International Lawyer

Volume 22 | Number 3 | Article 7

1988

Franchising in Europe - The First Practical EEC Guidelines

Dieter A. Schmitz

Hamme Alain Van

Dieter A. Schmitz*
Alain Van Hamme**

Franchising in Europe—The First Practical EEC Guidelines†

Americans traveling in Europe are struck by the signs of familiar restaurants, stores, hotels, and car rental agencies. United States franchise operations have invaded Europe and have been emulated by many European-based franchises. The Commission of the European Economic Community (EEC or Community) has indicated that approximately 1,500 business franchises operate in the EEC, a figure slightly higher than in the United States and nearly four times higher than in Japan. Franchising could yet account for up to 10 percent of all retail sales within the EEC. In spite of the importance of franchising within the EEC, the Community institutions have only now issued the first EEC guidelines.

On January 28, 1986, the European Court of Justice (Court of Justice or Court) issued its first decision addressing franchise agreements under the antitrust or "competition" rules of the Treaty of Rome (Treaty).[1] In this decision, commonly referred to as *Pronuptia*,[2] the Court held that franchise agreements that affect trade within the EEC can violate Treaty article 85(1). But clauses in such agreements necessary to prevent the

*Mr. Schmitz is a member of the Illinois bar and practices law with Baker & McKenzie in Chicago.
**Mr. Van Hamme is a member of the Brussels bar and practices law with Baker & McKenzie in Brussels.
The authors gratefully acknowledge the helpful comments of Michael L. Coleman, who practices law with Baker & McKenzie in Chicago and Otto J. Grolig, who practices law with Baker & McKenzie in Brussels.
†The Editorial Reviewer for this article is Wade Channell.
1. Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 11 (*entered into force* Jan. 1, 1958) [hereinafter Treaty].
2. Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis, [1986] 1 Common Mkt. L.R. 414, [1985–1986 Transfer Binder] 3 Common Mkt. Rep. (CCH) ¶ 14,245, [hereinafter *Pronuptia*].

communicated know-how and assistance from aiding the franchisor's competitors, and those necessary to protect the identity and reputation of the network, are permissible under article 85(1).

On December 17, 1986, the EEC Commission issued its first two decisions addressing the compatibility of franchise agreements with EEC competition law. In these decisions, involving Pronuptia[3] and Yves Rocher,[4] the Commission applied the Court's ruling to exempt two franchise agreements, pursuant to article 85(3), and to provide concrete guidelines for franchisees and franchisors with activities in the EEC. On July 13, 1987, the Commission granted yet another individual exemption, this time for Computerland's franchise agreements.[5] And on August 27, 1987, the Commission provided further guidance by issuing a draft regulation conferring a block exemption under article 85(3) for certain franchise agreements. The Commission anticipates that this regulation will enter into force on January 1, 1989.

This article begins by providing an overview of EEC competition law. Then, it analyzes the Court's *Pronuptia* decision and the franchising guidelines developed therein. Next, the exemptions under article 85(3) granted by the Commission to the franchise agreements of Pronuptia, Yves Rocher, and Computerland are discussed. Finally, this article describes the draft block exemption for certain franchise agreements.

I. Overview of EEC Competition Law

Competition law in the EEC is governed by Treaty articles 85 and 86. Article 85(1) provides that agreements (or concerted practices) between two or more enterprises that restrict competition within the EEC are prohibited.[6] Article 86 prohibits any enterprise or group of enterprises

3. *Re Pronuptia,* 30 O.J. EUR. COMM. (No. L 13) 39 (1987) (EEC Commission decision [hereinafter *Re Pronuptia*].

4. *Re Yves Rocher,* 30 O.J. EUR. COMM. (No. L 8) 49 (1987) (EEC Commission decision) [hereinafter *Re Yves Rocher*].

5. *Re Computerland,* 30 O.J. EUR. COMM. (No. C 222) 12 (1987) [hereinafter *Re Computerland*].

6. Treaty, *supra* note 1, art. 85(1) provides:

> The following shall be prohibited as incompatible with the Common Market . . .: all agreements between enterprises, any decisions by associations of enterprises and concerted practices which are likely to affect trade between Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market, and in particular those consisting in:
> - the direct or indirect fixing of purchase or selling prices or any other trading conditions;
> - limitation or control of production, markets, technical development, or investment;
> - market sharing or sources of supply;
> - the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage;

from abusing a dominant position within the EEC or in a substantial part thereof.[7] The location of the parties to the agreement is irrelevant, so long as the agreement produces its effects within the EEC.

Notwithstanding the general prohibition of article 85(1), an agreement that restricts competition within the EEC is not prohibited under EEC competition law if it meets the standards of either the so-called "*De Minimis* Notice"[8] or Treaty article 85(3).

The *De Minimis* Notice, which was issued by the EEC Commission, defines agreements that have a negligible effect on competition and, thus, do not infringe article 85(1). According to the Notice, which was last amended in September 1986, article 85(1) is not violated if (i) the parties to the restrictive agreement or practice, including their affiliates, have combined annual gross revenues of under 200,000,000 European units of account (also referred to as European Currency Units or simply, ECU),[9] *and* (ii) the products covered by the agreement do not account for more than 5 percent of the volume in the relevant market, i.e., identical products (or products considered by consumers to be similar on account of the properties, price, or use) in that geographic territory of the EEC where the agreement produces its effects.[10] Although the Notice is not binding on the Court of Justice or national courts of the Member States, parties covered by the Notice need not file or "notify" their agreements with the Commission and generally are not subject to fines by the Commission. Thus, parties to a franchise agreement generally should only be concerned

- the subjecting of the conclusion of contracts to the acceptance by a party of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

7. *Id.* art. 86 provides that any abuse by one or more undertakings of a dominant position within the Common Market or in a substantial part of it shall be prohibited as incompatible with the Common Market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in:
- the direct or indirect imposition of any inequitable purchase or selling prices or of any other inequitable trading conditions;
- the limitation of production, markets or technical development to the prejudice of consumers;
- the application to parties to transactions of unequal terms in respect of supplies, equivalent thereby placing them at a competitive disadvantage;
- the subjecting of the conclusion of a contract to the acceptance by a party of additional supplies which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

8. Commission Notice of 3 September 1986 on agreements of minor importance which do not fall under Article 85(1) of the Treaty Establishing the European Economic Community, 29 O.J. EUR. COMM. (No. C 231) 2 (1986), *replacing* 20 O.J. EUR. COMM. (No. C 313) 3 (1977), *replacing* 13 J.O. COMM. EUR. (No. C 64) 1 (1970) [hereinafter *De Minimis* Notice].

9. On April 1, 1988, one ECU was equal to approximately U.S. $1.24.

10. *De Minimis* Notice, *supra* note 8, art. II.

with article 85(1) if the Notice's gross revenue and market share standards cannot be met.

