Does perfume smell differently when sold on an online marketplace? Selective distribution systems and bans on sales by third-party online platforms. A commentary on the Opinion of Advocate General Wahl in Case C-230/16 - Coty Germany GmbH

EU Competition law – Article 101(1) TFEU – Selective distribution – Prohibition of online sales by third-party online platforms – Regulation (EU) 330/2010 – Guidelines on Vertical Restraints - Article 101(3) TFEU

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Introduction

According to the Commission in its Final Report on the E-commerce Sector Inquiry,[1] the use of selective distribution systems is widespread in the EU. Such systems are not limited to a particular category of goods, but are often used for the distribution of 'luxury' brands of goods, such as cosmetics, clothing and shoes. The Commission also observes that many distributors report agreements with suppliers containing clauses prohibiting the distributor from selling the goods in question on third-party electronic platforms or marketplaces, such as Amazon or eBay.

Such clauses have led a number of national competition authorities and courts[2] to question whether such a ban is permitted under the EU competition law rules. Various courts and competition authorities in the Member States have reached diverging decisions, some prohibiting such a ban and others permitting it. Case C-230/16, *Coty Germany GmbH* (the *Coty*case) gives the Court of Justice of the EU (CJEU) the opportunity to answer this question.

Advocate General Wahl handed down his Opinion on this case on 26 July 2016.[3] In this blog I will discuss the Opinion of the Advocate General.

Factual Background and Preliminary Questions

Coty Germany (Coty), a leading supplier of luxury cosmetics in Germany, operates a selective distribution system in order to protect the luxury image of its brands. In order to become an authorised retailer, a distributor must have a brick and mortar shop which meets certain requirements relating to environment, décor and furnishing of the store. Coty permits its authorised retailers to sell the products online, through their own "electronic shop windows" (websites) on the condition that the luxury character of the goods is also preserved for online sales.

Parfümerie Akzente, an authorised retailer of Coty products for many years, sells these products both in brick and mortar stores and over the internet. Internet sales are made partly though Parfümerie Akzente's own online store and partly via the platform 'amazon.de'.

In 2012 Coty revised its selective distribution agreements. These agreements permit authorised retailers to sell Coty products on the internet, provided that such sales are conducted through an "electronic shop window" (website) of the authorised retailer and that the luxury image of the products is preserved. However, the agreements expressly prohibit sales of Coty branded products through online third-party platforms, such as Amazon and eBay.

Parfümerie Akzente refused to approve the amendments to the selective distribution agreement. Coty, therefore, brought an action before the German court of first instance (*Landgericht Frankfurt am Main)* seeking an order prohibiting Parfümerie Akzente from distributing Coty branded products via the online platform 'amazon.de'.

The German court of first instance dismissed the action on the ground that the contractual clause in question infringed both EU (Article 101(1) TFEU) and German competition law (Paragraph 1 of the *Gesetz gegen Wettbewerbsbeschränkungen*). Coty appealed this ruling before the *Oberlandesgericht Frankfurt am Main* which decided to refer four questions to the CJEU for a preliminary ruling.

The first question was whether selective distribution systems that have as their aim the distribution of luxury goods and primarily serve to ensure a "luxury image" for the goods concerned are compatible with Article 101(1) TFEU. If the first question is answered in the affirmative, the German court asks, secondly, whether a ban imposed on members of a selective distribution system operating at the retail level from using third-party platforms discernible to the public to handle internet sales is compatible with Article 101(1) TFEU, irrespective of whether the supplier's quality

standards are infringed. The third and fourth questions concern the interpretation of Article 4(b), respectively Article 4(c), of the block exemption regulation on vertical agreements (Regulation 330/210).[4] In essence, the questions are whether the ban on the use of a third-party online platform constitutes a restriction of passive sales to end users "by object".

The Opinion of Advocate General Wahl

The Advocate General begins by making a few introductory and general remarks concerning the principles that should prevail in the application of Article 101(1) TFEU to selective distribution systems.[5] He stresses that EU competition law is not only concerned with price competition, but that competition on quality is equally important. Therefore, all aspects of competition should be taken into account when determining an agreement's compatibility with Article 101(1) TFEU.

Advocate General Wahl also notes that the CJEU has taken a cautious approach when dealing with selective distribution systems based on qualitative factors. Since the famous ruling in *Metro SB-Grossmärkte v Commission*,[6] (*Metro*), handed down in October 1977, the CJEU has accepted that such selective distribution agreements can escape the prohibition of Article 101(1) TFEU, if the following three conditions are met (the *Metro* conditions).

