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Antitrust Group Client Alert: ECJ provides important guidance for online trade – No luxury goods on online market places?

The European Court of Justice (“**ECJ**”) has recently held that a manufacturer of luxury goods may operate a selective distribution system that prohibits its distributors from selling the products via internet platforms, such as Amazon or eBay, in the interest of preserving the luxury image of the goods.¹ The practical implications of this landmark judgment for online trade are set out below, along with an overview of the corresponding framework in the US.

RESTRICTIONS OF ONLINE SALES PRE COTY

Whether selective distribution arrangements are compatible with EU competition law has been widely debated across the EU Member States. Numerous conflicting decisions from Member State competition authorities and national courts, even within the same EU Member State, created significant uncertainty for all market players. For example, while the German Federal Cartel Office (“**FCO**”) forced sports brand Adidas to refrain from using platform bans, the European Commission, in its report of the e-commerce sector inquiry of 10 May 2017, indicated that the assessment of permissible platform bans has to take into account the particular market conditions.

In the US, the treatment of vertical restraints, including vertical restraints applied in the context of internet distribution, has evolved. Originally, the treatment of vertical price restraints and vertical non-price restraints was dichotomous, with the former subject to *per se* treatment (i.e., strict illegality) and the latter subject to a rule of reason standard that weighed procompetitive justifications against any anticompetitive effects. Eventually, rule of reason standard was deemed applicable to all vertical restraints under *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).² As discussed below, US vertical restraints policy for markets with online sales does not diverge from

¹ Case No. C-230/16, Coty Germany GmbH v. Parfümerie Akzente GmbH - *Coty*, judgment dated December 6, 2017

² Treatment of resale price maintenance (“RPM”) under state law differs, as some states continue to treat RPM as *per se* illegal.

this standard and will generally permit online sales restrictions, irrespective of the use of selective distribution systems.

THE COTY CASE

The Coty judgement follows a dispute between Coty Germany (“**Coty**”), a supplier of luxury cosmetics under brands such as Calvin Klein, Chloé and Marc Jacobs, and Parfümerie Akzente, an authorized distributor of Coty. Coty operates a selective distribution system in Germany. Core elements of Coty’s restrictions on distribution include that brick-and-mortar retail locations must fulfil certain requirements that ensure an adequate point-of-sale environment for luxury goods. Coty subsequently amended its selective distribution system to allow authorized dealers to sell Coty’s products over the internet through the distributor’s own online shops. At the same time, Coty explicitly prohibited its distributors from selling Coty’s products through third party online platforms (e.g. Amazon or eBay), which have not been approved by Coty as authorized retailers. Coty’s rationale for the restriction was to protect the character of Coty prestige’s brands and the high end sales environments that support the luxury image of these brands.

Parfümerie Akzente refused to accept the amended terms, which resulted in Coty suing its dealer in Germany and seeking an order prohibiting Parfümerie Akzente from distributing its products via Amazon. The Regional Court of Frankfurt found the platform ban infringed Article 1 of Germany’s Act against Restraints of Competition and Article 101(1) of the Treaty on the Functioning of the European Union (“TFEU”).³ The appellate court, the Higher Regional Court of Frankfurt (case 11 U 96/14) overturned the initial decision, stayed the proceedings, and sought guidance from the ECJ on:

- 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 comply with Article 101(1) TFEU
- Whether the members of such distribution systems can be prohibited generally from using third-party platforms and
- Whether this restriction qualifies as a hard-core restriction in accordance with the EU Block Exemption Regulation on Vertical Restraints (restriction of a customer group or restriction of passive sales).

ECJ: PLATFORM BANS ARE PERMISSIBLE

The ECJ followed the General Advocate Wahl’s opinion of 26 July 2017, stressing the importance of brands and preventing retailers in selective distribution systems from selling on platforms if the manufacturer itself does not sell on these platforms. The ECJ held that manufacturers of luxury brands are allowed to ban sales on internet platforms

³ Case No. 3 O 128/13, decision dated July 31, 2014

when they are seeking to preserve the “aura of luxury” for their products so long as these restrictions are imposed equally on all distributors in a non-discriminatory manner and do not disproportionately restrict distributors.

