



International Distribution Institute

# **Limiting Access To The Internet By Franchisees: The EU v. U.S. Approach**

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Carl is a former IFA General Counsel, and IDI's U.S. Franchise Law Expert.





# E-Commerce Is Huge

- E-commerce is growing rapidly.  
3.3% of retail sales Q-1 2007—7.8% of retail sales Q-1 2016  
(U.S. Census Bureau)
- An estimated 211 million U.S. digital shoppers in 2016 out of a population of 321.4 million (Statista.com)
- U.S. online shoppers spent \$92.8 billion in Q-1 2016 (\$371.2 billion annualized) (U.S. Census Bureau)
- U.S. business format franchise turnover estimate for 2016 \$944 billion (International Franchise Association Educational Foundation, Franchise Business Economic Outlook for 2016)
- 69% of US adults shop online monthly in 2015  
33% shopped online weekly in 2015  
(Mintel's Online Shopping U.S. 2015)



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# **U.S. Federal Statutes Regulating Franchisors' Right to Restrict Franchisees' Use of Internet**



# **U.S. State Statutes Regulating Franchisors' Right to Restrict Franchisees' Use of Internet**



# **U.S. Cases Interpreting Franchisors' Right to Restrict Franchisees' Use of Internet**





## U.S. Rule

- As licensor of the brand and knowhow, the licensor may determine to whom and for what purposes it wishes to grant license rights
- Franchise/license agreements may limit where the licensed rights are used and how they are used
- Virtually every franchise agreement defines where and how a franchisee may use the Marks and System, and requires franchisor approval of uses not specifically prescribed or approved by the franchisor in the franchise agreement or manuals
- Since the inception of e-commerce in the 1990s, franchisors have generally restricted franchisees' use of the internet





- Why:
  - To control the advertising and promotional message and image of the brand
  - To avoid consumer confusion about sources of authorized products
  - To cause franchisees to focus on the rights granted to them in franchise agreements—often to serve customers at retail locations within designated territories
  - To allow franchisors to provide a unified e-commerce experience, often from online stores operated by the franchisor
  - Probably to mitigate disputes among neighboring franchisees about price advertising



- Product demonstrations in store and allowing the retailer to benefit from the investment in the facility and labor needed to do it
- Assembly or assistance with assembly or installation of products
- Ready access to warranty or other post-sale service
- Focus on developing discrete geographic markets, rather than hit or miss sales
- To justify investment in technology



# U.S. Competition Law Policy

- Interbrand, not intrabrand, competition is the focus of U.S. antitrust laws
- The law applicable to customer and territorial restraints carries forward into U.S. jurisprudence relating to the internet
- The vast majority of U.S. franchisors are small businesses, lacking market power under any recognized definition



- Estimated number of franchisors in U.S. and Canada - 4033 (Franchisor Database Breakdown, The World Franchising Network 2016)
- Franchisors with:
  - 1-5 units — 34.2%
  - 0-20 units — 51.6%
  - 0-100 units — 76.5%
  - 500+ units — 6.9%
  - 1000+ units — 3.8%



# European Union

- The Principle
  - It is forbidden to forbid the use of the internet:
    - By the franchisor even in the case of territorial exclusivity granted to the franchisee (Court of Cassation, March 14, 2006)
    - By the franchisee (EC Guidelines, May 19, 2010, pt. 52, ECJ October 13, 2011, Pierre Fabre case)
  - It is forbidden to limit the use of internet by imposing on the distributor limitations such as:
    - Higher prices for products bought to be resold through the internet
    - Limitation of the proportion of e-sales
    - Unjustified differences between on line sales and standard sales ...
    - .....

- Prohibition or limitation of using internet are « restrictions by object » (ECJ October 13, 2011) that is to say restrictions « per se » and so independantly of the franchisor's intention or of anticompetitive effect (ECJ November 20, 2008, beef industry case)
  - And could not benefit from the block exemption provided for in regulation 330/2010 and from the rule « de minimis » (EC guidelines pt. 9; FCC Art. L 464-6-2)
- However, anticompetitive restrictions have to be assessed through the « economic and legal context » (ECJ October 13, 2011)
  - And so might be exempted if the agreement meets cumulative conditions provided by TFUE Art. 101§3



**May be exempted the agreement which meets 4 cumulative conditions (art.101(3) TFUE):**

1. CONTRIBUTION TO IMPROVING THE PRODUCTION OR DISTRIBUTION OF GOODS OR TO PROMOTING TECHNICAL OR ECONOMIC PROGRESS.
  2. WHILE ALLOWING CONSUMERS A FAIR SHARE OF THE RESULTING BENEFIT.
  3. WITHOUT IMPOSING ON THE DISTRIBUTOR RESTRICTIONS WHICH ARE NOT INDISPENSABLE TO THE ATTAINMENT.
  4. WITHOUT ELIMINATING COMPETITION IN RESPECT OF A SUBSTANTIAL PART OF THE PRODUCTS.
- ✓ FRENCH COURTS STATED THAT THESE CONDITIONS WERE NOT SATISFIED IN PIERRE FABRE CASE.

# The Exceptions

- General exception
  - Permanently: product characteristics requiring specific individual and direct advice or services (EC Guidelines pt. 60, for example: dangerous products) but the aim of maintaining a prestigious image is not a legitimate aim (ECJ October 13, 2011)
  - Temporarily: new products (EC Guidelines pt. 61)



- Special exception for franchising because it is a specific contract?
  - 1) Franchise agreement is a contract transferring IPR's and especially know-how (EC Guidelines pt. 189)
  - 2) The know-how corresponds to a successful business method which the franchisee has to apply (ECJ January 26, 1986, pronuptia case)
  - 3) Success might be based on the prohibition or at least the limitation of the use of internet

However, the relevant arguments (see Carl Zwisler) based on the best consumer service and/ or a necessary focus of the franchisee on the local market have not been discussed and so accepted yet



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