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Selective distribution and resale bans on
internet

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EXECUTIVE SUMMARY

The European Court of Justice ("ECJ") handed down on 6 December 2017 its judgment in case *Coty Germany GmbH v. Parfümerie Akzente GmbH* (C-230/16), adopting a position in a debate which has been causing controversy among competition authorities of different Member States and the European Commission. The debate focused on whether a supplier can prohibit its distributors, within the context of a selective distribution system, from reselling their products on internet through third-party platforms when the latter are externally recognisable. The ECJE concluded that under certain circumstances a prohibition of this kind may be justified and does not constitute a restriction of competition within the meaning of Article 101(1) of the Treaty on the Functioning of the European Union ("TFEU").

This judgment is particularly relevant for luxury products, for which an image of quality, exclusivity and prestige is especially important to attract new customers and build brand loyalty. However, it will have general consequences for other types of products for which the supplier simply prefers to have a distribution network in line with its brand image and does not want its products to be sold through certain online distribution channels, where that image cannot be controlled.

Whilst the judgment does not clarify all questions related to the admissibility of clauses which prohibit resale through third-party platforms such as e-Bay, Alibaba or Amazon, in particular with regard to non-luxury products, it certainly sets out more homogeneous criteria than those that had existed up to now, and will allow suppliers to design their European distribution networks with greater legal certainty.

The most relevant aspects of the Coty case are provided below.

BACKGROUND

Coty Germany GmbH ("**Coty**") is a German supplier of luxury cosmetics commercialised through a selective distribution network. The deployment of this type of distribution system, which is acknowledged and permitted by most competition authorities, involves each of the distributor's points of sale having to be previously authorised by the supplier (in this case, Coty), for which certain conditions and quality standards must be met. The justification for such a system is that *"the character of Coty Prestige's brands requires selective distribution in order to support the luxury image of these brands"*.

Parfümerie Akzente GmbH (“**Parfümerie**”) distributes Coty’s products as an authorised retailer, both from its physical points of sale and on internet. A large part of internet sales were made through its own website and another part through a third-party online platform which displayed the latter’s company logo (namely Amazon).

In March 2012, Coty revised the selective distribution network contracts, establishing the retailers’ ability to offer and sell products through internet “*provided, however, that that internet sales activity is conducted through an ‘electronic shop window’ of the authorised store and the luxury character of the products is preserved*”. That entailed in practice an absolute prohibition for distributors to promote and sell products through marketplaces and third-party platforms such as Amazon.

Following Parfümerie’s refusal to abide by these contractual amendments, Coty brought an action before a German court of first instance requesting that Parfümerie be prohibited from distributing its products through Amazon’s platform. The German court of first instance stated, following the judgment of the ECJ, of 13 October 2011, in the *Pierre Fabre Dermo-Cosmétique* (C-439/09) case, that the prohibition included in contracts entered into by Coty restricted competition by object. In its view, the objective of maintaining a prestigious brand image cannot justify the introduction of a such a restriction in a selective distribution system. Coty appealed that ruling and, in the context of such appeal, the court decided to suspend the proceedings and refer a preliminary ruling to the ECJ, which was answered in the judgment of 6 December.

ANALYSIS

1. **Compatibility with Article 101.1 of the TFEU of selective distribution systems aimed at preserving the ‘luxury image’ in certain circumstances**

Following the opinion of Advocate General Wahl, the ECJ understands that “*selective distribution systems relating to luxury and prestige products, and designed mainly to preserve the “luxury image” of those products, are aspects of competition that are compatible with Article 101(1) TFEU*”. In practice, this implies that these distribution systems, whereby the supplier selects its distributors which comply with particular criteria which allow reselling its products only to third parties which are authorised distributors or to final users, are not considered restrictive of competition. Thus, if they do not restrict

competition, they neither require an individual exemption or block exemption by virtue of Article 101(3) TFEU.

However, the ECJ notes that the foregoing conclusion can be held in those cases where the distribution system is “purely qualitative” and to the extent that the three requirements set out in well-defined case law are met, namely that:

- resellers are chosen on the basis of objective criteria of a qualitative nature, determined uniformly for all potential resellers and not applied in a discriminatory fashion;
- the characteristics of the product in question (having regard to both its physical characteristics and its prestige image) require such a network in order to preserve its quality and ensure its proper use; and
- the criteria do not go beyond what is necessary.

