

FRANCHISING AGREEMENTS IN THE LIGHT OF EEC COMPETITION LAW ¹

Eva Maria Bernedo Vidal

Summary: I. Introduction; II. The concept; III. Classification; IV. International franchise; V. Structure of the contract; VI. Investment required in a franchise and pay-back; VII. Pronuptia case (case 161/84, January 28, 1986); VIII. Commission regulation (EEC) no. 4087/88 of 30 November 1988 on the application of art 85.3 of the Treaty to Categories of Franchise Agreements; IX. Franchising in Spain; X. Conclusion; XI. Bibliography.

I. INTRODUCTION

The original meaning of the term Franchise was: privilege granted to an individual exempting him from paying the duties imposed upon the imports of exports of any merchandises or upon the use of a public service. This was the concept of Franchise that was in force in the Middle Ages and its main purpose was to increase the population of some villages and to avoid emigration.

The concept has evolved considerably up to the present century where Franchise is perceived as a commercial formula to penetrate new markets. The formula as such was first introduced in the United States of America in the early years of the century by the World Radio Corporation, a company that manufactures and sells radio devices. It was then the general Motors who put Franchising into practice from 1930 on, in order to elude the stringent American antitrust laws. The General Motors and other car manufacturers undertook to select and train several candidates that would later on resell their automobiles

¹ A Beatriz Pérez de las Heras, que suscitó en mí, el interés por el Derecho Comunitario y de quien he recibido un apoyo inestimable a lo largo de mi carrera académica.

and the corresponding spare parts. These candidates were granted the exclusive right to distribute the cars and its spare parts over a territory strictly specified in the contract, those distributors were bound to pay some kind of financial compensations in return. This commercial formula spread rapidly to other sectors such as petrol companies and bottling plants. In the fifties Franchising became a major success in the States where thousands of networks started to spot the whole country. Despite this rapid expansion, the system suffered a cut-back in the seventies mainly because of the oil crisis.

This original formula to penetrate markets arrived in Europe in the late fifties enjoying a particular strength and a remarkable widespread tendency. Antecedents of the system in the continent were the so called «voluntary chain distribution systems»² which were operated mainly by supermarkets all over Europe. The formula consisted of a series of verbal agreements by means of which several wholesalers and retailers associated in order to achieve six major objectives: to rationalize the operations by adapting the system to new trends in productivity, to be able to operate with a wide variety of products, to introduce the concept of self-service, to increase sales through promotion and advertising, to reduce costs through the concentration of purchases and sales and finally to develop a whole range of services such as training, financing and so on. This system failed in practice due to the absence of a written contract containing the rights and obligations of the parties involved and to the lack of discipline of those engaged in the project. Those first efforts though unsuccessful were not useless insofar as they served to pave the way for the new method of cooperation between enterprises that we know today as Franchising.

The system enjoys at present a worldwide acceptance³ and success and its rapidly adapting to new demands in trade, while moving

² Ortiz de Zárate, **Manual de Franquicia**, Deusto, Bilbao, 1993, pp.11-12.

³ At present there are about 2,500 franchise networks operating in Europe. These networks are spread in more than 100,000 outlets. Statistics taken from Castaldi, Enrico, Document Italie, **Le système de la Franchise**. Droit et affaires économiques, N. 497. Juillet-Aout, 1990, p.144.

onto more sophisticated and complex formulas. One of the reasons for such and important success of Franchising in the States might be that all the shops in the network offer the same products (or the same quality) in the same way and at similar prices, thus the customer can easily identify the product which will be available relatively close to the place where he lives. In Europe Franchising is seen as a lifebelt for a large amount of small and medium-sized retailers that cannot afford competition from large surfaces by themselves. The European common market is perceived as a challenge for all those modest undertakings whose owners are obliged to develop creative formulas in order to survive. In this context Franchising is likely to play a major role. Many entrepreneurs have already resorted to this formula, but not all of them have a sound knowledge of the phenomenon itself and the difficulties that may arise in the course of the relationship to be established between franchiser and franchisee.

In this paper we will try to give an overall description of the phenomenon, paying special attention to some practical aspects, such as the investments required to start the operation of the network or the formulas to calculate the rentability of a Franchise. We shall then analyze the legal status of Franchising agreements in the light of EEC Competition Law. To this purpose we will comment the views of the European Court of Justice and the Commission from a critical position, pointing out the main ambiguities and incoherencies contained both in the Judgment of the Court in the Pronuptia Case in the Block Exemption Regulation adopted by the Commission. We will approach the issue of the specific legal nature of Franchising agreements taking those critics as a basis for our argumentation.

In the third part of the paper we will deal with Franchising in Spain. We will underline the main characteristics of the networks operating in the country and make reference to the most relevant structural defects and erroneous practices that need to be corrected in order to follow the pattern n put into practice in some other States where Franchising has already acquired a long-standing tradition.

Finally we will put forward the conclusions that we derive from the analysis carried out throughout the paper and we will finally drop some ideas as to the future of Franchising in the European Union and particularly in Spain.

II. THE CONCEPT

Most writers start their essays with the following sentence: «no universal definition of the term Franchise has been agreed upon so far» and this is still true at present. We are not going to add know a new definition to the thousands of them that have already been given by authorized experts in the field. The main reason why nobody has succeeded in finding a unique definition of the concept is the factual complexity and the wide variety of contracts covered by Franchising. The fact that the formula is continuously evolving and adapting makes it even more difficult. We can also see that the concept varies geographically; thus, what is regarded as Franchise in the States might well not be regarded as such in Europe⁴. This circumstance causes a certain degree of uncertainty when we try to define the borderline between Franchising and some other types of contracts such as selective distribution agreements or concessions. Thus, the concept of Franchising in the States is wider than in Europe where gasoline dealerships, car distributors or bottling plants are regarded as selective distribution networks, whereas in the States they are included within the category of Franchising agreements. This simple difference in treatment depending on the continent where the contracts are to be put into practice raises some doubts as to the specificity and autonomy of Franchising agreements as understood in the States. The fact that these three specific contracts that we mentioned above are regarded as Franchising agreements somehow contradicts the conclusions

⁴ In Europe the term franchise corresponds to the idea of the business-format or second generation franchise where the basis is not a certain product, but the whole concept of producing and/or selling a product or rendering a service. Bodewig, Theo, «Franchising in Europe. Recent Developments». *International Review of Industrial Property and Copyright Law*. Wheinheim. N. 2, April, 1993, p. 157.

forwarded by the European Court of Justice in the Pronuptia Case⁵ defending the originality and specific nature of this category of contracts. But we shall comment on this point at a later stage in the paper.

In order to provide our argumentation on the concept with a proper framework we shall now repeat two of the most widely accepted definitions of the term.

- a) Definition of the International Franchise Association. It is an exchange of relationships between a franchiser and a franchisee on the basis of a contract, where the franchiser undertakes to transfer his know-how to the franchisee and to provide him with continuous training and assistance. The franchisee in return undertakes to operate his business under the tradename or the trademark of the franchiser and following his indications.
- b) Le Comité Belge de la Distribution⁶ defines Franchising as a method of cooperation between two undertakings who are bound by a contract, where one of them (the so called franchiser) undertakes to grant the other (the franchisee) the right to exploit his tradename, trademark or a commercial formula and to provide him with assistance and training on a periodic basis. The franchisee in return undertakes to pay some economic compensations (royalties or/and entrance fees).

For the purposes of the present paper and insofar as the European Union is concerned we shall just concentrate on two definitions given by the European Union is concerned we shall just concentrate on two definitions given by the European Court of Justice in the Pronuptia Case and by the Commission in the Block Exemption Regulation 4087/88⁷.

⁵ Case 161/84 Pronuptia, 1986, ECR 353, pgph.15.

⁶ Comité Belga de la Distribución, **Franchising**, Hispano-Europea, Madrid, 1973, p.27.

⁷ Commission Regulation 4087/88 of November 30, 1988 on the application of art. 85.3 to certain categories of franchise agreements (OJ L359/46).

After having pointed out that Franchising agreements are very diverse in nature, the Court defines Distribution Franchising as a system where:

«an undertaking which have establish itself as a distributor on a given market and this developed certain business methods grants independent traders, for a fee, the right to establish themselves in other markets using its business name and the business methods which have made it successful. Rather than a method of distribution, it is a way for an undertaking to derive financial benefit from its expertise without investing its own capital»⁸.

The Commission defines a Franchise Agreement as:

«an agreement whereby one undertaking, the franchiser grants the other, the franchisee in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purposes of marketing specified types of goods and/or services; it includes at least obligations relating to:

»– the use of a common name or shop sign and a uniform presentation of contract premises and/or means of transport.

»– the communication by the franchiser to the franchisee of know-how.

»– the continuing provision by the franchiser to the franchisee of commercial or technical assistance during the life of the agreement»⁹.

As we can appreciate there are numerous similarities among the four definitions, even though the last two ones are more restricted in scope. Now we are in a position to derive some common features from them.

First of all we all seem to agree that Franchising is a method of continued economic cooperation between at least two parties juridically independent: the franchiser, who is the holder of a trademark and possesses a series of original products or services to offer, and the franchisee who is granted the right to either manufacture and/or distribute those products and services and to exploit the intellectual property rights attached to them employing some uniform technics that have already been tested and/or experienced by the franchiser.

⁸ See Pronuptia, *supra* note 4, art.15.

⁹ See Commission Regulation 4087/88, *supra*, art.1.

In the following paragraphs we shall spell out some of the most outstanding characteristics contained in the statement above.

- A continuous collaboration. In some early essays on Franchising we read that it is a «method of distribution», though it might have been so in the beginning we see now that it is somehow a narrow approach to the phenomenon. Franchising is not necessarily a formula to distribute goods and services, it can also deal with the production of those goods.

At present we can say that collaboration on a continuous basis is one of the most relevant features of Franchising.

