

Amendment of the Vertical-BER 330/2010

Submission by EuroFranchise Lawyers

Introduction

We are submitting our opinion on proposed amendments to Vertical-BER 330/2010 on behalf of EuroFranchise Lawyers which is a grouping of the leading franchise lawyers in Europe (which, for this purpose includes Ukraine, Russia and Turkey). Please let us know if you would like us to provide you with a full list of our members. Our group only selects for membership the leading franchise lawyers (Spain, Germany and the United Kingdom have two members) in each jurisdiction and accordingly the views set out in this opinion reflect the views of lawyers with very substantial knowledge of the practical and legal aspects of franchising. The group asked two of its members, Dr Karsten Metzloff (email: Karsten.Metzloff@noerr.com) and Martine de Koning (email: martine.de.koning@kvdl.com) to be the lead on this project and either of them would be very happy to respond to any issues or questions you may have or, alternatively, please contact me, John Pratt (email: john.pratt@hplaw.co.uk) in my capacity as Chair of EuroFranchise Lawyers.

1. Know-how-Definition in Art. 1 V-BER

„Know-how’ means a package of non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified: in this context, ‘secret’ means that the know-how is not generally known or easily accessible; ‘substantial’ means that the know-how is significant and useful to the buyer for the use, sale or resale of the contract goods or services; ‘identified’ means that the know-how is described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality;

The definition of ‘substantial’ (know-how must only be significant and useful to the franchisee for the use, sale or resale of the contract goods or services) creates no problem in practice.

However, still problematic is the definition of ‘secret’ which means that the know-how must not generally be known or easily accessible. ‘

-) This is because many parts of the franchisor's experience and even instructions for action on a procedure used in the franchise system are often freely available to the public. This is all the more true when the Internet is included ("ubiquity of knowledge"). In fact, then only the combination of the individual elements or the concrete implementation in the franchise system can be considered as „secret“.
-) In practice, this uncertainty as to whether the know-how in question is "secret" and thus protectable has led to a plethora of legal disputes and disputes with retired franchisees and third party imitators. It is difficult for judges to assess the commercial value of franchisors' operations manuals and confidential information. It does not seem helpful to have any subjective value assessment of the information that franchisors provide.
-) Since the existence and licensing of know how is a justification in competition law for certain contractual restrictions, the question arises whether the link between know how and the validity of these restrictions is still justified, In light of ECJ Pronuptia, this may not be up for evaluation and revision in the context of the V-BER review.
 - **Suggestions:** Recommendation to understand the term "secret" to mean that the specific type of combination of known individual elements/information may also constitute secret know-how.
 - See also the definition of „secret“ in Art. 2 Nr. 1 lit. a) VO (EU) 2016/945 (Know-How Directive)
 - Necessity to align definitions in Art. 2 Nr. 1 lit. a) VO (EU) 2016/945 (Know-How Directive) and Art. 1 of V-BER.
-) Necessity for **examples** of cases to be described within the future guidelines where valid know-how can be assumed.

2. Market Share Threshold (Art. 3)

According to Article 3 of the V-BER, it is required that neither the franchisor nor the franchisee has a market share of 30% or more on the affected markets. Thus, the market share of both the franchisor and the franchisee is decisive for the application of the V-BER. Only if a market share of 30% is not exceeded, the V-BER exempts restrictions of competition not listed in Article 4 (hard-core restrictions) or Article 5 (non-compete obligations subject to certain conditions) block exempted.

-) **Definition of the relevant market:**
 - The determination of the affected market is still a problem for small and medium-sized systems.
 - The majority of (small and large) franchisors face also difficulties in identifying the market shares concerned.

