



International Distribution Institute

**Which limitations regarding the internet can  
be imposed on the members of a selective  
network?**

**The Coty judgment of the European Court of  
Justice**

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## Our topic

- Under Art. 101 TFEU, are suppliers allowed to prevent authorized resellers, within a selective distribution network, from making use of a non-authorized third party (in particular, a marketplace) in the context of internet sales?
- Can these restrictions be justified within a selective distribution strategy? Only for luxury goods or also for other branded goods?
- Does it matter, for the compatibility of such restrictions, whether retailers have significant alternatives for selling online the contract products?
- What about limitations on the use of price comparison tools?

# The economic impact of e-commerce: challenges and reactions

## **Main results of the Commission Sector Inquiry (2017)**

- e-commerce provides a formidable opportunity for the expansion of sales
- online price transparency leads to increased price competition, both for online sales and for brick and mortar shops
- free-riding in the brick and mortar environment was less challenging than in the current environment: with the internet, arbitrage between online and offline purchases is much easier and more frequent, with a real risk of crowding-out the traditional channels - in the long term, this may be negative not only for the involved retailers, but also for manufacturers and consumers
- the look and feel of a website can change rapidly: the online environment requires closer management and monitoring
- suppliers need a consistent strategy for the positioning of their brand in the new market environment

## Observed reactions to market developments

- trend towards vertical integration
- omnichannel strategies to address the challenges resulting from the radical overhaul of the traditional marketing environment (e.g. free riding, brand positioning, consistent price strategy, initiatives aimed at preventing the online trade of counterfeit products)
- pro-active use of selective distribution agreements (adoption/revision of qualitative criteria for the presentation of the product on websites, reliability of order fulfilling etc.);
- more generally, more intensive use of vertical restraints (including resale price recommendations)

## Some caveats

- a. rapid innovation in business models: undertakings are still experimenting ways to successfully address the new market environment
- b. brands derive their added value from a stable consumer perception of their quality and exclusivity
- c. transaction costs, incomplete contracts: the use of different instruments (contractual restraints, different strategies) to ensure brand consistency, prevent free riding, prevent online trade of counterfeit products is not irrelevant in terms of costs and effectiveness

# The legal framework for the application of Art. 101 TFEU



## Structure of Art. 101

- A prohibition rule – Art. 101(1): agreements which may affect trade between Member States and have as their object or effect a restriction of competition are incompatible with the common market
- A nullity rule – Art. 101(2): incompatible agreements are null and void
- An exception rule -Art. 101(3): Art. 101(1) may be declared inapplicable if the agreement satisfies 4 cumulative conditions:
  - a. contributes to improving production or distribution or to promoting technical or economic progress
  - b. allows consumers a fair share of the resulting benefits
  - c. does not impose on undertakings restrictions which are not necessary to the attainment of these objectives
  - d. does not afford undertakings the possibility of eliminating competition in respect of a substantial part of the products in question

## The Vertical Block Exemption Regulation as a safe harbour (a)

- the Vertical Block Exemption Regulation no. 330/2010 (VBER) is legally binding and directly applicable in all Member States (art. 288 TFEU), thus represents a true safe harbor and is important for the uniform application of the rules by national competition authorities and national courts
- basically, if the vertical agreement does not contain any of the hardcore restrictions listed in Art. 4 and the market shares of the supplier and the purchaser do not exceed 30% of the relevant market in which they, respectively, sell and purchase the contract good, the VBER establishes that the prohibition of Art. 101(1) does not apply

## The Vertical Block Exemption Regulation as a safe harbour (b)

- the Commission and national competition authorities are empowered to withdraw the benefit of the block exemption for a vertical agreement which, in isolation or in conjunction with similar agreements, in practice is anticompetitive pursuant to Art. 101(1) and does not fulfil the conditions of Art. 101(3) (art. 29, Reg. 1/2003) – e.g. market share thresholds are not reached, but network of parallel agreements has an overall significant anticompetitive impact
- moreover, the VBER provides that, in case of parallel networks of vertical agreements which have similar anticompetitive effects and cover more than 50% of a given market, the Commission may by regulation declare the VBER inapplicable to vertical agreements containing specific restraints relating to that market.