- The independence of the two undertakings. In Franchising agreements the franchisee remains the owner of his business. In spite of this circumstance we see that this independence is quite often diminished when the parties engage in an industrial or an associative franchise agreement.
- A transfer of know-how by the franchiser to the franchisee. This is by all means one of the most relevant aspects of Franchising. The know-how to be transferred is very often qualified in terms of its substantiality and its secrecy.
- A grant by the franchiser to the franchisee of the right to exploit the intellectual property rights attached to his goods or services. This feature is the most frequently used to defend the specificity of Franchising agreements.

What has been said so far allows us to conclude that Franchising agreements should be laced within the category of long-term contracts ¹⁰. Franchiser and franchisee normally enter this collaboration with the view to establish a standing relationship to be maintained on the basis of a continuous communication of assistance and commercial experiences from both sides. It is a wrong starting point for the franchiser

¹⁰ Müller-Graff, Peter-Christian, «Franchising: A case of long-term contracts». **Journal of Institutional and Theoretical Economics**. N.1, February, 1988, p.126.

to enter the contractual relationship in order to take advantage of the investments made by the franchisee so that he can go on exploiting the market in his own or through his subsidiaries. In the case of the franchisee there is no point in making the effort of investing a large amount of money if he cannot get those investments paid back throughout a number of years.

Franchising as a long term business relation involve three main elements:

- Stability.
- Reliability.
- Flexibility.

Let us now analyze these three elements in connection with Franchising. The contract of Franchising provides the appropriate framework for a stable, long-lasting relationship by which the parties can achieve a substantial degree of security for the future, thus somehow being able to face the changes that are very likely to affect the market during the term of the agreement. The main obstacle for the achievement of this stability is the freedom that both parties have to refuse to accept some of the provisions in the contract. This is the reason why Franchising requires a high degree of conformity ¹¹ from both the franchiser and the franchisee on the contract. In many cases the contract will take the form of a standard form franchise contract offered by the franchiser to the potential franchisees, who will then have a single choice: either to accept the contract as a whole or to abandon the idea of becoming part of the network. At this point we would like to draw the attention of the legislator (both at a domestic and a Community level) on the need to prohibit the franchiser from inserting excessively restrictive clauses in the contract detrimental both to competition and to the franchisee who is the weaker party in the agreement.

¹¹ Crucelegui Gárate, Juan Luis, «Los contratos de franquicia y el derecho de la competencia de la CEE», **Cuadernos de Trabajo y Discusión**, Gobierno Vasco, Victoria, 1987, p.22.

As far as reliability is concerned we must say that if it is true that in all agreements each party expects the other to observe the terms of the contract as agreed upon, this is even more obvious in a business relation like the one established between franchiser and franchisee based on a continuous exchange of information and mutual assistance¹². Notwithstanding the fact that most franchising agreements contain some «clauses of cooperation»¹³ in order to guarantee that the spirit of the contract will be respected by both parties, there is still substantial place for good faith and care in the performance of the provisions in the contract. Therefore it is of the utmost importance to carry out an appropriate and well organized selection process¹⁴ in order to be in the position to choose the most reliable candidates.

The third element that characterizes Franchising as a long-term contract is flexibility. As we said in the beginning of the present paper Franchising is continuously evolving and getting adapted to new circumstances and new developments in trade, this is the dynamic aspect of the concept. In order for this dynamicity to be effective the contract has to be flexible in its terms and it may as well include some provisions to this purpose. Thus, renegotiation¹⁵ of the clauses in the agreement should always be possible at any time or at least on a periodic basis.

Once we have framed Franchising agreements in the category of long-term contracts we can now make a first attempt at revealing the legal nature of Franchise. If we go back to the early sixties we see that many scholars, mainly Americans tried to solve this question assimilation Franchising agreements to some other preexisting contracts. Thus, they found parallelism with the contract of agency, leasing agreements, partnerships or license contracts¹⁶. From the point of

¹² It is a contract *intuitu personae*, that cannot be assigned without the prior approval of the franchiser. Díez Picazo y Guillón, **Sistema de Derecho Civil Español, Obligaciones y Contratos**, Tecnos, 1986, p.345.

¹³ Provisions allowing the franchiser to carry out some checks in the premises of the franchisee for example. See Pronuptia, *supra* 4, art.17.

¹⁴ Most manuals on franchise devote one whole chapter to the selection process in order to underline its importance. Bescós, Modesto, **Factoring y Franchising**, Pirámide, S.A., Madrid, 1990.

¹⁵ Parties should apply in their contract the maxima *rebus sic stantibus rather than pacta sunt servanda*. See Müller-Graff, *supra* 9, p.127.

¹⁶ See the antitrust classification in Müller-Graff, *op.cit.*, pp.140-141.

view of anti-trust laws, some authors saw the relationship established between franchiser and franchisee as a merger situation or a cartel. Moving ahead in time we appreciate a substantial change in attitude in the late seventies when Franchising agreements started to be regarded as one specific and different type of agreement not assimilable to any other preexisting one. As we shall see further on, the European Court of Justice supported this opinion in the Pronuptia Case ¹⁷. The main arguments given by those who share this position read as follows: the necessary transfer of know-how inherent to all Franchising agreements, the continuous assistance and training provided by the franchiser to the franchisee and finally and this one is regarded as the strongest argument, the grant by the franchiser to the franchisee of the right to exploit the intellectual property rights attached to the goods or services that are the subject matter of the agreement. It is the existence of all these three elements in the contract that confers on it its specificity and differentiated legal nature.

In our opinion Franchising is a term far too wide to be regarded as unique and autonomous category. It covers such an incredible variety of different contracts that we do not dare to conclude that there is one only legal nature common to all of them. Moreover, there are some Franchising agreements where the know-how involved is insignificant ¹⁸, others where the theoretic continuous assistance and training amounts in practice to little more than fifteen hours of lessons altogether. Finally, in some others the use of the franchiser's commercial signs is not specially relevant (in some industrial franchises for example). We do not see how we can affirm that those agreements are different in nature from other preexisting ones. We agree that in most cases Franchising agreements should be regarded as an autonomous category of contracts and be treated as such, but we have to bear in mind that every Franchising agreement is a world in itself and to that respect we should not apply an *a priori* consideration on the legal nature of that very contract by the mere fact that it can be regarded as a Franchising agreement. As we mentioned above the circumstance

¹⁷ See Pronuptia, *supra* note 4, art.15.

¹⁸ It is the case in most franchise agreements for the distribution of fashion goods.

that Americans regard gasoline dealers as franchisees ¹⁹, while we Europeans regard them as exclusive distributors blurs the divisory line existing between selective distribution and Franchising. But we shall come back to this point when we analyze the conclusions of the Court of Justice in the Pronuptia Case.

III. CLASSIFICATION

One of the main obstacles we all bump into when we try to come across a definition of the concept of Franchise is the long list of different varieties that may be covered by the term. We can classify these different agreements according to two different criteria: the subject matter of the contract and the formal appearance of the network. Those are by no means the only classifications that we can make. Many authors have repeatedly made reference to classifications according to the degree of control exercised by the franchiser on the franchisee, to their different competitive qualities ²⁰, that is, whether they restrict or foster competition. To our mind, these other criteria give place to some degree of ambiguity, therefore we will follow here the traditional classification.

According to the subject matter of the agreement we can differentiate ²¹:

- Distribution franchises, where the franchisee merely sells the products of the franchiser. A further subdivision can be made within this group between distributor's franchises where the products do not bear the tradename or the trademark of the franchiser (only the franchisee's promises do so. e.g. Computerland) ²² and products franchises where both the products and the promises bear the commercial name or trademark of the franchiser (e.g. Yves Rocher) ²³.

¹⁹ The inclusion of certain categories of exclusive distribution agreements within the group of franchises in the States increases considerably the statistics of franchising in USA. There was a turnover of 750 millions Dollars in 1991. Prusak, Henri, Bernard, François, «La Franchise en Europe». **Problemes Economiques**, Paris, N. 2329, juin, 1993, p.22.

²⁰ See Müller-Graff, *supra* note 9, p.123.

²¹ See Pronuptia, *supra* note 4, art.13. See also Prusak, Bernard, *supra* note 18, p.24.

²² See description of the facts in Commission Decision of 13 July 1987 (1987) O.J. L 8/1987.

²³ See summary of the facts in Commission Decision of 17 December 1986 (1987) O.J. L 8/1987.

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- Service franchises where the franchisee offers a service under the business name or commercial signs (sometimes the trademark) of the franchiser (e.g. Avis, Herz).
- Production or industrial franchises where the franchisee manufactures the products following the instructions of the franchiser in order to sell them under the franchiser's trademark.

According to the external appearance of the outlet we can differentiate:

- Corner franchise. It is a franchised space inside a large commercial surface.
- Shop in the shop franchise. In this case the Franchise agreement involves the creation of a shop inside another shop for the exhibition and sale of certain goods.
- Associative franchise, where both the franchiser and the franchisee hold a stock of shares in each other's business. They create a sort of joint venture. In this case it is sometimes difficult to speak about two independent undertakings any more.
- Financial franchise where the franchisee's role is just to put the capital necessary to cover the initial investment. In this case a third party will be in charge of the operation of the business.

There is still another criterion worth being noted in view of the Block Exemption Regulation 4087/887 that excludes from its scope wholesale franchises²⁴, that is franchises where the franchisee offers the products or the services to retailers or to other wholesalers (this is quite common in industrial franchising). On the contrary retail franchises fall within the scope of the Regulation insofar as the destinataires of the products and services offered by the franchisee are end-users (that is consumers).

²⁴ In this type of franchise agreement there is no straight relation with end-users. See Commission Reg. 4087/88, *supra* note 6, recital 5.

