

IBA/IFA 34th

ANNUAL JOINT CONFERENCE

* * * * *

A New Era in International Franchising

* * * * *

**THE ECJ JUDGMENT IN THE COTY GERMANY CASE REGARDING THE USE OF
THIRD PARTY PLATFORMS IN SELECTIVE DISTRIBUTION SYSTEMS**

—

May 9, 2018

Washington, D.C. U.S.A.

**Rocio Belda de Mergelina
J&A Garrigues SLP
Madrid
Spain**

On December 6, 2017 the Court of Justice of the European Union (“ECJ”) delivered its long-awaited judgment in the Coty Germany case¹, a request for a preliminary ruling submitted by the Frankfurt Regional Superior Court in a dispute that said German court has to settle, confronting multinational luxury cosmetics producer Coty Prestige (“Coty”) and one of its authorized retailers.

As Advocate General Nils Wahl so rightly raised in his opinion dated July 26, 2017, the request for a preliminary ruling submitted by the Frankfurt Court has afforded the ECJ the opportunity to “think over” the legality of selective distribution systems under the competition law of the European Union (“EU”), in the light of recent developments in the e-commerce sector and its impact for said distribution model. This is because, in fact, the meteoric rise of e-commerce and the ever-increasing use by retailers of electronic marketplaces run by third parties, independent of the manufacturers, had led a number of national competition authorities and courts of the EU Member States² to question the legality of the ban imposed by suppliers on the use of those marketplaces by the retailers pertaining to their authorized networks, a ban that is commonplace in selective distribution systems. All in all, as Attorney General Wahl openly suggested, the ECJ should clarify whether the judgment rendered in 2011 on the *Pierre Fabre* case fundamentally altered, as many have construed, the assessment under EU competition law of the restrictions that are inherent to selective distribution systems. A particularly important factor in this case law scenario is the European Commission’s support for e-commerce and the conclusions in its final report of the E-commerce Sector Inquiry published on May 10³, 2017, which highlighted the importance of third party platforms as a sales channel for small retailers and the existence of many agreements between them and their suppliers restricting their access to online marketplaces.

1. The facts of the case and the legal framework for selective distribution systems within the European Union

The plaintiff in the national proceeding, Coty, distributes its products in a selective distribution network, a system in which retailers are chosen and authorized by suppliers on the basis of compliance with the objective quality standards determined by the supplier to meet the specific needs arising in connection with the distribution of their products (by reason of their prestigious and luxury product image, their technical features, the necessary sale and after-sales, or other factors). In this type of system, as defined by article 1.1. e) of the so-called Block Exemption Regulation (“BER”)⁴, the distributors undertake not to sell the goods to unauthorized

¹ Case C 230/16 *Coty Germany GmbH v Parfümerie Akzente GmbH*

² Among others, the decisions of the Bundeskartellamt (Federal Competition Authority, Germany) of June 27, 2014 in the *Adidas* case and of August 26, 2015 in the *ASICS* case; the decision of the French competition authority of July 2014 in the *Bang & Olufsen* case and other similar decisions; and the judgment of the Paris Court of Appeal of February 2, 2016 in the *Caudalie* case.

³ COM 2017 (229) FINAL

⁴ Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the TFEU to categories of vertical agreements and concerted practices, OJ 2010 L 102, page 1

resellers within the territory in which the manufacturer operates under that system. Coty's authorized distributor who has triggered the case resells the products to the public both at its brick-and-mortar stores and online. Those online sales are made partly through its own e-store and partly on the Amazon e-commerce platform. The contract binding Coty to its distributors contains a myriad of provisions determining the objective qualitative criteria to be met by their points of sales in order to preserve the luxury image of Coty products, providing for the distributors' right to sell the products in their own websites when they comply equally with the relevant objective quality criteria. The EU guidelines on vertical restraints⁵ (the "Commission Guidelines") deem it admissible to impose qualitative criteria for online sales in as far as it is for offline sales. However Coty's distribution agreement prohibits the distributor to use online marketplaces or websites identified as belonging to a third party, or to engage any non-authorized third parties in a discernible manner. Coty's distributor challenged the latter contractual provisions by arguing that they were contrary to competition law.

The German court of first instance held that the selective distribution system, by definition, restricted competition, and that the clause at issue did not warrant a block exemption as a result of not being necessary since there were other means that were also appropriate to preserve the image of the products but less restrictive of competition, such as the application of specific quality standards to the third-party platforms.

It must be noted that the BER treats as hardcore restrictions of competition or restrictions "by object", hence preventing the benefit of the block exemption under the BER, to any restrictions on customers⁶ and restrictions on passive sales to end users⁷, that are implemented within the framework of a selective distribution system. In its judgment in *Pierre Fabré*⁸, the ECJ ruled that a clause in a selective distribution contract resulting in a ban on the use of online sales by the reseller amounts to a restriction "by object" within the meaning of article 101.1 Treaty on the Functioning of the European Union ("TFEU") *where, following an individual and specific examination of the contents and objective of that contractual clause and the legal and economic context of which it forms a part, it is apparent that, having regard to the properties of the products at issue, that clause is not objectively justified*. It further ruled that article 4 c) BER must be interpreted to mean that the block exemption does not apply to a clause prohibiting *de facto* the sale of those products online, although such a contract may benefit, on an individual basis, from the exemption provided for in article 3 TFEU where the conditions of that provision are met.

