Who'd have guessed: *Coty* did not end the debate!

The e-commerce sector inquiry and inconsistent national case law and enforcement practice have illustrated the need for clarifications and/or reform regarding e-commerce restrictions. Even after the ECJ's Coty judgment, a number of key issues remain unresolved, as **Tilman Kuhn**, partner, and **Mathis Rust**, associate of global law firm White & Case, explain.

The retail landscape has undergone tectonic shifts over the last decade. Emerging new distribution formats have started challenging traditional brick-and-mortar chains long ago, but the industry has undergone radical change more recently, as manufacturers are increasingly engaging in dual distribution (i.e., selling both through retailers and their own stores, primarily online), price comparison websites are starting to offer direct-purchase options, traditional online players are opening brick-and-mortar stores, and more online retailers are offering sales opportunities for other retailers via online market places. These new distribution formats have challenged suppliers to think about how to design their go-to-market strategy, and "steering measures," such as online sales restrictions, have been scrutinized by a number of competition authorities for some time; and several of those, such as third-party platform and price comparison website bans, have been hotly debated.

Against this background, on December 17, 2018, the European Commission fined branded clothing manufacturer Guess €40 million for several anti-competitive restrictions contained in its selective distribution agreements. Inter alia, the Commission found that Guess prohibited its distributors from bidding on Guess brand names and trademarks as keywords for online search advertising (Google AdWords), and that such conduct constituted a restriction of competition by object. Being issued almost exactly one year after the ECJ's landmark *Coty* judgment that shed light on important questions around preventing distributors from selling through third-party platforms (e.g., eBay or Amazon Marketplace), it appears that the debate is far from over. With its *Guess* decision, the Commission has now added a new facet to an already controversial debate around selling and advertising restrictions in selective distribution agreements. Especially the German Federal Cartel Office (FCO) has taken a tough stand towards any form of restriction that limited the distributors' ability to sell online, emphasizing that "manufacturers of branded products do not have a carte blanche for third-party platform bans."

This debate will inevitably feed into the latest reform discussions, in particular with regard to the soon-to-expire Vertical Block Exemption Regulation (V-BER). The currently ongoing public consultation process regarding the V-BER's potential renewal now provides for a good opportunity for all stakeholders to alert the Commission to the need for and consequences of changes to this regulation, in particular with regard to limitations imposed on distributors regarding selling or advertising online.

Coty and what it clarified

In its landmark *Coty* judgment, the ECJ held that luxury goods suppliers may prohibit members of their selective distribution network from selling the contract goods through third-party platforms without infringing EU competition law. With this preliminary ruling, the ECJ for the first time had an opportunity to clarify several important points that were hotly debated across the EU. The ECJ had to answer two key questions: Does a ban to sell through third-party platforms that a manufacturer agreed to with its authorized retailers in its selective distribution agreements in order to preserve the luxury image of the contract goods constitute (i) a restriction of competition (by object) pursuant to Article 101(1) TFEU, and/or (ii) a passive sales restriction within the meaning of Article 4(b) or (c) V-BER?

First, the ECJ recalled its settled case law that selective distribution systems are exempt from Article 101(1) TFEU if the so-called *Metro* criteria are met, i.e., the distributors must be chosen (i) based on objective and (ii) qualitative criteria, which (iii) should be used in a uniform and (iv) proportionate manner. The ECJ then distinguished the case from its often-misinterpreted *Pierre Fabre* judgment, clarifying that a selective distribution system aimed at protecting the products' luxury image can be compatible with Article 101(1) TFEU. In doing so, the ECJ finally dismissed the notion that *Pierre Fabre* excluded the protection of brand image as a legitimate purpose for setting up a selective distribution scheme.

€40m

Fine issued by the EC to Guess for anti-competitive restrictions contained in its selective distribution agreements

Second, the ECJ clarified that within a justified selective distribution system, prohibiting the authorized distributors' resale through third-party platforms does not prevent the application of the *Metro* criteria, because a clause designed to preserve the products' luxury image is an objective qualitative criterion that is appropriate and proportionate.