- Especially in the initial phase, small and medium franchisors are not in a position, either financially or in terms of their resources, to make the necessary determinations themselves or with the help of third parties
- For some restrictions, the question arises why franchise systems are not categorically exempted, e.g. regardless of the market share (or existence and licensing of know how, see above). For example, most franchise contracts with a duration of more than 5 years establish the obligation for the franchisee to buy 100% of their supplies from the franchisor or suppliers approved by the franchisor. Even though we think that this restriction is permitted for the duration of the franchise agreement in view of ECJ Pronuptia we encounter parties in the market who argue that after 5 years, the obligation should be reduced to only 80% to fulfill with art 51a) of the V-BER because 190b of the VGL is not sufficiently clear). Ideally, franchise agreements should be categorically exempted, as outlined above. Otherwise, we suggest to specifically revise paragraph 190b) of the VGL so that it specifically mentions article 5.1.a): “In such cases, the duration of the non-compete obligation is also irrelevant under Article 5.1.a) as long as it does not exceed the duration of the franchise agreement itself.” In any case, it would be helpful if the VGL could include an example of a restaurant franchise system. Another example along the same lines concerns post termination non compete clauses in franchise agreements. Article 5.3(b) there is a reference to “premises and land”, which is generally strictly interpreted and applied, but many franchises in the EU (think of food trucks, bakeries etc.) are van based and so on a literal reading such a franchisor would not be able to impose post termination non compete covenants. Also, for many other franchises, in particular concerning services and in a digital context, the limitation to premises and land is overly strict and not reflective of the special nature of franchise, the need to compete in an increasingly competitive market and the integration of the physical and digital worlds. There is a clear rationale for post term non compete obligations for a certain duration, in franchise. These do not seem to appreciably restrict trade. We propose to acknowledge this which would be procompetitive and simplify the application of competition law to franchise systems.
- **Suggestions:** at least a temporal exception of e.g. 3-5 years beginning with the start of the franchise system would be desirable.
- Certain restrictions in franchise systems could be considered to fall outside art 101 TFEU altogether given the very specific context of franchising in stead of depending on the V-BER for exemption.
- If a categorical exemption of franchise is not possible, we request a clarification that 100% sourcing obligation are permissible for the duration of the franchise agreement and that post termination non compete clauses can be broader (e.g. replace ‘land’ by ‘markets’ in article 5.3.b) V-BER, so that the post contractual non-compete clause can apply to the mar-

ket/territory where the former franchisee has operated the franchise business.

) **Local markets**

- It is difficult to establish the franchisee's market share in local markets. Data on local markets are often not available.
- Local market shares also depend on the development of the local market. If a competitor is eliminated, the market share quickly increases significantly.
- There may be cases where the franchisee operates on a local market without any competitors, so that an exemption would be unlikely.
- This would lead to the strange result within a franchise system that some franchise contracts would be exempted and some not.
- **Suggestions:** If franchise systems are to remain dependent on V-BER exemption for some of the contractual restrictions, perhaps a specific rule can be adopted to avoid that a franchise system's contracts can be exempted in some jurisdictions in the EU but not in others. For example, a rule could be adopted that in franchise systems only the franchisor's market share is decisive, and not the franchisee's market share. This saves a lot of complex work in determining franchisee's market shares across geographic markets and it avoids the unwanted outcome that within a franchise system contracts are exempted in one jurisdiction but not the other, creating commercial hurdles and possibly also friction between franchisees of one franchise system which is not advantaging inter brand competition between different franchise systems in the same market.

) **Concepts with unique selling points**

- It should also be borne in mind that franchise systems often have concepts with unique selling points.
- Such franchisors would automatically have market shares that would be well beyond the 30% market share threshold although they increase inter-brand competition.
- Thus, a narrow market definition in local markets is rather counterproductive.

Suggestions: A workable solution would be desirable. For example, the future guidelines could provide further concrete examples of how to determine market shares, particularly at local level. Alternatively, privileged treatment of small and medium-sized enterprises (SMEs) and start up franchise systems and franchise systems in local markets should be provided for. Or the V-BER could in franchise systems only rely on the franchisor's market share to be below 30%, leaving the franchisee's market share outside the picture. Even better would it be to accept that in the specific context of franchise systems, certain contractual restrictions are not infringing art 101 TFEU.

3. Resale price maintenance, RPM

Article 4 of the V-BER contains a list of hardcore restrictions which, if contained in a franchise contract, would lead to the exclusion of the entire franchise agreement from the scope of the V-BER.

One of the hardcore restrictions concerns the fixing of resale prices. The V-BER 330/2010 prohibits the setting of fixed prices and minimum prices. However, maximum price commitments and price recommendations are permitted, provided that these do not actually have the same effect as fixed or minimum sales prices as a result of pressure exerted or incentives granted by one of the companies involved.

The VGL also provide for exemptions for the introduction of a new product, entry into a new market and short-term price promotions. ("Similarly, fixed resale prices, and not just maximum resale prices may be necessary to organise in a franchise system or a similar distribution system a coordinated short term low price campaign which will also benefit the consumers. In view of the short duration (2 to 6 weeks in most cases) this may not even have any appreciable negative effects".).

a) General

Necessity of further flexibility for RPM for franchise systems for the following reasons:

- the need for a clear positioning of the brand (price/quality image),
- advertising honesty and the promise of value for money,
- the enormous and disproportionate effort of carrying out advertising promotions in franchise systems with independent franchise companies compared to branch systems,
- and the ignorance of many franchisees of price-sales mechanisms.