2. The questions submitted to the Court

In the Coty judgment the Court was requested to provide a response to three fundamental questions.

⁵ Paragraph 54 of the Commission Communication dated May 10, 201 – Guidelines on vertical restraints [SEC (2010) 411 final]

⁶ Article 4 b) BER

⁷ Article 4 c) BER

⁸ Judgment of October 13, 2011 in *Pierre Fabre Dermo v Cosmétique*, C-439/09.

2.1 Whether selective distribution systems are caught by the general prohibition of agreements restrictive of competition

By its first question, the Frankfurt Court asked the ECJ whether, in essence, a selective distribution system for luxury goods designed, primarily, to preserve the luxury image of those goods, falls within the scope of application of the prohibition on restrictive agreements in article 101.1 TFEU.

In the Coty case the ECJ recalls and confirms the settled case law⁹ to the effect that the organization of a selective distribution system is not prohibited by the Treaty if three conditions are met: (i) the resellers are chosen on the basis of objective criteria of a qualitative nature, laid down uniformly for all resellers in the network and not applied in a discriminatory fashion; (ii) the characteristics of the goods for which selective distribution is used require a system of this type to preserve their quality and ensure their proper use; and (iii) the criteria laid down do not go beyond what is necessary¹⁰. And with regard to the question whether selective distribution may be considered necessary for the distribution of luxury goods, the Court, in line with the reasoning expressed in the fine opinion of the Advocate General to the effect of using the principles laid down in EU case law on trademark law, reiterates that the quality of luxury goods is not just the result of their material characteristics, but also of their allure and their prestigious image which is essential in that it enables consumers to distinguish them from similar goods and, therefore, an impairment to that aura of luxury is likely to affect the actual quality of those goods. In this finding, the Court confirms the view taken in its previous judgments¹¹ to the effect that the characteristics and conditions of a selective distribution system may, in themselves, preserve the quality of luxury goods. In reaching this conclusion in previous case law the ECJ had taken into consideration that the quality of luxury goods is not just the result of their material characteristics, but encompasses also their "aura of luxury" which is essential in enabling consumers to differentiate them from similar goods and that an impairment to the aura of luxury is likely to affect the actual quality of those goods

Having regard to the petitions of the General Advocate and of a number of parties in the proceeding, the ECJ takes the opportunity to clarify that the *Pierre Fabré* judgment, which did not concern the distribution system implemented in its entirety in that case (only the specific clause prohibiting online sale generally) and did not relate to luxury goods, did not seek to examine the EU system according to which the preservation of a luxury image may justify a restriction on competition of the type stemming from the existence of a selective distribution system used for that purpose. Therefore, the Coty judgment confirms that the preservation of the aura of luxury goods justifies the use of a selective distribution system and does not amount to a restriction on competition prohibited as such by the Treaty.

2.2 Whether a ban for authorized dealers to use third parties online market places falls within the prohibition of agreements restrictive of competition

⁹ Judgment of October 25, 1977 in case 26/76 *Metro SB-Großmärkte v Commission* (Metro I)

¹⁰ Those fundamental criteria are included in the Commission Guidelines as well (paragraph 171)

¹¹ In particular, the judgment of April 23, 2009 in case C-59/08 *Copad*

Secondly, the Court is asked to rule on the prohibition preventing authorized distributors from using third party platforms for the online sale of goods which are discernible as such.

While it is for each court to determine on a case-by-case basis whether such a contractual prohibition meets the above criteria to preserve the prestigious image of the products, the ECJ has not hesitated to provide the competent judge with the necessary legal principles to resolve on this issue and understood that the prohibition in the case at issue is proportionate in light of the aim sought. This is because it: (i) guarantees that the reseller will only be associated with the authorized network; (ii) enables the supplier to check that the goods will be sold online in an environment that meets the qualitative conditions that it has agreed with all of its authorized distributors and allows it to take action when this is not the case, whereas the supplier being unable to require compliance from third parties with the quality conditions involves a risk of deterioration of the luxury image of the goods; and (iii) does not go beyond what is necessary in that distributors are allowed to sell the goods online via their own websites. For this analysis (which is the task of the court in the light of the specific circumstances of each case) the ECJ draws a comparison with the supplier's lawful right to lay down uniform quality requirements at authorized dealers' brick-and-mortar points of sale. However, case law might develop in the future in this regard should the development of e-commerce enable suppliers to check the quality and identification requirements for the sale of their products on third-party platforms. This notwithstanding, we note the *obiter dicta* included in the Coty judgment that the fact that products are sold online solely in e-stores owned by authorized retailers contributes to the luxury image of the products hence to preserve one of the main features thereof as sought by consumers¹².