IV. INTERNATIONAL FRANCHISES

There are at least four basic structural ways to spread a franchise network across the borders ²⁵.

a) Direct franchising. The franchiser concludes the agreement from his country of origin with a franchisee established in the country where implantation is sought. It is quite an appealing system when the franchiser's activities in the foreign country are very limited and the communications between the two countries are good enough for the franchisee to be adequately supplied. It is a way to save taxes and to avoid compliance with some foreign legal requirements. Despite these advantages the system also presents some major draw-backs: the franchiser is not able to carry out an effective control on the activities of the franchisees, and therefore he is obliged to trust them almost completely, specially when the network starts expanding.

b) Branch office or subsidiary. The franchiser is already established in the country where the network is to be developed. It's main advantage is that the franchiser has the possibility to acquire a first hand knowledge of the characteristics of the market in that country, but it requires high continuous investments in order to keep the physical presence of the franchiser in that country through its subsidiary or branch.

c) Joint venture. The franchiser looks for a partner in the second country in order to create a common undertaking. Once they have done so, they share the financial and commercial risks involved in the development of a franchising network in that country. The franchiser can then benefit from the experience and the knowledge of his partner as regards consumption habits and market structures in that country.

²⁵ See Prusak, Bernard, *supra* note 18, p.23.

d) Master franchise. This is the most widespread method to internationalize a franchising network. The franchiser concludes a franchising agreement with one undertaking already established in the country where expansion is sought. In this agreement the second company undertakes both to produce and/or sell (whatever the subject matter of the contract is) some goods or to provide some services and also to appoint some other franchisees in that country. Thus, it is up to the master franchisee to develop the network in this second country ²⁶.

Sometimes the franchiser will decide to operate a combination of these four methods if the features of the Franchising network or the structure of the market in that second country advise him to do so.

V. THE STRUCTURE OF THE CONTRACT

Very few States if any have enacted some kind of specific legislation regarding Franchising agreements so far. In most cases, antitrust laws, consumer protection laws and private law are supposed to fill in the gap created by that lack of specific legislation in the field, but these legal instruments cannot cover all the aspects in a Franchising agreement. Therefore, the will of the parties plays a major role in the contract. In most cases it is of the utmost importance to have a very well drafted agreement, as exhaustive as possible but flexible enough to allow periodic revisions. A franchiser that seeks to be a good negotiator should always allow some place in the contract for the suggestions of the franchisee. The requirements of a Franchising network do not fit into a rigid agreement that would not leave some space for negotiation.

There is no standard form contract that could serve as a model for all Franchising agreements. Once again this is due to the fact that

²⁶ As we shall see further in the paper master franchises fall within the scope of the reg. See Commission Reg. 4087/88 *supra* note 6, recital 5.

there is a wide variety of contracts that may fall within the category of Franchise. Each Franchising network requires a number of specific clauses and provisions to be inserted in the agreement according to its own features. It would be completely useless and artificial to try to adjust all Franchising agreements to a unique model of standard contract.

Most frequently franchiser and franchisee engage in a sort of prefranchising contract that could be defined as an agreement to agree. The main purpose of this precontract ²⁷ is to prove to each other that they have a serious interest to become bound by a final agreement, that is, to gain the trust of the other party. This prefranchising agreement is usually valid for no more than 3 months (it is similar to an option contract). During this term the offer of the franchising contract usually contains a list of the provisions that will most probably be inserted in the final agreement.

Through this precontract the franchiser already undertakes no to seek for other candidates in the exclusive territory of the franchisee, to carry out a market study of the area and to provide the franchisee with all the information he might need in order to evaluate the advantages and draw-backs of joining the network. On the other hand the franchisee undertakes no to disclose those information to third parties, to start looking for the capital required to cover the initial investment and to pay a certain amount of money to the franchiser. If the franchisee decides to refuse the offer the franchiser will keep the security sum. If it is the franchiser who decides not to engage in the project the franchisee is entitled to recover the guarantee together with an additional sum as a compensation.

If both parties agree to sign the final agreement they will become finally bound by the provisions contained in the prefranchising contract and the contract will be enforceable before the Courts. The final agreement usually consists of the following six parts:

²⁷ See Díez Picazo y Gullón, *supra* note 11, p.435 on the nature of the category of precontracts.

1. Preamble, Project and Motivation ²⁸. There the parties insert their names, domicile (seat) of their companies, the subject-matter of the agreement and the reasons why they wish to enter into this contractual relation.

2. Territorial Exclusivity Clause. The exclusive area where the franchisee is going to operate has to be very clearly defined in the contract so that it cannot raise doubts as to its limits or its characteristics.

3. Mutual Obligations. Those mutual obligations can be grouped as follows: those that are to be carried out before the opening of the shop and those to be performed during the operation of the business. Among the first ones we can count the obligation on the franchiser to give instructions on the decoration of the shop, to train the franchisee, to provide him with a financial project and to inform the franchisee of the advertising campaigns to be carried out. In return, the franchisee at this stage undertakes to obtain the necessary licences and permits in order to start the operation of his business, to put the capital necessary to cover the initial investment and to pay the entrance fee if required in the agreement.

After the opening of the franchisee's outlet the franchiser undertakes to provide the franchisee with the Handbook or Bible. The Handbook is the physical support by which the franchiser transfers his commercial and technical know-how to the franchisee. It contains a series of indications that the franchisee is supposed to follow in the operation of his business. This Handbook is usually contained in an annex to the contract. It is the translation of the experience gained by the franchiser in the operation of his business into a series of theories and guidelines that must be made available to the franchisee in a very clear, concise and precise manner. Quite frequently this Handbook is protected by copyright which the franchisee is bound to respect by retraining from

²⁸ See Structure of franchising contracts in Casa: Casabó, **La franquicia**, Ediciones Gestió 2,000, S.A., Barcelona 1989, Chap. 3.#

introducing substantial modifications in it without the prior approval of the author. The Handbook consists of the following parts:

- A description of the goods and services that are the subject-matter of the contract ²⁹.
- Image. The franchiser here gives a series of instructions to be followed by the franchisee in order to preserve the image and the reputation of the network.
- Advertising. The franchiser here refers to the nature of the advertising to be carried out by the franchisee alone or together with him.
- Organization. This part of the book refers to the opening of the new outlet and teaches the franchisee how to organize his business in order to get optimal results. The franchiser also gives him some advice as to the way to train his employees.
- Management. This is the main core of the Handbook. It is the actual transfer by the franchiser of all his technical and commercial know-how to the franchisee. In this section the franchiser teaches the franchisee how to deal with the stocks, the quantities to be kept in stock and how to control them in order to get the maximum profit out of the capital invested in supplies. He also refers here to the best way to keep the books updated.
- Sales or provision of services. The franchiser here shows the franchisee how to sell and/or manufacture a product or to provide a service.

The Handbook is just a part of what is normally known as the franchise package in a wide sense. This package includes other

²⁹ Sometimes it might be quite difficult to identify the franchiser's good. As we shall see further ahead the definition of this term is very important in connection with the non-competition clause exempted in the Regulation. See, Commission Reg. 4087/88, *supra* note 4 art.1.3.d.

elements such as market studies, advertising plans, professional training and sometimes also financial assistance.

During the term of the agreement the franchiser is also obliged to supply certain quantities of goods and materials to the franchisee on a regular basis. The contract usually contains a clause providing for the imposition of a penalty (usually a fine) on the franchiser in case he fails to comply with this obligation. The franchiser is also to refrain from concluding other franchising agreements in the exclusive territory granted to the franchisee and also from exploiting the franchise himself ³⁰.

In return the franchisee undertakes not to seek customers outside his territory to follow the indications given by the franchiser specially insofar as stocks are concerned, to get supplies only from the franchiser, from other sources designated by him and from other franchisees ³¹. He is also prevented from engaging in commercial activities that may compete with the franchiser's.

He is also to submit to periodic checks of the books and the premises by the franchiser ³². Finally he has to participate actively in the training courses organized by the franchiser regularly.

But let us go back to the substantial corpus of the Franchising agreement.

4. Term of the Contract, Renewal and Termination. The term of the agreement varies according to the subject matter of the agreement (it is longer in an industrial franchise), to the rent to be paid for the premises and to the time required to pay back the initial investment. In most cases franchising agreements contain a provision for

³⁰ See the treatment afforded to territorial exclusivity by the Court in the Pronuptia Case, *supra* 4. art. 24.

³¹ Clause cleared by the Court in the Pronuptia judgment, *supra* note 4, art. 21.

³² Clause cleared by the Court in the Pronuptia case insofar as they aim at preserving the reputation of the franchiser's network.

automatic renewal upon expiration of the initial term unless one of the parties informs the other within the notification period (usually three months) of its will to terminate the agreement. Otherwise the contract will be automatically renewed for a period of time either analogue or inferior to the initial one. It is quite convenient for both parties to insert a provision in the contract containing a whole list of the incompliances that entitle either party to terminate the agreement.

Any modification made to the contract should always be agreed upon by both parties, modifications made unilaterally by one of the parties without the prior approval of the other would entitle that party to terminate the agreement.

5. Assignment of the Contract. Franchising agreements are regarded as *intuitu personae* (based on mutual trust). That is the reason why it is a major requirement to insert in the agreement a prohibition in the franchisee to assign the rights he has been granted in the contract to a third person without the prior consent of the franchiser. If both parties agree on the assignment of the rights in the contract to a third person they shall add to the initial agreement an Annex where a new term for the agreement will be fixed. If the franchisee fails to inform the franchiser of his intention to assign the rights in the contract to a third person or having done so the franchiser has refused to give his approval, the franchisee will be imposed a penalty stipulated in the agreement.

6. Finally. Most Franchising agreements contain an arbitration clause in order to settle the disputes that may arise during the life of the agreement.

