

CPI's Europe Column Presents:

Asics vs Coty: Competitive effects of selective distribution systems in light of diverging court decisions

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May 2018

Many brand manufacturers in different industries ranging from sport shoes (Adidas and Asics) over consumer electronics (Bang & Olufsen) to cosmetics and perfumes (Pierre Fabre and Coty) use a selective distribution system (SDS) vis-à-vis their retailers.² These SDSs are recently under intense scrutiny of Antitrust authorities and have gained a lot attention due to several court decisions. Particularly, the diverging decisions on in the Asics and the Coty case gave rise to a debate.³ In the Asics case, the German Bundeskartellamt (BKartA) ruled in August 2015 that the SDS of the sport shoe manufacturer Asics with respect to online advertisement and price search engines violates competition law (Art. 101 (1) of the Treaty of the Functioning of the European Union).⁴ By contrast, in the Coty case, the European Court of Justice in December 2017 ruled that relatively similar clauses in the SDS of Coty, a beauty products manufacturer known for brands such as Calvin Klein, Gucci, and Hugo Boss, are compatible with competition law.⁵ How to make sense of these diverging decisions? In this article, I explain the pro- and anticompetitive effects that SDSs may have, based on economic theories related to vertical restraints imposed by manufacturers. I then lay out the similarities and differences between the two cases, trying to help to understand the diverging decisions in what are seemingly similar cases.

Clauses of the selective distribution systems

Before discussing the competitive effects of a SDS, I briefly review the issues of the SDS that were scrutinized by the competition authorities. To start with, manufacturers usually put a SDS in place to ensure that authorized distributors fulfill a quality standard, thereby avoiding a loss in the brand valuation of consumers. In addition, manufacturers often include clauses that allow them to achieve better channel coordination in terms of prices, advertising, services, etc. A common way to do so is to restrict their selective retailers in advertising or pricing practices (e.g., to ensure that advertising campaigns or holding of sales are coordinated).

The regulations under scrutiny in the Asics case were the prohibition on allowing a third party to use Asics brand names in order to guide customers to the website of an authorized dealer (which, for example, prevents dealers to advertise on search engines), and the prohibition on supporting price comparison websites. In addition, Asics's SDS also prohibited dealers to use online market places. Similar to the clauses in Asics's SDS, also Coty's SDS prohibited its distributors to sell products of Coty on online market places such as amazon.com or price comparison websites where consumers can directly buy the product.

Competitive effects of the clauses in the SDS

The rules and clauses of the SDS have several effects on competition. In fact, they not only have an impact on competition between the authorized dealers of the manufacturer's product (intra-brand competition) but also on competition with products from rival manufacturers (inter-brand competition). We start with the anticompetitive effects.

A first and direct effect is that the searchability of the dealers falls, which makes it harder for consumers to find them.⁶ Therefore, potential customers are more likely to buy a different product or

use the online stores of the manufacturer directly instead of the ones of the distributors. This clearly involves a trade-off for the manufacturer: It may be able to demand a higher price due to reduced intra-brand competition but the demand for its products will very likely also be lower. A question is therefore whether the manufacturer has the incentive to implement clauses restricting the searchability of distributors, specifically when facing inter-brand competition. Answering this question becomes even more pertinent when taking into account that, via the wholesale price, the manufacturer can control the retail prices that its distributors can charge, thereby making it unprofitable for them to sell at low prices on online platforms. This implies that the manufacturer has other measures to discipline intra-brand competition instead of directly prohibiting online advertisements.