Third, the ECJ provided guidance on how third-party platform bans are to be treated under the V-BER, which comes into play when the *Metro* criteria are not met and Article 101(1) TFEU is applicable. The V-BER provides for a safe harbor for vertical restrictions if the contractual parties' market shares do not exceed 30 percent, but is not applicable if the agreement contains a "hardcore restriction" of competition. In *Coty*, the ECJ held that a third-party platform ban does not constitute such a hardcore restriction for two reasons. First, it does not (on its face) exclude online sales entirely, given that distributors could still sell through their own web shops or non-discernible third-party platforms. Second, third-party platform customers are not a definable customer group in the meaning of Article 4(b) V-BER, so that the ban did not exclude sales to a certain category of customers as a whole, which would have been illegal.

What *Coty* left open

The *Coty* judgment entailed controversial reactions. In particular, the FCO was quick to announce that it reserved its own interpretation as to which products the ECJ meant to include in its reasoning. FCO president Mundt twittered that the ECJ "had gone to great lengths to limit its findings to luxury products," whereas "manufacturers of [other] branded products do not have a carte blanche for third-party platform bans." In the same vein, the FCO published an article emphasizing its narrow interpretation of the *Coty* judgment. In contrast, Advocate General Wahl argued in his *Coty* opinion that there should be no distinction between luxury and quality goods when assessing a selective distribution system under the *Metro* criteria. The Commission shared this view, stating that "marketplace bans do not amount to a hardcore restriction under the V-BER irrespective of the product category concerned."

> **It remains unclear how to treat cases that fall just short of a de facto complete prohibition**

Expiration date for V-BER (Vertical Block Exemption Regulation)

Another question that *Coty* did not answer is how to treat other forms of online sales restrictions in the context of selective distribution systems, such as (i) the prohibition to use price comparison tools (such as billiger.de) and (ii) restrictions on keyword bidding in search term ad auctions (such as Google AdWords). Neither type of restriction has been subject to any Commission decisions or ECJ judgments yet.

In a decision in 2015, the FCO qualified the prohibition of using price comparison sites within a selective distribution system as a hardcore restriction of competition within the meaning of Article 4(c) V-BER. It seems doubtful that this view is compatible with the subsequent *Coty* judgment, given that a price comparison site ban still allows for several other methods to sell online, thereby falling short of a de facto prohibition of online sales. Strictly speaking, a price comparison site ban does not even amount to any form of sales restriction, but is rather a restriction on how to advertise (traditionally, price comparison websites are only a "window" showing search results, not a sales channel such as third-party platforms, given that the actual sale is typically performed via the distributor's website). In addition, a price comparison site ban does not restrict sales (or advertisement) to a definable customer group in the meaning of Article 4(b) V-BER.

Another unresolved matter concerns the prohibition on distributors to bid on keywords in search term ad auctions, in particular on trademarked terms for the contract good. Auction-based search ad services enable distributors to bid on keywords that users enter as search terms in a search engine, such as Google, and to ensure that their website is displayed in a favorable position among the search results. Restrictions on the distributor in this context are somewhat atypical, as they may also involve a horizontal element (the supplier wants its own website to show up first). Also, utilizing this advertising method will not necessarily have negative implications on the public perception and image of the advertised product (contrary to sales through certain market places that may feature the products being displayed next to used goods, giving a "flea market" image).

Finally, the *Coty* judgment does not contain a clear statement regarding how to deal with cases where several forms of restrictions apply in parallel, and thereby significantly limit the distributors' ability to sell the contract goods online. In fact, the ECJ also based its reasoning on the argument that *Coty* did not prevent distributors from promoting their own websites via online advertising and online search engines, which both enabled users to find the website. While this line of argument implies that restrictions resulting in a de facto ban from selling online probably constitute a restriction of competition by object, it remains unclear how to treat cases that fall just short of a de facto complete prohibition.

***Coty* aftermath**

Less than a week after the ECJ had rendered its *Coty* judgment, the German Federal Court of Justice (FCJ) held that shoe manufacturer Asics prohibiting its authorized distributors from using price comparison tools constituted a hardcore restriction of competition within the meaning of Article 4(c) V-BER. The FCJ saw no need to go along with the ECJ approach in *Coty*, given that it did not view athletic shoes as luxury

goods. The FCJ further argued that the accumulation of several types of restrictions contained in Asics's selective distribution agreements "substantially" limited (but did not fully exclude) the distributors' ability to sell the contract goods online. Thus, even absent a de facto ban of online sales, the FCJ found the prohibition from using price comparison sites to be a hardcore restriction.

