

**Re: Proposal from the EU Commission on the draft revised Regulation on vertical agreements and vertical guidelines - proposal C(2021) 5026 final e C(2021) 5038 final – observations from Assofranchising**

Dear Sirs/Madams,

on behalf of its members, Assofranchising (AIF) is grateful for the opportunity to submit to the European Commission its observations and proposals in relation to the draft revised Regulation on vertical agreements ("VBER") and vertical guidelines ("VGL") (hereinafter also simply "Drafts").

AIF is the association representing the largest number of franchising networks in Italy including the major brands and is an historic active member of the European Franchise Federation EFF (European Franchise Federation).

**Preamble - adherence to the observations of EFF**

AIF adheres to and endorses observations and proposals that EFF has submitted to the European Commission on the Drafts and therefore, from this point of view, AIF also reiterates here its strong opposition to the proposed new discipline of "Dual distribution" situations contained in art. 2.4 and 2.5. VBER, the non-alignment of the definition of "know-how" contained in the VBER with the provisions of Directive no. 2016/943, for not having clarified in art. \_\_\_\_ of the VBER that the post-contractual non-competition clauses can be extended beyond the distributor's premises including the exclusive allocation area, where foreseen by the parties, and, finally, the lack of greater flexibility in using fixed price assumptions (RPM).

As done in the previous phases of this long consultation process, AIF intends with this document to add considerations and present examples describing the Italian legal and economic context to the Commission with specific reference to the peculiarities of the distribution systems based on the franchising formula.

**Dual distribution**

As far as the dual distribution is concerned, AIF - on the one hand - endorses proposals set out in point 1 of the observations expressed by EFF and, on the other hand, in support of those proposals, add the following observations related to the Italian market.

1) According to the data collected by AIF among its members for the year 2020 in Italy franchising networks having at least one direct point of sale represent a higher percentage than the estimates provided at European level by EFF, i.e. they are about 72%. According to the same data, the percentage of networks having a number of direct points of sale between 5% and 50% of the total points of sale are more than 50% and, finally, networks reporting a percentage of direct points of sale more than 50% of the total number of outlets are around 17%.

2) The higher percentage of networks with at least one direct point of sale compared to the European average estimated by EFF is partly related to the fact that in the national law on franchising (Law 6 May 204 n.129) it is provided that for the establishment of a franchise network the franchisor "*must have tested his formula on the market*" (art. 3). This specific statutory provision, therefore, means that new franchisors often open and manage (at least) a direct sales point both before the launch of a new franchising network and during its management.

3) The greater percentage of franchising networks running more than one direct point of sale compared to the European average is also a consequence of the peculiarities of the Italian market. In Italy, indeed, preferences and needs of consumers in many sectors change considerably not only from north to south of the Country, but also between regions and often also between provinces. This high fragmentation of the preferences of consumers living in different geographical areas creates in some sectors, especially in the apparel and food ones, a very marked fragmentation of the relevant markets in a geographical sense and has prompted many franchisors to open direct stores in several areas of the Country to better intercept preferences of local consumers and so guarantee its affiliates in different areas of Italy not only effective and constant assistance, but also the possibility of organizing promotional and advertising campaigns targeted on the preferences of local consumers.

In the Italian scenario, therefore, the new rules set out in paragraphs 4 and 5 of art. 2 VBER are likely to have a very significant impact on franchise networks and, as far as networks created by SMEs are concerned, they will result in extra costs, the part of which that cannot be passed-on downstream to final consumers will jeopardise the economic sustainability of this distribution model which has contributed and contributes nowadays in making many sectors of the national economy highly competitive at the local level.

4) A systematic and detailed exchange of information between franchisors and their franchisees is an essential element of franchise agreements, so much that at European level, in the Draft Common Frame of Reference (DCFR) have been included various provisions according to which throughout the contractual relationship the franchisor is due to actively and closely cooperate with its franchisees in order to provide ongoing technical advice and commercial assistance. This cooperation is possible only with a constant and updated transfer of know-how which is the basis of the success of every franchise network. In this regard we highlight the following provisions “*franchisor must provide the franchisee with the know-how which is necessary to operate the franchise business*” (Chap IV.E – Franchising, Section 2, 4:202:know-how) and “*The obligation to inform requires the franchisor in particular to provide the franchisee with information concerning: (a) market conditions; (b) commercial results of the franchise network; (c) characteristics of the products; (d) prices and terms for the supply of products; (e) any recommended prices and terms for the re-supply of products to customers; (f) relevant communication between the franchisor and customers in the territory; and (g) advertising campaigns.*” (Chap IV.E, Section 2, 4:205: Information by franchisor during the performance).

