

Online Erosion and Grey Market Mitigation

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OVERVIEW

- Introduction
- The US position vs EU position
- Different distribution strategies
 - Exclusive distribution
 - Selective distribution
- Pitfalls to avoid
- Online advertising restrictions
- Price monitoring and distribution systems
- Looking forward – the VBER consultation

K&L GATES GLOBAL BRAND EROSION & GREY MARKET MITIGATION PRACTICE



- Evaluate product manufacturers' distribution arrangements and **tailor go-to-market strategies** geared toward the resale of products by suitable partners
- Develop **customised plans** that factor in regional / national legal dynamics to support authorized sales and minimize unauthorized sales
- **Monitor** the marketplace for distribution anomalies, infringements, and counterfeit products
- **Enforce** clients' distribution and intellectual property rights through efficient and effective litigation and other enforcement strategies

US v EU

US DISTRIBUTION STRATEGIES

- Absolute discretion to authorise or reject resellers, including in relation to online sales
- Removal of resellers carries limited legal risk
- Advertised or Resale Pricing Policy



EU DISTRIBUTION STRATEGIES

- Rules stricter in terms of restricting resellers:
 - Manufacturer cannot pick and choose resellers
 - Online presence difficult to curate
 - With respect to their resale prices
- Unlawful terms / agreements:
 - Can be void and unenforceable
 - Can expose companies to lengthy investigations and significant fines – major focus on RPM and online resale bans
 - Increasingly leading to risk of damages claims – legal regime has been simplified to bring private actions



Can use tools provided for under EU law to impose similar control over distribution strategies as in the US

EU Distribution Strategies

WHO CAN SELL YOUR PRODUCTS?

General rule: Once a third party reseller obtains a manufacturer's product, it may sell that product to whomever it wishes

EXCEPTIONS

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graph TD; A[EXCEPTIONS] --> B[Exclusive distribution:]; A --> C[Selective distribution:];
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Exclusive distribution:

- One reseller exclusively allocated a territory

Selective distribution:

- Only resellers that meet criteria can resell the product

EXCLUSIVE DISTRIBUTION

- Possible to prevent distributor selling **actively** into the exclusive territory / to customer group:
 - Allocated to another exclusive distributor
 - Exclusively reserved by the manufacturer
- Can be combined with selective distribution at a different level of distribution:



SELECTIVE DISTRIBUTION

*“A ‘selective distribution system’ means a distribution system where the supplier undertakes to sell the contract goods ..., either directly or indirectly, **only to [resellers] selected on the basis of specified criteria** and where these [resellers] undertake not to sell such goods ...to unauthorised [resellers]...”*

Article 1(e), European Commission Regulation No. 330/2010
 (“VBER”)

HISTORICALLY A STRATEGY USED FOR:

- Luxury / premium products requiring an appropriate retail environment to preserve the brand image
- Products requiring technical support or information



- **But** increasing application in branded or high quality products
- Even if product type does not fit within established categories, can generally benefit from exemption where market share is under 30%

SELECTIVE DISTRIBUTION CRITERIA

Criteria should be necessary and objectively justifiable to meet legitimate aims

- **Qualitative** criteria almost always acceptable:
 - Suitably trained staff
 - After-sales service
 - Attractive store / website layout
 - Not to be sold alongside down-market goods
 - Quality controls



SELECTIVE DISTRIBUTION CRITERIA

- **Quantitative** criteria may also be acceptable (depending on market share):
 - Buying a minimum quantity of goods
 - Achieving a particular turnover
 - Maintaining minimum stock
 - Limit on number of resellers if justified e.g. by insufficient local demand, capacity constraints in terms of production or sales resources



MONITORING AND ENFORCEMENT

- System should be monitored and enforced by reference to the objective criteria
- Should aim for uniformity and objectivity but...
- Can enforce with discretion if:
 - Market shares under 30%
 - Enforcement is not carried out by reference to price
 - Not enforcing predominantly against online resellers
 - Not enforcing in a way that creates market sharing



SELECTIVE DISTRIBUTION DEVELOPMENTS

European Commission's e-Commerce Sector Inquiry

- Concluded in May 2017
 - Largest ever sector inquiry: *questionnaire responses from over 1050 retailers, almost 260 manufacturers, 37 online marketplaces, 89 price comparison tools, and 17 payment system providers active in Europe*
- Conclusions included:
 - Intra-brand competition should **not** solely be based on price – quality (including brand) considerations may justify limitations on price competition, including requiring selective distribution criteria for online resellers

SELECTIVE DISTRIBUTION DEVELOPMENTS

Coty Germany GmbH case

- CJEU judgment on 6 December 2017
- Reference from German courts regarding online marketplace bans

- Conclusions:
 - Suppliers operating a selective distribution system **can ban their authorised resellers from selling on third party platforms absolutely**
 - No contractual link with marketplace to ensure quality conditions
 - Liable to harm luxury image
 - Ban falls outside EU competition law if justified by product, does not go beyond what is necessary, and applied uniformly and non-discriminately
 - Not a hardcore restriction so should benefit from exemption where under 30% *even if* these conditions are not all met
 - Commission unofficially recognised *Coty* applied to all types of products, not just luxury

Pitfalls to Avoid

THE GUESS CASE

- Selective distribution system across EEA
- The Commission's investigation started as a follow-up to the e-commerce sector inquiry
- The Commission found that Guess Europe's wholesale agreements, its retail store sublicense agreements and its General Sales Terms used with multi-brand retailers in the EEA contained a number of unlawful restrictive provisions
- The Commission fined Guess €40 million
- 50% fine reduction for cooperation

