Distribution Law Center
DRIVEN BY CONTRAST

contrast

CASE CARD | 23 August 2022

Pronuptia (IV/30937)

Ancillary restraints in the context of vertical agreements

1. CASE SUMMARY

A. Summary of facts

Pronuptia de Paris ('Pronuptia') is specialized in the sale of wedding apparel worldwide under the trademark 'Pronuptia de Paris'. Pronuptia holds approximately 30% of the bridal wear market in France and more modest shares in other Member States. Pronuptia typically uses franchising to distribute its products, but also operates owned subsidiaries in some Member States. Approximately two-thirds of the goods traded through the Pronuptia outlets are of Pronuptia's own design or of designs commissioned or selected by Pronuptia. The remaining goods are purchased directly by the franchisees from third-party suppliers.

Pronuptia requests the European Commission ('Commission') to take a formal decision clearing or exempting its standard form franchise agreement under Article 101 TFEU.

B. Notes on case history

The decision of the Commission in the present proceedings is preceded by the 1986 *Pronuptia* judgment of the European Court of Justice ('ECJ') in case 161/84 in a distinct proceeding opposing Pronuptia de Paris to one of its franchisees. A separate case card is available with respect to this ECJ judgment.

C. Legal analysis

The Commission first emphasized having requested Pronuptia to include in the standard form franchise agreement certain rights which the franchisees allegedly had in practice already, notably the right to

- purchase Pronuptia products from other franchisees;
- purchase goods not connected with the essential object of the franchise busines from suppliers of their choice, subject to *ex post* qualitative vetting by the franchisor; and
- set their own retail prices, prices circulated by the franchisor being only recommended prices (including as regards maximum prices).

C.1 - Article 101(1) TFEU – clauses not falling within Article 101(1) TFEU

The Commission then identified clauses of the standard form Pronuptia franchise agreement that, in line with the ancillary restraints doctrine applied by the ECJ to franchise in its *Pronuptia* judgment, do not fall within the scope of Article [101(1) TFEU] because they:

- merely define the basic services the franchisor provides to the franchisee (§24);
- are essential to prevent the know-how made available and the assistance given by the franchisor from benefitting competitors (§25(i));
- provide for the control essential to preserve the common identity and reputation of the network trading under the franchisor's name (§25(ii));
- do not, by reason of their object, nature or effect, fall within Article [101(1) TFEU] (§26); and
- do not constitute restrictions of competition on account of the specific nature and content of the bilateral obligations accepted by the parties to a retail franchise agreement (§27).

C.2 - Article 101(1) TFEU – clauses falling within Article 101(1) TFEU

The Commission subsequently identified clauses of the standard form Pronuptia franchise agreement that do fall within the scope of Article [101(1) TFEU] (§28). It concerns:

- the exclusivity granted to the franchisee to operate under the franchisor's name in a defined sales area (territorial exclusivity); and
- the obligation on the franchisee to carry on the franchise business exclusively from the premises approved for that purpose (location clause).

The Commission observed that the combined effect of these clauses is to protect each franchisee against competition from other franchisees. Moreover, the agreement also implies that the franchisor may not operate directly in the allocated territory. Therefore, the Commission, in line with the guidance from the ECJ in its *Pronuptia* judgment, found that these clauses involve market sharing and therefore do constitute restrictions of competition within the meaning of Article [101(1) TFEU) and are inherently likely to effect trade between Member States. The Commission observed that this was all the more likely on account of Pronuptia's significant market share held on the French market for the relevant products and the finding that its network covered several Member States (§29-30).

C.3 - Article 101(3) TFEU – no block exemption

The Commission followed the reasoning of the ECJ in its *Pronuptia* judgment that Regulation 67/67 was not applicable to retail franchise agreements, given that the retail franchise agreements display features which distinguishes them from exclusive distribution agreements, whereas Regulation 67/67 only refers to exclusive

distribution agreements and does not mention any of the clauses that are typical of retail franchise agreements (§33). It furthermore observed that the same applies in respect of Regulation 1983/83 (§34).

Therefore, no block exemption under Article [101(3) TFEU] was available for Pronuptia's proposed standard form franchise agreement.

C.4 - Article 101(3) TFEU – individual exemption

The Commission then assessed the Pronuptia standard form franchise agreement in the light of the four requirements for an individual exemption laid down in Article [101(3) TFEU]. It decided that all requirements were met and that the Pronuptia agreement was exempted under Article [101(3) TFEU].

