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Luxury Goods Manufacturers May Block Certain Online Sales on Third-Party Platforms

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Antitrust/Competition

On 6 December 2017, the Court of Justice of European Union (CJEU) issued its long-awaited Judgment in *Coty Germany GmbH v Parfümerie Akzente GmbH*. Taking an approach similar to that adopted by Advocate General (AG) Wahl in his Opinion in July, the CJEU found that a supplier of luxury goods may prevent its authorised retailers from using third-party platforms in a "discernible" manner[1] to sell its products, in order to preserve the products' luxury image.

On 25 April, the German Supreme Regional Court in Frankfurt referred a number of questions to the CJEU regarding steps taken by Coty in response to its authorised distributor Parfümerie Akzente's (Akzente) sale of perfumes on Amazon Marketplace.

In this case, the CJEU had to consider the type of restrictions on online sales on third-party marketplaces that do not infringe competition law or, as the AG put it "*to 'reconsider' the legality, under the competition rules, of selective distribution systems in the light of recent developments in the e-commerce sector.*" (at para. 2)

Background

Coty distributes its luxury cosmetic brands in Germany through selective distribution agreements that impose qualitative criteria on both brick-and-mortar shops and internet sales. Akzente refused to accept amendments made by Coty to its distribution agreements in 2012, which expressly prohibited online sales using a distinct name and unauthorised third-party sites in a discernible manner. Coty permitted its distributors to sell its products online using an "electronic shop window" or in a non-discernible manner via a third-party site.

The German Regional Court took the view that preserving a prestige brand image does not justify selective distribution, such that the clause at issue was a hardcore restriction of competition. On appeal, the German Supreme Regional Court in Frankfurt referred the following questions to the CJEU:

[1] The CJEU does not comment on the meaning of "discernible". However, footnote 35 of AG Wahl's Opinion refers to the notion of a "*prohibition on the visible use of third-party platforms*". This suggests that the term "discernible" used throughout the Opinion and the judgment refers to the "visibility" of the use of such platforms.

- Are selective distribution systems relating to the distribution of luxury goods and used to preserve the luxury image of these goods compatible with Article 101 of the Treaty on the Functioning of the European Union (TFEU)?
- Can a supplier prevent its selective distributors from selling products via third-party online platforms, regardless of whether the platform fulfils the selective criteria? and
- Can a sales ban on third-party sites amount to a restriction by object under the Vertical Agreements Block Exemption Regulation (VBER) as either or both of customer allocation and restriction of passive sales?

Can Selective Distribution Systems Preserve the "Luxury" Image of Goods?

The first question essentially asks whether selective distribution systems for luxury goods aimed at preserving the luxury image of these goods fall within the scope of Article 101(1) TFEU.

Paragraph 175 of the Guidelines on Vertical Restraints provides that purely qualitative selective distribution systems – which have at least neutral effects on competition – fall outside Article 101(1) TFEU, provided that they meet the *Metro* criteria: (i) the nature of the product requires selective distribution to preserve its quality and ensure that it is correctly used, (ii) the resellers are chosen on the basis of objective qualitative criteria which are determined uniformly for, and applied in a non-discriminatory manner to, all, and (iii) the criteria do not go beyond what is necessary.

In its *Coty* judgment, the CJEU provides guidance on the necessity of selective distribution systems.

Nature of the goods concerned

EU case-law to date has established that a selective distribution system may be necessary to preserve the "quality" of the product, irrespective of whether the products distributed are "luxury" products (*L'Oréal*). The necessity of such a selective system depends on the characteristics and properties of the products, including not only physical qualities (*e.g.*, high-quality or technology-advanced good), but also a luxury image. Referring to the *Copad* trademark case, the CJEU notes that "*the quality of* [luxury] *goods is not just the result of their material characteristics, but also of the allure and prestigious image which bestow on them an aura of luxury.*" (at para. 25)

Therefore, depending on the characteristics and nature of particular luxury goods, a manufacturer may use selective distribution to preserve the luxury image of those goods. It follows that a "*selective distribution system designed, primarily, to preserve the luxury image of those goods is therefore compatible with Article 101(1) TFEU on condition that the* [*Metro*] *criteria* […] *are met.*" (at para. 29)

Clarification on the scope of *Pierre Fabre*

The CJEU takes the position that this conclusion is not inconsistent with its 2011 judgment in *Pierre Fabre*. In that case, the CJEU concluded that a general and absolute ban on internet sales by authorised selective distributors could not be justified. Responding to the AG's call to clarify the scope of *Pierre Fabre*, the CJEU explains that this judgment related "*solely to the*

goods at issue in the case that gave rise to that judgment and to the contractual clause in question."[2] (at para. 34)

The CJEU goes on to note, that this did not mean that preserving the luxury image of a product cannot justify the use of selective distribution in "*regard to all goods, including in particular luxury goods.*"

Conclusion on the first question

The CJEU concludes that "*a selective distribution system for luxury goods designed, primarily, to preserve the luxury image of those goods complies with* [Article 101(1)]", to the extent that the *Metro* conditions are met[3] – which must be considered on the facts of each case. (at para. 36)

Is a Prohibition on the Use of Third-Party Platforms for Online Sales Compatible with Article 101(1) TFEU?