If the franchising parties cannot meet the standards of the *De Minimis* Notice, they can seek an exemption from article 85(1) by meeting the requirements of article 85(3). Pursuant to article 85(3), an agreement (or concerted practice) that infringes article 85(1) may be granted an individual exemption if the agreement meets the following four conditions:

- it improves the production or distribution of goods or promotes technical or economic progress;
- it reserves to consumers a fair share of the resulting economic benefits;
- it contains only indispensable restrictions; and
- it does not eliminate competition altogether.[11] Only the Commission has the power to grant exemptions under article 85(3). Subject to a few narrow exceptions,[12] no individual exemption from the prohibition of article 85(1) can be obtained without prior notification of the agreement to the Commission.[13]

Franchising parties should be warned that the consequences of a violation of article 85(1) are essentially threefold: automatic civil unenforceability of the infringing provisions;[14] exposure of the parties to the violative agreement to fines imposed by the EEC Commission;[15] and exposure of

11. Treaty, *supra* note 1, art. 85(3) provides:

> The provisions of [article 85(1)] may, however, be declared inapplicable in the case of:
>
> —any agreements or classes of agreements between enterprises;
> —any decisions or classes of decisions by associations of enterprises;
> —any concerted practices or classes of concerted practices;
>
> which contribute to the improvement of the production or distribution of goods or to the promotion of technical or economic progress, while reserving to users an equitable share in the profit resulting therefrom, and which:
>
> (a) neither impose on the enterprises concerned any restrictions not indispensable to the attainment of the above objectives;
> (b) nor enable such enterprises to eliminate competition in respect of a substantial portion of the goods concerned.

12. EEC Council, Regulation No. 17/62, First Regulation Implementing Articles 85 and 86 of the Treaty, J.O. COMM. EUR. (No. 13) 204 (1962), O.J. EUR. COMM. 87 (spec. ed. 1959-62) [hereinafter Regulation 17].

13. Treaty, *supra* note 1, art. 177. In lieu of granting a formal exemption pursuant to article 85(3), the Commission may issue an administrative letter, often referred to as a comfort letter, which informs parties that article 85(1) does not seem to apply to a notified agreement or that an exemption under article 85(3) seems available. Pursuant to Regulation 17, the Commission also may issue a negative clearance, which is a final act akin to a formal comfort letter in which the Commission states that article 85(1) does not apply to a specific agreement under the particular facts known to it.

14. *Id.* art. 85(2) provides: "Any agreements or decisions prohibited pursuant to this Article [85(1)] shall be null and void."

15. *Id.* art. 87(2)(a) empowers the EEC Council to promulgate regulations "to ensure observance, by the institution of fines or penalties, of the prohibitions referred to in Article

the parties to third-party claims for damages. Civil unenforceability may be declared by the Commission at any time and also may be declared by a court of a Member State (unless the Commission has granted an individual exemption pursuant to article 85(3), described above). The civil unenforceability provision applies only to those individual elements of the agreement that fall within the prohibition of article 85(1), provided that those elements are severable from the agreement as a whole. If the offending provisions are not severable, then the entire agreement is void and unenforceable. The law governing the agreement determines which provisions are severable.

The Commission may impose fines ranging from 1,000 to 1,000,000 ECU or up to 10 percent of the participating enterprise's annual worldwide sales of all products from the preceding business year, whichever amount is higher, on any enterprise that willfully or negligently violates article 85(1) or 86, or violates the terms of a stipulation in an exemption granted under article 85(3).[16] In fixing the amount of the fine, the Commission must pay attention both to the gravity and the duration of the infringement. Only the Commission has the power to fine. Although the Commission initially made fairly sparing use of this power, in recent cases the Commission has adopted a stricter fining policy. It has not shied away from extremely severe sanctions when it determines that flagrant violations have been committed.[17] Regulation 17 of the EEC Council provides for

85, paragraph 1 and in Article 86. . . ." This provision was the authority for Regulation 17, which granted the Commission the power to enforce the EEC competition rules and specifically outlined the Commission's power to impose fines and periodic penalty payments. Regulation 17, *supra* note 12.

16. Regulation 17, *supra* note 12, art. 15(2). *See also* SA Musique Diffusion Française v. Commission, 1983 E. Comm. Ct. J. Rep. 1825, 190709, [1983] 3 Common Mkt. L.R. 221, 335–36 (in which the Court upheld the Commission's position that the annual sales test of Regulation 17 includes worldwide sales of all products) [commonly referred to as and hereinafter *Pioneer*].

17. *E.g.*, *Re Polypropylene Cartel*, O.J. EUR. COMM. (No. L 230) 1 (1986) (the Commission assessed fines totaling 57.85 million ECU on 15 petrochemical producers, mainly multinationals, which operated a market-sharing and price-fixing cartel in the polypropylene market); *Re AKZO Chemie*, 28 O.J. EUR. COMM. (No. L 374) 1 (1985), [1985–1986 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 14,318 (the Commission assessed a fine of 10,000,000 ECU on AKZO Chemie for abusing its dominant market position by attempting to drive a smaller competitor from the market); *Re Pioneer Hi-Fi Equipment*, 23 O.J. EUR. COMM. (No. L 60) 21, 38 (1980), [1980] 1 Common Mkt. L.R. 457, 486–87 (fines assessed on Pioneer and its distributors amounted to over 7,000,000 ECU), *modified sub nom. Pioneer*, 1983 E. Comm. Ct. J. Rep. 1912, [1983] 3 Common Mkt. L.R. 339–40 (the Court reduced the fines on technical grounds to 3,200,000 ECU). The Court, however, upheld the Commission's new stricter fining policy: "[T]he fact that the Commission, in the past, imposed fines of a certain level for certain types of infringement does not mean that it is estopped from raising that level . . . if that is necessary to ensure the implementation of Community competition policy." *Pioneer*, 1983 E. Comm. Ct. J. Rep. at 1906, [1983] 3 Comm. Mkt. L.R. at 334. For a description of the Commission's new stricter fining policy, see EEC COMMISSION, THIRTEENTH REPORT ON COMPETITION POLICY ¶¶ 62-66 (1984).

automatic immunity from such fines with respect to agreements or practices actually notified to the Commission with a request for exemption under article 85(3). In these cases the immunity only extends from the notification date until the day the Commission issues its decision regarding article 85(3).[18]

A party that has been fined by the Commission or that has been denied an article 85(3) exemption may appeal to the Court of Justice.[19] The Court also plays a role in competition decisions when a national Member court requires an interpretation of Community law.[20] This situation may arise, for example as in *Pronuptia*, when a party to a contract enforcement action raises the defense that the contract violates article 85(1). In addition to its authority to issue individual decisions (e.g., *Re Pronuptia, Re Yves Rocher*, and *Re Computerland*), the Commission is authorized to issue block exemptions to certain categories of agreements[21] that produce anticompetitive effects but that are exempted from the EEC competition rules because of article 85(3). In the past several years, for example, the Commission has issued block exemptions for exclusive distributorship,[22] research and development,[23] and patent license agreements.[24] The draft exemption for franchise agreements is yet another example of a block exemption.

II. Discussion of the Pronuptia Decision

The *Pronuptia* case involved a business format franchise agreement between a French distributor of wedding apparel and one of its German franchisees. The plaintiff franchisor was a German subsidiary of the French company, and had sued the German franchisee in Germany for arrears of fees due under the franchise agreements. The franchisee claimed that no royalty fees were owed because the underlying franchise agreements were void as being violative of EEC competition law.