The ECJ based its decision in particular on the consideration that, due to the absence of a contractual relationship between the supplier and third-party platforms, a supplier is prevented from ensuring that these third-party platforms comply with the quality criteria that the supplier has imposed on his authorized dealers.

The ECJ also clarified that platform bans do not constitute a hardcore restriction, which means that platform bans would be generally exempted from the application of EU competition law if the market shares of the parties do not exceed 30%.

While the Higher Regional Court of Frankfurt has to decide its case observing the ECJ’s guidance, it is very likely that it will consider the clause used by Coty to be legitimate and proportionate.

FIRST REACTIONS

Within hours of publication of the judgment, both the German Federal Cartel Office (“**FCO**”) and the European Commission commented on the decision.

Andreas Mundt, president of the FCO, downplayed the significance of the decision by stating that he considers the ECJ’s ruling to have only limited effects on the FCO’s approach towards selective distribution agreements since it only relates to real luxury products and does not prevent the FCO from further pursuing platform bans in other sectors.

“Our preliminary view is that such manufacturers have not received carte blanche to impose blanket bans on selling via platforms.” (Andreas Mundt)

The Commission praised the ruling of the ECJ for providing more clarity and legal certainty to market participants, while also introducing a uniform application of competition rules for online distribution across the EU.

CONCLUSION AND OUTLOOK

Impact on restriction of online sales in the EU

At least for manufactures of luxury goods, the Coty judgment provides welcome clarification and legal certainty for the use of platform bans. However, the judgment fails to offer specific guidance on (i) what qualifies a product as a luxury good and (ii) the extent to which other branded goods may qualify as luxury, e.g. major fashion or sports brands.

While the judgment provides clarity regarding online retailers such as for Amazon Marketplace, it leaves open the question whether restrictions on distribution through online platforms that are specifically designed for distributing luxury goods or which have separate sections specifically dedicated to luxury goods would be similarly permissible.

The Coty judgment leaves open the possibility that selective distribution restrictions for luxury and non-luxury branded goods would also be permissible if the supplier can show that:

- The restriction is intended to preserve the *quality* and to ensure the *proper use of its products and/or*
- The supplier is seeking to guarantee that the goods will be *exclusively associated with the authorized distributor*. All of these justifications can also be applied to luxury and non-luxury branded goods.

Online sales in the US

As the Federal Trade Commission has explained, in the United States, “limitations on how or where a dealer may sell a product . . . are generally legal – if they are imposed by a manufacturer acting on its own.”⁴ Vertical restraints in the online sales context are analyzed under general antitrust law and are subject to rule of reason analysis under Section 1 of the Sherman Act. In general, a manufacturer or supplier in the United States has the right to decide how to organize its distribution channels and may reserve internet sales channels for itself or designated distributors. In this regard, unlike in the EU, selective distribution systems are not required to justify restrictions.

Rather, internet distribution policies in the US will be evaluated by weighing procompetitive justifications with any potential anticompetitive effects (e.g., collusion, competition softening, and entry deterrence). Factors relevant to the rule-of-reason analysis include:

- The market power of the entities involved
- The scope of the restraint
- The number of entities within the market adopting the restraint; and
- The restraint’s source

As a practical matter, under this analysis, a restriction on internet sales will be permitted under US antitrust law where manufacturers seek to address free-riding issues, protect

⁴ Manufacturer-Imposed Requirements, Federal Trade Commission, *available at* <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/dealings-supply-chain/manufacture-imposed>.

brand equity, or otherwise wish to improve the way in which their products compete with rival brands. So long as there are no anticompetitive effects that would outweigh such procompetitive justifications, then vertical restraints on internet distribution will be upheld under this standard. In this regard a company wishing to create such a restriction should do the following to ensure compliance:

- Define its business objectives specifically and highlight the procompetitive justifications for such objectives; and
- Avoid discussing its restrictions on internet sales with competitors, as the decision to restrict online sales must be reached by the manufacturer or supplier alone.

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