- Distributors are selected on the basis of objective criteria of a qualitative nature, determined uniformly for all potential distributors and applied in a non-discriminatory fashion.
- The selective distribution system is justified by the nature of the products in question.
- The criteria are not disproportionate (do not go beyond what is necessary).

Furthermore, in the drafting of a new generation of block exemptions, it has been accepted that selective distribution systems based on qualitative criteria have, under certain conditions, positive effects on competition.

The first question

The first question to be answered concerns the compatibility with Article 101(1) TFEU of selective distribution systems for luxury and prestige goods, aimed at preserving the "luxury image" of those goods.

According to Advocate General Wahl, the first question directly reflects the diverging interpretations of the ruling in the case *Pierre Fabre Dermo-Cosmétique SAS*[7] (*Pierre Fabre*), in particular paragraph 46 of that judgment.[8] He, therefore, finds that, in the present case, the CJEU should clarify that judgment, with reference both to the factual context and the reasoning adopted by the CJEU. He gives the CJEU some suggestions on how to do so.

The Advocate General endorses the view that the *Pierre Fabre* judgment cannot be interpreted as meaning that the protection of a luxury image is no longer capable of justifying the existence of a selective distribution system. He repeats that selective distribution systems, must due to their beneficial (or at least neutral) effects on competition, be regarded as compatible with Article 101(1) TFEU if the three *Metro* conditions are met.

Advocate General Wahl distinguishes the factual context of the present case from that of the *Pierre Fabre* ruling. Unlike the present case which concerns a ban imposed by Coty on its authorised distributors from selling Coty branded products via discernible third-party online platforms, the *Pierre Fabre* ruling was concerned only with a contractual clause containing a general and absolute ban on internet sales of the contract goods to end users. The selective distribution system was not in itself at issue.

Furthermore, the Advocate General goes on to discuss the reasoning of the CJEU in the *Pierre Fabre* ruling. He states that the fact that the CJEU found the outright ban on online sales imposed by Pierre Fabre to infringe Article 101(1) TFEU, does not mean that the CJEU ruled that selective distribution systems specifically designed to preserve the "luxury image" of the goods concerned, must necessarily be caught by Article 101(1) TFEU.

Consequently, Advocate General Wahl concludes that the *Pierre Fabre* ruling must not interpreted as overturning the previous case-law of the CJEU on the compatibility with Article 101(1) TFEU of selective distribution systems the object of which is to preserve the "luxury image" of the products concerned, provided that the three *Metro* conditions are satisfied.

The second question

The second question is whether and to what extent a prohibition on the use in a discernible fashion of third-party platforms or marketplaces for the online sales of the goods concerned imposed on the members of a selective distribution system for luxury products is caught by Article 101(1) TFEU.

This question is particularly relevant in the light of the conflicting approaches adopted by competition authorities and courts across the EU. The German *Bundeskartellamt*,[9] and in some cases German courts,[10] have been particularly strict in condemning such prohibitions as being contrary to EU (and national) competition law.

According to Advocate General Wahl, the second question is closely linked to the first question and should be analysed in a similar fashion.

The Advocate General finds that in the case at hand, the first *Metro* condition (the criteria laid down by Coty for the selection of its distributors) is clearly satisfied. Hence, in order to answer the second preliminary question, he focuses on the second and third *Metro* conditions, namely whether the ban on the use by authorised distributors of third-party platforms is legitimate in the light of the qualitative objectives pursued and whether such a ban is a proportionate way of achieving these objectives.

With regard to the first condition, the Advocate General examines whether the ban on the use of third-party platforms is specifically justified by the need to preserve the "luxury image" of the Coty products.[11] He takes the view that this is the case because "[s]uch a prohibition may be capable of preserving the guarantees of quality, safety and identification of the origin of the products by requiring retailers to supply services of a certain level when the contract products are sold. That prohibition also allows the protection and positioning of the brands to be maintained in the face of the phenomena of counterfeiting and parasitism, which are likely to restrict competition."[12]

He adds that the head of a distribution network may require quality standards for the use of an internet site to sell its goods, just as it may require quality standards for a brick and mortar premises or for sale by catalogue. When a third-party platform is used for the sale of the products in question, neither the authorised distributors nor the network head have any control over the presentation and image of the goods concerned.

Advocate General Wahl concludes that the prohibition imposed on authorised distributors from using third-party platforms discernible to the public is not caught by Article 101(1) TFEU because this prohibition is likely to improve competition based on qualitative criteria.

