Expert Analysis

What US Cos. Must Know About EU E-Commerce Rules: Part 1

By **Enzo Marasà, Portolano Cavallo**May 15, 2017, 1:22 PM EDT

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U.S.-based manufacturers of branded goods who wish to distribute them across the EU may face compelling legal challenges in protecting their ability to tightly select and control their distribution networks, particularly with regards to online sales.

Likewise, U.S.-based retailers of branded products wishing to set up e-commerce platforms in the EU may face similar challenges in understanding what restrictions on sales can and cannot be validly imposed by — or agreed upon with — manufacturers or sales partners.

Legal concerns in the e-commerce sector often arise around the extent to which branded goods manufacturers and suppliers can freely decide who can resell the goods, as well as how, where and to whom the goods can be resold online within the EU.

These legal challenges and concerns fall within the realm of antitrust law — namely, Article 101 of the Treaty on the Functioning of the European Union (TFEU), which prohibits anti-competitive agreements, including certain "vertical" agreements between suppliers and distributors.

Perhaps surprisingly for those who are not experts in competition law (and especially for those in the U.S.), even manufacturers or resellers without any market power may be caught in an infringement or tort under Article 101 of the TFEU — though the concerns obviously escalate when they do enjoy market power.

This is because, in the context of distribution agreements, Article 101 addresses intra-brand as well as inter-brand competition concerns. In addition, and most importantly, Article 101 aims to foster the EU goal of achieving a truly integrated EU single market, by prohibiting commercial practices whose object or effect is to erect unjustified barriers to the free flow of commerce across member states.

Hence, the long arm of Article 101 applies to a pretty broad range of situations in online distribution.

In light of this, the first part of this two-part article provides some background on the

application of Article 101 in the online distribution context to the benefits of U.S.-based companies, particularly in light of the European Commission's Final Report on the e-commerce sector inquiry, which was published on May 10, after a public consultation on the preliminary findings issued in September 2016 (which have been largely confirmed).

We will also consider a case (Coty Germany, C-230/16) referred to the Court of Justice of the EU (CJEU) by a Frankfurt court last year, requesting the CJEU's final, binding say on important questions about the correct interpretation of Article 101 in the field of restrictions to sales through third-party platforms (or marketplaces) in the context of selective distribution.

The judgment, which is expected at some point in 2018, may have a huge impact on the application of Article 101 to selective distribution systems for online sales.

General Background on TFEU Article 101, the E-Commerce Sector Inquiry, and Consequences of Infringement

Pursuant to TFEU Article 101, "all agreements between undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction, or distortion of competition within the internal market" are prohibited, unless the agreement is likely to generate pro-competitive effects (i.e. actual and potential efficiency gains) which outweigh the likely negative effects for competition (the so-called "individual exemption" — see Article 101, § 3).

The difference between "by-object" and "by-effect" restrictions underlying the provision reflects, to a certain extent, the difference between restrictions prohibited "per se" and those subject to a "rule of reason" under the U.S. antitrust regime.

While by-object restrictions are presumed to be significantly anti-competitive and thus contrary to Article 101, by-effect restrictions cannot be deemed contrary to Article 101 unless the anti-competitive effects of the restriction on the market have been duly analyzed and substantiated, the burden of proof being on the party claiming the infringement.

Notably, by-object (or hard-core) restrictions do not benefit under Article 101 from the de minimis general exemption, which is instead applicable to by-effect restrictions between small and medium-sized enterprises or ventures with very low market shares.

Furthermore, by-object restrictions are normally unlikely to benefit from an individual exemption under Article 101, §3 (though it is theoretically possible, the burden of proof being on the defendant).

In general terms, the case law on Article 101 has created a stricter standard for dealing with vertical restrictions than the standard applied in the U.S., either in offline or online commerce.

For instance, several investigations by national competition authorities (particularly of the German Bundeskartellamt) as well as the European Commission have consistently confirmed that Resale Price Maintenance (RPM) is dealt with as a by-object restrictions throughout the EU, with very limited exceptions. This is different from the U.S., where RPM is subject to the rule of reason following the U.S. Supreme Court's Leegin Creative Leather ruling of 2007.

The application of Article 101 to online distribution is not new. It has been there since the Commission issued the revised Vertical Block Exemption Regulation and Vertical Guidelines in 2010, and the CJEU applied the relevant principles in the Pierre Fabre ruling in 2011 (Case C-439/09). But it has been altered recently by three interconnected events:

1. The EU policy agenda for the most recent five-year round has set the Digital Single Market Strategy as a priority;
2. Preliminary questions in the Coty Germany case about the correct interpretation of Article 101 with regard to restrictions to sales through online marketplaces in selective distribution systems have been referred to the CJEU;
3. The Commission has carried out the its sector inquiry, and issued its Final Report, which implements the Digital Single Market Strategy in the field of e-commerce.

