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Franchising

Study for the IMCO Committee

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Franchising

STUDY

Abstract

This document was prepared by Policy Department A at the request of the Internal Market and Consumer Protection Committee.

It presents the evolution of franchising regulation in the European Union and comparative analysis of franchising regulation in selected legal systems. It identifies problems in the area of franchising and indicates the impact of the EU rules on functioning of the franchising. Recommendations indicate at a need for a profound review of market conditions in the EU and corrective legislative and regulatory actions.

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EXECUTIVE SUMMARY

1.1. General

[**Competition law impact**] The main conclusion that follows from the research is that the direct impact that **competition law** (Regulation 330/2010) **has on functioning of franchising contracts on the EU market might have an adverse effect**, when it comes to both: the development of franchising market and the relationships between the parties to a franchising contract. Within the given frame of the research, this conclusion comes from the analysis of the evolution of the EU competition policy towards franchising, as well as the interviews with stakeholders who claim to observe the requirements of 330/2010 Regulation when drafting their contracts, and the policy adopted by national courts who use the Regulation as a yardstick to establish the boundaries of the allowed content of franchising contracts.

[**The real market situation**] **Establishing the real market situation** in the area of franchising constitutes a challenge, since it is obscured by several factors:

- **The lack of market transparency**. On the basis of the methodology given for this research, it is not possible to fully verify how franchising contracts really function on the EU market. The number of court cases involving franchising is not great, generally speaking (though it varies from country to country), and there is no access to out-of-court proceedings. Even national agencies responsible for applying the Regulation have no real record of the practical issues, since the application of the block exemption relies on self-assessment.
- **A fear factor on the part of franchisees**. The lack of cases can be (at least partially) explained by the fear factor on the part of the franchisees. This is a well-recognised phenomena signalised in the unfair commercial practices context. Franchisees, being very often dependent on franchisors, are afraid that defending their rights will lead to the termination of the legal relationship with franchisors, so they refrain from defending their own rights. The cases are mostly initiated when the franchisees have nothing to lose (i.e. when the contractual relationship is over).
- **The lack of balanced representation of the parties**. There is a clear disparity between the representation of the franchisors (well-established and functioning) and the representation of franchisees (non-existent in the EU context). This impedes obtaining and verifying data on the functioning of the market. This also necessitates weighting the opinions present on the market and creates challenges when it comes to introducing and evaluating self-regulation.
- **Various stages of development on the national markets**: The development of franchising started in the “old” Member States back in the 1970s. The “new” Member States became familiar with the phenomena at least 20 years later. It seems that this gap in the stages of the market development has not yet closed, and that the markets of new and old Member States might be facing different challenges. This means that it is difficult to say whether, and to what degree, the observed market tendencies are characteristic of the EU market in general.

1.2. EU regulatory franchising framework

[**Evolution of EU franchising model**] Initially, EU law approached franchising as a distinct business model. It focused on specific features, i.e. the conditions necessary to make the franchising system operational: the need to protect the know-how and the need to uphold the network’s identity. This approach was established by the Court of Justice of the European Union in the Pronupia judgement, and continued in a series of Commission

decisions in franchising cases as well as in Regulation 4087/88, which dealt exclusively with franchising contracts.

Together with the reform of the EU competition policy towards vertical restraints, EU law began to treat franchising as one type of selective distribution system, and the specificity of franchising was, to a large extent, lost. This is the approach adopted in Regulations 2790/1999 and 330/2010. As a result, franchising is no longer given a "preferential treatment" (as the Commission called it), and is nowadays seen as an exclusive distribution with some extra IPR issues.

1.3. Regulation 330/2010 at a national level

[**Shortage of data**] In general, there is little information available on the functioning of Regulation 330/2010 in the franchising context at a national level. The self-assessment of the applicability of the block exemption means that the potential problems arising on the basis of the Regulation do not reach official instances.

[**Specific clauses**] When it comes to specific clauses – long-term competition clauses, purchase options, multi-franchising, and block exemptions – the research revealed case law only with regards to two of them. First, in Belgium and in the Netherlands the long-term competition clauses are probably the most frequent subject of court cases. Second, purchase options occasionally surface in the Belgian court practice.

The lack of data on the functioning of the Regulation in practice cannot, however, be seen as confirmation that the Regulation does not cause any problems, in particular that it does not impact the franchising market in an unintended way. It might be assumed that the potential side effects of the Regulation remain undetected.

[**Last resort weapon**] It is worth stressing that there is a visible tendency in Belgium and in the Netherlands to invoke the Regulation as a "last resort weapon" by franchisees wanting to free themselves from franchising contracts. It seems, however, that those attempts are mostly unsuccessful, based on the procedural problems the franchises face in proving their cases.

[**Self-assessment and accessibility**] The application of the Regulation is based on self-assessment. It means that the parties to a franchising contract must decide themselves whether or not they fall under the scope of application of the Regulation. However, the Regulation is formulated in a complicated way that makes it very difficult to understand even for a trained lawyer. This problem came up often during the discussions with the industry.

1.4. National franchising regulation

[Specific national legislation] Specific national regulation of franchising contracts exists **in several legal systems** from among those researched. The most comprehensive rules are present in Romania, where the legislation follows the Code of Ethics of the European Franchising Federation, and in Italy, where the rules are (at least partially) inspired by European legislation. Estonia provides less elaborated rules contained in the Civil Code, whereas Spain and Belgium focus on pre-contractual information duties. In Belgium there are additional rules applicable on termination. In **France, Germany**, **the Netherlands** there is established case law in the area of franchising, and additionally in the Netherlands a new self-regulation was adopted very recently. Only in **Poland no franchising-specific rules** is accompanied by a shortage in terms of case law.

[**Content of national rules**] If a legal system has rules on franchising, the rules usually contain **pre-contractual obligations aimed at protecting the franchisee,** very often

accompanied with **rules on termination**. In several legal systems also rules on the **content of the contract** are provided. Franchising is typically qualified as an innominative contract, even in legal systems where there are franchising rules. In systems with no specific franchising regulation, general contract rules apply.

[**Unfairness control**] All the researched legal systems **have certain measures** for **unfairness control** in franchising contracts. Italy, Estonia, France, Germany, the Netherlands, Spain and Romania simply allow **judicial control of unfairness**, sometimes subject to specific restrictions, coming from the professional character of the franchising relation. In Belgium and in Poland there is no unfairness control as such, though in Belgium all agreements must be executed "in good faith", and in Poland the potential control of franchising contract is given through the application of general clauses (but not frequently invoked by courts). At a national level, the content of vertical restraints allowed by 330/2010 Regulation construes the limits of the unfairness control and establishes the standards for the accepted business behaviour.

[**Typical national problems**] Problems characteristic for most of the legal systems include the **pre-contractual information** duties of the franchisor, the non-compliance of the franchisee with its **post-contractual non-compete** clause, and the grounds and consequences of **terminating** franchising contracts. Common problems (to some degree) are: the extent of **know-how** and **assistance** that the franchisor has to provide and the **definition of franchising**. Additional **problems specific for** given legal system appear in **Belgium, Germany** and **Spain.** In Estonia and in Poland it is difficult to define typical problems that the parties experience in practice.

1.5. Conclusions (the questions of the European Parliament)

The Parliament formulated several specific questions concerning franchising. The answers to these can be summarised in the following way:

1) **Does EU Regulation No 330/2010 need any adjustments concerning long-term competition clauses, purchase options, multi-franchising or block exemptions?**

The outcome of the research suggests that Regulation 330/2010 needs an adjustment even in the scope exceeding the clauses mentioned in the question. Establishing the concrete scope of the adjustments, however, requires further field studies on the market.

From a competition policy point of view (an economic analysis of the market required), one should establish whether the market development still needs such support as provided by the Regulation, and (if so) whether (1) the contents of the current vertical restraints are effective, proportional, and up-to-date considering the recent market developments; and (2) the model of the franchising contract adopted by Regulation 330/2010 reflects the market reality (franchising as one type of distribution contract).

From the perspective of the relations between the parties of franchising contract, the answer relates to establishing whether the adverse effect (the impact that the exempted vertical restraints have on the content of franchising contracts) is proportional, when compared to the market advancement they allow. In this respect, the materials gathered during the research suggest some of the problems encountered on the franchising market have their roots in the content of the Regulation, in particular the problems stemming from the exempted post-contractual clauses, or purchasing obligations.

,However, the problems relating to the long-term competition clauses, purchase options, multi-franchising and block exemptions not exhaust the list of problems observed on the franchising market. The problems relating to the lack of balance between the parties to a franchising contract (which Regulation 330/2010 strengthens, so it has an indirect effect also in these areas), remain outside the interest of the EU at the moment. The research revealed that national legal systems have begun to react normatively to the problems that can be observed there. This means that quite a paradoxical situation exists at the moment in the franchising area: the EU is using competition law tools in an attempt to eliminate the barriers hindering market development, turning a blind eye on the contractual repercussions of the introduced rules (presumably to accelerate the process). At the same time, the Member States are reacting to the problems encountered in the contractual dimension of franchising (which are fortified by the EU competition law instruments), and are introducing laws that are supposed to (generally speaking) support the position of the franchisee, creating market barriers for the franchisors. What is clearly missing at the EU level is the wider perspective on EU competition law that would take into account not only the direct market related effects of the introduced rules, but also the less visible indirect consequences that appear at national level. Here, new market barriers can appear, which are inspired (even if only indirectly) by EU law.

2) Does existing EU legislation simply need better enforcement?

While effective enforcement is a key aspect of any legislation, limiting the necessary changes to bettering enforcement would amount to lightening the problems encountered on the franchising market. That being said, two observations in this area can be made. First, the enforcement in case of EU franchising rules is characterised by an automatic application of the exempted restraints (application of the exempted restrains without verification whether or not they are necessary in a given case). Second, proper enforcement will always constitute an issue for contractual relationships with a high level of fear factor (and franchising contracts constitute a prime example of such relations). Therefore, specific actions should be undertaken to mitigate the effects of the fear factor (first of all, institutional support to self-organisation of franchisees).

3) Could possible European solutions be found in self-regulatory initiatives such as the European Franchise Code of Ethics, or an improved reporting or complaint system (e.g. using SOLVIT, Your Europe or another appropriate general or dedicated tool)?

The self-regulatory initiatives can undoubtedly benefit the market and its organisation. However, for constructing a proper self-regulation model, certain requirements must be met. One of the most important is equal and independent representation of the interested parties. This condition is not met at present on the EU franchising market. In order to rectify this, an action supporting self-organisation of franchisees is required. On the other hand, an improved reporting or complaint system would definitely be beneficial, as it could allow information to be gathered about the market situation.

4) **What are the current systems in place at a European level regarding cross-border cooperation and the exchange of best-practices in the field of franchising? Would additional action, e.g. the introduction of a new EU instrument be necessary?**

The only functioning system is organised by the European Franchising Federation, around the European Franchise Code of Ethics. This is absolutely not adequate, considering the role that franchising already plays on the EU market and the potential it carries for market development. What is definitely lacking is the cooperation and self-organisation of franchisees, at both a national and EU level. Any initiative in this regards should be strongly supported.

1.6. Recommendations

If the Parliament would consider taking further steps in the area of the EU franchising market, the following recommendations can be given:

(1) Better balance in representation

The research clearly showed that the franchising market suffers from **a lack of balance in the representation** of the parties to the franchising contract. **The franchisors have a well-organised net of organisations** at national, EU and world level. These organisations are very active and effective in representing and protecting the interests of franchisors. This is certainly an important and positive aspect of the market (self) organisation. However, these actions are very often presented as industry initiatives, whereas they seem to be driven by the franchisors. On the other hand, **franchisees are underrepresented**. A franchisee is normally a small business that lacks resources (in terms of both time and money) to become engaged in any extra activities (even self-representation). However, if the voice of the franchisees is not heard properly and on an equal footing with the voice of the franchisors, there can be no attempt at self-regulation.

Only balanced representation of the parties can ensure that self-regulation will consider the interest of the parties in an unbiased way (it would be utterly naive to believe in the altruistic behaviour of strong market players). In the situation of unbalanced representation, even the public consultation of hard law solutions is biased (the franchisors present their view, whereas the franchisees present no view). Therefore, actions should be taken promptly to strengthen the impact of the franchisee organisations and assure a proper institutional role for them in the EU law making process.

(2) The content of contracts

The main challenge in preparing this report was the inaccessibility of the franchising contract content. Any action undertaken without first first confirming the types of problems that normally occur in practice will be based only on “declaratory evidence” provided by the interested parties. To gather the necessary data, the Parliament could:

1) demand the European Commission to open a contact point that would allow anonymous information on the problems encountered by the franchisees in their business relations, e.g. through Your Europe
2) organise a collection of information on the content of contracts after the bankruptcy of the franchisee.

(3) The competition law impact

Gathering information on the content of franchising contracts should also allow an evaluation of **how deep the competition law solutions impact private law relations** in the area of franchising. Competition law pursues its specific market-oriented aims, but the impact of competition law goes deeper than shaping the market functioning. Cases decided in Germany, the Netherlands and Spain prove that national courts use competition law as a yardstick to decide what is and what is not allowed in private law relations (it follows the line of thinking that: if competition law allows it, private law must accept it).

(4) Verifying the correctness and effectiveness of competition law solutions in the franchising area

Last, but not least, two issues require verification in light of the need to prepare a new block exemption regulation.

1) Whether the model of franchising, as adopted by Regulation 330/2010 answers the needs of the franchising market;

Box 1: Verifying the adopted franchising model

Franchising has been present in EU competition law for almost four decades. Within this period, the competition law approach towards franchising has evolved substantially. At the beginning (the Pronupia case), **franchising was seen as a self-standing, distinct business method** with specific characteristics that clearly distinguished it from other forms of business cooperation. As such, franchising required a specific approach that would allow it to maintain its character. This attitude was continued in a series of the Commission's decisions and Regulation 4087/88. **With the new approach of the Commission towards widely understood distribution contract (as in Regulations 2790/1999 and 330/2010), franchising was put into one basket with all other methods of distribution between the business parties**. It was reduced to an exclusive distribution with some IPR issues. The change of approach was not explained by the Commission (the Action Plan simply stated that the approach had changed, but did not explain the reasons for aligning franchising with other methods of distribution and its consequences).

The results of the research do not allow an evaluation of whether the franchising model adopted by EU law reflects the market practice (due to the lack of transparency and the methodology used). Undoubtedly, this aspect requires further analysis, for which one must first establish market practice. The question is whether franchising has really lost its distinctive features to a degree that it is no different from other distribution contracts, and whether a uniform approach is appropriate. **The Commission has so far presented no convincing argumentation in this regard**.

2) Whether the content of exempted vertical restraints is proportional, adequate, and up-to-date, taking into account the stage of development of the franchising market in EU, and the digitalisation of trade.

3)

Box 2: Exempted vertical restraints

Discussions with franchisees and franchisors revealed that there is quite a **fundamental difference between them when it comes to evaluating the content of the exempted vertical restraints**. While the franchisors praise the content of the Regulation, the franchisees accuse it of not only further strengthening the position of franchisors against franchisees, but also restricting the entrepreneurial spirit of franchisees, which in turn translates to "freezing" market development instead of accelerating it.

The content of vertical restraints has not changed substantially since the adoption of Regulation 2790/1999. This provokes the question whether the once exempted restraints remain effective and proportional in the present market situation. This refers not to the impact of the restraints on private law relations, but on the market – i.e. the primary target of competition law. In addition, the question appears whether the Regulation (and the Guidelines) takes into account in an appropriate manner the new market developments that refer to the digitalisation of trade (the Internet) and the use of big data.

Also, **the EU competition policy** that aims at removing market barriers, supports franchisors and turns a blind eye on the consequences in brings about at the national level, where Member States introduce rules that aim at protecting franchisees. In other words, **while removing one type of barriers**, it **creates others** (there is no such thing as a free lunch). This aspect, i.e. the private law consequences of the competition law solutions should be taken into account during legislative works in the future.

(5) Possible further actions

The outcome of the research suggests several measures that would allow the problems revealed in the legal and social environment of franchising in the EU to be addressed. The recommended actions can be undertaken together, or separately (to address specific issues).

[Parliament resolution] The Parliament could call upon the Commission with a resolution:

- With the intention of **ensuring that retail market legislation is more thoroughly evidence-based**, particularly as regards the need to adequately examine and understand the impact of legislation on small businesses, as advocated by the

Parliament in the Resolution on a more efficient and fairer retail market of 25 May 2011 (2010/2109(INI)

a) to set up an **online complaint channel** (e.g. through Your Europe) that would allow complaints to be filed concerning the use of unfair trade practices in franchising contracts;
b) to **start public consultations** with a view to: correcting the model on which the future block exemption regulation is based; establishing the concept of a franchising contract to be used in any future EU legislation; and establishing a need for possible action in the area of private law.

- With a view to **facilitating the self-assessment process** of any future regulation: since the application of the regulation is primarily based on self-assessment, the regulation must be drafted in a way that takes this into consideration. It should be easy for the businesses that apply it to understand which contractual terms and practices are allowed, and which are prohibited. In this context, creating a list could be considered.
- With a view to **ensuring a balanced representation of the parties to franchising contracts**: to take action to strengthen the self-organisation of franchisees at the EU and national level, in order to grant franchisees equal access to the public debate on franchising and establish a level playing field for any future self-regulatory action.
- With a view to **correcting market failures in relations between franchisors**, through legislative action, either in by tackling unfair trading practices or by better regulating retail, contract law or/and competition law.

[Further actions, subject to the outcome of the consultations] The information gathered through the complaint channel and the public consultation should allow the **verification of the franchising market practices**. The following issues should be addressed in light of the established findings:

- **Regarding the regulation in force at the moment**: the possible adjustment of the guidelines accompanying Regulation 330/2010 with a view to making it more up-to-date with the current technological advancements (the Internet) and market developments (for example: the relation between franchising and exclusive distribution);
- **Regarding any future regulation**: (1) verifying the impact that the horizontal approach adopted in Regulation 330/2010 has on the functioning of franchising; (2) testing whether the franchising model adopted by the present regulation reflects the market reality, and correcting it if necessary; (3) assessing the effectiveness and proportionality of the allowed vertical restraints, taking into account also the fact that they directly impact the franchising market by establishing market standards; (4) establishing a list of issues that should be addressed in the new guidelines.

[Possible private law instrument] In light of the findings relating to the franchising market practice, the possibility of adopting a private law regulation dealing with certain aspects of franchising contract at the EU level could also be considered.

[Workshop] In addition, to initiate a debate, the Parliament could organise a workshop to discuss the results of the research, and open up the debate among the stakeholders. Any such event should ensure the proper representation of the franchisees and franchisors.

2. GENERAL INFORMATION: RESEARCH CHALLENGES AND METHODOLOGY

KEY FINDINGS

- The direct impact that competition law (Regulation 330/2010) has on the functioning of franchising contracts on the EU market might have an adverse effect when it comes to both: the development of the franchising market and the relationship between the parties.
- The most significant challenge to researching the EU franchising market lies in establishing the real situation on the market, which is obscured by several factors: the lack of market transparency, the lack of a balanced representation of the parties, a fear factor on the part of franchisees, and different phases of development on the national markets.
- Franchising contains features that distinguish it from other contracts between professionals. It includes provisions that are counter to the normal behaviour of traders on the market: the franchisor discloses its trade secrets to the other party, while the franchisee gives up part (sometimes a major part) of its entrepreneurial freedom. In addition, the franchisor is normally in a structurally stronger position as compared with the franchisee, which means that the concurrence of the relations between the parties is atypical and unusually complicated.
- Research into franchising market should focus on establishing how, why and to what result the competition rules set standards in private law relations. In order to achieve this, a proper methodological approach as well as a clear recognition of its limits are necessary.

2.1. Franchising – what is it?

Franchising is not officially defined under EU law.[1] There are, however, certain indicators, about what is understood as a franchising contract.

In the Pronupia case[2] (the only case decided by the Court of Justice of the European Union that dealt with franchising), the Court analysed the functioning of the distribution franchising and described it as a system whereby the franchisor grants independent traders, for a fee, the right to establish themselves in other markets using its business name and the business methods that have made it successful. The Court stressed that this is rather a method for deriving financial benefit from one's expertise without investing its own capital, rather than a method of distribution. Distribution franchising, as the Court said, gives traders who do not have the necessary experience access to methods that they could not have learned without considerable effort, allowing them to benefit from the reputation of the franchisor's business name. As a system that allows the franchisor to profit from his success, franchising does not in itself interfere with competition.

The Court further distinguished among: (1) service franchises, where the franchisee offers a service under the business name or symbol and sometimes the trademark of the franchisor, in accordance with the franchisor's instructions; (2) production franchises, under which the franchisee manufactures products according to the instructions of the franchisor and sells them under the franchisor's trade mark; and (3) distribution franchises,

[1] One should distinguish here between franchising as a business model and franchising as a contract.
[2] Case 161/84 of 28 January 1986, Pronuptia de Paris GmbH (Frankfurt am Main) and Pronuptia de Paris Irmgard Schillgalis (Hamburg), European Court reports 1986, p. 00353.

under which the franchisee simply sells certain products in a shop bearing the franchisor's business name or symbol. EU law is mostly concerned with distribution franchising, although, in its decision of 20 August 1988 in the ServiceMaster case,[3] the Commission took a position that, despite the existence of specific matters, service franchises show strong similarities to distribution franchises and can therefore be treated in basically the same way as distribution franchises (already exempted by the Commission).

The Guidelines issued by the European Commission,[4] which accompany the present block exemption Regulation (Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on functioning of the European Union to categories of vertical agreements and concerned practices[5]), give a description rather a definition of the franchising contract. They state, in paragraph 189, that franchising agreements contain primarily 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, the franchisor usually provides the franchisee with commercial or technical assistance for the duration of the agreement. The licence and the assistance are integral components of the franchised business method. The franchisor is, in general, paid a franchise fee by the franchisee for the use of a particular business method. Franchising may enable the franchisor to establish, with limited investment, 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 various vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete, and/or exclusive distribution or weaker forms thereof.

One definition of franchising (albeit not an official one) can also be found in the European Code of Ethics for Franchising, created by the European Franchising Federation. In its Article 1 it defines franchising as a system of marketing goods and/or services and/or technology, 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 franchisee the right, and imposes the obligation, to conduct the 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 trade mark and /or service mark, know-how, business and technical methods, procedural system, and other industrial and /or intellectual property rights, supported by the continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement concluded between parties for this purpose.

2.2. Distinctive features of the franchising contract

Franchising is, by its nature, a contract concluded by two professional parties. It is characterised by a particularly complicated structure of (inter)dependence relations existing between the parties that exceeds the typical structure of a B2B contract.

Unlike other contracts between professionals, it contains provisions that are counter to the normal behaviour of traders on the market. On the one hand, the franchisor discloses its trade secrets (the formula that made it successful) to the other party, whereas businesses are not normally willing to share such know-how with their potential competitors. On the other hand, the franchisee gives up part (sometimes a major part) of its entrepreneurial independence. This was recognised by the Court of Justice, which stated in the Pronupia case that two conditions must be met for the franchising system to work. First, the

[3] OJ EEC L 332/38 of 3 December 1988.
[4] Commission notice - Guidelines on Vertical Restraints, Official Journal C 130, 19.05.2010.
[5] OJ L 102, 23.4.2010.

franchisor must be able to communicate its know-how to the franchisees and provide them with necessary assistance in order to enable them to apply its method, without running the risk that the know-how and assistance will benefit competitors, even indirectly. Second, the franchisor must be able to take the measures necessary to maintain the identity and reputation of the network bearing its business name or symbol. This means that the parties to a franchising contract are mutually vulnerable towards each other: the franchisor faces the danger of losing the secrecy of its formula for success, whereas the franchisee loses its independence when it comes to making business decisions.

In addition, the franchisor is usually in a structurally stronger position as compared with the franchisee. This, however, is typical for other B2B contracts where only one of the parties is normally in possession of capital, experience and a network. This aspect of the franchising contract, however, remains outside the scope of interest of EU law at present. Moreover, EU law aims at deriving marked-oriented benefits from the imbalanced structure of the franchising relation, as it strengthens the position of the franchisor over the franchisee, in order to accelerate market penetration of the franchising networks.

The problem of the structural imbalance is tackled at a national level, although not in all legal systems under scrutiny (see chapters V and VI in this regards). Some systems have decided to introduce specific laws that would take the interests of the franchisees into account (mostly focusing on the pre-contractual disclosure duties). Almost all the researched legal systems allow for unfairness control when it comes to the franchising contract. However, the limits of this control are "remote controlled" by the EU competition rules, which favour the franchisors.

2.3. Advantages of franchising

Franchising as a business model offers specific advantages, not only to the parties that decide to either open or join a franchising network, but it also increases market standards to the benefit of consumers.

The advantages of franchising were very accurately described by Philip Mark Abell in "The regulation of Franchising in the European Union."[6] He stresses that franchising stimulates economic activity by improving the distribution of goods and/or the provision of services, as it gives franchisors the possibility of establishing a uniform network with limited investments. This may assist the entry of new competitors in the markets, particularly in the case of SMEs. Further, it allows independent traders (franchisees) to set up outlets more rapidly and with a higher chance of success than if they were to set up without the franchisor's experience and assistance. Franchisors, therefore, have a better opportunity to compete with larger distribution undertakings.

Abel also refers to the argumentation used by the Court of Justice in the Pronupia case, stressing that franchising generally allows consumers and other end users a fair share of the resulting benefits as they combine the advantage of a uniform network with the existence of traders personally interested in the efficient operation of their business. The homogeneity of the network and the constant co-operation between the franchisor and the franchisees ensures the constant quality of the products and services. One favourable effect of franchising on inter-brand competition and the fact that consumers are free to deal with any franchisee in the network guarantees that a reasonable part of the resulting

[6] Abell, The Regulation of Franchising in the European Union, PhD defended at the University of London, 4 July, 2011, p. 40.

benefits will be passed on to consumers.

According to Abel, franchising can also contribute to the establishment of a unified European Market:[7] it facilitates cross-frontier development as it is based on the leverage that an established name or idea can give a relatively small investment to enable the product or service involved to spread quickly, far and wide. Moreover, the combination of a franchisor's know-how and a franchisee's enterprise can boost economic activity and employment, while enlarging the range of goods and services on offer to the public. Franchising makes products and services available to a wide public and does not stop at national frontiers policymaking within the EU.

2.4. Franchising on the EU market

Franchising, as a business method, seems to be firmly established in the European Union. It is therefore quite remarkable that the available economic data regarding franchising is far from comprehensive. This view was also expressed by Abell, who conducted his research between 2008 and 2011.[8] According to the statistics of the European Franchise Federation, in 2009 the EU-17 Member States had more than 10,000 franchise brands They represented 10.8% of the share of employment among small and medium sized-enterprises (SMEs). In 2014, there were 11,512 franchising brands present in 19 member states.

Table 1: Number of franchising systems in Europe

Country	2007	2008	2009	2010	2011	2012	2013	2014 Est.
Austria	390	411	435	420	440	445		*445*
Belgium	200	240	320	360	350			*350*
Croatia	120	145	150	168	175	180	180	*180*
Czech Rep	131	137		150	168	200	219	*219*
Denmark	180	185	188	188	188			*188*
Finland	220	255	265	270	270	275	277	*294*
France	1137	1129	1169	1477	1569	1658	1719	*1796*
Germany	910	950	960	980	990			*990*
Greece	544	560	563	450	456			*456*
Hungary	330	350	350	361	361			*361*
Italy	847	852	869	883	878	938	939	*939*

[7] Ibidem, p. 40.
[8] Ibidem, p. 41.

Netherlands	676	687	692	714	739	769		*769*
Poland	402	512	618	739	805	864	930	*930*
Portugal	501	521	524	570	578			*578*
Slovakia					80			*80*
Slovenia	103	106	107	103	106	108		*108*
Spain	850	875	919	934	947			*1199*
Sweden	350	400	550	640	700			*700*
Switzerland			275	275	275			*275*
Turkey				1669	1708	1860	1840	*1840*
UK	809	838	845	900	929		930	*930*
TOTAL				12251	12712			*13627*

Source: European Franchising Federation.

Abell presents in his thesis an estimated value of the EU franchising market (claiming that it is not possible to state the precise data). Using three different methodologies he arrives at a figure in the middle of the range between US$ 333.6 billion and US$ 250 billion for the likely turnover of franchising in the EU during 2009. From this he deduces that the turnover in the EU in 2009 can reasonably be estimated at around US$ 300 billion or 215 billion EURO.[9]

2.5. Retail sector and franchising

The importance of the retail market for the single market can hardly be overestimated, as the European Parliament stressed in the Resolution on the European Action Plan of 11 December 2013 (2013/2093 (INI) – further: the 2013 Resolution). It represents 11% of EU GDP and delivers more than 15% of all jobs in Europe, including both skilled and unskilled labour, contributing to the social fabric of society. The retail sector, therefore, has the strategic importance as a driver for growth, employment, competitiveness and innovation, as well as for the strengthening of the European single market.

The European Parliament called on the EU institutions to give the highest political prominence to the retail sector, as a pillar of the Single Market Act and a vehicle for restoring public confidence in the single market back in 2011 (Resolution on a more efficient and fairer retail market of 25 May 2011 (2010/2109(INI) – further: the 2011 Resolution). The Parliament stressed that restrictive national rules, divergent interpretations and inadequate enforcement impede the free movement of goods and services in the EU, while requirements for extra tests and registrations, the non-recognition of certificates and standards, territorial supply constraints and similar measures create extra costs for consumers and retailers, in particular SMEs, thereby limiting the potential

[9] Ibidem pp. 42-48.

usefulness of the single market to European citizens and the business world. In the 2013 Resolution, the Parliament called on the Commission and Member States to give the highest political prominence to the retail sector as a pillar of the Single Market, and to lift regulatory, administrative and practical obstacles hampering the start-up of businesses, development and continuity, and making it difficult for retailers to fully benefit from the internal market.

Franchising as a business model clearly contributes to the development and strengthening the single market. As stated by Abell,[10] according to the 2010 NatWest/BFA Franchise Survey, franchising contributed £11.8 billion to the UK's GDP in 2009, an increase of £400 million from 2008, and nine out of ten franchise businesses were profitable. In 2009, the total 2009 turnover of franchising in Germany was €48 billion, according to the EFF statistics. A report in January 2008 by Deutsche Bank stated that the sector had tripled its nominal turnover in the ten preceding years. By comparison, Germany's nominal GDP has only grown by 25% over the same period. As a result, the franchising share of GDP increased by nearly 1% to 1.6% between 1996 and 2006. Deutsche Bank also reported that, between 1996 and 2006, the number of people working in the sector had nearly doubled. The 2008 total turnover of franchising in France was €47.6 billion. The number of franchise networks in France has doubled over the past ten years, with steady growth of 8-10% over the last four years (data for 2008).

The European Parliament has also recognised the importance of franchising for the single market and the retail sector. In the 2011 Resolution, the Parliament emphasised that franchising is a good formula for independent retailers to survive in a highly competitive environment, noting with concern that contracts for retailers to be part of a franchise are becoming more and more rigorous. In the 2013 Resolution, the Parliament continued that franchising constitutes a business model that supports new business and small-business ownership. However, it noted the existence of unfair contract terms in certain cases and called for transparent and fair contracts. Moreover, the Parliament drew the attention of the Commission and the Member States to the problems faced by franchisees who wish to sell their business or change their business formula, while remaining active in the same sector. The Parliament requested the Commission to examine the ban on price-fixing mechanisms in franchise systems and the effects of long-term competition clauses, purchase options and the prohibition of multi-franchising, and to reconsider in this respect the current exemption from competition rules for contracting parties having a market share of less than 30 %.

2.6. Implication of franchising regulation for the single market and for consumers

Franchising, as a business formula that allows for the rapid acquisition of new markets with limited investments (as compared to other methods) and an increased chance of success constitutes an important building block of the single market. From the point of view of consumers, franchising has great potential of offering them a fair share of the resulting benefits, as it combines the advantage of a uniform network with the existence of traders personally interested in the efficient operation of their business. The homogeneity of the network, and the constant co-operation between the franchisor and the franchisees, ensures the constant quality of the products and services. It also facilitates cross-frontier development and can boost economic activity and employment.

The present (very limited) EU regulation that applies to franchising claims to take all the positive aspects of franchising into consideration. However, it approaches franchising as

[10] Ibidem, pp. 41-42.

any other form of distribution, without paying attention to the specific characteristics of franchising. In addition, the 330/2010 Regulation gives support to the franchisor, allowing the more efficient acquisition of new markets. At a national level, an opposite tendency can be seen – i.e. there are either legislative interventions, or case law is being established that aim to give some support to the franchisee. Therefore, the 330/2010 Regulation aim to increase cross-border trade seems to be contributing to new legal barriers being established that may actually prevent increased cross-border activities of European companies. It is worth noting here Abell's claims that, comparing the level of franchising activity in the US and in Australia, franchising is underdeveloped in the EU, and that this is in part due to the regulatory environment.[11]

When it comes to the implications of the existing regulation for consumers, it seems that the very traditional approach is present in the case of franchising: i.e. consumers are seen as the ultimate beneficiaries of a well-functioning single market.

2.7. The impact of competition law on private law relations

The way that franchising is dealt with at an EU level, even though the regulation is limited to competition law, has a profound impact on the functioning of franchising agreements – both in national and EU contexts. Competition law pursues specific aims (improving market functioning and efficiency), with the help of specific instruments (EU regulation, enforced by cooperation from the EU and national agencies) and its success is measured in the market's progress. At the same time, competition law heavily impacts the content of cooperation schemes between the parties to franchising contracts.

The equation: actions that support the development of the market on the one hand, while strengthening the lack of balance between the parties on the other, constitutes the crux of the problem in light of the research questions pursued in this report. The main aim of regulating franchising through competition law tools is to allow the rapid acquisition of new markets via establishing new franchise networks and extending the existing ones. Therefore, competition law supports the structurally stronger party to a franchising contract, i.e. the franchisor. The effect of such actions is that the position of the franchisor (the stronger party) becomes even stronger towards the franchisee. This may lead to a situation where the position of franchisees is comparable to the position of a consumer,[12] and the question may appear whether consumer protection should be provided only to end-users, or whether it should be extended to all cases of contracts, where a structurally weaker party is involved. However, an automatic recourse to consumer law is not the answer, as franchising contracts are concluded by professional parties in order to pursue business goals. The automatic application of consumer protection tools may therefore not fit the nature of their relations.

EU law does not provide other directions than Regulation 330/2010 (accompanied by the Guidelines issued by the Commission) to answer the question of how the relationships between the parties of the franchising contract should look. Moreover, the content of Regulation 330/2010 sets limits to the control of the content of such relations, exercised at the national level by application of the unfairness standards. National courts apply Regulation 330/2010 as a yardstick to establish what should be seen as fair behaviour of the franchising parties (normally the franchisor). This aspect of the influence exerted by the Regulation was not considered at the EU level when discussing the content of the Regulation.

[11] Ibidem, p. 22.

[12] See for example: Atwell, The Franchisee as a Consumer: Determining the Optimal Duration of Pre – Contractual Disclosure, Journal of Consumer Policy, December 2015, vol. 38 (4), pp 457 – 489.

2.8. Establishing the real situation on the franchising market

2.8.1. The aim of the report and the available materials

The aim of this report, as formulated by the IMCO, was to establish the impact that Regulation 330/2010 has on the functioning of the EU franchising market (question 1: the effect of existing EU-legislation on the well-functioning/malfunctioning in the area of franchise). By setting this perspective, the IMCO directed the study to a field that so far was largely abandoned in the scientific research, i.e. to analysing the impact that EU competition law has on the parties' behaviour and the application of the national private law solutions at the level of the Member States.

Unfortunately, the available scientific works in the franchise area deal only with one of the two: they either analyse the competition law solutions (for example: D.A. Schmitz, A.V. Hamme, "Franchising in Europe: The First Practical EEC Guidelines" 22 International Business Law 717, 32, 1988, L. Ritter, F. Rawlinson and D. Braun, European Competition Law: a Practitioners Guide, 2nd edition Kluwer Law International pp 263-2000 278, V. Korah, An Introductory Guide to EEC Competition Law and Practice, Oxford: ESC publishing (4th ed) 1990, and V. Korah, "The New Vertical Restraints Block Exemption", Intereconomics, Vol. 37. Number 1, 4-11, DOI: 101007/BF02927395, 2002), or try to answer the question whether the introduction of a legislative solution is necessary at the EU level: Principles of European Law, Commercial Agency, Franchise and Distribution by. M. Hasselink, J.W. Rutgers, O. Bueno Diaz, M. Scotton, M. Veldman, Sellier 2006, or The Law and Regulation of Franchising in the EU by P. M. Abell published in 2013. Moreover, there is plenty of schematic information available on the Internet concerning requirements set by particular legal systems for the potential franchisees. There is, however, no analysis available as to the interaction between the national private law and EU competition law that would focus on the EU competition law impact. This subject has also been abandoned in the official EU legislative process.

2.8.2. The challenges of preparing the report

Considering the lack of ready available data, as well as the time and methodology related research restraints, the greatest challenge of this research was to establish what the situation is really on the EU franchising market. Recourse to the classical legal methodology would not bring about any real answers, since the specific characteristics of the franchising market did not allow the identification of the problem areas. There are several reasons for this: the franchising market is not transparent (no access to the content of contracts), which is related to the fear factor on the side of franchisees, the representation of parties to a franchising contract is not balanced, there is no "typical" franchising contract, and last but not least national markets seem to be at different stages of development.

- **Lack of transparency**

The franchising market lacks transparency. This is due to several reasons. First of all, access to the real content of franchising contracts is very limited. The members of franchisor associations, e.g. the national members of the European Franchise Federation, are bound to observe the terms of the Code of Ethics, which gives indications when it comes to certain aspects of franchising contracts. However, the national associations do not represent all franchisors functioning on the market. In 2009, the European Franchising Federation estimated that there were 9,971 franchise brands in Europe, of which the EFF and its national associations represented less than 1,577 franchised brands.[13] As Abell states, this is less than 16% of the franchises in the EU,[14] which means that 8,300 brands

[13] www.eff-franchise.com.
[14] Abell, p. 119.

remains outside of self-regulated structures. Information about the content of contracts outside of the organisations is very limited.

In addition, the number of court cases, although it varies from country to country, is generally speaking not considerable. When analysing the collected cases, one should remember that, although they indicate certain market tendencies, they do not have to reflect the franchising market reality, considering that the franchisees' behaviour is impacted by the fear factor (on that see the bullet point below). In addition, there is no access to the outcome of confidential (by their nature) out-of-court dispute resolution schemes.

This problem became evident when confronting the national reports with the information collected via interviews with the representatives of professional organisations and of the industry itself. The representatives of the franchisors unanimously claim that there are no problems on the market other than stemming from the poor performance of the franchisees, and that the present regulatory framework is optimal. The EFF says, moreover, that there might be problems on food distribution markets from the specific characteristics of this market. They see the relatively low number of court cases as proof of a lack of problems. Franchisees, on the other hand, claim that there are numerous problems that specifically relate to franchising relations, but that these remain largely unreported as a result of the dependency of the franchisees on the goodwill of the franchisors. The franchisees also emphasise that the position of franchisors is further strengthened by the content of Regulation 330/2010, which not only puts the franchisees at a disadvantage, but also fails to address the current market reality in terms of the market organisation and phenomena relating to Internet use.

- **The fear factor**

Establishing the real situation on the market is also obscured by a fear factor: i.e. the fear on the part of franchisee to go against the franchisor, even if the content of the contract concluded with the franchisor or the way the contract is performed violates the interests of the franchisee. The franchisee may not be willing to take action against the franchisor for the fear that the franchisor will end their contractual relations. This significantly limits the number of court cases (which could be a source of information), but also mediations (which would not make the franchise market more transparent, but could improve the position of franchisees).

- **The lack of balance in representation**

What must be stressed is the lack of balance in the representation of franchisors and the franchisees in the public debate in the EU. The franchisor organisations focus on supporting the franchisors' interests, and not that of the industry.[15]

The franchisors have well-established and active representation throughout Europe (which was also noticeable during the work on this paper), whereas the franchisee organisations, although equally active, are scarce in numbers. Moreover, the franchisor organisations, founded by their members, are better prepared for lobbying activities than the franchisee organisations. This makes the voice of the franchisors better heard.

The leading franchising association in EU is the European Franchise Federation (founded in 1972). Currently, the EFF represents 21 national franchise associations in Europe (Austria, Belgium, Croatia, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, the Netherlands, Poland, Portugal, Serbia, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom.)

On average, the national associations have 120 franchise system members (the largest is the British with 270 members, and the smallest is Serbian with 7). The associations offer

[15] On that, see Abell, who gives illustrates this claim by giving the example of the position of German and British organisations, pp. 116-118.

different categories of membership: the vast majority includes as their members franchisors (13), franchise companies (8) and master franchise companies (17). About half of the associations name professionals (10) or supporting members (2), only four name franchisees explicitly.

