Coty: Selective distribution and the luxury of prohibiting third party platform sales

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With the meteoric rise in internet selling, the permissibility of banning selective distributors from selling via "third party platforms" is a hotly debated topic across the EU, particularly in Germany and Austria. In yesterday's opinion, Advocate General (AG) Wahl sets out his view that third party platform bans seeking to preserve the "luxury image" of products are, subject to certain conditions, permissible because of their potential to improve competition.

In the analysis below we consider the background to the Coty case, a general overview of selective distribution, an analysis of selective distribution across the EU, Advocate General Wahl's opinion, and provide some preliminary comments on the impact of the opinion on selective distribution pending the court's final judgment.

Coty: case background

Coty (a perfume producer) introduced a selective distribution system in 2012 that blocked sales of its products through online marketplaces. When one of its authorized offline distributors began to sell Coty products on online marketplaces (in breach of the selective distribution agreement) Coty sought an injunction to enforce the prohibition. However, a regional court dismissed Coty's claim (on the basis that it was anticompetitive), and Coty appealed to the Higher Regional Court of Frankfurt.

In recent years, there have been several cases in Germany where court judgments appear to conflict with the European Commission's position (discussed in more detail below). As a result of the existing German cases, the significant risk that the Higher Regional Court might render a judgment that was inconsistent with EU law, and the concern that EU law was unclear, the Court requested a preliminary ruling (here) from the Court of Justice of the European Union (CJEU) on various points, including:

- The permissibility of restrictions on the use of online platforms in selective distribution systems
- Whether qualitative criteria can be used to maintain a luxury brand image (consistent with the Pierre Fabre decision of the CJEU)

Against this background, the CJEU's ruling will have important and practical relevance for producers of luxury goods operating selective distribution systems, specifically those using platform bans and AdWords.

Overview of selective distribution

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Operators of selective distribution systems use certain criteria to determine whether a distributor should be allowed to distribute its range of products. However, the application of such criteria will generally be subject to competition law as the criteria might distort competition between distributors.

The application of purely qualitative criteria to a selective distribution system will generally fall outside of the scope of the competition law prohibition if: (i) the nature of the product necessitates selective distribution so as to preserve its quality and ensure its proper use; (ii) distributors must be chosen on the basis of objective criteria of a qualitative nature applied uniformly to all distributors; and (iii) the criteria must not go beyond what is necessary.

It is not clear if Coty's whole product range would satisfy (i) above. On the other hand, the application of quantitative criteria will be subject to competition law rules and might benefit from the Vertical Agreements Block Exemption (VABE) Regulation, providing the agreement does not contain any hardcore restriction of competition law (e.g. price fixing, market sharing).

The extent to which a restriction of online market places might constitute a hardcore restriction (which removes the protection afforded by the VABE) is currently subject to differing interpretation across the EU (see below).

**Analysis of selective distribution across the EU**

**Germany and Austria's position**

The judicature in Germany has given inconsistent decisions as to the kind of product features that justify a selective distribution system.

Some courts ruled that durable, high-quality and technically complicated products giving rise to a particular need on the part of the consumer for advice, customer service and/or repair services may justify a selective distribution system. This applies not only to luxury goods but also to branded products where the manufacturer positions them as high-priced premium products and demands that the seller fulfills specific requirements as to presentation, advice and promotion of the brand image. Furthermore, selective distribution systems need to be applied in a consistent and non-discriminatory manner.

The courts apply these principles inconsistently. For example, a selective distribution system was upheld for a school backpack whereas it was not upheld for a digital camera.

In relation to selective distribution systems, the German Federal Cartel Office (FCO) currently considers that platform bans (as well as price comparison and AdWord use restrictions) constitute a “hardcore restriction” of competition. However, this position is not necessarily consistent with the VABE Guidelines which set out that "a supplier may require that its distributors use third party platforms to distribute the contract products only in accordance with the standards and conditions agreed between the supplier and its distributors for the distributors’ use of the internet.” (para 54).

In addition, the German Federal Supreme Court issued recently a judgment which sets out that where there are a number of manufacturers making direct sales to end customers, those manufacturers' direct sales should be excluded from any market share calculations. This would necessarily increase the market shares of distributors which could result in the selective distribution system falling outside of the scope of the VABE. The FCO has also questioned whether, even if market shares were below 30 percent, the VABE would cover these restrictions.

Because of the significance of the CJEU’s judgment in the Coty case, the FCO has stated that it will not enforce its view until the outcome of the case is known.

Austria supports the Commission's view that the guidelines allowing selective distribution systems for luxury-goods as mentioned above should apply in the Coty case. However, there is no relevant case law on this issue in Austria.

