FRANCHISE AGREEMENTS AND THE APPLICATION OF ARTICLE 101 TFEU

University of Oslo
Faculty of Law

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Content

1 Introduction

1.1 Choice of topic

Franchising is a business method that is becoming increasingly more popular around the world. Examples of franchises in Norway, are McDonald`s, REMA 1000, Maxbo and Deli de Luca to mention a few. Franchising is a way for the franchisor to expand and develop his successful business, and it is an opportunity for the franchisee to open up a business with the assistance and help of the franchisor and under his trademark and image, that has already been tested on the market.

This thesis will explore franchising agreements in the light of Article 101 of the Treaty on the Functioning of the European Union (from hereafter TFEU). Franchising is usually a combination of a distribution agreement, trademark and knowhow license agreements. Franchise agreements are interesting because they are composed of so many different elements, and in that matter distinct from pure license and distribution agreements.

In relation to Article 101 TFEU, franchising agreements are subject to the same regulations as other types of agreements and can therefore also be deemed to be restrictive of competition. Franchising agreements can be group exempted under the vertical restraints regulation if the necessary conditions are met.

The issues in relation to franchising agreements and the topics that will be discussed here, is, to what extent the different elements of a franchising agreement can restrict competition under Article101 TFEU, and under what conditions the agreements can be exempted.

The thesis will also look at the reason why many franchising agreements are found not to be restrictive of competition at all. The fact is that many franchising agreements contain provisions that might in other agreements be considered restrictions of competition, but are necessary for the proper functioning of a franchise agreement. The problem in relation to this is where the line is drawn. When will a provision go beyond what is needed to fulfill the purpose of the agreement and thus be within the scope of art.101 TFEU? It is also necessary to keep in mind that the purpose of the agreement can be to restrict competition.

1.1.1 The road ahead

The thesis will start with a general introduction of the competition law that is relevant for the purpose of this thesis namely art.101, as well as a look at the interaction between competition law and intellectual property law and the relevant sources and legal method.

Part two of this thesis will look at trade marks and know-how as parts of franchising agreements, and territorial and non-territorial protection in franchise agreements. The way the Court have viewed the topic of territorial and non-territorial restraints will also be looked at, to get an understanding of how these types of restrictions are treated in relation to art.101(1).

The thesis will end with a conclusion on the topic discussed.

1.2 Legal method and sources

1.2.1 The relationship between Norwegian competition law and EU/EEA law

I will in this thesis focus on EU sources as the basis for discussion. The EU sources have EEA relevance and thus relevance for Norway. Norway got a new competition law in 2004[1]. Krrl.§ 10 is now equivalent to § 53 in the EEA agreement and art.101 TFEU.[2]

One of the differences in respect of interpretation of the Norwegian competition rules as opposed to the EEA/EU rules are, that the EEA/ EU rules are interpreted within the aim of

[1] Lov 5.mars 2004 nr.12 konkurranse mellom foretak og kontroll av foretakssammenslutninger.

[2] See Norsk Konkurranserett 2006 ch.2.

market integration in art. 3 TEU.[3] When using EU sources in Norwegian law, the legal method of the EU will have to be applied, and it is the judgments from the CJEU that are the most important source when interpreting art.101 (1), when there are no Norwegian sources available[4].

In this thesis, the legal method of the EU will be applied as it is EU sources that are the focus. There will be no further discussion of EU legal method.

1.2.2 The different EU sources and their relevance for the application of art.101

The primary legislation in EU law is the treaties. The competition rules, and art. 101 can be found in the Consolidated Version on the Treaty on the Functioning of the European Union (TFEU). The secondary legislation in the EU consists of regulations and directives. Mostly relevant for this thesis is the regulations on vertical agreements and the technology transfer regulation. Regulations are binding, and they are directly applicable in all the member states.[5]In Norway however, because we are not member of the EU and we follow the dualistic principle, the regulations will not be directly applicable in the same way they are in the EU member states.[6]

The Court of Justice of the European Union (CJEU) is given the right to give judgments and preliminary rulings on the interpretation of union law from art.19 TEU. The case law of the court is an important and central source of EU law, as it is the Court that perform the ultimate control and interpretation of the legislation.[7]

The Commission has issued guidelines in relation to the two regulations mentioned above. The guidelines are soft law, and thus not binding as such. They do however, offer guidance

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[3] Consolidated Version of the Treaty on European Union, Article 3.

[4] Ørstavik,2011, p.36.

[5] TFEU art.288.

[6] See for example ,EØS –rett, 2004, ch. 8.

[7] Konkurrenceretten i EU p.28.

on how the Commission will apply the regulations to cases involving art. 101, and practice from the Commission can give indications on how future cases will be decided.[8]

1.3 The interaction between competition law and intellectual property law

Wish says in the first sentence of his book on competition law, that: “As a general proposition competition law consists of rules that are intended to protect the process of competition in order to maximize consumer welfare”.[9] Intellectual property law is also concerned with improving consumer welfare through new innovations. There is however, a difference in how the two sets of rules aim to achieve this. Intellectual property rights (IPRs) give the owner a right to exploit his creation and at the same time he can prevent others from taking advantage of his accomplishments. Inherent in an intellectual property right is also the opportunity f or the owner to transfer the right to exploit the innovation to someone else, or to license it for others to use for a certain period of time. Innovation is usually the result of costly investments and to encourage investments the holders of IPRs need to know that their innovations will not be exploited without their consent. The fact that IP law gives the right to the owner of an IPR to decide who where and how their rights can be used, is what can lead to the potential conflict with competition law.

In fact though, IPR and competition law in many ways complement each other. The Commission in their guidelines on technology transfer agreements (from hereafter TT Guidelines) acknowledge the investments and risks that go into the creation of IPRs, and they also point out that most license agreements are pro-competitive and lead to:” dissemination of technology and promotes innovation(…)”[10].Competition law is also concerned with encouraging innovation albeit in a slightly different way. Competition law is concerned with keeping markets open and in that way also stimulating innovation and new technology.

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[8] Konkurrenceretten I EU p.27-28.

[9] Wish 2009 p 25.

[10] Commission Notice 2204/C 101/02 The technology Transfer Agreements Guidelines(from hereafter the TT Guidelines)

IPRs are subject to the internal and national rules of IP law when it comes to their exercise, but at the same time they are also the subject of competition law. Anderman and Schmidt talk about how the competition rules have evolved to create a “second tier” of regulation of the exercise of IPRs.[11]The exercise of the IPR can be lawful in respect of the IP laws, but still be restrictive of competition and found to be in breach of the competition rules. The competition rules do however, acknowledge the special nature of IPRs, and they make room for the normal exercise of IPRs as long as the IPR is not used as a means to restrict competition.[12]. An example of how competition law has accommodated for IPRs is for instance the technology transfer regulation which will be discussed further below.

1.4 Franchise agreements

1.4.1 Introduction

Franchising agreements are described this way in the Commission Guidelines on Vertical Restraints:

“Franchise agreements contain licenses of intellectual property rights relating in particular to trademarks or signs and know-how for the use and distribution of goods or services. In addition to the license of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance (…)”.[13]

There is however, as Norheim explains in his book on franchising and agency agreements, it is hard to find a precise definition of franchising. Common in franchising agreements, is that they consist of many different elements. Although the contracts can vary from system to system, what makes them franchise agreements in his view is that they share many of the same elements and features.[14]

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[11] Anderman and Schmidt p.4.

[12] Anderman and Schmidt p.5-6.

[13] Commision notice, 2010/C 130/01, Guidelines on Vertical Restraints, para 189.

[14] Norheim 2003, p 47.

Franchising is thus agreements of a rather complex nature, and they contain both distribution and licensing.

What does franchising as a business model have to offer?

Franchising is a business model that gives the possibility for the franchisee to open a business with the support of the franchisor and under his name, image and business model which has already been tested on the market and already has a (good) reputation and a brand that is known to the public. In this way franchising promotes inter brand competition. This means that the opening of franchises contribute to more competition between the franchise brand and other competing brands on the market. Also, by being part of a franchise network the franchisees might be able to get their products at a lower cost and this could ultimately benefit the consumers who will pay less for the products.

1.4.2 The different types of franchising agreements

The different types of franchise agreements might entail different considerations under competition law. The issue under the competition rules might differ in relation to what element is most important in the different types of franchises.

1.4.2.1 Distribution and service franchising agreements

Before looking at the application of art.101 to franchise agreements, it is therefore worth taking a quick look at some of the different types of franchising agreements.

Service franchise is an arrangement whereby the franchisee offers services under the business name or symbol and sometimes the trade mark of the franchisor, and follows the franchisors instructions. The Commission is of the opinion that know-how is of more significance in service franchises than it is in distribution franchises.[15]

[15] Konkurrenceretten i EU,2009,p 372.

A distribution franchise is an arrangement where a franchisor sells products using the franchisors branding and business method in exchange for payment. These two types of franchising have been treated similarly in EU competition law. [16]A distribution franchise can be described as a franchise agreement where the franchisee sells certain products in a shop which carries the franchisor business name and or symbol.[17]

1.4.2.2 Production/industrial franchise

A production franchise, is as the name suggests, when a franchisee manufactures products in accordance with the instructions of the franchisor and then sells them under the franchisors branding.[18]For example, party A, a producer of special drinks, licenses to party B its know-how and trade mark. Party B then uses the license to produce the drink, and then sells the drink under the trade mark of party A.

1.5 Art.101 – restriction of competition

1.5.1 What can constitute a restriction on competition in a franchise agreement?

For an agreement to be caught by art.101 it has to fulfill certain conditions. Of most interest to this thesis will be the criterion of showing a restriction of competition, but I will briefly mention the other conditions.

Art.101 prohibits these types of agreements: agreement between undertakings, decisions by associations of undertakings and concerted practices. Franchise agreement will be agreements within the meaning of art.101.[19]

For art.101 to apply it is also necessary that the agreement "(…) may affect trade between Member States (…)".[20]The affect on trade must also be appreciable. The stronger the market power of the companies the more likely it will be that the effect is appreciable. It follows from this, that agreements with little effect on trade and competition will not be

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[16] Turner 2010 p 284.

[17] Case 161/84 Pronuptia para 13.

[18] Turner, 2010, p 284.

[19] See for example Wish 2009 p 97-113.

[20] Article.101 (1) TFEU.

caught by art.101.[21]This is not a relevant consideration in internal Norwegian competition law.

The focus of this thesis will be on the restriction of competition condition.

Art.101 prohibits agreements which have as their: "object or effect the prevention, restriction or distortion of competition within the common market (…)".[22]Franchise agreements like other agreements will be subject to the competition rules, and might be found to restrict competition. Art. 101 prohibit both agreements that have as their object the restriction of competition, and agreements that will have that affect. These conditions are alternative, and therefore once an agreement is found to have the object of restricting competition, it is not necessary to examine the effects.