The Commission launched the e-commerce sector inquiry in 2015 to identify restrictions to cross-border trade resulting from business practices that hamper competition and the creation of the EU Digital Single Market.

The Final Report, while recognising that e-commerce strengthens price competition and increases consumers' choice, has identified certain trends that may raise anti-competitive concerns and "artificially" partition the EU internal market along national lines.

For instance, the Commission points out that most retailers (78 percent) track online prices of their competitors and use automatic software and algorithms to adjust their prices accordingly, which may create collusive outcomes. Many others retailers (42 percent) frequently face some form of RPM practices from their suppliers.

Competition concerns are also raised in connection with the exchange of competitively sensitive "big data" between marketplaces and third-party sellers, or manufacturers with their own shops and retailers, where the same players are in direct competition for the sale of certain products or services.

Further, the Final Report reveals that the growth of e-commerce and online platforms has lead more manufacturers to adopt “selective distribution systems” to better control the online distribution of their products and reinforce their brand image and quality.

According to the consolidated case law of the CJEU, selective distribution systems are subject to a strict requirement that retailers be selected based on “objective criteria of a qualitative nature, laid down uniformly for all potential resellers and not applied in a discriminatory fashion, that the characteristics of the product in question necessitate such a network in order to preserve its quality and ensure its proper use and, finally, that the criteria laid down do not go beyond what is necessary.”[1]

Otherwise, selective distribution systems are deemed to fall within the by-object box.

In particular, following the Pierre Fabre judgement, a ban contractually imposed by the manufacturers prohibiting retailers to sell luxury branded goods (namely, cosmetics) on the internet has been characterized as a hard-core or by-object restriction, as it has been deemed equivalent to a restriction to “passive sales” (i.e., unsolicited sales to willing customers), limiting the cross-border sales of goods across the EU.

The pending judgement in Coty Germany will fix certain important competition law principles in this field that were not clearly addressed in Pierre Fabre, and in particular it will address restrictions to sell through marketplaces like Amazon.

In addition, geo-blocking obligations in online distribution agreements — which completely prevent e-retailers from either actively selling outside an assigned member state or from being reached by unsolicited customers from outside that member state — have also been characterized by the Commission in the Final Report as hard-core restrictions of “passive sales.”

However, the upcoming entrance into force of the EU regulation banning certain geo-blocking measures will likely overrule the application of competition law to such practices.

U.S.-based ventures must take into account that Article 101 may have an extraterritorial reach, as courts and competition agencies must apply it regardless of whether the parties of the agreement are established in the EU, and regardless of the contract law chosen by the parties. An appreciable “effect on trade between member states” might be sufficient to trigger jurisdiction of either the Commission or the member states’ courts and competition agencies.

The consequences of the infringement of Article 101 are twofold, as the provision can be enforced either by private parties or by public authorities.

On the side of private enforcement, should a restrictive agreement be deemed incompatible with Article 101, either the entire agreement or the clause containing the restriction, depending on the situation, would be deemed null and void, and thus unenforceable between the parties. The parties to the agreement may also be liable for compensatory damages caused by the restrictive agreement to consumers as well as to business ventures.

On the side of public enforcement, competition authorities across the EU may initiate public proceedings to impose sanctions on the parties to such agreements, depending on the authorities' priorities, resources and policies in pursuing competition infringements.

For instance, the German Bundeskartellamt is particularly active in the field of vertical restrictions to online sales, while other competition agencies have taken a lighter approach so far. Nonetheless, it is likely that in the near future more EU competition authorities will become increasingly active in this field as a result of the rapid growth of the e-commerce sector.

Needless to say, the Commission's sector inquiry into e-commerce is boosting public enforcement in this field throughout the EU. As a first test ground, the Commission has recently opened three separate probes for breach of Article 101 targeting: (1) consumer electronics manufacturers, on allegations that they have imposed RPM to online retailers; (2) video game publishers and distribution platforms, on allegations that they have introduced geo-blocking filters based on the consumer's location or residence; and (3) tour operators and hotels, on allegations that they have discriminated against consumers on pricing based on their location.

A boost in pubic enforcement in online distribution may in turn fuel private litigation in the same field, as follow-on actions for compensatory damages become more likely to succeed following the implementation this year of Directive 2014/104/EU in all member states, which facilitates damage claims caused by infringements of EU competition law.

The second part of this article will focus on two perplexing but typical kinds of restrictions to online sales within selective distribution systems, which have been singled out by the debate over the European Commission's Preliminary Report, as well as by the Coty Germany case: (1) restrictions to online advertising, specifically by bidding on AdWords; and (2) restrictions on selling through marketplaces.

