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Hamburg appeals court upholds marketplace ban

The extent to which a brand that sells its products through selective distribution can prevent its authorised resellers from using third party marketplaces to sell online has become one of the most hotly contested questions in EU competition law over recent years. In December last year, the hotly anticipated *Coty* judgment of the Court of Justice of the European Union ('CJEU')[1] confirmed that a manufacturer of luxury perfumes could lawfully impose a blanket restriction on its resellers' use of marketplaces. A more recent judgment of the Hanseatic Higher Regional Court ('OLG')[2] in Hamburg, in which the OLG moved away from the narrow focus on luxury adopted by the CJEU in *Coty*, underlines the high degree of control that brands enjoy over the distribution of their products under the current competition regime. In this article, Becket McGrath, Partner at Cooley LLP and member of the *Digital Business Lawyer* Editorial Board, provides analysis of the OLG ruling and its significance for marketplaces that help retailers sell branded products online.

Legal framework

Before summarising the OLG's judgment, it may be useful to review the basic elements of the applicable regime. Article 101 of the Treaty on the Functioning of the European Union ('TFEU') prohibits agreements that appreciably restrict competition within the EU. A restriction of competition may arise 'by object,' in which case an adverse impact on competition is presumed, or 'by effect,' in which case an anticompetitive effect must be proven by reference to the specific facts of the case. A restrictive agreement is void and unenforceable unless it can be demonstrated that its benefits outweigh its restrictive effect (in which case, it is 'exempt' from the prohibition). Agreements that fall within the safe harbour defined by a block exemption regulation are automatically exempt.

While the most serious infringements of Article 101 of the TFEU typically arise from restrictive agreements between competitors, agreements between businesses at different levels of the supply chain (i.e. 'vertical agreements') may also have an adverse impact on competition in certain circumstances, for example if a supplier seeks to impose minimum resale prices on its resellers. Reflecting the policy objective underpinning the TFEU, namely creating a single internal market across the EU characterised by the absence of legal, regulatory or contractual barriers to internal trade, the European Commission ('Commission') and courts have also used Article 101 to prohibit vertical agreements that unduly restrict trade between Member States.

This background is reflected in the Vertical Agreements Block Exemption Regulation (Regulation (EU) 330/2010) ('VABER'), which provides a broad exemption for vertical agreements from Article 101 of the TFEU, as long as neither party has a market share of more than 30% and provided that the agreement does not include any 'hardcore' restrictions of competition (which are presumptively unlawful). As well as RPM and market-sharing, hardcore restrictions specified by the VABER include certain limitations on 'where' and 'to whom' products can be sold. In particular, Article 4(b) of the VABER prohibits any form of territorial restriction, except in the limited circumstances specified in that provision, meaning that in practice bans on passive sales into another territory will almost always be prohibited. In addition, Article 4(c) of the VABER prohibits any restriction on active or passive sales to end users by members of a selective distribution network. In the *Pierre Fabre* case[3], the CJEU confirmed that an outright prohibition on online sales by a reseller is equivalent to a passive territorial sales ban and should therefore be treated as a hardcore restriction of competition.

Selective distribution, i.e. the practice whereby a brand supplies its products only to authorised resellers, who are in turn prohibited from selling to anyone except other authorised resellers and end-consumers, has traditionally benefited from relatively lenient treatment under Article 101 of the TFEU and its predecessors. Long-standing case law confirms that a selective distribution system falls outside Article 101 of the TFEU altogether, provided that: (i) the nature of the product means that selective distribution is a legitimate requirement, for example to preserve its quality and ensure its proper use; (ii) members are selected solely on the basis of criteria relating to their suitability to sell the goods that are applied uniformly and in a non-discriminatory way; (iii) the criteria do not go beyond what is 'necessary[4].' Systems that meet all of these requirements (commonly referred to as the '*Metro* criteria,' from the leading case) are described as 'simple' or 'purely qualitative.' A selective distribution system that fails to meet all three of these criteria[5], for example because the brand places quantitative limits on the number of authorised

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resellers that may be admitted, will still be lawful, as long as the brand's agreements with authorised resellers fall within the VABER safe harbour. Notably, members of the selective distribution network must be entirely free to sell to end-consumers, and to each other, wherever the network operates.