Horizontal agreements (agreements between companies that operate at the same level of the market) have always been subject to the application of art.101 (1).At first, there was discussion as to whether vertical agreements were capable of restriction of competition under art.101 (1), however, following the case of Consten and Grundig, it is now well established that also vertical agreements[23] can be caught.[24] Franchise agreements can therefore, as mentioned above restrict competition. It is not enough however, showing a restriction on competition, in addition, the restriction has to be appreciable. In relation to vertical agreements and thus franchising agreements the possible restrictions on competition can be to intra-brand as well as inter-brand competition. Intra-brand competition is competition between the same brand .Inter-brand competition, is competition between different brands. Inter and intra-brand competition will be further discussed in part two.

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[21] See for example Wish 2009 p 137-142.

[22] Article.101. TFEU.

[23] Vertical agreements, are agreements concluded between companies that operate at different levels of the market.

[24] Cases 56 and 58/64, Etablissements Consten As and Grundig-Verkaufs-GmbH v, Commission [1966] ECR 299.

In the Commission Guidelines on the application of article 101(3) they say at paragraph 17 that both the effect on inter and intra-brand competition will have to be considered to see if an agreements restricts competition.[25]

If an agreement is found to restrict competition and it cannot be exempted under Article 101(3) it will be void under art.101 (2).The CJEU has however held that it is only the clauses in the agreement that are prohibited that are affected. If the prohibited clauses cannot be severed from the rest of the agreement, the whole agreement will be void. The agreement will be void automatically.[26]

Agreements that are found to restrict competition can however by satisfying the conditions of art.101 (3) still be legal.

The conclusion can be made that art.101 (1) can be applied to franchise agreements.

1.6 Art.101 (3) – exemption

1.6.1 When does a franchise agreement satisfy the conditions of art.101 (3)?

If an agreement is found to restrict competition under 101 it can still be saved if it satisfies the conditions of art.101 (3).When an agreement is exempted it means that art.101(1) does not apply.

Art.101 (3) is where the weighing of positive and negative effects of the agreement takes place. There are four conditions that have to be fulfilled in order for art.101 (3) to apply.

Art.101(3) states that art,101(1) may be inapplicable in the case of agreements that:”(…)contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing the consumers a fair share of the resulting benefit and which does not:

a) Impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

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[25] Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08).

[26] Jones and Sufrin 2011,p 121.

b) Afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."[27]

Franchise agreements will often fulfill the first two positive conditions. The other two conditions will have to be looked at in relation to each agreement to see if they are fulfilled.

1.6.2 The block exemptions

In addition to individual exemption, agreements can if they fall into a certain category, be block exempted. If an agreement fulfills the conditions of a block exemption, art.101 (1) is no longer applicable.

Franchise agreements do not qualify under their own block exemption any longer.[28] They are now dealt with under the vertical restraints block exemption (the VBER). Franchise agreements do however, contain IPRs namely know-how and trade marks, and there is a connection between the two block exemptions, therefore the block exemption for technology transfer(the TTBER) will be discussed together with the vertical restraints block exemption.

The guidelines on vertical restraints do mention franchise agreements specifically. The guidelines make two specific remarks in relation to franchising:

"(a) The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or are indispensable to protect the know-how and that the vertical restraints fulfill the conditions of Article 101(3);

(b)A non-compete obligation on the goods or services purchased by the franchise falls outside the scope of Article 101(1) where the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of

[27] Article 101(3) TFEU.

[28] Regulation 4087/88, OJ [1988] L 359/46, now expired.

the non-compete obligation is also irrelevant under Article 101(1), as long as it does not exceed the duration of the franchise agreement itself".[29]

These two paragraphs show that the Commission recognizes in the guidelines the special nature of the franchise agreement and that certain restrictions are necessary for the protection of know- how in the agreement and for maintaining the identity and reputation of the franchise network.

To qualify for the TTBER and the VBER the undertakings will have to come within the market share thresholds. For agreements between non-competitors in the TTBER the market share threshold is 30 percent[30], the same is true for the VBER.[31] There is however, as the regulation clearly states, no presumption that agreements which exceed the 30percent threshold fall within art.101 (1).

The block exemptions have a list of hardcore restrictions that will not be allowed in agreements. There are however exceptions to the hardcore restrictions and these are important because they to a certain extent, allow territorial restrictions. These will be looked at below in part two.

1.6.2.1 The relationship between the block exemptions

The block exemptions cover two different areas. The Vertical Restraints Regulation say in art.2 (5) that it does not apply to "vertical agreements the subject matter which falls within the scope of another block exemption regulation, unless otherwise provided for in such a regulation"[32]Although they in some ways overlap, the vertical restraints regulation makes it

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[29] Guidelines on Vertical Restraints (2010/C 130/01) para (190).

[30] TTBER NO 772/2004 Article 3.2..

[31] VBER NO 330/2010 Article 3.1.

[32] Commission Regulation NO 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices Article 2(5).

clear that agreements which main purpose is the transfer of technology for example, will not be exempted under the vertical restraints regulation. Where an agreement contain both the transfer of technology as well as distribution of the products, the agreement will have to be analyzed to see which part constitutes the primary object of the agreement and thus which block exemption it will fall under, if any.

The vertical restraints guidelines describe when agreements which also regulate IPRs can be exempted under the vertical regulation. This is evidently important in the case of franchise agreements because of the importance of IPRs in such agreements. The vertical restraints guidelines mention five criteria that have to be satisfied for the IPRs in vertical agreements to be exempted. These conditions are:

"(a) The IPR provisions must be part of a vertical agreements, that is, an agreement with conditions under which the parties may purchase, sell or resell certain goods or services;

(b) The IPRs must be assigned to, or licensed for use by, the buyer;

(c)The IPR provisions must not constitute the primary object of the agreement;

(d)The IPR provisions must be directly related to the use, sale or resale of goods or services by the buyer or its customers. In the case of franchising where marketing forms the object of exploitation of the IPRs, the goods or services are distributed by the master franchisee or the franchisees;

(e)The IPR provisions, in relation to the contract goods or services, must not contain restrictions of competition having the same object as vertical restraints which are not exempted under the Block Exemption Regulation."[33]

Franchise agreements being agreements which involve licensing of know-how and trade marks must to qualify for exemption under the vertical restraints regulation comply with these conditions. If the main part of the franchise agreement is the licensing of IPRs for example in an industrial franchise, the regulation wont apply. It is possible that an

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[33] Guidelines on Vertical Restraints (2010/C 130/01) Article 2(4) para(31).

agreement having as its primary object the license of IPRs can be exempted under the technology transfer regulation.

The conclusion from this issue is that the two block exemptions to a certain extent overlap, and that the agreements and the clauses in them will have to be analyzed to see whether they qualify for exemption under one or the other of the block exemptions. Franchise agreements being and agreement involving the transfer of know-how and trade marks thus have to be analyzed to see if the transfer of IPRs is the main purpose of the agreement and so will not qualify under the VBER.

1.7 What has changed with the new economic approach to art.101?

The modernised economic approach introduced by the Regulation 1/2003, makes a change in how agreements will be assessed under art.101.Before the new approach, the important factor to look at was whether the agreements restricted the competitive autonomy of the companies. When assessing agreements under art.101 today, the anticompetitive harm of the agreements is the crucial factor. Restriction on the rivalry of companies does still play a role, but in addition to showing a restriction on the competition, the agreement has to have appreciable anticompetitive effects on the market.[34]

The new approach also affects the block exemptions, both the TTBER and the VBER. Whereas before, the block exemptions were very formalistic which means that they contained lists of clauses that were legal and not, the new block exemptions offer more flexibility. Under the old regime, to be safe, many agreements were construed to fit within the framework of the exemptions. The block exemptions now offer a “safe harbour”[35], but they do not offer the legal certainty that were offered with the old block exemptions,

[34] See Anderman and Kallaugher 2006 ch.3.

[35] Anderman and Schmidt 2011 p 204.

agreements above the market share limit will have to see if they qualify for individual exemption under art.101(3).[36]

With the new framework for the TTBER and the other block exemptions comes a new way of reaching the economic goal, which together with the other competition goals of freedom of action and vertical integration, looks at the effect the agreement will have on competition and hence consumer welfare .Another important change is that there is no need for prior notification of the agreements to the Commission. The parties themselves assess whether the agreements is covered by the block exemption or, if it is not covered, makes the assessments necessary under art.101 (3).[37]

From this the conclusion can be made that the new economic approach offers more flexibility for the parties when making agreements, because they are no longer constrained by the formalities under the old block exemptions. Under the new approach there is more focus on the actual anti-competitive harm of the agreements,

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[36] See Anderman and Schmidt 2011 p 204.

[37] See Anderman and Schmidt 2011 p 203-207.

2 The elements of franchising agreements and the application of art.101

How does the complex nature of the franchise agreement affect its treatment under art.101 in comparison to how other vertical agreements are considered?

- In relation to territorial restraints
- In relation to non-territorial restraints

2.1 Introduction

Franchises can, as mentioned above be found all around us in today's society. Franchising has become a business method which is popular when business wants to expand. Examples of international franchises that exist today are: McDonalds and 7-Eleven to mention a few. The relationship between the franchisor and the franchisee can be described this way:

For example, a manufacturer has come up with a new business model for selling teddy bears. Their new model involves customers coming to their shops and having teddy bears customized and made on the spot with special equipment also developed by the manufacturer. The manufacturer also produces the special cotton stuffing for the teddy bears and the teddy bears material used for the stuffing. It is important for the quality of these special bears that they use the special cotton stuffing produced by the manufacturer. The teddy bears are a big success and are sold from the manufacturers shops where the shops all share the same brand name and image. The manufacturer wanting to expand his teddy bear concept decides to open a franchise network. The franchisees will have to comply with certain conditions when joining the network. They are obliged to buy the special cotton stuffing, the material for the teddy bears and the machines to produce the teddy bears from the manufacturer. In addition to this they have to operate under the same name and have the same image as well as paying a royalty fee, contributing to the same advertising and keeping the information from the manual from the franchisor confidential. They also have to only sell the products from certain locations, to end-user or other franchisees in the network and only to sell the products from the franchisor. The franchisor also has obligations, he will not appoint any other franchisees in a given territory, and he will not himself open any shops in that territory. The franchisor is also under an obligation to keep developing his products, business outlook and the manual and to make the improvements achieved available to the franchisees.[38]

Franchise agreements can be exempted as mentioned above, by the vertical restraints group exemption and industrial franchises possibly by the technology transfer group exemption. The franchise agreement is treated similarly to other distribution agreements which can be exempted under the vertical restraints block exemption. I will look at in some detail two of the main components usually present in a franchising agreement, namely trademarks and know-how .These two elements are crucial to the franchise agreement, and they serve different purposes in the agreement. The trademark is important to maintain the uniform image of the network and to distinguish the brand from other brands. The know-how is also important for the uniformity of the franchise, making sure that the same methods are used in all the franchises and that the same quality is represented among all the franchisees. A closer look at these elements will show the role they play in franchising agreements and in other agreements and what legal implications they have as part of an agreement both as part of technology transfer agreements, and as part of other vertical agreements. The presence of the different elements in the franchise agreement is decisive for whether the agreements will come within the vertical restraints block exemption, the technology transfer exemption or if it will fall outside of both regulations.