The *Pronuptia* case reached the Frankfurt Court of Appeals, which held that the franchise agreements contained restrictions violating Treaty article 85(1). On appeal, the German Bundesgerichtshof (Federal Supreme Court) referred the EEC competition issues to the European Court of Justice under Treaty article 177.

18. Regulation 17, *supra* note 12, arts. 4, 5, 15(5).

19. Treaty, *supra* note 1, art. 173; Regulation 17, *supra* note 12, art. 9(1).

20. Treaty, *supra* note 1, art. 177.

21. *Id.* art. 85(3) allows exemptions for a "category" of agreements, and the EEC Council has authorized the Commission to issue such group exemptions regarding certain types of agreements.

22. EEC Commission, Regulation No. 1983/83, 26 O.J. EUR. COMM. (No. L 173) 1 (1983).

23. EEC Commission, Regulation No. 418/85, 28 O.J. EUR. COMM. (No. L 53) 5 (1985).

24. EEC Commission, Regulation 2349/84, 27 O.J. EUR. COMM. (No. L 219) 15 (1984) [hereinafter Patent Licensing Regulation].

In its decision, the Court of Justice considered only distribution franchise agreements, by which the franchisee restricts itself to the sale of certain products in a shop carrying the franchisor's name. The Court did not address other types of franchise agreements, such as service[25] and production franchises.[26]

In its analysis, the Court distinguished between clauses that are necessary to enable franchising to function and those that are not. The Court held that in order to find that a franchise agreement was compatible with article 85(1), it was necessary to analyze the agreement's content, the economic context in which it operates, and its economic consequences. Otherwise stated, the Court predicated its decision on a rule-of-reason analysis.[27] Set forth below are the guidelines that the Court developed and a discussion of the clauses permitted under article 85(1) and those that are violative of article 85(1).

A. Clauses Permitted Under Article 85(1)

1. *Know-How and Assistance*

The Court held that under article 85(1) clauses do not restrict competition if they are essential to preventing the risk that the know-how and assistance transferred by the franchisor to the franchisee will aid the franchisor's competitors. These permitted clauses include:[28]

- An agreement by which the franchisee is prohibited from selling its shop without the prior approval of the franchisor. This obligation ensures the franchisor's right to choose franchisees whose commercial qualifications will maintain the reputation that the franchisor seeks to protect, and protects the franchisor against the risk that the know-how transferred to the franchisee will end up in the hands of a competitor.

---

25. The Court defined a service franchise agreement as one by which the franchisee offers services under the sign and trade name, or indeed the trademark, of the franchisor and complies with the franchisor's directives. *Pronuptia,* [1986] 1 Common Mkt. L.R. at 442.

26. The Court defined a production franchise agreement as one by which the franchisee manufactures, according to the franchisor's instructions, products that it sells under the franchisor's trademark. *Id.*

27. The debate as to whether the EEC competition rules should be applied under a rule of reason analysis is well beyond the scope of this article. Suffice it to say that Justice Joliet, the author of the *Pronuptia* decision, has advocated the theoretical and practical merits of a rule of reason approach for over twenty years. R. Joliet, The Rule of Reason in Anti-Trust Law (1966). For discussions of this ongoing debate, see, e.g., Forrester & Norall, *The Laicization of Community Law: Self-Help and the Rule of Reason: How Competition Law Is and Could Be Applied,* 21 Common Mkt. L. Rev. 11 (1984); Korah, *Pronuptia Franchising: The Marriage of Reason and the EEC Competition Rules,* 4 Eur. Intell. Prop. Rev. 99 (1986); Korah, *The Rise and Fall of Provisional Validity—The Need for a Rule of Reason in EEC Antitrust,* 3 NW. J. Int'l L. & Bus. 320 (1981).

28. *Pronuptia,* [1986] 1 Common Mkt. L.R. at 443.

- The prohibition for the duration of the franchise and for a reasonable period after its termination on the franchisee from opening a shop with an identical or similar purpose in an area where the franchisee would compete with one of the members of the network. This obligation will prevent the franchisee from competing with the franchisor or another franchisee in respect of products that compete with the contractual products.

The Court's ruling does not contain any indication as to the geographical area that could be covered by such a clause. One probably safely can assume that the entire geographical area of the franchise network could be covered by the clause. Thus, this noncompetition clause could cover the entire EEC.

As to the term of the noncompetition clause, the Court in its ruling is more lenient than the Commission has been in its recent block exemptions. Under Regulation 67/67, the block exemption for certain exclusive dealing agreements, the franchisees could require the distributor not to manufacture or distribute competing goods during the entire term of the exclusive distribution as well as for one year after its termination. Under Regulations 1983/83 and 1984/83, the block exemptions replacing Regulation 67/67, the validity of noncompetition clauses has been strictly limited to the duration of the distribution or purchasing agreement.

2. *Identity and Reputation*

The Court also held that clauses necessary to protect the identity and reputation of the network do not violate article 85(1). These permitted clauses include:[29]

- The obligation of the franchisee to use the know-how and assistance of the franchisor, and to apply the commercial methods perfected by the franchisor. This obligation is designed to assure the uniformity of quality necessary to maintain customer loyalty to the network.
- The franchisee's obligation to sell only the merchandise covered by the agreement. This obligation will also help effect consistency of quality throughout the franchise network.
- The franchisee's obligation to set up and decorate the premises according to the franchisor's specifications, which will guarantee a uniform image.
- The franchisee's obligation to locate the shop in a place that similarly conforms to the franchisor's specifications and the prohibition to relocate the shop without the franchisor's written approval, in order

29. *Id.* at 443–44.

to protect the image of the network (e.g., to open up a shop only in a wealthy or otherwise well-respected area).

- The prohibition against the franchisee's assigning the rights and obligations under the agreement without the consent of the franchisor. This prohibition is similar to that against selling the shop without the franchisor's prior approval.
- The franchisee's obligation to obtain prior approval from the franchisor in regard to advertising, provided that the approval relates only to the nature of the advertising. This obligation will further establish uniformity and consistency among the franchise operations, and will encourage customer loyalty and recognition of the trademark.

Additionally, the Court held that in cases in which it would be impractical for the franchisor to formulate objective quality specifications as to the merchandise to be sold (as in the case of fashion goods) and in cases in which the large number of franchisees would make any effective quality control far too expensive, the franchisor may require the franchisee to sell only products provided by the franchisor or suppliers selected by it. However, the agreement must not prohibit the franchisee from acquiring the contractual products from other franchisees.

B. Clauses Violative of Article 85(1)

1. *Market Division*

The Court determined that clauses restrict competition under article 85(1) if they attempt to divide the market between franchisor and franchisee or between two or more franchisees.[30] Thus, a clause effectively prohibiting the opening of a second shop by requiring the merchandise to be sold only at the location designated in the agreement violates article 85(1).[31] Such a clause must be distinguished from a noncompetition clause that prevents a franchisee from opening a business connected with a different franchise network. When the prohibition to open up a second shop is combined with one in which the franchisor guarantees the franchisee exclusive use of the trademark in a given area, both the franchisor and other franchisees are prohibited from competing with the franchisee in the area, thereby creating a market partitioning between the franchisor and franchisee or among franchisees. This type of market partitioning

30. *Id.* at 444–45.

