Kluwer Competition Law Blog

The Coty Exception: A Luxury for a Selected Few?

Yves Botteman, Daniel Barrio Barrio (Dentons) · Friday, December 15th, 2017

Background

This case concerns a dispute between Coty Germany GmbH, a supplier of luxury cosmetic products, and Parfümerie Akzente GmbH, an authorised retailer.

Coty Germany, a subsidiary of the US parent company Coty Inc., sells luxury cosmetics in Germany through a selective distribution network of authorised distributors. Parfümerie Akzente is a longstanding authorised distributor for Coty products, selling both at its brick-and-mortar locations and online through its own online store and partly via 'amazon.de'.

In order to protect and support the luxury image of its brands, Coty established a selective distribution network which imposes a number of qualitative criteria on its retailers through:

- A selective distribution contract: which obliges the retailer to comply with certain conditions relating to the environment, décor and furniture of its brick-and-mortar stores; and
- A supplemental agreement on internet sales (amended after R. 330/2010 came into force): whereby the retailers are allowed to sell Coty's luxury products through their own 'electronic shop windows'. However, the retailers are not allowed to sell the products online using a different business name as well as using, in a discernible manner, third-party online platforms.

Following Parfümerie Akzente's refusal to sign the supplemental internet agreement, Coty asked a German court of first instance to prohibit the retailer from selling Coty's products on 'amazon.de'. The German court dismissed Coty's action on the ground that such a ban constitutes an infringement of the German antitrust law (*Gesetz gegen Wettbewerbsbeschränkungen*) – or its equivalent Article 101 TFEU – on the basis of the *Pierre Fabre* case (C-439/09, para. 46).

Coty appealed this decision before the Higher Regional Court of Frankfurt am Main. This Court, uncertain of the interpretation under EU law of such a selective distribution system and such a ban on online platforms, decided to stay the proceedings and refer the following questions to the Court of Justice of the EU (CJEU):

1. Is a selective distribution system, designed primarily to preserve the luxury image of goods, compatible with Article 101 TFEU?

To answer this question, the Court resorted to previous case-law which confirms that (i) selective distribution systems are compatible with Article 101 TFEU provided that certain criteria are

satisfied (*Metro* and later *Pierre Fabre*) and that (ii) selective distribution systems, designed primarily to preserve the luxury image of goods, are also compatible with Article 101 TFEU, provided that the above criteria are met (*Copad*, C-59/08).

Pierre Fabre

First, the Court confirmed that the organisation of a selective distribution network is not prohibited under Article 101 (1) TFEU provided that the following criteria are satisfied (*Pierre Fabre*, paragraph 41): (i) Resellers must be chosen on the basis of objective criteria of a qualitative nature; (ii) these criteria must be laid down uniformly for all potential resellers and not applied in a discriminatory manner; (iii) the product in question must require such a network in order to preserve the quality and ensure its proper use; and (iv) the criteria must not go beyond what is necessary to achieve the objective pursued.

Copad

Second, the Court examined, in the light of the *Copad* case, whether a selective distribution system for luxury goods is also valid under Article 101 (1) TFEU. In this regard, the CJEU recalled that '*the quality of such [luxury] goods is not just the result of their material characteristics, but also of the allure and prestigious image which bestows upon them an aura of luxury […]'.* According to the Court, the protection of that aura of luxury is essential because it enables consumers to distinguish luxury goods from other goods and an impairment of that aura is likely to affect the quality of the goods (*Copad*, para. 24 – 26).

In that regard, the Court confirmed that a carefully crafted selective distribution system, aimed at preserving the luxury image of the goods, may contribute to the reputation of those goods and to their aura of luxury (*Copad*, para. 29). A selective distribution system, such as the one at issue in the present case, is therefore compatible with Article 101 TFEU – namely it does not qualify as a restriction of competition and hence is not caught by the prohibition –, provided that the above *Metro/Pierre Fabre* criteria are fulfilled.

At this point, the CJEU also clarified that the assertion made in paragraph 46 of the *Pierre Fabre* case – which declared that '*the aim of maintaining a prestigious image is not a legitimate aim for restricting competition […]'* – should not be interpreted broadly to all selective distribution systems, but should rather be read in the context of a specific contractual clause which imposed an absolute internet ban on resellers of cosmetic and body hygiene products (*i.e.* non-luxury goods).

2. Is a clause which prohibits authorised distributors from selling, in a discernible manner, on third-party online platforms compatible with Article 101 TFEU?

Once the Court confirmed the validity of Coty's selective distribution system, it went on to examine the specific clause in the supplemental internet agreement which imposed a ban on its retailers from using third-party online platforms, in a discernible manner.

Here, the CJEU made a logical extension of its conclusion on the first question: in the same way that a selective distribution system – primarily designed to preserve the luxury image of the goods and complying with the *Metro/Copad* criteria – is not caught by the prohibition of Article 101(1) TFEU and is thus valid, a specific contractual clause which pursues the same goal is also valid provided that the same criteria are also met.