[38] See the Vertical Restraints Guidelines (2010/C 130/01) para (191) for the Commission`s example.

2.2 Trademarks

Trademarks are intellectual property rights, but they are different from patents and know-how in that they are not concerned with innovation. The role of trademarks is to indicate origin and perhaps quality, and to help the consumer in making their choices in the consumer market. Trademarks are there to distinguish one product from another. This can be contrasted to the function of patents which is to give a patented innovation protection from a third party manufacturing or selling the product during a fixed period of time.[39]

Trademarks play an important role in franchising agreements because they represent the franchise network and contribute to the same uniform image between the different franchisees. In relation to franchises this can be both good and bad. Having the same image makes the customers identify the different franchisees with each other, and they expect the same quality and products in all the franchisees. This means that the franchisees can benefit from each other's (good) reputation. On the other hand the mistakes or bad impression left by one franchisee to the customer, can affect the whole network in a negative way.[40]

2.3 Know-how

Know-how in franchise agreements –why is protection of know-how important in franchise agreements?

Know-how is for a business, valuable technical information relating to for instance how a product is made or information concerning other non-technical processes. Keeping such information and knowledge secret is important for the business, because it gives the company advantages compared to other companies not having this information. Know-how can be protected through provisions in the agreement. These provisions aimed at protecting the know-how, are provisions that can be restrictive of competition. Know-how can be compared to patents because they also concern innovation. Know-how is often licensed together with patents.

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[39] Ghidini, 2006, p 79-80.

[40] Norheim 2003,p 74-75.

A franchisor will invest a lot of time and effort in developing and operating an effective and profitable business system. The systems developed by the franchisor can include methods of distributing, merchandising, packaging, promoting and marketing. These systems might consist of a design, décor or color scheme for the premises, layout for equipment of furniture, or they might be procedures in accounting, inventory control and management. All these methods and what they entail, is what can be called the franchisors know-how. [41]

Know-how is very important for the proper functioning of a franchise agreement because it makes it possible for the franchisor to impose the same standard on all the franchisees. In fact, the vertical restraints guidelines states, that the more important the transfer of know-how, the more likely the agreement is to be exempted.[42]Know-how and the protection that can be offered in a franchise agreement without infringing art.101 (1) will be discussed further below in relation to non-territorial restraints.

Know-how license agreements can benefit from the technology transfer regulation. Although know-how is not an IPR as such, it is considered together with the other IPRs and shares as mentioned above some of the same qualities as patents. Know-how is defined this way in the technology transfer regulation:"

"know-how "means a package of non-patented practical information, resulting from experience and testing, which is:

(i) secret ,that is to say, not generally known or easily accessible

(ii)substantial, that is to say, significant and useful for the protection of the contract products, and

(iii) identified, that is to say, described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfills the criteria of secrecy and substantiality".[43]

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[41] Mendelsohn.2004,p 217.

[42] Guidelines on Vertical Restraints (2010/C 130/01) para (190) (a)

[43] On the application of article 81(3) of the Treaty to categories of technology transfer agreements (No 772/2004) Article 1.

This mean for franchise agreements, that first of all the know-how must not have been patented. In distribution franchise agreements it would be unlikely if the know-how would be of a nature that could be patented. This could perhaps be, because in distribution franchises the know-how is usually more of a commercial nature, relating to the business concept. Secondly, the testing and experience that goes into the know-how would have to be done by the franchisor himself. Thirdly, that the know-how has to be significant and useful means in relation to franchise agreements that it has to be significant and useful to the franchisee. This is a personal requirement. The last condition that the know-how has to be described is satisfied in franchise agreements if the know-how is described for example in a written document or perhaps in a programmed instruction that can be used on a computer.[44]

The fact that know-how is described as non-patented practical information implies that it is not limited to technical know-how.[45] The type of know-how usually licensed in a franchise agreement would therefore be covered by this definition, as well as technical know-how normally licensed in connection with an industrial franchise agreement.

The conclusion that can be made is that know-how is very important for the franchisor, as he has put a lot of time, effort and money into developing the know-how. Therefore it is necessary that the know-how is protected through clauses in the franchise agreement. Without provisions protecting the know-how in the agreement, there would be a risk that the know-how could fall into the hands of competitors, and taking such a risk would no franchisor do.

[44] Goyder, 2011, p 197.

[45] Lunde,2007,p 17.

3 Territorial restrictions and exclusivity in franchise agreements

3.1.1 Why are territorial restraints important in franchise agreements?

Territorial restrictions are restrictions imposed on in our case, the franchisor and the franchisee on, where they can sell the goods or supply a service, to whom they can sell goods or supply a service and on where and if they can open another shop in a given territory. Territorial restrictions can also be imposed in relation to the use of the franchisors trademark. The combination of different territorial protection in relation to the franchisee and the franchisor can lead to restrictions on competition that will need to be looked closer at to establish whether they are restrictions that can be exempted under the block exemptions, possibly by an individual exemption, or whether they are types of restrictions that will not be a concern under art.101 (1).

In vertical agreements the possibility of territorial restraints is important. This is due to a number of reasons. For example, imposing territorial restraints is a way of opening up and entering new markets. This is because, without certain guarantees relating to protection of the territory in which a licensee or a distributor operate, they would not have taking the risk of investing in new products and many products would not have found its way on to the market. This would be detrimental to the consumers who would have less to choose from.

This is also however; a type of restraints in an agreement competition law is focused on monitoring closely, this is because of the importance of market integration in the EU. There are several ways territorial restrictions are used in agreements, and there are differences in the way they are treated under competition law.

To see how territorial restraints are treated in franchise agreements, a look at how territorial restraints have been treated in general in relation to vertical agreements, can give an indication on how territorial restraints in franchise agreements are treated under the competition rules.

Both the TTBER and the VBER allow to a certain extent territorial restrictions. It is well established that certain restraints on competition are allowed because in fact they also have a positive effect on competition leading to new and better products on the market. Before territorial restraints in the block exemptions are considered we will have a look at how the Court has treated territorial restrictions in vertical agreements. These judgments are still relevant despite some of them being of old age, because they show how the Court looks at territorial restrictions in vertical agreements .The judgments have also influenced the block exemptions which will be looked at below.

3.1.2 The CJEUs view on territorial restrictions in vertical agreements

In Consten and Grundig[46] as mentioned above the agreement was found to restrict competition by object due to the fact that it gave absolute territorial protection in the way of an exclusive distribution agreement combined with absolute territorial protection. Consten was also assigned the Grundig trademark GINT which further reinforced the territorial protection given by Grundig. The agreement had the effect of preventing all parallel imports of Grundig products into France. This case demonstrates the great emphasis competition law has on preventing the division of the common market and the importance of the market integration goal in the EU.

In addition to being a case concerning distribution, the case also raises issues in relation to intellectual property rights and the way that IPRs can be used as a means of dividing the markets. The exclusive trademark license given to Consten was used as a means of creating absolute territorial protection. This shows that a trademark license can be used in combination with other territorial restrictions to create restrictions on competition that are prohibited under art.101(1).Trademark licenses can also be used this way in franchise agreements to create absolute territorial protection. This can happen when the trade mark license is combined with other territorial restrictions, and is problematic if the brand is well-know, because it can like in Consten and Grundig lead to absolute territorial protection. This would however, have to be decided upon an analysis of each agreement.

The next case involving an exclusive license to come before the court was the Nungesser case.

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[46] Consten and Grundig Joined Cases 56 and 58/64.

The case of Nungesser v Commission[47] was a case involving the license of plant breeders`rights, also called the Maize Seed case. Although this case is limited to plant breeders ` rights the reasoning of the court is relevant also:" to the consideration of territorial protection relating to the distribution of goods and services where substantial levels of investment are involved and distributors may be deterred from making such investments unless they have assurances that they will not face active competition from the grantor of the distribution rights".[48]

Therefore the reasoning of the court will apply to other manufacturing licenses such as patent and know-how licenses.[49]This case can thus have implications for how a franchise agreement involving licensing of know-how will be viewed by the courts.

In this case the court made a distinction between two types of territorial protection, open exclusivity and closed exclusivity. They described the difference between the two this way:

"It should be observed that those two sets of considerations relate to two legal situations which are not necessarily identical .The first case concerns a so-called open exclusive license or assignment and the exclusivity of the license relates solely to the contractual relationship between the owner of the right and the licensee, whereby the owner merely undertakes not to grant other license in respect of the same territory and not to compete himself with the licensee on that territory. On the other hand, the second case involves an exclusive license or assignment with absolute territorial protection, under which the parties to the contract propose, as regards the products and the territory in question, to eliminate all competition from third parties, such parallel importers or licensees for other territories."[50]

An open license thus only affects the relationship between the licensor and the licensee. This is not considered to cause any problems. A closed exclusive license in comparison will affect not only the relationship between the licensor and the licensee, but also the

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[47] Nungesser v Commission, 258/78 [1982] ECR 2015.

[48] Faull and Nikpay 2007, s1163.

[49] Jones and Sufrin 2011,p 723.

[50] Case 258/78 L.C Nungesser KG and Kurt Eisele v Commission, para53.

relationship to third parties. This is problematic because it results in absolute territorial protection. The absolute territorial protection occurs because the closed exclusive license prevents parallel imports, and thus prevents competition from third parties.

Although the reasoning of the court in Nungesser can apply to other types of rights, the special nature of the products in question will be a factor in determining whether the agreement restricts competition within art.101(1).[51]

Another case involving the license of seeds is the Erauw Jacquery case[52].In the case involving basic seeds, an export ban and customer restrictions on licensee were found to be compatible with art.101 (1).This was due to the need for quality control with the seeds. The risk of the technology in the seed falling into the hands of competitors the Advocate General compared with the risk faced by a franchisor risking that its know-how might benefit competitors.[53] Quality control is also something that is necessary in franchise agreements, because of the protection of the importance of the uniform image of the franchises. The franchise all need to have the same quality of their products, although this is important, it might not be as important as it is in the context of basic seeds, but there are certain similarities in that ensuring a certain quality is important for the agreement to fulfill its purpose.