The novelty of the ECJ judgment in the *Coty* case does not stem from indicating these three criteria, which are not new as noted above, but rather on the nuancement and rectification of a maximalist approach which had been increasingly extending on the basis of a previous ECJ judgment in the case *Pierre Fabre*. In this precedent, the ECJ had concluded that the protection of the brand image of a supplier could not justify by itself the implementation of restrictions of competition in a selective distribution system, which in that case consisted on an absolute prohibition for resale of products on internet by authorised distributors.

The ECJ states that this conclusion is not called into question by the judgment of *Pierre Fabre*, given that in such case the contractual clause entailed a total prohibition to the distributors of the network of any sale on internet. In this regard, the ECJ considered that the maintenance of the prestige image of the brand did not justify an absolute restriction of sales on internet. On the basis of such judgment, part of the doctrine and some competition authorities construed that protection of a brand's image of quality and prestige could not be a legitimate ground for justification on any restriction of sales on internet, even if they were much less serious than an absolute prohibition of sales through internet.

In *Coty*, the ECJ nuances its findings on the prior judgment *Pierre Fabre* and underlines that they shall be understood within the framework and specific circumstances of the former case, without inferring generalised conclusions therefrom. Therefore, it emphasises that in the former case the challenged

clause was an absolute prohibition of any sale through internet by the network distributors and was not referred to luxury products but to cosmetics and care products. However, in *Coty* the products concerned were genuinely luxury ones, since its demand largely depends on the quality and exclusivity image conveyed by the brand, which could be harmed should the products be commercialised through virtual stores selling any kind of products. Moreover, it is not an absolute prohibition on any sales through internet, but only by means of one of the possible internet channels (i.e., third party platforms with own distinguishing marks). It is in such a differentiated context where the ECJ nuances its prior finding and notes that some restrictions to the commercialisation of products on internet may be justified to the extent that they seek protection of the prestige of the brand and the aforementioned requirements are met.

2. Compatibility of products resale bans on internet through third-party platforms with Article 101(1) of the TFEU

The ECJ considers compatible with competition law a prohibition set out by a supplier to its authorised distributors belonging to a selective distribution network from selling their products on internet through third-party platforms that are externally recognisable, to the extent that it is necessary to preserve the brand or prestige image of the products in question.

With regard to the particular *Coty* case, the ECJ understands that such a prohibition *a priori* meets the three requirements noted *supra*, i.e., that it is applied in a homogeneous, non-discriminatory manner to all resellers and it is objectively justified by the product nature. In addition, it considers the restriction to be adequate in order to protect the luxury image of those products and proportionate to such aim.

In relation to the latter specific issues, the ECJ highlights that the absence of a contractual relationship between the supplier and the internet platform where distributors resell their products would prevent the former from requesting such platforms to comply with quality and prestige image requirements and standards imposed on authorised resellers. This is without prejudice that such platforms could adapt and comply with those standards. Therefore, the prohibition on using such platforms where they have not been approved by the supplier as an authorised distributor channel constitutes, according to the ECJ, an adequate measure in order to protect brand's image of luxury and prestige.

On the other hand, regarding the principle of proportionality, the ECJ reiterates that, unlike in *Pierre Fabre*, the challenged restriction would not impose an absolute prohibition for resellers to perform sales on internet; especially when, as noted by the European Commission in its recent e-commerce sector inquiry, most online sales are made on the distributors' own websites. Coty does not forbid the latter nor that its products may be found by means of search engines, thereby rendering the restriction not excessive for what is necessary to protect brand's image of luxury.

It follows from the above that a complete prohibition on internet sales, as in *Pierre Fabre*, continues to be considered a specially serious restriction of competition breaching Article 101 (1) TFEU. However, in a case like *Coty* where prohibition only extends to sales made on specific third parties' websites with the objective to preserve the image of luxury and prestige of the product, such a measure would not be a restriction of competition in breach of such legal provision. Thus, it would neither be necessary to further analyse whether such alleged restriction could be authorised by complying with the requirements for the exemption established in Article 101(3) TFEU.

