

Agenda

Advancing economics in business

No free rides? Platform bans in light of the *Coty* case

Are there good reasons for manufacturers to prevent retailers from distributing their products through third-party online platforms? On 6 December 2017, the European Court of Justice delivered a ruling on *Coty*, finding that, under certain conditions, manufacturers of luxury brands can restrict sales through particular online channels without raising competition concerns. What is the economic case for and against such restrictions, and is the Court’s judgment consistent with the economics?

The European Court of Justice judgment in the *Coty* case concerns a ban on online platform sales imposed by a perfume supplier, *Coty*, whereby *Coty* prohibits retailers from selling its products through platforms such as *amazon.de*. The ban is written into contracts between *Coty*—known for perfume brands such as Burberry, Davidoff and Hugo Boss—and authorised retailers in its selective distribution system. As a criterion of selection into its distribution network, *Coty* requires its retailers to have a bricks-and-mortar presence that complies with certain terms relating to ‘the décor and furnishing of the sales location, the selection of goods, advertising and the sales presentation’.¹ It allows the online sale of its products through the retailers’ own websites, but stipulates that they cannot offer the products on *amazon.de*.

One of the authorised retailers, Parfümerie Akzente, complained about this restriction and brought a case of infringement of Article 101 TFEU against *Coty* before the Landgericht Frankfurt am Main. Following a ruling against *Coty* and a subsequent appeal of that decision,² a higher court, the Oberlandesgericht Frankfurt am Main, referred the case to the European Court of Justice for guidance on two issues. These were:³

1. whether maintaining/building a brand image can justify setting up a selective distribution system, or whether it requires assessment under Article 101(1)—and, specifically, whether brand image can justify a platform ban that is not linked to other qualitative criteria;
2. whether a platform ban amounts to a partitioning of the market or a restriction of passive sales and thereby constitutes a by-object infringement, or whether the Vertical Block Exemption Regulation (VBER) applies.

In answering these questions, the European Court of Justice found that, in the context of luxury goods, an online platform or marketplace ban does not necessarily constitute an infringement under Article 101(1), nor is it a by-object infringement.⁴ The platform ban may be necessary to preserve the ‘aura of luxury’ of the products in question.

Diverging views

The judgment comes at a time of intense scrutiny across Europe of manufacturers’ distribution systems, and in particular of online sales bans. The latter might involve a ban of sales through online platforms only (such as in *Coty*), or a ban of all online sales (though platforms and retailer websites). For example, the UK Competition and Markets Authority recently fined golf club manufacturer, Ping Europe Limited, for restricting its retailers from selling its golf clubs through their websites.⁵ While the Authority stated that retailers must be allowed to sell online, it recognised that manufacturers should be allowed to impose certain quality conditions on online sales. Similarly, in *Bang & Olufsen*,⁶ the French Autorité de la Concurrence came to the view that the restrictions used by the parties amounted to (de facto) bans of all online sales, and found them to be anticompetitive. These cases involved a ban on all online sales, rather than platform sales alone.

As for cases involving platform bans, there have been a number of investigations by the German Bundeskartellamt (BKartA), including cases against shoe manufacturers Adidas and Asics. For example, in *Asics*, the BKartA viewed Asics’s restrictions in relation to the use of brand names and price comparison websites as ‘hardcore’ restrictions of competition.⁷ In addition, it argued that online marketplace

bans should be considered hardcore restrictions (although it ultimately left this question open in its decision).

The BKartA's view is therefore quite different from the European Court of Justice's view in *Coty*. It also differs from the views of other authorities and courts, which have considered that a platform sales ban can be legitimate where it is based on clearly defined qualitative criteria. For example, the Amsterdam District Court recently determined that Nike's ban on selling its products via online platforms was legal. The court found that it was based on objective qualitative requirements that were designed to protect Nike's brand image.⁸ Similarly, the Frankfurt Appeal Court ruled that the platform ban imposed by backpack manufacturer, Deuter, was necessary to protect Deuter's brand image and that it was therefore lawful.⁹ However, it ruled that Deuter's ban on sales through price comparison websites was anticompetitive due to the lack of a procompetitive justification.

The economics of platform bans: balancing potential harm and benefits

The assessment of the impact of a platform ban follows the same logic as that of other selective distribution systems, and vertical restraints more broadly. It is well established in the economics literature that vertical restraints can lead to harm by reducing intra-brand and inter-brand competition (i.e. competition between retailers offering the same product, and competition between products), but they can also deliver efficiency benefits for consumers.¹⁰ From an economic standpoint, platform bans are no different. To see this, it is useful to look at the economic incentives of a manufacturer to impose such a ban in the first place.