Two insights from economics can perhaps help to shed light on this issue. First, even if inter-brand competition is weak, a manufacturer suffers from fierce competition between its dealers if contracts to them are secret.⁷ As distributors cannot observe the deals of their rival distributors due to trading terms usually being secret, each one is afraid that the rival may obtain a better deal, for example, in terms of lower wholesale prices. A distributor is therefore only willing to pay a low franchise fee to the manufacturer. This effect, which is to the detriment of the manufacturer, is more pronounced the stronger is competition between distributors. It therefore gives the brand manufacturer the incentive to dampen intra-brand competition. However, one may wonder about the strength of this effect if there is also competition from rival brands. Then, a second insight comes into play. It is rooted in the effect that weaker intra-brand competition also dampens competition between different brands.⁸ The reason is that if brand manufacturers steer consumers exclusively towards their own online presence and charge higher prices there, rival brands will follow suit, which leads to a higher price and profit level in the industry in general. In addition, the collusive possibilities increase as fewer firms are involved, contributing to the increase in profits.⁹ This shows that manufacturers indeed may have an incentive to restrict competition between their dealers, which leads to higher prices and is therefore anti-competitive.

We now turn to the pro-competitive consequences of the clauses in the SDS. In the cases of Asics and Coty, two effects stand out. The first is that such clauses can ensure quality and service investment by retailers.¹⁰ For both products, providing services to consumers is an essential part of the company's success. For example, sport shoes are experience goods which may require advice from experts. Perfumes need to convey an aura of luxury and need to be displayed in adequate atmosphere. Doing this is costly for dealers. With fierce competition from own-brand rivals, a dealer cannot recoup this investment. In particular, the danger is that a consumer informs herself at a service-providing dealer but then buys at a cheaper price from a competing online shop. This erodes service incentives. This practice is known as free-riding and can be avoided through clauses in the SDS banning sales via online platform or price comparison engines.¹¹

The second effect is that such clauses allow better channel coordination of the brand producers.¹² For example, price comparison websites may lack functionality or advice, which reflects badly on the product's reputation. This can lower the brand image that is usually an important factor for perfumes and related products.

Comparison between the two cases

As mentioned above, the decisions in the two cases of Asics and Coty were very different. Whereas the BKartA viewed Asics's clauses as hardcore restrictions of competition and therefore banned these clauses of the SDS, the European Court of Justice found that Coty's restrictions are legal. Although the clauses in both SDSs were similar, there are several differences in the nature of the product which triggered these diverging court rulings. In what follows, I explain the main aspects in relation to the effects discussed above.

In the Asics case, the BKartA weighed the anticompetitive effects to a higher degree than the procompetitive ones. The searchability issue was of particular importance in the decision. As there is a large number of sport shoes available in the market, both from brand and non-brand manufacturers, the ban to use online advertising makes it very difficult to be found for retailers of the SDS. This reduces competition considerably.¹³ A similar reasoning holds for the prohibition to use online market places or price comparison engines. These websites reach a very large number of potential consumers, and can therefore be seen almost as an essential facility for online sales.¹⁴ The procompetitive effects, instead, are only present to a minor extent when it comes to running shoes. For example, it is unlikely that there will be a significant reduction in the brand image of Asics when its shoes are sold through third parties. In addition, the BKartA was also questioning the free-riding problem, pointing out that sometimes search behavior of consumers may even start online and they then buy at brick-and-mortar store.¹⁵ As a consequence, although channel coordination may be more difficult to achieve with third-party online sales, the overriding effects of the SDS on competition are negative.

By contrast, in the Coty case, the procompetitive effects of the SDS were the decisive factors. The points emphasized by the European Court of Justice were the brand image and the aura of luxury that the products of Coty convey. This image could be damaged by the sales over third-party internet platform. Specifically, the products contain a genuinely prestigious character, which gives them a luxury image.¹⁶ This implies that there are immaterial characteristics of the goods that need to be preserved to allow consumers to distinguish these products from perfumes of non-branded manufacturers. The 'selection of goods, advertising, and sales presentation'¹⁷ contribute to this luxury and are therefore essential. Whereas the competition-dampening effect was acknowledged, the overarching aim of preserving the aura of luxury was the major point in the decision. This aura of luxury is not present with running shoes and therefore did not play a role in the Asics decision.

