The judgment of the Court of Justice in the Coty case changes nothing for the selective distribution model. Discuss.

INTRODUCTION

The rise of the internet has brought great opportunities for distributors. In its E-commerce Sector Inquiry report ("**EC Report**"), the European Commission found that 59% of respondent retailers sell both online and in brick-and-mortar shops, while 40% sell only online.[1] Manufacturers should similarly welcome the previously untapped demand that the internet unveiled. However, in reality, many manufacturers restrict the ability of their distributors to sell online through the use of "selective distribution systems" ("**SDSs**").[2] For example, the EC Report found that 18% of retailers have agreed with manufacturers not to sell through online platforms such as Amazon and eBay. [3] In *Coty*, the European Court of Justice ("**CJEU**") considered whether a platform ban for the sale of luxury cosmetics fell afoul of Article 101 TFEU. [4]

This essay argues that *Coty* brings some welcome clarity to businesses that justify SDSs (including online restrictions) by reference to the protection of brand-image. However, EU law continues to take a strict approach to SDSs in furtherance of the single market. While *Coty* has changed the law for the better, uncertainty for manufacturers remains.

I. THE EU'S TOUGH STANCE ON ONLINE SELECTIVE DISTRIBUTION

Economists universally agree that most vertical restraints are procompetitive because they promote inter-brand competition. For example, vertical restraints can incentivise distributors to invest in "services or promotional efforts that aid the manufacturer's position as against rival manufacturers".[5] For luxury

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1 Final report on the E-commerce Sector Inquiry, COM(2017) 229, ¶ 188.

2 Under Article 1(e) VABER, an SDS exists where a "supplier undertakes to sell [product or service] only to distributors selected on the basis of specified criteria".

3 ¶ 461.

4 Case C-230/16, *Coty Germany GmbH vs Parfümerie Akzente GmbH*, EU:C:2017:941.

5 *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

goods manufacturers ("**LGMs**"), conditions of sale are sacrosanct because they promote their products' prestigious brand image, which is often their products' most valuable dimension. If some retailers under-invest in luxury sale conditions, the manufacturer's reputation is harmed and sales drop across all retailers. LGMs adopt SDSs to ensure that their distributors meet certain quality criteria to preserve the prestigious image of their goods. The ability to restrict or incentivise retailers ensures that consumers benefit from a healthy range of differentiated products in the marketplace.

Nonetheless, EU law takes a strict approach to vertical restraints. This is because the restriction of intra-brand competition – even if demonstrably procompetitive through the promotion of inter-brand competition – can inhibit market integration across EU member states by impeding retailers' ability to make cross-border sales. For example, EU law distinguishes "active" and "passive" selling because it considers as inherently "anticompetitive" any attempt to restrict customers' ability to approach distributors in a given member state to prompt a sale. In a sense, EU competition policy is willing to accept counterfactually less inter-brand choice for consumers as long as the choice that prevails is equally available to consumers across the single market.

This tug-of-war between the procompetitive effects of vertical restraints and market integration is striking in the online world. On one hand, online distribution and the single market lodestar pave the way for massive amounts of cross-border sales and unprecedented levels of intra-brand competition. As the Commission states, "In principle, every distributor must be allowed to use the internet to sell products."[6] The Commission regards as inherently anticompetitive any attempt to "dissuade [distributors] from using the internet to reach a greater number and variety of customers by imposing criteria for online sales which are not overall equivalent to the criteria imposed for the sales from the brick and mortar shop".[7] On the other hand, some manufacturers are especially likely to want to restrict online sales, where sales of counterfeit goods can tarnish manufacturers' brand image and retailers face the growing temptation to focus on price competition rather than the conditions of sale.

Nonetheless, EU law recognises that it is not worth sacrificing all inter-brand differentiation in order to maximise intra-brand competition. Indeed, there are three ways that a manufacturer can justify its SDS. Firstly, an SDS falls

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6 Vertical Guidelines, ¶ 52.

7 *Id.* at ¶ 56.

outside the scope of Article 101(1) entirely if it fulfils the so-called *Metro*-criteria, namely: the nature of the product requires an SDS; distributors are chosen on the basis of purely qualitative criteria that are applied in an objective and non-discriminatory fashion; and the restriction does not go beyond what is necessary to achieve its legitimate aim.[8] Secondly, SDSs that do not contain "hardcore" restrictions under the Vertical Agreements Block Exemption Regulation ("**VABER**") are exempted if certain market share thresholds are met. Thirdly, an SDS that is incompatible with Article 101(1) can be justified by way of individual exemption under Article 101(3). In theory, therefore, manufacturers that need to restrict online sales to some degree in order to protect their brand image should be able to.