As regards the requirement that the restriction should be indispensable, the Commission acknowledged that the territorial exclusivity and the location clause are both indispensable, as the prospective franchisees would probably be unwilling to undertake the necessary investment and pay a substantial initial fee to enter the franchise system without some protection against competition from other franchisees and from the franchisor in the allotted territory. The Commission furthermore emphasized that franchisees were free to buy and sell the products amongst themselves.

2. QUOTES

"*At the European Commission's request, Pronuptia has amended the standard form agreement to put into writing certain rights which the franchisee allegedly had in practice already, namely the rights (a) to purchase Pronuptia products from other franchisees, (b) to purchase goods not connected with the essential object of the franchise business from suppliers of their choice, subject to ex post qualitative vetting by the franchisor, and (c) to set their own retail prices, the prices circulated by the franchisor being only suggestions and the franchisee merely being recommended not to exceed the maximum prices quoted by the franchisor in advertising and promotions. Pronuptia has abolished the clause which requires the franchisee not to harm the brand image of the franchisor by his pricing level.*" (§12)

"*Retail franchise agreements, as the Court acknowledged in its judgment (see paragraph 15), are different in nature and in content from the bilateral obligations accepted by the parties, both in cases of exclusive distribution contracts and dealerships in a selective distribution system. […]*" (§27)

"*[…] In a selective distribution system, such obligations could be regarded as restricting competition when they exclude from the network firms that fulfilled the uniform qualitative selection criteria but were unwilling to accept such further obligations, and when their effect was that distributors would be forced to push certain products to the detriment of other items. It is a different matter, however, in the systems of distribution franchises operated by*

Pronuptia in this particular case. In effect, the characteristics of such a system are such that the franchisor grants to the franchisee the exclusive right to use his brand marks and his commercial know-how in a defined territory, and that the franchisor is free to choose his franchisees. The exclusion of any others from the territory allotted to the franchisee is therefore a consequence which is inherent in the very system of franchising. Likewise, one may consider as a consequence inherent to this franchise system the fact that the franchisee, because of the use of the franchisor's exclusive mark and brand which identifies the franchised sales outlet, and because of the obligation not to compete, will in fact concentrate his promotional efforts on the particular products franchised. […]" (§27)

"*The Court also held that 'retail franchise agreements containing clauses that involve market sharing between franchisor and franchisee or between franchisees are inherently likely to affect trade between Member States, even if they are between parties resident in the same Member State, because they prevent the franchisees setting up in another Member State' (ground 26). An effect on trade is all the more likely in the present case as Pronuptia holds a significant share of the French market for the relevant products and its network covers several EEC countries (see paragraphs 4 and 6).*" (§29)

"*The Pronuptia standard form agreement does not contain restrictions that are not indispensable to the attainment of the said benefits. The clauses referred to in paragraph 28, which restrict competition by giving the franchisee territorial exclusivity, can be considered, in the circumstances, to be indispensable in that prospective franchisees would probably be unwilling to undertake the necessary investment and to pay a substantial initial fee to enter the franchise system if they were not provided with some protection against competition from other franchisees and from the franchisor in the allotted territory. It should be noted that franchisees are free to buy and sell the products among themselves.*" (§36)

3. RELEVANT LEGISLATION

- Article 101 TFEU
- Regulation 67/67
- Regulation 1983/83

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 Commission applies the principles advanced by the ECJ in its *Pronuptia* judgment and confirms that a franchise agreement does not per se violate Article 101 TFEU. In assessing the specific provisions of the Pronuptia franchise agreement, the Commission again follows the guidance of the ECJ in its *Pronuptia* judgment. The only clauses retained by the Commission as not covered by the ancillary doctrine are those granting territorial exclusivity to the franchisee and obliging the franchisee to operate from an agreed location. These clauses are however exempted by the Commission under Article 101(3) TFEU.

Following this case, a new block exemption regulation (Regulation 4087/88) governing franchise agreements was adopted. No such specific regime is in place at present. Instead, the Commission acknowledges that franchise distribution may be set-up as selective, exclusive or free distribution systems and may therefore be covered by Regulation 2022/720. The accompanying Vertical Guidelines confirm the pertinence of the ancillary restraints doctrine to franchise distribution in line with the ECJ's *Pronuptia* judgment.