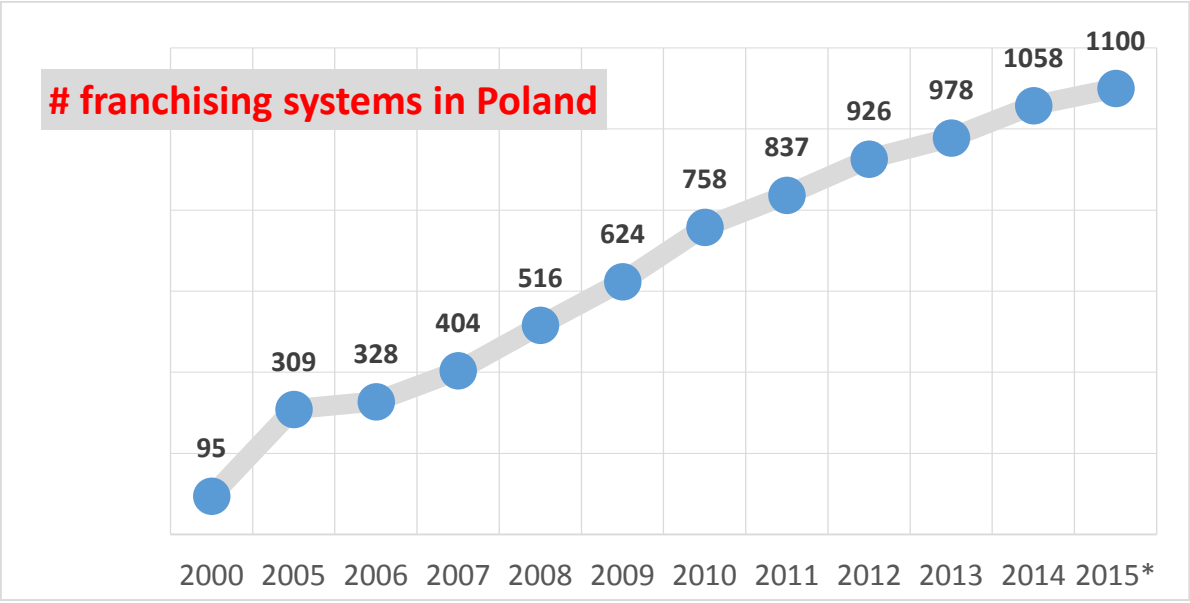
Franchisee organisations are present in several member states, i.e. in the Netherlands: http://vakcentrum.nl, Germany http://die-franchisenehmer.de, Belgium and France. However, even if they function well at the national level, the EU representation of franchisees is virtually non-existent.

- **Diversity of the national markets – various stages of the market development**

Competition law strives to create a well-functioning European single market, and in order to achieve this it introduces homogenous rules in all Member States. However, the research reveals certain differences in the way particular markets function, especially when one compares the old and the new Member States. Franchising as a business model has been used in the old Member States since the 1970s, whereas in the new Member States, due to different political and economic conditions, it was introduced only in the (late) 1990s. Moreover, the development of franchising in the new Member States is not homogenous: in Estonia, for example, franchising is still scarcely used in practice, whereas in Poland it has been rapidly penetrating the market since the beginning of 2000.

It follows from national reports and anecdotal evidence gathered during interviews with representatives of various legal systems that the differences between the markets refer to the degree of competition on the market (the number of companies operating on the market), which has an impact on the flexibility of the market (establishing new chains) and the possibilities to go cross-border. It also impacts the position of the franchisees, which seem to be enjoying more flexibility in the less developed markets. Additionally, the problems the franchisees' experience seem to be similar in certain areas (information before a contract is concluded), and different in others (i.e. the real possibility of a franchisee to change the franchise chain it belongs to). To analyse these similarities and differences, a different methodology would have to be employed that would also take into account other aspects of the analysed legal systems (i.e. the legal culture and national peculiarities). This area definitely requires further research.

Table 2: Franchising systems in Poland



Source: Raport o franczyzie w Polsce 2015, Profit system.

2.8.3. Establishing the real market situation - the Dutch example[16]

The developments that took place in the Netherlands can serve as an illustration of how difficult it is to diagnose the market situation and what methodology is required. The Netherlands is one of the very few countries where the franchisees have active organisation (VAKcentrum – an organisation for independent shopkeepers and franchisees). VAKcentrum repeatedly reported problems affecting its members and called for action in the area (the information was passed, among others, to the Dutch Ministry of Economic Affairs). At first, the Ministry looked rather sceptically at the problems signalled by VAKcentrum, nevertheless it started to investigate the franchising market. The initial findings related to cases of evident fraud, i.e. imposing very high prices for joining the network, or schemes offered by franchisors with no success story. However, opening a communication channel that assured anonymity encouraged franchisees to come forward about the problems they face (interviews were conducted with more than 80 people), which convinced the Minister of Economic Affairs that action is indeed required. At the end of 2014, a Writing Committee was established, composed of two representatives of franchisors, two of franchisees and two of the Ministry, with a view to prepare a Dutch Franchising Code. The EFF's Code was seen as too vague and not very effective: it does not apply until the franchisor expressly states so and the courts tend to disregard it. On 16 June 2015, a draft code was presented to the industry in the process of public consultations coordinated by the Ministry. The publication of the Code was originally planned on 3 September 2015, but in view of the numerous and contradicting consultation responses, more time was allowed for further debate with the sector. During the process the franchisors sent several emergency letters in which they opposed the newly prepared draft. The Minister upheld the Writing Committee and mentioned the possibility of adopting hard law solutions, should the soft law initiative fail. The Dutch Franchising Code was finally adopted and published on 17 February 2016 as a soft law solution.

2.9. Methodology

2.9.1. Sources

At the level of EU law, the report takes into account the case decided by the Court of Justice of the European Union, decisions of the European Commission, and all EU regulations that apply to franchising. The aim of the analysis is to focus not on presenting the content of particular instruments (although this is also done), but to show the development of the approach to franchising at a European level, as well as its potential impact on the functioning of franchising on the EU market. This is important considering that almost 30 years has passed since the Pronupia case, which laid the foundations to the approach to franchising regulations in the EU, and the evolution of the approach that took place in this period.

At a national level, the research was conducted using the traditional comparative law method, i.e. via questionnaires filled in by national researchers. The questions formulated for the researchers referred both to the application of EU competition rules on the national level (the results are presented in part. 2. Franchising under EU law) and purely national laws applicable to franchising (presented in part 3. Franchising under national law).

Table 3: list of national reporters

[16] The information on the process that took place in the Netherlands was received from a representative of the Ministry of Economic Affairs.

Belgium	dr. Stijn Claeys
Estonia	prof. Irene Kull
France	prof. Juliette Senechal
Germany	Anne-Katrin Suilmann
Italy	dr. Guido Comparato
Netherlands	dr. Joasia Luzak
Poland	dr. Aneta Wiewiórowska-Domagalska
Romania	dr. Lucian Bojin
Spain	dr. Odavia Bueno Diaz

The research was supplemented with meetings / conference calls with representatives of franchising organisations and franchising industry:

- Vakcentrum
- UAPME umbrella organisation for SMEs in Europe
- Albert Heijn franchisees, the Netherlands
- Delhaize Belgium (franchisor)
- The Polish Franchising organisation
- Luc Ardies (legal expert in the franchise area)
- Representatives of practicing lawyers dealing with franchising contract
- Profit (Polish consulting company specialising in franchising sector)
- Independent Retail Europe
- The European Franchising Federation
- The Dutch Franchising Organisation (NFV)
- The French Franchising Organisation
- Representative of the Dutch Ministry of Economic Affairs

Additionally, invitations were sent to the following, but the parties did not decide to participate in the consultations:

- The German Franchising Organisation
- Metro Germany
- Carrefour
- The Italian Franchising Organisation
- The Romanian Franchising Organisation
- The Estonian Franchising Organisation

2.9.2. The scope of the research

The work on the report proved that the initial assumptions concerning the scope of the research necessary to complete it clearly underestimated the amount of the time and effort needed. It became evident that franchising suffers from insufficient amount of legal and economic analysis, which is rather surprising, considering the meaning of franchising for the EU economy. The preparatory work conducted by the EU Commission during the consultation process on the changing the policy towards vertical restraints did not contain

proper analysis of the EU franchising market (although the reform has substantially changed the approach towards franchising). This combined with the fact that the report raised much attention among the interested parties meant that the report required much more expenditure in terms of time and analysis, than it was initially assumed. Also, considering the shortage of the available sources and the generated interest, preparation of the report was supplemented by a much greater number of interviews with the industry representatives than it was initially assumed.

2.9.3. The value of the collected materials

The size of the report considerably exceeds the expected size for such reports. This is due to the fact that, in the course of preparing the report, a vast collection of materials has been gathered that did not exist before. This is also one of the values of the report: the collected material sets out, in an organised manner, the solutions adopted at the national level, and allows further use of the data.

2.10. Limitations of the report

The primary focus of the report is on the legal analysis, referring to competition law (EU and national level) and private law regulation (national level). Analysing the legal environment was the starting point for preparing the report. However, during the work it turned out that the specific characteristics of the franchising market made it necessary to extend the scope of the report and include also elements of public policy.

The report focuses on the legal aspects of the EU franchising market. In the context of the field of research (the borderline between competition and private law regulation), the report can fill in (at least partly) the research gap that existed so far. In order to decide whether and to what extent the content of vertical restraints should be changed, market-oriented research by economists is required. A legal report may help to establish the link between the measures that aim to construct an EU market, and the content of the legal relationships that bind the parties of the franchising contract, which so far were largely neglected.

In the course of the research, around 20 interviews were conducted with 13 individuals. The collected data goes beyond what can be called “anecdotal” and provides rather a comprehensive overview of the market situation (though, without claiming to be complete or statistically significant). What must be stressed, however, is that a pattern can easily be established when it comes to the starkly contrasting views presented by the representatives of the industry, in particular in the old Member States.

3. FRANCHISING: THE PRESENT EU REGULATORY FRAMEWORK

KEY FINDINGS

- At present franchising is regulated at the EU level by Regulation 330/2010.
- Regulation 330/2010 covers a wide variety of vertical agreements and is not designed to deal specifically with franchising. Franchising is seen as one type of vertical agreement, and its peculiar characteristic is addressed in a rather superficial way in the Guidelines issued by the Commission that accompany the Regulation.
- The scope of the Regulation is limited, on the one hand by the de minimis rule and on the other by the 30% threshold introduced by the Regulation. As regards franchising, this means in principle application to contracts concluded by the parties who have a market share of between 10 to 30 %. Below this limit, contracts have no appreciable impact on market, above they are subject to individual exemptions.
- The Regulation distinguishes between the "hard-core" restriction (the Regulation does not apply to vertical agreements that contain such restrictions) and excluded restrictions (to which it does not apply).

3.1. Introduction

EU law has so far dealt with franchising only with regard to competition law. It began with the judgement of the Court of Justice of the European Union of 28 January 1986, in the case 161/84 Pronuptia de Paris GmBh and Pronupia de Paris Irmgard Schillgalis,[17] which shaped the principles on which the approach to franchising in EU law was initially based. In this judgement (the only one so far that has dealt with franchising), the Court recognised franchising as a self-standing method of contracting, distinguished between various forms of franchising (see also point 1.1 of Chapter I), and established which types of contractual provisions, although of a restrictive character, are necessary to allow the proper functioning of a franchising contract. The case was followed by a series of decisions by the European Commission, building on the foundation set by the Court of Justice: Decision 87/14/EEC Yves Rocher of 17 December 1986 (further Yves Rocher),[18] Decision 87/17/EEC Pronuptia of 17 December 1986 (further Pronuptia decision),[19] Decision 87/407 Computerland of 13 July 1987 (further Computerland),[20] Decision 88/604 ServiceMaster of 20 August 1988 (further ServiceMaster)[21] and Decision 89/94/EEC Charles Jourdan of 2 December 1988 (further Charles Jourdan).[22] The principles set out in the decisions were captured and further developed in the block exemption regulation regarding franchising contracts (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.[23] Later franchising was included alongside various types of distribution contracts in two subsequent block exemption regulations: Commission Regulation No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical restraints and concerted practices[24] and the current Commission

[17] European Court Reports 1986, 00353.
[18] OJ EEC L 8/49 of 10 January 1987.
[19] OJ EEC L 13/39 of 15 January 1987.
[20] OJ EEC L 222/12 of 10 August 1987.
[21] OJ EEC L 332/38 of 3 December 1988.
[22] OJ EEC L 35/31 of 7 January 1989.
[23] OJ EEC L 359/46 of 28 December 1988
[24] OJ L 336 of 29 December 1999.

Regulation No 330/2010 of 20 April 2010 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.[25] (the evolution of the policy is presented in the next chapter).

3.2. Article 101 TFEU

The competition policy towards vertical restraints is based on Article 101 TFEU (formerly Article 81). It applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition ("vertical restraints"). It provides a legal framework to assess vertical restraints that takes into consideration the distinction between anti-competitive and pro-competitive effects.

Regulation 330/2010 has universal character, i.e. it applies to all types of agreements, no matter what is the subject matter of the agreement, with the exception of vertical agreements the subject matter of which falls within the scope of any other block exemption regulation, unless otherwise provided for in such a regulation (Article 2(5)).

Article 101(1) prohibits agreements that appreciably restrict or distort competition, while Article 101(3) exempts agreements that confer sufficient benefits to outweigh the anti-competitive effects. As the Guidelines on Vertical Restraints (2010/C 130/01) explain (point 6), for most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels. Moreover, vertical restraints are generally less harmful than horizontal restraints and may provide substantial scope for efficiencies (the Guidelines, point 6).

3.3. The scope of application of Regulation 330/2010

For the reasons explained above, certain vertical restraints are excluded from the scope of application of the Regulation:

- Agreements that are not capable of appreciably affecting trade between Member States or of appreciably restricting competition by object or effect that do not fall within the scope of Article 101(1).
- Subject to the conditions set out in the *de minimis* notice concerning hard-core restrictions and cumulative effect issues, vertical agreements entered into by non-competing undertakings whose individual market share on the relevant market does not exceed 15% are generally considered to fall outside the scope of Article 101(1). For agreements between competing undertakings the *de minimis* market share threshold is 10% for their collective market share on each affected relevant market. There is no presumption that vertical agreements concluded by undertakings having more than 15% market share automatically infringe Article 101(1). Agreements between undertakings whose market share exceeds the 15% threshold may still not have an appreciable effect on trade between Member States or may not constitute an appreciable restriction of competition (See judgment of the Court of First Instance in Case T-7/93 *Langnese- Iglo* v *Commission* [1995] ECR II-1533, paragraph 98.).
- Vertical agreements between small and medium-sized undertakings, as defined in the Annex to Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises,[26] are rarely capable of appreciably

[25] OJ L 102/1 of 23 April 2010.

[26] Art. 2(1) The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises that employ fewer than 250 people, and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

affecting trade between Member States or of appreciably restricting competition within the meaning of Article 101(1), and therefore generally fall outside the scope of Article 101(1). In cases where such agreements nonetheless meet the conditions for the application of Article 101(1), the Commission will normally refrain from opening proceedings due to a lack of sufficient interest from the European Union, unless those undertakings collectively or individually hold a dominant position in a substantial part of the internal market.

3.3.1. Thresholds

The exemption contained in the Regulation applies only on a condition (Article 3(1)) 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. The Guidelines explain that 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 without 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. The new market thresholds for the application of the exemption is one of the most significant novelties introduced by the Regulation.

The Regulation gives the Commission and the competition authorities of the member states the possibility to withdraw the benefit of exemption if an agreement, to which the exemption applies, nevertheless has effects that are incompatible with Article 101(3) of the Treaty.

3.4. Hard-core restrictions and excluded restrictions

3.4.1. Hard-core restrictions

The Regulation states explicitly in recital 10 that it does not exempt vertical agreements containing restrictions that are likely to restrict competition and harm consumers, or which are not necessary for reaching efficiency-enhancing effects. Article 4 specifies that the exemption does not apply to vertical agreements that, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their 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 in 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.

The Guidelines to the Regulation take a stricter approach to the hard-core restrictions than the previous Guidelines, establishing (paras 47 and 223) a non-rebuttable presumption that any vertical agreement that contains them is incompatible with Article 101 (1).

3.4.2. Excluded restrictions

As stated in Article 5, the exemption does 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, a non-compete obligation that is tacitly renewable beyond a period of five years is deemed to have been concluded for an indefinite duration. However, the time limitation of five years does 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;

(b) any direct or indirect obligation causing the buyer, after the termination of the agreement, not to manufacture, purchase, sell or resell goods or services. However, the exemption applies such obligations if certain conditions are fulfilled:

- the obligation relates to goods or services that compete with the contract goods or services;
- the obligation is limited to the premises and land from which the buyer has operated during the contract period;
- the obligation is necessary to protect know-how transferred by the supplier to the buyer;
- the duration of the obligation is limited to a period of one year after the termination of the agreement.

Moreover, the Regulation gives the possibility of imposing a restriction, which is unlimited in time, on the use and disclosure of know-how that has not entered the public domain.

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

3.5. Application of the Regulation to franchising contracts

Regulation 330/2010 specifies categories of agreements that can be regarded as normally satisfying the conditions set out in Article 101(3), including 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' includes the corresponding concerted practices. Franchising is not specifically mentioned in the Regulation itself, but is dealt with in the Guidelines. The Guidelines are legally binding only on the Commission, but they have a profound impact on how national courts and competent authorities apply Article 101. It should be stressed, that, with regards to franchising, the Guidelines basically repeat precisely what the 2000 Guidelines established.

The Guidelines deal with franchising in Section 2.5 under Section VI "Enforcement Policy in Individual Cases" (paragraphs (189) and (190)). Paragraph 189 establishes what the franchise agreement is and what is its usual content, whereas paragraph 190 specifies when a franchising agreement can be exempted.

Franchise agreements (para. 189) primarily contain licences of intellectual property rights relating in particular to trademarks or signs and know-how for the use and distribution of goods or services. In addition, 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 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 various vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.

The Guidelines extensively deal with the application of the exemption to the licensing of intellectual property rights in franchising agreements (paras. 24 – 46).

When it comes to vertical restraints on the purchase, sale and resale of goods and services within a franchising arrangement, such as selective distribution, non-compete obligations or exclusive distribution, the Block Exemption Regulation applies up to the 30% market share threshold. The guidance provided in respect of those types of restraints applies also to franchising, subject to the following two specific remarks:

(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 meet 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.

The Guidelines also contain an example of franchising agreement and explain how the Regulation applies to it. A manufacturer has developed a new format for selling sweets in fun shops where the sweets can be coloured specially on demand from the consumer. The manufacturer of the sweets has also developed the machines to colour the sweets. The manufacturer also produces the colouring liquids. The quality and freshness of the liquid is of vital importance to producing good sweets. The manufacturer made a success of its sweets through a number of own retail outlets all operating under the same trade name and with the uniform fun image (style of lay-out of the shops, common advertising etc.). In order to expand sales the manufacturer started a franchising system. The franchisees are obliged to buy the sweets, liquid and colouring machine from the manufacturer, to have the same image and operate under the trade name, pay a franchise fee, contribute to common advertising and ensure the confidentiality of the operating manual prepared by the franchisor. In addition, the franchisees are only allowed to sell from the agreed premises, to sell to end users or other franchisees and are not allowed to sell other sweets. The franchisor is obliged not to appoint another franchisee nor operate a retail outlet itself in a given contract territory. The franchisor is also under an obligation to update and further develop its products, the business outlook and the operating manual, and make these improvements available to all retail franchisees. The franchise agreements are concluded for a duration of 10 years.

Sweet retailers buy their sweets on the national market, from either national producers that cater for national tastes, or from wholesalers that import sweets from foreign producers, in addition to selling products from national producers. On that market the franchisor's products compete with other brands of sweets. The franchisor has a market share of 30% on the market for sweets sold to retailers. Competition comes from a number of national and international brands, sometimes produced by large diversified food companies. There are many potential points of sale of sweets in the form of tobacconists, general food retailers, cafeterias and specialised sweet shops. The franchisor's market share of the market for machines for colouring food is below 10 %.

Most of the obligations contained in the franchise agreements can be deemed necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 101(1). The restrictions on selling

(contract territory and selective distribution) provide an incentive to the franchisees to invest in the colouring machine and the franchise concept and, if not a requirement, at least help maintain the common identity, thereby offsetting the loss of intra-brand competition. The non-compete clause excluding other brands of sweets from the shops for the full duration of the agreements does allow the franchisor to keep the outlets uniform and prevent competitors from benefiting from its trade name. It does not lead to any serious foreclosure in view of the great number of potential outlets available to other sweet producers. The franchise agreements of this franchisor are likely to meet the conditions for exemption under Article 101(3) in as far as the obligations contained therein fall under Article 101(1).

4. FRANCHISING: EU REGULATORY FRAMEWORK

KEY FINDINGS

- The EU approach to the franchising contract was first established in the Pronupia case decided by the CJEU in 1988. It recognised franchising as a distinct business model, but stressed that it is model for deriving financial benefits from one's expertise without investing one's own capital, rather than a method of distribution.
- The CJEU distinguished between the conditions necessary to make the franchising system operational, which did not restrict competition, and conditions that are not necessary for the franchising system to work and may restrict competition.
- This approach was continued in a series of Commission decisions in franchising cases: Yves Rocher, the Pronupia decision, Computerland, ServiceMaster and Charles Jourdan.
- The accumulated expertise of the Commission contributed to the enactment of Regulation 4087/88 which applied to certain franchising contracts.
- Together with the reform of EU competition policy as regards vertical restraints, which was initiated in 1997, EU law began to treat franchising as one type of a selective distribution system, and the particularity of franchising was no longer normatively recognised (Regulations 2790/1999 and 330/2010).

4.1. Introduction

4.1.1. Why presenting evolution of the EU regulatory is important?

The present regulatory framework is described in the previous chapter. However, the information limited to the current legislation does not provide a sufficient basis for understanding the potential problems of the EU franchising market. Regulation 330/2010 is only the end-effect of a long process, during which the approach towards franchising has changed fundamentally. This process of evolution raises several questions:

(1) Did the EU legislature take sufficient account of the special nature of the franchising contract when changing the approach to regulating vertical restraints?
(2) Does the new approach address the current problems of the franchising market effectively?
(3) What are the adverse effects of the introduced system?

In order to answer these, the entire process must be taken into account, not only its most recent developments. Presenting the evolution process also allows for a better understanding of the concepts that lie at the core of the current competition policy towards vertical restraints and the reasons that led to their acceptance.

4.1.2. Overview of the evolution

The initial EU approach to franchising, presented by the CJEU in the Pronupia case, assumed that franchising is a method for deriving financial benefit from one's expertise without investing one's own capital, rather than a method of distribution. The Court emphasised that franchising (more specifically, distribution franchising) provides traders who do not have the necessary experience access to methods that they could not have learned without considerable effort, allowing them to benefit from the reputation of the franchisor's business name. In the Court's eyes, as a system that allows the franchisor to profit from his success, franchising does not in itself interfere with competition. The Court

distinguished between conditions necessary for making the franchising system operational: (1) the need to protect know-how and (2) the need to uphold the network's identity. These conditions were not seen as restricting competition, as opposed to conditions that are not essential for the franchising model to work which could, however, restrict competition. Here, the Court listed provisions that share markets between the franchisor and the franchisee, and provisions that impair the franchisee's freedom to determine its own price. (details: see point 1.2 below).

The five decisions issued by the Commission that followed the Pronupia case (Yves Rocher, Pronuptia, Computerland, ServiceMaster and Charles Jourdan) the Commission simply applied the principles established by the Court of Justice. The cases elaborate further on when clauses are restrictive and not restrictive of competition and provide a very good illustration of how the Commission established whether or not a given condition goes beyond what is strictly necessary for achieving its purpose. Also, the Commission had regard to the effectiveness of the measures and emphasised the benefits that franchising networks offer to consumers (see point 1.3).

The Commission took the next step in developing normative tools by enacting Regulation 4087/88 that applied specifically to certain categories of franchising (for the retailing of goods or the provision of services to end users, or a combination of these activities and master franchising). The Regulation did not establish any specific thresholds for its application but distinguished several types of restrictions of competition, and clearly indicated to which restrictions the Regulation applied, to which it applied under certain conditions, and which were not exempted (further elaboration in point 1.4).

In 1997, a discussion on reforming EC competition policy as regards vertical restraints was began with the publication of the Green Paper on Vertical restraints.[27] The existing block exemption regulations were regarded as too legalistic and as stifling business (the "straightjacket effect"). They were also accused of creating a compliance burden arising from unnecessary legal uncertainty, and preventing the companies without significant market power from using vertical restraints to improve their competitive position in the market. At the same time, as was stressed, the Commission could have exempted agreements that actually distorted competition. The Communication from the Commission on the applicability of the Community competition rules to vertical restraints,[28] which followed the Green Paper, proposed an economics-based approach to vertical restraints policy: one broad umbrella block-exemption regulation covering all vertical restraints for the distribution of goods and services (preventing unjustified differentiation between forms or sectors), which would use market-share thresholds to distinguish between agreements that are or are not block-exempted (the safe harbour approach). Primarily based on a block-clause approach (defining what is not block exempted instead of defining what is exempted, to avoid the straightjacket effect), the regulation was to facilitate the simplification of the applicable rules. The economics-based approach meant that in the absence of market power, a presumption of legality for vertical restraints can be made except for certain hard-core restrictions, whereas when market power exists, no general presumption of legality should be allowed. Franchising was to be covered by new block exemption regulation, though, as a combination of vertical restraints, it was not to be given any preferential treatment.

This approach was implemented in two subsequent regulations: Commission Regulation 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical restraints and concerted practices, and Commission Regulation 330/2010 on the

[27] Green Paper on Vertical Restraints in EC Competition Policy, Brussels, 22.01.1997, COM(96) 721 final.
[28] Communication from the Commission on the application of the Community competition rules to vertical restraints, Brussels 30.09.1998, COM(1998) 544 final.

application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. Regulation 2790/1999 introduces the threshold (share of the relevant market accounted for by the supplier not exceeding 30%), as above this level "there can be no presumption that vertical agreements falling within the scope of Article 81(1) will usually give rise to objective advantages of such a nature and size as to compensate for the disadvantages that they create for competition". The Regulation did not apply to agreements containing hard-core restrictions (defined in Article 4), and certain specific obligations (though it continued to apply to the remaining part of the vertical agreement if that part is severable from the non-exempted obligations). Franchising was covered, although not mentioned specifically (with the exception of the Guidelines).

4.2. Pronupia case

4.2.1. Introduction

In the first (and so far – the only) case that dealt with franchising, i.e. the Pronupia case, the Bundesgerichtshof referred for a preliminary ruling on the interpretation of Article 85 of the 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 in order to ascertain whether those provisions are applicable to franchise agreements (the Court denied it).

4.2.2. Provisions necessary for the protection of the provided know-how or for the maintenance of the network's identity and reputation

The Court stated that, for the franchising system to work, two conditions must be met, and that the contractual provisions essential to secure these conditions do not constitute restrictions of competition (then Article 85(1)).

First, the franchisor must be able to communicate his know-how to the franchisees and provide them with necessary assistance in order to enable them to apply his method, without running the risk that the know-how and assistance will benefit competitors, even indirectly. The provisions that the Court saw as essential to avoid that risk included:

- 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 it may compete with a member of the network;
- The franchisee's obligation not to transfer his shop to another party without the prior approval of the franchisor.

Second, the franchisor must be able to take measures necessary to maintain the identity and reputation of the network bearing his business name or symbol. The provisions that establish the means of control necessary for that purpose include:

- The franchisee's obligation to apply the business methods developed by the franchisor and to use the provided know-how;
- 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 a uniform presentation in conformity with certain requirements;
- The choice of the location of the shop, and the exclusion of the possibility to transfer the shop to another location without the franchisor's approval;
- The prohibition on the franchisee assigning his rights and obligations under the contract without the franchisor's approval, which protects the latter's right to freely choose the franchisees, on whose business qualifications the establishment and maintenance of the network's reputation depend;

- A provision requiring the franchisee to sell only products supplied by the franchisor, or by selected suppliers. The Court explained that, by controlling the selection of goods offered by the franchisee, the public is able to obtain goods the same quality from each franchisee. Further, for certain types of goods (like fashion articles) it may be impractical to lay down objective quality specifications. In addition, the large number of franchisees may sometimes make it too expensive to ensure that such specifications are observed. Restrictions concerning supply may therefore be considered necessary to protect the network's reputation. The Court sets the limit of such provisions: they cannot have the effect of preventing the franchisee from obtaining those products from other franchisees;
- A provision requiring the franchisee to obtain the franchisor's approval for all advertising.

4.2.3. Provisions not essential for achieving the aims of franchising contract

The Court identified two types of provisions that are not necessary for the franchising system to work and which can restrict competition between the members of the network: (1) provisions that share markets between the franchisor and franchisees or between franchisees, or which prevent franchisees from engaging in price competition with each other, and (2) provisions that impair the franchisee's freedom to determine his own prices.

4.2.4. Provisions that share markets

The provisions that share markets between the franchisor and the franchisees or between the franchisees themselves can, in the opinion of the Court of Justice, affect trade between Member States, even if they are entered into by undertakings established in the same Member State, in as far as they prevent franchisees from establishing themselves in other Member States. The Court has also drawn the attention of national courts to provisions that prohibit the franchisee opening a second shop. It stressed that the real effect of such clauses becomes clear if it is examined in conjunction with the franchisor's undertaking to ensure that the franchisee has the exclusive use of his business name or symbol in a given territory. In order to comply with that undertaking, the franchisor must not only refrain from establishing himself within that territory, but also require other franchisees to give an undertaking not to open a second shop outside their own territory. A combination of provisions of that kind results in sharing markets between the franchisor and the franchisees, or between franchisees, and so it restricts competition within the network. This constitutes a limitation of competition if it concerns a business name or symbol that is already well known. It is, of course, possible that a prospective franchisee would not take the risk of becoming part of the chain, investing his own money, paying a relatively high entry fee and undertaking to pay a substantial annual royalty, unless he could hope, thanks to a degree of protection against competition on the part of the franchisor and other franchisees, that his business will be profitable (which is relevant only to an examination of the agreement in light of the conditions set out in Article 85 (3)).

4.2.5. Provisions that impair the franchisee's freedom to determine his own price

Provisions that impair the franchisee's freedom to determine his own prices are, in the opinion of the Court, restrictive of competition. The Court highlighted that the effect of restricting competition does not take place if the franchisor simply provides franchisees with price guidelines, so as long as there is no concerned practice between the franchisor and franchisees, or between the franchisees themselves, for the actual application of such prices. The control of the concerned practice is in the hands of the national courts.

4.3. Commission's decisions

In the five decisions issued by the EU Commission following the Pronupia case (Yves Rocher, Pronuptia decision, Computerland, ServiceMaster and Charles Jourdan) the Commission simply applied the principles established by the Court of Justice. The Commission distinguished between:

- Provisions that do not constitute restrictions of competition (within the meaning of Article 85 (1));
- Provisions restrictive of competition, but which can be granted individual exemptions under 85 (3); and
- Provisions not relevant from the competition point of view (in one case).

4.3.1. Contractual obligations not restrictive of competition

The Commission has strictly followed the division introduced by the Court of Justice and recognised clauses essential to prevent the know-how supplied and assistance provided by the franchisor from benefiting competitors, and clauses that provide for the control essential for preserving the common identity and reputation of the network. The list of clauses that the Commission qualified as not restrictive of competition was similar in all cases.

4.3.2. Clauses essential to prevent the know-how supplied and the assistance provided by the franchisor from benefitting competitors

The provisions essential to prevent the competitors from benefitting from the know-how presented by the franchisor included, for example, the franchisee's obligation to preserve, before and after the termination of the agreement, the secrecy of all information and know-how, and to impose a similar obligation on his employees, the prohibition on the franchisee to sell the franchised business or to assign its management to another person and the franchisee's obligation to use the know-how and licensed intellectual property rights solely for the purposes of exploitation of the franchise. The Commission paid particular attention to the anti-competitive clauses prohibiting the franchisee from conducting a business during a certain period after terminating the franchising contract. The Commission investigated, in light of the exclusivity of the territory allotted to the franchisee, whether or not the clauses go beyond what is strictly necessary to achieve their purpose, i.e. to protect the transfer of know-how and (in principle) the interests of the franchisor.

Four out of five franchising agreements contained a non-competition clause lasting one year. In the Yves Rocher and Pronupia decisions, the clauses were very similar. They prohibited the franchisee from conducting business in its former exclusive territory (Yves Rocher), and engaging in any similar business in the same area or in any other area where he would be in competition with another outlet (Pronuptia decision). In both cases, the Commission decided that the clause protects the franchisor's know-how and argued that it gives the franchisor a reasonable period to establish a new place of business, which he was not able to do during the term of the contact due to the exclusivity clause. In the Yves Rocher decision, the Commission argued that the clause does not go beyond what is strictly necessary to achieve its purpose, since a former franchisee can compete with Yves Rocher as soon as the contract expires, by setting up business outside his former exclusive territory, possibly in the territory of other franchisees. In the Pronupia decision, the Commission added that other ways of preventing the risk of know–how benefitting the competitors might not be as effective. The non-competition clause was further limited in the Pronupia decision. The franchisee could carry on the business in the allotted territory after the agreement has ended if he:

- has exercised the franchise for more than 10 years,

- has discharged his contractual obligations, and
- does not put the know-how and experience he has accumulated at the service of a competing network.

Under the ServiceMaster agreement, the franchisee, for a period of one year, could not be engaged in a competing business within the territory where he provided services prior to the termination of the agreement, and could not solicit customers who were his customers during the period of two years prior to the termination of the agreement. In the Commission's view, such clauses were acceptable as regards duration and geographical extent. Moreover, the clause was necessary to prevent the ex-franchisee using the know-how and the clientele he has acquired for his own benefit or for the benefit of ServiceMaster's competitors, and necessary to allow ServiceMaster a limited time period to establish a new outlet in the ex-franchisee's territory.

Initially, under the Computerland franchising agreement, the non-competition obligation continued for three years after terminating the agreement at a given distance from the ex-franchisee's former outlet, for two years at a given distance from any Computerland store, and for one year at any location. The Commission found it unreasonably broad as regards both duration and geographical extent. Following discussions with the Commission, it was limited to one year after terminating the agreement within a radius of 10 kilometres from the ex-franchisee's former place of business. This was, according to the Commission, a reasonable compromise between the franchisor's concern to protect the confidentiality of his business formula and to open a new outlet in the ex-franchisee's former exclusive territory on the one hand, and the ex-franchisee's legitimate interest in continuing to operate in the same field on the other. The Commission argued that, in view of the fact that, during the term of the agreement, a franchisee is not bound to over-the-counter sales, and is furthermore free to sell anywhere, then he can develop goodwill and clientele far beyond his own protected area; during the one year in which the post-term non-competition obligation is in force, he can thus continue to reap the benefits of the efforts he has made as a franchisee, only being prevented from competing during that period in the vicinity of his former outlet.

It is worth noting that, under the Charles Jourdan franchising agreement, the franchisee was not bound by any non-competition clause after ending the agreement. It was explained that such a non-competition clause would not be justified: first, as the know-how provided included a large element of general commercial techniques, and second, as this type of franchise was primarily granted to retailers who are already experienced in selling shoes.

4.3.3. Clauses that aim at securing the common identity and the reputation of the network

The list of clauses that provide for the control essential to preserve the common identity and reputation of the network trading under the franchisor's name included the obligation of the franchisee to:

- Conduct the franchised business in the manner prescribed by the franchisor, and to use the know-how and expertise it makes available;
- Conduct the franchised business from the premises approved by the franchisor and fitted and decorated according to its instructions;
- Obtain the franchisor's approval for his local advertising;
- Order the goods connected with the essential object of the franchise business exclusively from the franchisor, or suppliers nominated by the franchisor. It was emphasised that the franchisee may purchase such goods from any other franchisee in the network, and that the franchisor may vet, ex-post, the quality of products not connected with the essential object of the franchise business, which the franchisee may

purchase from the supplier of his choice, and to forbid the franchisee to market them from the outlet if they are damaging to the brand image;
- To communicate to the franchisor any improvements the franchisee makes in the operation of the business;
- To assign their contract without the written agreement of the franchisor;
- To devote the necessary time and attention to the franchisor's business and to use his best endeavours to promote and increase the turnover of the business;
- To submit to inspections of his premises by the franchisor and to present financial statements.

4.3.4. Contractual obligations restrictive of competition

Following the principles established by the Court of Justice, the Commission adopted a position that provisions that may lead in particular to market sharing between the franchisor and the franchisees, or between the latter, or that interfere with the franchisees' individual pricing policies, may be considered restrictions of competition.

4.3.5. Market sharing

The Commission stressed that the restrictions of competition entailed with the exclusivity clauses are indispensable to ensure the existence of the network. The potential franchisees would not be willing to make the investments necessary to open up a new outlet if they were not assured that no other franchisees outlets will be established in their near vicinity (certain of receiving a certain degree of protection against competition from other outlets). Therefore, the Commission perceived this restriction as the necessary cornerstone of the franchise system. At the same time, the provisions that lead to market sharing within the network and the obligation to sell to end-users were seen as liable to affect intracommunity trade, because franchisees were not free to expand their operations to other Member States, either at a retail or wholesale level.

The Commission classified as market sharing a combination of clauses that granted the franchisee the exclusivity to operate under the franchisor's trade marks in a given area and the obligation on the franchisee to conduct his business activity exclusively from the premises approved for that purpose. In the Yves Rocher case, the Commission argued that a combination of such clauses prevents franchisees from setting up business in another Member State, and may thus affect trade between Member States to an appreciable extent. In the Computerland case, the Commission emphasised that the prohibition on opening further outlets interferes with the franchisee's commercial independence, especially considering the fact that Computerland outlets are generally not one-man operations, but medium-sized enterprises employing on average ten to twenty people and sometimes even substantially more. For such businesses, for whom expansion may be a logical and desirable development, the limitation to one outlet unless otherwise authorised is clearly restrictive. In this case, franchisees were allowed to open 'satellite shops' also outside their protected areas, though subject to prior approval and payment of a fee similar to the usual entrance fee, and not in another franchisee's protected area.

Under the specific circumstances of this case, the franchisee's obligation to sell only to end-users or to other Computerland franchisees, unless otherwise authorised, was likewise deemed to be a restriction of competition. The Commission argued that in certain franchise systems, for example where franchisees sell products bearing the franchisor's name and/or trademark, the prohibition on resale by franchisees to resellers who do not belong to that franchise network is based on the legitimate concern that the name, trademark or business format could be damaged if the contract products were sold by resellers who do not have access to the franchisor's know-how and are not bound by the obligations aimed at preserving the reputation and unity of the network and its identifying marks. In this

particular case, however, the Computerland name and trademark cover the business format as such, but not the microcomputer products being sold, which bear the name and trademark of each individual manufacturer. The prohibition on Computerland franchisees selling products to otherwise qualified resellers is thus restrictive, both as regards the franchisees themselves, who, while being independent businesses, are thereby limited in their freedom in deciding whom to sell to, and as regards third party resellers, who are thereby deprived of a possible source of supply. This restriction is mitigated by a characteristic peculiar to sales in the microcomputer field, namely the fact that retailers can be part of a franchise network such as Computerland, and at the same time be appointed as an authorised dealer in a selective distribution system established by a manufacturer to ensure that his products are handled only by qualified resellers. A Computerland franchisee who thus operates simultaneously in two or more different networks must be in a position to meet the obligations and exercise the rights that flow from each one. In this context, the Commission has sought to ensure that a Computerland franchisee who is at the same time authorised by one or more manufacturers can function both within the Computerland network and within the selective distribution network(s) to which he belongs.

In ServiceMaster, the Commission noted that the territorial protection of the franchisee is limited by two elements: the franchisee holds a non-exclusive right only within his territory with regard to ServiceMaster itself, and each franchisee is entitled to provide services to non-solicited customers outside his territory. The trade between Member States is affected by the prohibition imposed upon franchisees against setting up outlets in other Member States and against actively seeking customers in territories of franchisees of other Member States. These prohibitions lead to market-sharing between the franchisees of the various Member States.

4.3.6. Pricing policy

The first franchise contracts concluded by Yves Rocher did not satisfy the requirements of Article 85 (3) because it contained resale-price-maintenance clauses and a prohibition on cross supplies between Yves Rocher franchisees. These obligations were deleted at the Commission's request. At the Commission's request, also Pronuptia amended the standard form agreement to put into writing rights that the franchisee allegedly had in practice already, namely the rights to (among other things) set their own retail prices, the prices circulated by the franchisor being only suggestions, and the franchisee merely being recommended not to exceed the maximum prices quoted by the franchisor in advertising and promotions. Pronuptia abolished the clause that required the franchisee not to harm the brand image of the franchisor by his pricing level. Since the Commission had no evidence of any concerted practice between the franchisor and franchisees or between franchisees inter se to maintain prices, it concluded that in these circumstances the mere suggestion of prices for the guidance of franchisees cannot be regarded as restrictive of competition (as acknowledged by the Court of Justice).

4.3.7. Provisions not relevant to competition

In the Computerland case, the Commission pointed out provisions not relevant to competition and therefore by their nature excluded from the scope of Article 85(1). The Commission listed, among other things, the franchisee's obligation to pay an entrance fee and subsequent monthly royalty payments, the franchisee's advertising contributions, the franchisee's obligation to form a corporation, and the franchisee's obligation to post a sign on the premises indicating that he is the independent owner thereof.

