

THE EUROPEAN UNION AND FRANCHISING

(A) HISTORY

The European Union has to date limited its activities in relation to franchising to the field of competition law.

(i) *Pronuptia*

The examination of franchising within the Communities began with the decision of the European Court of Justice in the case of *Pronuptia de Paris GmbH (Frankfurt am Main) and Pronuptia de Paris Irmgard Schillgalis (Hamburg)*.¹ The case was referred to the Court of Justice under Article 177 of the EEC Treaty by the German Federal Court of Justice for a preliminary ruling on the interpretation of Article 85 of the EEC Treaty and Commission Regulation No 67/67/EEC of 22 March, 1967, on the application of Article 85(3) of the Treaty to certain categories of exclusive dealing agreements. It concerned the franchisee's obligation to pay the franchisor arrears of fees. The Court came to a series of conclusions of general applicability in its discussion of the *Pronuptia* case. *Inter alia*, the Court admitted that the franchisor must be in a position to protect certain interests vital to the business and to the identity of the network (for example the know-how), although the provisions must be essential for this purpose. However, certain categories of clauses that limit the franchisee's activities (for example price determination clauses) were not considered acceptable by the Court.

Following the landmark *Pronuptia* decision, the Commission of the European Communities rendered five Decisions on franchising cases² and adopted a Block Exemption Regulation on franchise agreements.³

(ii) *The Block Exemption Regulation on Franchise Agreements*

The Block Exemption Regulation entered into force on 1 February 1989 and remained in force until 31 May 2000, when it was superseded by a Block Exemption Regulation on Vertical Restraints (see (iii) below).⁴ It should be noted that in accordance with Article 12(2) of this Regulation, the prohibition laid down in Article 81(1)⁵ of the European Community Treaty did not apply during the period from 1 June 2000 to 31 December 2001 in respect of

¹ Case 161/84 of 28 January 1986.

² Decision 87/14/EEC, Yves Rocher, of 17 December 1986 (OJ EEC L 8/49 of 10 January 1987); Decision 87/17/EEC, *Pronuptia*, of 17 December 1986 (OJ EEC L 13/39 of 15 January 1987); Decision 87/407, Computerland, of 13 July 1987 (OJ EEC L 222/12 of 10 August 1987); Decision 88/604, ServiceMaster, of 20 August 1988 (OJ EEC L 332/38 of 3 December 1988) and Decision 89/94/EEC, Charles Jourdan, of 2 December 1988 (OJ EEC L 35/31 of 7 January 1989).

³ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements (OJ EEC L 359/46 of 28 December 1988).

⁴ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (Text with EEA relevance) (OJ EC L 336/21 of 29 December 1999).

⁵ It should be noted that this Regulation follows the new numbering of the provisions of the Treaty, as applicable following the Amsterdam Treaty.

agreements already in force on 31 May 2000 which did not satisfy the conditions for exemption provided for in this Regulation, but which satisfied the conditions for exemption provided for in Regulations (EEC) No 1983/83, (EEC) No 1984/83 or (EEC) No 4087/88. The Vertical Restraints Block Exemption Regulation remained in force until 31 May 2010, when it was replaced by a second Block Exemption Regulation on Vertical Restraints, which entered into force on 1 June 2010 and will remain in force until 31 May 2022 (see (iv) below).

The Block Exemption Regulation identified different categories of franchise agreements (industrial franchises, distribution franchises and service franchises), specifying that it covers “[...] franchise agreements between two undertakings, the franchisor and the franchisee, for the retailing of goods or the provision of services to end users, or a combination of these activities, such as the processing or adaptation of goods to fit specific needs of their customers. It also covers cases where the relationship between franchisor and franchisees is made through a third undertaking, the master franchisee. It does not cover wholesale franchise agreements because of the lack of experience of the Commission in that field”.⁶

The text of the Regulation further gave what within the Communities came to be regarded as a more or less standard definition of franchising, when it stated that for the purposes of the Regulation, “(a) ‘franchise’ means a package of industrial or intellectual property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users; (b) ‘franchise agreement’ means an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purposes of marketing specified types of goods and/or services; it includes at least obligations relating to: - the use of a common name or shop sign and a uniform presentation of contract premises and/or means of transport, - the communication by the franchisor to the franchisee of know-how, - the continuing provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement”.⁷