Note: both for withdrawal and disapplication of the VBER, legal certainty is safeguarded, since these types of decisions apply only for the future (ex nunc)

## Hardcore restrictions

- If included, the entire agreement loses the benefit of the block exemption
- Usually considered restrictions by object pursuant to Art. 101(1)
- In principle, application of Art. 101(3) on individual basis is possible, but unlikely

Usually the market share thresholds are not met by selective distribution agreements.

The VBER may represent an important safeharbour, providing legal certainty with respect to the compatibility with competition law of both qualitative and quantitative selective distribution agreements not containing hardcore restrictions

=>better to avoid agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object a hardcore restriction

## Hardcore restrictions in the VBER (Art.4)

Hardcore restrictions include:

- a. Resale price maintenance (fixed or minimum resale prices)
- b. Restrictions of territories or customers, without prejudice to restrictions on the place of establishment, except:
  - ⊖ Restrictions of active sales into territories (or to groups of customers) assigned to an exclusive distributor
  - ⊖ Restrictions on sales to end users by wholesalers
  - ⊖ Restrictions of sales to unauthorized distributors within the territory reserved by the supplier to operate a selective distribution system
- c. Restrictions of active and passive sales to end users in selective distribution agreements, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment
- d. Restrictions of cross suppliers between distributors within a selective distribution system

## Role of the Commission: the vertical guidelines

- The Guidelines on vertical restraints (2010/C 130/01) illustrate the vision of the Commission, in the light of the case-law of the ECJ, on hardcore restrictions and the assessment criteria for agreements not covered by the VBER
- In particular, interpretation of the notion of active and passive sales in the online context (points 51-55): “in principle, every distributor must be allowed to use the internet to sell products. In general, where a distributor uses a website to sell products, that is considered a form of passive selling, since it is a reasonable way to allow customers to reach the distributor”. Limiting the proportion of overall sales made by the distributor over the internet is hardcore. This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount of the products offline to ensure an efficient operation of its brick and mortar shop, nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier’s distribution model (§54-56)

## Still on the role of the Commission

- The Guidelines are not legally binding for NCA or national courts
- On the other hand, Reg. 1/2003 provides a number of mechanisms to ensure a consistent application of Art. 101 and acknowledges the crucial role of the Commission to this aim (arts. 11, 15, 16):  
discussions within the European Competition Network; power for the Commission to initiate proceedings on a case relieving the NCA from its competence; power to provide advice to national courts etc.
- The Sector Inquiry and its final report of May 2017 should be seen in this context



# The case-law of the Court of Justice



## Since 2000....

Several cases on the application of Art. 101 to vertical agreements containing limitations on the use of the internet in selective distribution systems, mostly at the national level

- Commission (2001) *YSL* – requirement of brick and mortar shop
- Belgium (2002) *Mako* – ban on online sales
- France (2006) *Festina* – no pure online retailer
- F (2008) *Pierre Fabre* – need for the physical presence of a pharmacist, ban on online sales
- F (2014, 2015, 2016) *Samsung, Adidas* (communiqué), *Caudalie* – ban on marketplaces
- Germany (2015....) *Asics* – ban on marketplaces, p comparison tools, online advertising on search engines; *Coty* -marketplaces
- NL (2017) *Nike* –ban on marketplaces

Some referrals to the Court of Justice by national courts lead to important preliminary rulings => ensure a uniform interpretation of EU rules across Member States

## *Pierre Fabre* (2012) - absolute ban on online sales

a general and absolute ban on internet sales imposed by the supplier on authorized distributors in a selective distribution system:

- a. is restrictive by object and therefore prohibited, pursuant to Art. 101(1) (unless the clause is objectively justified), and
- b. is a hardcore restriction pursuant to Art. 4, letter c, of the VBER, entailing the loss of the benefit of the block exemption (application of Art. 101(3) on an individual basis in principle is available, in practice very difficult to obtain)

The case is about the distribution of cosmetics and personal care products

In §46 the Court states that “The aim of maintaining a prestigious image is not a legitimate aim for restricting competition and cannot therefore justify a finding that a contractual clause pursuing such aim does not fall within Art. 101(1) TFEU” – what is the impact on the compatibility of selective distribution agreements?