The court also in this cases emphasizes on the big investments that has gone into the development of the seeds, and because of the financial commitment the licensor have to be able to protect himself against improper handling of the seeds.[54]This shows that the territorial protection is necessary to protect the financial investments gone into the development of in this case basic seeds. The risk of investing and licensing will have to be supported by restrictions that will protect the investment and make sure that the investment will be profitable. It could be argued that the know-how developed by the franchisor using considerable effort and investments, also needs the same type of protection for the

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[51] Case 258/78 L.C Nungesser KG and Kurt Eisele v Commission para 58.

[52] Case 27/87 Erauw-Jacquery Sprl v La Hesbigonne Societe Cooperative [1988] ECR 1919.

[53] Anderman and Schmidt 2011,p 246.

[54] Case 27/87 Erauw-Jacquery, para 10.

franchisor to risk licensing his know-how to the franchisees. The level of protection needed would depend on the type of know-how in question in each franchise agreement.

In the Coditel cases[55], concerning exclusive exhibition rights to a French film (a performance copyright), the absolute territorial protection given was found not to restrict competition within art.101.Absolute territorial protection was found necessary because it was the only way of protecting against re-transmissions. These cases show that the court is special circumstances when it is necessary for the purpose of the agreement not to be frustrated to allow absolute territorial protection. In relation to certain types of franchise agreements it could also, if the type of product in question requires it, be necessary with absolute territorial protection .The Courts willingness to allow absolute territorial protection in Coditel opened up the width of clauses that can be found not to be restrictive of competition under art.101(1).Although considering the special nature of the product in Coditel, it is unlikely that absolute territorial protection would be allowed in many other cases.

Territorial restraints have also been the subject of a case involving a franchise agreement. Pronuptia[56] involved a distribution franchising agreement of weeding clothes and accessories between the French parent company, and the German subsidiary which acted in its own name. The court says in paragraph 14, that: “The compatibility of franchise agreements for the distribution of goods with Article 85(1) cannot be assessed in abstracto but depends on the provisions contained in such agreements (…)”.

The Court comes to the conclusion that the provisions in this franchising agreement that are necessary for the proper functioning of the agreement will not restrict competition. This is not the case however, with certain other provisions. The court explains it this way:”It must be emphasized on the other hand that, far from being necessary for the protection of the know-how provided or the maintenance of the network’s identity and reputation, certain provisions restrict competition between the members of the network. That is true of

[55] Case 62/79 Coditel v Cine Vog Films(Coditel I) and case 262/81 Coditel Cine Vog Films(Coditel II)

[56] Case 161/84 Pronuptia de Paris v Pronuptia de Paris Irmgard Schillgalis [1986]ECR 353

provisions which share markets between the franchisor and the franchisees or between the franchisees or prevent franchisees from engaging in price competition with each other”.[57]

The Court did clear many provisions as ancillary restrictions and thus not restrictive of competition but when it came to provisions dividing up the markets between the franchisor and the franchisees , the court was not willing to see them as genuine ancillary restraints, at least not where the brands were well-know and would restrict competition under art.101.The Court do acknowledge that a franchisee might not take the risk of joining the franchise network where he has to invest his money, pay an entrance fee, and pay annual royalties if he is not offered territorial protection. That consideration, says the court, shall be made under art.101 (3).[58]

Although Pronuptia was a case concerning a distribution franchise agreement, after Pronuptia a series of Commission decisions also involving other types of franchise agreements were given individual exemption under art 101(3).

First, there was the Commission decision in Yves Rocher [59].Yves Rocher is a cosmetic company, and the decision concerned a system of standard form franchise contract for the retailing of cosmetics .Yves Rocher was similar to Pronuptia in that both cases concerned goods selected or manufactured by the franchisor. The restrictions in the contracts concerning territorial protection were found to restrict competition. This clauses involved an exclusive territory given to a franchisee in which to use the trademarks and know-how for the sale of Yves Rochers products, an obligation on the franchisor not to establish himself in any of the territories of the franchisees and an obligation on the franchisees not to open any other shops which would be a result of the franchisees being prohibited from

[57] Case 161/84 Pronuptia,, para 23.

[58] Case161/84 Pronuptia, para 24.

[59] Yves Rocher [1987] OJ L8/49

using the Yves Rochers trademarks outside their given territory.[60]The clauses were however, exempted under article 101(3).

ServiceMaster [61]was a Commission decision concerning a service franchise. ServiceMaster is a supplier of housekeeping, cleaning and maintenance services to commercial and domestic customers. The Commission considered a service franchise to have strong similarities with distribution franchises, and because of that they can be treated in the same way as distribution franchises under the competition rules.[62]The Commission also in this case found that the territorial restrictions would fall under art.101 (1), but again an exemption was given. After these decisions, the Commission went on to adopt a block exemption for franchise agreements.[63] This block exemption has expired and has been replaced by the vertical restraints block exemption which is applicable to certain types of franchise agreements.

Theses decisions show that territorial restrictions in different types of franchise agreements that lead to a sharing of the markets will restrict competition under art.101 (1).It also shows the Commissions willingness to exempt the agreements under art.101 (3) because they make positive contribution to the competition, and that the reasoning adopted in Pronuptia, a distribution franchise, also applies to other types of franchise agreements such as service franchises.

Anderman and Schmidt considers that in relation to territorial IPR restraints there is a two-fold test for when a territorial provision is cleared under art.101(1).The first question is ,whether the degree of territorial protection is essential to ensure that the licensing agreement will result in market opening for the product? The second question is whether

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[60] Yves Rocher [1987] OJ L8/49 para (54).

[61] ServiceMaster OJ[1988] L332/38.

[62] Service Master OJ[1988] L332/38 para (6).

[63] Regulation 4087/88,OJ [1988] L 359/46

the provisions effect on intra-brand interstate is outweighed by the benefits of the extension of manufacture of goods or provision of service?[64]The first question in this test suggests that the product in question that has to enter the market will be a factor, when considering whether the territorial restraints are necessary. Certain products require more protection than other to be able to enter the markets something that can be seen in the courts considerations in the seed cases and in Coditel. The second question looks at whether the territorial restrictions that lead to less intra-brand competition none the less have a positive effect on competition because they give the possibility of introducing a new product or service to the market.

These cases show that the Court do not see all territorial protections as restrictions under art.101(1).They are willing to make exceptions but only to a limited extent. The cases where the Court found the restrictions not to be within the scope of art.101 (1) were cases where there was an IPR of a rather special nature like basic seeds and performance copyright. The nature of the IPRs was the reason why the IPR needed strong territorial protection and in my view why the restrictions were not caught be art.101 (1). In most other cases like Pronuptia and the other Commission decisions on franchising, the territorial restrictions were found to restrict competition and needed thus to be exempted. The restrictions in those cases were not considered necessary to protect the IPRs in question.

3.1.3 Hardcore restrictions under the block exemptions

In order to look at the territorial restrictions and non-territorial restrictions that are allowed under the block exemptions, a look at those restrictions that are not exemptible is necessary because under the block exemptions all restrictions that are not hardcore are allowed. There are some provisions that are seen as having as their object the restriction of competition, and because of that they cannot be exempted. What do the hardcore restrictions say about restrictions in vertical agreements and how will these prohibitions affect franchise agreements?

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[64] Anderman and Schmidt 2011, p 247.

Both block exemptions list the hardcore restrictions in Article 4.In the TTBER it is Article 4.2 which is relevant in this connection because it concerns agreements between non-competitors which includes vertical agreements. There are many similarities between the hardcore restrictions in the block exemptions, and these will be looked at first. Provisions of the kind listed as hardcore, are seen as having the object to restrict competition, and are also presumed unlikely to fulfill the conditions of art.101(3).[65]

Provisions involving price-fixing are prohibited under both block exemptions. This is not surprising as this would affect the competition in a negative way and be detrimental to the consumers who would most likely have to pay higher prices for the products and services.

Also restrictions on the territory to or on to which customers the party can sell are prohibited. This prohibition is not without exception, and both block exemptions will allow certain restrictions. These exceptions can be found in respectively TTBER Article 4.2(b) and VBER Article 4(b) .These are important exceptions, because without the ability to impose restrictions on customers or territory or both many agreements would not be concluded. These restrictions differ slightly, mainly because it has been acknowledged that there is a greater need to be able to have these restrictions in technology transfer agreements than it is in distribution agreements. This is due to the fact that innovation of IPRs requires larger investments.[66] These exceptions will be looked at in detail below as they are so important to vertical agreements including franchising agreements.

The conclusion to be drawn from the hardcore restrictions is that they limit the restrictions that can be imposed in franchise agreements. Provisions aimed at fixing prices in the franchise network will most certainly not be allowed. The same applies to provisions aimed a partitioning the market either in relation to territory or customers. These are restrictions

[65] Guidelines on Vertical Restraints (2010/C 130/01) para (47) and TT Guidelines (2004/C 101/02) para 75.
[66] Wish, 2009,p 760.

that are seen as having the object of restricting competition and therefore to allow them would ultimately harm the consumers.

In addition to hardcore restrictions there are also some restrictions that are excluded, this means that they will not be exempted, but they do not affect the rest of the agreement from being exempted. This excluded restrictions include non-compete clauses that are important to franchise agreements. However non-compete restrictions can under certain conditions be allowed. Article 5(a) in the vertical restraints regulation contains a list of obligations that the exemption in Article 2 will not apply to. This list of excluded restrictions involves direct or indirect non-compete obligations. Non-compete obligations will only be exempted if they do not exceed 5 years. If the non-compete clause is renewable beyond a period of five years, the clause will be seen as being indefinite and thus non-exemptible.

Article 5(b) excludes from exemption "any direct or indirect obligation causing the buyer after termination of the agreement, not to manufacture, purchase, sell or resell goods or services". However in Article 5.3 the regulation states that the exemption in article 2, shall apply to, for instance an obligation that is indispensable to protect the know-how transferred by the supplier to the buyer. [67]

This does definitely apply to franchise agreement where the transfer of know-how is very important for the franchise agreements function. Therefore the conclusion can be made that it is legitimate to include in a franchise agreement a non-compete clause, at least for the duration of the franchise agreement.

3.2 Territorial exclusivity in license agreements under the TTBER

The TTBER and the VBER are different in respect to how much territorial protection that can be given in an agreement. Therefore it matters whether a franchise agreement can be

[67] Regulation No 330/2010 ,Article 5.1 (b) and Article 5.3.

exempted as a technology transfer agreement or as a vertical agreement under the vertical restraint regulation. A closer look at both the block exemptions and the territorial restraints they offer will show what the difference consist of and why there is a difference in the territorial protection that can be given.