3. Applicability of Regulation 330/2010 of 20 April on the application of Article 101(3) TFEU to categories of vertical agreements and concerted practices

Lastly, the ECJ considers that, even if it were submitted in dialectic terms that the prohibition at issue could be found to be restrictive and thus contrary to Article 101(1) TFEU, it would not prevent the application of the exemption established in Article 101(3) TFEU should the prohibition clause meet the requirements set out therein.

Moreover, it considers that the restriction at issue could be deemed to be automatically authorised, provided that it meets the remaining requirements for the automatic exemption of vertical agreements set out in Regulation 330/2010 (among others, that the market shares held by the parties to the agreement do not exceed 30% of the relevant market). In this regard, the ECJ clarifies one of the main questions which had been a source of controversy to date among several national competition authorities and the European Commission. The Court clarifies that the prohibition stated by Coty would not constitute any of the hardcore restrictions listed in paragraphs (b) and (c) of Article 4 of the Regulation, which would prevent the application of the automatic exemption.

The first of these hardcore restrictions relates to the restriction of resales by the distributor to certain clients and in certain territories, while the second refers to the restriction of active or passive sales by members of a selective distribution system operating at the retail level.

In particular, the ECJ underlines that the challenged clause does not amount to an absolute prohibition of online sales, since distributors may sell through their own websites and the product may be found through search engines. Therefore, in its opinion, neither active nor passive sales are restricted, nor are they constrained to particular clients or territories.

PRELIMINARY CONCLUSIONS

The ECJ has partially ended an intense debate on the admissibility of a specific type of clause that limits sales on internet, at least with regard to luxury products and brands which deploy purely qualitative selective distribution systems and meet the three requirements mentioned in section 1 above. Thus, for this type of products and distribution systems the supplier may prohibit its distributors from reselling its products on internet through third-party platforms insofar as they are externally recognisable. From this perspective, this judgment represents a significant development in terms of legal certainty, but it does not settle the debate.

Two issues remain unresolved:

- Firstly, it must be determined whether a product is genuinely of a luxury nature or and whether the image of prestige cast by the brand needs to preserve its aura of exclusivity and elitism which may justify the fact that the products are not available on all kinds of internet platform.
- Secondly, it must be ascertained under which circumstances may a restriction such as the one submitted by Coty be admissible when a product is not of a luxury nature.

In principle, the answer to both issues would require a case-by-case analysis, taking into account the nature of the products concerned and the possible justification of the deployment of a selective distribution system. However, the rationale behind the *Coty* judgment may simplify the process. The judgment does not preclude the application in those cases of the automatic exemption established in Regulation 330/2010, provided that suppliers comply with the criteria set therein (i.e. that they hold modest market shares and that they do not include any other hardcore restrictions included in Article 4). Certainly the fact that suppliers allow their distributors to resell through their own websites and that customers may find such products on internet by means of other effective tools enabling a wide

dissemination (for instance, the use of online search engines) are factors to be taken into account – although not necessarily the only ones– when assessing whether the limitations hereby analysed are especially serious in accordance with Article 4 of Regulation 330/2010. In any case, it remains to be seen how national competition authorities will construe the *Coty* judgment when assessing subsequent similar restrictions concerning non-luxury products.

Lastly, it is important to note that the rationale of the ECJ in the analysed judgment only applies to the extent that the supplier does not sell directly in marketplaces and on internet platforms operated by third parties. Should the supplier perform such sales, this would amount to a tacit acceptance through its own acts of the adequacy of such third party to be a member of its selective distributor network. Therefore, it would be inconsistent to forbid its authorised selective distributors from using such sales channels by presenting an argument for the protection of the quality and luxury nature of its brand and products. The German precedent in the *Sennheiser* case reflects this clearly. In these cases, what would indeed be admissible would be for the supplier to require its distributors to respect the specific conditions that it may have agreed with the internet platform concerned in order to protect the brand image of the products (for instance, the creation of a specific section for its brand or the placement of the product in a particular section).

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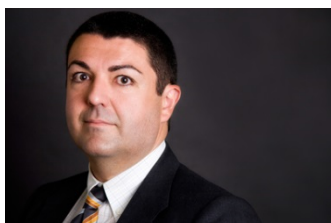


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