4.3.8. Conditions for individual exemption

The Commission repeated similar arguments to justify the individual exemption under Article 85 (3) in all cases:

- Franchise contracts contribute to improving the distribution of goods, as they help the producer to penetrate new markets by enabling him to expand his network without having to undertake any investment in fitting-out new shops. This is particularly important for relatively small companies, which would not be able to achieve it, at least not so quickly;
- The investment involved in setting up the new outlets is undertaken by the prospective franchisees, in return for which they receive the benefit not only of the franchisor's established name and reputation, but also of its expertise, commercial know-how and marketing, enables a larger volume of business at lower cost and with less risk.
- The development of a chain of identical retail outlets strengthens competition towards large retail organisations with a branch network;
- The policy of selection and training, directed mainly at prospective franchisees with no experience, increases inter-brand competition and accordingly improves the structure of distribution;
- The close integration of independent traders within the network leads to a rationalisation of distribution through the standardisation of trading methods covering every aspect of retailing;
- The direct nature (no wholesalers) of the relationship between franchisor and franchisees facilitates consumer feedback and the adjustment of supply to a constantly changing demand, the fickleness of which is a feature of the market concerned;
- The grant to franchisees of an exclusive territory, combined with the prohibition on setting up outside this territory, enables them to pursue a more intensive policy of selling products by concentrating on their allotted territory, helped in this by the fact that the retailing formula is based on a single brand. Territorial exclusivity also simplifies planning and ensures the continuity of supplies;
- The franchisee, thanks to his enjoyment of territorial exclusivity and his closeness to the marketplace, can make confident forecasts of his future sales, which help the franchisor to plan his production better and to guarantee regular supplies of the products.

4.3.9. Consumer benefits

When establishing that consumers (by which the Commission understood also professional end-users, as in the Computerland case) have a fair share of the benefits resulting from the improvements in the distribution, the Commission took into account the following advantages offered by franchising systems:

- Consumers have access to a wide range of goods and services, in a larger number of sales outlets and countries.
- It creates a coherent distribution network offering uniform product quality and a comprehensive range of the articles and accessories available in the trade.
- Because franchisees run their own business and are therefore motivated by the desire for maximum efficiency, they make dynamic and hard-working retailers, which is to the consumer's advantage. The franchisee has a personal and direct interest in the success of his business, since he alone bears the financial risks.
- The homogeneity of the network, the standardisation of trading methods and the direct link between franchisor and franchisee ensure that the consumer benefits in full from the know-how passed on by the franchisor, ensuring the quality and freshness of the products, which are liable to deteriorate rapidly with time.

- The freedom of consumers to obtain services elsewhere in the network forces franchisees to pass on to consumers a reasonable part of the benefits of this intra-band competition. Because of strong inter-brand competition, the franchisees can be expected to offer better services and prices.

In the Computerland case, the Commission additionally pointed out that the stores provide a single location at which customers can compare the prices and characteristics of a wide range of different brands of up-to-date microcomputer products and benefit from the advice of specially trained personnel especially as regards the possibility of using different brands of products together, and the training facilities offered. Moreover, customers are ensured of further advice, maintenance and repair services and if necessary further training possibilities.

4.4. Commission Regulation 4087/88 on the application of Article 85(3) of the Treaty to categories of franchise agreements

4.4.1. Introduction

The next step in developing a regulatory framework for franchising was Commission Regulation No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, in force between 1 February 1989 and 31 May 2000, was designed to deal specifically with franchising. In its preamble the Commission explained that, on the basis of its experience, it is possible to define categories of franchise agreements that fall under Article 85 (1), but can normally be regarded as satisfying the conditions set out in Article 85 (3) (recital 4). Hence, the franchise agreements regulated in 4087/88 Regulation normally improve the distribution of goods and the provision of services. The Commission's argumentation was clearly based on previously decided cases. And so, franchising (recital 7):

- Gives franchisors the possibility of establishing a uniform network, with limited investments;
- Promotes the entry of new competitors on the market, particularly in the case of SMEs, and gives the SMEs the possibility of competing more efficiently with large distribution undertakings;
- Increases inter-brand competition;
- Allows independent traders to set up outlets more rapidly and with a higher chance of success than if they had to do so without the franchisor's experience and assistance;
- Combines the advantage of a uniform network with the existence of traders personally interested in the efficient operation of their business;
- The homogeneity of the network and the constant cooperation between the franchisor and the franchisees ensures a constant quality of the products and services;
- Allows consumers and other end users a fair share of the resulting benefit. The favourable effect of franchising on inter-brand competition, and the fact that consumers are free to deal with any franchisee in the network, guarantees that a reasonable part of the resulting benefits will be passed on to the consumers.

4.4.2. Scope of application

4087/88 Regulation applied only to certain franchise agreements, i.e. agreements between 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 covered agreements, where the relationship between franchisor and franchisees was made through a third undertaking, the master franchisee (recital 5), but wholesale franchise agreements (because of the lack

of experience of the Commission in that field) and industrial franchise agreements (because of their different characteristics) were excluded. The "franchise" was defined as a package of industrial or intellectual property rights relating to trademarks, 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. 4087/88 Regulation identified (Art. 1(3)(b)) three features to distinguish a franchising network:

- The use of a common name or shop sign and a uniform presentation of contract premises;
- The communication by the franchiser to the franchisee of know-how; and
- The continuing provision by the franchiser to the franchisee of commercial or technical assistance.

4.4.3. Market thresholds

4087/88 Regulation did not establish any thresholds for its application. The Regulation followed a clause-based approach where the focus was on the freedom of action of dealers and on intra-brand competition between dealers belonging to the same distribution system. Apart from the withdrawal system and the possible application of Article 86, the exemptions were granted for all companies irrespective of market power.

4.4.4. Restrictions of competition - general

The Regulation distinguished several types of restrictions of competition, and clearly indicated to which restrictions the Regulation applied (, to which it applied under certain conditions, and which were not exempted.

4.4.5. Restrictions to which the exemption applied (Article 2)

The exemption applied to the following restrictions of competition:

(a) an obligation on the franchisor, in a defined area of the common market, the contract territory, not to:

- grant the right to exploit all or part of the franchise to third parties,
- itself exploit the franchise, or itself market goods or services that are the subject-matter of the franchise under a similar formula.
- itself supply the franchisor's goods to third parties;

(b) an obligation on the master franchisee not to conclude franchise agreements with third parties outside its contract territory;

(c) an obligation on the franchisee to exploit the franchise only from the contract premises;

(d) an obligation on the franchisee to refrain, outside the contract territory, from seeking customers for the goods or the services which are the subject-matter of the franchise;

(e) an obligation on the franchisee not to manufacture, sell or use in the course of the provision of services or goods competing with the franchisor's goods that are the subject-matter of the franchise; where the subject-matter of the franchise is the sale or use in the course of the provision of services of certain types of goods and spare parts or accessories therefor, then the obligation may not be imposed in respect of these spare parts or accessories.

4.4.6. Restrictions to which the exemption applied, notwithstanding the presence of certain obligations (Article 3)

In principle, the Regulation followed the principle established by the Court of Justice in

declaring that clauses essential to either preserving the common identity and reputation of the network or preventing the know-how made available and the assistance given by the franchiser from benefiting competitors fall outside of Article 85(1) (recital 11). In so far as they are necessary to achieve these aims, the following restrictions were exempted by the Regulation:

(a) to sell, or use in the course of the provision of services, exclusively goods matching minimum objective quality specifications laid down by the franchisor;

(b) to sell, or use in the course of the provision of services, goods that are manufactured only by the franchisor or by designated third parties, where it is impracticable, owing to the nature of the goods that are the subject-matter of the franchise, to apply objective quality specifications;

(c) not to engage, directly or indirectly, in any similar business in a territory where it would compete with a member of the franchised network, including the franchisor; the franchisee may also be held to this obligation after the termination of the agreement, for a reasonable period that may not exceed one year, in the territory where it has exploited the franchise;

(d) not to acquire financial interests in the capital of a competing undertaking that would give the franchisee the power to influence the economic conduct of such undertaking;

(e) to sell the goods that are the subject-matter of the franchise 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;

Moreover, the exemption applied notwithstanding the presence of certain obligations on the franchisee. If, because of particular circumstances, these obligations fell within the scope of Article 85(1), they were exempted even if they were not accompanied by any of the obligations exempted by Article 1 of the Regulation (Article 3(3)). The list of such obligations formulated in Article 3(2) included the obligations:

(a) not to disclose to third parties the know-how provided by the franchisor; the franchisee may be held to this obligation after the termination of the agreement;

(b) to communicate to the franchisor any experience gained in exploiting the franchise, and to grant it, and other franchisees, a non-exclusive licence for the know-how resulting from that experience;

(c) to inform the franchisor of any infringements of licensed industrial or intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers:

(d) not to use know-how licensed by the franchisor for purposes other than the exploitation of the franchise; the franchisee may be held to this obligation after the termination of the agreement;

(e) to attend or have its staff attend training courses arranged by the franchisor;

(f) to apply the commercial methods devised by the franchisor, including any subsequent modification thereof, and to use the licensed industrial or intellectual property rights;

(g) to comply with the franchisor's standards for the equipment and presentation of the contract premises and/or means of transport;

(h) to allow the franchisor to carry out checks of the contract premises and/or means of transport, including the goods sold and the services provided, and the inventory and accounts of the franchisee;

(i) not to change the location of the contract premises without the franchisor's consent;

(j) not to assign the rights and obligations under the franchise agreement without the franchisor's consent.

4.4.7. Restrictions to which the exemption applied on certain conditions (Article 4)

The exemption applied on the conditions that:

(a) the franchisees are free to obtain the goods that are the subject-matter of the franchise from other franchisees; where such goods are also distributed through another network of authorised distributors, the franchisee must be free to obtain goods from the latter;

(b) where the franchisor obliges the franchisee to honour guarantees for the franchisor's goods, that obligation will apply in respect of such goods supplied by any member of the franchised network, or other distributors that give a similar guarantee, in the common market;

(c) the franchisee is obliged to indicate its status as an independent undertaking; this indication must, however, not interfere with the common identity of the franchised network, resulting in particular from the common name or shop sign and uniform appearance of the contract premises and/or means of transport.

4.4.8. Restrictions to which the exemption did not apply (Article 5)

The exemption did not apply if:

(a) undertakings producing goods or providing services that are identical or are considered by users as equivalent in view of their characteristics, price and intended use, enter into franchise agreements in respect of such goods or services;

(b) the franchisee is prevented from obtaining supplies of goods of a quality equivalent to those offered by the franchisor (with some exceptions formulated by the Regulation);

(c) the franchisee is obliged to sell, or use in the process of providing services, goods manufactured by the franchisor or third parties designated by the franchisor, and the franchisor refuses, for reasons other than protecting the franchisor's industrial or intellectual property rights, or maintaining the common identity and reputation of the franchised network, to designate third parties proposed by the franchisee as authorised manufacturers (subject to Article 2);

(d) the franchisee is prevented from continuing to use the licensed know-how after the termination of the agreement where the know-how has become generally known or easily accessible, other than by breach of an obligation by the franchisee;

(e) the franchisee is restricted by the franchisor, directly or indirectly, in determining the sale prices for the goods or services that are the subject-matter of the franchise, without prejudice to the possibility for the franchisor of recommending sale prices;

(f) the franchisor prohibits the franchisee from challenging the validity of the industrial or intellectual property rights forming part of the franchise, without prejudice to the possibility of the franchisor of terminating the agreement in such a case;

(g) franchisees are obliged not to supply, within the common market, the goods or services that are the subject-matter of the franchise to end users because of their place of residence.

4.5. Shift in the approach

4.5.1. Introduction

The Green Paper on Vertical restraints,[29] published by the Commission in 1997, opened the discussion on the reform of the EC competition policy with regards to the vertical restraints. It emphasised that, although efficient distribution with appropriate pre- and after-sales support is part of the competitive process that brings benefits to consumers, arrangements between producers and distributors can also be used to continue the partitioning of the market and exclude new entrants that would intensify competition and lead to downward pressure on prices. Agreements between producers and distributors (vertical restraints) can therefore be used pro-competitively to promote market integration and efficient distribution, or anti-competitively to block integration and competition. The Communication from the Commission on the applicability of the Community competition rules to vertical restraints[30] proposed therefore an economics-based approach to the vertical restraints policy. This approach was implemented in two subsequent regulations: Commission Regulation No 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical restraints and concerted practices, in force between 1 June 2000 and 31 May 2010, and Commission Regulation No 330/2010 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 that entered into force on 1 June 2010 and will remain in force until 31 May 2022) (discussed in the previous chapter).

4.5.2. The Green Paper on Vertical Restraints in EC Competition Policy – the main assumptions

The Commission stressed in the Green Paper that, despite the fact that the EU competition policy has been successful, after over 30 years of its application a review is needed, because:

(a) The Block-Exemption Regulations (BEs) in force so far comprised rather strict form-based requirements, and as a result were considered too legalistic and working as a straitjacket. The Commission emphasised that such an approach is inappropriate in light of the continuing market changes when it comes to the methods of distribution. The vertical agreements that fell within the scope of application of the BEs suffered from a compliance burden arising from unnecessary legal uncertainty. Companies without significant market power suffered unnecessary regulation and **could have been prevented from using vertical restraints to improve their competitive position in the market.** The system exempted from Article 85(1), without distinction, companies with 1% and 100% market share, even for non-compete obligations and certain combinations of vertical restraints such as exclusive and selective distribution. It led to the result that small operators (the vast majority of companies) suffered unnecessarily strict regulations, while companies with significant market power were able to protect themselves simply by drafting contract clauses to fit within the existing block-exemption regulation.

(b) Therefore, for agreements that fell within the scope of application of BEs there was a real risk of the Commission exempting agreements that distorted competition. The BEs were form-based rather than effect-based, and did not contain any limit on market share, so companies with significant market power could benefit from them. The sanction of withdrawal was not seen as a real deterrent because it worked only with effect for the future. There was no pressure on companies to change their agreements

[29] Green Paper on Vertical Restraints in EC Competition Policy, Brussels, 22.01.1997, COM(96) 721 final.
[30] Communication from the Commission on the application of the Community competition rules to vertical restraints, Brussels 30.09.1998, COM(1998) 544 final.

or conduct because they could effectively enjoy provisional validity for their contracts. The preventive effect of the prohibition system of Article 85(1) was lost. Irreparable damage to competition could be caused without any remedy for the past (e.g. market foreclosure through exclusive dealings). At the same time, **smaller operators were prevented from using vertical restraints in an innovative way to improve their competitive position on the market, which hindered the development of new dynamic forms of distribution.**[31]

(c) The BEs only covered vertical agreements concerning the resale of final goods and not intermediate goods or services, so a significant part of all vertical agreements was not covered by the BEs, even when the parties involved had no market power. This means that an unnecessarily large number of vertical restraints could have been scrutinised, resulting in legal uncertainty and unnecessary enforcement costs.

4.5.3. The Green Paper on Vertical Restraints in EC Competition Policy – options for developing the EU strategy

The Green Paper put forward four options for developing the EU strategy with regards to vertical restraints:

Table 4: Options for developing the EU strategy

Maintaining the current system	
Wider block exemptions	This option consisted of maintaining the current approach but making it more flexible, covering more situations and less regulatory. It raised the question whether it is appropriate to adopt a block exemption regulation for selective distribution, or an independent arbitration procedure for disputes concerning admission to such distribution systems.
More focused block exemptions	A third option was to limit the exemption given by current block exemptions to companies with market shares below a certain threshold (proposed 40%).
Reduced scope of Article 85(1)	This option proposed the introduction of a rebuttable presumption of compatibility with Article 85(1) (the “negative clearance presumption") for parties with a market share less than 20%. The negative clearance presumption could be implemented by a notice, and subsequently in light of the experience acquired, within the framework of a negative clearance regulation. The presumption of negative clearance could be rebutted on the basis of a market analysis taking account of factors such as market structure (e.g. oligopoly), barriers to entry,

[31] Communication, p. 21.

	the degree of integration of the single market or the cumulative impact of parallel networks. Above the 20% threshold, two variants were put forward: (I): the wider block exemptions described in Option II; and (II): to follow option III with wider block exemptions of up to 40% market share but an inapplicable or limited scope of block exemptions above this limit.

4.5.4. Communication from the Commission on the applicability of the Community competition rules to vertical restraints: the foundations of the new policy

The Communication from the Commission on the applicability of the Community competition rules to vertical restraints,[32] which followed the Green Paper, proposed an economics-based approach to the vertical restraints policy. As explained by Karel van Miert (European Competition Commissioner 1993-1999) upon the adoption of the Communication, the aim of the new policy was to shift toward a more economic approach while increasing the overall level of legal security for companies, by providing them with a "safe haven" within which it is no longer necessary for them to assess the validity of their agreement under competition rules. This was to restore freedom to contract for the vast majority of companies, while improving the protection of competition to the benefit of consumers.[33] The objectives of the competition policy reform declared by the Communication[34] were the protection of competition (the primary objective of Community competition policy, enhancing consumer welfare and creating an efficient allocation of resources) and market integration (in light of enlargement, a second important objective when assessing competition issues). Moreover, the new policy sought to provide a reasonable level of legal certainty for business, resulting in acceptable enforcement costs for industry and the competition authorities and increasing decentralisation.

4.5.5. Safe harbour

The proposed safe harbour consisted of one broad umbrella block-exemption regulation covering all vertical restraints for the distribution of goods and services (preventing unjustified differentiation between forms or sectors). The regulation was to use market-share thresholds to distinguish between agreements that are or are not block-exempted. Primarily based on a block-clause approach, i.e. defining what is not block exempted instead of defining what is exempted (to avoid the straitjacket effect), the proposed regulation was to facilitate the simplification of the applicable rules. The policy was to ensure that the vast majority of vertical agreements, where no significant net negative effect can be expected, no longer require individual scrutiny.[35]

The vertical restraints falling outside the safe harbour were not to be presumed as illegal but in need of individual examination (the burden of proof that the agreement in question infringes Article 85(1) and an examination of whether or not the agreement fulfils the conditions of Article 85(3) was to lie on the Commission).

[32] Communication from the Commission on the application of the Community competition rules to vertical restraints, Brussels 30.09.1998, COM(1998) 544 final.
[33] Press release IP/98/853, European Commission 1-2, as quoted by Terhorst, Reformation of the EC Policy on Vertical Restranits, 21 Northwestern Journal of International Law and Business, Vol. 21, No 343 (2000-2001), p. 346.
[34] Communication p. 6.
[35] Communication, p. 6.

4.5.6. General rules for the evaluation of vertical restraints

The Communication evaluated the vertical restraints.[36] According to the Commission: (1) vertical restraints that reduce inter-brand competition are generally more harmful than vertical restraints that only reduce intra-brand competition; (2) exclusive agreements are generally worse for competition than non-exclusive agreements; and (3) the possible negative effects of vertical restraints are reinforced when not just one supplier practices a certain vertical restraint with its buyers, but when also other suppliers and their buyers organise their trade in a similar way (cumulative effects).

4.5.7. Economic approach and market-share thresholds

The Communication proposed an economic-based approach according to which: (1) in the absence of market power, a presumption of legality for vertical restraints can be made except for certain hard-core restrictions; and (2) when market power exists, no general presumption of legality can be made. This led to a conclusion that, from an economic perspective, it is justified to use market-share thresholds to limit the application of a block-exemption regulation.[37]

The Commission made two policy assumptions for the market analysis. First, in the majority of cases a market share of 20% is normally insufficient to bring about net negative effects on competition that would result from vertical restraints practised by a single firm. Secondly, for certain vertical restraints, in light of significant efficiencies, a block-exemption of up to 40% market share, which is the level at which a risk of dominance starts, can be envisaged. Above that level there is a risk that the last condition of Article 85(3) will no longer be fulfilled. Accordingly, the use of market-share thresholds in a block-exemption regulation does not establish an infringement, but serves to exclude certain categories of vertical restraints from the application of Article 85(1) by applying Article 85(3). The Commission intended to maintain the withdrawal mechanism for the (rare) cases where a serious competition problem may arise below these levels of market shares.[38] The Commission considered one and two market-share thresholds (clarity and simplicity constituted the advantages of a single-threshold system, whereas a dual-threshold system allowed an economically-justified gradation in the treatment of vertical restraints reflecting differences in their likely anti-competitive effects). It was assumed that the threshold system would eliminate the vast majority of notifications probably 80 to 90% of all cases, and it should allow the Commission and the national competition authorities to concentrate on the important cases.

4.5.8. New policy towards franchising

Franchising was to be covered by new block exemption regulation, though it was not to be given any preferential treatment, “as it is a combination of vertical restraints.”[39] The Commission argued that franchising is usually a combination of selective distribution and non-compete obligations in relation to goods that are the subject matter of the franchise. Sometimes other elements, like a location clause or territorial exclusivity, are added. Therefore, these combinations should be treated according to the general criteria set out in the regulation. The Commission further pointed out that certain distribution forms – in particular franchising – involve the licensing of Intellectual Property Rights (IPR). Referring to the Pronupia judgement, the Commission stressed that, in franchising, the transfer of IPR is an essential element of this distribution format and is used to assimilate the

[36] Communication p. 19.
[37] Communication, p. 21.
[38] Communication, p. 22.
[39] Communication pp. 31 – 32.

commercial practices of the franchisee as closely as possible to those of the franchisor. This licensing may include restrictions that are necessary or complementary to the vertical restraints placed on the sale of the goods or services. While vertical restraints on goods or services are important from a competition perspective and may result in a franchise agreement falling within the scope of Article 85(1), these necessary or complementary restraints must be examined in light of the need to protect the know-how provided or the maintenance of the network' s identity and reputation.[40]

4.6. Regulation 2790/1999

4.6.1. Scope of application

Regulation 2790/1999 implemented the new ideas elaborated by the Commission in the Communication. The Regulation (umbrella type) covered virtually all sectors except for motor vehicles and certain categories of technology transfers,[41] and did not mention franchising expressly. Article 2(1) declared that Article 81(1) does not apply to agreements or concerted practices entered into between two or more undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions on which the parties may purchase, sell or resell certain goods or services ('vertical agreements'). The exemption applied to the extent that such agreements contain restrictions of competition falling within the scope of Article 81(1) ('vertical restraints').

4.6.2. Threshold

The Regulation introduced, in its Article 3, a 30% market share threshold providing a "safe haven" for small and medium-sized companies that "will enjoy more freedom and legal security in the drafting process of vertical agreements."[42] As the Regulation explained in motive 8 of the preamble, it can be presumed that, where the share of the relevant market accounted for by the supplier does not exceed 30%, vertical agreements, if they do not contain certain types of severely anti-competitive restraints, generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits. In the case of vertical agreements containing exclusive supply obligations, it is the market share of the buyer that is relevant in determining the overall effects of such vertical agreements on the market. Above the market share threshold of 30%, as explained in motive 9, there can be no presumption that vertical agreements falling within the scope of Article 81(1) will usually give rise to objective advantages of such a nature and size as to compensate for the disadvantages that they create for competition.

Moreover, the Regulation applied only to agreements falling within the scope of application of Article 81(1), and all agreements not capable of appreciably affecting trade between Member States or capable of appreciably restricting competition by object or effect were not caught by Article 81(1) (*de minimis* notice).

4.6.3. Vertical restrictions in Regulation 2790/1999

The Regulation declared that a block exemption should be granted only to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 81(3). Such vertical agreements can improve economic efficiency,

[40] Communication p. 32.
[41] Terhorst, Reformation of the EC Policy on Vertical Restranits, 21 Northwestern Journal of International Law and Business, Vol. 21, nr 343 (2000-2001), p. 346.
[42] Ibidem.

within a chain of production or distribution, by facilitating better coordination between the participating undertakings, and can in particular lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels (recital 6).

The Regulation did exempt vertical agreements containing restrictions that are not indispensable to achieve the positive effects mentioned above. Article 4, which dealt with hard-core restrictions stated that the exemption does not apply to vertical agreements that, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier imposing a maximum sale price or recommending 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, the buyer may sell the contract goods or services, except:

— the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer,

— the restriction of sales to end users by a buyer operating at the wholesale level of trade,

— the restriction of sales to unauthorised distributors by the members of a selective distribution system, and

— the restriction of the buyer's ability to sell components supplied for the purposes of incorporation to customers who would use them to manufacture the same type of goods as those produced by the supplier;

(c) the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment;

(d) the restriction on cross-supplies between distributors within a selective distribution system, including between distributors operating at a different level of trade;

(e) the restriction agreed between a supplier of components and a buyer who incorporates those components, limiting the supplier to selling the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.

Article 5 of the Regulation excluded certain obligations from its coverage even when the market share threshold was not exceeded. The Regulation continued to apply to the remaining part of the vertical agreement if that part is severable from the non-exempted obligations.[43] These restraints included:

(a) any direct or indirect non-compete obligation for an indefinite period or exceeding five years. A non-compete obligation that is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration. However, the time limitation of five years does 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

[43] Guidelines, p. 57.

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;

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

— relates to goods or services that compete with the contract goods or services, and

— is limited to the premises and land from which the buyer has operated during the contract period, and

— is necessary to protect know-how transferred by the supplier to the buyer, provided that the duration of such a non-compete obligation is limited to a period of one year after the termination of the agreement; this obligation is without prejudice to the possibility of imposing a restriction that is unlimited in time on the use and disclosure of know-how that has not entered the public domain;

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

4.6.4. Regulation 2790/1999 and franchising

As already stated, franchising was not expressly tackled by the Regulation. The Guidelines on Vertical Restraints that the Commission issued (further the "2000 Guidelines")[44] dealt expressly with franchising in points 199-201. The 2000 Guidelines emphasised that franchising may enable the franchisor to establish, with limited investments, a uniform network for the distribution of its products. Franchise agreements contain not only the provision of the business method, but also usually a combination of different vertical restraints concerning the distributed products, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.

The 2000 Guidelines stressed that franchising agreements contain licences of intellectual property rights relating in particular to trademarks 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 franchised business method. The franchisor is, in general, paid a franchise fee by the franchisee for the use of the particular business method.

The Guidelines dealt separately with the licensing of IPRs contained in franchise agreements (paragraphs 23 to 45). As for the vertical restraints on the purchase, sale and resale of goods and services within a franchising arrangement such as selective distribution, non-compete or exclusive distribution, the Guidelines explained that the Regulation applies up to the 30% market share threshold for the franchisor or the supplier designated by the franchisor. The guidance provided by the Guidelines in respect of these types of restraints applied also to franchising, subject to some specific remarks:

1) The more important the transfer of know-how, the more easily the vertical restraints meet the conditions for exemption.

2) A non-compete obligation on the goods or services purchased by the franchisee falls outside Article 81(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete

[44] Commission Notice, Guidelines on Vertical Restraints, 2000/C 291/01), OJ C 291/1 of 13.10.2000.

obligation is also irrelevant under Article 81(1), as long as it does not exceed the duration of the franchise agreement itself.

Moreover, the Guidelines provided an example of franchising (point 201).

A manufacturer has developed a new format for selling sweets in fun shops, where the sweets can be coloured specially on demand from the consumer. The manufacturer of the sweets has developed machines to colour the sweets and produces the colouring liquids. The quality and freshness of the liquid is of vital importance to producing good sweets. The manufacturer made a success of its sweets through a number of own retail outlets all operating under the same trade name and with the uniform fun image (style of lay-out of the shops, common advertising etc.). In order to expand sales, the manufacturer started a franchising system. The franchisees are obliged to buy the sweets, liquid and colouring machine from the manufacturer, to have the same image and operate under the trade name, pay a franchise fee, contribute to common advertising and ensure the confidentiality of the operating manual prepared by the franchisor. In addition, the franchisees are only allowed to sell from the agreed premises, to end users or other franchisees, and are not allowed to sell other sweets. The franchisor is obliged not to appoint another franchisee nor operate a retail outlet itself in a given contract territory. The franchisor is under the obligation to update and further develop its products, the business outlook and the operating manual and make these improvements available to all retail franchisees. The franchise agreements are concluded for a duration of 10 years.

Sweet retailers buy their sweets on a national market from either national producers that cater for national tastes or from wholesalers that import sweets from foreign producers in addition to selling products from national producers. On this market, the franchisor's products compete with other brands of sweets. The franchisor has a market share of 30% on the market for sweets sold to retailers. Competition comes from a number of national and international brands, sometimes produced by large diversified food companies. There are many potential points of sale of sweets in the form of tobacconists, general food retailers, cafeterias and specialised sweet shops. On the market for machines for colouring food, the franchisor's market share is below 10%.

The Guidelines explained that most of the obligations contained in the franchise agreements can be assessed as being necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 81(1). The restrictions on selling (contract territory and selective distribution) provide an incentive to the franchisees to invest in the colouring machine and the franchise concept and, if not a requirement, at least help maintain the common identity, thereby offsetting the loss of intra-brand competition. The non-compete clause excluding other brands of sweets from shops for the full duration of the agreements allows the franchisor to keep the outlets uniform and prevents competitors from benefiting from its trade name. It does not lead to any serious foreclosure in view of the great number of potential outlets available to other sweet producers. The franchise agreements of this franchisor are likely to meet the conditions for exemption under Article 81(3), in as far as the obligations contained therein fall under Article 81(1).

5. REGULATION 330/2010 AT A NATIONAL LEVEL

KEY FINDINGS

- In general, there is little information available on the functioning of Regulation 330/2010 in the context of franchising at a national level, as the Regulation is self-assessed by the parties.
- Representatives of franchisees and franchisors present opposing opinions when as regards the evaluation of the Regulation.
- The lack of data on how the Regulation functions in practice cannot be seen as confirmation that the Regulation functions properly. It might be assumed that the side-effects of the Regulation remain undetected.
- There is a marked tendency in Belgium and in the Netherlands for franchisees to invoke the Regulation as a "weapon of last resort" to free themselves from franchising contracts.

5.1. Introduction

5.1.1. Application based on self-assessment and conflicting opinions of the industry

Generally speaking, in the legal systems under scrutiny there is no in-depth information about the use of 330/2010 Regulation in practice. Only in some countries does the Regulation give a foundation to decisions of the competent authorities or court cases. This is easily explainable by the fact that the Regulation is applied in a self-assessment process that does not involve public authorities and requires that the parties assess themselves whether they enjoy the benefits of being exempted under the Regulation, or whether an individual exemption is required.

5.1.2. Conflicting opinions of the representatives of franchisees and franchisors

There is no unanimity among the market players when it comes to evaluating the content of 330/2010 Regulation and the problems that it causes in practice. Franchisees and franchisors express clearly opposing views in this regards.

The franchisors organisation strongly stress that the current legislative environment is very well suited to the needs of the franchising market, and in particular it considers the interests of the parties engaged in the franchising contract in a very balanced and fair way. Any changes, and in particular the changes that would shift the normative balance between the parties more into the benefit of the franchisee would harm the franchising market and its prospects. The franchisors do not observe problems when it comes to functioning of franchising contracts, other than those steaming from a male performance of the franchisees. In the opinion of EFF if there are problems on the franchising market, they are not result of the content of the vertical restraints but the way the restraints are used in practice, which amounts to unfair commercial practices, and has a sector specific character. The continuity of the approach of the recent Regulations (content of 2790/1999 and 330/2010 is almost identical) is seen as a proof of the correctness of the approach towards the vertical restraints.

The franchisees organisations, on the other hand, point out many problems encountered

by the franchisees that remain invisible,[45] due to the fear factor that silences franchisees. UAPME, an organisation that calls itself the voice of small and medium enterprises in Europe, gives the following list of demands:

(a) Limiting the non-compete obligation to the contract period. According to UAPME the protection of know-how does not justify the exclusion of a franchisee from the market. Moreover, the franchisor gets compensated for the transfers of know-how through the fees the franchisee pays during the contract. According to their view not only the sector itself is more and more convinced that a balanced agreement should not contain a post contract non- compete obligation, but also the non-compete obligations are simply ineffective. Competition e.g. by a third party in the neighbourhood of the same selling point can never be avoided. As a result, only the franchisee is punished by such a clause while it has nearly no positive effect at all on the protection of the competitiveness of the supplier.

(b) The Regulation should contain a provision stating that the block exemption will not apply to vertical agreements containing a clause, in which the valuation of the business is fixed at the moment of the signature of the agreement. Such clauses restrict the free market and deprive the buyer of the possibility to sell his/her business at the end of the agreement at a competitive price. UEAPME believes that pre-emptive rights are only acceptable if the free competitive market can continue to play. If a buyer wants to sell his/her business, in which he or she has invested him/herself and for which he/she has taken risks, then he/she should be allowed to do so. Predetermined prices, as they are mostly lower then the real value, should be considered as “unwritten”.

(c) The Regulation should not apply also to agreements that contain performance obligations which oblige the buyer to generate a certain turnover in a fixed period or to purchase an X number of goods. Moreover, any sales obligation should never be linked with a dissolution clause: clauses that contain the possibility to dissolve unilaterally and immediately the contract without taking into account external factors should be declared null and void. After all, good commercial co-operation agreements depend on the efforts of every party. Unilateral imposed performance obligations harm commercial co-operation.

(d) UEAPME stresses additionally that retailers and franchisees can suffer from competition from their providers and franchisers as for example through direct internet selling by these providers and franchisers. While the retailer and franchisee have to cooperate in the services of the franchiser, the franchiser is operating in the “exclusive” market of the franchisee. UEAPME regrets that the Regulation does not take that into account.

5.2. National level - general overview

Since 330/2010 Regulation is self-assessed and self-applied, the vast majority of information on its practical application is hidden on the market. Only the cases that made it to the courts or competent competition authorities can be reported.

In **Belgium,** although the Regulation is used frequently for the interpretation and assessment of franchising agreements, there is little case law publicised regarding franchise agreements. The application of the Regulation is, however, a well-established principle. In **Estonia,** the requirements set out by the Regulation are normally taken into account before a franchise contract is concluded, as the violation of the prohibition on

[45] See also „Level playing field franchisors and SME franchisees”, available at https://www.vakcentrum.nl/paginas/openbaar/onderwerpen/ondernemerschap/franchising.

restrictive agreements is a criminal offence under Estonian law. Therefore, competition restrictions in vertical agreements (including franchise contracts) are usually formulated to fall within the accepted limits of the Regulation. Franchise contracts with large international franchisors present in Estonia have often been drafted by franchisors who have been advised on the Regulation, and their contract drafts are in most cases in line with the Regulation. In **France,** the Regulation operates relatively well and is subject to many court rulings concerning also purely internal disputes. However, its importance is limited when it comes to the formulation of contract clauses in practice, as the imperative provisions of the *Code de commerce* relating to distribution clauses provide for much more detailed rules in some areas. Furthermore, the practical significance of the Regulation may soon decrease further due to the entry into force of the much more detailed provisions of law No 2015-990 of 6 August 2015 on the growth, activity and equality of economic opportunities (the "Macron" law), which aims at promoting competition and protecting the vulnerable party, i.e. the franchisee. In **Germany**, according to information provided by the Bundeskartellamt (Federal Competition Office), there are no reported problems when it comes to the application of the Regulation. It is worth noting, however, that the provisions of the Regulation were used as a benchmark to decide whether a franchise agreement is immoral. In **Italy,** because of the control powers of the Authority for Market and Competition, which initiates investigations whenever there is the possibility that a business is pursuing its activity in violation of competition law, contracts are often drafted or amended in compliance with the requirements of national and EU legislation, which reduces litigation. That being said, also in Italy there is no reported case law on the application of the Regulation to franchising contracts. In **the Netherlands,** the Regulation has so far been used only sparingly in combination with issues arising from franchising contracts. Mostly it is invoked in the assessment that Dutch courts make of non-competition clauses and their validity (pursuant to Article 5 of the Regulation). Additionally, when the franchisees attempt to release themselves from the obligations under the franchise contract by claiming its invalidity due to the infringement of the prohibition on restrictive agreements and unfair competition, the courts seem willing to consider whether these contracts fall under the exemptions set in the Regulation. Given that, in the examined cases, the franchisees did not manage to prove the existence of unfair restrictions of competition in their respective markets as a result of the franchise contract, the Regulation, setting exemptions from being perceived as such, does not have a significant role to play in defending the franchisors' practice. In **Romania,** the Romanian Competition Authority (*Consiliul Concurenței*) has applied the Regulation in a number of cases, but very few of them related to franchising contracts and operations. In **Poland**, according to the information provided by UOKiK (the Office of Competition and Consumer Protection), the Office normally applies the Polish version of the Regulation: Regulation of the Council of Ministers of 30 March 2011 on excluding certain types of vertical agreements from the prohibition on agreements that restrict competition (PL: *Rozporządzenie w sprawie wyłączenia niektórych rodzajów porozumień wertykalnych spod zakazu porozumień ograniczających konkurencję*). Only rarely are the proceedings conducted on the basis of the EU law. The Office claims that they have virtually no cases involving the evaluation of whether an agreement between businesses meets the conditions of the block exemption. In **Spain** there are only a few references to the Regulation in a resolution regarding franchising adopted by the National Commission for the Market and Competition (CNMC).[46]

[46] The CNMC, and in particular its competition department, is an institution created in 2013 to replace the Tribunal for the Defence of Competition in the supervision of competition issues.

5.3. Typical problems with application

Belgium and **Estonia** notified difficulties with defining the relevant product and geographical markets and with calculating market shares. It is particularly perilous in **Estonia**, because an erroneous assessment could result in a criminal offence, as if the market shares are underestimated, then the block exemption does not apply and the conditions of individual exemption may not be satisfied, and in this case the contract may be in the ambit of Article 101(1) and its Estonian equivalent.

Additionally, in **Belgium,** franchise agreements are often combined with exclusive distribution, which would allow the franchisor the possibility to limit active sales of the franchisee into the territory of other franchisees. Franchise agreements can also be regarded as selective distribution systems, which would make it impossible to limit active sales, according to the Regulation. This has been rather controversial. The Guidelines to the Regulation stipulate that a combination of exclusive distribution and selective distribution is only exempted by the Regulation if active selling in other territories is not restricted. In practice, however, franchisors often want to grant exclusive territories to their franchisees and want to protect each franchisee from active competition in that territory from other franchisees. In particular, in industry sectors where sales are not limited to sales within a point of sales, but where franchisees visit their clients outside a brick and mortar point of sales, this gives rise to difficulties (e.g. the real estate sector, the insurance sector and the travel agency sector).

5.4. Case law

When it comes to case law on the application of the Regulation, as franchises make up only a marginal fraction of enterprises in **Estonia,** there is no case law to be found. In **Italy,** even national antitrust law 287/1990 has rarely been applied to franchising contracts, since clauses that were claimed to be anticompetitive had little significance because of the low market share of the enterprises involved. In **Belgium,** cases relate to the calculation of market shares and the practical implications of non-compete clauses. There is some case law regarding resale price maintenance, especially in supermarket industries, where franchisees are often linked to the franchisor's centralised till system, to facilitate stock management. Through such a system, the franchisor de facto lists the product at the 'recommended resale price'. Up until now, case law has ruled that if the system allows the franchisee to easily adapt the prices for the products, then this is not a violation of the hard-core restriction of Article 4 of the Regulation. Established case law can be found in **France**, **Germany, the Netherlands, Romania** and **Spain**; in **Poland** just one case has been decided so far.

In **France,** the most notable case is the ruling of the *Cour de Cassation* of 9 June 2009, No 08-14301 concerning the validity of an anti-competition clause in an internal dispute (no intra-community character). A franchise agreement concluded for seven years contained anti-competition clause, which lasted for one year after the termination of the agreement and covered an area of 30 kilometres from the supermarket. The clause prohibited the franchisee: (1) from operating or participating in any other manner, directly or through an intermediary in the operation, management, administration of an enterprise or a company having the same or a similar field of activity as the franchised unit, and (2) joining, associating or participating in any manner whatsoever in a chain competing with the franchisor, creating such a chain himself, or more generally from binding himself to any group, entity or company competing with the franchisor. The court ruling awarding compensation for the breach of this clause was overruled by the Cour de Cassation, which applied Article 5 (b) of 2790/1999 Regulation to check the admissibility of the clause. As the Cour de Cassation underlined, the exemption under Article 5 b) of Regulation

2790/1999 for post-contractual non-compete clauses is reserved only to those, for a period of one year, that are limited to the premises and land from which the franchisee has operated during the contract period and are necessary to protect the know-how that was transferred to it by the other party. Therefore, the territorial scope of the anti-competition clause was too wide.

Germany

Box 3: Invalidity of a franchise contract based on infringing antitrust law

If a franchising contract contains a clause that violates the hard-core restriction contained in Article 4 of Regulation 330/2010, it leads to the invalidity of the entire contract. In general, § 139 BGB allows the contract to be upheld (as if it was concluded without the invalid clauses), but this possibility does not arise in the case of violating Article 4 of the Regulation. Upholding such a contract would be against the intentions of the EU legislator, as the prohibition given in Article 4 of the Regulation is considered a serious violation of antitrust law and should lead to the invalidity of the entire contract. The invalidity of the entire contract follows from § 139 BGB, and is based on the breach of the hard-core restriction contained in Article 4 of the Regulation. It is considered as a breach of a statutory prohibition, as established by § 134 BGB. In this case, the clauses concerned absolute territorial protection, the obligation to take supplies from the franchisor only, the prohibition on cross-supply among franchisees and price-fixing, which all fall under Article 4 of the Regulation.

