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CASE CARD | 15 February 2022

Pronuptia (161/84)

Ancillary restraints in the context of vertical agreements

1. CASE SUMMARY

A. Summary of facts

Pronuptia de Paris distributes wedding dresses and other articles of clothing worn at weddings under the trademark 'Pronuptia de Paris'. In *Pronuptia*, a dispute has arisen between Pronuptia de Paris GmbH (the franchisor) and one of its franchisees about the latter's obligation to pay arrears on royalties. In order to avoid payments of the arrears, the franchisee claimed that its contract was contrary to Article 101(1) TFEU and did not qualify for exemption under Regulation 67/67, which was the prevailing block exemption regulation on certain categories of exclusive dealing agreements at that time. Initially, the franchisee was successful, as the national court (the German Court of First Instance) considered that the agreements did indeed contain certain mutual obligations of exclusivity which infringed Article 101(1) TFEU and were not covered by Regulation 67/67. On appeal, the German Bundesgerichtshof referred a number of preliminary questions to the European Court of Justice ('ECJ') on the scope of application of Article 101(1) TFEU in relation to 'distribution franchises', i.e., franchises under which the franchisee, for a fee, sells certain products in a shop which bear the franchisor's business name or symbol. According to the ECJ, distribution franchises (the main agreement in question) do not, in themselves, interfere with competition. Such franchises, in order to function properly, may furthermore include certain (ancillary) restrictions which are not restrictions of competition in the sense of Article 101(1) TFEU.

B. Legal analysis

The ECJ confirmed the following:

- A system of franchise agreements does not in itself interfere with competition. The compatibility of such franchise agreements with Article 101(1) TFEU cannot be assessed in abstracto, but depends on the provisions contained therein and on their economic context. (§14-15)
- The provisions of franchise agreements which are strictly necessary for the functioning of the system of franchises do not constitute restrictions of competition for the purposes of Article 101(1) TFEU. The ECJ identifies two conditions that must be met for a franchise system to work.
- The first condition is that the franchisor must be able to communicate his know-how to the franchisees and provide them with the necessary assistance to enable the franchisee to apply the franchisor's business

method. The franchisor must be able to do so without running the risk that the know-how and assistance might benefit competitors, even indirectly. Provisions which are essential in order to avoid that risk do not constitute restrictions of competition. Examples of provisions meeting this standard include the following:

  - Provisions prohibiting the franchisee, during the period of validity of the contract and for a reasonable period after its expiry, from opening a shop of the same or a similar nature in an area where he may compete with a member of the network; and
  - Provisions prohibiting the franchisee to transfer his shop to another party without the prior approval of the franchisor. (§16)

- The second condition is that the franchisor must be able to take the measures necessary for maintaining the identity and reputation of the network bearing his business name or symbol. Provisions establishing the means of control necessary for that purpose do not constitute restrictions of competition. Examples of provisions consistent with this second condition include the following: (i) provisions obliging the franchisee to apply the business methods developed by the franchisor and to use the know-how provided; (ii) provisions obliging the franchisee to sell the goods covered by the contract only in premises laid out and decorated according to the franchisor's instructions; (iii) provisions prohibiting the assignment by the franchisee of his rights and obligations under the contract without the franchisor's approval; and (iv) provisions obliging the franchisee to sell only products supplied by the franchisor or by suppliers selected by him, to the extent that such provision does not prevent the franchisee from obtaining those products from other franchisees. (§17-22)
- However, provisions leading to market sharing between the franchisor and the franchisees or among franchisees constitute restrictions of competition. The ECJ refers in this context to location clauses. (§23-24)
- The fact that the franchisor makes price recommendations to the franchisee does not constitute a restriction of competition, so long as there is no concerted practice between the franchisor and the franchisees or among the franchisees for the actual application of such prices. (§25)
- Franchise agreements for the distribution of goods which contain provisions leading to market sharing between the franchisor and the franchisees or between the franchisees themselves are in any event liable to affect trade between Member States, even if they are entered into between undertakings established in the same Member State, in so far as they prevent franchisees from establishing themselves in another Member State. (§26)
- In view of the particular characteristics of such agreements, in comparison with exclusive dealing agreements, Regulation 67/67 is not applicable to franchise agreements for the distribution of goods. (§34)

2. QUOTES

"*The compatibility of franchise agreements for the distribution of goods with Article [101(1) TFEU] depends on the provisions contained therein and on their economic context.*" (§27(1))

"*Provisions which are strictly necessary in order to ensure that the know-how and assistance provided by the franchisor do not benefit competitors do not constitute restrictions of competition for the purposes of Article [101(1) TFEU].*" (§27(2))

"*Provisions which establish the control strictly necessary for maintaining the identity and reputation of the network identified by the common name or symbol do not constitute restrictions of competition for the purposes of Article [101(1) TFEU].*" (§27(3))

"*Provisions which share markets between the franchisor and the franchisees or between franchisees constitute restrictions of competition for the purposes of Article [101(1) TFEU].*" (§27(4))

"*In that regard, the attention of the national court should be drawn to the provision which obliges the franchisee to sell goods covered by the contract only in the premises specified therein. That provision prohibits the franchisee from opening a second shop. Its real effect becomes clear if it is examined in conjunction with the franchisor's undertaking to ensure that the franchisee has the exclusive use of his business name or symbol in a given territory. In order to comply with that undertaking the franchisor must not only refrain from establishing himself within that territory but also require other franchisees to give an undertaking not to open a second shop outside their own territory. A combination of provisions of that kind results in a sharing of markets between the franchisor and the franchisees or between franchisees and thus restricts competition within the network. As is clear from the judgment of 13 July 1966 (Joined Cases 56 and 58/64 Consten and Grundig v Commission [1966] ECR 299), a restriction of that kind constitutes a limitation of competition for the purposes of Article [101(1) TFEU] if it concerns a business name or symbol which is already well-known. It is of course possible that a prospective franchisee would not take the risk of becoming part of the chain, investing his own money, paying a relatively high entry fee and undertaking to pay a substantial annual royalty, unless he could hope, thanks to a degree of protection against competition on the part of the franchisor and other franchisees, that his business would be profitable. That consideration, however, is relevant only to an examination of the agreement in the light of the conditions laid down in Article [101(3) TFEU].*" (§24)

"*The fact that the franchisor makes price recommendations to the franchisee does not constitute a restriction of competition, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices.*" (§27(5))

"*Franchise agreements for the distribution of goods which contain provisions sharing markets between the franchisor and the franchisees or between franchisees are capable of affecting trade between Member*

States." (§27(6))

"*[…] Regulation No 67/67 is not applicable to franchise agreements for the distribution of goods such as those considered in the proceedings*." (§34)

3. RELEVANT LEGISLATION

- Article 101 TFEU
- Regulation 67/67

4. RELEVANT LITERATURE

On the ancillary restraints doctrine, see F. WIJCKMANS and F. TUYTSCHAEVER, *Vertical Agreements in EU Competition Law*, Oxford University Press, 2018, §3.216 – 3.226.

5. PRACTICAL SIGNIFICANCE

The ECJ distinguished franchising from other distribution formulas, including selective distribution, and decided that a franchise agreement does not per se violate Article 101 TFEU. The compatibility of a franchise agreement with Article 101(1) TFEU depends on the provisions it contains. The ECJ has provided detailed guidance on provisions that are acceptable in a franchise agreement and it did so on the basis of the ancillary restraints doctrine. Pronuptia serves therefore as a landmark case pertaining to that doctrine. Following this case, a new block exemption regulation (Regulation 4087/88) governing franchise agreements was adopted.