-authorized resellers and do not demonstrate any willingness to proactively put in place strict measures against such illegal sales. Given the absence of a direct contractual link with the platform, it becomes impossible for the brand owner to protect its brand image. In addition, and as previously indicated, smaller retailers' have limited negotiation powers towards the large platforms.

Therefore, it is today considered by many cosmetics companies that a restrictive approach with respect to third party platforms is required, within the limits set by competition law. The current rules provide a suitable frame and work in practice. Cosmetics companies see no need for additional legislation or guidance on this point.

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