Munich Regional Court I, judgment of 13.06.2013, Az.: HK O 9678/11

Box 4: Ineffectiveness of a franchise contract due to an infringement of antitrust law

In this judgment, the Hamburg district court decided, in line with the decision of the Munich Regional Court referred to above, that violating the antitrust law provisions (hard-core restrictions) leads to the ineffectiveness of the franchising contract. In this case, the franchising contract was concluded before 31 May 2010, and so Regulation 2790/1999 was applicable. The Court expressly stated that Article 81(3) should prevail, though the result would be the same if Regulation 330/2010 was applied, as also then the legal consequences would be established via § 134 BGB.

LG Hamburg, judgment of 06.06.2012, Az.: 315 O 77/11

Box 5: Purchasing obligations are necessary in order to ensure the efficiency of a franchise system, and therefore do not restrict competition

The Court followed the line established by the ECJ in the Pronupia case and the judgement of the second instance court in Dusseldorf (judgment of 11.04.2007 - VI-U 13/06 Kart), in stating that purchasing obligations within a franchise system are necessary for the functioning of the system, as long as they do not restrict competition and therefore do not violate § 1, 2 para. 2 of the GWB (Gesetz gegen den unlauteren Wettbewerb) and Article 101 TFEU in conjunction with Article 1d, 5a of Regulation 330/2010, which could result in the entire franchise agreement being declared invalid on the basis of §§ 134 and 139 BGB. In specific situations, purchasing obligations are necessary to ensure quality and uniform standards in franchising systems. It applies

even when there is a range of only 102 products in the system, because variations in quality can also appear in such a case.

LG Dusseldorf judgment of 21.11.2013, 14c O 129/12

Box 6: The Regulation sets standards to evaluate whether a contract is immoral

In this case, the parties had mutual claims on the basis of a franchising contract. The claimant (franchisor) asked for the payment of the purchase price for delivered goods and the payment of a consulting fee. The defendant (franchisee) made a claim for damages due to the fact that he was not informed about all relevant facts at the conclusion of the contract. Further, the franchisee claimed that the contract is invalid and the franchisor has no claims against him. The franchisee raised the following grounds for invalidity: invalidity due to voidance (*Anfechtung*). § 142 BGB, moral invalidity due to § 138 BGB or invalidity on the grounds that the contract was duly terminated. On the question of moral standards, the Court pointed out that a transaction is immoral on the grounds of § 138 para. 1 BGB when there is a significant lack of balance between the rights and obligations of the parties and one of the parties will sustain damage as a result. Moreover, an act in law is immoral when the economic freedom of a contracting party is so limited that he loses his self-determination. In this case, however, the Court failed to find reasons to establish that the contract is immoral. In its reasoning, the Court recalled certain provisions of the Regulation, and concluded that, since the franchising agreement contains clauses that are permitted by European law, they cannot be contested on the ground of immorality.

OLG Rostock, decision of 29.06.1995, 1 U 293/94

The Netherlands

Box 7: Non-competition clause

An international company, Vedes, with its registered office in Germany, has a retail formula for selling toys under the name of “Vedes”. A daughter company of Vedes, Simon, with its registered office in the Netherlands, set up its own, independent retail formula under the name of “Top1Toys”. The companies compete with one another. Vedes hired person X, who, according to Simon, had knowledge of the organisation, working methods and clients of Simon. Simon further claimed that person X breached its non-competition obligation and that Vedes profited from this breach, which the Dutch courts should evaluate as tort against Simon. Vedes argued for the non-application of the non-competition obligation due to the franchise contract limiting fair competition on the toy-selling market.

The court of first instance assessed that the contract between Simon and person X obliges person X to purchase Simon’s toys only “to the extent that it is possible”, which means that this is not a case of an exclusive purchase channel. This sort of contractual term does not limit or hinder competition on the market, according to the court.

Simon introduced a non-competition contract term that continued to bind person X for two years after the termination of the contract. The court stated that this is within the five-year deadline set in Article 5 (1)(a) of the Regulation. The non-competition clause

was also not contrary to the purpose of Article 5 (1)(b) of the Regulation, since the contractual term obliged the franchisee not to conclude cooperation and other purchase-related contracts, which is not equivalent to a prohibition on purchasing, selling or reselling toys. Most importantly, Vedes did not manage to prove that the enforcement of the non-competition clause would hinder or limit fair competition.

Vedes appealed against this judgment. Gerechtshof Arnhem-Leeuwarden (Court of Appeal), with its judgment of 15 October 2013 (ECLI:NL:GHARL:2013:7702), confirmed the judgment of the court of first instance. Even though the Court of Appeal seemed to suggest that it could consider, contrary to the court of first instance, that the non-competition clause is drafted in a way that it contradicts Article 5 (1)(b) of the Regulation, the court still failed to see how the clause would lead to unfair competition on the market (the franchisee failed to prove this) and, therefore, the court of appeal did not see any reason to invalidate this clause.

Rechtbank Almelo (court of first instance), 7 March 2012, ECLI:NL:RBALM:2012:BV8702

Box 8: Clause stetting price

City Box is a self-storage business with 24 locations across the Netherlands and three franchise contracts, including for a storage location in Drachten. As of 2007, Drachten Storage had a franchise contract with City Box. Drachten Storage claimed that the franchise contract infringed the prohibition on restrictive agreements, and therefore, should be invalidated.

The court of first instance recognised in this case that the franchise contract contained a clause setting prices for the franchisee, aimed at preventing price-dumping practices. City Box claimed that this clause was necessary to protect the know-how, the identity and the reputation of its brand, and that there was no intention to restrict competition. The court considered this clause to be a hard-core restriction as listed in Article 4 of the Regulation. The price-setting clause could not serve to protect the reputation, know-how, etc. of the trader, since there were other provisions in the contract to this purpose, such as on the supervision of the franchisee's operation and non-competition clauses. The price setting clause, therefore, had a definite aim of limiting competition, and so restriction should be prohibited. However, the Court did not answer whether the Regulation applied and whether such a provision could fall under the exemption, since the franchisee had failed to prove that the competition on his market would have been grossly impacted by this restriction (the franchisee claimed that CityBox has circa 20% market share, but could not specify the exact market share after this number was questioned by CityBox).

Rechtbank Amsterdam (court of first instance), 21 August 2013, ECLI:NL:RBAMS:2013:6591

Box 9: Annulment of the non-competition clause

Yarden Franchise concluded a franchise contract with person X on 1 October 2008 for a period of five years. The contract was dissolved on 30 September 2013. On the basis of the franchise contract, person X provided funeral services pursuant to the Yarden formula. The contract had a non-competition clause prohibiting person X from being directly or indirectly involved in a company or having financial or other professional

interests in activities related to those performed under the franchise contract for a period of one year after the termination of the franchise contract, within the geographical area mentioned in the contract. Person X claimed that this clause is too broad, while Yarden demanded the enforcement of a contractual penalty for an infringement of this non-competition clause.

With regard to the non-competition clause, the court declared it to be fair, since it did not seem to impede competition on the market, at least in the limited picture of the market that the franchisee provided to the court (without making distinctions between local and regional markets; funeral and cremation services; funeral services and franchised funeral services etc.).

Additionally, person X tried to have the contract annulled, and in this way get out of the non-competition clause. He claimed that the franchise contract should be invalidated because it contained an illegal resale price maintenance. Due to the small fees that person X received for selling insured funerals and cremations, for uninsured services and for additional services he had to ask the maximum prices set by Yarden, which de facto forced a resale price maintenance on him. He was also forced to purchase goods only from Yarden or its distributors, according to person X. Yarden claimed that the maximum prices were only recommended prices and that the franchisee was allowed to deviate from them, which he did in practice. Person X added to this that the market share of Yarden with respect to cremations was more than 30%, and with respect to funerals it was above 10%. The court did not find the practices of Yarden with regard to setting recommended maximum prices as leading to unfair competition, and therefore found no grounds to invalidate the franchise contract (or to refer to the Regulation to establish whether such a practice could fall under the block exemption).

Rechtbank Midden-Nederland (court of first instance), 11 June 2014, ECLI:NL:RBMNE:2014:7395

The only once franchising case decided in **Poland** on the basis of 330/2010 Regulation concerned the biggest franchising chain for casual dining ("Sphinx") operated by Sfinks Polska SA. The Sphinx chain comprises of 91 restaurants, 46 of which are franchise restaurants and 45 of which belong to the franchisor. In 2013 UOKiK fined Sfinks Polska for imposing fixed resale prices on its franchisees (decision DOK-1/2013 of 25 June, 2013). The case was opened on the basis of signals from the market received by UOKiK. The fine imposed on Sfinks Polska was rather low (464,000 PLN - approximately 100 000 EUR). UOKiK established that Sfinks Polska arbitrarily imposed menu prices on its franchisees, which, as emphasised in the decision, is one of the most serious infringements of competition law. UOKiK also held unlawful the provisions that required the franchisees to participate in price promotions, lasting from two weeks to several months, during which Sfinks Polska imposed the prices of meals. In this regard UOKiK referred to the 2010 Guidelines, according to which franchisors may fix prices for the entire chain only in pro-motional campaigns, consisting in lowering prices, lasting for up to six weeks. UOKiK did not question the franchisor's right to control promotional campaigns conducted by franchisees, but limited it to technical and visual aspects of the promotion, significant for protecting the brand and the chain's reputation. UOKiK did not conclude that the franchisor cannot monitor resale prices charged by its franchisees, but stressed that imposing fixed or minimum resale prices goes beyond what is necessary for operation of the chain, is harmful to consumers, and restricts competition among franchisees acting on local relevant markets.

In **Romania,** the most prominent case is Decision No 65 of 31 October 2012 of the Consiliul Cocurentei concerning the acceptance of the commitment of Fornetti Romania SRL (Fornetti Romania).[47] The case originated from an investigation opened by the Competition Authority concerned with the agreements and practices between Fornetti Romania (franchiser) and its franchisees that were alleged to breach Article 101 of the TFEU though fixing selling prices and limiting competition through non-compete clauses valid for two years after the termination of the franchising agreements. Fornetti Romania is a multi-unit franchiser with circa 600 franchisees around Romania; it is controlled by the Hungarian mother-company Fornetti Holding Kft., and which is the master-franchisee of the mother-company for the Romanian territory. The franchised activity consisted in manufacturing and selling pastry products.

The franchiser admitted to have acted in cooperation with franchisees to fix prices, initially through inserting mandatory selling prices clauses in the franchising contracts, and subsequently, when such clauses were removed from the contracts, through monitoring the operations of the franchisees. As a result, it advanced a request for the acceptance of its commitment to remove the practices that were deemed anti-competitive by the Authority. The commitment was accepted by the Consiliul Concurentei and substantially contained the following obligations of the franchisor: eliminating any practice meant to fix and control the sale prices of the products, leaving the pricing policy exclusively to the franchisees (except for marketing promotion periods no longer than six weeks), amending the franchising contracts correspondingly, reducing the period of the non-compete clause from two years to one year after the termination of the franchising agreements.

In **Spain,** in a Resolution of 10 April 2014, the CNMC applied Regulation 330/2010 and indicated that the obligation imposed by the franchisor in the DIA chain of supermarkets on his franchisees to buy exclusively from the franchisor (non-competition clause) does not infringe competition. Non-competition clauses do not generally benefit from the exemption when they last for longer than five years (Article 5(1) of the Regulation), even in cases where the franchisor has a market share of less than 30%, unless the franchisor is the owner or possessor of the location used by the franchisees (Article 5(2)). As to fixing the price, the franchisor indeed fixes a maximum price, but the practice is allowed by Article 4(a) of the Regulation. Regarding the post-contractual non-competition clause, Regulation 330/2010 allows these clauses if they do not last longer than a year (Article 5.3). The prohibition on active sales outside the territory where the franchisee has exclusivity is also allowed by the Regulation (Article 4 (b) (i)).

On 1 July 2014, the CNMC initiated proceedings against the franchisor Food Service Project (ZENA) because there were reasonable suspicions that it does not comply with competition rules. The franchisor (1) unilaterally determined the suppliers and providers for its franchisees, and (2) fixed resale prices. A claim regarding the unilateral determination of suppliers by the franchisor could have succeeded on the basis of Regulation 4087/88, but not Regulation 330/2010 because with the Regulation currently in effect, any restrictions are relevant if the market share of the parties is more than 30% or if the restrictions are serious, which is not the case when the franchisor unilaterally determines the suppliers of its franchisees. The CNMC has decided, however, that both restrictions may be sanctionable. A resolution is still to come.

Some appeal courts have referred in their decisions to the importance of respecting the non-competition clause. They do not mention the application of Regulation 330/2010,

[47] See online: http://www.consiliulconcurentei.ro/uploads/docs/items/id8105/decizia_fornetti-publicare_site.pdf.

however, because the issue at stake is not the duration of such a clause, which is normally agreed for a year, but the non-compliance of the franchisee with that rule.[48]

Even though there are no Supreme Court (Tribunal Supremo, TS) cases on the application of Regulation 330/2010 as regards franchising contracts, the TS provided certain criteria for the co-application of private and competition law regarding franchising in its decision of 30 July 2009.[49] This decision regards the application of the "minima rule", which applies in Spain regarding competition issues, and which has even been consecrated in Article 3 of the Law on Defence of Competition. According to this rule, restrictions on competition are only prohibited if the impact on the market is relevant. This is not the case when the market share is of no significance, or if the market share is significant but the specific restriction has no relevant impact on the market. The TS has stated in the above mentioned decision (against the franchise network SVENSON) that the ´minima rule´ is to be applied restrictively if the action regards the direct or indirect fixing of prices. Franchisor SVENSON argued that the action was not relevant enough to restrict competition in the market. The TS ruled that the probability that such conduct could lead to a direct or indirect influence on the commercial exchange between countries, based on objective factors and not on intentionality, and it suffices to not apply the ´minima rule´. Such a probability normally exists when there are many franchised premises of the same network in various countries of the EU, and an important network in Spain. Factors that are to be considered to analyse whether the ´minima rule´ applies, are:

- the existence of a plurality of agreements between franchisor and franchisees,
- the geographical area and
- the type of clause.

Black clauses, such as clauses giving the prerogative to the franchisor to fix resale prices, can never benefit from the ´minima rule´. These clauses are listed in Regulation 330/2010.

5.5. Specific clauses in practice

5.5.1. Long-term competition clauses

No problems relating to long-term competition clauses were reported in **Estonia**, **Germany**, **Romania, Spain** or **Poland**.

In **Belgium,** the most relevant case law concerns the validity of the non-competition clauses. According to the Regulation, a post-contractual non-compete clause must be limited to "the premises and land from which the buyer has operated during the contract period." In a franchise context, for some sectors, a non-compete clause is only useful if it applies to the entire territory that was granted to the franchisee. Some Belgian scholars therefore argue that the scope of the post-contractual non-compete could be somewhat broader than the former point of sales (as was the case under the former specific block exemption for franchise agreements, Regulation 4087/88[50]). This is motivated based either on an individual exemption or on a liberal interpretation of "the premises and land…" as in Article 5 of the Regulation.

[48] See footnote 19.

[49] *STS* 30 July 2009, Roj: STS 5933/2009 - ECLI:ES:TS:2009:5933. There are references of judicial proceedings regarding competition but they regard distribution chains and not franchising chains. For example: *STS* 2 June 2015, Roj: STS 2544/2015 - ECLI:ES:TS:2015:2544 on restrictions of competition by suppliers of distribution chains of gas stations because of the fixation of resale prices (REPSOL/CEPSA/BP).

[50] Regulation No 4087/88 of the Commission of 30 November 1988 regarding the application of Article 85, 3 of the Treaty on groups of Franchise agreements, Pb.L. 359/46 of 28 December 1988.

In addition, the sanction of invalidity of non-compete clauses violating Article 5 of the Regulation gives rise to different interpretations. On 23 January 2015, the Belgian High Court (*Cour de Cassation*) has ruled that a non-competition clause that is deemed too long cannot be completely annulled by the court, but must be brought back to a duration that is legally possible if the parties have foreseen this possibility in their contract.[51] It is not yet clear, however, whether this case law also applies to non-compete clauses in vertical agreements that are not compliant with Article 5 of the Regulation.

In **the Netherlands,** non-competition clauses are one of the most frequent problems raised in the case law (on that see point: 5.4 above). In **Italy,** there is a specific regulation in the Civil Code stating that non-competition clauses must be limited to a certain territory and activity, and cannot exceed five years. Longer clauses are automatically reduced to five years. The franchising legislation does not provide special regulation in this regard. Contracts often include also a one-year post-termination non-competition clause.

5.5.2. Purchase options

In **Belgium,** it is not uncommon for franchise agreements to include a purchase option (or pre-emption right) on the business of the franchisee, upon the termination of the franchise agreement for whatever reason. Franchisors who wish to execute such a purchase option are likely to be confronted by the franchisees challenging the validity of either the termination or the purchase option, and the franchisor is obliged to launch summary proceedings to be allowed to take over the business of the franchisees. Some Belgian judges are reluctant to allow franchisors to execute such a forced execution of the purchase option in summary proceedings. This is often detrimental to the value of the business, since a decision on the merits can take several months to obtain. This means that the business is operated under a different brand and/or concept for several months after a franchise agreement ends before the franchisor is granted a forced execution of the purchase option. De facto, the purchase option therefore loses all benefits of being able to continue operating a point of sales (either directly or via a new franchisee) in a going concern. In most cases, the parties are therefore forced to reach an amicable solution. In principle, the case law recognises the validity of a purchase option, unless such a clause is abusive.

No particular problems have been reported in **Estonia, France, Germany, Italy, the Netherlands, Romania** or **Poland**.

5.5.3. Multi-franchising

No particular problems were reported concerning multi-franchising in **Belgium, Estonia**, **France, Germany**, **Italy, the Netherlands**, **Romania** or **Poland**.

5.5.4. Block exemptions

No problems were reported in **Estonia**, **France**, **Germany, Italy, the Netherlands**, **Romania** or **Poland**.

In **Spain,** cases brought before the CNMC by franchisees of the supermarket chain DIA claim that the franchisor has imposed an indefinite non-competition clause that imposes an exclusive purchase obligation on the franchisee. However, such a long-term non-

[51] This approach contrasts with the approach of the Dutch High Court (Hoge Raad) - HR 18 December 2009, 08/00899, NJ 2010, 410 – that did not accept that the courts had the competence to convert invalid non-competition clauses to valid clauses. This competence was considered to undermine the deterrent effect of the prohibition of clauses restricting competition.

competition clause (more than five years) is allowed by Regulation 330/2010 when the franchisor is the owner of the business premises.

5.6. Overall assessment of the functioning of 330/2010 Regulation on a national level

In **Belgium,** Regulation 330/2010 is not often used directly in case law concerning franchising agreements. It is mostly only called upon in cases where there is already a dispute between a franchisor and a franchisee, because the franchisee is not (or no longer) satisfied with the commercial formula or the assistance of the franchisor, and is looking for a way out of the franchise agreement. In such cases, the franchisee uses the Regulation to look for flaws in the franchise agreement enabling the franchisee to get out of the agreement, without being bound by notice periods and post-contractual obligations (such as a non-compete clause). In the case of an annulment, franchisees can also claim the repayment of the entrance fee, for example. The Regulation is not always easily transposable to a franchise context. This is especially true as a franchise agreement often combines elements of a selective and of an exclusive distribution agreement, which causes problems. Belgian lower courts in general lack expertise regarding competition law and could therefore use clearer guidelines on how to apply the Regulation to franchise agreements. The protection of intellectual property rights in franchise agreements and the extent to which the protection of trademarks or of know-how can justify exceptions from the rules set by the Regulation could be better explained in the Guidelines. The individual exemption (Article 101 (3) TFEU) requires a difficult self-assessment and assistance from the Guidelines, which is very general. Most franchisors are not willing to take this risk and the only safe option, therefore, remains within the (strict) conditions of the Regulation. In **Estonia,** as there is no relevant case law or practice of the Estonian Competition Authority with respect to franchise contracts, it is hard to make an overall assessment on the functioning of the Regulation. No analysis exists in **Germany** as to whether and how Regulation 330/2010 functions in practice. The body responsible for the application of the Regulation, the Bundeskartellamt, applies the Regulation directly, according to the guidance of the ECJ, to ensure that there are no divergences in this regard. Since it is the CJEU that has the final world when it comes to the interpretation of the Regulation, it would ultimately lead only to unnecessary problems if the German authorities would go against the interpretation of the Court. In **Italy**, while case-law does not offer indications, part of scholarship has criticised the stance of the Regulation and the Guidelines as being too distrustful and limitative of resale price maintenance, which, although being opposed in EU competition policy, is perceived by the franchising business community as necessary to maintain price uniformity in the entire network.[52] The same scholarship is also cautiously critical towards the vague regulation of online sales of the franchisee.[53] In **the Netherlands,** the case law suggests that the application of the Regulation to franchise contracts fails due to the lack of information/ documentation presented by the franchisee on the market share, and the influence of the franchise practice on the competition in the given area. The Regulation is invoked in proceedings as a potential argument to defend against unfair competition claims, but the franchisees never get to use it due to the lack of convincing arguments on the franchisee's side that there is a restrictive agreement to begin with. Unfortunately, among other things, the franchisee has to prove, for example, that the non-competition clause in the franchise contract hinders competition on the Dutch market, the courts may not automatically assume this or search for evidence thereof on their own initiative, see, for example, Hoge Raad (Supreme Court), 16 January 2009, NJ 2009, 54 (Whizz Croissanterie). In **Poland,** there is no relevant practice and almost no decisions. The companies make the self-assessment without referring to the Competition and Consumer Protection Office, and there are no available sources to verify the practice. In **Romania,** no criticism was voiced by the competent authorities concerning the

[52] Frignani, Franchising under Regulation 330/2010 on vertical restraints, International Journal of Franchising Law 2011; Frignani and Pardolesi (ed), *La concorrenza*, Turin, 2006, p. 131.

[53] Ibidem.

functioning of the Regulation with respect to franchising contracts. In **Spain,** there is only a little information about the application of Regulation 330/2010 in a franchising context. The CNMC has indeed taken Regulation 330/2010 into consideration because it was applied in the decision in the proceedings against the supermarket franchise chain DIA in order to conclude that the claims of franchisees were not grounded because the clauses imposed by the franchisor were not against the competition.

6. NATIONAL PRIVATE LAW APPLICABLE TO FRANCHISING – GENERAL OVERVIEW

KEY FINDINGS

- Specific regulation of franchising contracts exists in several of the legal systems studied.
- The most comprehensive rules are present in Romania, where the legislation follows the Code of Ethics of the EFF, and in Italy with rules inspired by European legislation. Specific franchising regulation is also present in Estonia, Spain and Belgium. In France, Germany and the Netherlands one might find rather well established case law, and only in Poland is there neither specific legislation, nor extensive case law.
- The problems in the franchising area typically appear with regard to pre-contractual informational duties, non – compliance of the franchisee with the post-contractual non-compete clauses and terminating the contract. Also, know–how and assistance that the franchisor is supposed to provide the franchisee with are frequently subject to disputes.
- All the researched legal systems have certain measures for unfairness control in franchising contracts. Italy, Estonia, France, Germany, the Netherlands, Spain and Romania simply allow judicial control of unfairness, sometimes subject to specific restrictions, emanating from the professional character of the franchising relationship. In Belgium and in Poland there is no unfairness control as such, though in Belgium all agreements must be executed "in good faith", and in Poland the potential control of franchising contract is given through the application of general unfairness clauses.

6.1. General overview

6.1.1. Introduction

From among the researched legal systems, most have elaborated certain measures designed for dealing with franchising. The most comprehensive rules exist in **Romania**, where the law follows the Code of Ethics of European Franchising Federation and in **Italy**, where the Regulation is (at least) partially inspired by European legislation. Also **Estonia** provides rather comprehensive set of rules, whereas **Spain** and **Belgium** focus on pre-contractual information duties. In **Belgium** there are additional rules applicable on termination. In **France** and **Germany**, although there are no specific franchising rules, there is well established line of case law that deals with franchising, and in **the Netherlands**, additionally a newly enacted national Franchising Code in form of self-regulation. Only in **Poland** there is neither legislation nor hardly any case law exists.

If a legal system contains rules on franchising, the rules normally contain pre-contractual obligations aimed at protecting the franchisee. This is the case in **Romania**, **Italy**, **Spain**, **Belgium** and **Estonia**. Franchising is normally qualified as an innominative contract, even in legal systems where there are franchising rules.

6.1.2. National regulatory solutions in nutshell

Country	Specific franchising legislation	Rules on Pre-contractual informational duties	Unfairness control	Regulation of the content of the contract	Rules on termination
Belgium	Legislation applicable ALSO to franchising	✓	Control subject to general rules only		✓
Estonia	✓	✓	✓	✓	
France	Case law		✓		
Germany	Case law		✓		
Italy	✓	✓	✓	✓	✓
The Netherlands	Case law + soft law		✓		
Poland			Control subject to general rules only		
Romania	✓	✓	✓	✓	✓
Spain	✓	✓	✓		

6.2. Systems with comprehensive regulation: Romania and Italy

6.2.1. Romania

In **Romania,** franchising contracts are regulated by Government Ordinance No 52 of 1997 on the legal discipline of franchising contracts (hereinafter referred to as the "Franchising Law"). The Franchising Law is largely based on the Code of Ethics of the French Franchising Federation and the Code of Ethics of European Franchising Federation.[54] It defines the most important terms and concepts of franchising contracts, and sets out rules that govern the relationships between the parties to a franchising contract: the minimum content of the contract, the obligations of the parties, the regulation of intellectual property rights, clauses regarding the termination of the contract, non-compete and confidentiality clauses, advertising and selection. Its provisions establish the general conduct to be followed by the parties in drafting and executing the franchise contract, but they fail to determine the applicable legal sanctions for non-compliance. The Franchising Law is divided into three parts according to the life-circle of the contract:

[54] Mocanu, Contractul de franciză, Bucharest 2008, p. 5.

(1) Pre contractual relations between the parties

At the pre-contractual stage, the franchisor must provide the potential franchisee with various information about the franchising using a pre-contractual information document to allow the franchisee to take an informed decision regarding the opportunity to cooperate with the franchisor. No form requirements are formulated, but the document should contain, among other things, a description of the franchisor's experience in the proposed business as well as information on financial aspects such as: the entrance fee, the scope of the exclusivity clause, information regarding the duration of the contract, renewal conditions and termination clauses.

In negotiating the contract and during the pre-contractual stage in general, the position of the parties seems to be asymmetrical, to the disadvantage of the franchisee. The contract is proposed by the franchisor, which has much more experience and knowledge than the other party. Although the franchisor's obligation to inform the franchisee is provided by law, sometimes the franchisor might be reluctant to reveal certain aspects of his activity.[55] Unfortunately, the Franchising Law does not introduce sanctions for the non-compliance of the obligation to inform the franchisee. In this case, and in the absence of any specific contractual provisions, the franchisee can initiate legal action against the franchisor for damages, based on tort liability. The existence and the amount of damages, as well as the causal link between the breach of obligation and the damage must be proven by the franchisee. Given the difficulty of proving all the conditions of a tort suit, it was advised that the parties conclude a negotiation agreement.[56]

(2) Contractual and post-contractual relations between the parties

The franchising contract should clearly define the duties and obligations of the franchisor and franchisee, as well as the cooperation between the parties. Whatever the nature of franchising is, the franchisor must provide the franchisee with a number of services such as: management consultancy, commercial and technical assistance, staff training, granting the right to use certain know-how or trademarks, or any other rights related to the intellectual property.

Franchising agreements must reflect the interests of the members of the franchising network, which means the need to protect the intellectual and industrial property rights of the franchisor by maintaining the common identity and reputation of the franchising network.

In order to conclude a franchising contract in Romania, the franchisor must have maintained and managed a business for a reasonable period of time before creating the franchise network. However, the law does not set the length of this period. The franchisor must own the intellectual and/or industrial property rights, and provide the franchisee with initial training and technical and/or commercial assistance during the entire duration of the franchising contract. The franchisee must pay the entrance fee to the franchisor, either at the moment of concluding the franchising contract, or periodically, as set out in the contract, in exchange for the transfer of the know-how and initial training provided by the franchisor. The franchisee must also pay a royalty during the entire performance of the franchising contract in exchange for the support and continuous training provided by the franchisor.[57] The royalty usually amounts to a certain percentage of the annual turnover. Other costs to be paid by the franchisee can be provided in the contract.

[55] Mocanu, Franciza, francizarea. Ghid Practic, Bucharest 2013, p. 93.
[56] *Ibidem*, p. 94.
[57] *Ibidem*, p. 156.

When it comes to the competition law impact, it should be noted that the Franchising Law allows the franchisor to impose on the franchisee non-competition and confidentiality obligations, in order to prevent the unauthorised transfer of the know-how. With regards to the non-competition clause, the European legislation is, to a certain extent, accepted as an exception to the provisions regarding anti-competition practices. The law establishes limits concerning non-competition clauses, both in contractual and post-contractual phase.[58]

6.2.2. Italy

In **Italy,** franchising is regulated in a specific statute – Law No 129 of 6 May 2004. The statute is at least partially of European inspiration, as it strongly relies upon Article 3 of EC Regulation 4087/1988. It is a compromise between opposed views: detailed regulations and a libertarian approach. In its final draft, the statute has become quite liberal and short. Accordingly, certain franchising business associations (Assofranchising, Confimprese and Federfranchising, which gather approximately 70% of the franchising market) that were in favour of the liberal approach are satisfied with the statute in its present form. Italian legislation mostly focuses on the negotiation and conclusion of the contract, imposing both formal requirements (mostly the written form *ad substantiam*) and disclosure obligations. The aspects relating to the performance of the contract are much less regulated. In addition, the statute does not explicitly foresee sanctions for infringements of the rules it imposes, which are therefore mostly drawn from general contract law. Because of this minimalistic approach, uncertainties occasionally arise regarding the consequences to be drawn by courts and scholars from general contract law; for example, it is unclear whether the invalidity of the contract or remedies against the non-performance of an obligation are applicable in certain cases, or the exact legal consequences of a violation of the cooling-off period.

The statute introduces a broad definition of franchising. It requires the contract to be concluded in writing, and that a copy of the contract be given to the other party. The act foresees a minimum duration of the contract in order to allow the parties to recover their investments in the case of fixed-term contracts, in any case not less than three years. It sets out disclosure obligations, a violation of which might lead to the annulment of the contract and damages. Parties are obliged to cooperate in light of the principles of loyalty, correctness and good faith. The same rules apply in the case of master franchising.

There is important case law applying the statute or general contract law to franchising contracts. Though it is impossible to estimate precisely how many cases are dealt with in confidential ADR schemes, or cases that are not published, the impression based on the available material, and in comparison with other countries, is that litigation is not particularly frequent, considering the high number of franchising contracts.[59]

Description of the Statute

Article 1 contains definitions. Among them, franchising is defined as an agreement, irrespective of its name, between two legally and economically independent parties, whereby one party grants the other, against consideration, a set of industrial or intellectual property rights, related to trademarks, trade names, shop signs, utility models, industrial designs, copyright, know-how, patents, technical and commercial consulting and assistance, under which the franchisee joins a network constituted by a number of

[58] Mocanu, Contractul de franciză, Bucharest 2008, p. 129.
[59] Frignani, Il contratto di franchising. Orientamenti giurisprudenziali prima e dopo la legge 129 del 2004, Milano, 2012, 5

franchisees operating in the territory for the purpose of distributing specific goods and services.

Article 1.2 provides that franchising can be adopted in any sector of economic activity. Scholarship, however, tends to exclude production and industrial franchising from the scope of franchising.

Article 1.3 defines the "know-how" as a body of non-patented practical information, resulting from the franchisor's experience and testing, which is secret, substantial and identified. "Secret" means that the know-how, as a body of information or in the specific configuration and assembly of its components, is not generally known or easily accessible; "substantial" means that the know-how includes information that is indispensable to the franchisee for the purpose of the use, sale or resale (distribution), management or organisation of goods and services identified under the agreement; "identified" means that the know-how must be described in a sufficiently comprehensive manner to check that it fulfils the criteria of secrecy and substantiality.

Article 2 defines the scope of application of the law, extending it to master franchising and concessions (defined in the Italian commercial practice as "corner franchising").

Article 3 sets out the content and the form of the contract, prescribing that is must be in writing in order to be valid. The franchisor must have tested its commercial formula on the market (references to a minimum period of time contained in previous legislative proposals have been abandoned in the final version). If the contract is for a limited term, the duration should be enough for the franchisee to recover its investment, and in any case not less than three years except in the event of earlier termination of the contract due to one of the parties not fulfilling its contractual obligations. Scholarship considers that this latter provision is applicable also in case of non-fixed term contracts. Additionally, the article lists a series of clauses that the contract must expressly mention: the amount of investments and other possible entry fees that the franchisee must bear before commencing activity; the manner of calculating and paying the royalties, as well as a possible indication of the minimum turnover to be achieved by the franchisee; the scope of the possible exclusive territorial rights granted either towards other franchisees of the network, or towards sales channels and outlets run directly by the franchisor; the details of the know-how; the possible means of acknowledging the contribution to the know-how by the franchisee; the details of the services offered by the franchisor in terms of technical and commercial assistance, setting-up and furnishing of the outlet and training; as well as the conditions for the contract renewal, termination or possible transfer.

Article 4 sets out the obligations of the franchisor, which include the obligation to provide, at least 30 days before the contract is signed, a complete copy of the contract to be signed, together with further information listed in the article, except that "for which objective and specific confidentiality requirements exist, which will be mentioned in the contract." The article then lists the disclosure requirements: information concerning the franchisor including corporate name and assets and, if the prospective franchisee asks for it, a copy of the franchisor's balance sheets for the last three years, or from the beginning of its activity if it has been in operation for less than three years; an indication of the trademark; a synthetic description of the elements characterising the activity of the franchise; a list of the other franchisees operating in the network and a list of the outlets directly run by the franchisor; an indication of the variation in number of the franchisees and their location; a short description of any judicial or arbitral proceeding raised in relation to the franchise system against the franchisor and concluded during the last three years.

Article 5 sets out the obligations of the franchisee, i.e. a ban on transferring its registered office, as mentioned in the contract, without the prior consent of the franchisor except in

the case of force majeure, and the obligation to respect and to ensure its collaborators and personnel respect, even after termination of the contract, the highest degree of confidentiality on the content of the franchise.

Article 6 sets out the pre-contractual obligations, in particular the obligation for the parties to behave with loyalty, correctness and good faith. The franchisor must further provide the affiliate with any data and information the latter deems necessary or useful for the purposes of signing the contract, except in the case of objectively confidential information, or if such disclosure would violate the rights of a third party. In this case the franchisor must justify the failure to disclose.

Article 7 allows for conciliation clauses, and Article 8 sets out that, in the event of false information, one party may ask for the annulment of the contract and claim damages.

6.3. Systems with less comprehensive regulation: Spain, Estonia, Belgium

6.3.1. Spain

There is no **Spanish** statutory private law regarding franchising contracts, which is qualified as an atypical contract. However, provisions relating to franchising were introduced in Article 62 of Law No 7/1996 on Retail Sales (hereinafter: *LOCM*).[60] Article 62 of the *LOCM* provides a definition of franchising and imposes two pre-contractual obligations on the franchisor, namely registration in a public register of franchisors, and to provide pre-contractual information to the franchisee. The Spanish Franchise Federation has adopted the European Code of Ethics for Franchising. It is, however, no more than a deontological code for franchisors, with non-binding effect. Article 62 *LOCM* has been implemented by subsequent Decrees (*Reales Decretos*, *RD*) in 1998, 2006 and finally in 2010, when the two pre-contractual obligations contained in Article 62 were further developed. The *RD* currently in force, i.e. *RD* 201/2010 of 26 February 2010 contains 12 articles.[61] Article 2 provides a definition on franchising and differentiates franchising from other similar types of contracts. Article 3 regulates the obligation of the franchisor to provide pre-contractual information. Article 4 regards the obligation of confidentiality, which can be imposed by the franchisor on the franchisee regarding pre-contractual information. Articles 5 to 12 regulate the functioning of the public register of franchisors.

As literally stated in Article 62 of the *LOCM*, the objective of the disclosure rule is to guarantee that the franchisee can decide freely and in full awareness of the facts whether to enter the franchise network. Although the obligation of pre-contractual disclosure was already deemed to exist before the enactment of the *LOCM*, the codification of this obligation is regarded by legal scholars as a concrete measure taken by the legislator to mitigate the information asymmetry between the parties, namely the asymmetry caused by the costs and difficulties involved for the franchisee in obtaining information concerning the business of the franchisor.[62] According to Spanish authors, the codification of the

[60] *Ley* 7/1996 *de 15 de enero, de Ordenación del Comercio Minorista, BOE* n.15 of 17 January 1996 *(RCL* 1996/148 and 554). For an English translation, see CCH, Business Franchise Guide, at p. 7255.

[61] *Real Decreto* 201/2010 *de 26 de febrero por el que se regula la actividad comercial en régimen de franquicia y la comunicación de datos al registro de franquiciadores* (BOE núm. 63, of 13 March 2010, pp. 25037-25046).

[62] Echebarría, El contrato de franquicia, Definición y conflictos en las relaciones internas, McGraw-Hill, Madrid, 1995, p. 256: " *… resulta apreciable la consideración del franquiciado como contratante débil; no tanto en le hecho de que sus intereses se vean funcionalmente disminuidos en la negociación sino en la inferioridad cultural del mismo por el menor acceso a la información.*" Ortuño Baeza, Contratos ligados a la propiedad industrial. Licencia de marca. Franquicia, in A. L. Calvo Caravaca & L. Fernández de la Gándara, Contratos Internacionales, Madrid, 1997, p. 1533: " … *una de las causas más importantes del posible fracaso de los sistemas de franquicia, es el carácter incompleto o engañoso de la publicidad de reclutamiento.*"

obligation is meant to introduce certainty as to the information to be disclosed, and to add strict requirements of form in order to provide a protective regime for the franchisee.[63]

The rules cause problems in practice. Firstly, there is some uncertainty about the applicable sanctions. Although the *LOCM* is of an administrative character, its final provision indicates that Article 62 has a private law character.[64] However, neither the *LOCM* nor the *RD* 201/2010 indicate the private-law remedies that apply if the franchisor fails to comply with his obligation to disclose and/or with his obligation to register. The options are: absolute invalidity caused by the non-compliance with a mandatory law (Article 6 Civil Code), or avoidance for mistake (Article 1265 and 1266 Civil Code). Regarding the non-compliance with the rules on disclosure, courts have so far seemed to prefer the application of private law rules on a mistake.

Regarding the non-compliance with the registration obligation, some courts have indicated that the non-compliance with the obligation to register, as set out in Article 62 *LOCM,* does not lead to the invalidity of the contract. According to the Madrid *Audiencia Provincial*, in a sentence of 30 December 2009, Article 62.3 does not state as a remedy the invalidity of the franchising contract if the franchisor does not comply with the registration obligation. According to this court, this is an administrative requirement, which must be distinguished from the private relationship between franchising parties.

Secondly, the meaningless impact of the rule as a means to protect franchisees is a problem. The approach of Spanish courts in favour of the application of the disclosure rule in accordance with general rules on defective consent, which is shared by some authors, implies that the lack of compliance with the information obligation is only relevant when it leads to a mistake. In most cases, a mistake is considered to be inexcusable because the franchisor is a professional who should have been aware of the situation. According to this approach, there is no presumption of a mistake where the franchisor does not comply with his obligation to disclose,[65] even though this presumption has been defended by Spanish courts and doctrine in the case of other types of contracts where a specific obligation to provide pre-contractual information is imposed on one of the parties (e.g. a medical contract).[66] An approach that is grounded in the fact that proving that information has not been provided (diabolic proof) is much more difficult than proving that it has been provided. The impact in practice of the specific rule on disclosure is therefore significantly tempered, and the protection that was supposed to be granted has not been achieved.

When it comes to invoking the rules, in several decisions where the franchisee referred to the application of the rules on disclosure, the courts (*Audiencias Provinciales*) did not base their conclusions on the specific disclosure obligations contained in the legislation. The courts did not even mention the relevant disclosure rules, but their reasoning was along the lines of the general contract law rules on disclosure (the courts verified whether the franchisee entered the contract under a mistake). The decisions in question are: Valencia

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63 Ortuño Baeza, 1997, p. 1535: "*las normas contenidas en los párrafos segundo y tercero del artículo 62 de la Ley de Ordenación del Comercio Minorista han venido a paliar la situación creada por la ausencia de una normativa específica al efecto imponiendo una serie de cautelas en favor del franquiciado* "; Similarly Echebarría, 1995, p. 119 and Alonso Espinosa et al., (coord.), Régimen Jurídico General del Comercio Minorista. Comentarios a la Ley 7/1996, de 15 de Enero, de Ordenación del Comercio Minorista, y a la Ley Orgánica 2/1996, de 15 de enero, complementaria de la de Ordenación del Comercio Minorista, Madrid, 1999, pp. 717-719.

64 Article 62 is therefore private law legislation that is of general application on Spanish territory on the basis of the exclusive competence of the Spanish State to regulate the contents of contracts on the basis of Article 149.1 of the Spanish Constitution.

