

## NEWSFLASH



### **Prohibition of online distribution in distribution systems**

**Higher Regional Court (OLG) of Karlsruhe now also rules in favour of brand manufacturers (OLG Karlsruhe of 25 November 2009, ref.: 6 U 47/08) in online platform cases**

*by Dr. Martin Rothermel*

It is both well known and understandable that many brand manufacturers have a particular interest in prohibiting their distribution partners from distributing through the internet. Many brands benefit from a special shopping experience created by lavish point of sale designs, intensive customer service and an aura of exclusivity. Plus, there is hardly any geographic limit to online distribution which is often associated with randomness and dumping. Therefore, brand manufacturers tend to prohibit their distribution partners from selling products online through their web sites or, in particular, through internet auction platforms. Prohibitions of this kind interfere with the freedom of competition, are so called restraints and subject to anti-trust regulations. Until a little while ago, there used to be established opinions on the matter at the European Commission, in courts, and in literature. Then, these were undermined by several new (and partly contradictory) decisions and some papers in legal literature – before two new Higher Regional Court decisions re-established clarity in favour of brand manufacturers.

#### **Previous situation**

Prohibiting a distribution partner from selling the furnished products through the internet basically constitutes a restraint of competition as such prohibition affects the business partner's autonomous decision-making with regard to market behaviour. In fact, there are clear statements that every distribution partner should be at liberty to advertise products on the internet and to sell them online, to be found in particular in the Commission guidelines (para. 51) on current block

exemption regulation for vertical agreements (vertical BER, No. 2790/1999). At best, the supplier can impose quality requirements; online selling may be prohibited only for objectively justified reasons.

That is one of the reasons why brand manufacturers, within the scope of selective distribution systems, adopted an additional quality criterion according to which the distribution partner must have physical business premises (brick-and-mortar clause) so that pure e-tailers are not accepted in the selective network at all. Furthermore, manufacturers' requirements with regard to web store designs are rather extensive.

For better understanding, the following remarks should be made: *'Selective distribution system' means a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors* (Art. 1 d) of the vertical BER). It has been acknowledged for a long time that selective distribution systems where selection is based on quality only, do not constitute a restraint of competition if selection criteria are of an objective quality-based nature, if they are applied in a non-discriminating manner and required for quality assurance with respect to the features of the product in question.

Against this background, distributors (seeking online distribution only) often argue that they would be discriminated against other distributors (not seeking online distribution, only) – and in this way they question the lawfulness of the selective distribution system as such, trying to compel delivery. On 4 November 2003, however, the German Federal Court of Justice in its well known perfumery decision (*depot cosmetics on the internet*) ruled that the prohibition of mere online distribution in selective systems was justified because that kind of distribution did not meet brand manufacturers' requirements in terms of the desired aura of exclusivity, and because there was no customer service and customers did not have the opportunity to test goods.

### **Recently confirmed decisions on selective distribution**

It may be assumed that many manufacturers subsequently adopted the selection criterion of brick-and-mortar premises in order to prevent online distribution. But it is obviously questionable whether only and automatically physical premises imply an aura of exclusivity, and whether such aura of exclusivity is even necessary.

Now, the Higher District Court of Karlsruhe in its *Scout-I* decision of 25 November 2009 confirmed the opinion of the District Court of Mannheim of 14 March 2008 and held that selective distribu-

tion systems do not contain a restraint of competition if selection criteria require distribution partners to avoid internet auctions. The particular case in question was about the distribution of well known “Scout” school bags. Both Courts deemed selective criteria to be objective and quality-based even if the case did not relate to any aura of exclusivity but mostly to quality and origin, that is, the brand was the main focus. The Courts thus considered the denial to authorize distribution through auction platforms objectively justified and not discriminating.

The Higher District Court of Karlsruhe furthermore explicitly contradicted the opinion of the District Court of Berlin which, in injunction proceedings, had ruled to the contrary on 24 July 2007, and had confirmed that decision by its (appealed) ruling in the proceedings on the main action on 21 April 2009 (*Scout-II*). The facts equalled those of the proceedings before the District Court of Mannheim as indicated above. The District Court of Berlin, however, held that a general prohibition of selling goods through the internet was not even a quality-based selection criterion. Also, according to the Court, it was rather questionable if an aura of exclusivity could be taken into consideration at all for school bags.

#### **New decision on non-selective distribution**

*Scout-I* was indirectly “confirmed” already in advance by the decision of the Higher Regional Court of Munich of 2 July 2009, which confirmed the decision of the District Court of Munich of 24 June 2008. The proceedings were not about school bags but sporting goods, and there was no selective distribution system. Still, the Court considered the prohibition imposed on the business partners with regard to the distribution through auction platforms a restraint of competition exempted by the vertical BER and referred to the above Commission guidelines – at least as far as concerns arguments. According to the Court, there was no prohibition of online distribution (and, therefore, no exclusion of certain customer groups that would be a hardcore restraint) but merely a specific quality requirement which could not be contested and was justified in particular because of the fact that, time and time again, fake brand-name products were offered at auction platforms. Therefore, the brand manufacturers’ interest to keep their distributors away from such platforms was absolutely legitimate in the opinion of the Court.

#### **New decision on trademark license agreements**

The ECJ decision *Christian Dior* of 23 April 2009 fits in with this subject matter, even if not perfectly. The preliminary ruling procedure was about a trademark license agreement and the question whether a licensee could be prohibited from selling the products manufactured under the license to discount stores. A direct comparison to the cases outlined above is not possible here since, in the European Union, the resale of products which were already brought into circulation

by the trademark owner is subject to the principle of exhaustion (no additional license required for resale). Yet, it can be derived from the ECJ ruling that a trademark's reputation may be protected to some extent, maybe also including the trademark owner's interest to not allow distribution of license products through discount stores. So the ECJ considers it objectively justified to differentiate between various channels of distribution.

### **Preview of the new vertical BER**

The current vertical BER will expire on 31 May 2010. The Commission has signaled that it intends to stick to the precept of free internet trade, but that it also wants to clarify the situation for brand manufacturers. Nothing substantial can be learnt yet in this regard from the draft of the new vertical BER submitted so far. But the current draft of the guidelines on the new vertical BER 2010 strengthens online distribution. It is clarified that the operation of a web site constitutes a form of "passive selling", regardless of the use of a specific language. The draft further provides for hardcore restraints in some ways of prohibition of online distribution.

### **Conclusion**

Full exclusion of online distribution is probably still an exception in distribution systems, and might be considered especially in selective distribution systems. But the special need for objective quality requirements must be respected in selective distribution systems, just as the non-discriminating application of such requirements. It is unlikely that all brand manufacturers could actually plead an objective justification of unequal treatment (otherwise it would be discrimination) without further ado (although there is a certain tendency to protect trademark reputation).

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