31. Although the Court does not clearly so state in *Pronuptia*, it seems likely that contractual clauses prohibiting the franchise from opening a second shop are anticompetitive only if such restrictions are not limited to the contractual territory of the franchisee. Ordinarily, the radius encompassed by the operating franchise is small.

was held to be restrictive of competition under article 85(1) in an earlier Court of Justice decision.[32]

The Court appears to be retreating from its judgment in the "Maize Seed" case,[33] in which it ruled that, if neither the licensor nor the licensee would have entered into the agreement without the exclusive license, the license itself did not restrict competition and consequently did not violate article 85(1). In the "Maize Seed" case, however, which involved the licensing of plant breeders' rights, the technically sophisticated products and risky market situation were quite different than those in *Pronuptia.*

Even if the franchise agreement is between enterprises located in one EEC Member State, the Court ruled, the clause requiring the merchandise to be sold only at the designated location is capable of affecting trade between Member States since such clauses prevent franchisees from setting themselves up in another Member State. This statement appears to be the Court's most extreme interpretation of this essential criterion for the application of article 85(1).

2. *Price Fixing*

The Court also held that provisions that impair the franchisee's freedom to determine its own prices are restrictive of competition. Thus, resale price fixing clearly violates article 85(1).

The Court added, however, that the mere recommendation of prices by the franchisor does not restrict competition unless there has been a concerted practice between the franchisor and franchisee or among franchisees to fix prices.[34] Thus, a risk exists that if all franchisees follow the franchisor's "nonbinding" price recommendations, their actions could be regarded as a concerted practice. This risk is difficult to quantify, but at a minimum, the advisors of parties to EEC franchise agreements should ensure that the franchise agreements contain no clauses that organize or encourage the concerting of franchisees' practices with respect to prices. The Commission's past decision practice suggests that it is highly unlikely that such clauses could be exempted under article 85(3).

The Court also discussed whether the block exemption under Regulation 67/67 applies to distribution franchise agreements. Regulation 67/67 (currently replaced by Regulations 1983/83 and 1984/83) provides a block exemption from article 85(1) for exclusive distribution agreements. The Court distinguished distribution franchise agreements from exclusive

32. Consten and Grundig Verkaufs GmbH v. Commission, 1966 E. Comm. Ct. J. Rep. 299.

33. L.C. Nungesser KG v. Commission, 1982 E. Comm. Ct. J. Rep. 2015.

34. *Pronuptia,* [1986] 1 Common Mkt. L.R. at 445.

distribution agreements, noting that distribution agreements are defined by Regulation 67/67 by reference to exclusive supply or purchase, and not by reference to other elements such as the use of a trademark or uniform commercial methods, which are characteristic features of a franchise operation. Also, Regulation 67/67 encompasses only exclusive sale agreements and allows for the imposition of restrictions on only one party to the contract (the distributor) rather than on both parties, as is the case with franchise agreements. Thus, the Court held that Regulation 67/67 does not apply to distribution franchise agreements.[35]

III. The First Exemptions for Franchise Agreements Granted by the Commission under Article 85(3)

In response to the Court's *Pronuptia* decision, the Commission announced that it planned to issue by mid-1988 at the earliest a regulation conferring a block exemption under article 85(3) for certain franchise agreements. To comply with the legislation enabling the Commission to issue block exemptions, however, the Commission had first to develop its experience in the franchising field by issuing a number of individual decisions.[36]

Because the judgment of the Frankfurt Court of Appeals in *Pronuptia* threatened the enforceability of franchise agreements under EEC competition rules, major franchisors sought to clarify the enforceability of their franchise agreements. They notified them to the Commission, requesting an individual exemption under article 85(3) or a negative clearance from any application of article 85(1).[37] Facing this new inflow of notifications, the Commission on December 17, 1986 issued its first two decisions involving notified distribution franchise agreements and on July 13, 1987, issued a third.

A. Re Pronuptia

The first decision dealt once more with the Pronuptia franchise system. Needless to say, the Commission's *Re Pronuptia* decision was inspired by the principles established and guidance given by the Court of Justice in its earlier judgment.

To assess the Pronuptia franchise system, the Commission began with a careful analysis of the relevant products and markets.[38] The Commission

35. *Id.* at 446–47.

36. EEC Council, Regulation No. 19/65, J.O. Comm. Eur. (No. 36/533 (1965)), O.J. Eur. Comm. 35 (spec. ed. 1965–66).

37. Regulation 17, *supra* note 12, arts. 2, 4.

38. *Re Pronuptia, supra* note 3, ¶¶ 7–9, at 40.

confirmed that the clauses under review are not restrictions of competition if they (i) are indispensable "to prevent the know-how made available and the assistance given by Pronuptia from benefiting competitors" or (ii) "provide for the control essential to preserve the common identity and reputation of the network."[39] (The clauses of Pronuptia's franchise agreements were described above in the discussion of the Court's judgment.)

At the Commission's request, Pronuptia had amended its standard form franchise agreement by putting into writing certain rights that franchisees allegedly had in practice already, namely, the rights:

- to purchase Pronuptia products from other franchisees;
- to purchase goods not connected with the essential object of the franchise business from suppliers of their choice, subject to *ex post* qualitative review by the franchisor; and
- to set their own retail prices, with the prices circulated by the franchisor being only suggestions and the franchisees merely being recommended not to exceed the maximum prices quoted by the franchisor in advertising and promotions. Pronuptia had deleted the clause that had prohibited the franchisees from harming the brand image of the franchisor by their pricing levels.[40]

In its decision, the Commission focused on two main clauses of the Pronuptia agreements: those that address noncompetition and territorial protection.

1. *Noncompetition*

In the *Pronuptia* judgment the Court dealt with the compatibility of the noncompetition clause with article 85(1), but only in rather general terms. The Court had stated that a noncompetition clause could be accepted for a reasonable period of time after the termination or expiration of the agreement. In its decision, however, the Commission had to be more specific. The Commission cleared the clause that provided that the franchisee would not, directly or indirectly, during the term of the agreement and for *one year* after its expiration or termination, engage in any business in the same area or in any other area where the franchisee would be in competition with another Pronuptia outlet.

This clearance conforms with the provisions of the block exemption under former Regulation 67/67 dealing with exclusive distribution agreements, and is more generous than Regulations 1983/83 and 1984/83 (which

39. *Id.* ¶¶ 22–28, at 43–45.
40. *Id.* ¶ 12, at 41.

replaced Regulation 67/67), which allow no restrictions upon competition after expiration or termination of the underlying agreement.