65 Rojo Auria, El dolo en los contratos, Madrid, 1994, p. 284; Alonso Espinosa et al., 1999, p. 728.

66 There is a presumption of a mistake in favour of the patient in contracts for medical treatment. If the medical service provider cannot prove that he has provided the necessary information to the patient, the patient is presumed to have given mistaken consent. See also *STS* 28 February 1990, Ar. 726, concerning the obligation of pre-contractual information imposed by the Land Act (*Ley del Suelo)*.

Audiencia Provincial of 17 January 2001, Teruel *Audiencia Provincial* of 24 October 2001, and Burgos *Audiencia Provincial* of 11 February 2002. In some decisions, neither the franchisee nor the court invokes the application of the specific rule in a claim for a mistake: Albacete *Audiencia Provincial* of 18 October 2013.[67]

Explicit reference to the disclosure rule can be found in more recent decisions. The line of thinking of courts, however, continues to be along the general rules on defective consent, which means that a mistake has to be proven by the franchisee. The avoidance of the contract has not been granted on this ground, because courts have generally decided that a mistake in these cases is not excusable, since the franchisee is a professional who can evaluate the type of relationship he is entering into. This is the case in the decisions of the *TS* of 30 June 2009 and 27 February 2012.[68]

The decision of 30 June 2009 regards a claim for annulment based on the lack of information and on the absence of any object. Concerning non-compliance with the information obligation, the *TS* does not attach any consequences to that, because the franchisee had three premises in the same network and he was a professional who should have been aware of the situation. The court added that the franchisee did not claim until he noticed that he did not have the expected benefits. The Sentence of the *TS* of 27 February 2012 deals with the claim of a franchisee regarding misleading information on earning claims provided by the franchisor. The *TS* states that the *RD* 2010 on disclosure does not require information of this kind. Moreover, the franchisee did not prove that the earning claims were unrealistic or had been made without rigor and prudency.

There are also recent examples of Appeal Courts: in proceedings before the Madrid *Audiencia Provincial*, which ended with a decision of 30 December 2009, the franchisee claimed the avoidance of the contract because he was not provided with the necessary information, including documents regarding the trademark. The Madrid *AP* answered that there is no excusable mistake, because the franchisee was a professional.[69]

6.3.2. Estonia

The **Estonian** Law of Obligations Act of 1 July 2002 (LOA)[70] sets out basic rules on franchising contracts in Chapter 19 of the LOA. The rules in the LOA were drafted on the bases of the UNIDROIT Model Franchise Discloser Law, the European Code of Ethics for Franchising and the Russian Civil Code (Art. 1027 ff). Article 375 of the LOA provides the definition of a franchise contract, which is, in principle, seen as a mixed contract: "By a franchise contract, one person (the franchisor) undertakes to grant another person (the franchisee) a set of rights and information belonging to the franchisor for use in the economic or professional activities of the franchisee, including the right to the trade mark, commercial identifications and know-how of the franchisor."

Article 376 LOA imposes on the franchisor an obligation to provide the franchisee with instructions for the exercise of the rights associated with the franchise, and to provide the franchisee with permanent assistance. Article 377 LOA contains a list of obligations on the part of the franchisee, who should use the commercial identifications of the franchisor (i.e. trade name, etc.), to ensure that the quality of the goods and services it provides is the same as that of the goods or services provided by the franchisor, to follow the instructions

[67] *SAP* Valencia 17 January 2001, *AC* 2001\1269; *SAP* Teruel 24 October 2001, *AC* 2001\1931; *SAP* Burgos 11 February 2002, *AC* 2002\892.

[68] *STS* 30 June 2009, Roj: STS 4437/2009 - ECLI:ES:TS:2009:4437; also 27 February 2012, Roj: STS 1327/2012 - ECLI:ES:TS:2012:1327.

[69] *SAP* Madrid 30 December 2009, Roj: SAP M 17675/2009 - ECLI:ES:APM:2009:17675.

[70] Law of Obligations Act (in Estonian: võlaõigusseadus), passed 26.09.2001, entry into force 01.07.2002. RT (State Gazette) I 2001, 81, 487. Available in English: https://www.riigiteataja.ee/en/eli/ee/516062015006/consolide/current#para1. (11.08.2015)

of the franchisor and to provide clients with all additional services they would expect from the franchisor upon acquiring goods or contracting for services from the franchisor. Lastly, Article 378 LOA gives the franchisor the right to check the quality of the goods manufactured or the services provided by the franchisee.

The rules are very general and mainly used in specifying the main elements and content of the franchising contract. There is no information about the real use of these rules, as there is no court practice concerning franchising, although the interviewees claimed that in practice these rules cause no problems.

6.3.3. Belgium

In **Belgium,** there is no specific legislation regarding franchise agreements only, but there are two specific statutes that also apply to franchise agreements: the Statute of 19 December 2005 on Pre-contractual information for commercial cooperation agreements (now Chapter 2 of Book X of the Belgian Code of Economic Law), the Statute regarding the termination of exclusive distribution agreements of indefinite duration, the Statute of 27 July 1961 (now incorporated as Chapter 3 of Book X of the Code of Economic Law), can apply to some franchise agreements.

- **Pre-contractual disclosure**

The Statute on pre-contractual information was adopted for franchising agreements. In some sectors, franchise agreements were used to avoid the application of labour law, as franchisees were de facto treated as employees. In other sectors, franchisors sold commercial formulas that were void of any competitive advantage, and assistance from franchisors was practically non-existent (particularly in the dating agencies sector). These business models were based on selling the formula as many times as possible, rather than on the success of the formula.

As a compromise between those in favour of imposing a comprehensive franchise agreement (in particular its termination) and those in favour of a liberal approach (application of general contract law), only the pre-contractual information requirements were regulated. The aim was to ensure that a franchisee, as an independent tradesman, was duly informed on the merits of the franchise network and formula, as well as on the contractual obligations under the franchise agreement before signing it.

To make sure that the parties could not easily avoid the application of the pre-contractual disclosure obligations, the application of the Statue includes all 'commercial cooperation agreements'. This vague concept, however, continues to give rise to interpretation and qualification issues. It applies in principle to all agreements where one party grants the other the right to use a commercial formula when distributing products or services. The commercial formula consists of the use of a commercial name/trade name, the transfer of know-how and commercial or technical assistance.

The Statute applies to all distribution and commercial agent agreements, though its scope is generally considered too broad. The Statute imposes an obligation to disclose, one month before the conclusion of the agreement, a document, containing the following pre-contractual information:

- The draft agreement;
- A summary of the most important obligations of the franchisee, including information on all direct or indirect remuneration of the franchisor;
- Information concerning the franchisor and its network (financial data, market, market share, market previsions, etc.).

- A similar document, limited to the elements that have changed, must be communicated in the event of the renewal or modification of the franchise agreement.

A franchisee that did not receive such a document at least one month before signing the agreement, can seek the annulment of the agreement within two years of its conclusion. If specific information regarding the material contractual obligation was not given, the nullity can be partial and limited to the clause containing such contractual obligation.

- **Termination**

The Statute only applies to 'exclusive' distribution agreements with an indefinite duration. However, Article X.38 of the Code of Economic law stipulates that an 'exclusive' distribution agreement with a definite duration is considered an agreement of indefinite duration upon its third renewal/extension. The Statute applies only to the distribution of products (not services) within Belgium. The Statute is thus auto-limitative.

The case law is still indecisive on whether this Statute and the right to the goodwill indemnity apply to franchise agreements. The Belgian High Court has, with its decision of 30 April 2010,[71] ruled in favour of a broad application of the Statute of 27 July 1961 to all agreements whereby a distributor distributes products and takes specific risks related to this distribution (such as exclusivities or specific investments in the brand) if the other conditions of the Statute are met. Franchise agreements of an indefinite duration regarding the distribution of products could therefore fall within the scope of the Statute.

Concerning the termination of exclusive distribution agreements of indefinite duration, the Statute sets out that a distribution agreement can only be terminated unilaterally by giving a "reasonable notice period" (Art. X. 36 of the Code of Economic Law) or by "paying a compensatory indemnity". The lawmaker took the position that a distributor who helps a producer to place its products on the market should, in some cases, be protected against the negative impact of the termination of the distribution agreement by the producer. The Belgian courts take the view that a notice period is reasonable only when the terminated party has enough time to find a new contract offering similar advantages to that of the terminated distributorship. The courts will take a number of parameters into account, including:

- the duration of the distribution agreement,
- the extensiveness of the territory,
- the importance of the distributorship in the global business,
- the reputation of the brand,
- the profits generated by the distributorship.

If the supplier terminates the agreement, the distributor will also be entitled to an additional compensation pursuant to Article X. 37 of the Code of Economic Law. This additional indemnity consists of three elements: goodwill, expenses and severance pay to workers. The goodwill compensation is due if the distributor proves that:

- there was a notable increase in the number of customers and/or turnover during the agreement,
- the increase was obtained through its marketing efforts, and
- the customers will continue to buy the supplier's products after termination.

[71] Cass. 30 April 2010, *J.L.M.B.* 2010, 1362; *T.B.H.* 2010, 686, noot O. VANDENBERGHE.

After the termination, the distributor is entitled to obtain compensation for the expenses incurred through the exploitation of the distributorship that could benefit the supplier after the termination of the agreement.

The severance pay that the distributor is required to pay to employees/workers who are dismissed as a result of the termination of the distribution agreement may be recovered from the supplier. The Statute of 1961 is applicable to some but not to all types of distribution agreements, and the distributor must be attributed "special rights". The act applies to three main categories:

- Exclusive distribution agreements, i.e. agreements whereby the distributor is the only seller of the supplier's products (not services) in a defined territory.
- Quasi-exclusive distribution agreements, i.e. agreements where, as the case law establishes, the distributor sells 80% or more of the supplier's products in the territory.
- Distribution agreements where important obligations are imposed on the distributor, such as investments in stores, hiring qualified personnel, following marketing instructions, reaching certain quotas, after sales services, etc.

6.4. No specific rules: France, Germany, the Netherland and Poland

In the remaining systems: **France, Germany, the Netherlands** and **Poland** there are no specific rules applicable to franchising contracts. In these legal systems franchising is classified as an innominative contract. This means that these systems do not contain rules specifically devoted to franchising[72] and that general contract rules apply. Normally contracts have the "innominative" status when they are not deemed common enough in the commercial practice to require specific regulation, or when the practice is not sufficiently homogenous.

In **France,** a definition of the franchising contract has been formulated through case law: "a franchise contract is a mutual "synallagmatic" contract involving a sequential performance, through which an enterprise, called the franchisor, transfers to one or more other enterprises, called franchisees, the right to the continuous operation, under the name of the franchisor and using his customer branding and ongoing assistance, of a management system that has been previously worked out by the franchisor to, thanks to the competitive advantage it provides, allow a reasonably diligent franchisee to make a profitable business."[73] The transfer of know-how is the distinctive criterion of franchising.

In **Germany,** certain regulation pertaining to specific contracts may apply (per analogy), because franchising contracts typically contain various elements of nominative contracts (mixed contract). The application depends on how the franchising contract is classified. The classification, in turn, depends on the configuration of the respective franchise agreement in each individual case. All this constitutes a sufficient framework to deal with franchise agreements in the German legal system.

In **Poland,** despite the fact that it is commonly recognised that franchising contracts contain certain characteristics of various contracts like sale, distribution, licencing, agency, commission, rent or lease, the doctrine speaks against the mixed character of the franchising contract[74]

[72] It must be noted, however, that the fact that a legal system contains rules on a given contract does not automatically give it the status of a nominative contract.
[73] Cour de Appel Toulouse, ch. 2, sect. 2, 25 May 2004, Juris-Data No 2004-247226.
[74] Promińska, in System Prawa Prywatnego, Prawo Zobowiązań – umowy nienazwane, (ed). W. J. Katner, Warszawa 201, p. 769.

6.5. Application of general contract rules to franchising contracts

Depending on whether there are franchising specific rules in a given legal system, rules that apply to franchising constitute either a combination of the specific franchising regulation and general contract rules, or simply apply general contract rules.

6.5.1. Only (general) contract law

Only general contract law rules apply in **France**, **Germany**, **the Netherlands** and **Poland.** The situation is relatively simple in **France**, **the Netherlands** and **Poland**. In **France,** franchise contracts are regulated particularly by: the part of the Code Civil relating to the obligations in general as an innominative contract in the sense of Article 1107 of the Code, Civil and the provisions of the Code de Commerce relating to distribution contracts in general or some specific distribution contracts depending on their characteristics, such as the potential purchase exclusivity clause imposed on the distributor (Article L. 330-3 of the Code de Commerce). In **the Netherlands,** parties to a franchise contract are free to form it at their discretion (freedom of contract and party autonomy). However, general contract law rules apply, including provisions to act pursuant to good faith and rules on unfairness control, to the extent that these apply to B2B transactions. The situation is similar in **Poland**, where the parties may, under Article 353^1 of the Civil Code, arrange their legal relationship as they deep proper, on the condition that the content or the purpose of the contract between them are not contrary to the nature of the relationship with statutory law and with the principles of community life.

In **Germany,** the doctrine and case law has developed concerning the notion of franchising and applicable rules. As a starting point, franchising contracts fall in the scope of the general contract law rules contained in the Civil Code, as well as certain specific regulations on specific contracts by analogy. In order for the analogy to apply, the franchising contract needs to contain sufficient elements of the respective nominative contract that the application of the specific rules appears reasonable. Franchising is regarded as a mixed contract that may contain elements of various types of contracts. The classification of the franchise agreement is therefore multiform, and depends on the content of the contract. Franchising contracts may contain elements of contracts concerning lease, rent, purchase, agency, or licence agreements concerning a company. Optionally, there are also views that a franchising contract can amount to a corporate contract of a company, if a common purpose exists. In any case, franchise agreements constitute long-term obligations.

The "*Subordinationsfranchising*", where the franchisee is bound by the instructions of the franchisor, is seen as a service contract containing elements of an agency contract. Because the specific position of the franchisee, similar to that of a commercial agent, §§ 84 ff HGB applies accordingly in this case. Normally, the franchisee is seen as an independent trader, and not a representative of the franchisor or its employee. The parties to a franchise contract are therefore, in principle, always two independent enterprises. In the event of an unclearly worded franchise agreement, it may happen that the franchisee will appear as an employee of the franchisor. In such a situation, certain labour regulations may be applicable (which is problematic). To answer the question whether the franchisee meets the criteria of independence, § 84 para. 1 HGB is applied, regardless of whether or there is a Subordinationsfranchising. § 84 para. 1 HGB contains a general indication of what it means to be an enterprise, and aims to ensure that, in particular, the entrepreneurial risk lies with the franchisee, who independently decides about the structure of the organisation, the prices and personnel.

There are several methods to assess the applicability of specific rules to a franchising contract. First, individual clauses in the franchising contract are evaluated as to whether they resemble clauses of nominative contracts. If rules on different nominative contracts

can apply to one franchising contract, the contract is divided (known as *Trennungsmethode*). It is also conceivable to determine the centre of gravity of the contract, and then to treat all the clauses of the contract according to the rules intended to be part of the contract that represents the centre of gravity (known as *Absorptionstheorie*). It cannot be generally stated which procedure is preferable, as it is decided on an individual basis. Since only after such procedure can it be established which provisions apply to a given franchising contract, it cannot be stated generally which provisions apply to franchise contracts. However, certain rules always apply, i.e. the general rules of BGB (§§ 1-240 BGB) for example, and the rules on legal capacity, validity of contract or avoidance.

Moreover, the German courts apply Regulation 330/2010 when it comes substantive requirements for assuring that franchising agreements can function effectively. Although the Regulation, in principle, introduces the vertical restraints exemptions on the basis of Article 101, it has an impact on the "civilian" part of the franchising contract. The case law decided on the basis of the previous Regulation constitutes a benchmark for evaluating the moral standards of a franchise contract pursuant to § 138 BGB.[75] Thus, Regulation 330/2010 sets out significant substantive requirements for franchise agreements under German law. Exempting a franchise agreement is only allowed under Regulation 330/2010 when the requirements of the Regulation are met. The general opinion, therefore, is that franchise contracts should be drafted in a way that does not violate the requirements of the Regulation.

6.5.2. General contract law next to specific regulation

In the countries where there are specific franchising rules, general contract law applies only in the absence of such rules. In **Belgium,** the franchisor's rights can be tempered if a court considers it an abuse of right. The pre-contractual disclosure obligations have considerably helped franchisees to seek the annulment of franchise contracts when they were misled by franchisors regarding the essential elements of the franchise contract (e.g. the extent of assistance to be granted by the franchisor or the value of the commercial formula). In **Estonia,** the general rules of the Law of Obligations Act applicable to franchising contracts include general principles, such as general principle of good faith, the non-mandatory nature of civil law, reasonableness, pre-contractual relations and specific rules, which must be applied if there are no special regulations in the law or contract. In **Romania,** these are the rules in the Civil Code concerning the general discipline of contracts (Articles 1166-1323) and tort law (Articles 1349-1395). In **Spain,** franchising, like any other atypical contract, is subject to civil and commercial general contract law rules.

6.6. Unfairness control

6.6.1. Overview

All the researched legal systems have certain measures that allow for unfairness control when it comes to franchising contracts. In **Italy,** franchising contracts are subject to unfairness control under both the specific statute and general contract law. The unfairness control in **Estonia, France, Germany, the Netherlands** and **Spain** employs a similar test of unfairness, though the systems differ in details (when it comes to the scope of application and the content). Judicial unfairness control is also possible in **Romania**. While the notion of good faith is of relevance under several legal systems. It is of major

[75] OLG Rostock, decision of 29.06.1995, 1 U 293/94, DB 1995, 2006.

importance in **Belgium**, where no unfairness control per se exists, apart from the requirement that all agreements must be executed "in good faith". The **Polish** legal system also does not introduce a specific mechanism for unfairness control, and the potential of controlling the content of a franchising contract exists only through the application of general clauses, like Article 5 of the Civil Code, according to which one cannot exercise one's right in a manner contradictory to its social and economic purpose or the principles of community life (such an act or omission is not deemed an exercise of rights and is not protected), or Article 353[1] which sets limits to exercising the freedom of contracts. These options are not, however, frequently invoked by courts.

6.6.2. Unfairness control - national solutions

In **Italy,** franchising contracts are subject to fairness control under both the specific statute and general contract law. The statute requires the parties to cooperate in light of the principles of loyalty, correctness and good faith. This provision basically replicates general contract law, which applies anyway, and prescribes good faith in all phases of the negotiation and performance of the contract. The fact that the legislation repeats the general rules has been interpreted as evidence that the judge should interpret these in a more stringent way than generally.[76] Good faith has been employed, in particular, to assess the legitimacy of withdrawing from the franchising contract and sanctioning all contract clauses that might allow the franchisor to push the franchisee out of the market. It is also important to note that jurisprudence (Trib. Bari, ord. 22 October 2004) considers that the Italian rules prohibiting the abuse of economic dependency in supply chains (l. 192/1998), prescribing the invalidity of such abusive contracts through which this dependency originates, are also theoretically (though in practice not always) applicable to the case of franchising contracts.

The general rules of the Civil Code on the unfairness of contract terms that have been set only by a contract party and which are listed in Article 1341 of the Civil Code also apply, requiring that those clauses must be individually signed, otherwise they have no effect.

In **Spain,** courts classify franchising contracts as contracts of adhesion where contractual terms are imposed by the franchisor.[77] Standard terms are regulated by the Law 7/1998 on Standard Terms, of 13 April 1998. In a judgement of the Madrid *Audiencia Provincial* of 16 October 2007,[78] the court indicated that a clause whereby the franchisee is obliged to open his premises within a period of six months, whereas permission to open the franchisee´s premises is to be given by the franchisor, is invalid. Such a clause leaves the performance of the contract to the discretion of one of the parties, which infringes Article 1265 of the Civil Code, and is also prohibited by the Standard Terms Law. The clauses imposed against the requirements of good faith and to the detriment of the franchisee, resulting in an evident and unjustified lack of balance between the parties, must be declared invalid.

Article 8.2 of the Standard Terms Law states that general clauses which are abusive are invalid, and it refers explicitly to the clauses defined in Article 10 bis and the First Additional Disposition of the Consumer Protection Act 26/1984 of 19 July: *all clauses that are not individually negotiated and impose, against the requirements of good faith, an important imbalance between the contractual rights and obligations of the parties to the detriment*

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[76] De Nova, Leo and Venezia, Il franchising, Milano 2004, 83.

[77] *SAP* Barcelona 16 December 1996, *AC* 1997\1650; *SAP* Sevilla 28 January 2002, *JUR* 2002\47775; *SAP* Madrid 16 October 2007, Roj: SAP M 13755/2007 - ECLI:ES:APM:2007:13755. In the literature: De la Cuesta Rute & Valpuesta Gastaminza, Contratos Mercantiles, Tomo I, Barcelona, 2001, p. 362.

[78] *SAP* Madrid 16 October 2007.

of the consumer. Clauses included in the First Additional Disposition of the Consumers law are in any case abusive (…).

Regarding minimum purchase obligations, the *TS,* in its sentence of 2 March 2001 (RJ 2001, 2616), indicated that such clauses impose a major obligation on the franchisee, but they are valid if they are proportionate (control unfair terms).[79]

In **Estonia,** the regulation of standard terms in an LOA (Ch. 2, division 2, Articles 35-47) applies to all contracts. A contract is deemed to be a standard term if drafted in advance for use in standard contracts, or which the parties have not negotiated individually for some other reason, and which the party supplying the term uses with regard to the other party, who is therefore not able to influence the content of the term (LOA Article 35 para 1). Unfairness control does not apply on individually agreed terms, except for individually agreed terms excluding a penalty for late payment in B2B agreements and legal entities in public law (LOA Article 113 para 10). The general rule defining unfair contract term applies to all contracts. It defines unfairness as if, "taking into account the nature, contents and manner of entry into the contract, the interests of the parties and other material circumstances, the term causes unfair harm to the other party, particularly if it causes a significant imbalance in the parties' rights and obligations arising from the contract to the detriment of the other party. Unfair harm is presumed if a standard term derogates from a fundamental principle of law or restricts the rights and obligations arising for the other party from the nature of the contract such that it becomes questionable as to whether the purpose of the contract can be achieved. The invalidity of standard terms and relating circumstances will be assessed as at the date of entering into the contract" (LOA Article 42 para 1).

Estonian law contains a list of unfair terms, which are black in B2C and grey in B2B contracts. In applying the rules on unfairness, the person who relies on the unfairness of standard terms specified in LOA Article 42 para 3 in a contract where the other party to the contract is a person who entered into the contract for the purposes of economic or professional activities, then the term is presumed to be unfair (LOA Article 47). Businesses can prove that the term is not unfair on given circumstances. If the term is not visually identified as a standard term, the other party has to prove that the term was not negotiated. Taking into account the quite high protection level of the businesses against unfair contract terms, the probability that franchising contracts will be made public, is rare. In most cases the Estonian franchisor (businesses) did not want to open the contract terms or complain about their content.

In **France,** the unfairness control is provided by the provisions of the Code de Commerce. One of the most important provisions in this respect is Article L. 442-6 setting out, among other things, the liability of the franchisor in the case of losses caused by subjecting or seeking to subject the trading partner to obligations that create a significant imbalance in the rights and obligations of the parties.

Moreover, if one of the forbidden practices mentioned in this article is applied, proceedings can be brought before the competent civil or commercial court by any person who provides proof of a legitimate interest, the Public Prosecutor's Office, the minister responsible for economic affairs or the president of the Competition Authority. During these proceedings, the minister responsible for economic affairs and the Public Prosecutor's Office may ask the court to which the case is referred to order that the practices mentioned in this article be ceased. They may also, for all these practices, request a declaration of the invalidity of the illegal clauses or contracts, and the recovery of any mistaken payments. They may

[79] *STS* 2 March 2001, RJ 2001, 2616.

also request the pronouncement of a civil fine of up to 2 million euros. The fine may be increased to three times the amount of the total sums unduly paid. Compensation may also be sought for the loss suffered. In any event, it is up to the service provider, producer, trader, manufacturer or the person listed on the trade register who claims to be discharged, to provide evidence of the circumstances that resulted in the extinguishment of its obligation. The court to which the case is referred may order that its decision, or an abstract thereof, be posted on the court noticeboard or website in the manner it stipulates. It may also order that the decision, or the abstract thereof, be inserted in the report on the activities for the financial year drawn up by the company's executives, board of directors or executive board. The costs will be borne by the sentenced person. The court to which the case is referred may order the enforcement of its decision under the threat of a progressive coercive fine. The judge ruling by way of summary proceedings may order the cessation of the abusive practices or any other temporary measure, if necessary, under the threat of a progressive coercive fine.

In **Germany,** the rules that govern the control have a general character (in particular the law on General Terms and Conditions and the general clauses as included in §§ 138 and 242 BGB). Furthermore, the EU block exemption regulations are relevant for assessing the unfairness of franchising contracts. The Supreme Court pointed out, in a decision of 2004, that in the context of the German law on Standard Terms, the current Block Exemption Regulation may be used when evaluating the disproportionate disadvantage suffered by the franchisee.[80] In **the Netherlands,** Article 6:235 of the Civil Code determines that, if a business has more than fifty employees or is obliged to publish its yearly financial statements or uses the same standard terms and conditions as its counterparty, then it may not rely on the protection against unfair contract terms as granted in Articles 6:233 and 6:234 of the Civil Code (general unfairness test and the right to be given a reasonable opportunity to read the terms and conditions). The Dutch courts in B2B cases may apply the black and grey list of unfair contract terms by analogy, and not directly. Franchisees, who fall outside the scope of the above-mentioned protection against unfair contract terms, may invoke protection against a particular contract term used in given circumstances contrary to good faith (Article 6:248 par. 2 of the Dutch Civil Code). If successful, this defence makes the clause inapplicable in a given situation, but does not remove it from the contract for future cases. In **Romania,** unfairness judicial control is possible, as in the case of any other contract, but no particular case law with respect to franchising agreements is available.

6.7. Typical problems in franchising contracts – an overview

There are problems among the researched legal systems that appear to be typical for franchising contracts. First of all, in several systems there are characteristic problems regarding the **pre-contractual information** duties of the franchisor and the the non-compliance of the franchisee with its **post-contractual non-compete** clause is another common issue. The **termination** of the franchising contract gives regularly rise to questions concerning its grounds and consequences. Problems shared between the legal systems to some degree are the extent of **know-how** and **assistance** that the franchisor has to provide, as well as the **definition of franchising**. Additional problems characteristic for those systems only appear in **Belgium, Germany** and **Spain.** One legal system that is exempt from this part of the research is the **Estonian** one, where it is impossible to define typical problems appearing since there is no case law concerning franchising contracts. A similar situation (lack of indication) is also present in **Poland**, though in this

[80] BGH, judgement of 13 July 2004, KZR 29/01.

legal system certain conclusions can be drawn from the publications of the franchising organisation.

6.7.1. Pre-contractual information duties

The extent of the pre-contractual information duties of the franchisor, and the consequences of their breach, are problems shared by the **Belgian, German, Dutch** and **Spanish** legal systems.

One of the main problems under **German** law is the obligation of the franchisor to provide sufficient information on the profits to be obtained and the economic risks to the franchisee at the pre-contractual stage. In principle, a party to any contract has to independently evaluate the advantages and disadvantages of the contract before the conclusion of the contract. However, when it comes to the franchising contract, the question arises whether it is necessary to correct the fact that a significant information gap exists between the franchisor and the franchisee that introduces a disadvantage on the part of the future franchisee. This in turn, raises the question whether the franchisor should be expected or even required to inform the franchisee about the profits to be obtained or the economic risks inherent in the franchising system it offers, or otherwise educate the franchisee, or at least provide the necessary information and know-how, so that the franchisee can make a sufficiently substantiated prognosis itself.

On this issue, the Court has ruled that the franchisor is obliged to submit all the appropriate and relevant information to the franchisee at the pre-contractual stage. The information must be true and based on facts, in order to enable the franchisee to independently evaluate how profitable the franchising contract might be for him. However, the franchisor is not a consultant to enterprises that should have to educate about the general risks of self-employment (OLG Dusseldorf, judgment of 10.25.2013, Az.: I - 22 U 62/13; OLG Hamm, judgment of 22.12. 2011 Az.: I-19 U 35/10; OLG München, decision of 20.07.2010, Az.: 7 U 2834/10). If the franchisor fails to adequately inform the franchisee, a claim may arise based on, in particular, contributory negligence, and the franchisor cannot defend himself by claiming that the franchisee did not diligently evaluate the risks

In **the Netherlands**, providing incorrect or misleading pre-contractual information, for example, on the expectations of the franchisee's success rate (forecast), is considered a breach of the franchisor's duty of care. In its decision of 25 January 2002, ECLI:NL:HR:2002:AD7329 (*Paalman*) the Hoge Raad (Supreme Court) stated that the franchisor has no obligation to provide the franchisee with a financial forecast for the franchise. However, if the franchisor decides to do this, then it breaches the duty of care by providing an incorrect forecast without mentioning this incorrectness to the franchisee. The duty of care is infringed if the franchisor knew, or should have known, about the mistakes in the forecast; it does not matter whether the wrong data was introduced into the forecast by the franchisor or by external advisors, the franchisor remains responsible for its correctness towards the franchisee.

With regard to the question when the duty of care of the franchisor is infringed, the Dutch lower courts – courts of first instance – seem to pay less attention to the fact whether the franchisor knowingly misled the franchisee, but rather to the proper performance of the special duty of care, i.e. whether the forecast was prepared with due diligence, for example see Rechtbank (court of first instance) Breda, 14 April 1998, ECLI:NL:RBBRE:1998:AI9699; Rechtbank (court of first instance) Arnhem, 18 June 1999, ECLI:NL:RBARN:1999:AI9915; Rechtbank (court of first instance) Dordrecht, 8 August 2007, ECLI:NL:RBDOR:2007:BB2204; Rechtbank (court of first instance) Arnhem, 15 June 2011, ECLI:NL:RBARN:2011:BR0232; Rechtbank (court of first instance) Den Bosch, 29 May 2013, ECLI:NL:RBOBR:2013:CA1429. The Hoge Raad (Supreme Court), in a

judgement of 19 February 1993, Prg. 1996/4449 (Renault), stated that even when the franchisee asks the franchisor to provide him with a (too) positive forecast, e.g. in order to acquire a bank loan, the franchisor remains liable for providing an incorrect forecast and thereby breaching the duty of care. The Rechtbank 's-Gravenhage (court of first instance), in its judgement of 19 September 2012 (ECLI:NL:RBSGR:2012:BY1753), repeated that the franchisor is not obliged to provide a financial forecast estimating the future success of the franchise to potential franchisees, but that if such information is provided and it turns out to be incorrect, then it could lead to the avoidance of the contract on the basis of a mistake being contrary to good faith or even tort (if there was an intention to mislead) (point 4.3). However, the sole fact that the franchisee does not achieve the success as forecasted does not mean that the forecast was incorrect and misleading. Such information may not and should not be considered as a guarantee of a specific success/result. An incorrect forecast is one based on incorrect data and assumptions, and not based on detailed, solid research. It could also be expected from a franchisee to thoroughly and critically evaluate the forecast presented to him (point 4.4). The requirement to critically evaluate information provided by the franchisor by the franchisee has been criticised by Kolenbrander, since it leads to practical (how can a franchisee acquire information to allow him to critically assess the franchisor's documents?) and emotional (risk of causing a rift and coming over as a problematic franchisee even before the conclusion of the contract) difficulties. Moreover, a franchisee has the right to receive advice and support. However, providing additional financial support as compared with the agreed one may go beyond the franchisor's duty of care (point 4.20). This is particularly the case if the requests for additional advice and support are met with setting up new meetings and action plans.

In earlier judgments, e.g. Rechtbank (court of first instance) Arnhem, 18 February 1993, Prg. 1996/4455, the courts accepted that the franchisee could assume the correctness of the forecast presented to him and would not need to research whether its data was correct. This held true even if the franchisor stated that the forecast was given without any guarantees as to its correctness, see Rechtbank (court of first instance) Dordrecht, 8 August 2007, LJN BB2204. Moreover, the franchisor may not defend itself for providing the franchisee with incorrect pre-contractual information by claiming that the franchisee could have conducted better research itself (Rechtbank (court of first instance) Den Bosch 15 June 2001 (unpublished) (La Venezia)).

The newer trend, as already seen in the above-mentioned judgment of Rechtbank 's-Gravenhage (court of first instance), 19 September 2012, ECLI:NL:RBSGR:2012:BY1753, seems to be that the franchisee should be observant and critical, and should notice, for example, that the franchisor has presented a forecast in too positive a light; if necessary, the franchisee should even conduct some research about the facts it has (or should have) reasons to doubt, see Rechtbank (court of first instance) Rotterdam, 16 May 2008 (unpublished). In the case of Rechtbank (court of first instance) Haarlem, 3 August 2011 (unpublished), the court went further in stating that, as a businessman, the franchisee has a duty to investigate whether its business would have a chance of success, an opinion that was been repeated in a judgment of Rechtbank 's-Gravenhage from 2012.

In **Belgium**, in most of the cases dealing with a lack of assistance by the franchisor, or a lack of economic viability of the commercial formula, the franchisee is forced to call upon a lack of pre-contractual information, or misleading pre-contractual information to try to obtain an annulment, since in general the obligations of the franchisor in that respect are described in a rather limited way in the franchise contract, so that it is difficult for the

franchisee to demonstrate that the franchisor is in breach of its obligations of assistance, or of the transfer of the know-how (commercial formula).[81]

In addition, the invalidity of an agreement, caused by a violation of the pre-contractual disclosure obligations, raises issues regarding the consequences of the invalidity sanction. In general, case law considers that in this case the entrance fee must be repaid, but not the recurrent franchise fees, since they are normally compensated by services and assistance provided by the franchisor. Disputes arise regarding the repayment of investments (e.g. in purchasing the business (*fonds de commerce*) and investments from fitting out the points of sale).[82]

In **Spain,** typical problems that are brought to courts by franchisees are those regarding the franchisor's non-compliance with the pre-contractual duty to inform.

6.7.2. Post-contractual non-compete clause

Problems with regard to post-contractual non-compete clauses appear in **Belgium, the Netherlands** and **Spain**.

In **Spain,** certain appeal courts have confirmed the importance of respecting the non-competition clause (though they do not mention the application of Regulation 330/2010, because the issue at stake is not the duration of the clause, which is normally agreed for a year, but the non-compliance of the franchisee to the rule). Examples include: *SAP* Valencia 29 December 2014, *SAP* Castellón de la Plan, 24 April 2014, *SAP* Barcelona 6 February 2014 or *SAP* Madrid 11 April 2012:[83] "*The inclusion of protecting clauses is usual in this type of contract, which are based on mutual confidence, such as those of post contractual non-competition; if the franchisee could continue to carry out the same activity, in the same place, with no other duty that not using the image of the franchisor, he would certainly keep his clientele, and in this manner he would prevent the franchisor from contracting another franchisee in that area, and thus to continue benefitting from his industry…"*

Accordingly, a franchisee who does not respect the post-contractual non-competition clause must compensate for the damage caused to the franchisor due to unfair competition. See, for example, *SAP* Las Palmas 30 September 2011: the franchisee must pay the amount stated by the criminal clause, because he continued to use the trademark after the contract had come to an end. However, courts have been strict in fixing the amount of compensation due, and have not refrained from refusing compensation when the franchisor does not prove damage or does not prove a causal link between the unfair competition and the damage that has to be compensated. In a decision of the Granada *Audiencia Provincial* of 2 July 2007, the AP concluded that, even though the franchisee had indeed continued the performance after the contract had terminated, it did not have to compensate because the compensation the franchisor was asking for did not correspond to the damage suffered

[81] Commercial court Brussel 15 March 1989, not published, A.R. 8733/87; Court of Appeal Antwerp 24 May 2004, not published, 1995/AR/1934. Commercial Court Brussels 11 December 1998, not published, R.G. 054/97 Court of Appeal Liège 4 June 1991, R.R.D. 1992, 241, comment C. MATRAY; Court of appeal Brussels 2 June 2003, not published, 1997/AR/2791.

[82] Commercial Court Hasselt 3 December 2010, *R.G.D.C.*, 2012, pp. 328 to 333, comment Danis, F., pp. 333 to 335 confirmed by Court of Appeal Antwerp 22 December 2011, *R.W.* 2012, 187. Commercial Court Antwerp 19 December 2011, *R.W.*2012-13, 194; Court of Appeal Antwerp 2 January 2012, not published. 2010/AR/2280; Commercial Court Luik 14 May 2009, *D.A.O.R.* 2009, comment S. CLAEYS "Niet naleven van de Wet Precontractuele Informatie kan zuur opbreken, 388.

[83] *SAP* Valencia 29 December 2014, Roj: SAP V 5978/2014 ECLI:ES:APV:2014:5978; *SAP* Castellón de la Plana 24 April 2014, Roj: SAP CS 920/2014 - ECLI:ES:APCS:2014:920; *SAP* Barcelona 6 February 2014, EDJ 2014/29476 or *SAP* Madrid 11 April 2012, EDJ 2012/84546.

because of the franchisee´s unfair competition. The same argumentation is followed in the sentence of the Madrid *Audiencia Provincial* of 5 June 2006.[84]

In **the Netherlands**, franchisees contest the validity of the non-competition agreement after the termination of the franchise contract. The non-competition clause is regulated in Dutch law for employment contracts in Article 7:653 of the Civil Code, though this provision is not applicable (also by analogy) to other contracts such as a franchise contract, which means that it is up to the courts to decide whether a given non-competition clause is valid or could be infringing the general provisions of contract law (e.g. because it is contrary to good faith to invoke it on the basis of Article 6:248 par. 2 of the Civil Code). The courts are reluctant to invoke general protection through the principles of good faith unless the circumstances of the case are dire. It is generally accepted that the franchisor may protect its interests by setting a non-competition clause, limiting the risk that the know-how it gives to the franchisee would be used by its competitors, and that the new franchisee would need to compete against the old one in the same area (Gerechtshof (Court of Appeal) Den Bosch, 21 August 2012, ECLI:NL:GHSHE:2012:BX5661).

The non-competition clause limiting franchisees' activities after the termination of the contract in the area of the whole Netherlands is not prohibited and not immediately considered to be contrary to good faith – see e.g. Rechtbank (court of first instance) Breda, 18 April 2012, ECLI:NL:RBBRE:2012:BW4396; Gerechtshof (Court of Appeal) Den Bosch, 21 August 2012, ECLI:NL:GHSHE:2012:BX5661; Rechtbank (court of first instance) Arnhem, 5 October 2009, ECLI:NL:RBARN:2009:BK1781. For example, in the last case it was decided that such a wide geographical non-competition clause could be upheld (and was not contrary to good faith) since the franchisee had already been active in the same market for 10 years and had performed at least two franchise contracts.

A franchisee's argument that the non-competition clause should not be upheld because it limits his opportunity to earn a living during a certain period of time is not decisive, especially if the franchisee knowingly accepted this clause in the contract, see e.g. Rechtbank (court of first instance) Breda, 18 April 2012, ECLI:NL:RBBRE:2012:BW4396. Recently, Rechtbank (court of first instance) den Haag (KG), 16 July 2014, ECLI:NL:RBDHA:2014:8667 supported this line of argument, i.e. even if the franchisee becomes insolvent as a result of enforcing the non-competition clause, it was a risk accepted willingly when concluding the contract. In this last judgement, a confusing condition to the enforcement of a non-competition clause was added, namely that the non-competition clause could only be enforced if the franchisor is further exploiting the franchise, i.e. when the new franchisee starts his activities in this region.

If the termination of the franchise contract happens prematurely due to circumstances attributable to the franchisor, the non-competition clause may be invalidated – see e.g. Rechtbank (court of first instance) Utrecht, 23 December 2011, ECLI:NL:RBUTR:2011:BV3058; Rechtbank (court of first instance) Utrecht, 24 April 2013, ECLI:NL:RBUTR:2013:BZ9503. Such an attributable situation may be providing the franchisee with incorrect forecast about the franchise prior to the conclusion of the contract, see Gerechtshof (Court of Appeal) Den Bosch, 26 November 1996, Prg. 1997/4675. If the franchisee terminates the contract prematurely, the non-competition clause is likely to be held in place, see Rechtbank (court of first instance) Maastricht, 17 November 2011, ECLI:NL:RBMAA:2011:BU5153. The same applies if the circumstances that could make the enforcement of the non-competition clause contrary to good faith are attributable to the franchisee, e.g. if the business premises are lease for one-year longer

[84] SAP Granada 2 July 2007, Roj: SAP GR 1241/2007 - ECLI:ES:APGR:2007:1241; and *SAP* Madrid 5 June 2006, IdCendoj: 28079370102006100346.

than the franchise contract, in which case the rent could not be paid if the franchisee is prohibited from further working in the same market. The courts consider it a good business practice for the franchisee to think about the consequences of the terminating the franchise contract beforehand, see Rechtbank (court of first instance) Den Haag, 17 February 2011, KG-ZA 10-1536, or if the franchisee has not accumulated sufficient funds during the period of the franchise to wait out the non-competition clause's timeframe, see Rechtbank (court of first instance) Maastricht, 17 November 2011, ECLI:NL:RBMAA:2011:BU5153.