VI. INVESTMENTS REQUIRED IN A FRANCHISE AND PAY BACK

In a Franchising agreement it is up to the franchisee to put the capital necessary to cover the initial expenses for the operation of the

business. Here is a non exhaustive list of the concepts to be covered with the capital of the franchisee ³³:

- a) The entrance fee. In most contracts the entrance fee is expressed as a lump sum, but not necessarily. Not all franchisers require an entrance fee from the franchisee in order for him to be admitted in the network. The entrance fee is a payment made in return for the grant of the right to exploit the intellectual property rights held by the franchiser.
- b) The acquisition of an initial stock to start operating the business.
- c) The price of purchase or the rent to be paid for the premises.
- d) The decoration of the shop.
- e) A sufficient reserve of cash in order to face unforeseen circumstances.
- f) Finally the franchisee has to buy some equipment such as computers, cash registers and so on.

The six investments we have just mentioned are necessary to start operating the business but they are by no means the only ones to be made. The franchisee has to keep on investing throughout the whole term of the contract, for example he has to pay some royalties to the franchiser. These royalties are normally expressed in terms of a percentage on sales or on purchases: this percentage may vary considerably according to the features of the subject-matter of the agreement in question. He also has to share with the franchiser the costs involved in advertising. The portion of advertising expenses that has to be borne by the franchisee varies from 0.5 up to 2% of the total cost.

In spite of what has been said so far, the franchisee is not the only one who has to spend money in the operation of the franchising agreement. The franchiser has to pay for the market studies necessary to assess the viability of the project. He has to cover the investments involved in the operation of the pilots if the creation of such pilots is envisaged in

³³ See Bescós, *supra* note 13, pp.88-102.

the contract. The franchiser bears also the cost of the Handbook. Finally it is up to him to carry out a proper selection process before entering into any Franchising agreement. Selection processes are usually very expensive and they involve quite a large amount of human resources, time and capital. Nonetheless, franchisers should not underestimate the importance of the selection process and they should be aware of the fact that 90% of the possibilities of success of the network depends on the suitability of the candidates chosen.

1. Return on Investments

When we refer to this aspect of franchising we must differentiate two stages in the operation of the network:

- a) return to investments involved in the operation of the pilots.
- b) return on investments involved in the normal exploitation of the network.

Most entrepreneurs apply to their pilots the 3*2 rule ³⁴, that is three shops operating for a period of two years. The main purpose of the pilots is to assess whether the products or services which are the subject-matter of the contract will be successful in that market or not. Franchisers should not apply the 3*2 rule blindly without taking into account the specific characteristics of the type of product he is going to distribute and the structure of the market in which he is going to operate.

In most cases a Franchising network will have to wait until the third or the fourth year of existence in order to get some profits. In order to achieve a high degree of rentability of the network it is necessary to follow an appropriate rhythm in opening new outlets. The franchiser should always bear in mind that he must be able to supply all his franchisees adequately, therefore he cannot afford opening

³⁴ See Ortiz de Zárate, *supra* note 1, p.190.

more outlets than he is able to supply. On the other hand if he misuses his capacity, that is he opens fewer shops than he should, the period of time needed for the investments to pay back will be longer.

From the point of view of the franchisee we can affirm that the expected volume of sales will run proportionally to the investments made. In small and medium-sized cities the rate of sales per square meter is higher than in bigger ones (assuming that the initial investment was equal in both cases).

The return on investments made on a Franchise can be expressed in terms of the following ratio: $ROI = \text{Benefit} / \text{Total Investment}$ ³⁵, the extended version of this equation is the following: $ROI (\text{Return on Investment}) = (\text{Benefits} / \text{Sales}) * (\text{Sales} / \text{Total Investment}) = (\text{Sales} - \text{Cost of sales}) / \text{Sales} * (\text{Sales} / \text{Total assets})$.

There is a second method to calculate the return on the investment made in the operation of a Franchise. It can also be expressed in terms of a ratio: $ROI = (\text{Cash} - \text{flow} + \text{financial expenses}) / (\text{Initial Investment} + \text{Initial Stock})$.

When the return on investment of a Franchise is inferior to 15% the network in question is not an will never be successful unless it is reformulated from its very foundations. There are many other methods to calculate the rentability of a franchise, but those two are the most widely used in practice.

Normally the investments made by the franchisee pay back at the end of the fourth year of operation according to La Federation Française du Franchisage. From this statement we can draw the conclusion that the term of the agreement should always be equal or longer than the pay-back period.

³⁵ See Casa: Casabó, *supra* note 27, p.115.

VII. PRONUPTIA CASE (CASE 161/84 JANUARY 28, 1986)

Before the entry into force of Regulation 4087/88 there was no specific legislation in the Community regarding Franchising agreements. In fact, there was some uneasiness among entrepreneurs engaged in this kind of contractual relationship as to the fate of their business in the light of EEC Competition Law. We can very well understand their fear if we bear in mind that some of the basic provisions contained in almost all Franchising agreements amount to a considerable limitation of the franchisee freedom to compete both with the franchiser and the other franchisees. This limitation of the potential competitiveness of the franchisee is very likely to affect trade between member states in a substantial manner and thus fall under the prohibition contained in art. 85.1 EEC Treaty.

Notwithstanding the fact that some provisions in this category of agreements definitely restrict competition within a certain in specific area of the common market, it is also undeniable that these agreements as a whole increase competition ³⁶, because they allow a large number of potential competitors to enter the market easily. Some Franchising agreements have been considered to fulfill the requirements contained in art. 85.3 and they have consequently been exempted by the Commission. Nonetheless there was an atmosphere of uncertainty mainly because very few agreements if any had been notified before 1984 in a childish attempt from the entrepreneurs engaged in this type of contractual relationship to distract the attention of the Commission from the anticompetitive effects of some of the provisions contained there in.

The landscape changed completely when in 1984 the European Court of Justice was asked to give a preliminary ruling on several issues related to a Distribution Franchise agreement. That was the first and only time that the Court of justice has settled a case related to Franchising, thus we can say that still nowadays the experience of

³⁶ See Commission Reg. 4087/88, *supra* note 6, recital 8.

both the Court and the commission in the field is quite narrow and restricted to Distribution Franchise, as we shall see later on.

But let us concentrate on the case. We shall now summarize the facts of the case briefly for the sole purpose of giving a coherent frame to the comments that will be dropped in this paper in relation to the conclusions of the Court.

The parties in the dispute were a German undertaking (Pronuptia in Frankfurt) who is a subsidiary and Master franchisee of Pronuptia Paris in Montreuil and frau Irmgard Schillgalis, franchisee in Hamburg.

The object of the dispute were certain royalties that frau Schillgalis had failed to pay during the period running between 1978 and 1980.

The Court of First Instance in Germany condemned Frau Schillgalis to pay 158.502 DM. She appealed the decision claiming that the agreement was null and void in the light of art. 85.1 and 85.2 EEC Treaty. The court of appeal dismissed the judgment rendered by the court of First Instance. The plaintiff then (Pronuptia in Frankfurt) raised the case before the Supreme Court who referred two questions to the European Court of Justice. The German Supreme Court asked whether Franchising agreements like the one that was the object of the dispute fall under the prohibition in art. 85.1 of the EEC Treaty, and whether Regulation 67/67³⁷, March 22, 1967 relating to the application of art. 85.3 to some exclusive distribution agreements in applicable to Franchising agreements.

The Court answered in the following terms:

- a) The Court said that Franchising agreements were very varied in nature and therefore it referred its Judgment only to Distribution

³⁷ Commission Regulation 67/67 of March 22, 1967 on the application of art. 85.3 to certain categories of exclusive distribution and purchase agreements. (1967). O.J. L 57/67.

Franchise agreements whose compatibility with EC competition law cannot be assessed in abstracto, but it depends on the specific provisions contained in the agreement at issue and on the economic context (par. 15).

- b) The Court also declared the specificity and autonomy of this category of agreements, specially in relation to selective distribution agreements (par. 15).
- c) The Court then concluded that:

«all clauses whose main target is to attain the two basic objectives of a Franchise, that is,

- to prevent the know-how transferred by the franchiser to the franchisee from benefiting competitors, even indirectly,
- to preserve the good name and reputation of the franchiser, are compatible with art. 85.1 (par. 16, 17)».

Among the first group the Court mentioned the following ones: prohibition on the franchisee to open a shop of the same or a similar nature in an area where he may compete with a member of the network during the term of the contract and for a reasonable period after its expiry and the obligation on the franchisees not to transfer his shop to a third party without the prior approval of the franchiser.

The Court included in the second group several clauses: the obligation on the franchisee to apply the business methods of the franchiser and to use the know-how provided, to sell the goods covered by the contract only in premises laid out and decorated according to the franchiser's instructions and to obtain the franchiser's approval for all advertising insofar as the provision concerns only the nature of the advertising. The Court also cleared the prohibition on the franchisee to transfer his shop to another location without the franchiser's approval. Finally, the Court said that under certain circumstances a provision requiring the franchisee to sell only products supplied by the franchiser or by suppliers selected by

him may be considered necessary for the protection of the reputation of the network. Nevertheless the franchisee must always be allowed to obtain the same products from other franchisees (cross-deliveries).

- d) The Court also examined some conflictive clauses and concluded that, provisions in the contract imposing reselling prices on the franchisee invariably result into a restriction of competition within one specific market, and therefore they fall under the prohibition of art. 85.1. On the contrary, clauses containing recommended or orientative prices are compatible with art. 85.1 provided there are not concerted practices between the franchiser and the franchisee or between the franchisees themselves.

The Court then reached an important conclusion in relation to the territorial exclusivity clause. It said that the combination of this provision and the location clause results in a certain degree of market sharing between franchiser and franchisee or between the franchisees and thus constitutes a restriction of competition for the purposes of art. 85.1 if it concerns a business name or symbol which is already well known (*Consten and Grundig Case*)³⁸. The Court concludes that this combination of clauses requires exemption under art. 85.3. In paragraph 24 the Court tries to introduce a timid innovation in its methods. It points at the possibility of a prospective franchisee not taking the risk of becoming part of the network unless he could get some degree of protection in return. The Court mitigates the innovative scope of this statement by adding that this is a consideration to be applied to the examination of the agreement under art. 85.3. To our mind the Court is here somehow invading the powers of the Commission who is the only one entitled to grant individual exemptions under art. 85.3. The Court is also going beyond the questions posed by the German Supreme Court where no reference was made to the possibility of an exemption under art. 85.3.