How does the TTBER show the importance of protecting the investments gone into IPRs in relation to territorial restrictions and how does trade mark protection affect territorial restrictions in agreements? First we will have a look at trademarks and trademark licensing.

To understand the effect trademarks can have on the market, and thus on the competition, it is worth looking closer at the function and goal of trademarks. Lassen and Stenvik in their book "Kjennetegnsrett" say, that the purpose of trademark law has from the beginning, been to mark the products commercial origin and, that this is the main function of trademarks. They also mention that this has been emphasized by the CJEU in several cases, and that it is symptomatic that this function of the trademark is established in the trademark directive[68] recital 11.[69]Trademarks are however, used to offer territorial protection, divide the markets and thus restrict competition. This can be seen from the Consten and Grundig case[70].

In Consten and Grundig, Consten was appointed as the exclusive distributor of Grundig products in France. The agreement which offered absolute territorial protection on the licensee of a trade mark was found to restrict competition within art.101 (1).

Trademarks are treated a bit differently than the other intellectual property rights. There is no block exemption that covers trademarks licensing, where the main part of the agreement is the licensing of a trademark. This is due to the fact that trademarks do not have the same function as patents and know-how and do not require the same type of protection. The TT guidelines explain how trademarks can be used in connection with other IPRs:

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[68] Directive 2008/95/EC , to approximate the laws of the Member States relating to trade marks.

[69] Stuevold Lassen and Stenvik 2011 p 25-27.

[70] Joined cases 56&58/64 Consten and Grundig v Commission [1978] ECR 299.

“The TTBER only covers licensing of other types of intellectual property such as trademarks(…),to the extent that they are directly related to the exploitation of the licensed technology and do not constitute the primary object of the agreement. This ensures that agreements covering other types of intellectual property rights are only block exempted to the extent that these other intellectual property rights serve to enable the licensee to better exploit the licensed technology. The licensor may for instance authorize the licensee to use his trademark on the products incorporating the licensed technology. The trademark license may allow the licensee to better exploit the licensed technology by allowing consumers to make an immediate link between the product and the characteristics imputed to it by the licensed technology. An obligation on the licensee to use the licensor`s trademark may also promote the dissemination of technology by allowing the licensor to identify himself as the source of the underlying technology (…).”[71]

From this the conclusion can be drawn that trademark licensing in technology transfer agreements can serve an important function as a way of making new technology known to the market and to connect the use of the trademark with the licensed technology. However when the trademark is not there to benefit the other intellectual property right, but the license of the trademark is the main purpose of the agreement, the block exemption won’t apply.

Trademarks can therefore as explained above have a very useful function used in connection with other IPRs. There are different types of licenses that are used to protect IPRs, so that the licensees will be willing to make the necessary investments in the technology.

One way of protecting the investments that usually comes with IPs, is with a sole license. A sole license will protect the licensee from others producing the same product in a given territory. The licensor can still produce in the territory. Similar to the sole license is the exclusive license. An exclusive license is like a sole license with the difference that the licensor will not himself produce in the territory of the licensee.

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[71] The TT Guidelines(2004/C 101/02) para 50.

The other way a licensor can offer protection to their licensees is with sales restrictions. A sales restriction will give the licensee the benefit that the licensor won't sell into their territory.

The technology transfer block exemption allows certain restrictions in license agreements because the agreements are in fact pro-competitive, due to the agreement being a way of introducing a new product to the market that might other wise not have been offered to the consumers. In both the TTBER and the VBER, because they no longer contain white and grey lists, everything that is not prohibited is permitted.

These are the type of territorial restrictions that can be offered to the licensee under the TTBER :

The first type of protection that can be given is an exclusive or sole license. Exclusive licenses between non-competitors are allowed because they are necessary for the licensee to want to invest in the licensed technology. Without an exclusive license the product would most likely not enter the market at all. The Guidelines point out that also outside of the safe harbor of the TTBER exclusive licenses are likely to be exempted under art.101(3) because the licensee would not want to invest without exclusive territorial protection, and this would be detrimental to competition.[72]

Sales restrictions are viewed in a stricter way than exclusive and sole licenses .They are regarded as fully within the scope of art.101 (1).[73]This can be explained by looking at the exhaustion of rights doctrine. The TFEU art.34 which is equivalent to EEA art 11, prohibits quantitative restrictions on imports and all measures having equivalent effect. This means that a country cannot impose restrictions on products being imported into their country once that product has been put on the market in the EEA. This rule is not without exception and art.36 TFEU, makes room for certain restrictions one of them being industrial and

[73] Anderman and Kallaugher, 2006, p 175.

commercial property. This exception is only available as long as it is not a disguised restriction on trade between the member states.[74]

A product protected by intellectual property rights put on the market in one member state with the consent of the owner of the IPR, cannot oppose to the import of the product back into his member state. This was established in the case of Centrafarm v Sterling Drug.[75] . Trademarks are exhausted within the meaning of EU law, once they have been put on the marked in the EEA.

Thus, the exhaustion of rights by putting a product on the market in the EEA is a principle that can be seen in competition law in relation to sales restrictions. This means that an IP right cannot be used as a means of preventing sales once the product have been put on the market and that restrictions on sale are not essential to the IP right.[76]

Sales restrictions between the licensor and licensee are permitted at least up to the market share threshold of 3o percent. This means as mentioned above obligations not to sell into the licensed territory. In art. 4(2) (b) (i), the regulation states that restrictions of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor is permitted. This means that also active sales into the licensors territory are allowed. The protection that can be given to the licensor this way is important because without it, the licensor might not be wiling to license his technology to third parties.[77]In the TT Guidelines the Commission makes the point that the licensor cannot be expected to create direct competition with himself on the basis of his own technology.[78]

Passive sales can be explained as sales made in response to requests by the consumers in the protected territory of the licensee, to import the goods from a licensee outside the

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[74] Art.36 TFEU.

[75] Case 15/74 Centrafarm BV v Sterling Drug [1974] ECR 1147.

[76] Anderman and Kallaugher, 2006, p175,footnote 16.

[77] Anderman and Kallaugher, 2006, p 182.

[78] TT Guidelines (2004/C 101/02) para 172.

territory[79].The difference between passive and active sales is important, because it can decide whether a restriction will be permitted or not. The TT Guidelines does not have a definition of active and passive sales, however the VBER Guidelines define active and passive sales in paragraph 51.

It also makes room for restrictions in4(2)(b)(ii) on passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling contract products in that territory.

If the restriction exceeds the two year it will fall within the hardcore restrictions in art.4(2)(b), and if the agreement falls outside of the block exemption, a passive sales restriction going beyond two years will be unlikely to satisfy the conditions of art.101(3).[80]

A restriction for two years is necessary because of the investments a licensee will have to incur in production assets and promotional expenses to be able to establish in a new territory.[81]

Active sales restriction on the licensees are not covered by art.4(2)(b), they are therefore block exempted up to the market share threshold.(not including restriction in relation to selective distribution systems).[82]

The conclusion to be drawn from the TTBER and territorial restrictions in license agreements is that it makes room for protection of the IPRs so that licensees will be willing to invest in the technology. This is important because it leads to new products on the market and this again is positive for competition .As will be seen below, the TTBER can offer more territorial restriction than under the VBER. This can be explained by the need to protect the often great investments that go into IPRs. The TTBER offers protection for the licensees from passive sales from other licensee up to two years. This is important for the

[79] Monti, 2007, p 364.

[80] TT Guidelines (2004/C 101/02) para 174.

[81] TT Guidelines (2004/C 101/02) para 101.

[82]See TT Guidelines (2004/C 101/02) para 105 and 106, regarding selective distribution.

licensee's willingness to enter into licensing agreements. The protection from passive sales from other licensees the two first years from the product is put on the market, can not be offered under the VBER.[83]

3.3 Territorial restrictions under the VBER

In distribution agreements trademarks licenses are also used. They can be exempted under the VBER as long as they do not constitute the main purpose of the agreement. The trademark must be directly related to the use, sale or resale of goods or services by the buyer or its customers. The Guidelines make it clear that the vertical restraints regulation does not apply to pure trademark licensing.[84]

Franchise agreements excluding industrial franchises can be exempted under the VBER if its conditions are satisfied. How can territorial restrictions be used in franchise agreements and when can they be exempted under the VBER? We will start with a look at the different ways that territorial restrictions can be used in vertical agreements under the VBER, and how these relates to and are used in franchise agreements.

3.3.1.1 Exclusive distribution

Exclusive distribution agreements involve giving a distributor exclusive right to distribute within a certain territory. The possible detriment to competition in an exclusive distribution agreement is that it can affect intra-brand competition. There are however, positive effects of exclusive distribution. An exclusive distribution might help a distributor penetrate a new market it would otherwise not have been able to. Also an exclusive distribution agreement can improve efficiency by the manufacturer only dealing with one distributor in a specified

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[83] Anderman and Kallaugher,2006, p 184.

[84] Guidelines on Vertical Restraints (2010/C 130/01)Article 2.4, para (33)(c).

territory. The reason for this is that transaction costs can be saved and customer feedback can be more easily obtained and the distributor does not have to worry that other distributors benefit from the investments they have made.[85]Franchise agreements usually involve exclusive distribution. It is important for the franchisees that they are given an exclusive territory so that they can get on to and establish themselves in the market without facing direct competition from other franchisees.

3.3.1.2 Selective distribution agreements and franchising agreements

Selective distribution agreements are agreements where the producers establishes a system where the producers products only can be sold and resold by officially appointed distributors and retailers. This means that distributor and retailer that are not appointed will not be able to obtain the goods, not only from the producers but also from the appointed distributors and retailer who will only be able to resell to other members of the network or to the final consumer. [86]

A selective distribution can be the chosen form of distribution when the quality of for instance the premises, the equipment, or services is important to the supplier. The distributors will be chosen based on specified criteria, and the supplier will not supply to unauthorized distributors[87]. This method of distribution can be used for example in the sale of various luxury products. In Metro[88] the Court ruled that when restrictions on who the distributor can sell to is based on objective specified criteria, and the chosen criteria are applied objectively and without discrimination, it does not restrict competition within art.101.

Selective distribution agreements share many of the same elements with distribution franchise agreements, but they are different from franchising in that they do not involve

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[85] Jones and Sufrin 2011, p 666.

[86] Wish 2009, p 630.

[87] See definition in Vertical Restraints Regulation No 330/2010 , Article 1(e).