The Commission's favorable approach, however, relies, at least in part, on the fact that the Pronuptia franchise agreements at issue provided that the franchisee could continue to carry on business in the allotted territory after the agreement had ended if the franchisee: (i) had exercised the franchise for more than ten years; (ii) had discharged its contractual obligations; and (iii) did not put the know-how and experience it had accumulated at the service of a competing network.[41]

2. *Territorial Protection*

Since the Court had warned that any form of market-sharing clearly violated article 85(1), the Commission had to decide whether to exempt under article 85(3) a limited form of territorial protection within the Pronuptia franchise system. The approval of such protection was essential for the further expansion of franchising within the EEC, since prospective franchisees would probably be unwilling to undertake the necessary investment and to pay a substantial initial fee to enter the franchise system if they were not provided with some protection against competition from other franchisees and the franchisor in the allotted territory.

As explained above, the territorial protection within the Pronuptia franchise network resulted from the combination of two clauses. The first clause involved the exclusivity granted to the franchisee to operate under the franchisor's name in a given sales area. The second clause contained the franchisee's obligation to carry on the franchise business exclusively from the premises approved for that purpose. The Commission scrutinized the advantages and the dangers of such protection under the criteria of article 85(3).

The Commission acknowledged that the intrabrand competition among franchisees or between franchisor and franchisees would be restricted as a consequence of the territorial protection granted to each franchisee. The Commission, however, weighed this restriction of intrabrand competition against the fact that the territorial exclusivity would actually increase interbrand competition among the other distributors of similar products.

This element of territorial protection can indeed enhance the strength of the franchise network when competing with other well-organized distribution networks. For example, the exclusivity clauses in the franchise agreement permit the franchisee to make confident forecasts of its future sales and enable the franchisor both to plan its production more effectively

41. *Id.* ¶ 11, at 41.

and to guarantee regular supplies of the products.[42] In this way, the Commission's approval of some degree of market protection could open up the market to new competitors. By the same token, the franchise system contributes to improving the production and distribution of the products concerned.

To be exempted by the Commission, however, the territorial protection must not be absolute. In the Pronuptia franchises, franchisees still compete with one another because they can sell to (i) any customer whether resident in the allotted territory or outside it and (ii) any other franchisee.[43] The fact that franchisees may freely buy and sell the products among themselves further guarantees a workable price competition among franchisees selling at different price levels in the respective Member States of the EEC. Moreover, since Pronuptia faces competition from a number of other manufacturers and suppliers in the EEC, Pronuptia does not have the possibility of eliminating competition for a substantial part of the products that are part of the relevant product market.[44]

The Commission finally determined that the franchise agreements would entail advantages for consumers. Through the franchise system, the consumers may benefit from a coherent distribution network offering uniform product quality and a comprehensive range of available articles and accessories.[45]

On the basis of the foregoing elements, the Commission granted Pronuptia an exemption from the application of article 85(1) until April 21, 1991.

B. Re Yves Rocher

In *Re Yves Rocher* the Commission exempted a system of distribution franchise agreements very similar to those underlying the Pronuptia franchise system. Because of this similarity, the *Re Yves Rocher* decision generally follows the same reasoning as the *Pronuptia* decision.

Yves Rocher has developed a well-known Franch franchise network that distributes beauty care products throughout the EEC and beyond. In its franchise agreements, Yves Rocher grants the franchisee an exclusive right within a defined area to use the franchisor's identifying marks and know-how with a view to selling its products through a retail outlet. The franchisor undertakes not to authorize third parties to open another Yves Rocher beauty center in that territory and not to establish such

42. *Id.* ¶ 34, at 46.
43. *Id.* ¶ 37, at 47.
44. *Id.*
45. *Id.* ¶ 35, at 46.

centers there itself. Yves Rocher reserves the right to sell its products to consumers by other means (in particular by mail order).[46]

With respect to noncompetition clauses, the Commission cleared the same provisions as it did in *Re Pronuptia*. Besides such provisions, the Yves Rocher agreements permitted the franchisee to acquire financial interests in the capital of a competitor of Yves Rocher, provided this investment does not involve the franchisee personally carrying on competing activities.[47]

As a result of comments by the Commission, Yves Rocher had deleted as of December 1, 1986, the resale price maintenance provisions (which were not applied in practice) contained in the first agreements concluded when its franchise network was originally set up. This deletion guaranteed each franchisee the freedom to set its own prices, merely taking into account the price recommendations of the franchisor.[48]

The agreements prohibited each franchisee from selling products even to other Yves Rocher franchisees. This provision also had been deleted as of December 1, 1986, as a result of comments by the Commission. Yves Rocher now authorizes in all agreements cross supplies, both national and transnational, between its franchisees.[49]

In *Re Yves Rocher* the Commission emphasized that, where any local advertising by the franchisee must be submitted for the prior approval of the franchisor, this approval may only concern the nature of the advertising and not the selling prices.[50]

As in *Re Pronuptia*, the Commission pointed out that the Yves Rocher franchise network resulted in a degree of market sharing between the franchisor and the franchisees or between franchisees, thereby restricting competition and violating article 85(1). The Commission, however, exempted (until January 14, 1992) the clauses establishing this territorial protection after an analysis of the merits of the franchise system under the criteria of article 85(3). The Commission, however, conditioned this exemption on the franchisor's submitting to the Commission each year its current recommended retail prices and prices payable by the franchisees in the Member States.[51]

C. Re Computerland

On July 13, 1987, the Commission granted yet a third individual exemption, for Computerland Europe SA's (CLE) distribution franchise

46. *Re Yves Rocher, supra* note 4, ¶ 19, at 51.
47. *Id.* ¶ 26, at 52.
48. *Id.* ¶ 30, at 53.
49. *Id.* ¶ 31, at 53.
50. *Id.* ¶ 44, at 55.
51. *Id.* art. 3, at 59.

network.[52] CLE is a 100 percent subsidiary of Computerland Corporation of California and has branches in several EEC Member States. Sales outlets in the EEC approximate seventy-five, with the largest numbers being in France, the United Kingdom, and the Federal Republic of Germany. Using the Computerland name, trademarks, and system, CLE franchisees sell to end-users numerous brands of microcomputer products (hardware, software, and peripheral products) and provide pre- and after-sales service and, usually, training facilities. CLE assists franchisees in setting up and running their stores, providing both commercial and technical know-how.

At the outset, the Commission emphasized that CLE is far from holding a dominant position in the Community or any Member State.[53] The notified standard form agreement includes the typical clauses with respect to the franchisee's (i) use of the franchisor's names, trademarks, and system, (ii) undertaking to devote its best efforts to the operation of the franchise, and (iii) financial obligations.

The CLE agreement's location clause, however, differs from the typical clauses found in the Yves Rocher and Pronuptia franchise agreements. The CLE franchisee must operate its store exclusively at the location approved in advance by the franchisor, but is not obliged to make "over-the-counter" sales. This provision means that customers do not actually have to buy the products in the store itself.

