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Reflections on the Coty judgment of the Court of Justice: consequences for platform restrictions and selective distribution

On 6 December 2017, the Court of Justice of the European Union (the ***ECJ*** or the ***Court***) handed down its eagerly anticipated judgment in Coty (C-230/16). In general, the ECJ closely follows the opinion of Advocate General Wahl (***AG Wahl***), published on 26 July 2016, in essentially holding that:

- the nature of luxury products justifies the use of selective distribution under Article 101(1) to preserve their luxury image, provided that the system itself meets the remaining established conditions of the case law;
- a prohibition on selling those goods on third party online platforms in a manner discernible to consumers is in principle compatible with Article 101(1) where it is intended to ensure the luxury image of those goods; and
- a prohibition on selling those goods on third party online platforms in this manner is, in any event, exempted by the Vertical Agreements Block Exemption (***VABER***).

Background

The case concerns a dispute between Coty Germany GmbH (***Coty***), a producer of branded luxury cosmetics, and Parfümerie Akzente GmbH (***Parfümerie Akzente***), a member of its selective distribution system. The dispute arose when Parfümerie Akzente began selling Coty products online through Amazon, in breach of the terms of Coty's selective distribution agreement which prohibited authorised retailers, when making internet sales, from either using a different name or from engaging an unauthorised third-party in a manner discernible to the public in relation to those sales.

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In this context, the Higher Regional Court of Frankfurt referred the following questions to the ECJ concerning the use of selective distribution for luxury goods and the platform restriction:

1. whether selective distribution systems for luxury goods that primarily serve to ensure the luxury image of the goods comply with Article 101(1) TFEU;

2. whether an undertaking can impose a general prohibition on authorised retailers from engaging third party undertakings discernible to the public to handle online sales regardless of whether the manufacturer's legitimate quality standards are violated; and

3. whether such a prohibition constitutes a "restriction by object" under Articles 4(b) or (c) of the VABER.

First question: Selective distribution systems for luxury products

The key issue in the ECJ's analysis is whether the characteristics of a luxury product should be considered to meet the apparent requirement of the selective distribution case law that, in order for such a system to escape Article 101(1), the characteristics of the product should necessitate the use of selective distribution in order to preserve its quality and ensure its proper use. Although the ECJ is not consistently explicit on the point, it appears that it considers "prestige" to be an essential element of luxury and that luxury and prestige products are therefore equivalent.

In deciding that this condition is met, the ECJ equates the luxurious image of a product with a product's quality, which is important because, as noted above, quality is a key element in justifying the use of selective distribution under the case law. Referring to the 'aura of luxury' that surrounds luxury goods, the ECJ notes that the quality of such goods is not simply the result of material characteristics, but also of the "allure and prestigious image" of the goods in question. The protection of that 'aura' may therefore justify the prohibition of sales through unauthorised resellers which is achieved through the use of selective distribution, and which ensures that the products are only displayed in sales outlets in a manner which contributes to their reputation in the eye of the consumer. The ECJ cites a trademark law case, *Copad* (C-59/08), in support of this position, thereby implicitly suggesting that selective distribution may be considered to comply with competition law where it is an appropriate way to protect an essential function of a prestigious trade mark.

The ECJ confirms that this assessment is not at odds with its earlier ruling in *Pierre Fabre Dermo-Cosmétique* (C-439/09), where it had stated that the aim of preserving a prestigious image is not a legitimate aim for restricting competition. The ECJ clarifies that this statement was made in the context of an assessment of the compatibility with Article 101(1) of a comprehensive prohibition imposed by *Pierre Fabre* of the internet sale of goods sold through its selective distribution system, whereas *Coty* does not impose such a comprehensive prohibition.

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It also notes that the products at issue in *Pierre Fabre* were not luxury products, but (instead) cosmetic and body hygiene products (although the fact that the products at issue in *Coty* are also described by the ECJ as "cosmetic products" brings into question how easily such a distinction can be drawn in practice). The ECJ therefore confines the significance of *Pierre Fabre* to its specific facts.

Having confirmed the appropriateness of the use of selective distribution for luxury goods in order primarily to preserve the luxury image of those goods, the ECJ goes on to confirm (as established since *Metro* (C-26/76)) that a selective distribution system for such goods does not infringe Article 101(1) provided that: (i) 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; and (ii) the criteria laid down are proportionate to the goal of protecting the luxury image of the goods.

Second question: Prohibition on authorised retailers from engaging, in a discernible manner, third-party platforms for online sales of luxury goods

The ECJ notes that this question concerns the lawfulness, under Article 101(1) TFEU, of a specific clause in a selective distribution system for luxury and prestige goods.

In responding to the first question above, the ECJ has already established that the nature of luxury and prestige goods justifies the use of selective distribution under Article 101(1) provided that the criteria applied in appointing authorised distributors meet the conditions of the established case law described above. As a result, in answering the second question, the ECJ focuses instead on whether the specific platform restriction itself meets those conditions. To recap, this will be the case if the restriction is considered to be (i) an objective criterion of a qualitative nature, (ii) laid down uniformly for all potential resellers, (iii) not applied in a discriminatory fashion, and (iv) proportionate to the objective being pursued and no more restrictive than is necessary.