G U E S S : THE ANTICOMPETITIVE CONDUCT

- Resale price maintenance
- Absolute online search advertising restrictions
- Online sales restrictions imposed subjectively, without reference to criteria
- Restrictions on cross-sales between members of the selective distribution system
- Restrictions on cross-border sales to end users

THE GUESS CASE: UNLAWFUL RESTRICTIONS

- Guess banned retailers from using or bidding for Guess brand names and trademarks as keywords for the purposes of online search advertising (AdWords)
- Restriction not included in the distribution agreements. Authorisation in theory may be granted but almost never in practice
- Guess' objective was to reduce competitive pressure from retailers on Guess' own online retail activities and reduce its own advertising costs
- Restriction by object

HOW DO YOU LEGALLY CONTROL ONLINE ADVERTISING?

- **What restrictions would be admissible?**
 - **Legitimate objective:** avoiding confusion between brand's websites and retailers websites/protect brand's image
 - **Non-discriminatory:** applied uniformly to all retailers
 - **Proportionate:** no total ban / objective criteria (e.g. use of brand's name combined with other keywords)

One to watch

Commission has not provided a clear position on whether only absolute bans are problematic

THE CASE

- Licensed merchandising (e.g. mugs, bags, toys) featuring the brands of a football club or a federation, not Nike's trademarks
- Via non-exclusive licensing and distribution agreements, Nike grants licenses to third parties to sell products in the territory
- The Commission found that Nike's practices partitioned the Single Market, led to less choice and higher prices for consumers
- The Commission fined Nike € 12.5 million
- 40% fine reduction for cooperation

: THE ANTICOMPETITIVE CONDUCT

- Direct measures restricting out-of-territory sales by licensees, including:
 - Provisions in the agreements prohibiting these sales
 - Obligations to refer out-of-territory sales to Nike
 - Imposition of double royalties for out-of-territory sales
- Indirect measures to implement the out-of-territory restrictions, including:
 - Threats to terminate contracts
 - Refusal to supply
- Intervention to ensure that retailers stopped purchasing products from licensees in other EEA territories

KEY CONDUCT TO AVOID

- Resale price maintenance (RPM)
- Absolute restriction on online search advertisement
- Online sales restrictions without an objective purpose
- For selective distribution:
 - Restrictions on cross-sales
 - Restrictions on cross-border sales to end users
 - Subjective enforcement



Price Monitoring and Distribution Systems

WHY USE PRICE MONITORING TOOLS?

- Market research prior to a launch
- Assess whether brand has been appropriately positioned
- To make recommendations (permitted) to resellers
- To consider whether wholesale pricing appropriately pitched



WHAT ARE THE DANGERS?

- **Monitoring in a vertical context**
 - Detection of any deviations from fixed or minimum resale prices - contribution to the effectiveness of RPM
 - Pressures to stick to recommended prices - RPM
- **Monitoring in a horizontal context**
 - Implementation of an explicit pre-existing collusion
 - Tacit collusion?



WHAT ARE THE DANGERS?

*“increased price transparency through price monitoring software enables easier detection of those retailers that deviate from manufacturers' pricing recommendations. It could therefore **allow manufacturers to retaliate against retailers that do not comply with pricing recommendations**”*

*“increased price transparency through price monitoring software may **facilitate or strengthen (both tacit and explicit) collusion between retailers** by making the detection of deviations from the collusive agreement easier and more immediate.”*

Final report on the E-commerce Sector Inquiry
European Commission, 10 June 2017

THE CONSUMER ELECTRONICS CASES

- Asus, Denon & Marantz, Philips, Pioneer
- Manufacturers used price monitoring tools to track resale prices set by retailers
- Manufacturers used threats of sanctions, such as blocking supplies of products or de-authorisation
- **Total fines issued: €11 million**
- More cases of this kind expected

Looking Forward – the VBER Consultation

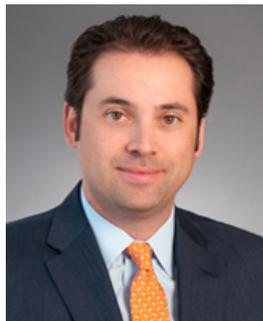
VBER CONSULTATION - TIMELINE

- **Evaluation phase** (approx. 18 months) / Publication of Staff Working Document (planned for Q2/2020) summarising feedbacks and giving proposition for the next step
 - **Evaluation roadmap** published on November 2018 (4 weeks feedback)
 - **Public consultation** published on 4 February 2019 (16 weeks; until 27 May 2019)
 - More than 160 submissions from number of different stakeholders
 - **Evaluation support study** to be launched before summer 2019 - including a summary of the results of the Public consultation
 - **Dedicated stakeholder workshop** planned for autumn 2019 - allows to have in depth conversation but difficult of accommodate all stakeholders interested / will only concern representative organisations
- **Impact Assessment** (approx. 24 months until expiry of the VBER): Commission will prepare a timetable and launch a consultation on the timetable

VBER CONSULTATION - ISSUES FLAGGED BY STAKEHOLDERS SO FAR

- **RPM** - Buyers ask for more stringent enforcement / suppliers ask for more flexibility
- **Exclusive distribution**
- **Selective distribution**
- **Dual distribution by manufacturers**
- **Lack of consistency** in the approach to the rules within the ECN

QUESTIONS?



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