³⁸ Case 56 & 58/64, *Consten & Grundig* (1966), ECR 299.

- e) Finally, the Court concluded that Regulation 67/67 on the application of art. 85.3 to certain categories of exclusive dealing agreements does not apply to Franchising agreements. The Court raises four arguments to defend its position (par. 33).
1. The Regulation does not make reference to the use of a single business name, to the application of uniform business methods or to the payment of royalties in return for the rights transferred to the franchisee by the franchiser. In respect to this argument of the Court we can say that it is quite incoherent with the wording of the Commission in the Block Exemption Regulation ³⁹, allowing industrial franchise agreements to benefit from exemptions granted by other Block Exemption Regulations. This expression does not exclude Regulation 83/83 ⁴⁰ which is the actualization of Regulation 67/67.

Industrial Franchises contain all those elements mentioned by the Court in order to say that Reg. 67/67 does not apply to Distribution Franchise agreements. The mere circumstance that in an industrial franchise the franchisee is granted the right to manufacture the products, does not change the fact that the franchisee is also entitled to use the franchiser's intellectual property rights and his know-how and is bound to pay royalties exactly the same as a franchisee in a Distribution franchise. Thus, in that case the same arguments should serve to the purpose of excluding industrial franchising from the scope of Reg. 67/67 which does not seem to be the case according to the Commission.

2. Art. 2 of the regulation expressly covers only exclusive dealing agreements which differ in nature from franchise agreements for the distribution of goods. The Court does not give any further arguments at this point. According to our opinion the fact that there are some clauses added to the ones usually contained in a selective distribution agreement does not necessarily change the

³⁹ See recital 4 in Commission Reg. 4087/88, *supra* note 6.

⁴⁰ Commission regulation 83/83 of June 22, 1983 on the application of art. 85.3 of the Treaty to categories of exclusive distribution agreements (1983) O.J. L 73/1.

nature of the contract, at the most it would allow regulation 67/67 to apply to these contracts just to a certain extent, but still it would be applicable.

3. Art. 2 lists restrictions and obligations that may be imposed on the exclusive distributor but does not mention those which may be imposed on the other party to the contract, while in the case of franchising agreements for the distribution of goods the obligations undertaken by the franchiser, mainly, the obligation to provide know-how and to assist the franchisee are of particular relevance. This argument of the Court evidences some omissions and defects in the Block exemption regulation, but is by no means conclusive. The party that grants the exclusive distribution also has to comply with very important obligations such as to supply specific quantities of goods to the distributor regularly, and this obligation is not listed in art. 2 either. Once again the franchiser in an industrial franchise has to comply with the same obligations as a franchiser in a distribution franchise and application of Reg. 83/83 is not excluded.
4. Finally the Court argues that the list of obligations which may be imposed on the distributor under art. 2 does not include the obligation to pay royalties or the obligations ensuing from provisions which establish the control strictly necessary for maintaining the identity and reputation of the network. Not every Franchising agreement contains a provision for the payment of royalties, and even in the case of those who do so we do not think that the form in which the franchisee gives some financial compensations to the franchiser is enough to exclude application of the Regulation to a whole category of agreements. The exclusive distributor is also bound to give some financial compensation to the other party; the only difference is that it is not given in return for the transfer of some know-how and the use of intellectual property rights. As regard the second part of the argument we will just repeat here the wording of art. 2.3. b) of Regulation 83/83 (updating of Reg. 67/67). It says that art. 1 shall apply notwithstanding that the exclusive distributor undertakes to sell the contract goods under trademarks, or packed and presented

as specified by the other party. At this stage no further comment is required in order to rebate the argumentation of the Court.

Once we have pointed out the main conclusions to be derived from the Judgment of the Court in the present case and in order to be in a position to comment and to a certain extent rebate some of the arguments of the Court we have to analyze briefly the method applied by the Court and the motivation that lead the judges to adopt this decision.

1. METHOD APPLIED BY THE COURT

The Pronuptia case is meant to be one of the first cases where the Court of Justice applied the method of the Rule of reason ⁴¹ that had been large and widely applied by the American Courts in order to mitigate the strict provisions contained in Section 3 of the Sherman Act (the US antitrust law).

Some authors think that the Court of Justice answered in the Pronuptia Case the question whether a rule of reason could be read in art. 85.1 notwithstanding the possibility of exemption under art. 85.3 which is a rule of reason in itself.

The first case where the Court implicitly admitted that it was possible to read some kind of rule of reason in art. 85.1 was in Consten and Grundig ⁴². This case dealt with a vertical sole distribution agreement which increased competition between similar products of different makes. In this occasion the Court concluded that there was no need for an economic analysis and the balancing of enhancement of interbrand competition with restrictions of intrabrand competition in cases in which the agreement has as its object the restriction of competition. Implicitly the Court seems to admit that it is possible to apply the rule

⁴¹ Joliet, R. **La license de marque et le droit européen de la concurrence**, R.D.E., 1984 pp.11 et 12. «restrictions de la concurrence ou clauses restrictives accessoires, nécessaires a la réalisation d'une convention licite échappent à l'interdiction de l'art 1 er du Sherman Act.

⁴² See Consten & Grundig, *supra* note 37.

of reason analysis to cases other than those referred to above. On the other hand, it is a fact that both the Commission and the Court of Justice frequently apply a legal policy rule of reason by often making reference to ancillary restraints and to the *de minimis* concept. The *Pronuptia* Case is just an example of the application of the concept of ancillary restrictions in order to narrow down the reach of the prohibition contained in art. 85.1. Nonetheless the case allows two different readings:

- Some scholars regard this judgment as a draw-back from the economic policy rule of reason as applied in the *Nungesser* Case ⁴³. Specially insofar as the Court expressly declares that the consideration that a prospective franchisee would not take the risk of becoming part of the chain unless he could hope thanks to a degree of protection against competition from the franchiser and the other franchisees, that his business would be profitable is relevant only to an examination of the agreement in the light of the conditions laid down in art. 85.3 ⁴⁴.
- Some others considered the judgment to be an extension of the application of the legal policy rule of reason afforded by the Court in the *Coditel II* case. According to these authors the Court, by considering distribution franchise agreements to be agreements restricting competition insofar as they contain obligations necessary for the protection of the know-how, but holding that those provisions are not restrictions of competition for the purposes of art. 85.1 the Court has extended its legal policy rule of reason as applying to Industrial Property rights to know-how.

Further ahead in the Judgment the Court states that some other restrictions not being necessary for the preservation of the chain's reputation are restrictions of competition within the meaning of art. 85.1 if the business name is already well known. Some scholars think

⁴³ Case 258/78, *Nungesser* (1982) ECR 2015.

⁴⁴ Korah, Valentine, *Pronuptia-Franchising*: «The marriage of reason and the EEC Competition rules». *European Intellectual Review*. Oxford. N. 4 April 1986, pp.99-104.

that according to this last statement the Court in the Pronuptia Case did not apply any balancing test under art. 85.1. They just see this reference of the Court of Justice to a prohibition on restrictions on intrabrand competition as an application of the *minimis* concept.

To our mind The Court of Justice does not apply in this judgment a balancing test between enhancement of interbrand competition and restrictions on intrabrand competition. The Court in its Judgment is just trying to be pragmatic in view of the economic context in which the case reaches the Court and of the inexperience of both the Commission and the Court in the field. According to us, there is no point in trying to see any rule of reason consciously applied by the Court. Quite the contrary, the Court tries to solve the case in a prudent manner and bearing in mind the consequences that might have been attached to a decision of the Court condemning Franchising agreements. The Court in this case was not in the best position to afford methodological innovations or advances insofar as the contract that was that object of the dispute was completely unfamiliar to the Court. As I mentioned above I think that the Court had in mind that by the time this case reached the Court in 1984 thousands of Franchising networks were already operating in almost all member states and most of these chains had proved to be successful and to benefit consumers to a large degree. The Court could not condemn all those successful experiences in one hit, specially after having admitted that the clauses that restrict competition are the substance of the agreement. On the other hand, the court did not want to bless Franchising agreements as a whole insofar as the real restrictive effects of the formula had not been clearly assessed so far, either by the Court of the Commission. This is the main reason for some of the cautious statements that leave the floor to the argumentation of the Court. This is also the reason for some of the cautious statements that leave the floor to the argumentation of the Court. This is also the reason why the Court decides to refer its judgment exclusively to Distribution Franchise agreements, where this would have been a good opportunity for it to clarify the legal status of franchise agreements as a whole.

It seems that the court is somehow afraid to give definitive answers to the questions referred by the German Supreme court but being forced to do so the Court has chosen to limit as much as possible the scope of its decision so as to allow the court to give a different answer to other questions related to Franchise that may be referred to it in the future. In a way the Court is seeking to give the commission the possibility to create an appropriate legislation on the subject *ex novo* without getting onto the difficulties involved in trying to fit the category of franchise agreements into other preexisting community legal instruments.

Turning back to the substance of the case we cannot but disagree with the definition of Distribution franchise given by the Court. At the most we could say that it is relatively ambiguous. The Court says:

«distribution franchises, under which the franchisees simply sells certain products in a shop which bears the franchiser's businessname or symbol» (par. 13).

According to the Court it is only the shop that bears the franchiser's name in a distribution franchise. In reality that may be the case but it might well be that both the products that are sold by the franchisee and the shop bear the tradename of the franchiser. It's quite surprising that the Court seems to forget this possibility when the distribution franchise that was the object of the dispute was of the second type: that is, not only the shop, but also the products sold by Frau Schillgalis bore the tradename of the franchiser (Pronuptia).