Each CLE franchisee location is surrounded by a "protected area" having a radius of less than one kilometer after the first year of the agreement (during the first year it is twice that distance), in which no other CLE outlet may be established. The protected area, however, is not one of marketing or clientele exclusivity. This means that in spite of the protected area, any franchisee can sell to any end-user customer wherever the customer resides or does business. A franchisee also can set up so-called "satellites," which offer showroom and selling facilities and may be inside or outside the "mother store's" protected area. For stocking, servicing, and operational support, however, such satellite outlets remain dependent on the mother store to which they are contractually linked.[54]

Since the CLE franchisees sell numerous brands of microcomputer products, franchisees are not obliged to purchase their requirements from CLE. They are permitted to purchase products, however, since CLE performs a central purchasing function. CLE leaves its franchisees free to determine their own resale prices, but franchisees may receive recommended resale price lists from their other sources of supply.

52. *Re Computerland*, *supra* note 5.
53. *Id.* ¶ 3, at 13.
54. *Id.* ¶ 7, at 14.

The noncompetition clauses of the CLE standard franchise agreement provide that during the term of the agreement the franchisee may not engage or have an interest in any business whose activities include the sale or service, at retail or wholesale level, of computer hardware, software, and related products and services offered by CLE stores. The franchisee must, however, remain free to invest in a competing enterprise, provided such investment does not enable it to effectively control such a business.

Under the agreement as notified, the above noncompetition obligation continued for three years at a given distance from the ex-franchisee's former outlet, for two years at a given distance from any CLE store, and for one year at any location. Following discussions with the Commission during the notification procedure, CLE conceded that a noncompetition obligation of one year within a radius of ten kilometers of the ex-franchisee's former outlet would be sufficient to safeguard the confidentiality of the know-how transmitted to the ex-franchisee during the term of the agreement. This protection would also be sufficient to allow a new CLE store to be established and start accumulating goodwill and clientele in the ex-franchisee's former zone of business activities.[55]

Based upon the revised franchise agreement developed by the Commission and CLE, the Commission issued a favorable decision on July 13, 1987. Thus, the Commission's decisions elaborated upon the Court's *Pronuptia* decision, and provided the first set of practical guidelines for franchising in the EEC.

IV. The Draft Block Exemption

Peter Sutherland, the EEC Competition Commissioner, who has repeatedly stressed the growing importance of franchising in the Community, disclosed in early 1987 the Commission's plans to issue a regulation conferring a block exemption under article 85(3) for certain franchise agreements. In a speech delivered on January 27, 1987, to the twenty-seventh annual convention of the International Franchise Association in Mexico, Sutherland stated:

> Franchising is a natural partner for the Common Market. It is based on the leverage which an established name or idea can give a relatively small investment to enable the product or service involved to spread quickly, far and wide. It makes products and services available to a wide public and does not stop at local or natural frontiers. . . . Economic growth, employment creation and consumer satisfaction are goals we all share. The development of the Common Market in Europe and new technologies and methods of selling goods and

55. *Id.* ¶ 12, at 15.

services should come together as a catalyst for industrial and commercial developments.[56]

The Commission already has made great progress with respect to such a block exemption. On August 27, 1987, the Commission published in the Official Journal of the European Communities a Draft Regulation (Draft Regulation) concerning the application of article 85(3) of the Treaty to "Categories of Franchising Agreements."[57] The Commission has solicited comments from interested parties and expects the Draft Regulation to be effective as of January 1, 1989.[58] Nevertheless, the history of the EEC Patent Licensing Regulation demonstrates that many years can pass between the first draft and the final regulation.[59]

Not surprisingly, the Commission favors European Economic Community-wide franchising agreements as a basic option. This means that, under such an agreement, all franchisees within the EEC will have access to and be able to use the "franchise package" in a similar way. It also means that franchisees must be treated equally throughout the EEC, and that consumers will find similar products throughout the EEC. The franchise agreement thus cannot be used to fragment the EEC market into several national markets under the auspices of business imperatives, unless such fragmentation can be justified with strong support. The unity of the EEC market must be preserved from territorial division and price-fixing.

A. Scope of the Draft Regulation

The Draft Regulation covers distribution and service franchises, but excludes manufacturing franchises. The parties to manufacturing franchises will have to continue to rely on individual notification and decisions, although some of them may be able to benefit from the block exemptions relating to patent[60] or know-how licenses[61] if they fulfill the conditions defined by those regulations.

---

56. Sutherland, *Franchise Agreements under EEC Competition Rules*, Address delivered during the Euro-Conferences in Brussels, March 25, 1986, at 3, *reprinted in* AGENCE EUROPE Jan. 29, 1987, at 10.

57. 30 O.J. EUR. COMM. (No. C 229) 3 (1987) [hereinafter Draft Regulation].

58. *Id.* art. 9.

59. The Proposal for a Commission Regulation on the Application of Article 85(3) of the Treaty to Certain Categories of Patent Licensing Agreements was issued in 1979 (22 O.J. EUR. COMM. (No. C 58) 12 (1979)), whereas the Patent Licensing Regulation was not effective until January 1, 1985. *See supra* note 24. Moreover, the Draft Regulation may be subject to additional revisions, because its present form has been criticized as, *inter alia*, "too restrictive," with economic tests that are "difficult to apply." *See, e.g.*, Clough, *Franchising in Europe Since the Pronuptia Case*, 11 EUR. INTELL. PROP. REV. 317, 326 (1987).

60. Patent Licensing Regulation, *supra* note 24.

61. EEC Commission, Draft Regulation on the Application of Article 85(3) of the Treaty

Article 1 of the Draft Regulation defines a franchising agreement as an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for financial consideration, the right to exploit a franchise for the purpose of marketing determined goods or services. A "franchise" is defined as a package of intangible 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. Further, a franchise must include at least (i) the use of a common name or sign and a uniform presentation of contract premises, (ii) communication by the franchisor to the franchisee of substantial know-how capable of conferring a competitive advantage on the latter, and (iii) continuous provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement. Finally, "know-how" is defined as nonpatented practical knowledge[62] relating to the sale of goods or the provision of services to end users, and in particular, to the presentation of goods for sale, the processing of goods in connection with the provision of services, methods of dealing with customers, and administration and financial management. The Draft Regulation also includes master franchise agreements.

The form of the Draft Regulation is patterned on the Patent Licensing Regulation.[63] Thus, the Draft Regulation distinguishes three groups of clauses: (i) the "permitted list," consisting of clauses that may infringe article 85(1) but are exempted; (ii) the "white list," including clauses that are common to franchises, but generally do not infringe article 85(1) and are worthy of exemption in those cases in which they do; and (iii) the "black list," describing clauses that generally restrict competition and will prevent the granting of a block exemption under the Draft Regulation. Franchise agreements that contain clauses described only in the "permitted list" or the "white list" and none included in the "black list" are automatically exempted from article 85(1) of the Treaty (assuming the conditions of article 4 are met as described below). As such, these agreements need not be notified to the Commission.[64]

---

to Certain Categories of Know-how Licensing Agreements, 30 O.J. EUR. COMM. (No. C 214) 2 (1987) [hereinafter Draft Know-how Regulation]. The Commission anticipates that the Draft Know-how Regulation will be effective as of July 1, 1988.

62. The Draft Know-how Regulation defines know-how as nonpatented "technical information." *Id.* ¶ 2.

63. For a discussion of the Patent Licensing Regulation, see generally Coleman & Schmitz, *The EEC Patent Licensing Regulation—Practical Guidelines*, 42 BUS. LAW. 101 (1986).