In March of 2018, the Higher Regional Court Hamburg followed the *Coty* judgment in a case concerning non-luxury goods. Although the products at hand were "only" brand/quality products, the court saw no reason not to apply the particularities criteria, and concluded that Article 101(1) TFEU was not applicable.

In the same vein, in a recent case in October 2018, the French Autorité de la concurrence found that a third-party platform ban regarding non-luxury goods could be justified under the *Coty* case law, provided that it was necessary and proportionate. Nevertheless, it ultimately fined power equipment manufacturer STIHL because its distribution contracts contained provisions that, according to the Autorité, amounted to a de facto prohibition of online sales (such as an obligation either to pick up the order personally at the distributor's premises or to have the distributor personally deliver the order to the customer).

Ultimately, while the latter decisions seem to follow the Commission's position that *Coty* is not limited to luxury products, neither of them discussed the more controversial question of whether bans on price comparison sites, restrictions on keyword bidding, or the accumulation of both constitute hardcore restrictions within the meaning of Article 4(b) or (c) V-BER.

The *Guess* decision

Following the 2018 Consumer Electronics decisions, the *Guess* decision is the second vertical fining decision within a short time.

The Commission fined Guess, a manufacturer of branded clothing, €40 million for several vertical restrictions contained in its selective distribution agreements that violated Article 101(1) TFEU. Guess prevented its distributors from (i) bidding on its brand names and trademarks as keywords for online search advertising; (ii) selling online, unless Guess had authorized it; (iii) selling to consumers located outside allocated territories; (iv) cross-selling to other authorized distributors; and (v) setting resale prices autonomously.

Like the Commission's report on the results of the e-commerce sector inquiry, the decision reaffirms the Commission's recent trend to focus on (resale pricing and) e-commerce restrictions in distribution agreements. It also complements the EU Geo-Blocking Regulation ((EU) 2018/302), and is one of the few non-cartel cases where the Commission reduced the defendants' fines for effectively cooperating beyond their legal obligation to do so pursuant to para. 37 of the Fining Guidelines.

Notably, following its decision, the Commission published a brief fact sheet to provide guidance on the main parameters for cooperation in non-cartel cases.

As regards content, most of the restrictions included in the Guess distribution agreements, such as resale price maintenance clauses, prohibiting cross-selling to other authorized distributors, or using the online sales authorization process arbitrarily with the explicit goal of limiting the number of online distributors, constitute clear-cut violations. The Commission's assessment and conclusions in this regard are, therefore, not surprising. With a view to *Coty*, the Commission followed the ECJ insofar as it emphasized that a specific contractual clause within a selective distribution agreement is lawful if the *Metro* criteria are met.

The V-BER provides for a safe harbor for vertical restrictions if the contractual parties' market shares do not exceed 30 percent

Yet, the decision contains several notable points. Most importantly, the Commission found that an absolute ban on using trademarks and brand names for online sales advertising, which prevents authorized distributors from bidding on these keywords at online advertised auctions (and therefore presently reserving this privilege to Guess only) was a restriction of competition by object. Surprisingly, the Commission did not link this finding to the other, additional restrictions imposed on the distributors, let alone on a de facto prohibition of online sales, but considered the keyword bidding ban to be a hardcore restriction in itself.

At first sight, it appears that the pendulum swings back to the distributor-friendly view the FCO and FCJ haven taken. However, the Commission's finding must be seen in context of the particularities of the case at hand. First, unlike other cases, *Guess* contained a clear horizontal element, given that Guess as a dual distributor with its own web shop, by imposing the keyword bidding ban, sought to maximize traffic through its own website and to minimize its own advertising costs. The Commission relied heavily on internal Guess documents to corroborate the restriction's rationale. Second, Guess had no evident legitimate objectives to justify the restriction; in particular, in contrast to Coty, STIHL or Asics, Guess could not invoke reasons such as protecting the brand image or ensuring proper use of the products at hand to justify the restriction.