The centrality in franchise contracts of assistance and technical and / or commercial advice from franchisor to franchisee, for which the exchange of information is a necessary corollary, has been recognized both in the case law of the European Court of Justice (see §16 of Pronuptia case, C-161/84, “*franchisor must be able to communicate his know-how to the franchisees and provide them with the necessary assistance in order to enable them to apply his methods*” and by leading authors across Europe.

On this point, it seems useful for the debate to recall what was written by a leading author who highlights that the assistance and advice given by the franchisor to franchisees finds its “*raison d’être*” in the franchise formula and this because, among other things, “*it constitutes an help to the franchisee both for his inexperience and for the difficulties he will encounter when entering a new market (with reference to both a new product or service and a new market in a geographical sense).* [moreover] *the obligation in question is required by the need to adapt the formula to the peculiarities of the customers reached by the franchisee: in fact, if on the one hand the formula must remain unitary, constant and recognizable, on the other hand it could not be mechanically and rigidly exported to other latitudes precisely because of local tastes and needs. Know-how (as the result of experience, trials, tests) is not a static notion: these in fact can lead to the placing on the market of new models (e.g. for cars, clothing), to restyling of old ones, to abandon products that no longer meet the public's favor, to expand the assortment to complete the range, to narrow it to gain in*

*specialization, to different packaging or product presentation* "(A FRIGNANI – M TORSELLO, *Il contratto internazionale, diritto comparato e prassi commerciale* – 2° ed. in *Trattato di Diritto Commerciale e di Diritto Pubblico dell'Economia* - XII vol. (diretto da F. GALGANO), CEDAM, 2010, p. 686).

In order to maintain an efficient franchise distribution system and, therefore, to keep alive and concrete the benefits that consumers enjoy from it in terms of greater competition and availability of new products and services, it is essential that the franchisor constantly has precise commercial data generated in each point of sale, data which lead to a constant updating of the “know-how” that the franchisor transmits to all its franchisees.

5) In franchise contracts, the constant and detailed exchange of information between franchisors and its franchisees is also an essential element for maintaining the common business format and identity of the network bearing his “business name or symbol”.

It is therefore more than likely that the new rules set out in paragraphs 4 and 5 of art. 2 VBERs will also have a very negative effect in this respect. In areas where franchisor will not be able to operate a disaggregated and constant exchange of commercial data with its franchisees due to the 10% threshold being exceeded, in fact, it will not be able to propose the same initiatives and promotional campaigns to the franchisees or it will be able to do so without the knowledge of some very important data. This will place the franchisor in front of a very difficult choice in terms of network unity. Or on the one hand it accepts that only a part of its network successfully develops and implements some initiatives thus renouncing to have a true uniform service standard (but this would distort the essence of franchising) or, more realistically, in order to maintain the unity of the network and common service standard, franchisor will study and apply solutions that, from consumer prospective, are sub-optimal and which, therefore, will weaken the capacity of the network to be competitive in the medium-long term.

#### Examples of exchange of information

In order to lead the EU Commission better understands how central and vital is a constant and detailed vertical exchange of information between franchisors and its franchisees, AIF also elaborates below some considerations and operational examples.

First of all, it should be noted that the most crucial information for an efficient management of a franchising network is the sharing of the following updated and disaggregated data by point of sale.

- a) Turnover generated by the franchisee divided between the different products and services offered;
- b) Type of products / services sold by the franchisee with specification of sales prices;
- c) Inventory of each individual stores
- d) Information on customers of the franchisee:
  - i. Type: company or private;
  - ii. Purchased volumes;
  - iii. Type of products / services purchased;
  - iv. Product rotation.

In an economy where online and offline channels of communication blend each other, access to and exchange of data in real time is also a vital component for the functioning of the promotion nowadays and allow franchise networks to compete vigorously between brands. Targeted

promotional campaigns in particular can be appropriately planned and launched only by evaluating the numbers and types of individual operations at the store level.

Please find hereinafter some concrete examples that AIF, like EFF, will be glad to discuss with the Commission officers.

- Example 1 - Shipping of wine to the United States

Following the exchange of information between a franchisor and its franchisees, it has been possible to gain awareness of a specific market need (and, in particular, of the market of some regions of Italy): offering wine shipping services, in particular to the United States, to foreign tourists who are on vacation in Italy. A special service was thus created (from the methods of packaging the bottles, up to the management of administrative / customs formalities) so that franchisees are now able to offer this service to foreign customers on holiday in Italy and who would like to buy wine in Italy and subsequently ship it to the States. United States is a country with complex regulations for importing such products.

To sum up, the detailed exchange of information has allowed the franchisor to create, test and operate an additional service that has found the appreciation of consumers, who have thus been able to satisfy the need to be able to safely receive in the USA what is appreciated during their holidays.