## ***Coty Germany (2017)*- use of marketplaces**

### Facts

Dispute between a supplier of luxury cosmetics and an authorized distributor of these goods (Parfumerie Akzente) concerning the prohibition of the use by authorized distributors in a discernible manner of third party undertakings for internet sales of the contract good

A national court of first instance in Germany considered the contractual clause:

- } contrary to Art. 101(1)
- } a hardcore restriction pursuant to Art. 4, letter c, of the VBER
- } not meeting the requirements for an individual exemption pursuant to Art. 101(3) (not necessary and proportionate)

## The referral to the ECJ

- Coty brought an appeal before the Higher Regional Court, Frankfurt am Main, which stayed the proceeding and referred 4 questions to the Court of Justice for a preliminary ruling:
- questions 1 and 2 concern the application of Art. 101(1) to selective distribution systems
- questions 3 and 4 concern whether such clause is a hardcore restriction pursuant to Art. 4, letters b or c, of the VBER

## Question 1 – the aim of maintaining a prestigious image (a)

*Are selective distribution systems that have as their aim the distribution of luxury goods and primarily serve to ensure a luxury image for the goods compatible with Art. 101(1)?*

- Remember §46 of Pierre Fabre
- In *Coty* the Court (§24) recalls the Metro case law (C-26/76) whereby a selective distribution system is not prohibited pursuant to Art. 101(1) if 3 conditions (so-called Metro criteria) are met:
  - a. resellers are chosen on the basis of objective criteria of a qualitative nature, laid down uniformly for all potential resellers and not applied in a discriminatory fashion
  - b. the characteristics of the product in question necessitate such a network in order to preserve its quality and proper use
  - c. the criteria laid down are proportionate, i.e. do not go beyond what is necessary

## Question 1 – the aim of maintaining a prestigious image (b)

- For high quality or technology products the ECJ has repeatedly affirmed that selective distribution may contribute to improving competition for aspects different from price (*AEG Telefunken*, C-107/82, §33). In *Coty* the ECJ recalls its case-law on trademarks (*Copad*, C-59/08): the quality of products is not just the result of material characteristics, but also of the allure and prestigious image which bestow on them an aura of luxury (§25); a selective distribution system may contribute to maintaining the image of the product and thus its quality (§26-27)
- The statement in *Pierre Fabre* does not invalidate this conclusion (§30-35): it must interpreted in the light of the context of the judgment (it refers not to selective distribution systems in their entirety, but to a specific contractual clause entailing an absolute ban on online sales for cosmetic and body hygiene goods: the ECJ was trying to give elements to the referring court to enable it to assess whether such restriction was justified and proportionate

## Question 1 – the aim of maintaining a prestigious image (c)

- In its answer to question 1 the ECJ gets rid of uncertainties on the legitimacy of competition on aspects different from price
- The competitiveness of EU companies on global markets crucially depends on their ability to differentiate their products: importance of high quality brands =>EU competition policy should consider and protect both price competition and non price competition
- Answer no. 1: a selective distribution system for luxury goods designed primarily to preserve the luxury image of those goods complies with Art. 101(1) to the extent that it complies with the other *Metro* requirement, i.e. resellers are chosen on the basis of objective criteria of a qualitative nature, laid down uniformly for all potential resellers and applied in a non discriminatory fashion and the criteria do not go beyond what is necessary