As regards the specificity and the autonomy of the category of distribution franchise agreements, we think that the Court could have got deeper into the argumentation by analyzing different types of Distribution franchises. In our opinion there are some distribution franchising agreements, specially in the field of fashion and shoes that could very well be assimilated to exclusive distribution agreements. Let us analyze the arguments forwarded by the Court in order to support the specificity of Distribution Franchising agreements in relation to selective distribution agreements.

- The use of a single business name.
- The application of uniform business methods (know-how).
- The payment of royalties in return for the rights granted in the contract.

According to us, none of these arguments serves the purpose sought by the Court. In fact, it seems that the Court had already decided on the conclusion before finding the necessary arguments to support its decision. Thus, the argument of the obligation on the franchisee to pay royalties, that has been commented in preceding paragraphs does not change the nature of the agreement itself. We do not see any substantial difference between the payment of a lump sum periodically which is the case in most exclusive distribution and concession agreements and the obligation to pay a royalty expressed in terms of a percentage on sales or on purchases by the franchisee; even more, it is quite frequent to find in some exclusive distributor. The only difference that can be seen is that those periodic payments are regarded as royalties in the case of a franchise agreement which is by no means a conclusive argument in order to settle the issue of the specific legal nature of some distribution franchise agreements.

As regards the second argument, where the Court refers to the know-how transferred by the franchiser to the franchisee, we must underline that in most agreements of the kind of the Pronuptia distribution franchise agreement the know-how transferred is not very relevant, and this is so in most distribution franchises where the subject matter of the agreement is the resale of fashion goods, shoes, etc. thus, if we enter one of the outlets of a very well known franchising network for the distribution of shoes; we shall not be offered the product in a particularly original way, different from the way in which they would be offered to us by a shop which is the exclusive distributor of a specific brand of shoes but is not part of any franchising network. It is quite surprising that the court keeps on using arguments that are not applicable to the distribution franchise which is the object of the dispute. The argument of the know-how could be adequately raised in order to support the specificity and originality of franchising

agreements for the provision of services where the know-how transferred by the franchiser to the franchisee is the cornerstone of the success of the whole network.

We can conclude that we can not raise the argument of the transfer of know-how to defend the specificity of distribution franchises where such know-how is of hardly any importance for the operation of the business.

The third argument is probably the strongest ones, though it could be arguable whether it has enough entity in itself to make of distribution franchise agreements a brand new category of agreements different from exclusive distribution agreements. In my opinion, the obligation on the franchisee to operate its business under the business name, sign or trademark of the franchiser simply adds something to the characteristics of the agreement as we said above, but it does not change its nature. If we take into account the consequences that, the Court draws from this argument: the compatibility with art. 85.1 of all those clauses in the contract whose main aim is to preserve the name and reputation of the franchiser, we have already seen that also the exclusive distributor has to respect some rules in order to preserve the reputation of the supplier's goods (art. 2.3.b).

In order to summarize what we have said so far about the legal nature of distribution franchising agreements we can say that there is no conclusive argument among those forwarded by the Court in its Judgment that overrides the remarkable similarities existing between this category of agreements and exclusive distribution agreements.

We shall now analyze the reference made by the Court to the economic context (par. 27.1) in which the agreement is to be operated as an element to be taken into account in order to assess its compatibility with art. 85.1. This statement drives as back to the issue of the application of an economic policy rule of reason in the judgment. In fact, the Court seems to open the door to the Commission for such an application. Thus, the Commission by applying this economic policy

rule of reason in its Decisions it could regard some agreements as compatible with art. 85.1. Whenever they are operated in a highly competitive market. Nevertheless, the Commission has not used this possibility in the five Decisions relating to distribution franchise agreements that were taken shortly after the Pronuptia judgment. The Commission has not cleared any of the agreements notified even though in some cases the territorial protection was extremely limited like in the Computerland case⁴⁵. All five agreements were operated in markets where there was a substantial amount of competition. The Commission decided not to use the parameter of the economic context to clear the agreements, but stuck strictly to the doctrine of the Court that requires exemption to be granted under art. 85.3 to the territorial exclusivity clause combined with the location clause. This doctrine of the Court is somehow inconsistent with the previous statements of the Court in the Judgment. For example in paragraph 15 the Court says «such a system, which allows the franchiser to profit from his success, does not in itself interfere with competition». Here the court is referring to the system as a whole and provided that exclusive territorial protection is an element that is substantial to almost all franchising agreements, we can conclude that either the Court was wrong in paragraph 15 or it was wrong in paragraph 24. It seems that the Court «at first sight» clears all distribution franchise agreements as a whole and afterwards it becomes frightened by the consequences that such a wide clearance would involve. The Court in the Pronuptia judgment goes quite far in the first paragraphs and afterwards it comes back on its own steps restricting the scope of its first statements. With the judgment of the Court in its hands, the Commission chooses to follow the narrow view in it and go on exempting conflictive clauses contained in agreements that «do not in themselves interfere with competition»⁴⁶. In order to keep some coherence with the position adopted in its five decisions the Commission inserts the aspect of the economic context

⁴⁵ «Franchising (Computers): The Computerland Case». **Competition Law in the European Communities**. Sudbury N. 6. June 1987, pp.96-101.

⁴⁶ See Pronuptia, *supra* note 4, art. 15.

in the Block Exemption Regulation as a factor to be taken into account in the examination of the agreements in the light of art. 85.3, thus eliminating all traces of rule of reason in art. 85.1 itself.

The other clauses dealt with by the Court in this judgment have already been thoroughly examined by many authors in various essays. We shall not comment them here insofar as they do not rise any major difficulties.

Shortly after the Court rendered its judgment in the Pronuptia case, Mr. Sutherland, Member of the Commission Division in charge of competition matters, announced that the Commission would give priority to the examination of those franchising agreements that had been notified at the time, in order to gain the necessary experience and knowledge in the field to be in a position to afford drafting a block exemption regulation related to this category of agreements. According to this announcement the Commission adopted the five decisions we mentioned above: Yves Rocher⁴⁷, Charles Jourdan⁴⁸, Pronuptia⁴⁹, Computerland⁵⁰ and Masterservice⁵¹.

The considerations of the Court in the Pronuptia Case regarding territorial exclusivity as a restriction of competition that requires exemption under art. 85.3 produced an atmosphere of uneasiness among all those entrepreneurs engaged in franchise contractual relations. In fact they feared that the commission would impose some conditions to be fulfilled in order for the exemptions to be granted. Franchisees were particularly affected by this uncertain situation because franchisers could decide to narrow their territorial protection in order to avoid the possibility of the agreement being condemned by the Commission. In the beginning these fears prevented franchisers and franchisees from notifying their agreements to the

⁴⁷ See Yves Rocher, *supra* note 22.

⁴⁸ Commission Decision of December 2, 1988 (1989), O.J.L. 35/31.

⁴⁹ Commission Decision of December 17, 1986. Pronuptia (1987) O.J.L. 13.

⁵⁰ See Computerland, *supra* note 21.

⁵¹ Commission Decision of December 3, 1988, Masterservice (1988). O.J.L. 3332/138.

Commission. And maybe these reticence were justified to a certain extent. Thus, the Commission found in the Yves Rocher Decision that a combination of a location clause and a territorial protection one was incompatible with art. 85.1. Even in the case of a brand representing a relatively low market share (5%) in a highly competitive market. The Commission nevertheless exempted the agreement under art. 85.3. The reason given by the commission to refuse to merely clear the agreement was that Yves Rocher is a large group selling beauty products not only by means of its franchisees but also by a highly developed mail order system, even though franchisees were not afforded protection in relation to these sales in their exclusive territory. This was a clear sign that the Commission had the intention to require exemption in all cases where some degree of territorial protection was afforded to the franchisees, but also that she was willing to grant the exemption in almost all cases. In this way entrepreneurs somehow started to fill a little bit more comfortable, and this somehow positive perspectives crystallized in the Block Exemption Regulation adopted by the commission in 1988. We shall now move onto the analysis of the main aspects contained in this legal instrument.

VIII. COMMISSION REGULATION 4087/88 OF 30 NOVEMBER 1988 ON THE APPLICATION OF ARTICLE 85.3 OF THE TREATY TO CATEGORIES OF FRANCHISE AGREEMENTS

The franchising regulation has been exhaustively analyzed by a large number of experts in previous essays. It is not our purpose to repeat here what other far more authorized authors have already said. Therefore we shall not engage at this stage in a detailed examination of all articles in the regulation. Our main intention is to underline and comment the most relevant legal issues related to its legal basis, its scope and the innovations introduced by the Commission in some of the provisions of the regulation as compared to the decision of the Court in the Pronuptia Case.

1. Legal Basis of the Regulation

Art. 87 EEC Treaty empowers the Council to adopt regulations and directives concerning the application of art. 85 and 86. On the basis of this provision the Council adopted in 1965⁵² a Regulation concerning the application of art. 85.3 to certain categories of agreements where only two undertakings are involved and relating to exclusive distribution or exclusive purchase of goods as well as agreements containing restrictions related to the exploitation of some intellectual property rights. At this point we shall draw the attention of the reader on the fact that the Commission adopts Regulation 4087 on the basis of this instrument (reg. 1965) and not on the basis of regulation 67/67. This might be seen as a redundant and somehow unnecessary a priori statement, but we shall see in following paragraphs that some authors seem not to be much aware of this apparently irrelevant fact. This first statement will allow us to rebate the assumptions of those who defend that the argumentation of the Court in the Pronuptia Case in favor of the inapplicability of Reg. 67/67 to the category of distribution franchise agreements might at the same time raise some doubts as to the powers of the Commission to exempt those agreements on the basis of art. 1.1 (a) of Regulation 19/65.