The business incentives

At first sight, it might be assumed that a platform ban (and, more generally, a selective distribution system), by restricting the channels through which a product can be sold, will result in the manufacturer losing potential customers and therefore profits. In the case of *Coty*, as certain perfume brands are not available on amazon.de, it might be assumed that fewer people will buy the product. This raises the question of why the manufacturer would want such a ban.

Assuming it is indeed imposed by the manufacturer, this apparent paradox can be explained by the possibility that manufacturers will increase sales volume and/or margins, precisely by restricting the number or type of retailers they sell through.¹¹ They can thereby recoup some of the profits lost due to lower visibility on platforms through increased sales and/or prices as a result of an enhanced consumer perception. For example, selling through an exclusive set of retail channels can improve consumer perception of a product (through the sales environment), and this may increase consumer willingness to pay. Alternatively, limiting the number of retailers and providing them with extra

margin may help them to deliver services that are valued by consumers, such as pre-sales information and testing, or the option to sample products. Restrictions such as platform bans can effectively prevent 'free-riding' by other retailers and platforms and ensure that authorised retailers have the incentive to stock and provide these services. Indeed, these are some of the efficiency justifications of vertical restraints that are highlighted in the literature and by businesses themselves.¹²

In a case such as *Coty*, manufacturers have no direct contractual or other influence over the placement of their product on platforms (for example, to provide information or influence the wider product range on the platform website). Hence, they may find a platform ban to be the most effective way of ensuring that the efficiency benefits above are delivered by the authorised retailers (all of which have bricks-and-mortar shops, as per the criteria of the selective distribution system of *Coty*).

When do these efficiencies outweigh potential harm?

The net impact of platform bans on a specific market depends on the impact on inter-brand competition as well as the role of the players along the distribution chain.

Impact on retailers

Platform bans mean that some retailers win, while others may lose. Those that offer the product face competitors that fulfil the same requirements and hence may have similar cost structures. While this involves the exclusion of, for example, pure online retailers, and hence reduced retail-level competition, it also enables the authorised retailers to offer the additional services mentioned above.

There may also be a concern that platform bans put small retailers at a disadvantage if they rely more on platforms than other retailers do to obtain visibility. As found by the European Commission in its 2016 ecommerce inquiry, small and medium-sized online retailers tend to make a larger share of their online sales through platforms.¹³ On the other hand, smaller retailers may also become strongly reliant on platforms in the long run, thereby reducing their bargaining power vis-à-vis platforms and perhaps even leading to a lower number of retailers in the long run.

Impact on platforms

The most direct impact of these bans is of course on platforms and marketplaces such as eBay and Amazon (specifically, Amazon Marketplace, the part of Amazon that is open to third-party sellers), which involve facilitating transactions with a wide range of products from a large number of sellers. Platform bans limit the product range available on these platforms, which may weaken the platforms' bargaining position vis-à-vis other manufacturers, and retailers that are not affected by platform bans. The magnitude of such effects depends

on the current and expected balance of bargaining power among platforms, retailers and manufacturers.

Net effect on consumers

The potential reduction in intra-brand competition that results from a platform ban may weaken price competition. In assessing the reduction of choice and price competition, and the ultimate impact on consumers, it is necessary to consider whether consumers are presented with a competitive offering despite the platform ban. For example, in the case of *Coty*, it can be argued that various types of consumer can find a range of products to choose from despite the restriction. For example:

- those searching for one of *Coty*'s products specifically, or luxury brands in general, are likely to find the product on the websites of the authorised retailers. They can also use general search engines to locate the nearest bricks-and-mortar store to try and/or buy the product;
- those searching for perfumes in general are likely to find multiple brands on the Internet, either through authorised retailer websites (if a selective distribution is in place) and/or through platforms;
- those searching for perfumes on a specific platform (say, amazon.de) are likely to find a range of brands in any event.

There therefore appears to be no clear consumer group whose options are significantly reduced because of the platform ban. If platforms were a strong driver of competition, on the other hand, the third group listed above might experience a more limited choice in the event of a platform ban.

The potential for reduced competition should also be weighed against any other benefits, such as when a platform ban helps authorised retailers to deliver services such as customer advice. It may also give manufacturers a way of differentiating themselves from each other on dimensions other than price, such as quality or brand image.