If the non-competition clause could be seen as a standard contract term, then it could also be tested for its unfairness under Article 6:233 para 1a of the Civil Code. This, however, is not common in practice. An ambiguous non-competition clause should be interpreted by the courts restrictively, in general in favour of the franchisee, see e.g. Rechtbank (court of first instance) Arnhem, 9 November 2005, ECLI:NL:RBARN:2005:AU9750.

In **Belgium,** post contractual non-compete clauses are one of several areas that cause problems in practice.

6.7.3. Termination of the franchising agreement

In **Belgium, Italy** and **Romania**, difficulties arise when it comes to the grounds and consequences of terminating franchising agreements.

In **Italy,** the most frequent issue dealt with in case law concerns the termination of franchising contracts. The regulation offered by l. 129/2004 is not exhaustive on termination, and a considerable amount of case law has emerged dealing with this issue. Litigation in this regard might arise when the franchisee realises it is not making the profit that was initially estimated, and therefore tries to invalidate the contract, or, on the contrary, the franchisee wants to continue a contractual relationship that the franchisor does not intend to renew, so the franchisee considers the reasons of the franchisor as unfair.

In **Belgium**, the termination of a franchise agreement may entitle the franchisee to a goodwill indemnity. Given the long tradition in Belgium of granting exclusive distributor generous goodwill indemnities upon termination, and given the goodwill indemnity granted to agents (chapter 1 Book X Code of Economic Law), many franchisees, supported by several scholars, have sought legal grounds to claim goodwill indemnities for franchisees, either by applying the Statute of 1961 as explained above, or by arguing an abuse of the right to terminate by the franchisor, for which a compensation is due. The majority of the Belgian scholars rightfully reject the use of the "*action de in rem verso*". The fact that the franchisor's goodwill increases in value after the termination of the franchise agreement is not without cause, since the cause lies in the franchise agreement itself.

In **Romania,** the termination of a contract has also been the subject of litigation, as in the following case: The claimant, E Group SRL, submitted a request to Bucharest Tribunal to oblige the defendant, MJU SRL, to comply with the obligations it undertook as franchisee by signing a franchising contract and, if it refused to, to compel it to pay the amount of 112,894 lei (approx. €25,000) for each day of delay, as damages. The franchising contract concerned a coffee shop, at which the franchisor accused the franchisee of not displaying the brand of the franchisor and of selling products other than the ones agreed on in the franchising contract. According to the defendant the claimant's request had no legal grounds; he also requested the termination of the franchising contract due to the fact that the claimant had failed to provide the necessary information for operating the franchise, as well as the assistance and training in conducting the franchised business. The Bucharest Court of Appeal (Decision No 131/2010[85]) ruled against the claimant. It said that the

[85] http://legeaz.net/spete-drept-comercial-jurindex/obligatia-de-a-face-131-2010-4gm.

franchising contract has a mutually binding character, so unless different deadlines are stated in the contract for the obligations of the two parties, they are bound to simultaneously perform their obligations. The court noted that the franchisor did not comply with its contractual obligations and so it is not entitled to ask for the termination of the contract. The Court of Appeal also held that, based on the mutually binding character of the franchise contract, the first instance was right not to order the defendant to perform its obligations, since the claimant had not performed its own.

6.7.4. The duty to provide know-how and assistance

In **Belgium, Romania** and **Spain,** the typical problems brought up to courts by franchisees concern the franchisor's obligation to provide know-how and assistance.

In **Spain**, the case law on know-how typically concerns two types of claims: claims based on the non-compliance of the know-how with the necessary requirements that would allow the franchisee to successfully operate the business,[86] and claims based on non-compliance with the franchisor's obligation to transfer all the know-how agreed in the contract.[87] The courts do not generally invalidate contracts based on the non-existence of know-how, because they give more weight to the role of the franchisee as a professional who should be aware of the business method that it is buying. Thus, the attitude and the aptitude of the franchisee are regarded by the courts as an important factor excluding the liability of the franchisor. This is also the case regarding the obligation to provide pre-contractual information. Thus, the Madrid *Audiencia Provincial* indicated, in a sentence of 11 July 2008, that the claim of the franchisee that the know-how had no added value should be disregarded, because the franchisee should have analysed the characteristics of the business method before the contract was concluded. This sentence is in line with a previous decision of the same appeal court of 27 July 2007, concerning a claim to invalidate a franchise contract based on the non-existence of the know-how. The court did not grant the annulment of the contract because the know-how indeed existed. However, the court granted the franchisee's subsidiary claim for termination, because the franchisor did not comply with its obligation to communicate the know-how (delivery manuals). In the *SAP* Baleares of 26 June 2005, the franchisee claimed that there had been a previous non-performance of the franchisor on the obligation to communicate the know-how as agreed. The court responded that the franchisee had never even required compliance by the franchisor.[88] In addition, the non-performance of the obligation to provide assistance is of relevance. The TS´s decision of 4 March 1998 is one of the few judgments available from the TS concerning a claim for the non-performance of the obligation to assist. The court in this decision emphasised the importance of the obligation to assist in franchising agreements as a means to allow the franchisee to achieve the expected good economic results.[89] There have been considerably more cases concerning assistance heard by the *Audiencias Provinciales*. Pursuant to some of these, assistance is to be considered as a

[86] *SAP* Valencia 21 May 1993, *AC* 1993\1024; *SAP* Zaragoza 16 September 2003, *AC* 2003\1507 and 17 November 2003, *AC* 2003\2350; *SAP* Barcelona 24 March 2004, *JUR* 2004\122633.

[87] *SAP* Valencia 28 April 2000, *AC* 2000\1193; *SAP* Zaragoza 25 July 2000, *JUR* 2000\273349 and *SAP* Sevilla 28 January 2002, *JUR* 2002\47775.

[88] *SAP* Madrid 11 July 2008, Roj: SAP M 12103/2008 - ECLI:ES:APM:2008:12103; *SAP* Madrid 27 July 2007, Roj: SAP M 11747/2007 – ECLI:ES:APM:2007:11747; *SAP* Baleares 20 June 2005, SAP IB 851/2005 - ECLI:ES:APIB:2005:851.

[89] *STS* 4 March 1997, *RJ* 1997\1642: this case concerned a franchise for the operation of a bakery. The franchisee terminated the contract because the franchisor had not provided it with the agreed assistance. The franchisee was able to prove that it had asked the franchisee several times to provide the assistance agreed, but to no avail. It argued that this gave it the right to terminate and that the franchisor was not entitled to invoke Articles 1124 and 1101 of the Civil Code because it had not performed its obligations.

means to communicate the know-how.[90] The Spanish courts have given a restrictive interpretation to the contents of the generic obligation to assist. In some cases, if "any" assistance had been provided, the franchisor was considered to have performed.[91] In other cases, the courts have held that the particular obligation that, according to the franchisee, had not been performed was not due because it was not explicitly agreed upon in the contract.[92] As is the case of the obligations on pre-contractual information and know-how, the courts place the burden of proof on the franchisee. For example, in *SAP* Madrid of 11 July 2008, the court indicated that the franchisee had not proven that it was not assisted (this is again a case of "diabolic proof" because the franchisee is required to prove that it was not assisted, whereas it is more logical and realistic to ask for proof that the assistance was provided).[93]

In **Romania,** a lawsuit brought by the company D SRL against the Romanian Agency of Payments and Intervention for Agriculture ("APIA") concerned questions about what exactly is the notion of "know-how", and whether it includes not only the knowledge to be transmitted to the franchisee, but also the necessary authorisations, where required by the law for the performance of a specific activity. The claimant requested the annulment of a document issued by APIA, through which the claimant was refused a grant it claimed it was entitled to. APIA justified its refusal on the ground that the claimant was not in possession of a veterinary health authorisation for raising chickens. The claimant defended itself by saying that it was authorised to function through an authorisation given by the competent authorities to the company B3000 S.A, because there was a franchising contract between the two parties, in which the claimant acted as a franchisee. Alba Iulia Court of Appel, in its decision No 103 from 30 January 2008,[94] stated that, according to Article 1 letter a of the Franchising Law, the franchising contract transmits from the franchisor to the franchisee the right to conduct and develop its business. Therefore, the franchising contract covers all the necessary authorisations to allow the franchisee to legally conduct its activity from the moment of concluding the franchise contract. The decision of the court is not immune to criticism because it did not discriminate between the content of the properly called franchising contract and the contractual clause that transferred the title the former had over the place where chickens were raised from the franchisor to the franchisee. So the conclusion reached by the Court of Appeal, namely that the particular

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90 *SAP* Valencia 21 May 1993, *AC* 1993\1024; *SAP* Valencia 28 April 2000, *AC* 2000\1193; *SAP* Zaragoza 25 July 2000, *JUR* 2000\273349; *SAP* Barcelona 31 March 2001, *JUR* 2001\215218; *SAP* Sevilla 28 January 2002, *JUR* 2002\47775.

91 *SAP* Barcelona 10 May 2000, *JUR* 2000\211264: this case concerned the operation of a business that provided a certain therapy to help people to stop smoking. The franchisee claimed that no training had been provided. The court indicated that the contract was not clear concerning the assistance that was to be provided, but that it was clear that the therapy consisted of the electric stimulation of the ears, face and hands. It had been proven that the franchisor had provided certain courses, and on this basis the court held that the assistance had been sufficient; *SAP* Teruel 24 October 2001, *AC* 2001\1931: here, the franchisee sued the franchisor for non-performance of its obligations, including a lack of assistance. The *Audiencia Provincial* concluded that it had been proven that the franchisor had provided "some" assistance and that the franchisee must be presumed to have agreed with the assistance so provided as there was no evidence that it had asked for training courses or information that was not provided.

92 *SAP* Sevilla, 28 January 2002, *JUR* 2002\47775: in this case, the franchisee claimed that the assistance given was not sufficient. The *Audiencia Provincial* analysed the literal contents of the contract and indicated that it did not contain an obligation to provide an exploitation account to indicate the costs and income that would be adequate for the optimal operation of the business, but that the franchisor only undertook an obligation to assist the franchisee in evaluating the conditions of the local market and to help process the provisional results. The court considered that the franchisor had done enough to comply with its contractual obligation by making available staff and help centre facilities to deal with requests from franchisees.

93 *SAP* Madrid 11 July 2008, Roj: SAP M 12103/2008 - ECLI:ES:APM:2008:12103.

94 http://legeaz.net/spete-contencios-jurindex/anulare-act-administrativ-fiscal-103-2008-6b4. A similar case was adjudicated by Constanta Court of Appeal through Decision 557/2002 (online http://portal.just.ro/118/Lists/ Jurisprudenta/DispForm.aspx?ID=50).

know-how on the conduct of the business includes any potential authorisations to perform the business, seems deprived of basis in the actual text of the law.

In **Belgium**, in the case of a lack of assistance by the franchisor, the franchisee is often forced to call upon a lack of pre-contractual information to try to obtain an annulment (see above).

6.7.5. Definition and interpretation of franchising contracts

The Definition and Interpretation of franchising contracts is a common issue in **France, the Netherlands** and **Spain**.

As under **French** law, franchising contract is an innominate contract, there is a risk that the parties will choose to describe as franchise a contract that does not fulfil the definition of real franchising agreements, as defined, for example, in the aforementioned judgement of the Cour d'appel de Toulouse. In this case, the contract may be reclassified in the course of the court proceedings. Accordingly, when the obligations imposed by the franchisor to the franchisee are too heavy, there is a risk of the franchising contract being reclassified into an employment contract. Therefore, the franchisor should avoid demanding specific opening hours or wearing specified clothing, as well as controlling the bank accounts of the franchisee. In the event of bankruptcy proceedings, the franchisor could even be considered as a de facto manager of the franchise company.

Since the franchise contract is not specified in **Dutch** contract law, there is no definition thereof and Dutch courts need to establish themselves whether a particular contract between the parties in the dispute could qualify as a franchise contract. For the recognition of the franchise contract, the court finds it necessary that the parties used a "shop formula", an obligation to conduct business according to a particular style, that the franchisor gives the franchisee (financial) support and that the franchisee pays monetary compensation to participate in the formula to the franchisor (Rechtbank Breda (court of first instance), 21 December 2011, ECLI:NL:RBBRE:2011:BU9904).

In **Spain**, three landmark decisions of the TS make up the leading case law regarding franchising contracts. In these sentences, the Spanish Supreme Court defines franchising and determines its legal nature and characteristic elements. These are the decisions of 27 September 1996, 4 March 1997 and 30 April 1998.[95] These decisions keep recurring in other sentences of the TS, and in many of the decisions taken by the *Audiencias Provinciales*.[96]

6.8. Country specific problems

6.8.1. Germany: status of the franchisee before concluding the contract, contract revocation

- **Franchisee treated as an enterprise even before the conclusion of the contract.**

According to the jurisprudence of the BGH[97] (the German Supreme Court), the franchisee is an enterprise even before it actually concludes the contract. As a result, the AGB-law is in principle applicable. This is certainly the case when it is a franchise contract provided by

[95] *STS* 27 September 1996, *RJ* 1996\6646; 4 March 1997, *RJ* 1997\1642 and 30 April 1998, *RJ* 1998\3456.

[96] See for example *STS* 21 October 2005, Roj: STS 6410/2005 – ECLI:ES:TS:2005:6410; and 9 March 2009, Roj: STS 1129/2009 - ECLI:ES:TS:2009:1129; *SAP* Huesca 20 November 1998, *AC* 1998\2476; *SAP* Barcelona 9 September 2002, *AC* 2002\1728; *SAP* Teruel 24 October 2001, *AC* 2001\1931.

[97] BGH (German Supreme Court), Decision of 24.02.2005, III ZB 36/04. This decision was not made in the context of a franchise contract, however, it contains the general principle that a business founder is to be seen as an enterprise and not as consumer.

the franchisor as a standard contract, which usually is the case. However, because the franchising contract is a B2B contract, only a limited review of the individual contract terms is possible, on the basis of § 307 para. 1 BGB, as follows from § 310 para. 1 BGB. Here, a problem arises whether the franchisee, which is most frequently a start-up, will be adequately protected by the less intensive control of unfairness. Considering that the protection should be adequate, it can be argued that those who want to become self-employed, must be, to a certain extent, capable of taking the risk, which means also to be able to evaluate the contract and the risks that follow it. For this reason, the franchisor is burdened with more intensive pre-contractual disclosure obligations, and there is no need on the part of the franchisee to use the full protection of the AGB-law. [move to unfairness control]

- **Revocation of the franchise contract**

The franchisee may, under certain circumstances, have the right to withdraw from the franchising contract. In principle, a franchisee could have the right to revoke a contract only if it was classified as a consumer, which the German Supreme Court explicitly denied in 2005 (BGH, decision of 24.02.2005, Az. III ZB 36/04). Therefore, the franchisee has no withdrawal right under consumer protection law. It is, however, conceivable to grant the franchisee a right to withdraw pursuant to § 512 BGB, as this provision goes beyond the provisions of the Consumer Rights Directive and grants anyone who falls within its scope further reaching rights, i.e. the right to withdraw. Full harmonisation causes no problems in this regard, as "business founders" (the persons § 512 applies to) fall outside the scope of the directive. According to the prevailing view, § 512 BGB does not broaden the definition of consumer, but extends the scope of the §§ 491-511 BGB. Thus, § 512 BGB takes on great practical relevance when it comes to franchising contracts. According to the case law, § 512 BGB can even be applied to grant the franchisee a right to revoke after the franchising contract has been concluded and the franchisee/business founder then concludes a contract for the delivery of goods (BGHZ 97, 351, 356 f.; BGHZ 112, 288; BGHZ 128, 156). What must be considered, however, is that § 512 BGB only applies to contracts with a maximum value of € 75,000; beyond this amount the right to withdraw is excluded for the lack of worthiness of protection of the franchisee. Nonetheless, the possibility of reducing the scope of § 512 BGB on teleological grounds is being considered, so that it can perform its main purpose – the protection of business founders – completely.

6.8.2. Spain: lack of payment by franchisees and IPR

In **Spain,** one problem that appears frequently is the non-performance of the payment obligation on the part of the franchisee (for example: *STS* 27 February 2012, *SAP* Albacete 18 October 2013, *SAP* Baleares 20 June 2005 and *SAP* Madrid 23 April 2007 and 11 July 2008.[98] Additionally, the number of cases suggests that there is a problem relating to holding a valid title allowing the franchisor to license the intellectual property rights. In such cases, franchisees claim the invalidity of the contract due to the non-registration of the trademark by the franchisor. The position of the courts on the question as to whether registration is a requirement for the validity of the contract is unclear. In some decisions this was considered to be the case, whilst in others it was not. Whenever the registration was considered as a validity requirement, the lack of it led to the annulment of the contract: *SAP* Zaragoza 23 February 1999 and *SAP* Asturias 22 January 2001.[99] Other courts,

[98] *STS* 27 February 2012, Roj: STS 1327/2012 ECLI:ES:TS:2012:1327; *SAP* Albacete 18 October 2013, Roj: SAP AB 939/2013 - ECLI:ES:APAB:2013:939; *SAP* Baleares 20 June 2005, Roj: SAP IB 851/2005 - ECLI:ES:APIB:2005:851; *SAP* Madrid 23 April 2007, Roj: SAP M 5478/2007 - ECLI:ES:APM:2007:5478; *SAP* Madrid 11 July 2008, Roj: SAP M 12103/2008 - ECLI:ES:APM:2008:12103.

[99] *SAP* Zaragoza 23 February 1999, *ARP* 1999\447 and *SAP* Asturias 22 January 2001, *AC* 2001\959.

however, investigated whether the franchisee was able to effectively use the intellectual property rights: *SAP* Barcelona 10 May 2000; *SAP* Zaragoza 18 July 2000 and 16 September 2003; *SAP* Barcelona 23 January 2001 and 31 March 2001, and more recently *SAP* Granada of 2 July 2007.[100] In proceedings before the Granada *Audiencia Provincial,* a franchisee claimed the annulment of a contract because of "*dolo causal*" on the part of the franchisor. The franchisee argued that the franchisor entered the contract by giving defective consent, because the IPR were not owned by the franchisor. The *AP* indicated that, although the trademark is not owned by the franchisor, that did not prevent the franchisee from using it. According to the court, another result would have been reached if the claim had been grounded on the impossibility for the franchisor to cede the IPR.

The approach of Spanish courts is surprising if we take into account the fact that the *RD* 201/2010 requires the franchisor to provide the franchisee with proof of legal ownership or proof of the right to license the Intellectual Property Rights.

6.8.3. Belgium: e-commerce

In **Belgium**, an area that raises problems relates to e-commerce. The question arises whether a franchisee can prohibit the use of its trademarks or other intellectual property rights on the website of a franchisee? There is no decisive case law up until now. The Pierre Fabre case law is followed, and would most likely also be applied to franchise agreements. How can a franchisor set up an e-commerce platform in which franchisees participate, without limiting the rights of the franchisees to freely set their resale prices online (national e-commerce platforms generally want to apply a uniform pricing policy, but can, in principle, not impose prices for participating franchisees)?

6.9. Reform plans - overview

In the majority of the researched legal systems there have been discussions on whether franchising should be addressed in legislation. Specific reform plans exist in **the Netherlands**, where the rising importance of franchising is seen as a potential argument to introduce new legislation. In the ongoing process to strengthen self-regulation in the franchising sector, a new Dutch Franchising Code, has been published very recently. In **France**, a draft modification of the contract law provides certain provisions relevant for the protection of franchisees. In **Italy**, while some franchising associations have drafted suggestions for a possible reform, there are no fixed proposals yet. In **Spain**, two main attempts to introduce franchising-specific provisions in the area of private law have been made, though both failed. The **Belgian** Ministry of the Economy has asked the Franchise Federation several questions concerning possible changes of law. In **Germany,** is not clear whether considerations to achieve a higher level of protection for the franchisee will be continued or taken up again in the current legislative period. In **Poland,** there were suggestions that franchising should be dealt with as a nominative contract in the new (planned) Civil Code, but nothing has come out of this so far. In **Estonia** and **Romania** there are no reform plans.

6.9.1. The Netherlands

When it comes to **the Netherlands,** Jan-Willem Kolenbrander, a lawyer with De Clercq Advaocten Notarissen in Leiden who specialises in franchising, published an article in 2013 in one of the main Dutch legal journals (Nederlands Juristenblad, vol. 39), in which he

[100] *SAP* Barcelona 10 May 2000, *JUR* 2000\211264; *SAP* Zaragoza 18 July 2000, *JUR* 2000\272692 and 16 September 2003, *AC* 2003\1507; *SAP* Barcelona, 23 January 2001, *JUR* 2004\54712 and 31 March 2001, *JUR* 2001\215218 and more recently the *SAP* Granada, 2 July 2007, Roj: SAP GR 1241/2007 - ECLI:ES:APGR:2007:1241;

argued for the introduction of a franchising contract as one of the nominate contracts to Dutch contract law. The popularity of franchising in the Netherlands grew from 360 franchise formulas being recognised in 1997, to 769 formulas in 2012, which could present an argument for the introduction of a new regulation. The author calls for the introduction of a pre-contractual information duty (just like in French and Belgian law) and a specific duty of care for the franchisor, including with regard to the duty to (financially) support the franchise. Additionally, he argues for the introduction of the mandatory written form of the franchise contract to guarantee a legal certainty with regards to the parties' rights and obligations in this long-term contractual relationship. Moreover, the new law should establish the court of the place of business of the franchisee as having jurisdiction over any disputes arising from the franchise contract, which would then prevail over the choice-of-court term in a franchise contract. To complete the protection of the franchisees in cross-border contracts, who mostly conduct business in the Netherlands, the parliament could declare Dutch law as applicable to them, regardless of the choice of law clause in the franchise contract.

Very recently (on 17 February 2016) a new self regulation was adopted in the Netherland (on this: See Chapter 2, point 2.6.3).

6.9.2. France

In **France,** the reform plans do not include formulating specific provisions relating to franchising contracts. Article 8 of the Law 2015-177 of 16 February 2015 on the modernisation and simplification of law and procedures in the areas of justice and home affairs provided the Government with a task to modify the contract law.

The draft of the new law provides the following provisions relevant for the protection of franchisees:

- Article 1168: Any clause that deprives an essential obligation of the debtor of its substance is deemed unwritten.
- Article 1169: A clause that creates a significant imbalance between the rights and obligations of parties to the contract can be eliminated by the judge at the request of the party at the expense of which it is stipulated. The appreciation of a significant imbalance relates neither to the definition of the object of the contract nor to the adequacy of the price" (this rule is new).
- Article 1163: In framework contracts and contracts involving periodical performance, it can be agreed that the price of the service will be fixed unilaterally by one party, with the burden of proof concerning the amount in the event of a dispute. In the event of an abuse in pricing, the judge may, upon a motion, revise the price given particular consideration, use market prices or legitimate expectations of the parties, award damages, and if necessary terminate the contract.
- Article 1196: containing a *rebus sic stantibus* clause.

6.9.3. Italy

In **Italy,** certain franchising associations (AZ franchising, IREF Italia – Federazione delle reti europee di partenariato e franchising, ANCommercialisti) consider that the current legislation is not sufficient and have therefore drafted several suggestions for a possible reform, which have been presented to the government. They included the promotion of transparency and knowledge of the economic profile of franchisors through registration requirements. Members of the Italian Parliament have taken these remarks in consideration, saying that the current statute works well but needs to be updated. More concrete legislative proposals are nonetheless lacking and do not appear to be a priority

on the political agenda.[101] The legislative intervention in the franchising area has so far been less about the regulation of the contract, and more concerned with the business activity. There are, occasionally, secondary interventions of the government creating financial incentives for the constitution of new franchising activities, especially in certain economically disadvantaged areas of Italy.

6.9.4. Spain

In **Spain,** two main attempts have been made to provide distribution contracts, including franchising, with specific private law legislation. These are: the Government Draft of law on distribution contracts of 2011[102] and the Draft of a new Commercial Code drawn up by the Commercial Law Section of the General Codification Commission of the Ministry of Justice (presented to the Government in May 2014), including a proposal for regulation on distribution contracts.[103] Both attempts have failed. The Government's proposal was submitted for publication and discussion in Parliament in June 2011, but it was never discussed. The draft Commercial Code was approved by the Government in May 2014, and has started the Parliamentary process, but the part on distribution contracts eventually disappeared from the text.

6.9.5. Belgium

In **Belgium,** the Ministry of the Economy has recently asked the Franchise Federation several questions concerning the possible changes of law:

1. Whether it should be necessary to provide for a specific obligation of pre-contractual disclosure (going beyond the obligations regarding pre-contractual information based on general contract law)? The legislature is therefore considering abolishing the specific Statute on pre-contractual information, although this does not seem to be very likely.
2. The fact that the scope of the Statute on pre-contractual information is much broader than for franchise agreements has given rise to many disputes. The Ministry of the Economy therefore inquired about limiting the scope of the Statute on Pre-contractual information to SMEs. This would mean that a larger company (acting, for example, as a master franchisee or serial franchisee), would not be entitled to pre-contractual information.
3. Whether a cooling off period of one month between the delivery of the disclosure document and the signing of the agreement is useful and whether the harsh invalidity sanction is appropriate?
4. Is there a need for legislative intervention in other aspects of the franchise agreement (such as termination, goodwill indemnity etc.)?
5. Should the scope of Chapter 3 of Book X of the Code of Economic Law, of the old Statute of 27 July 1961 regarding the unilateral termination of exclusive distribution agreements of indefinite duration (as mentioned before), be broadened to include franchise agreements.

6.9.6. Germany

In **Germany**, there have been discussions as to whether the law should deal with the pre-contractual disclosure obligations of the franchisor, in order to achieve a higher level of

[101] http://www.iref-italia.it/speciale-iniziativa-legislativa-per-una-riforma-del-settore/
[102] Proyecto de Ley de Contratos de Distribución, Boletín Oficial de las Cortes Generales, 29 de junio de 2011, núm 138-1.
[103] Propuesta de Código Mercantil elaborada por la Sección de Derecho Mercantil de la Comisión General de Codificación, Ministerio de Justicia, Madrid, 2013, pp. 695-698.

franchisee's protection and to prevent the situation where the franchisee enters into an agreement based on misconceptions. It is not clear whether these considerations will be continued or taken up again in the current legislative period. The reasons why the project was dropped are not apparent. However, the courts have already developed a nuanced approach to prevent problems in this area.[104] Recent years have brought developments in the case law in the direction of increasing the scope of liability of the franchisee. The franchisee is not to be protected against every risk that may be associated with the conclusion of a franchise contract.[105] The courts tend to stress the entrepreneurial freedom of the franchisee. Recent trends, however, have seen the protection of the franchisee increase again, and the higher demands concerning the disclosure obligations of the franchisor, established by the courts, reflect this.[106]

[104] OLG München, judgement of 16.09.1993, NJW 1994, 667; judgement of 17.11.1996, NJW-RR 1997, 812, judgement of 24.04.2001, NJW 2001, 1759; judgement of 01.08.2002, BB 2003,443; judgement of 27.07.2006. BB 2007,14.

[105] Fort he change in the case law see for example: OLG Schleswig, NJW-RR 2009, 65; OLG Brandenburg, NJW-RR 2006, 51; OLG Düsseldorf, judgement of 30.06.2004, U Kart. 40/02.

[106] On this issue: OLG Düsseldorf, ZVertriebsR 2014, 46.

7. NATIONAL PRIVATE LAW APPLICABLE TO FRANCHISING – SPECIFIC ISSUES

KEY FINDINGS

- Some of the specific issues raised by the IMCO do appear in practice, at a national level. They show certain similarities, i.e. they often refer to the same area of the franchising practice in several member states, which suggests certain patterns.
- The most striking differences among the researched legal systems stem from whether or not there is specific franchising legislation in the area, and whether the courts can evaluate the unfair character of contract terms in the franchising contract.
- The cross-border dimension of franchising does not seem to be causing particular problems at a national level.

7.1. Introduction

The IMCO has posed several very specific questions concerning contractual practice in the franchising area. A clear answer (whether or not specific problem is present in a given legal system) could be found only in limited number of cases (included in the tables). In the remaining cases, legislative or jurisprudence background characteristic for the given legal system is presented (where available). If legal system contains a rule that directly addresses the problem at stake, it is interpreted as if the system has encountered the problem in practice.

7.2. Pre-contractual issues

7.2.1. Overview

Country	Incorrect forecasts	Limiting access to information	Oral information divergent from the contract	Reflection time	From employee to franchisee
Belgium	✓		Info required in writing	Cooling off period before concluding the contract	✓
Estonia					
France	✓			Cooling off period before concluding the contract	
Germany	✓				

Italy	✓	✓	Info required in writing	Cooling off period before concluding the contract	
The Netherlands	✓	✓			
Poland					
Romania	✓		Info required in writing		
Spain	✓				

7.2.2. Providing misleading or incorrect information through forecasts offered by the franchiser to interested franchisees regarding profit margins, turnover and growth

In **France, Germany, Italy, the Netherlands, Romania** and **Spain,** the franchisor has to provide all the appropriate and relevant information to the franchisee at the pre-contractual stage. What this information must comprise of differs among the researched legal systems, though there seems to be no legal obligation of the franchisor to provide forecasts regarding profit margins, turnover and growth.

Incorrect or misleading information provided by the franchisor before the contract conclusion leads to sanctions in all the legal systems. **Spanish** law offers specific solutions to cases where the franchisor provides information on sales forecasts voluntarily, whereby it is not automatically liable if the estimated profits are not achieved by the franchisee. In **Italy,** this behaviour is sanctioned according to both general contract law and the statute, with the annulment of the contract and the payment of damages incurred by the franchisee. Sanctions in **Belgium, Germany, the Netherlands, Poland** and **Romania** are based on general principles of contract law. In **Estonia,** misleading or incorrect information may also lead to a claim for damages on the bases of pre-contractual liability (Article 14 of the LOA), though there is no information about these in the franchising context.

The provision of incomplete or misleading information is a recurrent issue in **Spanish** franchising practice and its importance has not gone unnoticed by the Spanish legislator and jurisprudence. Parties have no obligation under Spanish law to provide information on sales forecasts. This was already the case before the enactment of the *LOCM* and its implementing decrees, and has remained so after codifying the duty of pre-contractual disclosure. The *RD* requires information on the situation in the market sector in which the franchise business is operating, though this concerns objective information on the market concerned rather than information on estimated profits.[107] Nevertheless, the Spanish legislator introduced provisions in *RD* 201/2010 that deal with the situation whereby the franchisor volunteers information on sales forecasts. Such information must be based on the previous experience and studies sufficiently grounded in reality.[108]

[107] Alonso Espinosa et al., 1999, p. 719.
[108] Article 3 (e) of *RD* 201/2010.

According to the very few existing cases and to the legal doctrine, the liability of the franchisor in respect of information on estimated profits is to be determined with due regard to specific factors. First, the obligation to provide information concerning sales forecasts is an obligation of means: the franchisor does not guarantee that the estimated benefits will be achieved.[109] Second, it is, in principle, up to the franchisee as a business entity to assume the risk of making less profit than expected.[110] Third, the provision of information that exaggerates the advantages of the network is not subject to sanctions *per se*. Spanish doctrine refers to such information as a case of *dolus bonus*: the franchisor emphasises the positive aspects of his network to attract new members. This practice is considered tolerable, due to the fact that any person might expect the franchisor to exaggerate positive information, as its aim is to increase business. The sentence of the *TS* of 27 February 2012 refers to the estimation on earning claims and says that the *RD* on disclosure did not require information of this kind. Moreover, the franchisee did not prove that the earning claims were not realistic or had been made without rigor and prudency.[111]

In **Italy,** Law 129/2004 explicitly requires the franchisor to provide certain information that can offer the franchisee a picture of the economic viability of the franchising. This includes the duty for the franchisor to give a numerical list of the franchisees operating in the network, country by country, and, at the request of the franchisee, a list and the contacts of at least 20 franchisees. There are no other specific legal requirements as to the need to incorporate forecasts in the contract on perspective profit margins and growth. The requirement for the contract to include a "business plan" drafted by the franchisor came under heavy criticism and was eventually excluded from the final version of the statute. If this information is offered by the franchisor during the negotiations, but not included in the contract in writing, it cannot legitimise any claim by the franchisee, according to case-law settled already prior to the 129/2004 Law. This could, nonetheless, be evaluated as a case of the lack of good faith in the phase of negotiations or misleading information. Misleading or incorrect information is sanctioned according to both general contract law and the statute with the annulment of the contract and the payment of damages incurred by the franchisee. The growth of the network in purely numerical terms can be determined by the indication requested by 129/2004 Law on the number of franchisees. In this context, the Authority for the Market and Competition considered as illegal a claim by a franchisor that the network was continuously growing, when in reality there were more franchisees leaving the network than new ones (AGCM, dec. 20951/2010).

In **the Netherlands,** most of the case law concerns incorrect information provided to franchisees about the forecasts. The Dutch courts may void a contract or its particular provisions if they find out that incorrect information was provided by the franchisor either knowingly or through negligence prior to the conclusion of the contract or during its performance. In such a case, the franchisor breaches his duty of care towards the franchisee.

The new self-regulation Code includes provisions on pre-contractual information duties, aimed at not only obliging franchisors to be more careful while they provide forecasts, but also informing franchisees that they should critically assess these forecasts, and what the risks are of not doing so.

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[109] *SAP* Burgos 11 February 2002, *AC* 2002\892. See also Echebarría, 1995, p. 726; Martínez Sanz, Contratos de distribución commercial: concesión y franchising, Scientia Ivridica, t. XLIV, nn 256/258,1995, p. 363 and Alonso Espinosa et al., 1999, p. 720.

[110] *SAP* Valencia 17 January 2001, *AC* 2001\1269. See also Echebarría, 1995, p. 347; Martínez Sanz, 1995, p. 363; Alonso Espinosa et al., 1999, p. 723.

[111] *STS* 27 February 2012, Roj: STS 1327/2012 - ECLI:ES:TS:2012:1327.

The forecast information has been a problem also in **Belgium**, though it was at least partially resolved by the statute of 19 December 2005 imposing pre-contractual disclosure (Book X chapter 2 of the Code of Economic Law). The statute, however, only obliges the franchisor to grant information, but without any quality control. Providing misleading information is only sanctioned on the basis of the general principles of contract law. If the misleading information concerns a material element of the contract and if the franchisee was rightfully misled and would not have concluded the agreement (or not under the same conditions) had it been correctly informed, it can seek the annulment of the agreement. The statute on pre-contractual information only entitles the franchisee to information that should allow him to make its own business plan. The franchisor is not legally obliged to make a market study for the franchisee (it must only describe the market situation, not assess the economic viability of the franchise project).

In **Germany,** there are no rules specifically tailored to franchising that would prevent the franchisor from providing false or misleading information to the franchisee, and thus would hinder the franchisor from presenting its franchising concept as being more interesting and profitable than it actually is. However, the courts have reacted to this with a well-differentiated casuistry. The case law clarified that the franchisor is obliged to submit all appropriate and relevant information to the franchisee at the pre-contractual stage. The information must be true, and based on facts, in order to enable the franchisee to evaluate independently how profitable the franchising contract might be.

In **Romania,** the Franchising Law requires the franchisor to properly inform the franchisee about financial aspects such as: the entrance fee; the scope of the exclusivity clause; information regarding the duration of the contract, renewal conditions, termination clauses. However, the Franchising Law does not establish any sanction for non-compliance with the informational duty, which means that the general private law rules are applicable. Therefore, the franchisee must rely on a tort claim, which entails proving the existence and the amount of damages, as well as the causation of the damage through the breach of the contractual duty.

In **France,** the pre-contractual disclosure is established by Articles L. 330-3 and R. 330-1 of the Code de Commerce, which regulate a document of pre-contractual disclosure ("*document d'information précontractuelle* (DIP)). According to the se clauses, any person who provides to another a trade name, brand or corporate name, by requiring therefrom an exclusivity or quasi-exclusivity undertaking in order to carry out their activity, is bound, prior to signing any contract concluded in the common interest of both parties, to provide the other party with a document giving truthful information allowing the latter to commit to this contract in full knowledge of the facts. This document, whose content is determined by decree, must specify in particular the age and experience of the business, the state and development prospects of the relevant market, the size of the network of operators, the term and the conditions of renewal, termination and assignment of the contract and the scope of the exclusive rights. Where the payment of a sum is required prior to signing the contract indicated above, particularly to obtain the reservation of an area, the benefits provided in return for this sum must be specified in writing, together with the reciprocal obligations of the parties in the event of renunciation. The document specified in the first paragraph and the draft contract must be notified at least twenty days before the signing of the contract or, where applicable, before the payment of the sum indicated in the above paragraph.

7.2.3. Limiting access to information and advice on complex franchising contracts through a duty of confidentiality with severe penalty clauses

The most comprehensive rules on confidentiality clauses exist in **Italy**. While the rules recognise the need for confidentiality in franchising, excessively severe penalty clauses are reduced by the courts. In **Estonia**, such clauses are presumed to be unfair and invalid in B2B contracts. Confidentiality clauses are common in **Belgium, Germany** and **the Netherlands**, though case law on this issue is only reported in the latter system. There is no **Romanian, Spanish** or **Polish** legislation or case law relevant for this topic.

In **Italy,** Article 5.2 expressly refers to the issue of confidentiality. It states that the franchisee has to respect and have respected by its own collaborators and personnel, even after termination of the contract, the highest degree of confidentiality regarding the contents of the activity forming the object of the franchising contract. The law (Articles 6.1 and 6.2) also acknowledges the issue of confidentiality during negotiations, so while the parties have to communicate to each other any useful information, the franchisor can legitimately refuse to disclose information that is objectively confidential, or which can harm third parties if divulged. In this case, if the franchisee has requested the information, the franchisor has to justify the refusal to disclose the information. In **the Netherlands** there is a case (Rechtbank (court of first instance) Arnhem, 14 September 2011, ECLI:NL:RBARN:2011:BT6358), in which the franchisee claimed a breach of the duty of care of the franchisor because it was required to sign a preliminary agreement including a duty of confidentiality prior to being able to see the report on the franchise location. The court saw it differently, since the franchisor had invested money in the report and it contained sensitive information about the potential new location of a franchise shop, this meant that agreeing to the duty of confidentiality could have been a condition on further participating in the negotiations. In addition, a sample interview with Dutch franchisees indicated a practice of limiting access to legal advice by imposing a very strict confidentiality duty, which included a prohibition on seeking a legal advice.

In **Germany,** the imposition of contractual penalties in a franchise contract is not uncommon. Contractual penalties are customary when ensuring the confidentiality of franchising systems. To what extent these penalties are used to restrict access to the mostly complex franchising contracts, and therefore uphold the significant information gap between the franchisor and the future franchisee, or how far the contractual penalty simply serves to ensure the proper functioning of the franchising system, depends on the configuration of the contractual penalty in each individual case. Unfortunately, there is no case law or any specific regulations on this issue. Therefore, it is not possible to make any further and more detailed comments. In **Belgium,** most contracts contain confidentiality clauses. The research, however, did not disclose any major issues regarding these confidentiality obligations – the logical counterpart for the fact that the franchisee is granted access to the knowhow of the franchisor. In addition, the research did not establish whether a practice exists whereby franchisees are limited in seeking (legal) advice from external counsels before signing a franchise agreement by obligations of confidentiality. In **Poland,** confidentiality clauses are also seen as a typical part of franchising contracts. It is stressed that such clauses can have an undetermined duration, subject to making certain information public by the franchisor. No information on abusing the clauses was discovered though.

7.2.4. Oral pre-contractual information divergent from the actual contract

In **Italy** and **Romania**, providing false oral pre-contractual information leads to the liability of the franchisor for a violation of good faith. In **Romania** and **Belgium,** this issue is

addressed by providing a written pre-contractual information document. This issue was not discussed in **Estonia, Germany, the Netherlands, Spain** or **Poland.**

Italian Law 129/2004 follows an established formalist trend and requires franchising contracts to be concluded in writing. It also prescribes a cooling off period of 30 days for the franchisee to carefully read and renegotiate certain contract clauses. In this light, the only legally relevant terms are those included in the contract, which prevail over the previous divergent oral pre-contractual information. These can at most be relevant in the perspective of pre-contractual liability for violating the good faith principle. In addition, in **Romania** the franchisor is obliged to inform the franchisee about any important matters regarding the future franchise contract, according to the Franchise Law. However, the law does not provide how this obligation should be performed, i.e. if it should be made orally or in writing. In order to overcome disputes of this kind, it is customary for the franchisor to provide the franchisee with a written "pre-contractual information document". However, if oral pre-contractual information offered diverges from the actual contract, then a tort law claim is available to the franchisee, based on the general duty of good faith during pre-contractual negotiations (Article 1183 of the Civil Code). In **Belgium,** such a situation may theoretically happen, but it will be almost impossible to prove. In any case, this is made difficult by the legal disclosure obligations – the pre-contractual information document must be in writing. A franchisee that receives oral information that is different to information in the pre-contractual information document should be alarmed. The legislature pays particular attention to making sure that franchisees are well informed before entering into a franchise agreement.

7.2.5. Limiting reflection time for concluding the contract in order to place pressure on the conclusion of the contract. No cooling off time after the conclusion of the contract.