[88] Case 26/76[1977] ECR 1875.

licensing of trademark or know-how. Selective distribution is a type of agreement that can be placed somewhere in between exclusive distribution agreements or agency agreements, and franchising agreements.[89]

Selective distribution can also be used in a franchise agreement as a method of distribution. If the agreement involves territorial restrictions, the agreement would have to comply with the conditions for exemption of selective distribution under the VBER.[90]

The vertical restraints regulation will allow certain restraints on territory and on the customer to whom a party can sell. Restrictions that are not hardcore are permitted.

In Article 4 (b) the regulation list a group of territorial exceptions that will not be prohibited. In Article 4(b) (i) :

”the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customer of the buyer”, is mentioned as a restriction that will be permitted.

Active sales can be explained as, when a distributor approaches customers in the protected territory or if he for instance opens shops in the territory.[91] This exception is subject to a few conditions. For this exception to apply there has to be only one exclusive distributor for each territory. In addition to this the supplier will have to impose prohibitions on active sales into the protected territory for all of his distributors.[92]This is something that is different from the TTBER, where to do this is not a requirement.

The regulation also accepts in selective distribution systems a restriction on the member the sales to unauthorized distributors within the territory reserved by the supplier to operate the system.[93]Selective distribution in the territory where the supplier operates however,

[89] Fejø, 2009, p,501.

[90] Goyder, 2011,p 197-198.

[91] See the Vertical Restraints Guidelines para 51-54 for a detailed description of passive and active sales.

[92] Goyder, 2011,p 106.

[93] Regulation No 330/2010 Article 4 (b)(iii).

cannot be combined with exclusive distribution as this would lead to hardcore restrictions on active and passive sales by the dealer under art. 4(c) of the VBER.[94]

If a franchise agreement involves selective distribution it has to comply with the rules concerning selective distribution. The territorial restriction allowed under the VBER shows that certain agreements containing territorial restrictions will be exempted, because the agreement will have a positive effect on competition. The recital to the VBER states that: “Certain types of vertical agreements can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings. In particular they can lead to a reduction in the transaction costs of the parties and to an optimization of their sales and investment levels”.[95]

The conclusions that can be drawn from this, is that some territorial restraints in franchise agreements under the VBER are allowed under certain conditions. The exceptions to the hardcore restriction on territorial restraints are necessary for franchise agreements to be concluded, without the possibility of imposing certain territorial restriction the franchisee would not be willing to make the investments it needs to under the agreement. The VBER do however, not allow restrictions on passive sales. This is due to the fact that restrictions on passive sales would prevent parallel imports.

3.3.1.3 Territorial trademark protection in Norway

Although territorial restraints in franchise agreements are discussed here in a European Union context, how is the situation in relation to territorial restraints imposed on an agreement containing the license of a trademark in Norway?

Trade mark protection is a national issue, but as have been seen above trade marks can be used to impose absolute territorial protection when it is combined with other territorial restrictions.

[94] Vertical Restraints Guidelines(2010/C 130/01) para (57).

[95] Regulation No 330/2010 , recital number 6.

Lassen and Steinvik in their chapter on trade mark licensing, say that a trade mark license can apply to the whole country a small part of the country or a big part of the country.[96] However if the trade mark license is used to prevent import into Norway, this would be a restriction of competition and thus like in Consten and Grundig [97]be prohibited.

3.4 Territorial restrictions in franchise agreements- conclusions

As can be seen from the discussion above, territorial restrictions are allowed to a certain extent in franchise agreements .As was made clear in Pronuptia , provisions that share markets between the franchisor and the franchisees will be caught by art.101(1).
The technology transfer regulation is more lenient towards territorial restrictions, something that can be explained by the difference between technology transfer agreements and distribution agreements. Because of the investments going in to innovation, licensee of technology are in need of more protection, without such protection they might not want to make the necessary investments and this will prevent new products entering the market. Distributors do not have to make the same investments and thus their need for protection is not as strong.

Franchise agreements involve the licensing of IPRs, but since most franchise agreements are being subject to the vertical restraints regulation they cannot offer the franchisees the same protection that can be given under the technology transfer block exemption.

In addition to this, some franchise agreements have as the main part of the agreement the license of trademarks, and these agreements won't as of today, qualify under any of the block exemptions. If the main part of the agreement is the transfer of know-how, the franchise agreement might qualify under the TTBER if, also the other conditions under the regulation are fulfilled. The Commission does state in their Guidelines that franchise

[96] Lassen og Steinvik 2010, p 481.

[97]Cases 56/64&58/64 Consten and Grundig v Commission [1966] ECR 299.

agreements that fall outside of the block exemption should apply the same principles as in the regulation and the guidelines. How this will be done remains to see.

4 Non-territorial restraints in franchise agreements

4.1.1 Introduction

In addition to want to protect their interests with territorial restrictions, in franchise agreements and other agreements concerning licensing of IPRs, there is also a number of other provisions that are important for the agreements to function properly. These provisions involve among other things, no-compete clauses, royalty obligations, no-challenge clauses etc. In franchise agreements there are many elements that must be present for the franchise agreement to function properly. Many of the provisions of a franchising agreement will be allowed because they are ancillary to the main non-restrictive agreement and necessary for the proper functioning of this type of agreement.

The issues to look at are, how non-territorial restraints are used to protect the franchise, and how non-territorial restraints can be used without infringing art.101 (1)?

4.1.2 The ancillary restraints doctrine

Many of the provisions that are found not to be restrictive of competition are considered to be ancillary to the main agreement. The court has through a number of cases developed what can be called the ancillary restraints doctrine. The Court and the Commission uses the ancillary restraint "test" as a criterion for finding that a clause in an agreement is not restrictive of competition.[98] A closer look at this doctrine will give an understanding of how the Court and the Commission applies this test to provisions in vertical agreements.

Nikpay and Faull describes the ancillary restraints doctrine this way: " Clauses which restrict rivalry between the parties and/or third parties fall outside Article 81(1) if they are directly related and necessary to the implementation of a legitimate purpose; this purpose may be commercial or relate to a public interest".[99]The clauses do thus not restrict competition but they restrict the commercial freedom of the parties. There are two elements to this doctrine. The clauses have to be directly related to the main operation. This means that the clause has to be part of the main agreement or linked to or closely linked to it. It also has to be a necessary restriction, meaning that it has to be objectively necessary for the main operation and it will have to be proportionate. [100]

Objective necessity can be illustrated by the Metropole television v Commsission case[101].In this case the court distinguished between clauses that were required for the agreement to function , and on the other hand clauses that might be necessary depending on the economic circumstances of each individual case.[102]This distinction is the same as can be seen in Pronuptia[103] where the Court distinguished between those provisions that were necessary for the system to work, and those that were not, such as price fixing and sharing of markets.

The Commission guidelines on the application of art.101 (1)[104] contain a section which examines how ancillary restraints should be applied to individual restraints in the agreements. The guidelines points out that: "The application of the ancillary restraint concept must be distinguished from the application of the defense under Article 81(3)

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[98] Anderman and Schmidt,2011,p 279.

[99] Faull and Nikpay , 2007 p 235.

[100] Faull and Nikpay, 2007 p 299.

[101] Case T-112/99 [2001] ECR II – 2459.

[102] Faull and Nikpay , 2007 p 240.

[103] Case 161/84 Pronuptia.

[104] Guidelines on the application of Article 81(3) of the Treaty, OJ C101 (2004/C 101/08).

which relates to certain economic benefits produced by restrictive agreements. The application of the ancillary restraints concept does not involve any weighing of pro-competitive and anti-competitive effects. Such balancing is reserved for article 81(3)."[105]

This Commission thus reserves the balancing act of pro and anti-competitive effects for art.101 (3).

The guidelines specifically mentions as an example of ancillary restrictions, franchise agreements, which main object, does not restrict competition and therefore the restrictions needed to protect the uniformity and reputation of the franchise, will fall outside of art.101(1).

This shows that the court and the Commission find some clauses in agreements to be ancillary to the main non-restrictive agreement and thus they do not restrict competition. These clauses are seen as necessary for the main agreement to work, and the main agreement is in these cases pro-competitive. The Commission emphasizes that the weighing of pro and anti-competitive effects should not be done under art.101 (1), but under art.101 (3).This has been debated in the literature but will not be discussed further here.[106]

4.1.3 Non-territorial restraints and licensing agreements in general

Franchise agreements involve the licensing of IPRs and therefore the way that licensing agreements and non-territorial restraints are considered in relation to art.101 (1) will be relevant also when considering franchise agreements.

Non-territorial restraints can be categorized into two types, namely those that are non-restrictive of competition and those that are exemptible.[107]The obligations that are non-

[105] Guidelines on the application of Article 81(3) of the Treaty, OJ C/101 (2004/C 101/08), para 30.

[106] See discussion in Jones and Sufrin, 2011, p 233-239.

[107] Anderman and Schmidt, 2011, p259.

restrictive will not be a concern under art.101 (1), whereas those that are exemptible will have to satisfy the conditions for exemption. Both types of clauses will be looked at below.

The TT Guidelines has in relation to license agreements, to help with the task of knowing which clauses in license agreements restrict competition or not, provided a list which indicates the provisions that are :”(…) generally not restrictive of competition within the meaning of Article 81(1).”[108]These involve, confidentiality obligations, obligations on licensees not to sub-license, obligations not to use the licensed technology after the expiry of the agreement, obligations to assist the licensor in enforcing the licensed intellectual property rights, obligations to pay minimum royalties or to produce a minimum quantity of products incorporating the licensed technology, and obligations to use the licensor`s trade mark or indicate the name of the licensor on the product.

These obligations are to an extent also mentioned in relation to provisions that are needed for the franchise agreement to function .In addition to these provisions mentions in the guidelines as almost always not restrictive of competition, there are also a few others that have been seen as ancillary restrictions by the courts because they are seen as indispensable to the licensing of IPRs.

First there is the obligation to keep know-how secret. This is as mentioned above, important in franchise agreements, because the know- how is important for among other things the uniformity of the franchise network. There are a few Commission decisions where the Commission deals with this type of obligation. In Delta Chemie[109] the Commission found that the obligation not to divulge the secret know-how in question did not fall within art.85(1)(now art.101(1)).This was due to, as the Commission explained: ”In fact, the commercial value of the know-how rests largely in its confidential character, and each disclosure brings prejudice to the holder of that know-how. Such an obligation must be considered to be necessary in the context of the present type of agreement .Furthermore

[108] TT Guidelines (2004/C 101/02) para 155.

[109] Commission Decision Delta Chemie OJ L 309/34

since the validity of know-how, is not limited in time by the expiry of a period of legal protection, as is the case for a trade mark, it is legitimate for its holder to impose upon a licensee the obligation to respect its secrecy for so long as this know-how has not entered in the public domain and is freely accessible to all interested parties".[110]

The obligation to keep know-how secret will be important and legitimate in all franchise agreements. This is because the franchisor would not license his know-how to the franchisee without knowing that his know-how would be protected from being revealed to his competitors.