2.3 Whether a prohibition to use third party platforms would merit the benefit of the block exemption for agreements restrictive of competition

Lastly, the referring court also asks the ECJ to shed light on cases where the referring court would find, in the light of the facts of the case, that the clause at issue restricted competition within the meaning of article 101.1 TFEU, and therefore had to assess whether it would merit the benefit of the exemption to the prohibition provided by that article, under the BER. It therefore requests the Court to rule as to whether that clause may amount to a restriction on customers or on passive sales to end users, none of them qualifying for authorization under the BER due to being deemed to be *hardcore restrictions*.

The Court recalls that to the extent that the Coty contracts allows online sales and that the system, in turn, allows dealers to advertise their brands on third-party platforms and to use online search engines to locate the websites authorized by the brand, the clause at issue does not result in customers being unable to find the authorized retailers' online offer. As a result, the clause would benefit from the exemption under the BER from the prohibition laid down by

¹² Paragraph 50 of the judgment. This *obiter dicta* is important because the relevant contractual clause for the Coty case did not provide for an outright ban of sales in third parties platforms, but only in those ones discernible as such. Conversely, the Commission Guidelines (para. 54) only provide that where the distributor's website is hosted by a third party platform, the supplier may require that customers do not visit the distributor's website through a site carrying the name or logo of the third party platform. For this reason we take the view that case law may develop if technology allows authorized dealers the use of third parties platforms in a manner non-discernible and respecting the selective criteria provided by the supplier for online points of sale, and the importance of the above *obiter dicta* for a future assessment by case law.

article 101.1 TFEU, should the latter applied, something that, in view of the principles provided by the ECJ in response to the previous questions made in the Coty judgment does not appear to be likely.

3. The situation of online selective distribution in third party market places after the Coty judgment – the applicability of the conclusion of the ruling to other goods beyond luxury goods

In summary, the Court has clarified certain uncertainties raised by the *Pierre Fabré* judgment (or by misinterpretations thereof) for the online selective distribution of luxury products, and has headed off a proliferation of decisions of the Member States authorities concerning sales by authorized dealers on third party platforms. However, it is to be noted that the Coty case only regards the compatibility with competition law of a contractual ban on dealers' sales on online marketplaces not authorized by the supplier, but it does not rule about sales by any resellers of brand products in online marketplaces not authorized by the brand owner, in general. This issue, as that of any offline sales in the grey market non-authorized by the brand owner, must be assessed under the ECJ doctrine on the exhaustion of trademark rights. Notwithstanding this, the Coty judgment has resoundingly confirmed the compatibility of selective distribution with competition law, its adequateness for the distribution of luxury goods, and the legitimate right of trademark holders to prevent that their products are marketed in an environment that is likely to hinder the prestige of said brands. The luxury goods industry can now continue working on optimizing their distribution with legal certainty.

This comes as good news at a time when both the suppliers of luxury goods and their selective distributors are investing heavily in authorized online sales which will enable them to preserve the aura of luxury surrounding their products and the experience of purchasing them.

However, the Coty judgment refers to luxury goods hence the question remains open as to whether the conclusions of the case could be applied to other goods which are distributed through selective distribution systems, principally high quality and high tech products. The European Commission appears to be clearly in favor of an extensive interpretation of the ruling in the Coty case allowing the application of its conclusion to the products which qualify for selective distribution systems under the criteria settled by the *Metro I* ruling¹³, on a case-by-case basis. The European Commission¹⁴ has recently taken the view that the differentiation made by the Court in the *Coty* judgment between luxury goods (at issue in the Coty case) on the one hand and other products such as the cosmetic and body hygiene goods (at issue in the *Pierre Fabré* judgment) should in practice only be of limited relevance, as a clear delineation between one and the other will in many cases neither be possible, nor necessary as high-quality and high-technology products similarly qualify for selective distribution compliant with Article 101(1) TFEU. This position does not appear to be aligned with the views which have been expressed by the national competition authorities of some of the EU Member States (notably, the German authority), though. However the European Commission justifies its view in the fact that the ECJ does not specifically address the question whether marketplace bans that do not comply with the *Metro I* -criteria (hence falling within the prohibition of restrictive agreements) should be

¹³ See note 9 *supra*

¹⁴ Occasional discussion paper by the Competition Directorate-General of the European Commission (Competition Policy Brief) 2018-01 dated April 2018

considered restrictions of competition "by object" or by "effect". However, given the Court's reasoning that marketplace bans neither have the object of restricting customers to which the goods can be sold within the meaning of Article 4(b) VBER nor of restricting passive sales to end users within the meaning of Article 4(c) VBER, it would seem that a marketplace ban cannot be qualified as a "passive sales" or "customer group" restriction of competition "by object" under Article 101 TFEU.

As a conclusion, when assessing marketplace bans under EU competition rules, it is necessary to look at (i) first, whether the ban fulfills the Metro I criteria; (ii) second, when that is not the case, whether it is capable of restricting competition under the EU rules ¹⁵; and (iii) finally, should that be the case, the block exemption provided to marketplace bans by the VBER.

¹⁵ In practice, this needs to be considered only when the market shares of the parties to the agreement exceed the 30% market share threshold provided by the VBER