## What about non luxury products?

- the reasoning of the ECJ in principle may apply to any product for which the image is an element of quality, including in particular well known brands
- remember, however, that according to the *Metro* case-law, the criteria laid down in the selective distribution system should not go beyond what is necessary. The different image/aura of luxury of a specific product may justify different requirements for selective distribution



## Question 2: general ban on the use of marketplaces and *Metro* (a)

*A general ban on the use of third party undertakings discernible to the public to handle internet sales is compatible with Art. 101(1)?*

The ECJ leaves to the referring court to assess whether the Metro criteria are met in the case at issue, but gives some indications:

-as to the objective of the clause at issue in the main proceedings, it is clear that it aims at preserving the image of luxury and prestige, which may justify a selective distribution system; moreover, it emerges from the documents that the clause is objective, applied uniformly and without discrimination to all authorised distributors (§42)

## Question 2: general ban on the use of marketplaces and *Metro* (b)

-as to whether the restriction is appropriate to preserve the image of the products, the Court argues that:

- a. the ban provides the supplier with the guarantee from the outset, in the context of e-commerce, that the contract goods will be exclusively associated with authorised distributors, consistently with a selective distribution system (§44-46) (holds for any product for which a selective distribution system is justified)
- b. the absence of a contractual relationship between the supplier and third-party platforms makes it more difficult to monitor and enforce compliance with the qualitative conditions imposed on authorised distributors (§47-49; *idem*)
- c. if the platforms constitute a sales channel for goods of all kinds, selling the products via such platforms may have a negative impact on the luxury image of the product (depends on the type of platform; may be more or less important depending on the image of the product at issue)

## Question 2: general ban on the use of marketplaces and *Metro* (c)

As to whether the restriction is proportionate:

- the ECJ observes that the restriction is not an absolute ban on online sales: in the *Coty* case, authorized distributors were allowed to sell via their own websites according to the qualitative requirements of the system, and also via unauthorised third party platforms when the use of such platforms was not discernible to the consumer (§52-53)
- the sector inquiry shows that the main distribution channel in the context of online distribution is constituted by distributors' own online shops, operated by over 90% of the distributors surveyed (on the other hand, the proportion of retailers using marketplaces differs between MS. The Bundeskartellamt argues that the use of platforms is essential for small retailers to effectively sell online)
- the provision of qualitative requirements in the absence of a contractual relationship with the platforms is less effective, therefore the ban is proportionate (§58)

## Question 2: general ban on the use of marketplaces and *Metro* (d)

Answer no. 2: in a selective distribution system for luxury goods, a ban on the use in a discernible manner of third party platforms for the internet sale of the contract goods may be compatible with Art. 101(1) on condition that the clause satisfies the *Metro* criteria

Open issue: applicable also to non luxury branded goods? The same reasoning applies in so far as a selective distribution system is justified for these goods

## Questions no. 3 and 4

*Is the ban on the use in a discernible manner of third party platforms a hardcore restriction pursuant to Art. 4, letter b (restriction of customers) or to Art. 4, letter c (restriction of passive sales in a selective distribution system)?*

The ECJ observes that:

➤ differently from the Pierre Fabre case, the clause does not prohibit the use of the internet by distributors as a means of marketing of the contract goods or services (§65)

➤ it is apparent from the documents before the Court that it is not a restriction of customers because it is not possible to circumscribe, within the group of online purchasers third party platform customers (§66)

➤ the contract allowed, under certain conditions, authorised distributors to advertise via the internet on third-party platforms (e.g. by means of price comparison tools) and to use online search engines, so that their online offers may be easily found by customers (§67)

## Answers no. 3 and 4

- in circumstances as those at issue in the case, the prohibition does not constitute a restriction of customers or a restriction of passive sales and therefore is not hardcore: the VBER applies

Open issues:

- Does the assessment depend on factual circumstances (i.e. the possibility to circumscribe third party platform customers, the availability of channels which allow authorised distributors to effectively sell online?)
- Have we reached a uniform approach? As already seen, the proportion of retailers using marketplaces and also the proportion of agreements containing marketplace restrictions varies among MS (highest in Germany and France)

Cases since 2017 in NL (*Nike*), F (*Caudalie, Coty France*), Germany (*Asics*) ...