II. ONLINE SELECTIVE DISTRIBUTION AFTER *COTY*

Prior to *Coty*, our most recent guidance from the CJEU on online restrictions was *Pierre Fabre*, where the court held that an SDS containing a *de facto* prohibition on online sales of cosmetics and hygiene products constituted a restriction "by object" under Article 101.[9] The ruling controversially stated that "[t]he aim of maintaining a prestigious image is not a legitimate aim for restricting competition",[10] which effectively prevented any manufacturers, including LGMs, from justifying SDSs by reference to brand protection either under the *Metro*-criteria or Article 101(3). However, the CJEU did not rule out the objective justification of online sales bans ("**OSBs**") by reference to other factors, such as "the maintenance of a specialist trade capable of providing specific services as regards high-quality and high-technology products."[11] It seems perverse that LGMs could not introduce a justification specific to their products' characteristics, when other manufacturers could.

The CJEU in *Coty* clarified the controversial statement in *Pierre Fabre*, holding that, for luxury goods, quality 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".[12] That aura is "essential in that it enables consumers to

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8 *Coty*, ¶ 24.
9 Case C-439/09, *Pierre Fabre*, EU:C:2011:649, ¶ 47.
10 ¶ 46.
11 ¶ 40-41; 50.
12 ¶ 25.

distinguish them from similar goods and… an impairment to that aura of luxury is likely to affect the actual quality of those goods".[13] Therefore, "luxury goods may require the implementation of [an SDS] in order to preserve the quality of those goods".[14] The CJEU held that Coty's prohibition on its distributors selling its luxury goods through Amazon was appropriate to preserve the luxury image of its goods, referring to Coty's need to monitor the conditions of online sale and the lack of contractual relationship between Coty and third-party platforms.[15] Furthermore, Coty's platform ban did not go beyond what was necessary to achieve its legitimate aim because Coty's distributors still had plenty of online routes to access consumers.[16] Coty's platform ban fulfilled the *Metro*-criteria for the sale of its luxury cosmetics and it therefore *prima facie* fell outside the scope of Article 101(1). Let us now examine *Coty*'s effects on online selective distribution.

A. Platform Bans

After *Coty*, LGMs can plainly objectively justify platform bans by reference to their products' prestigious image. Some have interpreted *Coty* as being restricted to LGMs, such that non-LGMs can only justify platform bans by arguing that their goods are "luxury" goods.[17] However, showing that a product is luxury is only one method of fulfilling the *Metro* criteria. Prior to *Coty*, a Dutch court ruled that Nike running shoes were sufficiently prestigious to justify a platform ban.[18] Moreover, a German court has applied *Coty* where a non-LGM prevented a distributor from selling through eBay.[19] Theoretically, as long as a manufacturer, LGM or otherwise, can show that brand-image is sufficiently crucial to maintaining its inter-brand position that a platform ban is necessary, the SDS will satisfy *Metro*. Indeed, Commission officials consider that a "clear delineation between [luxury and non-luxury goods] will in many cases neither be possible, nor necessary as high-quality and high-technology products similarly

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13 ibid.
14 ¶ 28.
15 ¶ 47-51.
16 ¶ 52-53.
17 Charley Connor, 'Coty wins on selective distribution in Germany' (*GCR*, 26 July 2018) <https://globalcompetitionreview.com/article/1172311/coty-wins-on-selective-distribution-in-germany>.
18 Case C/13/615474 / HA ZA 16-959, *Nike v. Action Sport Soc. Coop* (4 October 2017).
19 Andrzej Kmiecik, 'Higher Regional Court Of Hamburg Addresses Ban On Online Sales Via Third-Party Platforms For Non-Luxury Products' (*Mondaq*, 7 August 2018).

qualify for selective distribution compliant with Article 101(1) TFEU as long as the *Metro*-criteria are fulfilled."[20] Moreover, the CJEU held in *Coty* that platform bans do not constitute hardcore restraints under Article 4(b) or 4(c) VABER, which means that *any* manufacturer that implements a platform ban can benefit from the block exemption as long as it and its distributor's respective market shares do not exceed 30%.[21] *Coty* therefore clarifies that any manufacturer can seek to justify a platform ban by reference to brand protection, confining *Pierre Fabre* to its facts.

B. Online Sales Bans

The CJEU in *Coty* distinguished *Pierre Fabre* not only by reference to the fact that the latter concerned an OSB (not a platform ban), but also to the fact that it concerned "*not luxury goods*, but cosmetic and body hygiene goods."[22] The assertion in *Pierre Fabre* that protecting a product's prestigious image did not constitute a legitimate aim was confined "solely to the *goods at issue in the case*… and to the contractual clause in question".[23] Therefore, the CJEU's statement in *Pierre Fabre* that "maintaining a prestigious image is not a legitimate aim" is arguably confined to those cases where a *non-LGM* justifies an *OSB* by reference to products' *prestigious image*. *Pierre Fabre* did not deny the economic logic of restricting online sales as a means of protecting brand image. However, in effect, the CJEU in *Pierre Fabre* deemed this procompetitive goal unworthy of protection when pitted against restrictions of intra-brand competition. The CJEU in *Coty* interpreted the statement as forming part of the court's guidance as to the proportionality of Pierre's OSB: an OSB implemented by a *non-LGM* is obviously disproportionate to the aim of brand protection.[24] Conversely, *Coty* implies that brand protection *may* be worthy of protection for both LGMs implementing OSBs and *all* manufacturers that operate less restrictive online SDSs (as stated, *Pierre Fabre* already permitted the objective justification of OSBs by reference to other factors). In these situations, the trade-off between inter- and intra-brand competition could fall in favour of the former.