In answering the second question, Advocate General Wahl once again emphasises that the ban at issue in the *Coty* case must be distinguished from that applicable in the *Pierre Fabre* judgment. In the latter judgment, an absolute prohibition on online sales was imposed on the authorised distributors. In the case at hand, the situation is completely different. Coty allows its authorised distributors to distribute Coty products via their own websites. Coty also permits those distributors to use third-party platforms in a non-discernible way for the distribution of its products. The Advocate General adds that, in the present state of the development of e-commerce, the ban imposed by Coty cannot be equated with an outright ban or a substantial restriction of online sales.

As far as the second *Metro* condition (the proportionality requirement) is concerned, the Advocate General finds the ban imposed by Coty on its authorised distributors to be a proportionate way of achieving the objectives pursued by Coty. The reason for this is that the head of a selective distribution network is not able to exercise control over the distribution of its products through third-party platforms because it has no contractual relationship with such platforms.

In his interim conclusion,[13] Advocate General Wahl states that even if the referring court were to find that the ban imposed by Coty on its authorised distributors may be caught by Article 101(1) TFEU, because it fails to fulfil all the *Metro* conditions, this court will still have to determine whether that ban has a restrictive effect on competition, and in particular will have to determine whether the ban amounts to a restriction 'by object' within the meaning of Article 101(1) TFEU.

According to the Advocate General, the ban on the use of third-party platforms is "wholly incapable of being classified as 'restriction by object' within the meaning of Article 101(1) TFEU." The concept of 'restriction by object' must be interpreted restrictively and can "be applied only to certain types of coordination between undertakings which reveal a *sufficient degree of harm* to competition to render an examination of their effects unnecessary."[14]

Third and fourth questions

By its third and fourth questions, the referring German court asks whether the prohibition imposed on its authorised distributors by Coty from using in a discernible manner third-party platforms for the sale of its products constitutes a restriction of the customers to whom the distributor may sell the contract goods within the meaning of Article 4(b) of Regulation 330/2010 and/or a restriction of passive sales to end users within the meaning of Article 4(c) of the same regulation.

Before answering both questions, Advocate General Wahl puts forward some preliminary observations on the scope and *ratio legis* of Regulation 330/2010.[15] He first stresses that the objective of block exemption regulations is to allow the undertakings concerned to carry out a self-assessment exercise in order to determine whether one or more of the exceptions to the block exemption concerned contained in the so-called black list applies. In order to make this possible, the exceptions, in particular those contained in Article 4 (b) and (c) of Regulation 330/2010, must be easily identifiable and must not be dependent on a detailed analysis of market conditions and the restrictive effects on a specific market at a particular time.

The Advocate General then states that it is necessary to distinguish between 'restrictions of competition by object' within the meaning of Article 101(1) TFEU and so-called 'hardcore' restrictions within the meaning of Article 4 of Regulation 330/2010. However, according to the Advocate General, in both cases it boils down to identifying conduct that is presumed to be particularly harmful to competition by reference to the assessment of the *immediate* economic and legal context of the measures adopted by the undertakings in question. In addition, both Article 4 (b) and (c) of Regulation 330/2010 must be seen in the context of the more general and fundamental objective of combatting the phenomenon of market foreclosure. This means, according to Advocate General Wahl, that these provisions are intended to exclude from the benefit of the block exemption certain clauses in a contract which are designed to restrict the territory into which, or the customers to whom, a distributor may sell. These provisions are not intended to exclude from the benefit of the block exemption restrictions on the methods whereby the contract products are sold.

In the light of these preliminary observations, the Advocate General provides an answer to the third and fourth questions.

The third question pertains to the interpretation of Article 4(b) of Regulation 330/2010 which concerns market-sharing or customer-sharing clauses, which tend to have

market-partitioning effects.[16] Advocate General Wahl is of the view that the ban which Coty imposes on its authorised distributors from using discernible third-party platforms for the distribution of its products is not intended to partition markets because it is not possible *a priori* to identify a customer group or a particular market to which users of third-party platforms would correspond.

The Advocate General examines the content of the prohibition imposed by Coty on its authorised distributors and comes to the conclusion that, since the prohibition does not preclude all online sales, but only one way of reaching customers via the internet, the prohibition does not have a market-partitioning effect. Unlike the ban at issue in the *Pierre Fabre* ruling, the prohibition imposed by Coty does not forbid its authorised distributors from using their own websites or non-discernible third-party websites for the sale of the contract products, provided that the "luxury image" of the Coty products is preserved.

Furthermore, as far as the objective of the prohibition is concerned, the Advocate General states that this consists in preserving the "luxury image" of the Coty products by requiring that sales on the internet must take place through an "electronic shop window" of the authorised distributor. The objective of the prohibition is not to partition the market by limiting the territory into which, or the customers to whom, the authorised distributors are allowed to sell.