While recognizing that it is for the referring court to determine whether these conditions are met, the ECJ nonetheless points out that the restriction has the objective of preserving the image of luxury and prestige of the goods at issue (which presumably fulfils the requirement for the obligation to be qualitative) and, furthermore, seems objective and uniform and is applied without discrimination to all authorised distributors.

Most of the ECJ's analysis focuses on the proportionality requirement. In a first step, it concludes that the platform ban appears to be appropriate in light of the legitimate objective of preserving the products' luxury image for the following reasons:

(i) Together with the obligation imposed by Coty on authorised distributors to sell through their own online shops using their own business name, the ban is viewed as a "coherent" means of guaranteeing that the goods are associated exclusively with authorised distributors, which is precisely one of the objectives of such a selective distribution system (which makes such a system an appropriate means by which to preserve the luxury and quality image of luxury goods);

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(ii) The ban enables the supplier to ensure that its goods are sold online in a manner that meets its qualitative requirements because, where there is no contractual relationship between the supplier and third party platforms (i.e., where the platforms are not themselves authorised distributors), the supplier cannot take action against a third-party platform which does not meet the quality conditions set by the supplier to preserve the product's character; and

(iii) As all kinds of goods are sold through platforms (i.e., not just luxury goods), ensuring that luxury goods are sold only in the online shops of authorised distributors contributes to their luxury image.

As a second step in the analysis of proportionality, the ECJ finds that the platform ban appears not to go beyond what is necessary to realise the appropriate objective of protecting the luxury image of the products for three reasons:

- First, in contrast to the restriction at issue in *Pierre Fabre*, the ban does not amount to an absolute prohibition on online sales since authorised distributors can sell via their own websites and via unauthorised third-party platforms whose use is not discernible to the consumer;

- Second, the results of the E-commerce Sector Inquiry indicate that distributors' own online shops - rather than platforms - are in practice the main online distribution channel used by distributors (used by over 90% of distributors surveyed); and

- Third, because there is no contractual relationship between the supplier and unauthorised third-party platforms enabling the supplier directly to require such platforms to comply with the quality criteria imposed on authorised distributors, an alternative approach of permitting authorised distributors to use platforms subject to those quality criteria being met by the platform would not be as effective as the platform ban.

Third and fourth questions: Application of the VABER

The ECJ begins by affirming that it is only if and where a platform ban restricts competition within the meaning of Article 101(1) that the question arises whether the clause benefits from an exemption under the VABER.

In examining whether the clause at issue constitutes a hardcore restriction under the VABER that would prevent the application of the exemption, the ECJ focuses on whether or not the clause should be considered, within the meaning of Articles 4(b) and (c) of the VABER, to restrict either: (i) the customers to whom authorised distributors can sell the goods; and/or (ii) passive sales by authorised distributors to end users.

In that respect, the ECJ re-iterates that, although the clause at issue restricts a specific type of internet sale, it does not - in contrast to the restriction at issue in *Pierre Fabre* - prohibit use of the internet as a means of marketing the goods.

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It further notes that it does not appear possible to delimit a group of third-party platform customers within the group of online purchasers (to whom sales should be considered restricted for the purposes of Article 4(b) of the VABER). Finally, since it was apparent from the case file that Coty's authorised distributors can advertise via online third-party platforms and search engines, the ECJ further notes that customers can usually find the products offered online by authorised distributors (thereby enabling passive sales). In conclusion, the ECJ finds that the restriction of this specific kind of internet sale does not restrict either the distributors' customers or their passive sales to end users within the meaning of the VABER.

Comment on the ruling

In general, the part of the ruling concerning the application of the VABER to platform restrictions is of broadest application and of most practical significance, especially given the extent of the inconsistency in the interpretation of the rules that has occurred at the national level concerning this issue. Where the VABER does not apply for reasons of market share, the very clear endorsement of such restrictions under Article 101(1) is also valuable, at least in the case of luxury products. The principal value of the selective distribution analysis is that it confirms the case law before *Pierre Fabre*, namely that the use of selective distribution for luxury products is justified regardless of whether the VABER is applicable.

Initial reactions to the ruling have been varied, with the President of the Bundeskartellamt discounting its significance for non-luxury products and with the Commission expressing its intention to consider its implications for on-line related restrictions other than platform restrictions.

This is considered in more detail below.

1. Platform restrictions

VABER: It seems clear, at least in the context of a selective distribution system, that a supplier may impose a ban on the use by authorised retailers of unauthorised platforms (at least in a manner discernible to the consumer) where the 30% market share thresholds of the VABER are met. This is consistent with the Commission's view in the Vertical Guidelines. Although the ECJ refers specifically to luxury goods in its assessment of the VABER, its reasoning would appear equally applicable to other types of products as the conclusion focuses primarily on the likely limited effects of such restrictions. As such, it is not apparent why the same conclusion would not be reached also outside of selective distribution.