The second question asks whether the prohibition against authorised distributors using third-party platforms for internet sales "*in a discernible manner*" is compatible with Article 101(1) TFEU. While it is for the national court to determine whether the *Metro* conditions are met, the CJEU analyses the clause and finds that it is both legitimate and proportionate to the objective pursued.

The Coty restriction allowed products to be sold online through an "electronic shop window", but prohibited the use of a different business name or third-party sites in a discernible manner. In practice, this means that authorised retailers can distribute through (i) their own website or (ii) a third-party site in a non-discernible manner.

Legitimacy of the restriction

The CJEU found that the restriction on the use of a different business name and third-party platforms in a discernible manner is legitimate, in light of the objective of preserving a luxury image for the following reasons:

- The restriction meets the objective of selective distribution systems, which is to ensure that the goods will be "*exclusively associated*" with authorised distributors (at paras. 44-45).
- The restriction ensures that the goods are only sold "*in an environment that corresponds to the qualitative conditions*" agreed between the supplier and the authorised distributors. Because they do not have a direct relationship with third-party platforms, suppliers cannot ensure compliance with their quality conditions. This may impair the online presentation of goods, "*which is liable to harm their luxury image and thus their very character*." (at paras. 47-49)

[2] The clause required authorised distributors to supply evidence that at least one qualified pharmacist would be physically present at their outlets at all times. This obligation excluded *de facto* online sales.
[3] As explained by AG Wahl, preserving the prestige image of goods may not be legitimate, depending on the properties of the goods concerned or in case of "*particularly serious restrictions*", such as outright bans on internet sales.

- Finally, given the range of goods sold on third-party platforms, the CJEU considers that the fact that luxury goods are not available on such platforms "*contributes to that luxury image among consumers and thus to the preservation of one of the main characteristics of the goods sought by consumers.*" (at para. 50)

Proportionality of the restriction

The CJEU further found that this restriction does not go beyond what is necessary to achieve the objective. Unlike *Pierre Fabre*, the restriction does not contain an absolute prohibition of online sales: authorised distributors can sell online via their own websites and unauthorised third-party platforms when the use of such platforms is not discernible to consumers. (at para. 53)

Moreover, given the absence of contractual relationships between suppliers and third-party platforms, the prohibition of sales on third-party platforms in a discernible manner is more effective than authorising sales on third-party platforms "*subject to their compliance with pre-defined quality control*." (at para. 56)

Compatibility with the VBER

The third and fourth questions address the applicability of the safe harbour set out in the VBER[4] to the prohibition imposed by Coty (in the event that Article 101(1) TFEU applies to Coty's clause).

In introduction, the CJEU states that, in the event that the clause falls within Article 101(1) TFEU, it would be eligible for exemption under the VBER, unless it amounts to a hard core restriction under Articles 4(b) and/or 4(c) VBER. (at paras. 59-61) In his Opinion, the AG went further, stating that these articles "*cannot be interpreted as excluding from the benefit of the block exemption restrictions that determine the methods whereby the products can be sold*" and that a supplier "*must be able to enjoy great freedom in defining the methods whereby those products can be distributed*." (at para. 138)

The CJEU found that the prohibition does not restrict the territory into which, or the customers to whom, an authorised distributor may sell Coty products, within the meaning of Article 4(b) VBER, nor does it restrict passive sales to end-users within the meaning of Article 4(c) VBER. First, unlike in *Pierre Fabre*, the restriction does not prohibit retailers from using the internet for marketing. Second, it is not possible to circumscribe third-party platform customers, within the group of online purchasers. Finally, authorised distributors can still advertise via third-party platforms and use online search engines. It follows that "*even if it restricts a specific kind of*

[4] Specifically Article 4(b) and 4(c) which provide that "[t]*he exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object*: […] (b) *the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services* […]; *(c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment*."

internet sale", the prohibition does not amount to a hardcore restriction under Articles 4(b) and 4(c) VBER.

Additional Observations

The European Commission welcomed this judgment, observing that it "*confirms the Commission's position on the issue, as set out in the vertical Guidelines*" and that it "*will facilitate a uniform application of competition law across the EU*". The treatment of these issues in the Final Report was read by many as suggesting that, while marketplace bans are not generally a *de facto* prohibition on online selling, they may not be generally compatible with European competition law, and suggested that competition authorities may decide to scrutinise such restrictions. Following this judgment, at least some restrictions on the use of third-party sites by authorised distributors fall outside Article 101(1) TFEU.

However, because of the facts of the national proceedings, the *Coty* judgment is limited to luxury goods. As a result, it may not end the discussions about online platforms bans. In particular, national competition authorities and courts will have to determine the scope of the notion of "luxury products". This may lead to divergence across the EU. For example, following this judgment, the Federal Cartel Office (FCO) and certain courts in Germany (which have been very active in connection with restrictions on the use of marketplaces, finding that they amount to hardcore restrictions of competition) will have to consider their approach. That said, Andreas Mundt (President of the FCO) has already indicated that this judgment will likely only have limited effects on the FCO's decisional practice, which is mainly concerned with restrictions imposed by non-luxury brand manufacturers.

Next Steps

The German Supreme Regional Court in Frankfurt will now have to apply the CJEU's findings to the particular facts of the case.

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