Lastly, as regards the economic and legal context of the prohibition, Advocate General Wahl observes that the results of the Commission's E-commerce Sector Inquiry make clear that the use of third-party platforms or marketplaces, although this varies significantly from one Member State to another and also from one product to another, is a relatively marginal channel of distribution because retailers in a selective distribution mainly use their own websites for selling the contract goods.

Advocate General Wahl proposes that the CJEU should answer the third question to the effect that the prohibition imposed by Coty on its authorised distributors from using in a discernible fashion third-party platforms for online sales does not constitute a restriction of the distributor's customers within the meaning of Article 4(b) of Regulation 330/2010.

The fourth question is whether the ban on the use of third-party platforms imposed by Coty on its authorised distributors forms a restriction of passive sales to end users within the meaning of Article 4(c) of Regulation 330/2010.

The Advocate General's answer to this question is short. He refers to the fact that in order to determine whether the ban on the use of third-party platforms is intrinsically capable of harming passive sales, it is necessary to analyse its wording, its objective and the economic and legal context of which it forms part. He has already carried out this analysis within the framework of the third question. Once again emphasising the difference between the prohibition imposed by Coty and the outright ban on internet sales at stake in the *Pierre Fabre* ruling, Advocate General Wahl concludes that the ban imposed by Coty on its authorised distributors from using third-party platforms to sell Coty products does not constitute a restriction of passive sales within the meaning of Article 4(c) of Regulation 330/2010.

Conclusion

In summary Advocate General Wahl invites the CJEU to decide as follows.

Firstly, selective distribution systems concerning the distribution of luxury products and primarily intended to preserve the "luxury image" of such products are not caught by Article 101(1) TFEU if the three *Metro* conditions are satisfied. It is for the referring court to decide whether these conditions are fulfilled in the *Coty* case.

Secondly, in order to establish whether a contractual clause which contains a prohibition on authorised distributors in the framework of a selective distribution system from using in a discernible manner third-party platforms for the online sales of the contract products is compatible with Article 101(1) TFEU, the referring court must examine whether that clause meets the *Metro* conditions. Advocate General Wahl is clearly of the opinion that it does.

Lastly, the prohibition imposed by Coty on its authorised distributors from using in a discernible fashion third-party marketplaces does not constitute a restriction of the distributor's customers within the meaning of Article 4(b) of Regulation 330/2010 nor a restriction of passive sales to end users within the meaning of Article 4(c) of the same regulation. So even if this prohibition were to infringe Article 101(1) TFEU, it would still be capable of exemption under Regulation 330/2010.

Discussion

The Opinion of Advocate General Wahl is in line with the approach adopted by the Commission, both in its Final Report on the E-commerce Sector Inquiry[17] and its

Guidelines on Vertical Restraints.[18] Paragraph 56 of the Guidelines, which were published in 2010, states that all distributors should be free to sell, both actively and passively via the internet. Nonetheless paragraph 54 explicitly permits the supplier to lay down quality standards for the use of a website for the sale of the contract goods, just as it may require quality standards for a brick and mortar shop or sales by catalogue. This paragraph goes on to state that, "[f]or instance 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."

In its Final Report, published in 2017, the Commission observes that restrictions on the use of online marketplaces are mostly found in selective distribution agreements and that such restrictions usually concern branded goods, but are not limited to luxury, complex or technical goods.[19] The Commission takes the view that a ban on the use of an electronic platform does not amount to a *de facto* blanket ban on online sales and should not be regarded as a hardcore restriction of competition within the meaning of Article 4(b) and Article 4(c) of Regulation 330/2010.[20] The Commission does not, however, give *carte blanche* to all marketplace bans, but highlights that each restriction on the use of electronic platforms must be considered on its own merits. In the *Coty* case, the Commission intervened recommending that a similar approach be followed.

If the CJEU follows Advocate General Wahl on all points, this will be good news for brand owners and suppliers who have increasingly expressed concern about the possible devaluation of the image of their products when sold on third-party platforms. Suppliers and brand owners will have more scope to control the way in which their products are sold online and will be able to keep a tight rein on their selective distribution networks. In addition, such an approach will enable brand owners and suppliers to guard against counterfeiting and free-riding by ensuring that the investments and efforts made to improve the quality and image of their products do not benefit others. It is however important to note the Advocate General Wahl does not give suppliers a blank cheque to enforce a ban on the use of third-party platforms for the sale of their goods. Suppliers will still need to ensure that their selective distribution agreements satisfy the three *Metro* conditions, in particular that the ban is justified on account of the nature of the product and proportionate to the need to protect the image of the product in question. Moreover, the legitimacy of the ban will depend on the facts of the case, the nature of the products in question and the reason for the ban.