Online third party marketplaces have become a popular means for retail businesses to reach customers online, as they provide a convenient, ready-made infrastructure for them to access a large number of potential customers at minimal up-front cost. Similarly, they are popular with consumers, who can easily search available offers for a product from a number of sellers conveniently in one place and complete their purchase without leaving the site. As the use of such marketplaces grew, questions arose regarding the extent to which brands' wish to exert a degree of control over the presentation of their products online, typically through the use of selective distribution, permitted them to prevent their authorised resellers from using marketplaces in any circumstances.

Although the CJEU settled the question of how restrictions on online sales should be viewed in competition law in its *Pierre Fabre* judgment, its position was consistent with existing Commission policy so did not mark a step-change in approach. Marketplace bans occupied a legal grey area, however, since their status depended on whether they should be characterised as equivalent to hardcore bans on online sales, reflecting the importance of marketplaces for at least some types of seller, or a legitimate quality criterion for a branded sales environment, and thus no different in principle from the sort of criteria that had traditionally been associated with selective distribution. While the German Federal Cartel Office in particular tended to take the former view[6], this approach was ultimately blocked by the CJEU in its *Coty* judgment, which confirmed that marketplace bans were a legitimate means of controlling how luxury products could be sold online that fall outside Article 101 of the TFEU altogether, as long as the *Metro* criteria are met. In its recent judgment taking account of the CJEU's guidance[7], the referring court in that case agreed and upheld the restriction.

Since the referring court in *Coty* defined the scope of its questions according to the luxury character of the products in that case, the CJEU limited itself to answering those questions by reference to that characteristic. Although the Commission took a broader approach in its e-commerce sector inquiry final report[8], the terms of the CJEU's judgment in *Coty* triggered a wider debate over the extent to which its approach was applicable to non-luxury products.

The judgment

The judgment of the OLG of 23 March[9] is particularly interesting in this context, as it concerned the sale of dietary and cosmetic products which, although of high quality, were not characterised as luxury items. The judgment arose from proceedings brought in the Hamburg first instance court ('LG') by a US-based manufacturer of dietary supplements and cosmetics based on aloe vera ('the Claimant') against one of its distributors ('the Defendant'), who was selling the Claimant's products on eBay in the face of a ban on such sales in his agreement with the Claimant. The Claimant, who used a form of 'network marketing' (sometimes more pejoratively referred to as 'pyramid selling') to sell its products, argued that this ban was needed to ensure that its authorised resellers provided the necessary level of personal advice and care for customers.

The Claimant also required resellers to present the full range of its products in a high quality setting, which it claimed could not be ensured when selling on an online marketplace. It also argued that marketplaces did not disclose the seller's identity sufficiently clearly and that it was unable to verify whether a seller was using the specified photos and product descriptions in marketplace listings. Online sales were permitted, albeit the Claimant appears to have steered its resellers to use web shops that it provided, and for which it charged a fee.

Since the Defendant did not dispute the fact that it had been selling the products in question on eBay, which was expressly prohibited in its contact with the Claimant, the only question at issue in the proceedings was whether the marketplace ban infringed EU and German competition law and was hence unenforceable. After the LG found for the Claimant in a judgment of 4 November 2016, the Defendant appealed to the OLG. In essence, he argued that the ban amounted to a *de facto* ban on online

sales, given the relative attractiveness of marketplaces compared with the high cost of setting up an online store, and challenged the need for the criteria applied by the Claimant to justify the ban, on the grounds that the products could easily be sold without individual advice.

The OLG dismissed the Claimant's appeal. Essentially, the OLG considered that the *Metro* criteria were fulfilled in this case, and hence the system fell outside Article 101 of the TFEU altogether. Noting that long-standing case law supported the use of selective distribution for long lasting, high quality and technically advanced consumer products, as well as for protecting the 'aura' of luxury items[10], the OLG considered that there were no grounds for limiting selective distribution to the latter category.