A cooling off period before the contract conclusion is provided in **Belgium, France** and **Italy.** While **German** law does not impose a cooling off period, the franchisee may have the right to revoke the contract if it is pressured into concluding it through limited reflection time. This issue has not been discussed in **Estonia**, **the Netherlands, Poland**, **Romania** or **Spain**.

In **Belgium, France** and **Italy,** the law imposes a cooling off period. In **France** the cooling off time is secured by Article L. 330-3 of the Code de Commerce: the document specified in the first paragraph and the draft contract must be notified at least twenty days before signing the contract or, where applicable, before the payment of the sum indicated in the previous paragraph. In **Italy,** the period is provided for by Article 4 of law 129/2004, according to which, at least 30 days before signing the franchising contract, the franchisor must provide the prospective franchisee with a complete copy of the contract to be signed. There are, therefore, no problems relating to limiting the reflection time in order to pressure the conclusion of the contract. The doctrine presents diverging opinions as to the remedies applicable in the case of a violation of this provision. A minority proposal has also suggested the applicability in this situation of a right of withdrawal following the model of EU consumer law directives.[112] In **Belgium,** the law requires a contract document be presented 30 days before concluding the contract. While some claim that this has given rise to practical issues and delays that are sometimes perceived as burdensome (for example lease agreements or other ancillary contracts are at risk of being jeopardised by the cooling off period, which has led some franchisors to produce ante-dated documents), representatives of the franchisees stress the importance and beneficial effects of

[112] Cian, La nuova legge sul franchising, 1171.

formalised informational duty. In **Germany** there is no case law and no legislation that would aim at protecting the future franchisee from being overwhelmed by the franchisor with a limited reflection time. The franchisee could have the right to withdraw from the contract only if it is considered a consumer. However, the German Supreme Court explicitly denied this in its decision of 24 February 2005 (Az. III ZB 36/04). It is, however, conceivable to grant the franchisee a right to withdraw from the contract pursuant to § 512 BGB, as this paragraph goes beyond the provisions of the respective EU-Directive and grants the entities that fall within its scope further reaching rights, i.e. the right to withdraw. Full-harmonisation of the EU-Directive causes no problems in this regard as "business founders" (the persons that § 512 applies to) fall outside the scope of this directive. According to the prevailing view, § 512 BGB does not broaden the definition of consumer, but extends the scope of the §§ 491 – 511 BGB.

Thus, § 512 BGB has great practical relevance when it comes to franchising contracts. According to the case law, § 512 BGB can be applied to grant franchisees the right to withdraw after the franchising contract has been concluded and the franchisee/business founder concluded a contract for the delivery of goods (BGHZ 97, 351, 356 f.; BGHZ 112, 288; BGHZ 128, 156). What must be considered, however, is that § 512 BGB only applies to contracts with a maximum value of €75,000, beyond this amount the right to withdraw is excluded for lack of worthiness of protection of the franchisee. Nonetheless, it is being considered to reduce the scope of § 512 BGB on teleological grounds, so that it can fulfil its main purpose – the protection of business founders – completely.

7.2.6. Switching status from employee to franchisee without sufficient information and reflection time

Case law regarding false independents exists in **Belgium**. In **Germany** and **Italy,** it is not possible to switch from an employee to franchisee without providing appropriate information and reflection time due to the franchisors' disclosure obligations. This issue has not been discussed in **Estonia**, **France, the Netherlands, Romania, Poland** and **Spain**.

In **Belgium,** false independents (de facto treated as employees, but under a franchising agreement) have been subject to case law. The fact that the activities of the franchisee are contractually limited to a certain territory, that the franchisor decides upon the location of the point of sales and similar restrictions to the activity of the franchisee are part of the know-how and are therefore not an indication of subordination as an employee. It is the franchisee's free choice to submit to the commercial formula and know-how of the franchisor.[113] The fact that the franchisor imposed binding resale prices has, in older case law, been considered as an indication of subordination.[114] In a leading case regarding MacDonald's, it was argued that all franchisees were to be considered as the same 'technical company unit' and thus were subject to collective labour law obligations, such as the appointment of syndical representatives etc. This view was rejected, however. The labour court considered that there was no joint employment programme for all franchisees, since each franchisee could independently manage their staff.[115] Given the statute on pre-contractual information, employees will, since 2006 at least, have received all necessary information regarding their new status as franchisees. In **Italy** there are no reported cases in this area. Establishing franchising relation requires formal and disclosure requirements imposed by legislation to be met, so switching from employee to franchisee without sufficient information and reflection time would not be possible. It should be noticed that,

[113] Brussels 8 November 1988, *J.L.M.B.* 1988, p. 1568.
[114] Arbh. Antwerpen 16 June 1995, *Soc. Kron.* 1996, p. 261.
[115] Labour court Brussels 10 March 2000, *D.A.O.R.* 2000, pp. 382-384,

before 129/2004 law, franchisees occasionally and unsuccessfully requested courts to declare that they were under an employment relationship instead of a franchising relationship, as this would be more favourable for them, but their claims were rejected since their activity was considered entrepreneurial. It is worth noting that in **Germany** the extensive pre-contractual disclosure obligations of the franchisor prevent an employee from becoming a franchisee without appropriate and relevant information or a reasonable amount of time to consider.

7.3. Contractual issues

7.3.1. Overview

Country	Imposing unbalanced obligations in contracts	Changing contractual terms retroactively	Limiting access to attractive products	Restrictions of acquiring outlets	Limiting access to advice	Taking over know-how
Belgium	✓					
Estonia						
France	✓	✓	✓			
Germany	✓			✓		✓
Italy						✓
The Netherlands	✓	✓		✓		
Poland						
Romania				✓		
Spain	+					

7.3.2. Imposing unbalanced obligations in contracts, such as an obligation to acquire additional services or goods for above the market prices, often attached to franchising contracts as side-letters or appendixes during the duration of the contract; lack of transparency and ad-hoc unilateral contract changes

In **France,** such issues are explicitly regulated in the Code du Commerce. Specific case law on tying supply agreements exists in **Germany** and **the Netherlands**. In those countries where these issues are not explicitly regulated: **Belgium, Estonia, Germany, Italy, the Netherlands, Poland** and **Romania**, the franchisee's remedies in the event of unbalanced obligations, lack of transparency and unilateral changes are mostly subject to general contract law.

In **France,** the recently modified Article L. 442-6 of the Code du Commerce placed in the chapter relating to anti-competition practices regulates these issues. It provides liability for damages if one of the listed trade offences causes a loss. Among the relevant unfair practices, the following may be listed:

1) Obtaining, or seeking to obtain, from a trading partner any advantage unrelated to a commercial service effectively rendered, or which is clearly disproportionate to the value of the service rendered. Such an advantage might consist, among other things, in participation in the financing of promotional activities, an acquisition or an investment that is not justified by a common interest and does not offer proportionate compensation, particularly in the context of shop renovation or access to outlets or central listing or purchasing facilities. The advantage may also consist in the artificial consolidation of turnover figures or a demand to match the sales terms obtained by other clients.

2) Subjecting or seeking to subject a trading partner to obligations that create a significant imbalance in the rights and obligations of the parties.

3) Obtaining, or seeking to obtain, an advantage as a prerequisite to placing orders without providing a written undertaking concerning the proportionate volume of purchases and, if appropriate, a service requested by the supplier which is the subject of a written agreement.

The presented problems appear partially under **German** law. There are no cases or commentaries yet on the issue of obligations to acquire additional services or goods being hidden in incomprehensible or non-transparent contract terms, or even appendixes. It cannot, of course, be excluded that such situations do not happen in practice. In such cases, the franchisee may have the right to withdraw or avoid the contract under specific circumstances, though the prerequisites of an avoidance are probably difficult to prove, at least when the grounds for invalidating the contract is fraudulent misrepresentation (§ 123 BGB). Tying supply agreements as such occur as a problem under German franchise law. In a case regarding this issue, the court ruled that such agreements do not constitute restrictions of competition, at least where they are necessary for the functionality of the franchising system (LG Düsseldorf, judgement of 21 November 2013 – 14 c O 129/12 U). Accordingly, a franchising contract that contains a tying supply agreement is not to be considered as invalid or immoral/lacking good faith for imposing an unreasonable economic burden as established by § 306 III BGB. In addition, it is permitted under competition law and therefore has no consequences on the validity of the franchising contract, if the franchisor does not completely pass on the price benefits, bonuses, discounts or the like that exist towards its suppliers, to the franchisee. This also applies to cases where a tying supply agreement between franchisor and franchisee exists (BGH, Decision of 11 November 2008, KVR 17/08 (OLG Düsseldorf)). In this context, it remains relevant that a franchising contract can set out the obligation for the franchisee to use advertising designed by the franchisor, or to buy the necessary advertising material. The costs arising from this are determined, for example, by the franchisee's net sales and amount to a certain percentage thereof. The advertising may dictate to the franchisee a selling price for the advertised products when it refers directly to a certain price for such products, and thereby creates the impression for customers that they can expect exactly this price. In such cases, the franchisee may be entitled to damages from the franchisor. (BGH, Judgement of 20 May 2003 - KZR 27/02).

In **the Netherlands,** in the case Rechtbank (court of first instance) Almelo, 15 September 2006, ECLI:NL:RBALM:2006:AY8624 the court decided that if the franchise contract obliges the franchisee to purchase more than 80% of its products from the franchisor, then this

contract term could be invalidated as contrary to fair competition rules. This would not automatically lead to the possibility of the franchisee terminating the contract on the basis of the unfairness of this provision.

In **Italy,** these problems are mostly not explicitly taken in consideration by legislation. Law 129/2004 is primarily focused on the pre-contractual stage and generally disregards the phase of the execution of the contract and the issues possibly arising during the contractual relationship. It was the intention of the franchising business community to limit the legal regulation in these areas and rely on self-regulation. The issues would therefore be considered from the perspective either of the codes of self-regulation of the franchising business or of Italian general contract law, which generally acknowledges freedom of contract. There is no reflection of the problem in the case law.

Furthermore, scholarship and most recent jurisprudence apply Article 9 of the 192/98 law on supply chains to franchising contracts. This prohibits the "abuse of economic dependency", describing it as a situation where "an enterprise can determine a considerable unbalance between rights and obligations in its relation with another enterprise." This abuse can also consist in the refusal to buy or sell goods, arbitrarily interrupting the commercial relationship, or imposing unreasonably hard contract terms. The article was applied in cases dealing with the termination of the contract. Law 129/2004 contains several provisions on disclosure, so that considerable problems of lack of transparency do not usually arise. The statute does not give the franchisor the power to unilaterally change contract terms or other powers over the franchisee. Generally, any contractual integration or modification has to be agreed upon and in writing.

Also in **Estonia,** this particular problem has not been raised. However, if a contract prescribes an obligation to accept goods or services not ordered, in addition to goods and services agreed upon, then the term may be proved to be unfair and void (LOA Art. 42 para 3 subparagraph 23). Similarly, in **Romania** there is no specific legislation or case law, though the general private law provides some remedies in certain described situations. Articles 1202 and 1203 of the Civil Code regulate "standard clauses" and "unusual clauses". "Standard clauses" are those clauses that are unilaterally established by one of the parties and not negotiated with the other party. Some "standard clauses", such as a limitation of liability, the right to unilaterally terminate or suspend the contract, limitation of defences, a limitation on the freedom to conclude contracts with other parties, etc., are considered "unusual clauses" and are not effective unless expressly accepted by the other party, i.e. the consent must be expressed specifically for these clauses. The ineffectiveness of such contractual clauses could be argued if they were not expressly assumed by the franchisee when the contract was stipulated.

In **Belgium,** the statute regarding pre-contractual information was altered, in May 2014, to include the stipulation that information must be disclosed regarding the remuneration paid to the franchisor directly, as well as regarding indirect remuneration of the franchisor (such as the margin on sales of products and services, or fees paid by suppliers or rebates granted regarding goods that franchisees are obliged to buy only from such authorised suppliers). Most franchise agreements foresee the possibility for the franchisor to unilaterally change certain elements of the franchise formula. In the event of an imbalance, the franchisees' only remedy will in most cases be to claim that such a unilateral change is a breach of the franchisor's contractual obligations or its general obligation to execute the agreement in good faith. This would allow the franchisee to claim damages or possibly seek a termination for a breach by the franchisor (giving rise to damages).

7.3.3. Changing contractual terms or the entire contract retroactively

Retroactive changes of contract are invalid under certain circumstances and may lead to the liability of the franchisor in **Belgium, Estonia, France, the Netherlands** and **Romania**. No references were found in **Germany, Italy, Poland** and **Spain**.

In **the Netherlands,** in the case Rechtbank (court of first instance) Zwolle-Lelystad, 14 April 2010, ECLI:NL:RBZLY:2010:BO1431, the court decided that the franchisor could not change the terms of the franchise contract, i.e. remove its obligation to support the franchisee due to financial difficulties, especially when it previously introduced, on its own initiative, a new, experimental formula in the franchisee's shop that required more support to be provided, without infringing his duty of care towards the franchisee. The parties intended to cooperate on the introduction of the new formula and the franchisor had no right to unilaterally withdraw from this cooperation, even if the franchisor's situation had changed. In **Romania,** a franchising contract is a contract of adhesion (Article 1175 of the Civil Code), which means that if the franchisee agrees to conclude the contract it will have to comply with the terms and conditions imposed by the franchisor. This feature of the franchise contract arises on the basis of Article 1, letter (c) of the Franchising Law stipulating that the franchisee is selected by the franchisor and adheres to the principle of homogeneity of the franchise network. Therefore, there is not much space for the franchisee to act on its own, even if the same law provides for a certain independence of the franchisee regarding its activity within the franchising network. However, despite the obvious position of dependency of the franchisee, a clause reserving for the franchisor the right to unilaterally change the contractual terms retroactively would be invalid as being contrary to the public policy (Article 1236 of the Civil Code). Unilateral changes with a limited scope and if well justified might be accepted. Unfortunately, there is no case law relevant for the field. An additional instrument of protection of the franchisee is Article 1269 of the Civil Code, which provides that adhesion contracts will be interpreted against the party that drafted the contract (the franchisor).

In **France,** this practice may lead to liability under Article L. 442-6 of the Code de Commerce. The liability will be triggered by an action consisting of such things as:

"*8) refusing or returning goods, or unilaterally deducting from the amount of the invoice issued by the supplier, any penalties or discounts corresponding to the non-compliance with a delivery date or non-compliance of the goods, when the debt is not certain, liquid and due, without the supplier being able to check the validity of the corresponding claim;*

…

12) imposing, adjusting or charging an order for products or services at a price different from the agreed price, resulting from the application of the scale of unit prices mentioned in the terms of sale, when they were accepted without negotiation by the buyer, or the price agreed at the conclusion of commercial negotiations subject to the agreement referred to in Article L. 441-7, modified if necessary by amendment or renegotiation as provided for in Article L. 441-8."

Furthermore, the following clauses that allow the producer, trader, manufacturer or a person listed in the trade register to commit the following acts are invalid:

1) to benefit retroactively from discounts, rebates or commercial cooperation agreements;
2) to benefit automatically from more advantageous terms granted to competing undertakings by the co-contracting party;

3) to obtain from a reseller operating a retail space of less than 300 square metres that it supplies, but which is not linked, directly or indirectly, to it by a trademark or know-how licence, a preferential right on the assignment or transfer of its business or a post-contractual non-competition obligation, or to condition supplies to this reseller upon an exclusivity or quasi-exclusivity commitment undertaking to buy its products or services for a period of more than two years.

No cases regarding those problems were found in **Belgium.** In any case, the statute regarding pre-contractual information foresees that a new pre-contractual information document needs to be communicated in the event of changes to the original contract. Changes without such a new pre-contractual information document could lead to the annulment of the franchise contract. In **Estonia,** there is also no information about this issue. If this is a standard term, there is a possibility of it being proven to be unfair (LOA Article 42 para 3 subparagraph 14 provides that if a term sets out the right of the person supplying the term to alter the terms or conditions of the contract unilaterally for a reason or in a manner not provided by law or specified in the contract, it may be proven to be unfair and invalid).

7.3.4. Limiting access to attractive products (the franchisor may give preference to its own outlets when introducing new products) or using the possibility of limiting supply as a contractual threat

In **France**, limiting access to attractive products is prohibited as an anti-competition practice under the Code de Commerce. In the three other countries that submitted reports on this issue, **Belgium, Germany** and **Italy,** the behaviour of the franchisor would be considered a violation of good faith and may lead to damages. There is no information about this issue from **Estonia, the Netherlands**, **Poland**, **Romania** and **Spain.**

In **France,** limiting access to attractive products is qualified in the same way as other restrictions on the freedom of the franchisee as an anti-competition practice in the understanding of Article L. 420-1 of the Code de Commerce. In particular, this article prohibits any actions, agreements, express or tacit undertakings or coalitions, even through the direct or indirect intermediation of a company in the group established outside France, that have the aim or may have the effect of preventing, restricting or distorting the free competition in a market. This legal norm also lists examples of such anti-competition practices, among which limiting access to market may also be found (1°). The consequence of this prohibition is the invalidity of any contractual clause establishing it as, according to Article L. 420-3 of the Code de Commerce, any undertaking, agreement or contractual clause referring to a practice prohibited by Articles L. 420-1, L. 420-2 and L. 420-2-1 is invalid. In addition, the legal norms of Article L. 442-6 of the Code de Commerce may apply to unbalanced or unfair terms.

In **Germany**, save for error or omission, no cases regarding this problem have been decided yet. However, this does not lead to the conclusion that such actions do not exist in practice. This phenomenon may, in the absence of specific rules, only be dealt with by recourse to the general principle of good faith and trust (§ 242 BGB). According to this principle, each contracting party has to perform in a way required by loyalty and good faith with regard to the prevailing practice. The franchisor would be acting contrary to good faith, if it did not provide the franchisee with a sufficient amount of goods or products to run the franchise profitably. Therefore, the franchisor may be liable for damages resulting from such behaviour. Comparable situations with new products introduced would most likely be treated in a similar way. A franchisor who makes new products exclusively available in its own stores, will render the stores of the franchisee less attractive, and thereby reduce the opportunity of its contract partner to make a profit. Such behaviour

would run contrary to the duty of the franchisor to constantly review and further develop its franchising system, to make it attractive and profitable in the long term for all involved. Admittedly, the franchisor must have the opportunity to test the profitability of new products on a smaller scale, but this should be conducted in consultation with the franchisee, and not used as an instrument to exert pressure. However, the associated liability for possible damages should render such approaches rather unattractive for franchisors. This does not seem to be a major issue in **Belgium**. A franchisor discriminating between its own outlets and its franchisees could be attacked for lack of assistance. This would be considered a breach of the general obligation to execute contracts in good faith. This will, however, only be so in extreme cases. In principle, the franchisees cannot oblige their franchisor to grant them the right to new products.

7.3.5. Restrictions on the franchisor acquiring additional outlets, or a prohibition on franchisers from opening additional outlets in the same sector with other franchisees

In most of the researched legal systems, territorial restriction clauses are quite common and classified as necessary, since they protect the franchisee against competition from the franchisor and other franchisees. In **France**, however, restrictions on the acquisition of additional outlets may be invalid if they are qualified as anti-competition practices. Case law on territorial restriction clauses is available in **Germany** and **the Netherlands.** In **Romania**, the territorial restriction clause needs to comply with rules provided in the franchising law, and under **Italian** law these clauses must be in writing. There is no other regulation. No specific provisions (other than allowing the clause under competition law) exist in **Poland**, though it is a normal and frequent practice to have territorial exclusivity clauses included in franchising contracts. No information is available also in **Estonia** and **Spain**.

In **France,** restrictions on the acquisition of additional outlets is qualified equally as other restrictions of the freedom of franchisee as an anti-competition practice in the understanding of Article L. 420-1 of the Code de Commerce. In particular, this may be qualified as one of two examples of anti-competition practices expressly provided in Article 420-1 of the Code de Commerce: (1°) Limiting access to the free exercise of competition by other undertakings; or (3°) Limiting or controlling production, opportunities, investments or technical progress. Any contractual clause qualified as introducing an anti-competition practice is invalid under Article L. 420-3 of the Code de Commerce.

In **Germany**, territorial restriction clauses are quite common in franchising contracts. The territorial protection allows the franchisee to maintain a certain exclusivity and protects the franchisee against the threat of competition from the franchisor. To be truly effective, a territorial restriction clause must prohibit all internet sales of the franchisor in the territory of the franchisee. The limits of such territorial protection may be determined by using an area map or postcode areas that are within the contract territory. Instead of optional territorial protection, a franchising contract may also contain a customer- or location safeguard clause. Even if a respective protection clause is not included in the franchising contract, under the principle of good faith (§ 242 BGB), the franchisor is still obliged to take the commercial interests of the already existing franchisees into account and must not endanger their commercial viability when it grants licenses to new franchise outlets. Examples of case law:

BGH, Decision of 1 August 2013 – VII ZR 268/11: Action for disclosure on revenue obtained by the franchisor from a prohibited competitive business activity.

The parties involved in these proceedings had a dispute over claims resulting from a terminated franchise relationship. The claimant operated specialist optical stores

throughout Germany (partly in their own name, partly by franchisees). The defendant was a former franchisee of the claimant. The franchise relationship between the two was terminated by the franchisor (claimant). This termination subsequently turned out to be invalid. The claimant, however, opened its own store in the territory of the defendant after the termination. The defendant kept operating its former franchise business under its own commercial name. The defendant demanded disclosure of the revenue that the claimant generated with its store in the territory of the former franchisee. The purpose of the request for information was to prepare a claim for damages against the claimant. The revenue that the franchisor achieved by violating the territorial restriction clause in the franchising contract may serve as an indicator when assessing the amount of damages that the franchisee incurred. The BGH allowed the defendant's request and sentenced the claimant to provide the requested information. A franchisor that issues an invalid termination has to compensate for the damage that the franchisee suffers from the, at least negligent, breach of the territorial restriction clause in the franchising contract. This also applies when the franchisee continues to operate its business in the same territory under a different commercial name.

LG Freiburg, Judgement of 27 February 2007, Az.: 2 O 459/06 ("Carela Service Point"): Breach of the territorial protection clause by the franchisor

In this case, the franchisor performed cleaning and disinfection of water and piping installations in the territory of the franchisee, although the franchise contract contained a territorial restriction clause and these services were allotted to the franchisee. This clause, however, expressly prohibited the franchisor only from allowing other franchisees to operate a business in the territory, but did not bar the possibility of the franchisor operating one itself. Moreover, the services provided by the franchisor in the territory of the franchisee were conceived as "testing a new procedure". According to the franchisor, the services should constitute no breach of the territorial protection clause. However, the court decided that this behaviour constituted a breach of the territorial protection clause and that franchisor is no longer allowed to provide these services without sanctions. Furthermore, the franchisor has to adequately involve the franchisee into future field trials and tests in his territory. What is remarkable here is that the court interpreted the territorial restriction clause very broadly, as the wording of the clause only prohibited the settlement of new franchisees in the protected territory. By doing so, the court impliedly affirmed the importance of territorial protection for franchisees

This issue has been the subject of one case in **the Netherlands,** Rechtbank (court of first instance) Den Haag (KG), 16 July 2014, ECLI:NL:RBDHA:2014:8667. The franchisee of a book/newspapers-formula under the same franchisor opened a second bookshop with its permission. In this second bookshop, the franchisee also sold toys, under a separate franchise contract. When the co-operation between the parties ended, the franchisee stopped conducting business in the first bookshop, but continued to do so in the second bookshop/toy store. The franchisor considered this an infringement of the non-competition clause after the termination of the franchise contract. The clause prohibited the franchisee from conducting business in the same region for one year, either fully or partially competing against the franchisor's organisation. The court considered the non-competition clause valid, even though its enforcement would lead to the insolvency of the franchisee. It was seen as a 'logical' consequence of the agreement concluded between the parties. The court thought that the franchisee could, however, continue with the sale of the basic assortment of the toy store, including children books and gifts. Additionally, the franchisee could continue to sell books until the franchisor gave the franchise in the first bookstore to someone else.

In **Romania,** most franchising contracts contain a territorial exclusivity clause in order to protect the franchisee. The legal doctrine justifies the exclusivity on taking the financial perspective into account. Accordingly, even the Franchising Law states that the franchisee must be able to recover the investment it has made, and if the franchisor opens the same activity in the area franchisee's exclusive area, or passes this right to others, then the chances of the first franchisee recovering the incurred expenses are seriously compromised.[116] The Franchising Law provides several governing principles that must be taken into consideration when writing and implementing the exclusivity clause into the contract. According to Article 9, an exclusivity clause must comply with the following: if an entrance fee is paid at the moment of concluding the franchising contract, the amount for the exclusive rights contained in the contract is proportional to the entrance fee and added to the latter; if there is no entrance fee, the arrangements for refunding the exclusivity fee must be provided for in the event of the early termination of the contract; the exclusivity contract must provide for a termination clause suitable to both parties.

In **Italy,** Article 3.4.e prescribes: "*possible exclusive territorial rights granted either towards other franchisees of the network, or towards sales channels and outlets run directly by the franchisor*" should be included in the contract. Therefore, these clauses are not obligatory, but if they exist then they have to be done in writing. Franchising contracts indeed generally include non-competition clauses that limit the franchisee's possibility of operating with other competitors in the same business sector. According to general Italian contract law, a non-competition clause cannot exceed five years. A violation of such clauses represents a breach of contract that allows termination. In **Belgium,** most franchise agreements are limited to one point of sales, without the franchisee having the right to open additional outlets (even if a territory was awarded exclusively to each franchisee). No case law was found questioning the validity of contractual provisions forbidding multi-franchising.

7.3.6. Limiting access to legal and financial (independent) advice

This issue has not been reported in any of the legal systems, though **Belgium, France, Italy** and **Romania** provided additional comments.

According to **Romanian** legislation, the franchising network consists of independent members who conduct their activity on their own, taking the decisions and assuming the risks they consider proper for their business. Their independence is manifested within the limits of keeping the common identity of the franchise network. The independence of the franchisees means that a franchising network is not a group of companies under the franchisor's control.[117] As such, a contractual clause that would limit access to independent legal and financial advice would certainly be deemed invalid. Also in **France,** a contractual clause limiting access to legal and financial advice could be invalid as an anti-competition practice on the basis of Articles L. 420-3 and 420-1 of the Code de Commerce. In **Belgium,** franchise agreements in general do not limit the possibility of franchisees seeking independent legal or financial advice. Some franchise agreements oblige franchisees to use the services of a recognised accountant. This does not seem to give rise to abuses.

7.3.7. Taking over know-how and information (franchisers claim franchisee know-how and information as their property)

In **Italy**, the law expressly sets requirements for the recognition of the know-how that the franchisee provides. Under **German** law, case law concerns the question whether or not

[116] Lupu, Contractul de franciză în Noul Cod civil, http://legalmagazin.ro/contractul-de-franciza-in-noul-cod-civil/.
[117] Mocanu, Franciza, francizarea. Ghid practic Bucharest 2013, p. 84.

the franchisee is entitled to compensation for providing its customer base to the franchisor after the termination of the franchising contract. Contractual clauses on taking over know-how and information may be invalid in **Estonia** and **France.** This problem has not been discussed in **the Netherlands, Poland**, **Romania** or **Spain**.

In **Italy,** Article 3.4. of 129/2004 law sets out that a contract must expressly mention "*the possible criteria for acknowledging the contribution of the franchisee to the know-how of the franchisor.*" Because of this formulation, the contract must not expressly include such criteria. Part of the scholarship[118] considers this possible clause as practically useless, as contrary to the area of the transfer of technology, where this case might happen frequently, in franchising practice it is normal for the franchisee to follow the franchisor's know-how without contributing to it. In this sense, no case law in Italy so far deals with franchisors claiming the know-how and information of franchisee as their property.

It has not yet been clarified by the **German** legal system or case law how the situation must be assessed if the franchisor claims all the information that the franchisee has obtained through its own franchise and customer base. The question as to whether the franchisee is entitled to compensation for its customer base after the termination of the franchising relationship under the analogous application of § 89 b HGB is debatable and cannot be answered in a generally valid manner. This depends on whether the clients are regular- or one-time customers, and how the franchise system is designed. The BGH in principle approves of an analogous application of § 89 b HGB for trademark licence agreements. The application is not possible, if the licensor is not active in the field of the products that the licensee distributes, and the licensee is therefore not integrated into the sales organisation of the licensor (BGH, Decision of 29.10.2010, Az.: I ZR 3/09). The consequence for franchising contracts is that the right to compensation pursuant to § 89 b HGB is ruled out if the focus of the contract is to grant the franchisee a license and the franchisee, in absence of the duty to promote sales (which is typical for franchising), is not involved in the sales organisation of the franchisor. In such cases, the duties of the franchisor will be primarily the transfer of know-how and the grant of a licence on the trademark rights. This decision probably means that, in cases of service franchising or when the sold products are not provided by the franchisor but a third party, the right to compensation under the analogous application of § 89 b HGB is ruled out. The remaining types of franchising contracts also require that the franchisee leaves its customer to the franchisor after the termination of the franchising relationship. However, according to case law, an obligation of the franchisor to compensate the franchisee cannot simply be derived from the fact that a customer card programme is implemented, or that the factual continuity of the customer base in an anonymous high volume business is assumed (OLG Schleswig, Decision of 11 December 2014, 4 U 48/14, BGH, Judgement of 5 February 2015, VII ZR 109/13).

In **Estonia,** the only legal measure to prevent this kind of contract term is to apply a general rule on the unfairness of standard terms (LOA Article 42 para .1). In **France** too, a contractual clause on taking over know–how and information could be deemed invalid as an anti-competition practice on the basis of Articles L. 420-3 and 420-1 of the Code de Commerce. No case law has been found in **Belgium,** though most franchise contracts foresee that improvements to the know-how of the franchisor by the franchisees become the property of the franchisor.

[118] Frignani, Franchise disclosure legislation in Italy, 3 *International Journal of Franchising Law*, 2004.

7.4. Contractual issues with post-contractual consequences

7.4.1. Overview

Country	Unfair clauses leading to termination	Insufficient protection upon termination	A non-competition obligation permitted after the expiry of a franchising contract	Compulsory purchase options
Belgium		✓		
Estonia	✓			
France	✓	✓	✓	
Germany			✓	
Italy	✓	✓	✓	
The Netherlands	✓	✓		
Poland		✓	✓	
Romania		✓	✓	

7.4.2. Unfair clauses leading to the termination of a franchising contract (e.g. if turnover targets are not met due to reasons independent of franchisees)

While clauses regarding termination for not meeting turnover targets are allowed and rather common in **Italy**, they remain subject to an unfairness test. Similarly, a court in **Spain** held that a franchisor acted abusively when it used unreasonable commercial targets as the ground for termination, while a **Dutch** court classified a clause that granted the franchisor two per cent of the franchisee's annual profit, even in the event of the franchisor terminating the contract, as unfair. Respective clauses are also tested for unfairness, especially if they are standard terms, in **Estonia, France** and **Romania.** Problems with such clauses may also occur in **Belgium** and **Germany**. This particular problem has not been signalled in **Poland**.

In **Italy,** the possible unfairness of clauses allowing the termination of a contract has been tested. A court held that a clause giving both parties the right to withdraw from an indefinite term franchising contract, although unilaterally drafted by the franchisor, cannot be considered as unfair per se, and does not therefore fall within the scope of the general

contract law rules of the Civil Code prescribing that abusive clauses have to be specifically signed by the parties in order to be valid (Tribunale Bari, sez. II, 8/4/2005). Outside the hypothesis of these rules of the Civil Code (Article 1341 CC), freely negotiated clauses in the contract are not considered unfair. Their infringement justifies the termination of the contract when the breach is "important" (Article 1455 CC). Since the questionnaire explicitly refers to clauses dealing with unmet turnover targets, it can be noted that these clauses are allowed and rather common. Article 3.4.b sets out that the possible indication of minimum turnover to be achieved by the franchisee has to be included in writing in the contract. There is no relevant case law on this issue. In **Spain,** the court indicated that the commercial targets imposed on the franchisee were abusive when compared to the objectives imposed on other franchisees in the same area (STS 22 October 2012 (Roj: STS 7805/2012 - ECLI:ES:TS:2012:7805)). In this case, the franchisor indicated that the contract was not renewed because the franchisee had not reached the commercial objectives, and that meant that the franchisor neither had to pay an indemnity for clientele (on the basis of the law on agency), nor had to compensate for non-performance. In **the Netherlands,** in the case of Rechtbank (court of first instance) Utrecht, 27 February 2008, ECLI:NL:RBUTR:2008:BC5136, a standard contract term required a franchisee who would prematurely terminate the contract to pay 2% of the profit from his last bookkeeping year immediately upon termination. This clause was contested as unfair. The franchisor attempted to claim that this was a core term and was excluded from the unfairness test, but the court rejected this point of view. Considering that the compensation was fixed at a specific price, and that it was to be paid regardless who terminated the contract and for what reasons, it was possible that it could end up being a high compensation, to be paid even if the franchisor was the party who failed to perform the franchise contract (like in this case), regardless of the franchisor's damages and irrespective of the moment of termination – it was considered an unfair contract term. In **Romania,** there is no specific legislation or case law on this topic. In some cases, the defences provided by general private law could be used, such as Article 1203 of the Civil Code, according to which standard clauses (as the ones in the franchising contract) concerning the unilateral termination of the contract must be expressly accepted by the franchisee, otherwise they are not applicable. Other grounds for contesting the validity of an unfair clause could come from the general rule concerning the legality and fairness of a contractual cause (Article 1236 of the Civil Code). In **Estonia,** available information suggests that, in some cases, the right to terminate is unfair. A party could try to prove that the standard term is unfair (LOA Article 42 para. 1: A standard term is invalid if, taking into account the nature, contents and manner of entry into the contract, the interests of the parties and other material circumstances, the term causes unfair harm to the other party, particularly if it causes a significant imbalance in the parties' rights and obligations arising from the contract to the detriment of the other party. Unfair harm is presumed if a standard term derogates from a fundamental principle of law, or restricts the rights and obligations arising for the other party from the nature of the contract, such that it becomes questionable as to whether the purpose of the contract can be achieved. The invalidity of standard terms and the circumstances relating thereto must be assessed as at the date of entering into the contract.) In **France,** an abrupt termination of an established commercial relationship may lead to liability for damages under Article L. 442-6 of the Code de Commerce. This provision expressly mentions, in section I No 5, under which circumstances such a termination may lead to liability. The examples include abruptly breaking off an established business relationship, even partially, without prior written notice commensurate with the duration of the business relationship and consistent with the minimum notice period determined by the multi-sector agreements in line with standard commercial practices. Where the business relationship involves the supply of products bearing the distributor's

brand, the minimum notice period should be double what would apply if the products were not supplied under the distributor's brand. In the absence of such agreements, ordinances issued by the Minister for Economic Affairs may determine a minimum notice period for each product category, taking due account of commercial practices, and may lay down conditions for the severing of business relations, in particular based on their duration. These provisions do not affect the right to terminate without notice in the event of a failure by the other party to perform its obligations or in the event of force majeure. Where the business relationship is terminated as a result of competitive bidding via distance auction, the minimum notice period is double that of the period resulting from the application of the provisions of this paragraph if the duration of the initial notice period is less than six months, and at least one year in other cases. The other cases of unfair termination may be covered by No 2 of the same section, setting out a prohibition on subjecting or seeking to subject a trading partner to obligations that create a significant imbalance in the rights and obligations of the parties. Furthermore, a clause providing the franchisor with the possibility of unfair termination of the franchising contract may also be qualified as an anti-competition practice in the sense of Article L. 420-2 of the Code de Commerce if it constitutes an abuse of the dominant position of the franchisor on the market. Such a clause could then be invalid on the basis of Article 420-3 of the Code de Commerce. In **Belgium,** the reasons that can lead to a termination of the franchise agreement, and any other sanctions for a breach of contractual obligation of the franchisee, must be mentioned explicitly in the pre-contractual information document. While no information on this topic is available in **Germany**, it is conceivable that, despite the protection mechanisms available under German law (control of general terms and conditions, moral nullity pursuant to § 138 BGB and the principle of good faith under § 242 BGB), some franchise contracts may contain such unfair terms that would render the franchising project financially unsustainable for the franchisee and lead to the termination of the franchising contract. In **Poland,** there is no information or case law on this particular subject. The question that seems to appear in practice concerns the consequences of automatic renewal clauses (whether a clause that stipulates contract renewal after x years for the same period, subject to continuing the contract performance, applies just once).

7.4.3. Insufficient protection upon the termination of a franchising contract resulting in a substantial loss in investment

In **Italy** and **Romania**, the parties are required to include clauses concerning the termination of the contract, and must include a minimum term that is long enough to allow the franchisee to recover its investments. The investments of the franchisee are also considered under **Belgian** law, when deciding whether or not the termination constitutes an “abuse of right”, and in **the Netherlands**, where premature termination by the franchisor may invalidate the non-competition clause. In **France,** the same end date needs to be prescribed for all contracts that may potentially limit the franchisee’s freedom to carry on with the franchise. Under **Estonian** law, a term allowing for termination might be considered as unfair in certain cases. No specific references have been found in **Germany** and **Spain**. In **Poland,** no specific references to franchising exist, though a case decided by the Supreme Court touches upon the problem.

In **Italy,** the termination of a contract is often dealt with in case law, though law 129/2004 is generally silent on this aspect. The statute rather demands that parties expressly regulate the termination of the contract, since Article 3.4.g. sets out that the contract must expressly mention “the conditions for the contract's renewal, termination or the possible transfer.” The termination of a franchising contract is subject to the party autonomy principle and general contract law. The termination of long-term contracts, such as franchising, has an *ex nunc* effect, so that the loss of investments could indeed be a

consequence of termination. However, Article 3.3 of law 129/2004 states that in fixed-term contracts (though scholarship extends the scope of application to all contracts) the franchisor must guarantee the franchisee a minimum term to allow the latter to recover its investments, in any case not less than three years, except in the event of earlier termination of the contract for a breach. Concerning the termination of a non-fixed-term contract, withdrawal can be exercised anytime with a reasonable notice, a more precise determination of which can be performed by a judge in light of the principle of good faith, and taking into consideration various aspects such as also the investments made by a party. In **Romania,** the law simply requires the parties to include in the franchising contract clauses concerning the termination of the contract (Article 5 of the Franchising Law). According to this, the contract should be concluded for a period that is sufficient in order to allow the franchisee to recover its investment (Article 6 para. 1). In practice, an issue noted with a certain frequency was the problem of the stock of merchandise or of the inventory of equipment still in the possession of the franchisee, who cannot make any use of it after the termination. The recommended solution is inserting a clause in the franchising contract providing for the take-over of the stocks and inventory relevant for the franchising network by the franchisor from the franchisee.[119] In **Belgium,** the statute regarding pre-contractual information obliges the franchisor to inform the franchisee of the duration of the contract, as well as of the franchisee's rights to a renewal/extension of the contract. The pre-contractual information document must also make the franchisee aware of the investments that will be required of it at the start of the cooperation and during the entire term of the franchise agreement, as well as of the impact of the termination on such investments. Besides the fact that the franchisee should, therefore, be fully aware of the risks taken by signing the franchise contract and making the required investments, the only protection in the event of an untimely termination lies in the theory of an 'abuse of right'. Case law has ruled that a franchisor, upon terminating the franchise agreement, must grant a reasonable notice period taking into account the investments of the franchisee.[120] The decision of a franchisor not to renew the contract can also be deemed abusive if the franchisee was required to make material investments before the end of the contract, and was led to believe that a renewal would be granted. In **the Netherlands,** this issue has mostly been raised in combination with the enforcement of the non-competition clause, where the premature termination by the franchisor of the franchise contract could be an argument that the non-competition clause should not be enforced, since it would be contrary to good faith to further impinge on his financial situation. For example, in the case Rechtbank (court of first instance) Zutphen (KG), 15 July 2008, ECLI:NL:RBZUT:2008:BD7263, since the franchisor terminated the contract prematurely without sufficient grounds to do so, the franchisee may have the right not to comply with the non-competition clause, if it proves that it would otherwise not be able to support itself. See also the above-discussed cases: Rechtbank (court of first instance) Utrecht, 23 December 2011, ECLI:NL:RBUTR:2011:BV3058; Rechtbank (court of first instance) Utrecht, 24 April 2013, ECLI:NL:RBUTR:2013:BZ9503. However, the non-competition clause could be enforced if it was the franchisee who decided to terminate the contract prematurely, thereby risking severe financial consequences. In **France,** Article L. 341-1 of the Code de Commerce, as amended by the Macron Law, states that the same end date must be prescribed for all contracts entered into between the distribution network head and a given member of the distribution network, where they include clauses that may potentially limit that member's freedom to perform the commercial activity concerned. Subject to further confirmation as to the interpretation of the Macron law, the same end

[119] Mocanu, *idem*, p. 176.
[120] Brussels 9 February 2007, not published, A.R. 2004/AR/1647; Court of Appeal Liège 16 January 1998, *J.L.M.B.* 1998, 589.

date could be provided either as a fixed term or as a result of the lapse of the contract. In addition, under the new changes the termination of one contract will automatically terminate the others.[121] In **Estonia,** there are certain ways to prove that the possibilities of the franchisor are limited in cases of termination. First, by proving that the term is unfair on the bases of the general definition of unfairness (LOA Article 42 para. 1). The term may be proved unfair also under Article 42 para. 3 subparagraph 10 of the LOA, as a term that deprives the other party of the opportunity to protect the party's rights in court, or that unreasonably hinders it from being exercised. In **Poland,** the Civil Code (Article 365^1) sets out a rather harsh rule concerning the termination of obligations without a fixed term of continuing performance. Such an obligation ceases to exist after notice is given by the debtor to the creditor observing the notice period indicated in the contract, by law or established in practice, and if there is no such notice period, then immediately after giving the notice. The Polish Supreme Court dealt with the problem of protection of a franchisee at the moment of terminating the franchising contract that might result in a substantial loss of investment, but did not really refer to this in its justification (judgement of the Supreme Court of 7 March 2007, ICSK 348/06). In this case, the Supreme Court Stated that since the franchising contract had been concluded against payment, and the obligations of the parties are supposed to be equivalent, the franchisee has no legal grounds to demand, after the termination of the contract, the return of payments made for using the firm of the franchisor. In this case, Company A built a network of fuel stations and concluded a series of franchising contracts (including the contract with the claimant (a married couple). The contract was prepared in German and subsequently translated into Polish. After a year, Company A terminated the contract with notice. The parties argued about the settlement of reciprocal payments: Company A demanded payment for the delivered fuel, while the franchisee requested the deduction of the paid franchising payments. One of the contract clauses provided that, after ending the contract (irrespective of the reasons), the franchisee may demand the return of the paid fees, and other outstanding payments in cash. Company A claimed, however, that due to a mistake in translation, each of the parties understood the contract differently. The Supreme Court stated that the key factor in this case was establishing the meaning of the contract clause. Since the parties disagreed on its interpretation, an objective meaning had to be given, which would take into consideration the specific characteristics of the given contract. Since franchising constitutes a contract concluded against payment, one cannot assume that the franchisor provides his know-how and experience against payment that is to be returned upon the dissolution of the contract. This is internally contradicting and franchisees, when engaging into cooperation with a franchisor, must assume the obligation to pay for the know-how (the equivalent for the franchisor).

