



International Distribution Institute

THE NEED FOR SPECIFIC RULES ON FRANCHISING

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Franchising is a very special kind of retail distribution

Franchising is substantially different from selective distribution

The approach to franchising under competition rules has a long history which should be respected

THE PRONUPTIA JUDGMENT OF 28-01-1986

Pronuptia lists a number of restrictive clauses in **distribution franchising** contracts with retailers which do not fall under the prohibition of Article 101(1).

The principles contained in the judgment have never been overruled by the Court of Justice.

They are still valid, although only a small number of experts is aware of their existence.

In some situations they may conflict with VBER 330/2010 and the Guidelines.

We will look at some of them in the next slides.

PRINCIPLES ESTABLISHED IN PRONUPTIA - 1

Non-compete obligation

Compatibility with Article 101(1) of « ... *a clause prohibiting the franchisee, during the period of validity of the contract and for a reasonable period after its expiry, from opening a shop of the same or a similar nature in an area where he may compete with a member of the network ...*» (Pronuptia, § 16)

PRINCIPLES ESTABLISHED IN PRONUPTIA - 2

Obligation to sell only **in** the franchised premises

Compatibility with Article 101(1) of « ...the franchisee's obligation to sell the goods covered by the contract **only in premises** laid out and decorated according to the franchisor's instructions, which is intended to ensure uniform presentation in conformity with certain requirements» (Pronuptia, § 19)

PRINCIPLES ESTABLISHED IN PRONUPTIA - 3

Discretionary choice of the franchisee

Compatibility with Article 101(1) of « ... *the prohibition of the assignment by the franchisee of his rights and obligations under the contract without the franchisor's approval*», since this prohibition «*protects the latter's right freely to choose the franchisees, on whose business qualifications the establishment and maintenance of the network's reputation depend.*» (Pronuptia, § 20)

PRINCIPLES ESTABLISHED IN PRONUPTIA - 4

Prohibition to sell to traders outside the network is apparently implied

The Court does not deal with the issue whether the franchisee can sell to traders not belonging to the network.

Considering the context of the agreement examined by the Court it would seem that an obligation of the franchisee to sell **only to end users** from his outlet was implied and that consequently the prohibition to sell to traders not belonging to the franchising network did not even need to be mentioned.



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THE BLOCK EXEMPTION REGULATION 4987/88 -1

After Pronuptia the Commission takes control over franchising agreements through a block exemption regulation.

The Regulation **exempts all the typical clauses of franchising agreements (exclusivity, non-compete, ban on active sales outside the territory, location clause, etc.) provided that the freedom of cross-supplies is warranted and the franchisees remain free to fix their resale prices.**

There are however some important differences with respect to Pronuptia.

REGULATION 4987/88 – 2

Exempted restrictions

- Obligation on the franchisee to exploit the franchise **only from** the contract premises (and not **only in** the contract premises): Art. 2(c).
- Obligation on the franchisee to **refrain, outside the contract territory, from seeking customers** for the contractual goods or services: Art. 2(d).
- Franchisee's obligation to sell the contractual goods **only to end users**, to other franchisees and to resellers within other channels of distribution supplied by the manufacturer of these goods or with its consent: art. 3(1)(e).

REGULATION 4987/88 – 3

Requirements imposed

- The franchisee must be free to obtain the contract goods from other franchisees or other networks of authorised distributors: Art. 4(a): freedom of passive sales.
- The franchisee cannot be prohibited to supply contractual goods or services within the common market to end users because of their place of residence: Art. 5(g).
- The franchisee must be free to fix his resale prices, but resale prices may be recommended: Art. 5 (e).

REGULATION 2790/1999

One block exemption for all vertical agreements

- **Uniform rules for all vertical agreements**, without taking fully into account the differences existing between them.
- Substantial problems when the specific needs of certain categories of agreements are not considered, like in the case of franchising.
- The problem has not changed under Regulation 330/2010.

REGULATION 330/2010

Franchising under the rules for selective distribution

- Franchising is subject to the special rules on selective distribution, whenever the franchisee is prevented from selling to traders outside the network.
- This means that franchising agreements are subject to the rules on selective distribution, unless the franchisee remains free to sell the contractual goods to any trader not belonging to the franchise network.
- Most contracts do not even mention this issue which is implied by the very nature of the franchise agreement.

SELECTIVE DISTRIBUTION AND FRANCHISING

- Applying the rules for selective distribution to “selective” franchising (i.e. to almost all franchising agreements) **is not appropriate.**
- Moreover, the incorporation of franchise agreements under the rules on selective distribution has been achieved in an indirect way. Many franchisors have been (and some still are) unaware of this important change.

DIFFERENT IMPACT ON COMPETITION

- Franchising implies a much higher degree of characterisation of the outlet, which normally sells only one brand; selective distribution is normally multibrand and requires only a certain standing of the outlet.
- Within selective distribution the negative impact on competition is more important, especially in case of quantitative selection. In franchising, a closed network is required by the very nature of a system based on uniformity of the outlets and exclusive know-how.

RULES WHICH SHOULD NOT APPLY TO FRANCHISING

- Right of distributors/franchisees to sell actively and passively to end users throughout the EU.
- Prohibition to sell to non members of the network limited only to territories covered by the franchising system.
- Freedom of cross-supplies at different levels of trade.
- Post-contractual competition clause limited to one year and only to the “premises and land” from which the buyer has operated during the contract period.

APPROPRIATE RULES FOR FRANCHISING

- A prohibition of active sales in the territory of other franchisees should in principle be permitted. Only passive sales to end users should be admitted (as in Regulation 4987/88).
- Non compete clauses after the end of the contract should be admitted for longer periods than one year and with respect to the area where the former franchisee may compete with a member of the network.
- Cross-supplies should be free only between franchisees (retailers), and not between master franchisees and franchisees and franchisees.

INTERNET SALES

- The reasons which may justify a stricter control of access to internet of the franchisees (uniformity of the image of the network and of the outlets), are much stronger than in selective distribution.
- In principle an absolute prohibition to sell on the internet might be justified if the franchise concept cannot be transferred on line, but such an absolute prohibition would never be accepted by the antitrust authorities.
- Franchisors may however provide strict criteria for online sales in order to protect the image and uniformity of the network.

JOINT ACCESS TO INTERNET

The close links between members of the network may justify the creation of a joint website for the whole network.

If this is made in such a way as to involve all franchisees it might perhaps justify an agreement of the franchisees not to access directly internet .

CONCLUSION

What recommendations should we present as IDI in view of the revision of the Block Exemption ?