While it is for the national court to assess whether a specific contractual clause complies with the criteria, the CJEU went on to provide an interpretation of the *Metro/Copad* criteria under EU law. Since it was clear from the national proceedings that the clause is objective and is uniformly applied without discrimination to all distributors, the Court examined whether the clause was proportionate, i.e. (i) *appropriate* in light of the objective pursued and (ii) not excessive in the sense that it did not *go beyond what is necessary* to achieve the desired outcome.

Is the clause appropriate to protect the luxury image?

According to the Court, a contractual clause which requires authorised distributors to only sell through their own online shops and prohibits them from using different business names when selling online or using, in a discernible manner, third-party online platforms, provides a guarantee to the supplier that those luxury goods will be *exclusively associated* with the authorised distributor.

Given that one of the objectives of such a selective distribution system is precisely to ensure such an association, the Court concludes that such prohibitions imposed on retailers are coherent with the overall objective and characteristics of the entire system.

In addition, the Court asserts that this prohibition enables the supplier to check that the qualitative criteria agreed with the authorised distributors are fulfilled when selling online. It is precisely the contractual relationship between the supplier and the retailers that allows the supplier to take action in case of non-compliance with those criteria. The absence of such a contractual link between the supplier and the third-party online platforms therefore constitutes an obstacle to control the compliance with the qualitative conditions and generates a risk that the luxury image of the goods is deteriorated on the internet.

Does the clause go beyond what is necessary?

To answer this question, the CJEU addresses three points:

First, contrary to the clause in *Pierre Fabre* which imposed and absolute ban on internet sales, the clause in this case does not contain an absolute prohibition on retailers to sell online. Instead, retailers are only precluded from selling the contracted goods online on third-party platforms which are discernible to the customers. Authorised distributors are still allowed to sell online via their own websites – as long as they operate an electronic shop window and the luxury character of the goods is preserved – and via unauthorised third-party platforms which are not discernible to the consumer.

Second, the Court agreed with the observations of the Commission and Advocate General (AG) Wahl that the results of the Preliminary Report on the E-commerce Sector Inquiry of 15 September 2016, showed that, despite the growing importance of third-party platform as a channel for online sales, the main channel – at least at this stage of the development of e-commerce – is still the distributors' own online shops.

Finally, the Court confirmed once again that in the absence of a contractual relationship between the supplier and the third-party platforms, a prohibition to use non-authorised third-party online platforms is more effective to ensure compliance with the quality criteria than an authorisation to retailers to use such platforms subject to certain conditions.

All in all, the Court concludes that the contested clause is appropriate and does not go beyond what is necessary to ensure the objective of preserving and supporting the luxury image of Coty's brands and, therefore, that it is compatible with Article 101 (1) TFEU.

3. Does a clause which prohibits authorised distributors from selling, in a discernible manner, on third-party online platforms constitute a restriction of their customers or a restriction of passive sales?

This question concerns the interpretation of the hardcore restrictions found in Article 4 (b) and 4 (c) of Regulation 330/2010. According to this Article, the exemption does not apply to vertical agreements which have as their object the restriction of the territory into which or the customers to whom a retailer can sell. Similarly, the exemption does also not apply to vertical agreements which restrict active or passive sales to end users.

In this regard, the Court notes that contrary to *Pierre Fabre* where the clause at issue imposed an absolute ban on internet sales, the clause in Coty's distribution agreement does not contain such an absolute prohibition as it still allows the authorised distributors to sell through other online channels.

In addition, the Court also notes that the selective distribution contract allows, under certain conditions that authorised distributors advertise via the internet on third-party platforms and to use online search engines with the result that customers are able to find the online offers. Finally, the Court considers that it is not possible to circumscribe a specific group of customers of third-party online platforms within the larger group online purchasers.

The Court concludes on this point that the clause at issue does not amount to a restriction of the customers of the authorised distributors or of passive sales to end users, within the meaning of Article 4 of Regulation 330/2010.

Presumably, as an online marketplace restraint applies irrespective of the intrinsic characteristic of the product, the above considerations would equally apply to other branded goods, which do not qualify as luxury. Accordingly, high-end or highly technical products could well fall within the scope of the exemption of the Regulation. This suggests that while an online marketplace ban is not 'hardcore', it could nonetheless trigger antitrust concerns if the supplier enjoys market power (well beyond the 30% market share threshold provided in the Regulation) and/or the restraint is pervasive in the industry, e.g. as it was the case for sport shoes in Germany.

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The *Coty* case clarifies that selective distribution systems for luxury goods and clauses which restrict sales of luxury goods on third-party online platforms are compatible with EU competition law. The case, however, also provides fertile ground for speculation on a number of questions.

What does luxury exactly mean?