Example: A drop in turnover often leads to prices being increased by the franchisees, which in turn leads to a further drop in turnover as a result of buyers breaking away. The decline in sales quickly sets off a downward spiral in prices that threatens the existence of the company.

Suggestions:

- Franchise systems that position themselves as high quality/luxurious should be protected from freeriding by franchisees focusing on internet sales and offering products at a reduced price on the internet, thereby taking sales away from other franchisees who are concentrating on the bricks and mortar retailing of products.

b) Promotions

System-wide advertising campaigns play an important role for franchise systems. In this respect, the franchise industry wants more room for manoeuvre in order to be able to compete with the large internet trading platforms and branch chains (same level playing field). Reasons:

- Different prices with different franchisees despite uniform advertising campaigns (with price recommendations) irritate and annoy customers who feel treated unfairly.
- Uniform prices in advertising increase the clout and competitiveness of all franchise companies in the market vis-à-vis competitors (especially branch systems or large trading platforms such as Amazon).
- Avoidance of enormous and ultimately disproportionate effort required to carry out central advertising measures and campaigns in franchise systems with independent franchisees in order to meet the requirements of antitrust law. These requirements currently prevent any form of competition with branch systems and strong online retailers (who work with price algorithms and today reacts to promotions from franchise systems within seconds. This includes immediate price adjustments. Counter-reactions of franchise systems, however, are currently hardly possible).
- **Suggestions:** Sales advertising periods in which price is aligned should be permissible for longer periods (including extensions of the period), and ban on any form of coordination (see further below) should be redefined to allow for coordinated responses by franchise networks in sales promotion tactics.

c) **Exceptions to the general prohibition of vertical price fixing**

It appears necessary to clarify the legal uncertainties with regard to exceptions to the general prohibition of vertical price fixing:

-) **Recommended retail prices:** There is an unclear legal situation in the case of a non-binding recommended retail price being discussed with a retailer. Such a theming is, however, common and even necessary in franchise systems in order to draw the necessary conclusions from the experiences of the franchise partners and their sales data (e.g. for the positioning of products in advertising or for the identification of short-lived products of the fashion industry).
-) **Price setting in E-Commerce:** Clarification that the setting of sales prices in an online distribution shop operated by the franchisor with the participation of the franchisees, cannot, at least in principle, be regarded as an impermissible price setting or as impermissible pressure on the setting of sales prices. Otherwise, franchise systems would not be in a position to react appropriately to the pricing policy of the large online retailers as described above.
-) **Short-term advertising campaigns:**
 - Unclear whether the VGL allow the printing of free quantities on product packaging as part of short-term promotions
 - In general, a period of 2 - 6 weeks for an advertising campaign is regarded as insufficient in time. Periods of up to 3 months would be necessary in order to reach certain customer groups, to convey a new price position or even to contribute to a change in the propensity to buy.

- It is also unclear whether several actions can be switched behind each other (e.g. three actions of two weeks each).
- It is unclear whether turnover-related considerations are permissible (e.g. instead of 6 out of 52 weeks, a corresponding sales share of 8.5% out of 100%). For example, is a fixed price permissible in the context of a gastro-nomic franchise concept which only applies to coffee throughout the year (which accounts for only 8.5% of turnover)? It would be desirable to clarify that in this respect not only temporary advertising campaigns but also campaigns limited to a certain share of turnover are permissible and do not have any major effects on competition.
- It is also unclear whether it is harmful under competition law for the dealer/franchisee to inform the manufacturer in good time of the price reduction it plans to achieve in the context of future promotions in order to ensure uniform and joint quantity planning for the system.

d) **Demarcation between EU consumer protection law and antitrust law arises**

-) According to **EU consumer protection law**, the advertiser must inform the public of his identity and address when advertising an offer. In Germany (see Section 5a (3) No. 2 of the Act against Unfair Competition (UWG)), consumer centres had increasingly attacked the campaign advertising of franchise systems. It has been demanded that the identity and address of all companies participating in the campaign be stated. This appears to be hardly feasible given the large number of franchisees in a system.
-) Such a claim puts franchise systems at a disadvantage compared to promotional advertising by branch systems.
-) Furthermore, the designation of the participating franchisees is actual and legally impossible, since the franchisees are independent entrepreneurs. A binding declaration of those franchisees who will participate in the campaign would violate antitrust law. As a result, such a demand would result in a de facto ban on advertising in franchise systems.
-) Here at least a clarification in the future guidelines would be desirable.