Even when we could defend the applicability of Erg. 67/67 to certain categories of distribution franchise agreements, thus contradicting the conclusions of the Court to this respect, that does not interfere with the powers vested on the Commission by the Council in Reg. 19/65. Thus, art. 1.1 (b) of this instrument expressly refers to the possibility the Commission has to adopt directives and regulations exempting agreements where the licensing of some intellectual property rights is involved. We cannot deny that franchise agreements involve the transfer of know-how, commercial signs or trademarks. Therefore we do not see why the Commission should not be allowed to use the powers expressly granted in this second paragraph of art.

⁵² Council Regulation 19/65 of March 2, 1965 on the application of art. 85.3 to certain categories of agreements and concerted practices (1965) O.J.L. 36 p. 533/65.

1.1 in Regulation 19/65. We should bear in mind that the main argument the Court raised against the applicability of Regulation 67/67 to this category of agreements was that this regulation does not mention the obligations on the franchiser to provide know-how and to assist the franchisee. This point comes to reinforce the idea that franchise agreements involve the transfer of some intellectual property rights and therefore there can be no doubt that they fall within the category of agreements referred to in art 1.1 (b) of Regulation 19/65. In our opinion a thick line should be clearly drawn between the question of the applicability of Regulation 67/67 to distribution franchise agreements and the issue of the powers vested by the Council on the Commission in Reg. 19/65. To our mind the Commission by adopting Regulation 4087/88 has made a correct use of the prerogatives granted by the Council in Regulation 19/65.

2. Scope of the Regulation ⁵³

2.1. Territorial scope

The Regulation applies to certain categories of bilateral exclusive agreements falling within the scope of art. 85.1 that may in particular affect trade between member states or where they form the basis of a network which extended beyond the boundaries of a single member state. In the first drafts the Commission referred to restrictions related to the territorial protection granted by the franchiser to the franchisees and to the market sharing resulting from some of the provisions in the agreements. At this point we do not know the reason why the Commission decided to omit these references in the final draft, but contrary to the opinion of some authors who regard this omission as a limitation of the scope of the regulation, thus the Commission just mentions two of the most relevant restrictions that may affect intracommunity trade leaving the door open for other types of restrictions to be covered by the regulation. So in our opinion this omission has widened the scope of the regulation instead of restricting it.

⁵³ Gestinel, Eric, «La procédure d'opposition et la franchise commerciale en droit communautaire des ententes», *Revue Trimestrielle de Droit Européen*, Paris, N. 3, Juillet-Septembre, p. 471.

2.2. Material scope

The Commission limits the scope of the regulation to franchise agreements for the distribution of goods and the provision of services. In this sense the scope of the regulation is wider than the scope of the judgment of the Court in the Pronuptia Case.

The Regulation expressly excludes industrial franchise agreements from its scope because of their different characteristics. We understand this exclusion when we read recital 5 in the Regulation that refers to agreements between two undertakings, for the retailing of goods or the provision of services to end users. The fact that in most industrial franchises there is no direct link between producer and final customer can be seen as an argument in favor of this exclusion. Nevertheless, we should not forget that in some industrial franchises the franchisee is a manufacturer and a retailer at the same time. We do not know what arguments we could be given to defend the exclusion of these agreements from the scope of the regulation.

The Commission excludes also wholesale franchising from the regulation. At this point the Commission should have inserted a definition of what is to be understood by wholesale and retail franchise. Having failed to do so we do not see the use of this express reference, it would have been enough to read recital 5 that refers only to franchise agreements where the destination of the goods or of the services is an end user to exclude wholesale franchises from the scope of the regulation. Nevertheless the Commission feels the need to justify this exclusion by saying that she has not acquired enough experience in the field of wholesale franchises yet. This might seem to be quite a poor argument but is consistent with recital 4 of regulation 19/65 which empowers the Commission to adopt regulations once it has already gained enough experience in the field.

2.3. Personal scope

Recital 5 of the regulation reads as follows:

«this regulation covers franchise agreements between two undertakings, the franchiser and the franchisee. It also covers cases where this relationship

between franchiser and franchisee is made through a third undertaking, the master franchisee».

The only limit imposed by the Commission on the personal scope of the Regulation is that it does not apply to franchise agreements concluded between competitors (5a). At this point it is worth underlining that this regulation differs from the know-how and the patent licensing reg. in the sense that it does not exclude franchising agreements concluded between competitors who hold interests in a joint venture of between one of them and the joint venture, if the agreements relate to the activities of the joint venture. In our opinion the exclusion of such reference would have been redundant insofar as the Regulation excludes from its scope all franchise agreements between competitors in art. 5.1.

3. Definitions

Some of the definitions contained in art. 1 are imprecise in their terms and allow some degree of doubt as to the agreements covered by the regulation. Most of them are narrow and they serve only for the purposes of the regulation.

1. The term franchise agreement is quite narrow in the regulation. It refers only to agreements between «two undertakings» to the purpose of «marketing goods» and/or «services». At this point we see that the definition does not require that these goods and services be offered to «end-users» which is inconsistent with recital 5.
2. Know-how. The regulation does not refer to technical know-how, mainly because this type of know-how is only relevant when a high degree of alteration in the original materials is required from the franchisee. It is the so called two-tier franchise whose legal treatment still remains obscure and uncertain.

The requirement that know-how be substantial has been applied by the Commission in a fairly flexible way. The Commission is

very well aware that the know-how involved in most distribution franchises is quite irrelevant. We could agree with Prof. Korah⁵⁴ that the territorial protection granted to the franchisees in agreements involving some insignificant know-how should not be seen as a restriction of competition requiring exemption provided the network has not acquired a reputation yet. The terms secrecy and identifiable are defined in the same way as in the know-how regulation. One more doubt we come across when we read this definition is whether the know-how has to be developed by the franchiser himself or it can be acquired from a third party. We do not see in the definition any requirement to this respect, so we can conclude that it can be acquired from a third party, provided it is secret.

3. The term franchiser's goods raises some doubts as to its exact limits. Franchiser's goods are goods «produced» by the franchiser, or «according to his instructions» and/or «bearing the franchiser's name or trademark». In the Computerland network the products sold by the franchisees do not bear the trademark of the franchiser, they are not manufactured by him or according to his instructions. Nevertheless the Commission regarded it as a distribution franchise and exempted the agreement under art. 85.3.

4. Some Relevant Clauses

In this section we shall analyze only those clauses containing some innovations in relation to the judgment of the Court in the Pronuptia Case.

- a) Grant-back clause. It is contained in art. 3.2.b and it does not require that the franchisee be allowed to use the improvements made by him and that are demonstrably several from the know-how of the franchiser during and after the expiry of the

⁵⁴ Korah, Valentine, Franchising and the draft group exemption. **European Competition Law Review**, ECLR., Oxford, N. 2, 1987, p.129.

term of the contract. This is a requirement in the know-how regulation⁵⁵. Here the only condition required is the non-exclusivity of the license.

- b) Art. 2. The clauses contained in art. 2 are regarded by the Commission as restrictions of competition. This consideration is inconsistent with the judgment of the Court insofar as the Court regarded as incompatible with art. 85.1 only a combination of the location clause and the territorial exclusivity one and only to the extent that the network was widely known. The Commission omits any reference to the reputation of the network. In this point the regulation is more restrictive than the judgment of the Court.

The Commission does not make any reference here to clauses having similar but less extensive effects. Some authors consider that agreements containing this sort of restrictions should come within the opposition procedure. In our opinion they should just be considered exempted.

- c) Art. 3 is the white list in the regulation, that is, those clauses that were regarded by the Court as compatible with art. 85.1 *per se*. The regulation here is also more restrictive than the Court insofar as it imposes some conditions (that they are necessary to protect the franchiser's industrial or intellectual property rights or to maintain the common identity and reputation of the franchised network) in order for them to be considered compatible with art. 85.1.
- d) Opposition procedure. The opposition procedure is introduced in recital 14 of the regulation and further explained in art. 6. In recital 14 this procedure appears as a mechanism similar to what is known by «positive silence» in administrative practice. The procedure refers to agreements containing clauses not listed in art. 2 and that do not contain any of the clauses in the black list (art. 5).

⁵⁵ Commission Regulation 556/89 of November 30, 1988 on the application of art. 85.3 of the Treaty to certain categories of know-how licensing agreements (1989) O J. L. 61/1 recital 14.

These agreements are to be notified to the Commission and if no answer is given in six months the agreement is deemed to be exempted not by means of an individual exemption, but under the Block Exemption Regulation. This procedure has the following advantages: it is fast, the Commission cannot impose any conditions on the agreement to be exempted, it allows some flexibility under the regulation and discharges the Commission of the task to issue a formal decision. This procedure has also some draw-backs; it raises some doubts so as to its legality.

Those who claim that the procedure is *ultra vires* ⁵⁶ argue that:

- Art. 85.3 does not envisage intermediate figures (either block exemption or individual exemption).
- It is an individual exemption granted within the Block Exemption Regulation. This is somehow contradictory. Regulation 19/65 did not vest on the Commission the necessary powers to insert such procedure insofar as the conditions to be fulfilled for an exemption to be granted have to be laid down according to objective criteria.
- It is a way to avoid the procedural requirements contained in Reg. 17. The fact that it requires notification of the agreement by the parties results in the exemption not being automatic as it would be if it would have been granted under the regulation.

Arguments in favor of the legality of the procedure ⁵⁷:

- It is not a mixture of the two kinds of exemption. The Exemption granted under the opposition procedure is subject to withdrawal under art. 8 and its linked to the existence of the regulation as far as modifications are concerned.

⁵⁶ Venit, James, S., «The Commission's opposition procedure, Between the Scylla of Ultra Vires and the Charybdis of perfume: Legal Consequences and Tactical Considerations», **Common Market Law Review**, 1985, p.167.