Another example of where the Commission has cleared a clause which contained an obligation to keep the know-how secret, in that case five years, is the Commission decision in Boussois/Interpane.[111]

Obligations on not to assign or sub-license the know –how ,have also been found not to restrict competition within art.101(1).For such an obligation to be cleared it is also here a condition that the know-how is not in the public domain.[112]The reason for clearing this, would be the same as the obligation to keep know-how secret, namely, in the case of franchising, that the franchisor do not want the know-how to fall into the hands of his competitors without his approval.

In the same category as the two obligations above, are post-term use bans. These are conditions on the licensee not to use the licensed technology after the expiry of the contract. In DeltaChemie a clause of this kind preventing the licensee from using the know-how after the expiry of the agreement was found by the Commission not to fall under art.81(1)(now art.101(1).The Commission states that having the licensee ceasing to use the

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[110] Commission Decision Delta Chemie OJ L 309/34 para (32).

[111] Commission Decision Boussois/Interpane OJ L 050/30.

[112] Anderman and Schmidt 2011, p 281.

intellectual property right after the expiry of the agreement is essential for the conclusion of licensing agreements .[113]

Without such a clause the licensor would not be willing to make agreements if he knew that the know-how that he has developed could be used by other as they please after the expiry of the contract. To develop a franchise, a lot of time, money, and effort will be spent by the franchisor and therefore to be able to protect his investments from being used by the franchisees after the expiry of the agreement is necessary for him to want to make the investments to develop the franchise .Without this protection the franchisor might be reluctant to license his know-how.

Other clauses that might be necessary for the protection of the franchise, is non-compete clauses. Non-compete obligations on the goods or services purchased by the franchisee will fall outside of art.101 (1), when they are necessary to maintain the common identity and reputation of the franchise network. The duration of the non-compete clause will not be an issue under art.101 (1) when the clause is limited to the duration of the franchise agreement.[114]

There are also in license agreements usually clauses relating to improvements. When a licensee for example gets access to the licensor know-how, he might himself make discoveries that lead to new innovations or improvements. The licensor might not be willing to make agreements, if he is not entitled to get access to the licensees improvements .On the other hand the licensee must not be under so strict obligations that it discourages new innovation and improvements.[115]Under the TTBER grant back and improvements are listed as excluded restrictions, this means that they will have to be evaluated to see if the clause can be given individual exemption. The Commission states in their Guidelines that the purpose of the excluded restrictions relating to grant back and improvements is to avoid

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[113] Commission Decison DeltaChemie OJ L 309/34 para (35).

[114] Vertical Restraints Guidelines (2010/C 130/01) para 190(b).

[115] See Anderman and Schmidt,2011, p 283-284.

the block exemption of agreements that as they say, may reduce the incentive of licensee to innovate.[116]

A license agreement might also have a non-challenge clause. A non-challenge clause involves an obligation by the licensee not to challenge the validity of the licensors IPR during the contract term.[117]Non-challenge clauses are in the TTBER not blacklisted, they are however excluded under art.5, but the licensor can terminate the agreement if the licensee were to challenge the validity of the licensed technology.[118]

Obligations relating to the quality of the goods are also obligations that can be found in license agreements and in certain franchise agreements. Quality controls can be of great importance to the franchisor. This is especially relevant in the case of production franchises. It is essential to ensure the quality of the produced products, which are sold under the franchisor trade mark and thus identified with him.

Minimum quality requirements and checks on the quality have not been seen as a restriction on competition under art.101 (1), and have been seen by the courts and by the Commission as necessary to exploit the innovation in a proper way. [119]

The franchisee will have to pay the franchisor for the use of the franchise. Royalty obligations are usually not a concern for competition law. That is, as far as they are freely negotiated between the parties.[120]

It can be concluded from this, that many obligations in licensing agreements are necessary for the protection of the IPR in license agreements in general and in franchise agreements..

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[116] TT Guidelines (2004/C 101/02) Article 5, para (108)(a) and (b).

[117] Anderman and Schmidt, 2011, p 289.

[118] TT Guidelines (2004/C 101/02), Article 5 ,para (108) (c).

[119] Anderman and Schmidt,2011,p 285.

[120] Anderman and Schmidt, 2011, p 286.

Some obligations will have to be exempted or they are excluded because they are not as clearly necessary for the protection of the IPR. The other obligations are seen as ancillary to the main non-restrictive agreement and thus do not pose any competition concerns. The obligations mentioned above are also relevant for franchise agreements because franchise agreements involve the licensing of know-how and trade marks.

4.1.4 Non-territorial restraints viewed by the Court and the Commission

In Pronuptia[121], many of the provisions in the franchise agreement were cleared and found not to restrict competition. The Court says that a distribution franchise system does not in itself restrict competition.[122] The reasoning of the Court in relation to clearing these provisions are of general application and therefore worth having a closer look at.[123]The reasoning of the Court will show how it views the non-territorial restrictions in distribution franchise agreements and what type of clauses it considers necessary for the functioning of a franchise agreement, and thus outside the application of 101(1).

The first provisions that will be cleared are provisions relating to the protection of the franchises know-how. It is essential that the know-how won't fall into the hands of competitors and so clauses preventing this from happening are allowed and necessary. This also includes provisions prohibiting the franchisee for the time of the contract and for a reasonable time after the expiry of the contract from opening a similar shop in the area where another member of the network operates .Also a clause preventing the franchisee from transferring the shop to another party is permitted as this too is important to protect the know-how of the franchise.[124]

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[121] Cae 161/84 Pronuptia.

[122]Case 161/84 Pronuptia, Para 15.

[123] Korah and O`Sullivan ,2002, p 98.

[124] Case 161/84 Pronuptia,para 16

The importance of the franchise network sharing the same trade name and uniform image, also calls for clauses that the court has cleared as not restrictive of competition. To be able to maintain that the franchisees all have the same uniform image, the franchisor has to be able to control the way the franchisees use the trade name and image of the network. This is not restrictive of competition. In connection with maintaining a uniform image is the importance of the franchisee applying the same business method and know-how as developed by the franchisor. This also considered not restrictive of competition within art.101 (1).[125]

It can also be important for the franchisor and the operation of the franchise network that the premises of the shops are decorated and laid out in line with the franchisor instructions. This is connected to the importance of the uniform presentation of the shops and the reputation of the franchise as a whole.

The ability of the franchisor to choose his franchisee is a clause found not restrictive of competition. This means that the franchisee cannot assign his rights under the contract to another party without the approval of the franchisor.[126]

Two other provisions were also found necessary for the function of the network. First, restrictions in relation to where the goods are obtained were allowed in cases where the quality of the goods is indefinable, for instance fashion articles, or there are a large number of franchisees which make them hard to monitor. The franchisee may only have to obtain articles from a designated source or from other member of the network. Finally restrictions can be imposed without infringing art.101 (1) on advertising. The franchisee will have to get the franchisor approval on advertising. This is also a clause that is important to maintain the identity of the network. [127]

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[125] Case 161/84 Pronuptia, para 17 and 18.

[126] Case 161/84 Pronuptia para 20.

[127]Case 161/84 Pronuptia, para 21 and 22.

From Pronuptia the conclusion that can be made is that certain clauses in franchise agreements will not be restrictive of competition under art.101 (1). These are clauses that first of all, are necessary for the protection of the franchisors know-how, and secondly clauses that are necessary for the protection of the identity of the franchise network, and for the reputation of the network.

4.1.5 The vertical restraints regulation

How are non-territorial restraints dealt with under the regulation?

The guidelines on vertical restrains mentions in paragraph (45) a list of obligations that as they say, are generally necessary to protect the franchisors IPRs and are covered by the block exemption. These are:

“(a) an obligation on the franchisee not to engage, directly or indirectly, in any similar business;

(b) an obligation on the franchisee not to acquire financial interests in the capital of a competing undertaking such as would give the franchisee the power to influence the economic conduct of such undertaking;

(c) an obligation on the franchisee not to disclose to third parties the know-how provided by the franchisor as long as this know-how is not in the public domain;

(d) an obligation on the franchisee to communicate to the franchisor any experience gained in exploiting the franchise and to grant the franchisor, and other franchisees, a non-exclusive license for the know-how resulting from that experience;

(e) an obligation on the franchisee to inform the franchisor of infringements of licensed intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers;

(f) an obligation on the franchisee not to assign the rights and obligations under the franchise agreement without the franchisor`s consent.”[128]

[128] Guidelines on Vertical Restraitns (2010/C 130/01) para (45).

Many of these provisions are similar to those mentioned by the Court in Pronuptia[129] as falling outside of 101(1).They are needed to protect the uniform identity of the franchise network and they are important to protect the know-how.

4.1.6 Conclusion on non-territorial restraints

The issue discussed above namely non-territorial restrictions, show that many of the obligations in franchise agreements are deemed necessary for the proper functioning of a franchise. It is important that the franchisor can impose the same standard on the franchisor, and that they all have the same commercial methods, to mention a few things. Because of the important role the IPRs play in a franchise agreement, it is not problematic to have the franchisor impose restrictions on the use of the IPR rights. In fact that he can impose these restrictions are so important that it is unlikely that any franchisor would want to enter into agreements involving the transfer of his IPRs, without such protection. The know-how being an essential part of a franchise agreement, need to be protected so that the franchisors will be willing to share his knowledge with the franchisees and contribute to the success of the franchise network.

5 Franchise agreements that fall outside of the block exemption

Franchise agreements that exceed the market share threshold of 30 percent, contain hardcore restrictions, or agreements that contain obligations that are incompatible with art. 5 in the vertical restraints block exemption cannot be exempted by the regulation if they contain clauses providing territorial protection and the brand is well known.[130] The same is true for franchise agreements which main object is the transfer of intellectual property rights. Agreements containing mainly the licensing of IPRs might if they fulfill the

[129] Case 161/84 Pronuptia.

[130] Korah and O`Sullivan, 2002, p238.

conditions, be exempted under the technology transfer regulation. The situation for industrial franchises will be looked at in detail below.

When an agreement falls outside of the block exemptions it becomes it is necessary to look at in more detail the effect the agreement will have on inter brand and intra brand competition. This is because it is the effect the agreement will have on the competition in the market that will determine whether or not it will qualify for individual exemption under art.101 (3).Because the effect on intra and inter brand competition plays an important part in the application of agreements that fall outside of the block exemptions, it is worth having a closer look at what inter and intra brand competition means and their significance for competition in the market.

5.1 Intra and inter brand competition

Why is competition law concerned with vertical agreements?