The right balance between price and non-price competition, and the value that consumers attach to each aspect, ultimately depends on the product in question—as does the question of whether a platform ban is justified. The

European Commission also recognised the importance of non-price competition in its ecommerce sector inquiry, highlighting the tension between the scope of ecommerce to intensify price competition, and manufacturers' desire to incentivise innovation, quality and brand positioning to 'help them ensure the viability of their business in the mid to long term'.¹⁴ Of course, if platforms and marketplaces can provide suitable product presentation for luxury brands on their websites and offer such features to retailers, this might assist in the entry of new players (such as an online equivalent of an upmarket department store) and benefit consumers.

Coty: supporting the economic approach?

The *Coty* judgment supports a balancing exercise between potential harm from reduced intra-brand competition and efficiencies from providing a distinct brand image. This is in line with the economic reasoning. In fact, the judgment makes ample reference to the 'aura' of a product that is required to maintain a 'luxury' image; and in the specific context of luxury goods, the judgment finds to be lawful—as long as the selective distribution criteria are objective, qualitative, and applied uniformly and in a non-discriminatory manner, and do not go beyond what is necessary.¹⁵

In general (and in relation to the second set of questions asked by the German court), the European Court of Justice finds that restrictions such as platform bans are not by-object infringements, but that they instead require an assessment of the effects on a case-by-case basis.¹⁶ This is sensible from an economic perspective.

It is likely that the *Coty* judgment will not be the last word in the debate on online sales and online platform bans. For instance, it is not clear where to draw the line between luxury and other goods, including whether a product is 'image-dependent' or 'technically complex'. In a dynamic online environment, the ability of different channels to support brands or value-added services may evolve if retailers and/or platforms learn to offer more services through online channels (for example, using virtual reality features). This means that, from an economic perspective, the product-specific harm and efficiencies matter and may change over time.

¹ See C230-16, *Coty Germany GmbH v Parfümerie Akzente GmbH*, para. 12.

² The lower court, the Landgericht Frankfurt am Main, ruled that the platform ban infringed competition law (Az. 2-03 O 128/13). Coty appealed the decision before the next instance, the Oberlandesgericht Frankfurt am Main.

³ Az. 11 U 96/14 (Kart).

⁴ See C230-16, *Coty Germany GmbH v Parfümerie Akzente GmbH*, paras 20, 36, 58 and 69.

⁵ See Competition and Markets Authority (2017), 'CMA fines Ping £1.45m for online sales ban on golf clubs', 24 August.

⁶ Decision no. 12-D-23.

⁷ Bundeskartellamt decision in the *Asics* case (B2-98/11), 26 August 2015, pp. 8–9.

⁸ Rechtbank Amsterdam, Case number C/13/615474, 4 October 2017.

⁹ See Oberlandesgericht Frankfurt am Main (2015), 'Oberlandesgericht Frankfurt am Main entscheidet über das Verbot des Internetvertriebs von Markenartikeln und deren Einstellung in Preissuchmaschinen', press release, 22 December.

¹⁰ For an overview of the theories of harm and efficiencies relating to vertical restraints in general as discussed in the economics literature, see section 4 of Oxera and Accent (2016), 'Vertical restraints: new evidence from a business survey', prepared for the Competition and Markets Authority, 24 March.

¹¹ It is also possible, however, that the platform ban or selective distribution system is requested by retailers to help them earn a sufficient margin.

¹² Oxera and Accent (2016), 'Vertical restraints: new evidence from a business survey', prepared for the Competition and Markets Authority, 24 March. One argument in favour of platform bans for certain product types is that they facilitate contracting: it may be easier to impose a platform ban to give other retailers a margin for their efforts, than to devise complex (and potentially infeasible) contracts about remuneration of effort.

¹³ The European Commission finds that, while on average 35% of businesses sell through marketplaces, the practice is most widespread among businesses with an annual turnover of between €500,000 and €2m (at 54%) and least widespread among those with an annual turnover of between €10m and €50m and above €100m (at 27% and 28%, respectively). See European Commission (2016), 'Preliminary Report on the E-commerce Sector Inquiry', para. 416.

¹⁴ European Commission (2017), 'Final report on the E-commerce Sector Inquiry', para. 12.

¹⁵ See C230-16, *Coty Germany GmbH v Parfümerie Akzente GmbH*, paras 36 and 58.

¹⁶ See C230-16, *Coty Germany GmbH v Parfümerie Akzente GmbH*, paras 20 and 69.