As the OLG noted, it was not possible to distinguish between luxury and non-luxury items using clear criteria, making a focus on luxury impossible to administer. Going further, the OLG found that there were no legal grounds for limiting selective distribution to the previously recognised categories, as long the products in question were characterised by high value or 'other aspects' that justified selective distribution to protect their 'prestige character.' Such justification might include the need to provide associated services that emphasise the 'special' nature of the products, thereby increasing customers' perception of value and ultimately maintaining that differentiation.

The OLG was persuaded that maintaining the high quality image of the Claimant's products relied on establishing a durable customer relationship through individual advice by trained sales personnel. This durable relationship differentiated the Claimant's products from otherwise comparable products available in supermarkets and supported much higher retail prices. As the OLG observed, the Claimant's business model relied on it being able to differentiate its products from the 'usual' products in order to ensure that its clearly higher prices appeared to be justified (adopting the OLG's wording).

The OLG accepted that it was also legitimate for the Claimant to require resellers to display its complete product range to protect its product image. In the OLG's view, this ruled out sale on marketplaces such as eBay, on the grounds that it allegedly only permitted the display of individual products. The OLG was not prepared to assess the Defendant's arguments that some customers may prefer to search for a single product, ruling simply that the requirement for resellers to display the entire product range with full product characteristics was part of the Claimant's business concept and hence its own commercial decision. The OLG noted that, unlike in *Pierre Fabre*, the Claimant did not prohibit online sales as such and even provided resellers with ready-made online store pages for this purpose.

The OLG also ruled that the Claimant's criteria were applied without discrimination and were proportionate. Specifically, they facilitated the objective of ensuring that customers were advised of qualities of the products that were 'not directly apparent,' thereby maintaining the Claimant's 'claim of quality' that justified the high price. The OLG did not accept the argument that the Claimant could have specified criteria for sale of its products on eBay, rather than banning it outright, responding that the Defendant had not demonstrated how this could have been achieved in a way that maintained the standards of the Claimant's online store (apparently ignoring the possibility that the Claimant's criteria may have been designed specifically to exclude sale on marketplaces).

Rather, it noted that the Claimant's criteria did not definitively bar sales on eBay but instead interpreted that the reference in its terms to such sales being banned 'at the moment' appeared as an acceptance that such sales may be permitted at some point in the future, once the presentation options offered by eBay were sufficient to meet the Claimant's requirements.

Commentary

While the OLG can perhaps be forgiven for declining to concentrate on the rather nebulous question of whether a product has an 'aura of luxury,' its focus instead on whether the Claimant's products displayed 'special characteristics' demonstrates that the 'type of product' requirement of the first *Metro* criterion has limited meaning in practice. It may be assumed that the operator of a selective distribution network will always wish to differentiate its branded product from the mass market and thereby protect its ability (and that of its network members)

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to charge higher prices[11]. The OLG appeared happy to cut to the chase on this point. Rather than requiring evidence that the need to ensure proper advice for customers was important to ensure correct use, for example, the OLG appeared to accept that the availability of advice on the Claimant's products directly fed into the perceived quality of those products and was hence needed specifically to preserve higher prices.

Looked at this way, any manufacturer that wishes to preserve the value of its brand by limiting distribution to authorised resellers can create a selective distribution network that falls outside Article 101 of the TFEU, regardless of the particular characteristics of its product, simply on the grounds that its products are in some way special.

While this reflects the position under the VABER[12], where selective distribution agreements are protected regardless of the characteristics of the product up to the 30% market share threshold, this approach reduces the practical importance of the first *Metro* criterion[13]. It also calls into question the Commission's policy that it will consider removing the benefit of the VABER safe harbour where the characteristics of a product do not require selective distribution[14].