AG Wahl in his Opinion, referred a number of times to 'high-quality', 'high-technology' and 'high-end' products or to their 'high-quality/technological' nature (11 times to be exact) while also referring to luxury goods. The CJEU did not refer to high-quality products even once.

Does this mean that AG Wahl is advocating in favour of a wider exception which also includes

other non-luxury goods but whose prestige image still warrants special protection? And what are luxury goods anyway?

The answer to the second question may be in paragraph 92 of AG Wahl's Opinion where he says that the conclusion that a selective distribution system aimed at preserving the luxury image of the goods is compatible with Article 101 (1) TFEU, provided that the *Metro* criteria a satisfied, may apply both to 'luxury products' and 'quality products'. What ultimately matters, according to AG Wahl, is the need for the network to preserve the prestige image.

In any case, one of the unintended consequences of the narrow focus on luxury goods provided by the CJEU is that brand owners with mainstream products may have greater incentives to bestow an 'aura of luxury' on their products in order to get a tighter grip on their authorised distributors' online sales.

How will this case be applied in the different Member States?

A number of commentators have raised concerns that this case will lead to divergent application by national competition authorities and courts. To some extent, this has already happened.

In November 2015, the French Competition Authority closed an investigation into Adidas after the German sports shoemaker agreed to amend its online sales policy to allow resellers to use online marketplaces provided that certain quality criteria are satisfied. Similarly, in July 2014, the German *Bundeskartellamt* ended an investigation into Adidas after it removed from its distribution contracts a ban on sales over online platforms such as Amazon and eBay.

On April 2017, the Higher Regional Court in Düsseldorf confirmed a decision by the German Competition Authority against Asics for imposing a general prohibition on its retailers of using online comparison engines. More recently, in October 2017, a court in Amsterdam confirmed that Nike's selective distribution system, which allowed sales only via certain authorised online platforms (such as Zalando and Otto) did not infringe EU competition law, mainly because Nike did not ban online sales completely.

There is another point of potential concern. As the *Coty* case shows, assuming that the supplier fails to meet the proportionality test and also fails to show that its clauses is eligible for exemption under the Regulation, then a ban on marketplaces has to be assessed on an effect-based standard. Depending on the strength of the brand in certain markets and the importance of online marketplaces as a distribution channel, it may well be that the same ban would be valid in some national markets but not in others. As a result, brand owners may be faced with different levels of compliance risk from one EU Member State to the next. In addition, a modulated approach on such a ban may raise compatibility issues with respect to the requirements that the ban is applied uniformly and objectively across the distribution network.

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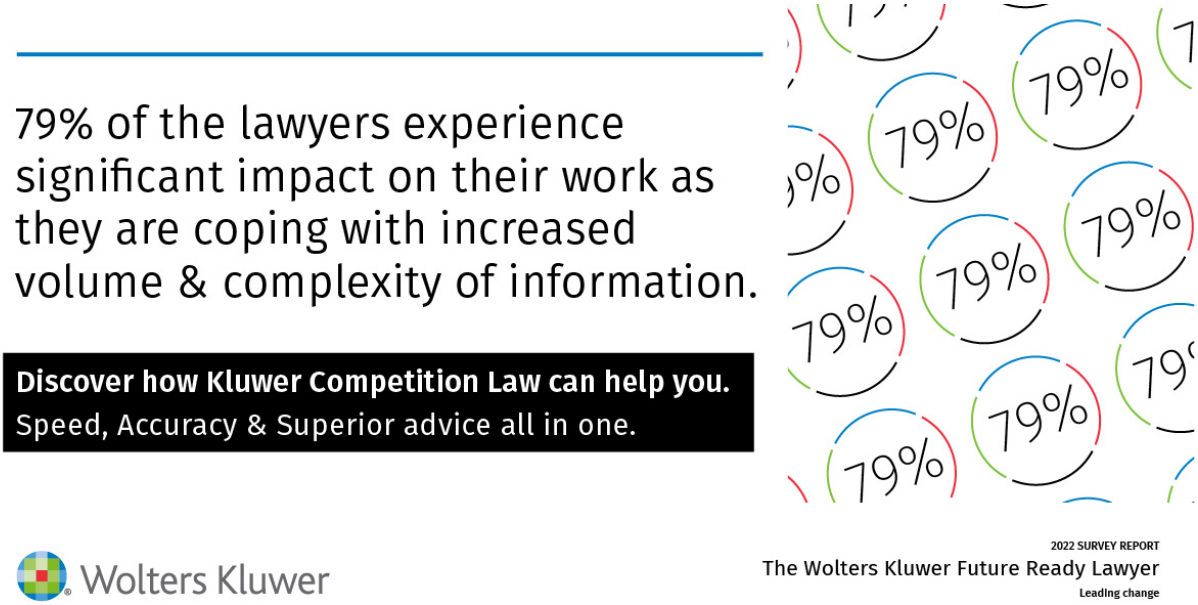

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