- Example 2 - "Pick-up" service ancillary to shipping and addressing to "business" customers

Following the exchange of information between a franchisor and its individual franchisees, the franchisor understood how some customers (companies) could hardly manage also the delivery of their packages / parcels to the premises of the franchisees, so that they later take care of the shipment. It was therefore decided to offer, in addition to the pure and simple shipping service, a collection service ("pick-up") of the package / parcel from business customers. This further possibility (together with other factors), has allowed - in the long term - the network to change its "business model" from "retail" to "business model" strongly oriented towards customers represented by small-medium enterprises (which are very common in Italy, so that today they represent most of the customers of the franchisees). The parcel / parcel pick-up service was then extended to consumers as well.

In summary, in the example the exchange of information was the driving force behind a successful expansion of a franchise network which, by studying the disaggregated data in depth, was able to effectively study a plan to enter a new market (business sector) and subsequently to transfer the acquired know-how also in the services provided to consumers.

- Example 3 - "click & collect" service

By means of "click & collect" service, customers can order products online and choose to collect them in a shop. This way of delivery, has proved to be very popular, both among consumers and among franchisees:

- By consumers because it combines convenience of online shopping with substantial savings for them due to the absence of shipping costs, especially for purchases of small quantities of product;
- from franchisees as they have the opportunity to earn from online purchases made by customers living in their area and to increase in-store sales, for example through additional purchases or as customers, who have purchased online, become clients of the physical store,

The click and collect delivery can only be effectively implemented by knowing the availability of the products in the franchisee's warehouse.

If the Commission's proposal on "dual distribution" will be maintained without adopting changes proposed by EFF, it will happen that in relevant markets where the market share of the franchisor and franchisee exceeds 10%, it will not be possible to substantially continue to offer an efficient service of "click & collect" in the terms described above; all this to the evident detriment not only of the franchisees, but above all of the local consumers who will see disappear the possibility of a much appreciated purchasing method, especially for expenses of limited amount.

- Example 4 - *exchange of information for the management of PV stocks in the clothing sector*

A further example of how the exchange of information is essential for a franchise network is the management of the supplies of the points of sale of the network and of product stocks.

For several years, most franchisors have implemented ad hoc IT systems which, through a real-time and detailed exchange of sales data made in individual stores, allow them to organize a supply and inventory management system capable of optimizing management of a critical aspect for every entrepreneurial activity.

The current information exchange carried out through the aforementioned informatic tools, in fact, generates an efficiency advantages that are beneficial not only for the franchisors, but represents a significant advantage for the franchisees also as (i) it reduces problems of over-stocking of some products, (ii) it significantly decreases the direct and indirect costs given that through a computer system for real-time exchange of stock data, the PV can maintain a warehouse in some cases very small and, finally, (iii) the timely supply of the most requested products in the local market in which the franchisee operates.

Furthermore, also consumers in the final analysis take advantages from these benefits, as they can count on the timely availability in all the shops of the network of those products that meet their preferences the most in a given period and area.

- Example 5 - *exchange of information aimed at providing additional services or other facilities to customers*

In recent years, more and more franchise networks offer their customers the possibility of returning the product at any point of sale belonging to the network.

This service is appreciated by consumers because it is perceived as an obvious convenience. It also generates concrete benefits for franchisees as (i) it is a further opportunity for visibility of the point of sale as well as (ii) in the return phase they can propose further purchases.

Another important aspect is the one related to the management of loyalty cards, which allow customers to accumulate points every time they make a purchase in any point of sale of the network and can then be used by the customer to obtain rewards or discounts on the purchase of other products, even in different stores, as long as they belong to the same network.

In both cases, this is possible thanks to the implementation of complex IT systems that are essentially based on the availability by the franchisor of the disaggregated sales data relating to each point of sale in the network also in order to allow the franchisor to carry out correct and timely compensation also for tax purposes.

## **Know-how**

Also with reference to the choice made by the Commission to keep the definition of "know-how" unchanged, AIF endorses the requests of EFF to align it with the definition contained in Directive (EU) no. 2016/943. In this regard AIF intends to add the following observations.

Maintaining as a condition the fact that the know-how is "substantial" constitutes greater severity towards commercial know-how compared to technical know-how which traditionally falls within the notion of secrecy commonly identified as an independent industrial property right.

While recognizing the extreme importance of know-how, as an essential element of franchising contracts, the substantive requirement, if interpreted in an excessively rigid way, risks restricting its scope of protection and creating uncertainty of interpretation on the part of national courts, especially in cases where the franchisor asks for the protection provided for trade secrets against former members of the network who, despite the termination of the contract, continue to use the know-how transmitted to them by the franchisor during the contractual relationship.



Due to the complexity of the examples and concerns raised in this paper, AIF will be grateful if it could be allowed together with EFF to discuss with EU Commission and investigate in greater detail consequences on the franchise business model in Italy of the new rules set out in the Drafts.

Your faithfully.

Assofranchising