6 Recital (5).

7 Article 1(3)(a) and (b). The European Franchise Federation (EFF) has adopted a definition of franchising in its Code of Ethics which is in substantial agreement with the definition in the Regulation - it was in fact prepared in consultation with the Commission. This definition indicates that: “[f]ranchising is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its Individual Franchisees, whereby the Franchisor grants its Individual Franchisees the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept. The right entitles and compels the individual Franchisee, in exchange for a direct or indirect financial consideration, to use the Franchisor's trade name, and/or trademark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between the parties for this purpose”. A footnote specifies that “know-how” means a body of non-patented practical information, resulting from experience and testing by the franchisor, which is secret, substantial and identified. The footnote goes on to specify that “secret” means that the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible and is not limited in the narrow sense that each individual component of the know-how should be totally unknown or unobtainable outside the franchisor's business; that “substantial” means that the know-how includes information which is of importance for the sale of goods or the provision of services to end users, and in particular for the presentation of goods for sale, the processing of goods in connection with the provision of services, methods of dealing with customers, and administration and financial management, and that “identified” means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality. The know-how must be useful for the franchisee by being capable, at the date of conclusion of the agreement, of improving the competitive

The Regulation indicated to which restrictions of competition the exemption applied,⁸ to which it applied notwithstanding the presence of certain obligations,⁹ to which it applied on certain conditions¹⁰ and to which it did not apply.¹¹ The Regulation also provided for an opposition procedure, in that it provided that the exemption would also apply to franchise agreements that fulfilled the conditions laid down in Article 4 and included obligations restrictive of competition that were not covered by Articles 2 and 3(3) and did not fall within the scope of Article 5, on condition that the agreements in question were notified to the Commission and the Commission did not oppose such exemption within six months.¹²

Prompted by the imminent expiration of the Block Exemption Regulation, as well as by the approaching expiry of the Block Exemption Regulations on exclusive distribution¹³ and exclusive purchasing agreements,¹⁴ the Commission in January 1997 published a *Green Paper on Vertical Restraints in EC Competition Policy*.¹⁵ In this Green Paper it examined the structure of distribution in the Community, made an economic analysis of vertical restraints and the single market, examined current Community procedures and their institutional framework, the current rules for vertical restraints and the advantages of the current system, compared Community law with member State and third country law and policy applicable to vertical restraints, gave a review of the results of the fact finding and offered options for the competition policy of the future. Franchise agreements and the Block Exemption Regulation and its operation were also examined in this Green Paper.

The Green Paper was extensively commented on by the business and legal communities, by the Member States of the Union, by the European Parliament, the Economic and Social Committee and the Committee of the Regions.¹⁶ The outcome was a proposal to adopt one Block Exemption Regulation only, covering the areas previously covered by the three Block Exemption Regulations mentioned above plus selective distribution.¹⁷

position of the franchisee, in particular by improving the franchisee's performance or helping it to enter a new market.

8 Article 2.

9 Article 3.

10 Article 4.

11 Article 5.

12 Article 6.

13 Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Distribution Agreements (OJ EEC L 173/1 of 30 June 1983, corrected by OJ L 281/24 of 13 October 1983).

14 Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the Application of Article 85(3) of the Treaty to Categories of Exclusive Purchasing Agreements (OJ EEC L 173/5 of 30 June 1983, corrected by OJ L 281/24 of 13 October 1983).

15 COM(96) 721.

16 See the document containing the Proposals for Council Regulations (EC) amending Regulation No 19/65/EEC on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices (98/0287 (CNS)) and amending Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty (98/0288 (CNS)), Explanatory Memorandum.

17 Proposal for a Commission Regulation on the application of Article 85(3) of the EC Treaty to categories of vertical agreements and concerted practices.