4. **Territorial protection and online sales**

Distribution via the retail trade is subject to dramatic change due to digitalisation and the ever-increasing relevance of online trading platforms.

a) *The special role of Amazon*

By way of example, since 1999, Amazon has been driving developments in the e-commerce industry and has developed into the world's leading online shop and marketplace. Amazon is still increasing not only its portfolio offer, but also its supremacy, e.g. by the following projects:

-) **Amazon Same Day, Amazon Now:** if a customer orders by 12 noon, he will be supplied on the same day and can access thousands of items. If he is also an Amazon Prime customer, he can receive his order free of charge within 2 hours (or for an additional charge within 1 hour)
-) **Amazon Logistics:** Amazon's logistics branch is growing steadily and, in addition to logistics centres that also provide fulfilment services for dealers, Amazon Logistics is a transport company that delivers to the customer's door. In the meantime, Amazon itself has started to operate its own fleet of aircraft for parcel delivery.
-) Platforms for purchasing by companies (**Amazon Business**) as well as for retail / end customers (**Amazon Marketplace**).

At the same time, Amazon is shaping the market with customer centricity. In addition to services such as free shipping and delivery on the next working day (see above), the **Amazon Prime** customer loyalty program is also binding through offers such as the **Prime Video** or **Prime Music** streaming services.

From the end customer's perspective, shopping at Amazon is also attractive because the end customer can buy everything from a single source thanks to Amazon's comprehensive product range and thus reduce his individual transaction costs.

b) **Franchisor's online strategy**

Retail franchise systems cannot resist the growing pressure of the Internet and major trading platforms and are forced to develop appropriate digital strategies. In particular, they are under enormous pressure from major trading platforms such as Amazon. The franchise systems are likely to lose this battle between David and Goliath.

As a rule, only the franchisor company has sufficient funds to operate sustainable Internet sales and to be able to compete successfully with the large online trading companies and platforms (e.g. Amazon). A uniform online presence of the franchisor is therefore necessary and desirable for many systems in order to survive in competition.

In addition, there is a need and necessity for franchisors to be able to determine the general online strategy, especially as brand owners. In franchise systems, the brand is a core component of the franchise concept. Franchisors must therefore be able to control and determine, for example, the online presence, communication in the ordering process, the CRM strategy and the use of brands by franchisees in their online presence.

- **Suggestion:** It would therefore be desirable to clarify the legal framework within which franchisors and franchisees can cooperate in Internet distribution without exceeding competition law limits. From a brand positioning perspective, also to avoid confusing consumers as to who they are dealing with, it is important that franchisors are able to prevent franchisees from having their brand as part of franchisees' website addresses/email addresses. There is also a clear need to develop an approach on the use of social media.

c) **Legal certainty for individual sales measures**

In recent times, a large number of sales measures have been thematised under anti-trust law (e.g. sales via Internet trading platforms, use of price comparison portals, best price clauses). For reasons of legal certainty, it would be desirable to clarify the antitrust treatment within the framework of the future guidelines.

- J The question of the admissibility of a ban on the use of **online auction platforms** is not really answered by the Vertical BER. The supplier can indeed impose quality requirements on the buyer. But it is not clear from the VGL whether these quality requirements may also include a ban on selling the goods via online auction platforms. Here the standards of the Coty ruling of the ECJ should be incorporated into the future guidelines and continued.
- J The question of the use of **price comparison websites** has also not yet been clearly clarified. The German Federal Supreme Court (BGH) has declared the provision of price data to price comparison portals inadmissible under certain circumstances. Nevertheless, it is still unclear whether this view should also be applied uniformly in the EU. The ECJ has not yet made a decision in this respect. A statement by the Commission in the future guidelines would be helpful in this respect
- J Another unresolved question from the online sales sector concerns the possibility of restricting online advertising measures. It is unclear to what extent manufacturers - and franchise system operators among others - can prohibit their sales partners or franchisees from using trademarks and similar terms in search engine optimization and so-called targeted marketing measures.

5. Selective Distribution

- J Selective distribution should remain block exempted. Article 4 c of the V-BER prohibits both active and passive distribution, provided that the distribution is selective (as opposed to exclusive distribution). It is initially unclear whether and when franchise systems can or must also be regarded as selective distribution.
- J A franchise system may be selective unless a franchisee is explicitly assigned a contract territory including sales restrictions outside the territory. It is then questionable whether quality requirements for distribution can already be regarded as hardcore restrictions or whether - in addition to the principle of equivalence for distribution via the Internet (= comparability of quality requirements between stationary and Internet distribution) - there must also be a requirement of materiality for the restriction to fall under Article 4 c of the V-BER.

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