Even if the OLG's treatment of product categorisation builds on the previous case law, the judgment rests on an overly-simplistic representation of the sales experience that marketplaces can offer. After all, there is nothing inherent in the concept of a third party marketplace that prevents the high quality presentation of branded products. Indeed, some marketplaces are indistinguishable from luxury retail sites. Notably, eBay itself offers sellers the option of listing via an 'eBay shop,' which mirrors the look and feel of its own retail site, as well as offering branded showrooms that permit the display of a brand's product range in a manner that is consistent with its requirements[15]. Given this context, it is hard to see how a *per se* prohibition on the use of marketplaces as a sales model can be proportionate (i.e. the third *Metro* criterion)[16]. It is therefore unfortunate that the proportionality of the Claimant's requirements was not adequately assessed by the OLG, which appears instead to have accepted the Claimant's arguments on this point at face value and was not prepared to engage with the question of whether suitable presentation was possible. At the end of the day, the OLG appears to have been reluctant to interfere with the individual commercial freedom of the Claimant to run its distribution network as it saw fit, even though this maintained high retail prices and excluded online sales in any format other than that specified (and tightly controlled) by the Claimant. Notwithstanding the fact that the level of control exerted by the Claimant may have flowed from its choice of network marketing, rather than a classic form of selective distribution, the OLG saw fit to apply the standard *Metro* framework. By giving the Claimant the benefit of the doubt in this way, the OLG provided a reminder of the extent to which the application of old case law on selective distribution structurally favours brands over online marketplaces.

Ultimately, the adoption of a more nuanced approach to marketplace restrictions that takes account of the options that are available now to protect brands' legitimate requirements, while facilitating competition, may require legislative change. Since the current VABER will remain in place until 1 June 2022, a quick resolution of this issue remains elusive.

1. *Coty Germany GmbH v. Parfümerie Akzente GmbH*, judgment of 6 December 2017, Case C-230/16.
2. The court of appeals from the first instance courts of the city state.
3. *Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence and Ministre de l'Économie, de l'Industrie et de l'Emploi*, judgment of 13 October 2011, Case 3-439-09.
4. See the Commission's 2010 Guidelines on Vertical Restraints ('Verticals Guidelines'), para 175 and, for example, *Metro v. Commission* (Case 26/76), *L'Oréal v. De Nieuwe AMCK* (Case 31/80) and *Leclerc v. Commission* (Case T-19/92).
5. In *Coty*, the fact that the products being distributed were luxury perfumes meant that the first criterion was clearly met.
6. See, for example, decision of 27 June 2014 in *Adidas* (case B3-137/12) - English summary available at: https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Fallberichte/Kartellverbot/2014/B3-137-12.pdf?__blob=publicationFile&v=2
7. See press release of the OLG Frankfurt of 12 July 2018, at https://ordentliche-gerichtsbarkeit.hessen.de/pressemitteilungen/luxusprodukte-rechtfertigen-vertriebsverbot-auf-amazonde.
8. See paragraph 503 of the accompanying Commission Staff Working Paper, available at: http://ec.europa.eu/competition/antitrust/sector_inquiries_e_commerce.html An updated statement of the Commission's policy, taking account of *Coty*, is set out in its April 2018 Competition Policy Brief, available at: http://ec.europa.eu/competition/publications/cpb/2018/kdak18001enn.pdf.
9. Available at http://www.rechtsprechung-hamburg.de/jportal/portal/page/bsharprod.psml;jsessionid=1C580247C9C8004A71D01E2AD642749B.jp24?printview=true&doc.id=KORE209972018&st=ent&doctyp=juris-r&showdoccase=1&paramfromHL=true%20-%20focuspoint
10. *Copad SA v. Christian Dior couture SA, Vincent Gladel and Société industrielle lingerie (SIL)* (Case C-59/08), judgment of 23 April 2009.
11. Indeed, this central objective is acknowledged in the early case law.
12. Verticals Guidelines, paragraph 176.
13. Given that previous cases accepted that simple selective distribution was suitable for televisions (*SABA* - 1976) and newspapers (*Binon* - 1985), but not branded plumbing equipment (*Grohe* - 1985) or tobacco products (*Van Landewyck* - 1980), the coherence of the case law on this criterion is in any event questionable.
14. As set out in paragraph 176 of the Verticals Guidelines - albeit this has not been applied in practice in any event.
15. See for example https://www.ebay.co.uk/rpp/adidas?_trksid=p2380057.m570.l1523
16. Similarly, the judgment of the CJEU in *Coty* rested on the erroneous view that, in contrast to direct sales on a reseller's own website, a brand cannot control how its products are displayed on a marketplace. In so doing, it ignored a brand's ability to mandate sales standards in its agreement with the reseller, for which the reseller can be held contractually responsible, regardless of how it chooses to meet those standards when selling the brand's products.