(iii) *The Vertical Restraints Block Exemption Regulation 2790/1999/EC*

On 1 June 2000 Commission Regulation 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical restraints and concerted practices entered into force. This Block Exemption Regulation did not in its text mention franchising, although the Guidelines that accompany the text made it quite clear that it applied also to franchising.¹⁸

The Regulation concerned vertical agreements falling within Article 81(1) which fell into a category which could normally be regarded as satisfying the conditions laid down in Article 81(3). These vertical agreements included agreements for the purchase or sale of goods or services where these agreements were concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods, vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights. For the purposes of the Regulation, the term “vertical agreements” included the corresponding concerted practices.¹⁹

The Regulation did not exempt vertical agreements containing restrictions which were not indispensable for the attainment of the positive effects of some vertical restraints, i.e. the improvement of economic efficiency. In particular, vertical agreements containing certain types of severely anti-competitive restraints such as minimum and fixed resale prices, as well as certain types of territorial protection, were excluded from the benefit of the Block Exemption, irrespective of the market share of the undertakings concerned (Recital 10 and Article 4(a) and (b)). Of particular interest to franchising were also the provisions relating to intellectual property (Article 2(3)), and in-term and post-term non-compete provisions (Article 5(a) and (b)).

(B) THE PRESENT

(iv) *The Vertical Restraints Block Exemption Regulation 330/2010/EC*

The Block Exemption for Vertical Restraints 2790/1999 expired on 31 May 2010. On 1 June 2010 a new Block Exemption *Regulation on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, No. 330/2010/EC*,²⁰ entered into force and will remain in force until 31 May 2022. The categories of agreement that can be regarded as normally satisfying the conditions laid down in Article 101(3)²¹ include “vertical agreements for the purchase or sale of goods or services where those agreements are concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods. It also includes vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights. The term ‘vertical agreements’ should include the corresponding

¹⁸ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (Text with EEA relevance) Official Journal L 336 , 29/12/1999 P. 0021 – 0025. with Commission Notice, Guidelines on Vertical Restraints, OJ 2000, C 291/1

¹⁹ Recital (3).

²⁰ OJ No. L102/1 of 23 April 2010.

²¹ Please note the new numbering of the articles.

concerted practices.”²² Franchising is not specifically mentioned in the Regulation itself, but is dealt with in the Guidelines.²³

The main amendment introduced by this Regulation is that for the Exemption Regulation to apply, not only the supplier’s share of the relevant market must not exceed 30%, also the buyer’s market share must not exceed 30%: “It can be presumed that, where the market share held by each of the undertakings party to the agreement on the relevant market does not exceed 30%, vertical agreements which do not contain certain types of severe restrictions of competition generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.”²⁴ The Regulation states quite explicitly that it “should not exempt vertical agreements containing restrictions which are likely to restrict competition and harm consumers or which are not indispensable to the attainment of the efficiency-enhancing effects. In particular, vertical agreements containing certain types of severe restrictions of competition such as minimum and fixed resale-prices, as well as certain types of territorial protection, should be excluded from the benefit of the block exemption established by this Regulation irrespective of the market share of the undertakings concerned.”²⁵

The Regulation provides for the possibility of the Commission to withdraw the benefit it has granted “[...] where it finds in a particular case that an agreement to which the exemption provided for in this Regulation applies nevertheless has effects which are incompatible with Article 101(3) of the Treaty.”²⁶ The competition authorities of the member States may also withdraw the benefit of the Regulation.²⁷

The provision which concerns the market share threshold is Article 3, which in paragraph (1) states that “The exemption provided for in Article 2 shall apply on condition that the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services and the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services.”

Article 4 deals with the “Restrictions that remove the benefit of the block exemption – hardcore restrictions” and Article 5 with the “Excluded restrictions”:

“Article 4

**Restrictions that remove the benefit of the block exemption —
hardcore restrictions**

The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their

²² Recital (3)

²³ European Commission, Guidelines on Vertical Restraints (Text with EEA relevance) (2010/C130/01) in *Official Journal of the European Union* No. C 130, p. 1, of 19 May 2010.

²⁴ Recital (8).

²⁵ Recital (10).

²⁶ Recital (13).

