



AAI – Webinar

**Vertical restrictions and luxury goods
after the Judgment of the EU Court in the Coty Case**

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Introduction

- The web has become a powerful channel for the distribution of goods and services → significant changes in distributors' strategies, depending on whether they saw the Internet as an **opportunity** or a **threat** to their existing sales networks.
- As suppliers of sophisticated goods have relied for decades on selective distribution as the cornerstone of their supply policies, it has been argued that Internet sales have “**shaken selective distribution out of its comfort zone**”.
- In particular, suppliers fear that using **third-party platforms**, like Amazon or E-Bay, might have a negative impact on the product's image or on their quality, because the customers cannot benefit from a special shopping experience, intensive customer service and care, and the aura of exclusivity.
- In Europe, some suppliers reacted by introducing an outright ban on sales via the Internet, while other suppliers introduced an absolute ban on members of a selective distribution system making use of third-party platforms.



The general ban of internet sales is unlawful ...what about the clauses which ban sales via third-party platforms?

- The illegality of a general ban on sales via the internet is unquestionable, especially after the ruling of the ECJ in the **Pierre Fabre Dermo-Cosmétique** case (2011) → but that judgment was confined to the specific facts of the case, involving an absolute ban on Internet sales.
- So, the contractual clauses which ban sales via third-party platforms have remained controversial.
- These contractual clauses have determined the opposition of some distributors and third-party undertakings, fuelling a debate as to whether an absolute ban on the use of a third-party platforms constitutes an illicit restriction of competition and, if so, whether such a restriction can be exempted.
- The debate also regards the preliminary question as to whether a selective distribution system relating to prestige, luxury, high quality, highly technical or sophisticated products is compatible with art. 101 (1) TFUE.



The “Coty case”

- So far, the EU Courts have not dealt with the case of restrictions of sales via third party platforms within selective distribution systems, until recently, when a German Court has requested the ECJ for a preliminary ruling.
- Facts: Coty Germany is one of Germany’s leading suppliers of luxury cosmetics. It sells its products via a selective distribution system and justifies this system in the following terms: “the character of Coty Prestige’s brands requires selective distribution in order to support the luxury image of these brands”. Coty has introduced the prohibition on the use, by the distributors of those products, in a discernible way of non-authorized third-party undertakings for internet sales of the contract goods.
- The Higher Regional Court of Frankfurt asked the European Court of Justice:
 - a) whether selective distribution systems that serve to protect the luxury image are permissible under EU competition law;
 - b) whether manufactures may ban members of their selective distribution system from using third-party platforms in a discernible manner for online sales.
 - c) assuming such a prohibition includes a restriction of competition in the sense of Art. 101(1)TFEU, does it constitute a hard-core violation under Art. 4 (b) or Art. 4 (c) of the VBER?



The opinion of the ECJ Advocate General Wahl

- On 26 July 2017 Advocate General (AG) Wahl delivered his opinion on the case: EU competition law allows selective distribution system that are intended to preserve luxury image of a product to ban the use of third party platforms, if the three standards conditions, established by ECJ's case law, are met → the clause at stake pursues qualitative objectives and it is proportionate for their achievement.
- Very interesting in the AG conclusions → the importance of competition not solely based on prices → legitimate requirements – such as the maintenance of a distribution system capable of providing specific services as regards to high quality and high technology products - may justify a reduction of price competition in favor of competition relating to factors other than price.
- Since the Metro case (1977) the ECJ has emphasized that the nature and the intensity of competition may vary according to the nature of the goods and services in question and the economic structure of sectorial market concerned. These factors may justify the existence of differentiated distribution channels adapted to the characteristics of the various products.
- By its reasoning – in the view of AG - “the Court has implicitly but necessarily acknowledged that a reduction of intra-brand competition might be accepted when it is essential to the stimulation of inter-brand competition”.



The ECJ judgment (1)

- On 6 December 2017, in line with AG Wahl's opinion, the ECJ ruled that a selective distribution system for luxury goods designed, primarily, to preserve the luxury image of those goods **complies with article 101(1)TFUE**, provided that the resellers are chosen on the basis of objective criteria of a qualitative nature that are laid down uniformly for all potential resellers and applied in a non-discriminatory fashion and that the criteria laid down do not go beyond what is necessary (Metro criteria).
- Such a ban can be proportionate to the goal of preserving the **luxury image of goods**.
- This judgment was highly anticipated in Europe, as it deals with key issues of online distribution within selective distribution systems and its ruling brings **more legal certainty** both to undertakings and competition authorities as to the application of competition law in the online marketplace.
- Indeed, the judgment defines an important line for suppliers of branded goods and online marketplaces, which has been the subject of much controversy.



The ECJ judgment (2)

- The Court requires a **case by case assessment**: such a contractual clause does not infringe art. 101(1) TFUE, on condition that has the objective of preserving the luxury image of those goods, that it is laid down uniformly and not applied in a discriminatory fashion, and that it is proportionate in the light of the objective pursued.
- The Court noted that in its *Copad* ruling in 2009 held that a luxury image is an essential element of some products and that selective distributions systems can preserve the quality and good use of such products and rejected the argument that Pierre Fabre had reversed this principle → PF had imposed an absolute ban and the goods at issue were non-luxury goods, but cosmetic and body hygiene goods .
- Furthermore, the Court clarified that such a prohibition imposed on the distributors at the retail level of trade does not constitute a restriction of customers, within the meaning of Article 4(b) of Reg. 330/2010, or a restriction of passive sales to end users, within the meaning of Article 4(c) of the said regulation.
- The Court distinguished the present case from its previous ruling in Pierre Fabre → in particular, the Court specified that, contrary to Pierre Fabre where an absolute ban on online sales was at stake, in the present case the clause did not prohibit the use of the internet as a means of marketing the contract goods, but it only prohibited to the internet sale of the contract goods via third-party platforms which operate in a discernible manner towards consumers.



