Selective distribution: the consequences for non-luxury products

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Selective distribution aims at protecting brands by enhancing the quality and excellence of their products.

Producers of luxury goods have often felt that online marketplaces (e.g. Amazon) ‘dilute’ the prestige of the image associated with their brands as a result of sizeable advertising investments strategies.

Several court decisions have dealt with this issue to date, but the recent Nike case marks a notable turning point.

Selective distribution and the law

EU Regulation 330/2010 (1) on vertical agreements defines selective distribution as ‘a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors within the territory reserved by the supplier to operate that system’.

The creation of an exclusive commercial network, preventing third parties from entering, can lead to delicate issues of compatibility with special rules operating in competition matters.

The strategy under analysis is, in fact, a form of vertical restriction of competition. In recent years, jurisprudence has considered whether it is prohibited by Article 101 (1), TFEU (Treaty on the Functioning of the European Union) or whether it is exempted. It is a fundamental rule belonging to the antitrust legislation, which places a general prohibition on restrictive agreements of competition. With reference to the creation of an exclusive commercial network, there is no doubt that it can lead to delicate restrictive effects on competition. However, the mentioned article recognises the non-application of the general prohibition of restrictive agreements of competition in favour of agreements and / or practices that ‘help to improve the production or distribution of products or to promote technical or economic progress, while reserving users part of the resulting profit, and avoiding: a) imposing restrictions on the companies concerned that are not indispensable to achieve these objectives; b) giving these companies the possibility of eliminating competition for a substantial part of the products in question’.

According to the jurisprudence, selective distribution seems to be recognized as exempt from this prohibition.

Coty – what happened?

With sound legal grounds, important interpretative principles were offered by the ruling of the Court of Justice in the Coty Germany case (2) – a dispute between Coty Germany (one of the leading suppliers of luxury cosmetics in Germany) and Parfümerie Akzente (one of its authorised resellers) concerning the sale of products through ‘amazon.de’.

The German Court of Frankfurt debated whether selective distribution systems are aimed at the distribution of luxury and prestige products and, primarily, guaranteeing a luxury image constituting an element of competition compatible with Article 101 (1), TFEU. The Court of Justice reiterated that a selective distribution system, which has as its primary objective the protection of the luxury image of the products, does not fall within the prohibition pursuant to Article 101 (1), TFEU when three conditions are met:

1. It must be ascertained that the characteristics of the products in question require a selective distribution system, whereby this system constitutes a legitimate need, in relation to the nature of the products considered;
2. The choice of resellers must be made according to objective criteria of a qualitative nature, established without distinction for all potential resellers and applied in a non-discriminatory manner; and

3. The criteria defined must not go beyond what is necessary.

The German judge subsequently questioned the compatibility with Article 101 (1) TFEU of the general prohibition of using marketplaces for online sales without detecting satisfaction by the marketplace of the quality requirements requested by the manufacturer from its authorised dealers. The Court of Justice replied affirmatively, considering that this prohibition is core to the preservation of the luxury image as it guarantees that the products are associated solely with authorised distributors. Furthermore, the Court of Justice found that this prohibition is also necessary as it allows the manufacturer to verify compliance with the qualitative criteria, which would not be possible in relation to the manager of a marketplace as a third party with respect to the contractual relationship between manufacturer and authorized distributor. Finally, the Court of Justice found that all kinds of products are marketed on the marketplaces and this in itself can affect the image of luxury.

In conclusion, the Court of Justice found that the manufacturer did not impose an outright ban on online sales, and that the restriction in question had not prevented authorized distributors from collaborating with third parties for internet advertising purposes. Consequently, potential customers have always been able to access, via the Internet, the offer of authorized distributors using search engines for example.

As marketplaces continue to expand, the Court of Justice’s decision has undoubtedly contributed to providing greater certainty on this increasingly important issue. However, the case is not closed. In the argumentative process of the Court of Justice, the nature of luxury products marketed by Coty Germany assumes a fundamental importance. The legality of clauses limiting access to marketplaces imposed by branded (but not luxury) manufacturers remains uncertain.

Nike and non-luxury products

Given the mixed responses from the European courts following the earlier Coty decision, the Nike case marks a significant step forward. The lawsuit started over three years ago when Nike terminated its distributor agreement with Action Sport, an Italian retailer. According to Nike, Action Sport was offering up and selling authentic Nike products – previously ordered from Nike – on Amazon, an unauthorized third-party platform. This violated Nike’s Selective Retailer Distribution Policy, which prohibits such sales even by authorized retailers. Consequently, Action Sports filed a lawsuit, arguing a breach of contract by Nike since it avoided selling the Nike products on Amazon’s marketplace, in this way violating Article 101(1) of TFEU.

The Amsterdam District Court released a decision in October 2017 siding with Nike, stating that the famous brand ban on authorized distributors sales did not clash with the antitrust regulation. The court’s decision was actually based mainly on the conclusions of the Advocate General of the Coty case – not yet decided at the time – then also taken up by the decision of the Court of Justice. It pointed out that the prohibition of a luxury goods company from selling via authorized resellers on third party online markets is consistent with the TFEU.

Not satisfied, Action Sport appealed to the Amsterdam Court of Appeal, which unexpectedly turned the issue further. In fact, in the ruling issued last summer, not only did the court of appeal confirm the decision of the lower court, believing that Nike’s selective distribution agreement is, in fact, in line with the competition law of the EU, but considered that this mandate does not apply exclusively to suppliers of luxury goods.

This is a decision of enormous importance. Not only has the issue in question remained in the spotlight in recent years, but all of the European courts have made decisions on the matter. The courts are predominantly in agreement that where luxury goods are concerned, selective distribution agreements should not violate antitrust legislation. With this decision, the scope of application of the Coty decision has also been extended to non-luxury suppliers. Brands are encouraged to address the use and application of selective distribution agreements on an individual case-by-case assessment, taking the terms of distribution, the characteristics of the products concerned and the brand image into consideration.

What next?

Selective distribution remains a hot topic, confirmed by the fact that the European Commission is currently reviewing the Vertical Block Exemption Regulation (VBER) and a decision is expected by the end of 2020. The Commission is going to decide whether there is a need to adapt or amend the VBER or its guidelines with regard to selective distribution (or even with specific reference to platform bans or online restrictions).

This highly debated topic is likely to be subject to continuous updates and changes over the coming years. It will certainly be interesting to follow its future development and the impact this will have on brands worldwide.

If you have any questions or would like any further information in relation to the above, please do get in touch.

**FOOTNOTES**

(1) Article 1, letter (e)
(2)(C-230/16)
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