There are different forms of competition in the market, and encouraging competition at both the inter brand and intra brand level is important. Despite this, sometimes agreements that restrict intra brand competition can be pro-competitive because in fact they encourage an open up for inter-brand competition that would not otherwise have occurred. A closer look at inter and intra brand competition is necessary to appreciate the effect franchise agreements can have on the market and on the competition in the market.

Inter brand competition is as mentioned briefly above, competition between producers of different brands, whereas intra-brand competition is competition between distributors of the same brand.

In vertical agreements like franchise agreements, concern with inter brand competition usually only arises when the company imposing the restraint in question has market power .Since competition will be restricted when it comes to inter-brand competition, it will be desirable that intra-brand competition within the brand with market power is encouraged.

The concern with intra-brand competition is not as strong as that with inter-brand competition, however when there is weak inter-brand competition there is a concern also with intra-brand competition. The concern with vertical agreements in the EU is because of the importance of market integration.[131]

Although there is a concern with loss of intra-brand competition with vertical agreements, there are several positive effects of vertical agreements that should be mentioned.

One of the positive effects of vertical restraints is that they protect the distributors from free-riders. If a distributor for example, gets an exclusive territory to distribute in, this can encourage him to provide additional services necessary to boost sale and also to persuade customers to buy more of the suppliers` product. Without the territorial protection the distributor might not want to incur the extra cost of providing these services because of the danger that other distributors would also benefit from the investment he has made (free-ride).[132]

Another positive side to vertical restraints is in relation to what is called the hold-up problem. The hold-up problem may arise in connection to know-how which is as mentioned earlier a significant element in franchise agreements .When a company wants to or have to make certain investments that are related to a buyer or a supplier he will need to know that the other party will keep to their obligations as well, for him to want to make the investments[133]

In relation to franchise agreements the hold-up problem would be that the franchisor will not be willing to license the know-how to the licensee without assurance that his know-how will be protected. Once the know-how is available to the other party it cannot be reversed, and that makes certain vertical restrictions relating to the know-how necessary if the

[131] Wish 2009,p 613-615.

[132] Jones and Sufrin, 2011 p 638-639.

[133] Lunde 2007 , p 110-112.

agreement shall be concluded. The vertical restraints guidelines refer to what they call the "specific hold-up problem that may arise in the case of transfer of substantial know-how" in paragraph (107)(e).

Finally the guidelines also mention as positive vertical restrictions uniformity and quality standardization.[134]This is a positive side that is particularly relevant in relation to franchise agreements. The vertical restraint will be a way of making sure that all the franchises have the same standard of quality and that this quality is reflected in all the franchises creating a uniform brand image that the consumers can relate to.

The conclusion to be drawn from this, is that he effect an agreement has on inter and intra-brand competition is important when considering whether an agreement outside of the block exemptions will none the less qualify for individual exemption. There are many positive effects of vertical agreements and these will have to be considered to see if the restriction on competition in the agreement is outweighed by its positive effects. The vertical guidelines give helpful guidance on which considerations are relevant for agreements that fall outside of the block exemption. This will be looked at next.

First of all it must be mentioned, that as the vertical guidelines explain, there is no presumption that an agreement which falls outside of the block exemption is within the scope of art.101 (1).[135]

The vertical restraints guidelines can be of assistance when considering whether the agreement can be exempted outside of the block exemption .The guidelines mention factors that will be particularly relevant when assessing vertical agreements that fall outside of the block exemption. The guidelines mention that the nature of the agreement will be a factor in deciding whether the agreement appreciable restrict competition under art.101 (1). Therefore the special nature of the franchise agreement will be a relevant consideration.

[134] Guidelines on Vertical Restraints (2010/C 130/01) para (107)(i).

[135] Guidelines on Vertical Restraints(2010/C 130/01) para (23).

The market position of the parties as well as the market position of competitors will be relevant. Also of relevance according to the guidelines is the market position of the contract products. The barriers to enter the market is a relevant factor a long with the maturity of the market, level of trade, nature of the product and finally the guidelines mention "other factors". [136]

Of particular relevance to franchise agreements is that the guidelines says that the more important the transfer of know-how, the more likely it is that the agreement will be exempted.[137]Restrictions to protect the know-how is thus seen to create more positive effects than negative and therefore the agreement would be likely to fulfill the conditions of art.101(3).Although the franchise agreements contains restrictions that affect intra-brand competition, this will usually be outweighed by the positive effects a franchise agreement will have on the market by allowing often small business owners to open up a franchise and thus creating more inter-brand competition in the market.

Outside of the block exemption, the conclusion can be made that if the franchise agreement thus not contain any hardcore restrictions it is likely to fulfill the conditions of art.101 (3).This is especially the case if transferring of know-how is important for the agreement. Each agreement will, however, have to be considered to see if it has the effect of restricting competition.

5.2 Industrial franchise agreements

Industrial franchise agreements are discussed together with agreements that fall outside of the block exemption, because this type of agreement will often not qualify for exemption under either of the regulations.

An industrial franchise agreement is an agreement that includes both the licensing of trademark and know-how. An example of an industrial franchise can be, that party A

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[136] Guideines on Vertical Restraints (2010/C 130/01) para (111).

[137] Guidelines on Vertical Restraints (2010/C 130/01 para (190)(a).

grants to party B the right to produce, promote, market and sell for example beer under party A`s trade mark in a licensed territory, using As know-how. This type of agreement can be problematic because they are not genuine franchising agreements in the sense that they do not contain the distribution element. They are interesting in that they are in between vertical agreements and technology transfer agreements. If the licensing of the trademark is the main part of this agreement, it cannot be exempted under the technology transfer regulation. The vertical guidelines say that in the case of franchise agreements that fall outside of the block exemption, because they concern primarily the licensing of IPRs, they should be treated similarly to agreements that do fall under the block exemption.[138]A trademark license combined with the licensing of know-how was the subject of the Moosehead/Whitebread case[139] which was a beer supply agreement. The licensee wanted to manufacture and promote the Canadian beer Moosehead in the UK. The agreement prohibited active sales outside the UK. The Commission decided that the exclusive trademark and restriction on active sales infringed art.101 (1).An exemption was given due to the fact that the agreement would benefit consumers in that they would get another type of beer to choose from. The know-how in the agreement was found to be ancillary to the trademark license and it would therefore not qualify under the know-how block exemption which existed at the time.

Because this type of agreement falls outside of the block exemptions, the guidance into what restricts competition or not will have to be found in the case law of the CJEU , the Commission decisions, the Article 101(3) Guidelines and where appropriate in the Technology Transfer and the Vertical Restraints Guidelines.[140]

From the discussion of industrial franchises the conclusion can be made that this is a type of franchise agreement that is on the border between a technology transfer agreement and a distribution agreement. The different elements of the agreement will have to be analyzed to see if it is closer to one or the other.

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[138] Guidelines on Vertical Restraints (2010/C 130/01) Article 2.4, para(44)

[139] OJ [1990] L 100/32.

[140] Jones and Sufrin,2011 p 768.

6 Conclusions

Franchise agreements are, as have been shown, capable of restricting competition under art.101TFEU.

Franchising agreements usually involve provisions restricting the territories where the franchisee and franchisor can sell and produce their products or give their services. Territorial restrictions are important in franchise agreements because it is usually necessary with some territorial protection to be able to establish themselves and enter the market especially with a new product or a new service. However, as have been seen, when territorial restrictions are combined, they can lead to absolute territorial protection something that is considered as having the object of restricting competition under art.101 (1). In Pronuptia a territorial restriction combined with a clause prohibiting the franchisee from opening another shop was found to create a restriction on competition under art.101(1) which was not as the Court explained, necessary for the protection of the uniformity and image of the franchise network. The Court did however exempt the agreement under art.101(3).The Commission decisions following Pronuptia were all given exemption under art.101(3) and shows in my view, that franchise agreements are viewed as improving competition both by the Court and the Commission. However, because of the competition concern with territorial restraints and their capability of dividing the common market, clauses imposing such restrictions will either have to qualify for exemption under the block exemptions or by an individual exemption under art.101(3).

The Courts decisions regarding license agreements has shown that the CJEU have found territorial restrictions in license agreements to be outside the scope of art.101(1). Those judgments however, were involving very special IPRs and so it cannot be expected in my view that the Court will view territorial restraints for example in a distribution franchise agreement as leniently. Although, territorial restraints in a distribution franchise in many instances would qualify for exemption under art.101(3) or the block exemptions they would still be considered to be within the scope of art.101(1).

Franchise agreements involve the transfer of know-how from the franchisor to the franchisee. It has been shown in this thesis that restrictions for the protection of know-how are crucial in a franchise agreement. It can been seen from the judgment of the Court in Pronuptia, the Commission decisions , the Commission guidelines and the regulations, that clauses aimed at protecting the know-how does not restrict competition under art.101(1). These clauses are necessary for the franchisor to want to enter into an agreement with a franchisee and disclose his know-how to him. I agree with their treatment of clauses aimed at protecting the know-how. This is because without protection of the know-how in the agreements, the risk the franchisor would take, that the know-how might end up in the hands of his competitors, would be too high.

As well as the transfer of know-how, franchise agreements also include the transfer of the franchisors trade mark .In both regulations trade marks can be used as part of the agreement to help with the distribution of the goods or in the case of technology transfer with linking the technology to a company. When trade mark licensing is the main part of the agreement neither of the regulations apply. I am not sure why that is, but the Commission seems unwilling to include trade mark licensing in a block exemption.

When there is a franchise agreement and the main purpose of the agreement is considered to be the license of the trade mark, the vertical restrains guidelines say that as a general rule they would apply the principles set out in the regulation and the guidelines[141]. In my opinion, the Commission this way somewhat avoids the problem of having to specifically deal with the situation when the primary purpose of the agreement is the license of a trade mark. However, since those agreements are likely to be considered in the same way as other agreements containing IPRs under the regulation perhaps this will not cause any problems. If the main purpose of the franchise agreement is the transfer of know-how, it could if it fulfills all the conditions be exempted under the technology transfer regulation. This regulation as have been shown exempts more territorial restrictions than the vertical

[141] Vertical restrains guidelines (2010/C 130/01)para (44).

restraints regulation. This is because the creation of IPRs involves large investments and is thus more in need of protection. It is therefore of significance whether the agreements is considered as mainly an agreement transferring technology or as a distribution agreement.

Franchising is a business model that I believe will continue to be used as a way for the franchisor to develop and expand his business, and it will be a way of helping other business owners to establish a business with the assistance of a skilled and experienced franchisor. It is important I believe that art.101 (1) is not applied to franchise agreements in such a way that it restricts the parties willingness to enter into agreements. The new economic approach is a promising development, because it allows the franchise agreements' actual effects on the market to be considered when applying art.101(1) and I think in most cases, franchise agreements will be found to create positive effects on the competition.

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