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[1] Case 26/76, Metro SB-Großmärkte v Commission [1977] ECR 1875, § 20, and Case 31/80, L'Oréal [1980] ECR 3775, §§ 15-16.

Expert Analysis

What US Cos. Must Know About EU E-Commerce Rules: Part 2

By **Enzo Marasà, Portolano Cavallo**May 16, 2017, 11:20 AM EDT

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U.S.-based manufacturers and retailers who want to sell in the EU face legal challenges in selecting and controlling their distribution networks, particularly with regard to online sales. All stakeholders must understand the restrictions imposed by Article 101 of the Treaty on the Functioning of the European Union, which prohibits anti-competitive agreements.

The first part of this article provided some background on the application of Article 101 in the online distribution context to the benefits of U.S.-based companies, particularly in light of the European Commission's Final Report on the e-commerce sector inquiry, published last week.

This installment will focus on the analysis of two perplexing but typical kinds of restrictions to online sales in the context of selective distribution systems: (1) restrictions to online advertising, specifically by bidding on AdWords; and (ii) restrictions on selling through marketplaces (or "platform bans").

These restrictions have been singled out in the debate over the Commission's e-commerce sector inquiry, as well as in the preliminary appeal pending before the Court of Justice of the EU (CJEU) in the Coty Germany case.

Restrictions on Bidding for Certain Keywords on Search Engines

The Commission has noted that one type of restriction encountered in the sector inquiry relates to the use of trademarks/brand names for online advertising. More specifically, the Staff Working Document accompanying the Final Report suggests that some distribution agreements limit the ability of authorized retailers to use or bid for the manufacturers' brand names in order to get a preferential listing in search engines' paid listings (such as Google AdWords), or only allow them to bid on certain positions.

In the words of the Commission:

Such restrictions typically aim at preventing retailer's websites from appearing prominently in the case of usage of specific keywords. This may be in the interest of the manufacturer in order to allow its own retail activities to benefit from a top listing and keep bidding prices down. Given the importance of search engines for attracting customers to the retailers' website and improving the findability of their online offer, such restrictions may also raise concerns under Article 101 TFEU as they restrict the ability of retailers to attract online customers. Conversely, restrictions on the ability of retailers to use the trademark/brand name of the manufacturer in the retailer's own domain name rather help avoiding confusion with the manufacturer's website (§ 632 of the Staff Working Document).

Preferential listing services on search engines are organized as auction markets, where the supplier usually enjoys strong market power (the Commission unsurprisingly refers specifically to Google's AdWords), while there is fierce competition on the demand side (between the manufacturers' own online shops and their authorized online retailers') to win the first position in relation to certain keywords. The outcome of the auction is often inefficient, since the increase in sales generated by obtaining the top positions does not always compensate for the steep price paid to obtain them.

However, precluding preferential listing can be construed as discriminatory conduct that directly affects traffic and sales and raises rivals' costs. In fact, this practice can result in a manufacturer no longer facing competition from its retailers for the first listing position, while its authorized retailers continue the bidding war for non-top listing positions (e.g., the second or third paid position). One may argue that this conduct is likely to appreciably reduce intra-brand competition to the advantage of manufacturers' own e-retail shops.

The challenge here is to evaluate whether the restraint can be justified for trademark protection reasons, or for other plausible economic justifications; otherwise it may be considered as a "by-object" restriction.

The Commission has not articulated a clear stance on this specific issue so far, but it does not seem likely to accept trademark protection as a justification in relation to the use of keywords on search engines in the context of selective distribution networks, as authorized retailers are already allowed to use trademarks and brand names for their online offerings.

Restriction to Selling Through Marketplaces (AKA "Platform Bans")

With its Final Report, the Commission has taken the opportunity to clarify its position on whether a restriction to selling via online marketplaces is a "by-object" or "by-effect" restriction. It has done so within the scope of its inquiry into how to assess selective distribution systems with regard to competition law in the online environment (§§ 38-43 of the Final Report).

Some of the most well-known examples of internet marketplaces are Amazon, eBay and Alibaba, though other sorts of online platforms may also fall into this category (e.g., price comparison tools, or social networks providing e-commerce capabilities).

In business practice, restrictions on selling through marketplaces usually take the form of contractual requirements levied by manufacturers or suppliers on their appointed retailers in selective distribution systems not to sell their products online through “third-party platforms that carry the third party’s names and logos."

The Commission says that restrictions against selling via marketplaces — including complete bans — cannot be characterized as "by-object" restrictions against competition, and thus they can benefit from the automatic and general exemption under the vertical block-exemption regulation, provided that the other conditions set forth therein are met (§§ 499-514 of the Staff Working Document).