**The Commission’s position**

The European Commission takes the view that restrictions with respect to the use of online platforms by a distributor do not necessarily affect other online sales channels. Even a total ban on using online platforms may not always be anticompetitive.
For example, the European Commission's VABE makes it clear that, in the context of selective distribution, the supplier may impose quality criteria, including with respect to sales through third party platforms. Likewise, the European Commission's final report into the e-commerce sector (10 May 2017 see our comment here) noted that there has been an increase in contractual restrictions imposed on distributors 'to better control product distribution' including restrictions on marketplace bans, and restrictions of pure online players. The Commission stated that some of these practices may be justified, for example in order to improve the quality of product distribution. However, others may unduly prevent consumers from benefiting from greater product choice and lower prices in e-commerce and therefore warrant Commission action to ensure compliance with EU competition rules. In the European Commission's view, even an absolute ban on the use of online marketplaces should not necessarily be considered to constitute a hardcore restriction.

This is potentially at loggerheads with Pierre Fabre, where the CJEU suggested that a ban on the use of the internet should be considered as an object restriction. It is in this light that the European Commission now backed Coty’s position and asked the Court to clarify the expansive Pierre Fabre doctrine.

**Other EU Member States’ position**

In the aftermath of the Pierre Fabre judgment, national competition authorities have increasingly prioritised the scrutiny of online sales restrictions and findings of infringements to competition rules.

The UK Competition and Markets Authority (CMA) has already expressed its concern with different types of restrictions to online sales, thus following the Commission's approach in the VABE Guidelines, by highlighting that “the internet is an increasingly important distribution channel and that retailers’ ability to supply via this channel should not be unduly restricted.” For instance, in an ongoing investigation, the CMA considered that Ping Europe Limited has breached UK and EU competition law by operating an online sales ban. In doing so, the CMA highlighted the importance of a grounded justification for such a restriction, thus not considering it an object restriction.

The French Autorité de la Concurrence seems to follow an equivalent approach. More precisely, in cases Caudalie, Bang & Olufsen, and Adidas the Autorité has expressed that the terms and conditions imposed by manufacturers to their distributors in what regards online sales must not unduly restrict the development of e-commerce. In Caudalie, the manufacturers concerned removed the prohibitions from their selective distribution agreements and attenuated the requirements and restrictions on third party platforms so as to overcome the competition concerns of the Autorité. In Adidas, joint cooperation between the Autorité and the FCO in the context of such investigations led to changes of commercial policy of Adidas in both jurisdictions.

The importance of online sales competition with traditional businesses is acknowledged and welcomed by national competition authorities’ notably due to the advantages for the consumer. Notwithstanding, several authorities seem to avoid straightforward prohibitions of online sales restrictions as such and prefer to adopt a case by case analysis of the reasonableness and adequacy of those restrictions in the light of the objectives of the manufacturers when creating their own selective distribution systems. Ultimately, changes are tailored according to the case by case specificities in an effort to meet – to the extent possible - the reasonable aims of all the involved parties.

**AG Wahl’s opinion**

AG Wahl today rejected arguments that Pierre Fabre called into question established case law and he re-affirmed the position (set out above at section 2), that selective distribution systems relating to the distribution of luxury and prestige products will generally fall outside the scope of the competition law prohibition if they meet the three criteria identified at (i)-(iii) above. In addition to this, AG Wahl stated that prohibition clauses on the use of third party platforms, as at issue in this case, will also generally fall outside of the scope of the competition law prohibition where the clause is: (i) dependent on the nature of the product; (ii) determined in a uniform fashion and applied without distinction; and (iii) does not go beyond what is necessary.

AG Wahl has set out his view that, whilst it will ultimately be for the German court to consider the validity of the contested clauses of the selective distribution agreement, the clause does not appear to be caught by the competition law prohibition. In fact, he considers the prohibition is likely to improve competition based on qualitative
criteria. The opinion emphasises that Coty's prohibition is not an absolute ban on online sales, only a ban on third party platforms which are not required to conform to Coty's qualitative requirements. Consequently, AG Wahl considers that the prohibition is likely to improve the luxury image of the products by ensuring they are sold in an environment that meets Coty's legitimate qualitative criteria. It also enables Coty to ensure that its investments to improve the products' image, as well as the efforts of its authorised distributors, will not benefit other "parasitic" undertakings.

Furthermore, AG Wahl considered the prohibition to be proportionate to the objective pursued in view of the fact that compliance with selective distribution qualitative criteria can only be effectively ensured if the "internet sales environment" is devised by authorised resellers with a contractual obligation to comply with these criteria.

Preliminary comments pending the CJEU's judgment

Online market place bans have not been considered to be anticompetitive in some jurisdictions (outside of Germany and Austria) and AG Wahl's opinion lends further support to the permissibility of such bans. Nevertheless, there remains a risk of investigation and until the CJEU's final judgment has been published, there must be some doubt as to whether a national court would enforce a contractual restriction prohibiting market place sales.

If you have any comments or queries or would like further information, your local DLA Piper contacts (here) will be able to provide assistance or advice.

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