²⁷ Recital (14).

object:

(a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

(b) the restriction of the territory into which, or of the customers to whom, a buyer party to the agreement, without prejudice to a restriction on its place of establishment, may sell the contract goods or services, [...]"

"Article 5

Excluded restrictions

1. The exemption provided for in Article 2 shall not apply to the following obligations contained in vertical agreements:

(a) any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years;

(b) any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services;

(c) any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.

For the purposes of point (a) of the first subparagraph, a non-compete obligation which is tacitly renewable beyond a period of five years shall be deemed to have been concluded for an indefinite duration.

2. By way of derogation from paragraph 1(a), the time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer. By way of derogation from paragraph 1(b), the exemption provided for in Article 2 shall apply to any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services where the following conditions are fulfilled:

(a) the obligation relates to goods or services which compete with the contract goods or services;

(b) the obligation is limited to the premises and land from which the

buyer has operated during the contract period;

(c) the obligation is indispensable to protect know-how transferred by the supplier to the buyer;

(d) the duration of the obligation is limited to a period of one year after termination of the agreement.

Paragraph 1(b) is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain.”

Article 6 deals with the *Non-application of the Regulation*, Article 7 with the *Application of the market share threshold* (the calculation of the market share threshold), Article 8 with the *Application of the turnover threshold*. Article 9 provides for a transitional period to run from 1 June 2010 to 31 May 2011, and Article 10 establishes the period of validity of the Regulation (until 31 May 2022).

The Guidelines deal with franchising in Section 2.5 under Section VI. “*Enforcement Policy in Individual Cases*” (paragraphs (189) and (190)).

Paragraph (189) describes franchise agreements and what they usually contain:

“Franchise agreements contain licences of intellectual property rights relating in particular to trade marks or signs and know-how for the use and distribution of goods or services. In addition to the licence of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance. The licence and the assistance are integral components of the business method being franchised. The franchisor is in general paid a franchise fee by the franchisee for the use of the particular business method. Franchising may enable the franchisor to establish, with limited investments, a uniform network for the distribution of its products. In addition to the provision of the business method, franchise agreements usually contain a combination of different vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.”

Paragraph (190) specifies when it is likely that the franchise agreement is exempt:

“(a) The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or are indispensable to protect the know-how and that the vertical restraints fulfil the conditions of Article 101(3);

(b) A non-compete obligation on the goods or services purchased by the franchisee falls outside the scope of Article 101(1) where the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also

irrelevant under Article 101(1), as long as it does not exceed the duration of the franchise agreement itself.”

Paragraph (148) specifies that

“The transfer of substantial know-how (paragraph (107)(e)) usually justifies a non-compete obligation for the whole duration of the supply agreement, as for example in the context of franchising”.

The Regulation also includes a number of provisions on internet sales, in particular on passive sales, which are described in the Guidelines in some detail. Thus, agreements to limit access to the website by persons outside the territory, or to terminate their contract, are considered to be restrictions,²⁸ as are agreements to limit the proportion of sales that can be made up over the internet²⁹ and agreements to charge differing prices for products intended to be resold on-line (“dual pricing”).³⁰ These agreements are therefore prohibited. On the other hand, there are a number of other agreements and requirements that are permissible, such as a requirement that a distributor must also maintain a brick and mortar shop,³¹ a requirement to sell at least a certain absolute amount in value or volume of the products off-line.³² It is also permissible to require links to websites of other distributors or to the supplier,³³ or for the supplier to pay a fixed (not variable) fee to support the distributor’s off-line sales efforts.³⁴ Furthermore, the supplier is permitted to impose quality standards for the use of an internet website³⁵ and the supplier is permitted to impose quality standards on third party platforms used by its distributors to host their internet presence and may require that customers do not visit the distributor’s website through a site carrying the name or logo of the third party platform.³⁶

28 Para. (52)(a) and para. (52)(b).

29 Para. (52)(c)

30 Para. (52)(d)

31 Para. (52)(c)

32 Para. (52)(c)

33 Para. (52)(a)

34 Para. 52)d)

35 Para. 54

36 Para. 54