Main findings

- 1) The ruling provides an opportunity for the ECJ to clarify its earlier Pierre Fabre ruling: the court did not intend to outlaw the possible use of selective distribution systems for luxury goods per se in its Pierre Fabre judgment and confirms that the Metro criteria continue to apply to distributors of luxury goods.
- 2) The clause at issue in the Coty case does not constitute a restriction of competition in the sense of Article 101 (1) TFEU.
 - the referring court already recognized that the clause is applied in an objective and uniform manner without discrimination to all authorized distributors. In this context it will be particularly important for the brand manufacturer not to sell products via third-party online platforms and not to allow such sales elsewhere in its distribution system.
 - the clause is necessary, appropriate and proportionate for the preservation of the image of Coty's luxury goods. It ensures that the products are sold only by the authorized distributors.
 - with regard to proportionality, the Court highlights that the clause does not contain an absolute prohibition of online sales because the prohibition only refers to "the internet sale of the contract goods via third-party platforms which operate in a discernible manner toward consumer." Authorized distributors remain in fact free to sell through their own websites if they have an "electronic shop window" for the authorized store.
- 3) it would not have been necessary to discuss the remaining questions of whether a third-party online platform ban can be considered as a hard-core restriction.

The context

- The ECJ ruling fully aligns to the position of the European Commission:
 - Guidelines on vertical restrictions: suppliers may require quality standards on resellers for use of the internet or third-party online platforms, including the requirement to have a brick and mortar shop (par. 54).
 - Final report of the Sector inquiry on e-commerce: the Commission confirmed its view that marketplace bans do not constitute a “hardcore” restriction so can benefit from the VBER as they do not, in practice, amount to an absolute ban on online sales.
 - In line also with the position of Italy and some other MS;
- However, some national competition authorities and courts have adopted a more **restrictive approach** → Court cases in Germany and France in particular have viewed marketplace bans as incompatible with the Article 101(1) TFEU.



The ban on the use of third party platforms as an hardcore restriction ?

- Also some scholars have argued that an absolute ban on the use of third party platforms, within a selective distribution system, is a restriction of competition **by object** that violates art. 101 TFUE and an **hardcore** restriction pursuant to art. 4(c)VBER (L. Solek and S. Wartinger).
- This provision requires that the members of selective distribution systems operating at retail level are not restricted in their active or passive sales to end-users. An absolute ban prevents the distributor from selling its products via the third party platform, and hence from passively selling its products to customers who wish to purchase the products from such a platform and are located outside the physical trading area of the distributor. These customers may be regarded as a separate customer group, different from customers that purchase products via other distribution channels.
- To argue the illegality of the restriction in question, art. 4 (b) is also invoked, which qualifies as a hardcore restriction of every measure which has as its object the restriction of the territory into which, or the customer to whom, the distributor may sell.



The “ASICS” decision

- Such interpretation influenced the decision adopted by several German Courts and the German Federal Cartel Office (Bundeskartellamt). The **ASICS decision** (26 August 2015) is especially relevant → the German antitrust agency decided that the distribution system in question contained provisions that were **restrictions by object**. Among them, a restriction on the use of the ASICS brand names on third-party platforms in order to guide customers to the website of an authorized ASICS retailer, and a per se prohibition of supporting online price comparison engines.
- These restrictions were deemed to hinder access to sale channels that are of particular importance for end customers. In the view of the German Competition Agency, for many retailers a prohibition of sales via online marketplaces in a selective distribution system leads to a major restriction of their possibility of making online sales to end customers. Moreover, the prohibitions in question were considered **hardcore restrictions** within the meaning of art. 4 (c) of the VBER.
- In a preliminary comment on the Coty judgment, the German Federal Cartel Office stated: *“At first glance, we see only limited effects on our decisional practice”* noting that the judgment relates to **luxury products**. The German authority’s initial view is therefore that its case law, which relates to a wider selection of goods, such as branded sporting and leisure goods, remains unaffected by the CJEU’s judgment.

The impact of the Coty judgment

- The case provides opportunity for speculation on a number of questions. Is the clause appropriate to protect the luxury image? Does it go beyond what is necessary? What does luxury exactly mean? Is the Coty exceptions a luxury for a selected few?
- and how will this case be applied in the different Member States? Some commentators have raised concerns for a possible divergent application by NCAs and courts. For example, there might be some discrepancies at national level in the interpretation of luxury products or in the evaluation of the proportionality test. To some extent, this has already happened.
- However, not all national competition authorities and courts have taken a restrictive approach, with French and Dutch courts apparently moving in the opposite direction in 2017 (already before the ruling).
- It remains to be seen where the line will be drawn by each national court and enforcement agency.
- In any case, the ECJ judgment will facilitate a uniform application of competition rules across the European Union.



Conclusions

- ECJ's judgment in the Coty case brings more legal certainty both to competition authorities and undertakings to the application of competition law in the online marketplace.

- Competition agencies perspective:
ICA, as the European Commission, welcomes the judgment as a very important step to provide more clarity and legal certainty to market players, with regard to selective distribution agreements and in general to vertical restrictions.

- Companies perspective:
Suppliers should find comfort in the CJEU's decision but should carefully design selective distribution systems for luxury products and ensure that such bans are proportionate with the overall objective of preserving quality or brand image in accordance with qualitative criteria → Indeed, companies who consider such limitations necessary should:
 - (i) clearly articulate the specific luxury nature of their products,
 - (ii) organize a coherent and non-discriminatory distribution system with objective qualitative criteria, and
 - (iii) carefully consider the specific reasons that might require a limitation of internet sales.





Thanks for your attention!