It is also striking that the Commission barely discussed *Coty*, which is only addressed in a general statement regarding the applicability of the *Metro* test. In particular, there is no detailed discussion of *Coty* in the context of the V-BER assessment, which remains very high-level.

It is not clear at first sight why the Commission saw no need to take the *Coty* case law into account when assessing an exemption under the

> **It is striking that the Commission did not discuss Coty in the context of its high-level assessment of the V-BER**

V-BER. Given that (i) the keyword bidding ban did not (on its face) exclude online sales entirely, and (ii) (in the same vein as "marketplace users") customers using search engines do not seem to be a definable customer group within the meaning of Article 4(b) V-BER, one would have expected a detailed assessment of Article 4(b) and/or (c) V-BER in light of *Coty*. However, instead of rejecting an exemption under the V-BER, the Commission simply argued that the keyword bidding ban had the (ultimate) objective to "partition the market since they limited the ability of the authorized retailers to sell the contract products actively or passively (depending on the targeted audience or territory)."

Two potential explanations of why the Commission considered the keyword bidding ban a "by object" restriction come to mind. The first is that, without explicitly stating so, it took into account the other restrictions that Guess imposed on its resellers, and ultimately found (without saying so) a complete online sales ban. However, such a conclusion does not seem to be in line with the Commission's own findings in the context of the *Metro* assessment, according to which the keyword bidding ban restricted (but did not exclude) the "findability" of online retailers. While the Commission concluded that retailers were "deprived of the ability to effectively generate traffic to their own websites," this statement leaves open whether the ban de facto only im-peded or excluded online sales. It does sound a little more like the FCO's and FCJ's "substantial limitation" standard.

A second explanation is that the Commission took into account that the keyword bidding ban had a horizontal dimension insofar as Guess was directly competing with its distributors when bidding for keywords and selling its products online. This horizontal element distinguishes the case from *Coty*. However, the V-BER expressly also applies to cases of dual distribution (see Article 2(4)(a)), so, a priori, the fact that Guess was also selling through its own website as such should not have prevented the Commission from assessing the restriction under the V-BER.

The above shows that *Guess* does not constitute a clear-cut case that can easily serve as a template for other cases. Nevertheless, it must be noted that the Commission appears to be determined to treat a keyword bidding ban as a "by object" restriction. This might even be the case when the manufacturer has a "better story" that the restriction serves to protect a legitimate interest than Guess. Given that, other than the FCJ, the ECJ has at no point held that a "substantial limitation" to be found online and to generate online traffic suffices as a hardcore restriction, it remains doubtful whether the Commission approach is in line with the *Coty* case law.

Outlook

The V-BER will expire on May 31, 2022. As part of the evaluation process, the Commission has just launched a 12-week public consultation phase in order to determine whether the V-BER should be prolonged, revised or allowed to lapse, and that will end on May 27, 2019. In parallel with any changes to the V-BER, the Commission will also need to update the Vertical Guidelines, which national competition authorities and courts tend to rely on when dealing with vertical restraints.

The e-commerce sector inquiry, inconsistent national case law and enforcement practice, and certainly cases such as *Guess* have illustrated the need for clarifications and/or reform. Even after *Coty*, a number of issues relating to e-commerce restrictions remain unresolved. The question of the extent to which manufacturers can prevent distributors from selling through third-party platforms is the most prominent example but, as determined illustrates, not the only one.

Going forward, manufacturers need to look at their distribution systems carefully to ensure that any limitations imposed on their distributors regarding selling or advertising online are in line with the *Coty* principles. Until the V-BER and the Guidelines are revised, there will be limited legal certainty for many distribution strategies. The ongoing public consultation process provides for a good opportunity to alert the Commission of the need for and consequences of changes to the V-BER.

From a procedural viewpoint, *Guess* illustrates the Commission's increased willingness to reward companies for their cooperation in vertical cases (following *Nintendo* , *ARA Foreclosure* and the *Consumer Electronics* cases), which is something national competition authorities such as the FCO have been doing for quite a while. Not granting immunity, but reducing the fine sunstantially, may at least make sense for companies in cases of clear-cut restrictions and evidence—*Guess* is a perfect case in point.

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