Conclusion

In summary, although the two cases have a lot in common and the clauses under scrutiny are very similar in both cases, the nature of the product for which the SDSs were established is different. Because a SDS has both pro- and anticompetitive effects, these effects can have different strength for different products. The decisions point out that procompetitive effects tend to dominate for luxury goods, in which channel coordination is particularly important, whereas the anticompetitive effects tend to dominate for more 'regular' products.

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- ² A selective distribution system is a vertical agreement between a manufacturer and a limited number of selected distributors (or dealers) in a dedicated geographic area. It is usually used by manufacturers to distribute branded products and prohibits sales of non-authorised dealers.
- ³ See, for example, Clifford Chance, “Selective Distribution Systems: CJEU Judgment in the Coty Case”, December 2017, available at: https://www.cliffordchance.com/briefings/2017/12/selective_distributionsystemscejuejudgmenti.html, or Oxera, Agenda, “No Free Rides? Platform Bans in Light of the Coty Case”, December 2017 available at: <https://www.oxera.com/Latest-Thinking/Agenda/2017/No-free-rides-Platform-bans-in-light-of-the-Coty-c.aspx>.
- ⁴ Bundeskartellamt, Case Summary, “Unlawful Restrictions of Online Sales of ASICS Running Shoes”, (B2-98/11), 26 August 2015, available at: https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2015/27_08_2015_ASICS.html.
- ⁵ See Urteil des Gerichtshofs, C-230/16, Coty Germany GmbH versus Parfümerie Akzente GmbH, 6 December 2017, available at: <http://curia.europa.eu/juris/liste.jsf?num=C-230/16>.
- ⁶ See Bundeskartellamt Case Summary, “Unlawful Restrictions of Online Sales of ASICS Running Shoes (B2-98/11), 26 August 2015, page 5.
- ⁷ See, for example, McAfee, R.P. and M. Schwartz (1994), “Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity and Uniformity”, *American Economic Review*, 84, 210-230, and P. Rey and J. Tirole (2007), “A Primer on Foreclosure”, In: Armstrong, M. and R.H. Porter (Eds.), *Handbook of Industrial Organization*, Vol III, Elsevier, North-Holland.
- ⁸ See P. Rey and J. Stiglitz (1995), “The Role of Exclusive Territories in Producers’ Competition”, *RAND Journal of Economics*, 26, 431-451.
- ⁹ See S. Piccolo and M. Reisinger (2011), Exclusive Territories and Manufacturers’ Collusion, *Management Science*, 57, 1250-1266.
- ¹⁰ See de Meza, D. and M. Selvaggi (2007), “Exclusive Contracts foster Relationship-Specific Investment”, *RAND Journal of Economics*, 38, 85-97.
- ¹¹ See, for example, Mathewson, G.F. and R.A. Winter (1987), “The Competitive Effects of Vertical Agreements: Comment”, *American Economic Review*, 77, 1057-1082, or Bernheim, B.D. and M.D. Whinston (1998), “Exclusive Dealing”, *Journal of Political Economy*, 106, 64-103.
- ¹² See Desai, P. and K. Srinivasan (1995), “Demand Signaling under Unobservable Effort in Franchising”, *Management Science*, 41, 1608-1623.
- ¹³ See Bundeskartellamt, B2-98/11, Beschluss in dem Verwaltungsverfahren ASICS versus eBay et al., 26 August, 2015, para 15, page 6, available at: <https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Kartellverbot/2015/B2-98-11.html>.
- ¹⁴ See Bundeskartellamt Case Summary, “Unlawful Restrictions of Online Sales of ASICS Running Shoes (B2-98/11), 26 August 2015, page 10.
- ¹⁵ See Bundeskartellamt Case Summary, “Unlawful Restrictions of Online Sales of ASICS Running Shoes (B2-98/11), 26 August 2015, page 9.
- ¹⁶ See Urteil des Gerichtshofs, C-230/16, Coty Germany GmbH versus Parfümerie Akzente GmbH, 6 December 2017, paras 25 and 26.
- ¹⁷ See Urteil des Gerichtshofs, C-230/16, Coty Germany GmbH versus Parfümerie Akzente GmbH, 6 December 2017, para 12.