7.4.4. A non-competition obligation permitted after the expiry of a franchising contract that substantially drives up entry barriers

The most comprehensive regulation amongst the researched legal systems exists in **France** and **Romania**, where the law is based on the European legislation on vertical agreements (Regulation 330/2010), and where non-competition clauses can only last up to one year after termination of the contract. In **Italy,** respective clauses are also permitted and may cover up to five years after termination. In **Estonia,** there is a certain indication that unfair non-competition obligations are included in contracts. The only remedy in this case is to prove that the term is unfair (LOA Article 42 para. 1 of the LOA).

121 http://www.eversheds.com/global/en/what/articles/index.page?ArticleID=en/Competition_EU_and_Regulatory/What_it_changes_in_Commercial_and_Distribution

Post-contractual non-competition obligations create problems in **Belgium** and **Germany** as well.

In **France,** new rules applying to such situations have been established by law No 2015-990 dated 6 August 2015 on the growth, activity and equality of economic opportunities (the Macron Law). Article L. 341-2 of the civil code provides that post-contractual non-compete clauses that restrict the commercial freedom of the former member are prohibited. However, post-contractual non-compete clauses may nonetheless be valid provided they abide with a certain number of conditions. The conditions mirror those provided by Regulation 330/2010, namely:

- the obligation relates to goods or services that compete with those of the contract;
- the obligation is limited to the premises and land from which the entity has operated during the contractual period;
- the obligation is essential to protect know-how transferred during the contract;
- the duration of the obligation is limited to a period of one year after the termination of the agreement.

Nevertheless, it is not clear how tacit renewal clauses will be perceived under the Macron Law, and whether they might be considered contrary to these provisions. The new provisions enter into force on 6 August 2016 and they are not limited to contracts in the retail food sector. It is not clear whether they should apply to international distribution contacts but it is to be expected that the *Direction générale de la concurrence, de la consommation et de la répression des frauds* ("*DGCCRF*") will take the view that the Macron Law applies as long as the distributor operates on the French market. Any current distribution contracts should therefore be reviewed and amended, if need be, by August 2016.[122]

In **Romania,** the Franchising Law allows parties to include in their franchise contract a non-competition clause in order to give the franchisor the opportunity to maintain the identity of its franchise. Non-competition clause can operate during the contract as well as after its termination. Such clauses are limited in three ways: regarding objects, space and time. Concerning the contractual period, non-competition clause, as well confidentiality clause, is implied. In opposition to this, a non-compete clause in the post-contractual stage can be considered a limitation to the freedom of trade if it does not comply with certain strict validity conditions. Romanian legislation[123] regulates the non-competition clauses in a manner similar to the European legislation, as an exception to the provisions regarding anti-competition practices. Therefore, the clause may only concern goods or services that compete with those that were the object of the franchise contract; it is limited to the areas in which the buyer has operated during the contract; and cannot be for longer than one year starting from the termination of the contract. As mentioned above, one of the few recent cases adjudicated by the Consiliul Concurenței concerning franchising contracts dealt, among other issues, with the problem of the period of a non-compete clause that was initially set to two years after the termination of the contract. Following an investigation started by the Competition Authority, the franchisor undertook to reduce the period of the non-compete clause in its franchising contracts to 1 year.[124] In **Estonia,** there

[122] http://www.eversheds.com/global/en/what/articles/index.page?ArticleID=en/Competition_EU_and_Regulatory/What_it_changes_in_Commercial_and_Distribution

[123] Art. 6 lit. b of the Competition Council regulation regarding the applicability of Art. 5 para 2 of Competition Law No 21/1996 concerning vertical agreements.

[124] Decision No 65 of 31 October 2012 of the Consiliul Cocurentei (see fn. 1).

is an indication that unfair non-competition obligations are included in contracts, where the only remedy is to prove that the term is unfair (Article 42 para. 1 of the LOA). Non-competition clauses (not exceeding five years) are permitted in **Italian** law. In franchising contractual practice, they are often employed also to cover a period of time after the termination of the contract. In the case Soc. Tride v. Soc. Natuzzi, Ord. Trib. Bari, 22/10/2004, a franchisee whose contract was not renewed after three years, complained that the termination was unlawful since, contrary to good faith requirements, the franchisor created a legitimate expectation in the franchisee that the contract would be renewed, as he previously requested the franchisee to make new investments in the renovation of the store to meet the standards required by the franchisor. In addition, this investment could not be recovered because of the presence of a one-year non-competition clause after the termination of the contract. The Court, however, held that the termination of the contract was lawful as it was neither unexpected nor arbitrary, and the possibility for the franchisee to recover its investments is guaranteed by the minimum duration of three years of the fixed-term contract, as required by law 129/2004. In **Belgium,** in specific sectors, where points of sales have a larger area, socio-economic permits are necessary and difficult to obtain, post-contractual non-compete clauses or non-affiliation clauses could create a barrier to entry for new players on that market. The number of these points of sales are limited and if a large number of sales points are linked to specific franchisors, this could make it difficult for a competing franchise chain to enter the market if a large part of the available points of sales are tied up to other franchisors or because of post-contractual non-compete obligation. Up until now, however, no research exists showing that this is a material issue for a specific industry sector. In practice, post-contractual non-compete clauses are not always easy to enforce. In **Germany,** the LG Potsdam (LG Potsdam, Judgement of 13 March 2008, Az.: 2 O 385/07) had to decide whether or not claims for injunctive relief under competition law were available to a franchisor against its former franchisee. The judgement dealt with the question of who has the rights to a slogan that the franchisee had registered as a protected trademark at the German patent office. The court decided that the registration of the slogan was unjust, and that the rights belonged to the franchisor. However, the case boiled down to the question of whether the franchisor qualifies as a competitor of the former franchisee, as a franchisor can only claim for injunctive relief under the German Act against Unfair Competition (UWG) if there is a competitive relationship between it and the former franchisee. The court affirmed this question and considered it as sufficient that the franchisor had another franchisee that was competing with the former franchisee in the same region. While the franchisor itself had its place of business in a completely different location, it was therefore sufficient that it competed with the former franchisee through one of its current franchisees. Consequently, the court granted the franchisor injunctive relief under the UWG. In **Poland**, while there is no case law in this regard, there are certain indications that the scope of post-contractual anti-competition clauses, as allowed by Regulation 330/2010 are extended. First, the one-year limit after the contract ends is not always respected, second, the anti-competition clauses cover not only the franchisee but extend to immediate family members, for example spouses. An extreme example of an anti-competition clause covered family members up to the fourth line of kinship.

7.4.5. Unfair compulsory purchase options below market price

Generally speaking, this problem has not been noted at a national level. Compulsory purchase options are commonly included in **Belgium.** General remarks on this issue have been submitted from **Estonia** and **Belgium**. No references were found in **France, Germany, Poland** and **Spain**.

In **Belgium,** there is a practice of including a compulsory purchase option in the contract (upon the termination of the contract). There is, however, no case law regarding purchase options at below market price. In reality it will be difficult to evaluate the potential value of a business beforehand in the contract. The value of the franchisee's business is, furthermore, at least partially linked to the brand and commercial formula of the franchisor. Most Belgian franchise contracts link the purchase price, if the purchase option is exercised, to turnover or to profit. In **Estonia,** the remedy would be to prove that the term is unfair and void (LOA Article 42 para. 3 subparagraph 23: a term presumed to be unfair if it prescribes the obligation of the other party to accept goods or services not ordered in addition to the goods and services agreed upon), whereas in **Romania** the general provisions of the private law concerning the fairness of the *cause* of the contract or reasons of public policy might be used in order to challenge the validity of such a clause.

7.4.6. Specific issues - Spain

In **Spain,** two other issues were raised:

The franchisor must have its own premises and must it have been successful? A novelty in the *RD* of 2006, which amended the previous *RD* of 1998, was its reference for the first time to franchising as a business method that has proven to be successful. The former definition of franchising in the 1998 *RD* did not mention this. Accordingly, the *RD* of 2006 required franchisors to inform the register of franchisors concerning the number of years that the franchisor has been operating its business. Furthermore, Article 12 announced the creation of a new section in the register intending to identify franchisors that are consolidated on the market. The *RD* of 2010 also includes a requirement that the franchisor must have "enough experience and success" in operating the franchise business. However, in practice it is doubtful whether this has any significance. In fact, the *Tribunal Supremo*, in a decision of 27 February 2012, states that there is no legislation that obliges the franchisor to have its own premises, and that the franchisee was aware of the lack of experience of the franchisor at the time of entering into the contract, so it cannot use such an argument to avoid the contract.[125]

The approach of Spanish courts regarding the requirement for the franchisor to hold a valid title concerning the IPR:

The approach of appeal courts in Spain is not to look at whether the franchisor has a title or right to use the IPR, but whether the franchisee can use effectively the IPR. This is rather surprising given that the *RD* 201/2010 requires the franchisor to provide the franchisee with proof of legal ownership, or proof of the right to license the Intellectual Property Rights.

[125] *STS* 27 February 2012, Roj: STS 1327/2012 - ECLI:ES:TS:2012:1327.

7.5. Franchising in a cross-border dimension

7.5.1. Available data

The available data on the percentage of domestic brands shows that in the vast majority of countries domestic brands dominate markets.

Table: % domestic franchising brands

Country	2007	2008	2009	2010	2011	2012	2013	2014 Est.
Austria		43%		46%		51%	51%	
Belgium	60%				60%	60%	60%	
Croatia	20%				30%		13%	
Czech Rep		49%		55%	55%	55%	60%	
Denmark				82%				
Finland	75%	74%	74%	74%	74%	73%	75%	
France				85%	85%	85%	85%	85%
Germany			80%	80%	80%			
Greece					70%			
Hungary	55%	55%	60%	70%	70%		60%	
Italy	90%	90%	90%	90%	85%	85%		
Netherlands				85%	85%			
Poland	71%	69%	72%	74%	74%	74%	75%	
Portugal								
Slovakia								
Slovenia	47%	52%	51%	50%	48%		43%	
Spain	81%	82%	81%	81%	81%			
Sweden		90%	80%	80%	80%			
UK	80%	80%	80%	80%	80%			

Source: European Franchising Federation.

7.5.2. Legislative solutions

The national character of franchising networks is reflected in both – the legislation and practice of national markets. On the legislative level, the cross-border dimension of franchising is tackled only in **Italy** and **Spain**. In **Italy**, law 129/2004 imposes, among other things, a slightly more detailed information obligation on the franchisor in cross-border situations. Cross-border franchising generally uses the master franchising model, and Article 2 of the statute makes clear that the statute applies also to master franchising. More directly, Article 4.2 of the statute authorises the Government to pass a decree defining specific information duties affecting franchisors who previously operated exclusively abroad. On that basis, the Government issued Decree 204 of 2 September 2005, which deals with foreign franchisors intending to operate in Italy. The scope of application "is limited to cases in which, on the basis of the provisions of international private law, the contract is governed by Italian law" (Article 1.2). According to the decree, the franchisor has to offer (in Italian) slightly more detailed information than that generally requested by law 129/2004 for Italian franchisors. In particular, the franchisor has to provide a numerical list of franchisees operating in the network, a list containing the data and the contact details of at least twenty current franchisees (or a complete list if there are less than twenty), an indication of the change on a yearly basis and by country of the number of franchisees, with their relevant locations in the last three years.

In **Spain**, the cross-border element is present where the Retail Commerce Act and its implementing *RD* impose on franchisors the obligation to submit all relevant data regarding the franchise network to the public register of franchisors. No such obligation is imposed on foreign franchisors if they do not have a permanent establishment in Spain. However, foreign franchisors must in any case communicate that they will start franchising their business to the register of the autonomous community in which they will start their franchise business in Spain. If there is no register in the autonomous community, they will have to register in the central register. Foreign franchisors with a permanent establishment in Spain are considered as local franchisors with regard to the contents of the register obligation. Foreign franchisors who have concluded a master franchise contract with a master franchisee in Spain are also required, via their master franchisees, to comply with registration obligations.

7.5.3. Contractual practice

In **Germany,** franchising contracts with a cross-border element are evidently concluded on a regular basis. It is not apparent, however, that there are any significant material problems in this context that cannot occur in purely domestic contracts (apart from the fact that it is necessary to clarify the applicable law and competent jurisdiction in these cases). In one case, the court had to deal with the question of whether the arbitration clause in a franchising contract was valid and effective (Hanseatic OLG in Bremen, Decision of 30 October 2008 – Sch 2/08). The parties to the franchising contract were a Dutch limited liability company with its registered office in Amsterdam, acting in Europe for an US American parent company based in Florida, as franchisor for gastronomic establishments and a German franchisee. The parties had a dispute over the payment of franchising fees for three franchise operations. The main problem in this case was the arbitration clause, which referred all disputes between the parties to arbitration in New York. The parties agreed in the franchising contract that it is governed by the private law of Lichtenstein. The franchisor conducted arbitration in the USA in accordance with the arbitration clause and obtained an arbitral award that was supposed to be declared enforceable. The franchisee defended itself against this declaration. The court concluded that the arbitration clause was invalid, and the arbitral award was consequently not

enforceable, as the arbitration clause placed the German franchisee unilaterally at a disadvantage. It would require substantial financial efforts and would be quite time consuming for the German franchisee to assert its rights in the USA. Therefore, the court came to the conclusion that the arbitration clause is invalid pursuant to § 879 III of the Austrian ABGB. This norm is applicable as the contract is governed by the private law of Lichtenstein, where the Austrian ABGB is the applicable law for such cases. The sole objective of this arbitration clause was to further increase the imbalance in power between the commercially less adept franchisee and the franchisor, with the help of the US American parent company (OLG Dresden, Decision of 07.12.2007, 11 Sch 8/07). In **the Netherlands,** only one franchising case contained a cross-border element (case Rechtbank Almelo (court of first instance), 7 March 2012, ECLI:NL:RBALM:2012:BV8702) - one party was German and one was a Dutch. In **Poland,** a cross border case (German franchisor and Polish franchisee) was decided by the Supreme Court, though the problem referred to a discrepancy in the language versions of the contract, rather than the cross-border character of the contract as such (judgement of the Supreme Court of 7 March 2007, ICSK 348/06).

In **Romania,** very few of the scarce amount of cases that reach the courts involve a foreign element, which is somehow surprising given that the largest franchisers on the Romanian market are EU- or US-based companies. One reason could be that the foreign companies often establish a Romanian company[126] under their control (the master-franchisee) for the whole of Romania, who acts a franchisor with the Romanian franchisees.

In 2011, however, the Consiliul Concurentei issued a decision[127] concerning an agreement between a Croatian producer of pharmaceutical products and a Romanian distribution company. Their relationship was not one of franchising, but in its reasoning the Competition Authority referred also to the situation of franchising contracts, implying that its decision would have been the same if there had been a franchising contract between the parties. The agreement included a prohibition on exports clause, whereby the distributor was not allowed to sell products outside Romania, and was bound to ensure that its buyers do not resell the products outside Romania. The Competition Authority noted that the agreement between the parties did not concern the transmission of some intellectual property rights, and as such it does not benefit from the exemption provided for by the EU (and Romanian) legislation. Moreover, no individual exemption could have been granted because, according to the Competition Authority, the restriction was not indispensable in order to improve distribution or to transfer benefits to consumers. The Consiliul Concurentei suggested (paras 365, 369 and 375) that, should the agreement be a franchising one, the exemption would not apply equally, because the restriction was meant simply to "divide the market, by isolating the Romanian market and impeding the parallel trade with Belupo products on different markets, including those within the European Union."

In **Spain,** few references can be found on proceedings concerning franchising networks with a cross-border dimension. The judgment of the *TS* of 21 October 2005 concerned a claim of a French franchisor against its Spanish franchisees because of the non-compliance of the latter with the obligation to stop using the franchisor's know-how.[128] However, the *TS* proceeds as if the franchisor was Spanish, thereby excluding the cross-border dimension. The cross-border element of franchising also appeared in a decision of the *TS* of 30 July 2009. It was stated that the cross-border dimension of a franchise network is an element to be considered in order to determine whether the "minima rule" that applies

[126] For the case of the McDonald's franchise, operated through McDonald's Romania SRL, the Romanian subsidiary of the US company, see Decision No 32 of 12 August 2015 of the Consiliul Concurentei.

[127] Decision No 51 of 28 October 2011: http://www.consiliulconcurentei.ro/uploads/docs/items/id7313/decizia_nr_51_28102011_site.pdf.

[128] *STS* 21 October 2005, Roj: STS 6410/2005 - ECLI:ES:TS:2005:6410.

to competition issues is to be put into effect here as well. Restrictions to competition in a network with a presence in several EU countries can hardly benefit from an exemption.[129]

[129] *STS* of 30 July 2009, Roj: STS 5933/2009 - ECLI:ES:TS:2009:5933.

8. THE QUESTIONS OF THE EUROPEAN PARLIAMENT – CONCLUSIONS

KEY FINDINGS

- Regulation 33/2010 focuses on the advancement of the internal market and does not consider the effect it has on the functioning of the franchising market from the point of view of private law relations.
- The impact of the Regulation is direct (it exempts certain potentially unfair vertical restrains) and indirect (it provides support to the franchisor – a party that is in a structurally stronger position).
- The outcome of the research suggests that though changes to the Regulation may be required, any changes must be assessed both from the perspective of competition law and private law.
- The existing European reporting and complaint systems could be used for gathering information on the functioning of the franchising market.
- An action supporting self-organisation of franchisees is very much needed.

8.1. What is the effect of existing EU-legislation on the well-functioning / malfunctioning in the area of franchise?

8.1.1. Introduction – the focal points

To say that Regulation 330/2010 impacts the functioning of the EU franchising market would be stating the obvious. The questions that truly require answering are how and to what effect does the Regulation impact the functioning of franchising contracts.

The mechanism that the Regulation promotes can be described in the following way: although certain contractual terms (may) have a restrictive character from the point of view of competition law, they play a very useful role as they allow for further market development. Their potential anti-competitive effect is therefore outweighed by the benefits they bring (to the market and to the consumers). Competition law is not concerned, however, with the effect those terms have on the relations between the contract parties, as this is the private law domain. The influence of the Regulation on the content of the private law relation can be observed on two levels:

1) the impact on the parties' behaviour (how are the contracts drafted);
2) the impact on the practice of the courts (how the courts apply the content of the allowed vertical restraints in the context of private law relations).

8.1.2. The impact on the parties' behaviour

The application of the Regulation is based on a self-assessment by the parties. The findings of the research strongly suggest that the market takes a "compliance approach". This means that, whenever the Regulation assumes that – subject to certain conditions - a specific clause is acceptable and should not be seen as infringing competition, it is accepted on the market. Achieving this result was one of the aims of the reform of EU competition

law, as clearly explained in the Communication published by the Commission. This practice, however, extends also to franchising contracts that do not fall within the scope of application of the Regulation (according to the *de minimis* rule). From this point of view, the Regulation has achieved its target: allowing (and encouraging) the parties to rely on vertical restraints in order to integrate and develop the market. However, it seems that the Regulation is applied in practice in a rather automatic way, i.e., there is no mechanism (other than the possibility to remove the benefits of the block exemption) that would force the parties to consider whether, in a given (market/ contractual) situation, the vertical restraint is really justified. In other words, Regulation 330/2010 sets standards for franchising contracts. This approach is reinforced by the franchisor organisations, which establish the fairness standards by referring to the content of the Regulation. In this way, the vertical restraints that are merely allowed by the Regulation (in order to achieve market-oriented aims) become the applicable market standards.

8.1.3. Approach of national courts

The process described above is further supported by national courts. When dealing with franchising, the courts use the content of Regulation 330/2010 to test the fairness of contractual clauses (to decide whether certain contract clauses should be allowed by private law). This means that competition law exerts a direct impact on the standards acceptable in the private law domain, for example in Germany where the case law decided on the basis of the previous regulation constitutes a benchmark for evaluating the moral standards of a franchise contract pursuant to § 138 BGB.[130] In the Netherlands, the court declared the non-competition clause fair, since it did not seem to impede competition on the market.[131] In Spain, a rather more nuanced approach can be found: the court[132] concluded that minimum purchase obligations indicated impose a major obligation on the franchisee, but are nevertheless valid if they are proportionate.[133]

8.2. Does EU Regulation No 330/2010 need any adjustments concerning long-term competition clauses, purchase options, multi-franchising or block exemptions?

8.2.1. Introduction – position of the stakeholders

This question raises much controversy among the stakeholders. Adjustments to Regulation 330/2010 are demanded by the representatives of franchisee circles, and strongly opposed by the representatives of franchisors. The franchisees claim that the clauses containing vertical restraints are too repressive, as their application severely restricts the entrepreneurial spirit of the franchisees. Moreover, while the clauses that the Regulation allows strengthen the imbalances existing between the parties to franchising contracts, the fact that the Regulation approves of them gives them legitimisation. The franchisors, generally speaking, are of the opinion that the present regulatory environment is appropriate, and the problems that might be found in practice (if any), are caused not by the content of contractual clauses that contain vertical restraints, but by the way the vertical restraints are applied. This amounts to unfair trade practices, and takes place mostly in the food-chain industry (as explained by the EFF), or in the general food sector (The French Franchise Organisation).

[130] OLG Rostock, decision of 29.06.1995, 1 U 293/94, DB 1995, 2006.
[131] Rechtbank Midden-Nederland, 11 June 2014, ECLI:NL:RBMNE:2014:7395.
[132] TS, sentence of 2 March 2001 (RJ 2001, 2016).
[133] *STS* 2 March 2001, RJ 2001, 2616.

8.2.2. Various perspectives for answering the question

The question whether Regulation 330/2010 needs adjustment should be approached from two different perspectives: competition law and private law. From a competition policy point of view, in order to answer this question one should establish whether the market development still needs such support as provided by the Regulation, and (if so) whether (1) the contents of the current vertical restraints are effective, proportional, and up-to-date considering the recent market developments; and (2) the model of the franchising contract adopted by Regulation 330/2010 reflects the market reality (franchising as one type of distribution contract). These are, however, questions directed at economists, as to answer them through an economic analysis of the market is required.

Second, from the perspective of the relations between the parties of franchising contract, answering this question relates to establishing whether the adverse effect (the impact that the exempted vertical restraints have on the content of franchising contracts) is proportional, when compared to the market advancement they allow. In this respect, the materials gathered during the research suggest that the Regulation might need adjustment, as some of the problems encountered on the franchising market have their roots in the content of the Regulation (i.e. the problems stemming from the exempted post-contractual clauses, or purchasing obligations). Sometimes it is difficult to distinguish what really constitutes the problem: the content of the exempted vertical restraint or the potentially abusive way in which the exempted clause is used in practice by the franchisor (as signalled by the franchisors).

It must be emphasised that the problems relating to the content of four clauses expressly referred to by the IMCO do not exhaust the list of problems observed on the franchising market. However, the problems relating to the lack of balance between the parties to a franchising contract (which Regulation 330/2010 strengthens, so it has an indirect effect also in these areas), remain outside the interest of the EU at the moment. The research revealed that national legal systems have begun to react normatively to the problems that can be observed in the franchising area. The national legislative interventions mostly aim at balancing the position of the franchisee against the franchisor. The legislative processes that lead to introducing franchising laws seem to be particularly difficult. As Abell puts it: “it took seven years and eight bills in Italy, twenty-four years and five bills in Belgium, and nineteen years and twelve bills in Sweden to produce a franchise law.” Despite these problems, franchising laws have been introduced in Italy, Spain, Lithuania, Estonia, Sweden, Belgium and Romania. Additionally, in Germany and France there is a clearly established line of case law in the area, and a new soft law was accepted in the Netherlands very recently. This process clearly creates barriers that restrict the ability of franchisors to freely expand from one Member State to another.[134]

This means that quite a paradoxical situation exists at the moment in the franchising area: the EU is using competition law tools in an attempt to eliminate the barriers hindering market development, turning a blind eye on the contractual repercussions of the introduced rules (presumably to accelerate the process). At the same time, the Member States are reacting to the problems encountered in the contractual dimension of franchising (which are fortified by the EU competition law instruments), and are introducing laws that are supposed to (generally speaking) support the position of the franchisee, creating market barriers for the franchisors. What is clearly missing at the EU level is the wider perspective on EU competition law that would take into account not only the direct market related effects of the introduced rules, but also the less visible indirect consequences that appear

[134] Abell, p. 85.

at national level. Here, new market barriers can appear, which are inspired (even if only indirectly) by EU law.

These processes may tame the possibilities that meeting the potential of franchising contracts has for contributing to the internal market by improving distribution and giving businesses increased access to other Member State markets.[135]

8.2.3. Updating the Guidelines

Another related issue that should be referred to here are the Guidelines that accompany the Regulation. In principle, with regards to franchising, they have not been changed since 1999 (when Regulation 2790/1999 was passed).

The Guidelines should provide the parties and the national courts (which may not be familiar with applying competition rules) with practical help in the process of a self-assessment of the Regulation. In order to do so, they should be up-to date with the market developments in terms of new trends regarding network organisation as well as technological advancements. During the research, the following issues were indicated as either requiring revision or inclusion into the Guidelines: resale price maintenance, the protection of intellectual property rights in franchise agreements and the extent to which the protection of trade marks or know-how can justify exceptions from the rules set by the Regulation. It was also pointed out that the Guidelines to the Regulation stipulate that a combination of exclusive distribution and selective distribution is only exempted by the Regulation if active selling in other territories is not restricted. In practice, however, franchisors often want to grant exclusive territories to their franchisees and want to protect each franchisee from active competition in that territory from other franchisees. In particular, in industry sectors where sales are not limited to a point of sale, but where franchisees visit their clients outside a brick and mortar point of sale, this gives rise to difficulties (e.g. the real estate sector, the insurance sector and the travel agency sector).

8.2.4. E-commerce

The current approach to franchising at the EU level does not take any account of the new challenges that appear for relations between franchisors and franchisees in the context of e-commerce. This subject also hardly ever appears at national level. However, during sample interviews with the representatives of the industry this subject was broached by both sides. This issue should therefore be the subject of further investigation, especially in the context of territorial exclusivity clauses and a clear position on permitted options should be included in the Guidelines.

8.3. Does existing EU legislation simply need better enforcement?

While effective enforcement is a key aspect of any legislation, limiting the necessary changes on the franchising market to improving enforcement would amount to reducing its problems. That being said, two observations can be made regarding enforcement issues.

8.3.1. What is “better enforcement”?

The first issue that requires clarification in this case is what does “better enforcement” mean in the context of applying Regulation 330/2010 in the franchising area. Here it does not mean that the rules should be applied more strictly, on the contrary, its application should be proportionally adjusted, as far as the clauses are necessary to fulfil the aim for

[135] Abell, p. 41.

which they were introduced. The research suggests that the application of the Regulation is quite automatic: i.e. the contracts tend to include the exempted restrictions without verifying whether or not they are necessary from the point of view of the aims for which they were exempted. A similar tendency seems to be present in the court practice at the national level.

8.3.2. Enforcement and fear factor

Proper enforcement (in its traditional context, i.e. the possibility of effectively enforcing one's rights in cases of their violation) constitutes an issue for contractual relationships with a high level of fear factor. Franchising contracts constitute a prime example of such relations. In order to limit situations where franchisees will refrain from enforcing their rights, specific measures should be promoted. Here, one might refer to the institutional support to the self-regulation of franchisees that can work as a whistle, or handle an alternative dispute resolution system for its members, or by referring to unfair trade practices (if the EU project in this area will come to fruition). One should remember, however, that the fear factor constitutes an inevitable and probably natural part of business relation, and its complete elimination is neither advisable, nor possible.

8.4. Could possible European solutions be found in self-regulatory initiatives such as the European Franchising Code of Ethics, or an improved reporting or complaint system (e.g. using SOLVIT, Your Europe or another appropriate general or dedicated tool)?

The self-regulatory initiatives can undoubtedly benefit the market and its organisation. However, for constructing a proper self-regulation model, certain requirements must be met. One of the most important is equal and independent representation of the interested parties. This condition is not met at present on the EU franchising market (see chapter I point 2.6.2). In order to rectify this, an action supporting self-organisation of franchisees is required. On the other hand, an improved reporting or complaint system (such as SOLVIT) would definitely be beneficial, as it could allow information to be gathered about the market situation. Despite the work done while preparing this report, much still remains to be discovered when it comes to unveiling the franchise practice in EU. Collecting market information via reporting systems that guarantee anonymity may be a very useful tool for verifying the mutually exclusive positions presented by the franchisors and franchisees.

8.5. What are the current systems in place at a European level regarding cross-border cooperation and the exchange of best practices in the field of franchising? Would additional action, e.g. the introduction of a new EU instrument be necessary?

The only functioning system is organised by the European Franchising Federation, around the European Franchise Code of Ethics. This is absolutely not adequate, considering the role that franchising already plays on the EU market and the potential it carries for market development. What is definitely lacking is the cooperation and self-organisation of franchisees, at both a national and EU level. Any initiative in this regards should be strongly supported.

9. RECOMMENDATIONS

KEY FINDINGS

- A better balance in representation.
- Establishing the content of franchising contracts.
- Establishing the competition law impact
- Verifying the correctness and effectiveness of competition law solutions in the franchising area.

9.1. A better balance in representation

The research clearly showed that the franchising market suffers from a lack of balance in the representation of the parties to franchising contracts. Hence, the only action that can be taken immediately refers to strengthening the impact of franchisee organisations.

The franchisors have a well-organised net of organisations at national, EU and world level. These organisations are very active and effective in representing and protecting the interests of franchisors. This is certainly an important and positive aspect of the market (self-)organisation. However, these actions are very often presented as industry initiatives, whereas they seem to be driven by the franchisors.

It is easily understandable why the **franchisees are underrepresented**. A franchisee is normally a small business that lacks resources (in terms of both time and money) to become engaged in any extra activities (even self-representation). However, if the voice of the franchisees is not heard properly and on an equal footing with the voice of the franchisors, there can be no attempt at self-regulation. Only balanced representation of the parties can ensure that self-regulation will consider the interest of the parties in an unbiased way (it would be utterly naive to believe in the altruistic behaviour of strong market players). In the situation of unbalanced representation, even the public consultation of hard law solutions is biased (the franchisors present their view, whereas the franchisees present no view).

It is of crucial importance that franchisees have **effective and independent** representation at both national and EU level. It should therefore be considered what type of organisational, educational and technical support could be provided to them. Here it would be useful to consult these issues with the existing organisations at the national level, as well as involve UAPME ("the voice of SMEs in Europe"), which has already voiced an interest in franchising matters.

9.2. Establishing the content of franchising contracts

The main difficulty in completing this report was the **inaccessibility of the franchising contract content**. Any future action undertaken without establishing first what types of problems normally occur in practice will be based on "declaratory evidence" provided by the interested parties.

The opinions presented by the parties to franchising contracts are (in a nutshell) the following – the franchisors claim that the franchising market functions (almost) ideally; the normative support given by EU competition law is perfectly suitable and does not cause any problems in practice; and that any kind of legislative intervention would damage the proper balance in supporting the interest of parties, achieved by EU legislation. If there

are any problems on the market, they are caused by the poor performance of the franchisees, or are characteristic to specific sectors of the market (food sector). However, even in such cases, the vertical restraints per se are fine; what is problematic is the way they are used, which in certain situations may amount to unfair trading practices.

The franchisees report a variety of abusive practices that, in their opinion, have their roots in the content of vertical restraints allowed by Regulation 330/2010. In the eyes of the franchisees, the content of the Regulation not only places franchisees at a disadvantage, but also prevents the development of the franchising market, by restricting their entrepreneurial spirit. The franchisees therefore call for changing the content of the Regulation (in order to eliminate the possibility of abuse on its basis), but also for introducing a national regulation of franchising contracts, in order to better shape the normative environment of franchising contracts.

In order to be able to verify these claims, it is necessary to gather information about real life franchising contracts. Two options are possible here.

1) Parliament can demand the European Commission to open **a contact point** that would allow anonymous information on the problems encountered by the franchisees in their business relations. It should be widely advertised, via the Internet and press publications addressed to the franchise sector. Collecting information from franchisees will not provide a quantitative indication of the scale of problems, but it will, nevertheless allow discovery of patterns in practice.
2) **A collection of information on bankruptcies** is also possible. Such a project would consist of analysing the content of contracts after the bankruptcy of a franchisee. It could reveal whether the content of the franchising contract played a role in the failure of the franchisee business. It would require cross border cooperation with national bodies that administer bankruptcy procedures. This could also allow a (more) comprehensive analysis of the differences that exist among the national markets.

9.3. Establishing the competition law impact

Gathering information on the content of franchising contracts should allow an evaluation of **how deep the competition law solutions impact private law relations** in the franchising area. Competition law pursues its specific market-oriented aims, but the impact of competition law goes deeper than shaping the market. Cases decided (among others) in Germany, the Netherlands and Spain prove that national courts use competition law as a yardstick to decide what is and what is not allowed in private law relations (it follows the line of thinking: if competition law allows it, private law must accept it).

The unintended (side-effect-like) impact of competition law (setting a normative level playing field for the parties to a franchising contract) **should be analysed** and taken into account when proposing and implementing new competition law instruments. The competition law measures should be evaluated not only in light of the market integration aims, but also as building blocks of private law relations.

9.4. Verifying the correctness and effectiveness of competition law solutions in the franchising area

Two issues require verification in light of the need to prepare a new block exemption regulation.

1) **Whether the model of franchising, as adopted by Regulation 330/2010 answers the needs** of the franchising market, and
2) Whether the content of exempted vertical restraints is proportional and adequate, taking into account the stage of development of the franchising market in the EU

Ad.1 **Verifying the adopted franchising model**

Franchising has been present in EU competition law for almost four decades. Within this period, the competition law approach towards franchising has evolved substantially. At the beginning (the Pronupia case), **franchising was seen as a self-standing, distinct business method** with specific characteristics that clearly distinguished it from other forms of business cooperation. As such, franchising required a specific approach that would allow it to maintain its character. This attitude was continued in a series of the Commission's decisions and Regulation 4087/88. **With the new approach of the Commission towards widely understood distribution contract (as in Regulations 2790/1999 and 330/2010), franchising was put into one basket with all other methods of distribution between the business parties**. It was reduced to an "exclusive distribution with some IPR issues." The change of approach was not explained by the Commission (the Action Plan simply stated that the approach had changed, but did not explain the reasons for aligning franchising with other methods of distribution and its consequences).

The results of the research do not allow an evaluation of whether the franchising model adopted by EU law reflects the market practice (due to the lack of transparency and the methodology used). Undoubtedly, this aspect requires further analysis, for which one must first establish market practice. The question is whether franchising has really lost its distinctive features to a degree that it is no different from other distribution contracts, and whether a uniform approach is appropriate. **The Commission has so far presented no convincing argumentation in this regard**.

Ad. 2 **Exempted vertical restraints**

Discussions with franchisees and franchisors revealed that there is quite a **fundamental difference between them when it comes to evaluating the content of the exempted vertical restraints**. While the franchisors praise the content of the Regulation, the franchisees accuse it of not only further strengthening the position of franchisors against franchisees, but also restricting the entrepreneurial spirit of franchisees, which in turn translates to "freezing" market development instead of accelerating it.

The content of vertical restraints has not changed substantially since the adoption of Regulation 2790/1999. This provokes the question whether the once exempted restraints remain effective and proportional in the present market situation. This refers not to the impact of the restraints on private law relations, but on the market – i.e. the primary target of competition law. In addition, the question appears whether the Regulation (and the Guidelines) takes into account in an appropriate manner the new market developments that refer to the digitalisation of trade (the Internet) and the use of big data.

Also, **the EU competition policy** that aims at removing market barriers, supports franchisors and turns a blind eye on the consequences in brings about at the national level, where Member States introduce rules that aim at protecting franchisees. In other words, **while removing one type of barriers**, it **creates others** (there is no such thing as a free lunch). This aspect, i.e. the private law consequences of the competition law solutions should be taken into account during legislative works in the future.

9.5. Possible further actions

The outcome of the research suggests several measures that would allow the problems revealed in the legal and social environment of franchising in the EU to be addressed. The recommended actions can be undertaken together, or separately (to address specific issues).

Parliament resolution

The Parliament could call upon the Commission with a resolution:

- With the intention of **ensuring that retail market legislation is more thoroughly evidence-based**, particularly as regards the need to adequately examine and understand the impact of legislation on small businesses, as advocated by the Parliament in the Resolution on a more efficient and fairer retail market of 25 May 2011 (2010/2109(INI)
  c) to set up an **online complaint channel** (e.g. through Your Europe) that would allow complaints to be filed concerning the use of unfair trade practices in franchising contracts;
  d) to **start public consultations** with a view to: correcting the model on which the future block exemption regulation is based; establishing the concept of a franchising contract to be used in any future EU legislation; and establishing a need for possible action in the area of private law.
- With a view to **facilitating the self-assessment process** of any future regulation: since the application of the regulation is primarily based on self-assessment, the regulation must be drafted in a way that takes this into consideration. It should be easy for the businesses that apply it to understand which contractual terms and practices are allowed, and which are prohibited. In this context, creating a list could be considered.
- With a view to **ensuring a balanced representation of the parties to franchising contracts**: to take action to strengthen the self-organisation of franchisees at the EU and national level, in order to grant franchisees equal access to the public debate on franchising and establish a level playing field for any future self-regulatory action.
- With a view to **correcting market failures in relations between franchisors**, through legislative action, either in by tackling unfair trading practices or by better regulating retail, contract law or/and competition law.

Further actions, subject to the outcome of the consultations

The information gathered through the complaint channel and the public consultation should allow the **verification of the franchising market practices**. The following issues should be addressed in light of the established findings:

- **Regarding the regulation in force at the moment**: the possible adjustment of the guidelines accompanying Regulation 330/2010 with a view to making it more up-to-date with the current technological advancements (the Internet) and market developments (for example: the relation between franchising and exclusive distribution);
- **Regarding any future regulation**: (1) verifying the impact that the horizontal approach adopted in Regulation 330/2010 has on the functioning of franchising; (2) testing whether the franchising model adopted by the present regulation reflects the market reality, and correcting it if necessary; (3) assessing the effectiveness and proportionality of the allowed vertical restraints, taking into account also the fact that they directly impact the franchising market by establishing market standards; (4) establishing a list of issues that should be addressed in the new guidelines.

Possible private law instrument

In light of the findings relating to the franchising market practice, the possibility of adopting a private law regulation dealing with certain aspects of franchising contract at the EU level could also be considered.

Workshop

In addition, to initiate a debate, the Parliament could organise a workshop to discuss the results of the research, and open up the debate among the stakeholders. Any such event should ensure the proper representation of the franchisees and franchisors.

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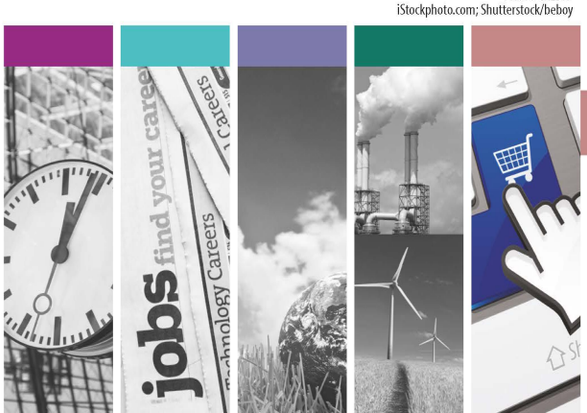

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