However, taking into account that the ECJ emphasises in its reasoning that Coty allows its authorised retailers, subject to unspecified conditions, to advertise their own online stores through search engines and even through platforms (thereby enabling consumers to find those webstores), it cannot be assumed that broad restrictions on online advertising will necessarily be covered by the VABER.

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Such restrictions are still an issue in the ongoing *Asics* litigation in Germany, and restrictions on the use of price comparison have also been viewed critically (both by the Bundeskartellamt in *Asics* and by the Commission in the E-Commerce Sector Inquiry report). However, subjecting online advertising to appropriate quality criteria would presumably not raise concerns.

The focus of the ECJ - in its hardcore restriction assessment - on the extent of likely effects (rather than potential justifications) does question the validity of the suggestion in the Vertical Guidelines that differences in the criteria applicable to on- and off-line selling need to be justifiable by reference to the differences in these forms of distribution in order to avoid stricter on-line criteria constituting a hardcore restriction. Will a distributor necessarily be considered unable to effectively sell online where it is subject to somewhat stricter criteria when selling online (regardless of whether they are justified)?

Article 101(1): Where the VABER does not apply, and an individual Article 101(1) assessment is required, the ruling suggests that a supplier of luxury goods may impose a ban on the use by authorised retailers of unauthorised platforms (at least in a manner discernible to the consumer) in a selective distribution system without infringing Article 101(1). The ECJ accepts that this is a key means of protecting the image, and quality, of luxury products and consistent with the basic premise that, in a selective distribution system, such products are only available in the selling environment of authorised distributors, where the supplier may also be able to ensure that they are only offered for sale with products of similar standing. Given that the ECJ refers at two different places in its proportionality analysis to the importance of the fact that suppliers do not have a contractual relationship with unauthorised platforms and thus cannot directly require them to meet the online quality criteria applied to authorised distributors, it appears that this is otherwise liable to be the key factor in determining why such a platform restriction is justified. Unlike AG Wahl, the ECJ does not address the issue whether such a platform restriction in a selective distribution system constitutes a restriction by object where the *Metro* conditions are not met (AG Wahl thought it did not), or whether an effects assessment is required before concluding that Article 101(1) is infringed. In light of the limited effects identified by the ECJ in confirming that the restriction does not constitute a hardcore restriction under the VABER, it is questionable whether (if an effects assessment were to be necessary) such a restriction would be considered to have an appreciable effect on competition under Article 101(1). The ECJ also gives no guidance on when and whether the criteria for exemption under Article 101(3) would be met where the restriction infringes Article 101(1).

Furthermore, the ECJ does not provide guidance in respect of the application of Article 101(1) to platform restrictions applicable to the sale of goods other than luxury goods, although certain of the factors relied on by the ECJ could be considered to apply more generally (in particular, where brand owners do not have direct contractual rights against platforms). This specific issue is also related to the broader question of how the use of selective distribution is justified in the case of non-luxury products, which is discussed under 2. below.

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Finally, the judgment does not address the legitimacy under Article 101(1) of platform restrictions outside of selective distribution, but the argument in their favour will be more difficult to make where distributors appointed by a supplier are anyway allowed to sell to unauthorised resellers under the type of distribution in question, which in any case probably makes platform restrictions much less important commercially outside of selective distribution.

2. Selective distribution

Given that the market share thresholds of the VABER were not exceeded, and that the VABER clearly exempts selective distribution systems regardless of the type of product at issue, it is not immediately clear why the ECJ was asked to consider specifically whether the use of selective distribution for luxury products can comply with Article 101(1) TFEU. Unsurprisingly, the ECJ confirms that the use of selective distribution for luxury products will comply with Article 101(1) where the various criteria set out in the long-established case law are met, and the reasoning it applies specific to luxury products is consistent both with its own application of trade mark law (in *Copad*) as well the application of Article 101(1) by the General Court in *Perfumes* (e.g., T-88/92).

The judgment says nothing new concerning the circumstances in which the use of selective distribution for other types of products can comply with Article 101(1) (outside of the VABER) as this was not relevant to the questions asked. The judgment repeats the long-established maxim that the use of selective distribution may be justifiable where the characteristics of the product necessitate the creation of a selective distribution network in order to preserve its quality and ensure its proper use. In the case of luxury products, the preservation of *quality* is analysed in terms of the aura of luxury which may be compromised if the products are sold in retail environments that do not meet the supplier’s qualitative criteria. But, consistent with the conclusions of AG Wahl, there would appear to be no good reason why the use of selective distribution for other quality products should not be considered to comply with Article 101(1), as their reputation for quality is also liable to be compromised if they are sold in environments that do not meet the qualitative criteria of the brand owner.

In any event, any claim to the uniqueness of luxury products is arguably outdated, as luxury is now only one type of imperceptible “aura” associated by consumers with the products of major brands. Why should the aura associated with lifestyle products, green products and the like not be considered sufficient to justify that these products should only be sold subject to the qualitative criteria of the brand owner to ensure that the specific aura that attracts consumers to these products is not compromised?

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