A ruling by the CJEU in line with the Opinion of the Advocate General is, however, less likely to be welcomed by third-party marketplaces, such as Amazon and eBay, as this will limit their ability so sell goods which are subject to a (justified) selective distribution agreement.

A further observation that I would like to make is that the Opinion of Advocate General Wahl is not crystal clear on all points. He stresses that there is a need to distinguish between 'restrictions by object' for the purposes of applying Article 101(1) TFEU and 'hardcore' restrictions which cannot be exempted under Regulation 330/2010.[21] Unfortunately, the Advocate General does not explain why this distinction is so important. In fact, he appears to state that the test for identifying both types of restriction is similar: "it is a matter of identifying the conduct that is presumed to be particularly harmful to competition by reference to the assessment of the *immediate* economic and legal context of the measures adopted by the undertakings."[22] It will be interesting to see whether the CJEU finds the distinction between the two types of restriction to be equally important.

A final observation concerns a case handed down by the *Rechtbank Amsterdam* (District Court of Amsterdam) on 4 October 2017,[23] which concerned a ban imposed by Nike, within the framework of a selective distribution system, on sales by non-authorised online platforms in order to preserve the "luxury image" of Nike's products (sports clothing). Referring to the Opinion of Advocate General Wahl in the *Coty* case, the Amsterdam court ruled that Nike's selective distribution system did not contravene Article 101(1) TFEU as this system fulfilled the three *Metro* conditions. When examining the third *Metro* condition (the necessity of excluding non-authorised dealers from the network), the Amsterdam court referred extensively to the Advocate General Wahl's Opinion and came to the conclusion that the ban on sales by non-authorised online platforms did not go further than necessary to preserve the high quality of Nike products. The other party to the case, one of Nike's authorised distributors, Action Sport, argued that the Amsterdam court should await the ruling of the CJEU in the *Coty* case before delivering judgment. The Amsterdam court did not find this to be necessary as it found the Opinion of the Advocate General to be 'convincing' and likely to be followed by the CJEU.

We will have to wait and see whether the CJEU indeed finds the Opinion of Advocate General Wahl to be equally 'convincing'. In any event, it is to be hoped that the ruling of the CJEU will put an end to the confusion created by the *Pierre Fabre* judgment. The

ruling of the CJEU will be eagerly awaited by suppliers and distributors and also by third-party electronic platforms.

[1] Report from the Commission to the Council and the European Parliament. Final report on the E-commerce Sector Inquiry, COM(2017) 229 final.

[2] A list of the decisions of German courts and the *Bundeskartellamt* and French courts and the French Competition Authority can be found in footnote 3 of the Opinion.

[3] ECLI:EU:C:2017:603.

[4] Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ 2010, L102/1.

[5] See paragraphs 32-58 of the Opinion.

[6] Case 26/76, *Metro SB-Grossmärkte v Commission*, ECLI:EU:C:1977:167.

[7] Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS*, ECLI:EU:C:2011:649.

[8] Paragraph 46 of the *Pierre Fabre* ruling states "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 an aim does not fall within Article 101(1) TFEU."

[9] See, for example, Decision B2-98/11, ASICS, handed down by the *Bundeskartellamt* in August 2015.

[10] The decision of the *Bundeskartellamt* in the ASICS case was confirmed by the *Oberlandesgericht Düsseldorf* (Higher Regional Court Düsseldorf) on 5 April 2017 (Case VI-Kart 13/15 (V).

[11] See paragraphs 99-106 of the Opinion.

[12] Paragraph 102 of the Opinion.

[13] See paragraphs 115-121 of the Opinion.

[14] Paragraph 117 of the Opinion. Emphasis in the text of the Opinion itself.

[15] See paragraphs 126-139 of the Opinion.

[16] See paragraph 50 of the Commission Guidelines on Vertical Restraints, OJ 2010, C130/1.

[17] COM(2017) 229 final.

[18] Commission Guidelines on Vertical Restraints, para. 50-56.

[19] Paragraph 40 of the Final report on the E-commerce Sector Inquiry.

[20] Paragraph 41-42 of the Final report on the E-commerce Sector Inquiry.

[21] See paragraphs 56 and 133-135 of the Opinion.

[22] See paragraph 113 of the Opinion. Emphasis in the text of the Opinion itself.

[23] ECLI:NL:RBAMS:2017:7282. For reasons unknown to me, this judgment, which was published on the website on which the rulings of Dutch courts are published, has been removed from this website.