64. The Draft Regulation, however, exempts a franchise agreement only from art. 85(1); art. 86 and its prohibition against abuses of a dominant position still apply to franchise agreements.

B. Permissible Clauses

The "permitted list" of clauses that may infringe article 85(1), but which are exempted, is in article 2 of the Draft Regulation and consists of four permitted restrictions on competition.[65] First, limited territorial protection to the franchisee is permitted by restricting a franchisor from licensing all or part of the franchise to third parties or from exploiting, itself, the franchise in the contract territory. Such limited territorial protection, which grants the franchisee exclusivity within the contract territory, is indispensable to protect the franchisee's investment and to guarantee that it will concentrate its activity on the contract territory. Second, the "permitted list" also includes a location clause, an obligation on the franchisee to exploit the franchise only from the contract premises. Third, the franchisee may be required to sell the franchised goods only to end users or other franchisees. Finally, the franchisee may be prohibited from selling competing goods in the franchised territory or in territories allocated to other members of the franchise network.

Article 3 includes the "white list"—a nonexhaustive[66] list of the following fourteen obligations that are common to franchise agreements but not restrictive of competition:[67]

- an obligation on the franchisee to sell exclusively goods matching minimum objective quality specifications laid down by the franchisor, insofar as necessary to protect the franchisor's know-how or to maintain the common identity and reputation of the franchisor's know-how or to maintain the common identity and reputation of the franchised network;
- an obligation on the franchisee to purchase the goods exclusively from the franchisor or third parties designated by it, but only if necessary to protect the franchisor's know-how or to maintain the common identity and reputation and only for products for which it is impracticable to formulate objective quality specifications; only clauses 1 and 2 require that the restrictions be necessary to protect the franchisor's know-how or to maintain the common identity and reputation;
- a prohibition on the franchisee from engaging, directly or indirectly, in any similar business in a territory where it would compete with a member of the franchised network; thus, if the franchised network included all of the EEC,

65. Because the following four clauses are in the order listed in art. 2 of the Draft Regulation, citations have been omitted.

66. Draft Regulation, *supra* note 57, recital 11. A list of additional clauses that are common to franchise agreements but generally not restrictive of competition can be found in *Re Computerland*, *supra* note 5, ¶ 24, at 19.

67. Because the following fourteen obligations are in the order listed alphabetically in art. 3 of the Draft Regulation, citations have been omitted.

this noncompetition clause could cover the entire EEC; however, unlike the Court's *Pronuptia* decision[68] and the Commission's three individual franchising decisions,[69] all of which permitted a noncompetition restriction for the term of the franchise agreement plus one year after its termination, the Draft Regulation limits the noncompetition restriction to the term of the agreement;

- a prohibition on the franchisee from using, during the life of the agreement and after its termination, the know-how and intellectual property rights licensed by the franchisor for the exploitation of the franchise; such prohibition must expire, however, when the know-how no longer confers a competitive advantage to the franchisee;
- a prohibition on the franchisee, during the life of the agreement and after its termination, from disclosing the know-how provided by the franchisor, and an obligation to impose the same restriction on its staff; clauses 4 and 5 are intended to prevent the know-how and assistance provided by the franchisor from benefiting competitors;
- an obligation on the franchisee to inform the franchisor of infringements on the licensed intellectual property rights, to take legal action against infringers, or to assist the franchisor in any legal actions against infringers; however, this obligation cannot prevent the franchisee from challenging the validity of the intellectual property rights that form part of the franchise;
- an obligation on the franchisee to attend or have its staff attend training courses arranged by the franchisor;
- an obligation on the franchisee to use its best endeavors to sell the goods or provide the services that are the subject of the franchise, achieve a minimum gross revenue, plan its orders in advance, keep minimum stocks, and provide customer and warranty services;
- an obligation on the franchisee to pay to the franchisor a specified proportion of its revenue for advertising and obtain the franchisor's approval for the advertising it carries out itself; this obligation encourages trademark recognition and customer loyalty;
- an obligation on the franchisee to apply the commercial method devised by the franchisor and use the licensed know-how, trademarks, and signs;
- an obligation on the franchisee to comply with the franchisor's standards for the equipment and general appearance of the contract premises; clauses 10 and 11 can be used to protect the identity and reputation of the network and guarantee a uniform image;
- an obligation on the franchisee to comply with the franchisor's standards for the equipment and general appearance of the contract premises; clauses 10 and 11 can be used to protect the identity and reputation of the network and guarantee a uniform image;
- an obligation on the franchisee to allow the franchisor to carry out checks on its inventory, accounts, and contract premises;

68. *Pronuptia*, [1986] 1 Common Mkt. L.R. at 443.

69. *Re Pronuptia, supra* note 3, ¶ 25(i), at 44; *Re Yves Rocher, supra* note 4, ¶ 48, at 56; *Re Computerland, supra* note 5, ¶ 12, at 15, ¶ 22(ii), at 17.

- a prohibition on the franchisee from changing the location of the contract premises without the franchisor's consent; and
- a prohibition on the franchisee from assigning the rights and obligations under the franchise agreement without the franchisor's consent; the last two clauses are intended to protect the image and the quality reputation of the network and to prevent the know-how provided by the franchisor from benefiting competition.[70]

These "white clauses" are generally not restrictive of competition, but if, because of particular circumstances, any of them (e.g., the noncompetition clause) do fall within article 85(1), they still are exempted.[71]

As stated above, franchise agreements that contain clauses described only in the "permitted list" or the "white list" and none included in the "black list" are automatically exempted from article 85(1) of the Treaty. Article 4 of the Draft Regulation, however, states that the block exemption applies only if four conditions are met.[72]

The first condition is that interfranchisee sales must be possible, or if the franchise network is combined with a selective distribution system, the franchisee must be free to obtain goods from approved distributors. This possibility of parallel imports (i) guarantees a workable price competition among franchisees selling at different price levels in the respective Member States of the EEC, (ii) prevents the elimination of competition for a substantial part of the franchised products, and (iii) prevents the territorial protection of the franchisees from becoming absolute.[73]

The second condition states that if the franchisor obliges the franchisee to honor guarantees for the products that are the subject of the franchise, this obligation must also apply to such products supplied by other franchisees. This condition is a fairness requirement, ensuring that all consumers receive a fair share of the resulting benefits.

Third, even if franchisees can be prohibited from competing with the franchisor,[74] they must always remain free to invest in competing com-

---

70. The last three clauses also must be read in conjunction with art. 8(d) of the Draft Regulation, which permits the Commission to withdraw the block exemption if the franchisor exercises its rights under those three clauses for reasons other than to verify that the franchisor abides by its obligations under the agreement.

71. Draft Regulation, *supra* note 57, art. 3(2).

72. Because the following four conditions are in order listed in art. 4 of the Draft Regulation, citations have been omitted.

73. Limited territorial protection is permitted pursuant to the Draft Regulation, *supra* note 57, art. 2(a).

74. Certain noncompetition clauses are permitted pursuant to *id.* arts. 3(c), (d).

panies when they are not involved personally in carrying on competing activities, in particular, when they do not have control or are not a member of the governing board.