⁵⁷ See Gastinel, Eric, *supra* note 541 p.497.

- There is no provision in regulation 19/65 that requires conditions to grant the exemption to be based on objective criteria.
- The procedural requirements in Reg. 17 do not need to be observed because the legal basis for the procedure is Reg. 19/65.

In our opinion the opposition procedure raises reasonable doubts as to its legality. We don't think that Reg. 19/65 requires some kind of objective criteria in the conditions laid down in a Block Exemption Regulation, especially when it says that the block exemption must contain a black list of provisions that may not be inserted in the agreements to be exempted and a list of conditions to be fulfilled by those agreements. Finally we think that if the parties are required to notify the agreement the Commission should also comply with the procedural requirements in Reg. 17. If we admit the argument that the opposition procedure is based on Reg. 19/65 and therefore it has nothing to do with Reg. 17 we are assuming *a priori* that the procedure is legal.

To our mind the opposition procedure has been inserted in different Block Exemption Regulations in order to repair the defects contained in them. Maybe it would be better to draft regulations that allow a certain degree of flexibility in themselves without having to resort to hybrids such as the opposition procedure that allow the Commission a larger degree of discretion and entrepreneurs a lower degree of certainty.

IX. FRANCHISING IN SPAIN

In Spain, as in many other states no specific legislation on franchising has been enacted so far. We can find some rules that may be applicable to this category of contracts among the provisions in the Civil Code, Commercial Code, antitrust laws and Consumer Protection Laws

The first franchise networks started to operate in Spain in the late fifties. They were Spanish franchisers seeking to be represented in the whole country. It was not until the late seventies that some foreign

franchising networks started to expand to our country. Spanish potential franchisees were at the time eager to acquire some know-how and assistance in order to improve the operation of their small business. After the accession of Spain to the community many European firms sought expansion in our country. Spain was and still is a very appealing market with a high rate of consumption.

1. Legal Status of Franchising in Spain

Under Spanish Private Law Franchising is regarded as an atipic contract, not assimilable to any other pre-existing category of contracts. It is of a consensual nature, bilateral and creates reciprocal obligations on both parties (*sinalagmatico*). The main provisions applying to franchising in Spain are:

- Art. 1255 Civil Code (freedom of the parties' will) ⁵⁸.
- Art. 1258 Civil Code (Agreement of both parties is required).
- Art. 1277 Civil Code (no formal requirements).

It is *intuitu personae*, that is, based on the mutual trust of both parties.

So far, only one Judgment of the Spanish Supreme Court in relation to franchising agreements has been rendered. In this judgment they were incorrectly assimilated to trademark licensing agreements. The Supreme Court in its judgment did not take into account the transfer of know-how and the continuous assistance granted by the franchiser to the franchisee.

2. Taxes

The entrance fee is regarded as an expense for the purposes of the *Impuesto de Sociedades* (Tax on companies revenues). The franchiser

⁵⁸ Código Civil Español, de octubre de 1988.

regards royalties as an income, and it is up to the franchisee to bear the VAT (12% as applied to trademark, patents and copyright licensing). The Vat is regarded by the franchisee as an expense that can be deducted from his income tax ⁵⁹.

3. Structure of Franchising ⁶⁰

The main feature of franchises operating in Spain is the lack of organization and of experience. A high percentage of contracts terminate because of the infringement of one party (37%). Very few franchisers carry out a proper selection process before the conclusion of the agreement. Once they have entered into the contractual relationship very few franchisers offer periodic training and assistance to the franchisee and if they do so the training consists on a few hours of theoretical courses, to be carried out mainly by a member of the staff of the franchiser who is not specially qualified to do so.

93% of franchisers ask the franchisees to comply with certain requirements regarding the surface of the shop to be operated, but only 37% of the shops comply with those requirements. As regards the investments to be made by the franchisee we see that in 89%! of cases the investment is not fully made.

If we turn now to the obligations of the franchiser we can see that only 17 out of 100 provide the franchisee with an initial project and 30 give them some kind of technical assistance and training.

In relation with the payment of royalties and entrance fees, we must say that the figures available are extremely low. Three statistical data will be enough to give an idea of the high degree of flexibility and tolerance involved in the operation of franchising networks in Spain:

⁵⁹ See Casa, Casabó, *supra* note 27, p.143.

⁶⁰ Statistics provided by the Spanish State Office of Commerce, June, 1992.

- 73% of franchisers do not receive any entrance fee.
- 79% of franchisees do not pay any royalties at all.
- 45% of franchisees do not contribute to advertising costs.

Those figures decrease even more if we combine the three concepts:

- Franchisees who contribute to advertising only: 32%
- Franchisees who pay advertising quota and an entrance fee: 10%
- Franchisees who pay the advertising quota and royalties: 7%
- Franchisees who pay for the three concepts: 6%!

As we can see the figures are incredibly low. The truth might be that franchisees do pay, but these payments are not reflected in the books in order to avoid taxes. Otherwise we should conclude that 94% of franchising networks operating in Spain at present are not viable. We do not think that these statistics reflect the actual situation.

Let us analyze now the degree of control normally exercised by the franchiser on a Spanish franchisee. We shall see that franchiser and franchisee widely disagree to this respect. 81 out of 100 franchisers affirm that they carry out a strict control on the sales of the franchisee, 68 control the stocks and 19 control the management of the business by the franchisee. Those figures are much lower according to the franchisee. Only 28% admit that the franchiser controls their sales, 21% admit some control on stocks and none of them is subject to a control on his management.

Finally we shall refer now to the non-competition clause. Only 28 franchising agreements out of 100 contain such a clause. This percentage seems to contradict the wording of the Court in the Pronuptia Case where it was held that this clause is indispensable in

order to prevent competitors from taking advantage of the know-how and the assistance of the franchiser.

The number of franchising networks operating in Spain at present is 255 with 18,000 outlets spread all over the country ⁶¹. It is not an impressive number if we compare it with countries like France (684-29107) or the United Kingdom (348-16,000), but it is increasing every day. If we want this trend to continue we shall have to organize things in a different way, create the Spanish Franchise Association and try to put together the experiences of all the franchisees that have been operating within a franchising network for several years. It is time for Spanish firms ⁶² to cross the borders and start developing franchising networks abroad, but in order to do so many structural defects are to be corrected and old ideas to be changed in our country.

X. CONCLUSION

We started this paper saying that in the Middle Ages franchises were used as a means to increase the population of the cities and to avoid emigration. At present franchising is perceived as a method to penetrate new markets, thus, allowing an increase in the population of competitors in that specific market. As we see there is some kind of parallelism between the two concepts despite the 500 years that have run in the meantime.

⁶¹ Some statistics on the number of franchisees per franchiser according to sectors:

- Foodstuff: 376.
- Textile and shoes: 43.
- Household equipment: 13.
- Services: 15.
- Various: 40.

⁶² Spanish franchising networks operating abroad at present:

- In Portugal: 10.
- In France: 4.
- Other memberstates: 7.
- USA: 3.
- Rest of the world: 6.

The purpose of the present paper was to approach the phenomenon of franchising, both from a practical and a legal point of view, pointing out the main difficulties and problems that may affect its development. We have tried to give an answer to some of the questions raised by franchising in the light of EEC Competition Law and to comment, sometimes even criticize the opinions of some authors and the position of the Court and the Commission in relation to different aspects of franchising. From this brief analysis we have drawn the following conclusions.

The issue of the legal nature of franchising agreements is still pending, though in practice most authors and entrepreneurs seem to agree with the Court that franchising is a specific category of contract that cannot be fitted into any other preexisting category.

If the Court did not go further into the issue of the legal nature of franchising agreements it did on the other hand apply an innovative approach by regarding some restrictive clauses contained in these agreements as compatible with art. 85.1 insofar as they are indispensable in order to guarantee the viability of franchising. This declaration of the Court eliminated the atmosphere of fear and pessimism that surrounded the formula in relation to the treatment it would receive from EEC Competition Law. At present franchisers and franchisees have moved onto a clear landscape where their agreements can develop without major obstacles.

The Block Exemption Regulation came to fill in the gap created by the absence of specific legislation in the field. Though restricted in scope it brought some legal certainty to the situation of these agreements and is a first step towards the adoption of an exhaustive regulation of the phenomenon. Nevertheless we have to bear in mind that the experience of the Court and the Commission in this field is still quite narrow as the commission itself admits in the Regulation. Many questions are still to be answered, the situation of two-tier and wholesale franchises, the reason why industrial franchises can benefit from the regulation on selective distribution

agreements and the others may not, etc. Some of those questions will most probably be answered in a near future, but we shall have to wait until another case related to franchising is raised before the Court of Justice.

The Commission has chosen in its decisions not to apply any kind of *force of reason* to attenuate the prohibition contained in art. 85.1 and we have learned that this is not likely to change in the near future. We shall keep on having franchising agreements exempted under art. 85.3 and not simply cleared.

While franchising is consolidating in most countries, there is still much to be done to this respect in others such as Spain where franchising is rapidly spreading, but in a very disorganized way. In Spain the formula presents some structural defects that need to be corrected in order to improve the operation of the franchising networks already existing in the country. Despite these defects franchising is becoming quite a successful formula in our country where foreign firms mainly from USA and member states of the European Union are spreading their networks. In return the number of Spanish firms seeking implantation abroad by developing a franchising network is still very low. The reason might be the traditional orientation of most undertakings towards the domestic market and the small size of most Spanish firms. At present, these traditional views are changing and there is a large number of undertakings willing to concentrate and join their efforts in order to face competition coming from other member states. We hope that this trend will increase and will allow Spanish companies to expand abroad.

We shall conclude by saying that franchising is still a rather unknown phenomenon which is evolving nowadays into new more sophisticated formulas and mixing up with other relatively recent contracts such as factoring or leasing. This evolution will suppose in a near future a real challenge for lawyers, courts and legislators.