Indeed, years before this sector inquiry (namely, in the 2010 Vertical Guidelines) the Commission had already expressed a clearly lenient approach towards marketplace restrictions with regard to Article 101.

However, that position of the Commission has been challenged in litigation pending in German courts between the U.S.-based cosmetic manufacturer Coty and one of its distributors in Germany. The distributor has claimed in court that Coty Germany’s 2012 general terms of sale

breach Article 101 by prohibiting retailers from selling specified products through third-party websites that: (a) display the products in a way that affects the luxury image of the products; or (b) are managed by third parties and carry the third party's name and logo. These contractual provisions were used by Coty Germany to prohibit its distributors from selling on Amazon.

The question of the interpretation of Article 101 in this situation has been referred to the CJEU by a Frankfurt court for a preliminary ruling. In particular, the CJEU will have to address whether: (1) the aim of protecting the luxury image of branded goods may be deemed a legitimate reason to restrict sales through online marketplaces within a selective distribution system; and, consequently, (2) whether a restriction on selling through marketplaces is a hard-core (or by-object) restriction or a by-effect restriction subject to a case-by-case analysis.

According to several commentators (and the Commission), the matter arises from a misunderstanding of a phrase in the reasoning of the Pierre Fabre judgement, whereby the CJEU incidentally stated that: "The aim of maintaining a prestigious image is not a legitimate aim for restricting competition and cannot therefore justify a finding that a contractual clause pursuing such an aim does not fall within Article 101(1) TFEU" (§ 46 of the judgement).

Notably, the Pierre Fabre case was about a (de facto) absolute ban against selling on the internet, and confirmed that such an absolute ban is a hard-core restriction (that can only be justified in exceptional circumstances). That case does not concern online marketplace restrictions.

Nonetheless, if the (unfortunate) wording of that specific paragraph were to be read in isolation, it might be read as deeming contrary to Article 101 any restriction on online sales aimed at preserving the prestigious brand image of products — irrespective of whether the restrictions in question prohibit all sales on the internet or just limit the use of third-party platforms.

Such an interpretation would conflict with the Commission's stance that the requirements and criteria in question are held to be by-effect restrictions (and as such, presumptively compatible with Article 101), insofar as they concern the question of how the distributor can sell the products over the internet, and do not have the object of restricting where or to whom distributors can sell the products.

Indeed, allowing retailers to offer and sell the contracted products through unauthorized third-party platforms may loosen the manufacturer's control over how its products are offered and sold throughout the internet and, thus, jeopardize the consistency of required "quality" standards. Based on this rationale, one can deem it legitimate — and presumptively

compatible with Article 101 — that manufacturers and brand-owners may restrict the ability of appointed retailers to sell through third-party platforms, provided that such platforms are not members of the supplier's selective network of authorized retailers.

Notwithstanding, the Commission's Final Report remarks that "this does not mean that absolute marketplace bans are generally compatible with the EU competition rules. The Commission or a national competition authority may decide to withdraw the protection of the [block exemption] in particular cases when justified by the market situation" (§ 43).

The ruling — which is expected at some point in 2018 — will settle the position of the Commission, and will thus set the standard on how to handle marketplace restrictions uniformly across the EU (and, more generally, online sales restrictions in selective distribution systems).

Final Remarks

The Commission's Final Report on its e-commerce sector inquiry has highlighted that the kind of online sales restrictions described in this article may, under certain circumstances, hamper online shopping and cross-border sales within the EU, ultimately preventing consumers from benefiting from the greater choice and lower prices promised by e-commerce.

On the other hand, in relation to the widely debated restrictions against online marketplace sales, the Final Report calls for a case-by-case approach based on the effects of individual restrictions, rather than on a general outright prohibition of such bans. However, this issue will be addressed by the CJEU in the Coty Germany case within a year, and therefore it would be premature to take a stance on the correctness of the Commission's position.

This said, it is difficult to dispute that — since the internet is a combination of pictures, logos, words and brands — pursuing "quality" in the use of the internet mostly means pursuing consistency of the brand's house style and of the customers' perception thereof, also known as the overall "customer shopping experience."

Thus, manufacturers who select their authorized online retailers based on objective, uniform and non-discriminatory criteria aimed at preserving such "quality" parameters should not fall afoul of EU competition rules, because such criteria are focused on how their goods are sold online within the EU, rather than where or to whom.

Nevertheless, U.S.-based firms distributing their products online or setting up e-retail platforms in the EU must pay particular attention to how they select online distribution partners, as well

as what type of sales restrictions they impose or agree to, if they want to avoid being caught in unexpected disputes based on infringement of Article 101.

The EU case law on such issues is likely to develop greatly in the coming years, as the Commission and national competition agencies are set to open further investigations, and the CJEU will have to provide guidance on the uniform application of Article 101 in the online environment.

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