If any manufacturer can, in theory, justify an OSB if it shows that its goods are luxurious, the criticism levelled erroneously at *Coty* as regards platform bans,

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20 Commission, 'EU competition rules and marketplace bans: Where do we stand after the Coty judgment?' (briefing paper, April 2018).
21 ¶ 59, 62-69.
22 ¶ 32 (emphasis added).
23 ¶ 34 (emphasis added).
24 ¶ 33.

namely that manufactures will have the incentive to claim that their goods are luxury when they are in fact not, does apply here. In practice, a manufacturer would very rarely have the incentive to block online sales *unless* it was an LGM (or if there was an anticompetitive motivation), but there will be rare instances where it could. For example, a non-LGM could be subject to rife counterfeiting online. There is therefore a risk that parties, courts and authorities will lose sight of the forest ("Does this OSB promote inter-brand competition sufficiently to justify its restriction on intra-brand competition?") for the trees ("Are these running shoes luxury goods? Do they have gold laces? Does demand go up as price increases?").

III. THE AFTERMATH OF *COTY* IN PRACTICE

It is one thing to say that manufacturers are legally capable of restricting online intra-brand competition by reference to brand protection. However, *Coty* may have modest implications in practice. Firstly, manufacturers cannot rely on *Coty* as a *carte blanche* to restrict platform sales. Though the EC Report found that platform bans do not currently equate to OSBs, the extent to which retailers rely on platforms to access consumers varies across member states.[25] For member states in which platform sales constitute a popular distribution channel, *Coty* may alter the framing of the proportionality analysis for brand-image conscious manufacturers, but it will probably not affect the outcome. In Germany, where 62% of retailers distribute through marketplaces,[26] the competition authority has stated that *Coty* will not change its decisional practice, which focuses on branded, but not luxury, goods.[27] With the infrastructure and convenience that platforms like Amazon provide retailers, the use of independent retailer websites to access consumers online could dwindle across all member states, especially for small-to-medium sized businesses. Furthermore, platforms are more important distribution channels for certain product categories, such as clothing and consumer electronics.[28] As the EC Report notes, "the potential impact of marketplace restrictions on competition needs to be assessed on a case-by-case basis."[29]

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25 EC Report, ¶ 978-80.
26 EC Report, ¶ 978-80.
27 Yves Botteman and Daniel Barrio Barrio, 'Where do we stand after *Coty*?' (2018) 17 Competition Law Journal 20, 25-26.
28 EC Report, ¶ 504.
29 EC Report, ¶ 980.

Secondly, even if *Coty* is interpreted as letting LGMs justify SDSs containing OSBs by reference to their products' prestigious image, doing so will remain exceedingly difficult. The recent English *Ping* case shows that it is incredibly hard to justify OSBs, even for a manufacturer that differentiates its inter-brand position by selling bespoke products that require face-to-face customer interviews.[30] Because online sales constitute such an important method of distribution and make such a significant contribution to market integration, the Commission and national authorities will be loath to set a precedent where an OSB is deemed proportionate to the aim of protecting a prestigious image.

Coty therefore leaves certain stones unturned. While manufacturers can refer to brand protection when justifying online restrictions, specific restrictions will turn on their facts when it comes to the proportionality assessment. Moreover, it remains unpredictable whether, in any given case, an authority or court will favour the promotion of inter-brand competition over market integration. The two goals are discordant and incommensurable; they cannot be balanced and the choice between them can appear arbitrary. The compatibility of SDSs with Article 101 therefore remains uncertain for manufacturers. While *Coty* has brought some welcome clarity to the law on selective distribution, additional guidance may be required as online markets evolve.

CONCLUSION

Vertical restraints are part of a unique area of EU competition law, where the EU's legitimate goal of market integration has stultified the move to a proper effects-based approach. These goals come to loggerheads when one examines the compatibility of a particular SDS with Article 101. *Coty* improves the law on selective distribution by permitting the justification of SDSs by reference to brand protection, and is a step in the right direction towards the promotion of inter-brand competition. However, in any particular case, it is still hard to predict *ex ante* whether an authority or court will favour inter-brand differentiation and choice over or under EU-wide availability. Some SDSs will be especially restrictive of the latter, but necessary to preserve the former. Uncertainty for manufacturers that seek to restrict online sales remains.

20 October 2018.

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30 *Ping v CMA* [2018] CAT 13.