The last condition states that the parties must describe in the contract or any related document, in as much detail as possible, the know-how and other rights that are the subject of the franchise.[75]

C. Impermissible Clauses

The "black list" of article 5 enumerates six clauses or circumstances that will prevent the Draft Regulation's exemption from applying to the franchise agreement, namely when:[76]

- manufacturers of identical or equivalent goods enter into reciprocal franchising agreements for the distribution of such goods; this prohibition on reciprocal franchising agreements is intended to prevent market division by manufacturers or distributors of similar goods;
- the franchisee is prohibited from obtaining supplies of goods of equivalent value to those offered by the franchisor, for reasons other than protecting the franchisor's know-how or maintaining the common identity and reputation of the franchise network;
- the franchisee is obliged to sell goods manufactured by the franchisor or designated third parties, and the franchisor refuses, without objectively valid reasons, to designate third parties proposed by the franchisee;
- the franchisee is restricted, directly or indirectly, from determining the resale prices for the products or services that are the subject of the franchise; this resale price maintenance clause is one of the main obstacles for the application of the exemption; specifically, Commissioner Sutherland has stated that "price competition should not only never be excluded, but should be safeguarded as much as possible";[77] nonetheless, based upon *Pronuptia,*[78] *Re Pronuptia,*[79] and *Re Yves Rocher,*[80] retail price recommendations or suggestions may be permitted, unless the franchisor and franchisee, by concerted practice, fix resale prices based upon such recommendations or suggestions;
- the franchisee is prohibited from challenging the validity of the intellectual property rights that form part of the franchise; this impermissible clause is in the "black list" of the Patent Licensing Regulation, which also provides, however, that the licensor may retain the right to terminate the licensing agreement in the event of such a challenge;[81] and

75. This requirement appears less onerous than the one imposed in art. 1(3) of the Draft Know-How Regulation, which requires that the parties not only describe the transferred know-how in detail but also maintain detailed records of any subsequent improvements thereto.

76. Because the following six clauses or circumstances are in the order listed in art. 5 of the Draft Regulation, citations have been omitted.

77. Sutherland, *supra* note 56, at 3.

78. *Pronuptia,* [1986] 1 Comm. Mkt. L.R. at 445.

79. *Re Pronuptia, supra* note 3, ¶ 26, at 44.

80. *Re Yves Rocher, supra* note 4, ¶ 51, at 57.

- one or both of the parties is prohibited from supplying the products or services to end users because of their place of residence; such a clause is not exempt because it would contribute to an absolute territorial protection of the franchisees when added to the limited territorial protection clause.[82]

If a franchise agreement that may restrict or distort competition within the EEC includes any clause from the "black list," the agreement must be notified to the Commission by filing Form A/B (which has been revised as of January 1, 1986[83]) with the Commission's Directorate of Competition in Brussels, Belgium.[84] The Commission will review the agreement to determine if it infringes article 85(1). If so, the Commission will decide whether the agreement qualifies for an article 85(3) exemption. Based upon Commission and Court decisions, however, any clause on the "black list" will likely be found to violate article 85(1) and will probably not qualify for an article 85(3) exemption. Thus, every effort should be made to avoid the inclusion in franchise agreements of clauses included in the "black list" unless the *De Minimis* exemption is applicable, or the risks of doing so have been carefully weighed.

D. Procedure

Article 6 provides for an "opposition procedure," which was first included in the Patent Licensing Regulation.[85] Pursuant to this procedure, the exemption may be extended to franchise agreements containing restrictions of competition that are not in the "permitted list" or the "white list" but do not fall within the "black list," provided that the agreement is notified to the Commission on Form A/B. The information provided to the Commission must be complete, and the notification must refer expressly to this article of the Draft Regulation. If the Commission raises no objection within six months, the notified agreement will receive an automatic exemption.

81. Patent Licensing Regulation, *supra* note 24, art. 3(1).
82. Limited territorial protection is permitted pursuant to the Draft Regulation, *supra* note 57, art. 2(a).
83. EEC Commission, Regulation No. 2526/85, 28 O.J. Eur. Comm. (No. L 240) 1 (1985).
84. For a good discussion of Community competition procedure, see C. Kerse, EEC Antitrust Procedure (2d ed. 1988) (updated with supplements).
85. Patent Licensing Regulation, *supra* note 24, art. 4.

The Member States will receive a copy of the notification, and the Commission is required to oppose an exemption if it receives a request from a Member State within three months after the notification copy is sent to the Member States.

The Commission may withdraw its opposition at any time, but if the exemption is being opposed upon request of a Member State, the Commission's opposition may be withdrawn only after consultation with the Advisory Committee on Restrictive Practices and Dominant Positions.[86] If the Commission withdraws its opposition because it concludes that the original agreement fulfills the requirements of article 85(3), then the exemption is effective from the date of notification. If its opposition is withdrawn based upon the parties' amendment to the agreement, however, the exemption dates only from the date upon which the amendment was effective.[87] If the Commission fails to withdraw its opposition, the provisions of Regulation 17 shall govern the effects of the notification.

Even though the Draft Regulation grants a blanket exemption to a group of agreements, the Commission has reserved the power to withdraw such an exemption in certain situations. Article 8 outlines such cases, which are those in which access to, or competition within, a particular market is substantially restricted. In particular, the Commission may withdraw an exemption if territorial protection is awarded to the franchisee and:[88]

- access to the relevant market is difficult because of the cumulative effect of franchise networks created by competing manufacturers or distributors;
- the franchise products or services do not face, within the contract territory, effective competition from identical goods or goods considered as equivalent by the users;
- the parties prevent the end users from obtaining the franchise goods and services because of their place of residence;
- the franchisor uses its right to check the franchisee's inventory and accounts, or refuses its agreement to requests by the franchisee to move the contract premises or assign his rights and obligations under the franchise agreement, for reasons other than verifying that the franchisee abides by its obligations under the agreement.

E. Effective Date

Finally, the Draft Regulation is intended to enter into force on January 1, 1989, for an initial term of eleven years.[89]

86. Draft Regulation, *supra* note 57, art. 6(6).
87. *Id.* arts. 6(7), 6(8).
88. Because the following four circumstances are in the order listed in art. 8 of the Draft Regulation, citations have been omitted.
89. Draft Regulation, *supra* note 57, art. 9.

V. Conclusion

The Court's *Pronuptia* decision provided an important first step toward the clarification of the legality of franchise agreements within the EEC. The Commission provided further clarification in its decisions addressing the Yves Rocher, Pronuptia, and Computerland franchise networks. The Draft Regulation advances the certainty as to the compatibility of franchise agreements with EEC law, yet another step. Together these Court and Commission actions have provided the first set of guidelines for parties franchising within the EEC.

Clearly, these first decisions of the Court and the Commission and the Draft Regulation have met the expectations of franchisors as to the future of their business involvement within the EEC, especially with respect to the territorial protection granted to each franchisee. These developments should be heartening to those in the franchise field, as well as to the consumers located in the EEC.