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Brand owners: controlling internet sales while remaining compliant with competition law

Restrictions on internet distribution and competition law compliance generally do not mix. However, in a recent speech, Johannes Laitenberger, a high-ranking official within the Competition Directorate of the European Commission, stated that “while blanket internet sales bans are undoubtedly a hardcore restriction [...] this does not apply to all restraints on online sales.” He was referring to a case, *Coty*, which is currently before the European Court of Justice (“ECJ”) for a preliminary ruling on whether online sales restrictions linked to selective distribution systems are legitimate from a competition law perspective. Mark Tricker and Amanda Town of Norton Rose Fulbright LLP explore why this case will bring some much-needed clarity to an area where different competition authorities have taken different views and what this might mean for brand owners seeking to exercise control over how and where their products are sold online.

The general approach to online resale restrictions

In general, competition law takes a dim view of attempts by brand owners to restrict online sales. In its guidelines on vertical restraints published in 2010, the Commission noted that the internet is “a powerful tool to reach a greater number and variety of customers than by more traditional sales methods,” that “every distributor must be allowed to use the internet to sell products” and that using a website is a form of “passive selling,” which generally cannot be restricted without such a restriction being considered “hardcore.”

More recently, in its provisional findings from the e-commerce sector inquiry (launched as part of its Digital Single Market Strategy), the Commission expressed concerns that the increased price transparency and competition facilitated by the internet has led suppliers to seek to take back control, including by resorting to the imposition of an increasing number of contractual restrictions on online sales in an attempt to better control distribution.

The Commission considered that certain of those practices would require further investigation.

However, the Commission also recognised that, exceptionally, restrictions may be legitimate. In her September 2016 speech announcing the e-commerce provisional report, the European Commissioner responsible for competition, Margrethe Vestager, explained that there can be valid reasons for suppliers imposing certain pricing and availability restrictions on internet sites which might preserve the existence of bricks-and-mortar shops, or maintain a luxury brand’s image of exclusivity. In its guidelines on vertical restraints, the Commission has long suggested that certain restrictions that are legitimate when imposed on bricks-and-mortar distributors can apply to sales over the internet. So, for example, just as it is legitimate to restrict active selling (marketing) by a bricks-and-mortar distributor into a territory or customer group exclusively allocated to another, so online advertising by an internet site targeted outside an allocated territory

can be restricted. The guidelines suggest that the same may be true of restrictions used in selective distribution systems, provided those systems are genuine and justified by the nature of the product.

Commission guidelines on selective distribution

Selective distribution systems restrict the number of authorised distributors not on the basis of territories but on the basis of qualitative, objective criteria linked to the nature of the product that distributors must satisfy in order to be selected. These systems are often used for the distribution of luxury or branded goods where there is a brand image to protect or where there is a need to preserve quality or to explain its use.

The Commission’s vertical restraints guidelines state that suppliers may require quality standards for the use of an internet site to resell its goods (in the same way as they might for sales via shops). In relation to third party platforms, such as online marketplaces, the guidelines note that suppliers may require that their distributors only use

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such platforms in accordance with the standards and conditions governing the distributor's internet use.

This suggestion that it is permissible for suppliers' selective distribution systems criteria to ban distributors from using certain third party internet platforms, as long as the criteria restricting such use achieve the same objectives as any bricks-and-mortar criteria, and only go as far as is necessary and proportionate to achieve the aim, seems logical. To the extent suppliers implementing selective distribution systems are permitted to prohibit sales through third party bricks-and-mortar retailers, they should be able to achieve the same objective online.

However, although the guidelines are clear, application of this principle in cases to date has been far from consistent.

Diverging case law

Online resale bans were first considered by the ECJ in *Pierre Fabre*. A branded cosmetic goods supplier had imposed resale terms on its distributors, requiring its products to be sold only in a physical store where a pharmacist was present, so prohibiting any sales of its products over the internet. The ECJ ruled that such a ban was a hardcore restriction of competition. Although *Pierre Fabre* only concerned internet-wide sales bans, an excerpt from the judgment has since been used by German national courts to develop a wider principle that, "the aim of maintaining a prestigious image is not a legitimate aim for restricting competition," directly contradicting the view expressed by the Commission in its guidelines.

A later judgment in a higher German national court sought to reconcile the two views by suggesting that protecting a luxury brand image was insufficient to justify a blanket internet sales ban (as in *Pierre Fabre*), but could be sufficient

to justify third party internet platform restrictions, through the application of criteria for a selective distribution system.

Michael Grenfell, Executive Director of enforcement at the UK Competition and Markets Authority, suggested a similar approach in his November 2016 speech where he discussed the difference between an outright online sales ban and an online platform ban - whereas the former is strictly prohibited, the latter should not be considered an automatic or 'hardcore' restriction but rather requires case-by-case analysis to analyse the effects of (and justifications for) such a ban.

This seems a sensible reconciliation. Certainly, the broad interpretation of *Pierre Fabre* by the lower German national court contradicts another ECJ ruling in *Pronuptia*, which found that, in the context of a franchise distribution system, aiming to maintain a luxury brand image and preserving a uniform distribution system could be legitimate aims and should not be automatically dismissed as justifications. It would seem odd if what were true for franchise distribution models did not hold for selective distribution systems.

Clarification expected in Coty

The upcoming *Coty* case represents a good opportunity for the ECJ to clarify the position. This case relates to restrictions on selected distributors' use of third party internet platforms (rather than a blanket ban on internet sales as seen in *Pierre Fabre*). *Coty*, a supplier of luxury cosmetic products, prohibited selected distributors from using online marketplaces (such as Amazon or eBay), but allowed its selected distributors to use their own websites. Germany has asked the ECJ to opine on whether a qualitative selective distribution system can justify restrictions of online sales where the

aim is to maintain a luxury brand image. The case has caused a split between national competition authorities. In a formal intervention in the case, the European Commission has stated that, in its view and in the context of a selective distribution system, "mere marketplace bans are not hardcore restrictions," but should not go beyond what is necessary to protect the system. The Commission's view is supported by Austria, Italy, France and the Netherlands. However, Germany and Luxembourg have argued that online platform bans should be considered hardcore restrictions in the same way as blanket restrictions on online sales (as in *Pierre Fabre*).

What implications does this have for brand owners as regards online reselling?

It is clear that, in general, brand owners should be very cautious when attempting to restrict online reselling activity. Internet-wide bans on resales will always infringe competition law and could lead to significant fines being imposed by competition authorities. However, it does appear that there is substantial support at the European Commission and amongst certain national authorities for the view that what is acceptable to restrict in bricks-and-mortar sales should, in principle, be acceptable to restrict online.

In the context of a selective distribution system, this view would mean that it is acceptable to restrict online sales to websites and platforms that conform to certain objective, qualitative criteria and prohibit sales through platforms that might damage the brand's image, provided such restrictions are justifiable given the nature of the product and are proportionate and necessary to achieve the aim. This view seems the most logical. We will know shortly whether the ECJ agrees.