## The DG Comp Policy Brief (April 2018)

DG Comp, in a policy brief of April 2018, provides its view on marketplace restrictions in the light of the Coty judgment

Main points:

- the different position of the ECJ in *Pierre Fabre* and *Coty* highlights that each potentially restrictive clause within a selective distribution system should be analysed separately under the *Metro* criteria
- a selective distribution system can be operated, and bans on third party marketplace may be compatible with Art. 101 also for other product categories than luxury goods, provided that the *Metro* criteria are fulfilled
- the arguments provided by the ECJ to exclude that the ban is a hardcore restriction are valid also for non luxury products
- the assessment of hardcore restrictions in order to preserve legal certainty should not depend on the product category concerned or on market conditions

## Importance of the position of DG Comp

- DG Comp suggests that NCAs and NCs, when assessing bans on the use of marketplaces, should not assess on a case by case basis whether there is a hardcore restriction and thus the agreement is not covered by the VBER (*v. Asics*): the safe harbor ensures legal certainty across the EU. In order to prevent divergent positions the Commission in principle might be able to use its powers under Reg. 1/2003 and relieve NCAs from their competence=> the view of DG Comp may have a very important impact
- On the other hand, it is still possible to withdraw the benefit of the block exemption if in a specific market situation such clause does not fulfil the Art. 101.3 requirements and raises significant competition concerns
- See also the position adopted by the Commission in the Final report of the sector inquiry



## Outside the safe harbour

How to apply Art. 101(1) to selective distribution agreements when the agreement is not covered by the block exemption (e.g. in case of withdrawal of the benefit of the VBER or when the market shares are higher than the thresholds)? The *Metro* case-law follows an approach of “objective justification” which is typical of restrictions by object: not prohibited only if objectively justified

However, in *Cartes bancaires* the ECJ suggests that RBO should be used only in cases which are by their very nature harmful to competition => highly controversial to consider selective distribution agreements RBO (excessive focus on intrabrand competition). This does not exclude that some specific clauses, when not fulfilling the *Metro* criteria, might be considered RBO

## Outside the safe harbour (b)

With reference to bans on marketplaces, Dg Comp acknowledges that in *Coty* the ECJ does not expressly address the issue of whether marketplace bans that do not comply with the *Metro* criteria are to be considered restrictions by object. However, DG Comp observes that the fact that the ECJ excludes that marketplace bans are hardcore restrictions of customer groups or of passive sales pursuant to Art. 4 VBER suggests that they cannot be qualified as “passive sales” or “customer group” restrictions by object pursuant to Art. 101

Note that in the Final Report of the Sector Inquiry the Commission encourages suppliers using selective distribution systems to use only requirements that are justified and proportionate: e.g. the requirement to hold a brick and mortar shop, which excludes pure online distributors, only when justified

When the restriction is not proportionate, the Commission announces that the benefit of the VBER might be withdrawn

## What about bans on price comparison tools?

- Price comparison tools are considered differently because they are not an unauthorized distributor but a tool used by authorized distributors to effectively promote their online sales. They also contribute to increasing price competition across sales channels. Suppliers, on the other hand, may be concerned because they focus only on price, neglecting other variables (scope and quality of service), and thus may negatively affect the brand image. Restrictions are frequent, ranging from outright prohibitions to specific requirements based on certain quality criteria.
- In the Report the Commission argues that absolute bans on the use of price comparison tools not linked to quality criteria might restrict the effective use of the internet as a sales channel and may amount to a hardcore restriction of passive sales under Art. 4, letters b and c, of the VBER. On the contrary, restrictions based on objective qualitative criteria are generally covered by the VBER (e.g. range of products, use of brand name).
- Some restrictions may be seen as restrictions on active sales