

COMPETITIVE EDGE

Coty Opinion – balancing brands and online platforms

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This week's Advocate-General's Opinion in the *Coty* case¹, gives brand owners comfort that appropriate restrictions to protect a brand and the environment for its sale in an online context will be acceptable.

The case concerned how far brand owners could use selective distribution online. A selective distribution system is one where the manufacturer or brand owner sets quality conditions, typically for the environment in which products are sold and does not allow resale to those who do not meet its criteria. Here the AG concluded that a supplier may prevent authorised resellers within its selective distribution system from using third party online platforms such as Amazon and eBay in a visible or discernible manner. Whilst not binding on the European Court of Justice (**ECJ**), the Opinion provides a hopeful steer for luxury cosmetics manufacturer Coty, and other suppliers who use selective distribution, on the eventual direction of the ECJ when it gives judgment.

There has been much anticipation around the *Coty* case ever since the Higher Regional Court in Frankfurt made its reference to the ECJ seeking preliminary rulings on competition issues raised in a contractual dispute between Coty and one of its authorised distributors, German retailer Parfumerie Akzente. Expectations were heightened by the earlier ECJ decision in *Pierre Fabre*² in which a restriction that operated as an absolute ban on internet sales within a selective distribution system was found to be restrictive of competition by object and therefore unlawful. The concern has been that *Pierre Fabre* signalled a direction of travel which would not allow sufficient protection to brand owners such as luxury goods manufacturers to set the right conditions for the sale of their products. AG Wahl points out that this is an opportunity to clarify that ruling and prevent further divergent interpretations by national competition authorities and courts which may fundamentally alter their approach to selective distribution systems. His Opinion lays the groundwork for the ECJ to make that clarification.

The questions before the ECJ

The German court asked the ECJ to rule on a number of questions, including:

- i. whether selective distribution systems for luxury goods are compatible with the prohibition on restrictive agreements in Article 101(1) TFEU³; and
- ii. if the answer to i) is yes, whether it is also permissible to prevent authorised retailers in a selective distribution system from engaging third-party undertakings that are discernible to the public to handle internet sales (**third party platform restriction**).

Clarifying *Pierre Fabre* – the first question

AG Wahl stresses that *Pierre Fabre* was concerned with a particular contractual position imposed in the context of a selective distribution system and the proportionality of that restriction; the selective distribution system in its entirety was not at issue. It was not the ECJ's intention that distribution systems designed to preserve the brand image of products are necessarily caught by the Article 101(1) prohibition and its judgment did not call into question previous case law on the point. Then, having reviewed the relevant case law, AG Wahl concludes that selective distribution of luxury goods may be justified under the competition rules. Under the case law, selective distribution systems based on purely qualitative criteria (with no quantitative limits on authorised distributors) are not caught by the Article 101(1) prohibition when three conditions are met (the *Metro* criteria⁴):

- i. necessity – the properties or nature of the product necessitates a selective distribution system to preserve their quality and ensure they are correctly used;
- ii. objectivity – resellers must be chosen on the basis of objective qualitative criteria applied in a non-discriminatory way; and
- iii. proportionality – the criteria used for selection of resellers must not go beyond what is necessary for the supplier's (legitimate) objectives.

In relation to the first requirement, AG Wahl maintains that the properties of the product include the "luxury" image of the product. He notes that luxury brands in particular derive their added value from a stable

¹ *Coty Germany GmbH v Parfumerie Akzente GmbH (C-230/16)*

² *Pierre Fabre Dermo-Cosmetique (C-439/09)*

³ Treaty on the Functioning of the European Union

⁴ *Metro SB-GroBmarkte v Commission (26/76)*

consumer perception of their high value and of the exclusivity in their packaging and marketing; selective distribution permits marketing of the products while maintaining that stability of perception. He also links the aura of luxury which helps to define luxury and prestige goods with the physical quality of the goods to further justify selective distribution for luxury and prestige products. His conclusion is that selective distribution networks that are mainly intended to preserve the luxury image of such products are compatible with Article 101(1) provided the nature of the product, including its prestige image, requires selective distribution in order to preserve the quality of the products and ensure they are properly used, and the other *Metro* criteria are satisfied.

Restrictions on the use of third party platforms – the second question

On the specific issue of whether Coty can prohibit its authorised retailers from using third party platforms in a visible or discernible manner for online sales, AG Wahl again found that the restriction will be compatible with Article 101(1) if it complies with the *Metro* criteria and, more particularly, if it is necessary to preserve the nature and quality of the products; is determined and applied in a uniform and non-discriminatory fashion; and is proportionate (questions which, ultimately, will be for the German court to decide on the facts before it).

In his observations, the AG notes that he had already concluded that preserving the image of luxury and prestige of products is a legitimate objective for justifying a qualitative selective distribution system. His analysis then focuses on whether the restriction itself can be specifically justified by the need to protect the luxury image of the products. He concludes that that is the case because the clause is likely to improve quality-based competition. He considers that the prohibition is likely to improve the luxury image of the products by ensuring that the products are sold in an environment that meets the qualitative requirements of the selective distribution system and by making it possible to guard against "free-riding" by third parties who may gain from the investments and efforts made by the supplier and other authorised distributors to improve the quality and image of the products.

The Opinion clearly distinguishes the third party platform restriction in *Coty* from the clause at issue in *Pierre Fabre*, which prevented authorised distributors from all online selling. Far from imposing an absolute ban on online sales, the *Coty* restriction only prevents online sales made, in a discernible manner, via third party platforms, on the basis that those platforms are not required to comply with the qualitative requirements imposed on the authorised distributors. Authorised distributors are still free to sell on the internet through their own "electronic shop window" or in a non-discernible manner via a third party site.

Comments

If confirmed by the ECJ, this analysis will support Coty's third party platform restriction, and boost Coty's position in its contractual dispute with its German retailer. Beyond that, it should resolve the uncertainties raised by *Pierre Fabre* as to whether selective distribution systems for brands and specifically luxury or prestige goods are compatible with the competition rules.

AG Wahl's analysis of the third party platform restriction is a common-sense extension of the normal principles applying to restrictions on offline sales within a selective distribution system. If an online restriction is comparable with a legitimate offline restriction, it too should be compatible with the competition rules; thus a prohibition on using (in a discernible manner) an unauthorised third party online platform is capable of being justified on a like basis to a prohibition on selling offline through unauthorised resellers.

The conclusions reached in the Opinion on the third party platform restriction are not limited to luxury or prestige goods, but are capable of applying to selective distribution of all types of goods and services (for which selective distribution may be justified under the competition rules). However those conclusions are limited to selective distribution systems, where the nature of the product justifies restrictions on the environment in which it is sold. Outside of that context there must be very real questions as to whether, or in what circumstances, suppliers may ban the use of third party online platforms by resellers.

We have yet to see whether the ECJ will agree with AG Wahl – look out for more in this space.

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