European Parliament

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Dear Commissioner Bieńkowska, Dear Commissioner Vestager,

I am sending you this letter in response to the Commission´s reaction document received on 21 February 2018 regarding the follow up to the European Parliament resolution of 12 September 2017 on the functioning of franchising in the retail sector. As EP rapporteur for the above mentioned resolution I must say that I am fairly disappointed in the way the Commission intends (not) to follow up Parliament's recommendations.

Of course I am fully aware that the Commission's term is coming to an end next year but this should not withhold the Commission from taking action in the field of franchising. The following policy recommendations that were adopted by an almost unanimous European Parliament are of an urgent nature and should be followed up before the end of this legislature. This is both in the interest of entrepreneurs as well as consumers and the internal market as a whole.

1. In paragraph 10 the Parliament calls for the facilitation of the creation of associations representing franchisees in order to ensure a more balanced representation.
   Proposed action for the Commission: organise as soon as possible a meeting for franchisees and franchisee organisations and encourage dialogue between franchisees from the various Member States. Facilitate their exchange of views and give them guidance as to how a European association for franchisees could be set up.

2. In paragraph 26 the Parliament requests the Commission to open a public consultation in order to obtain unbiased information as to the real situation in franchising and to draft non-legislative guidelines. These guidelines should then better shape the normative environment of franchising contracts (paragraph 3).
   Proposed action for the Commission: open this public consultation in parallel with the planned public consultation on the evaluation of the Vertical Block Exemption Regulation in the first quarter of 2019. In your response to the resolution you only commit to involving Eurostat, but this simply won't be enough. Only by a public consultation, involving all stakeholders, the Commission can really get a grip on this subject. As rapporteur I have been and keep receiving messages that franchise relationships are getting more stringent and that action is needed.

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3. In paragraph 33 the Parliament requests the Commission to open a public consultation and inform Parliament of the suitability of the model on which the future block exemption regulation will be based. Paragraph 30 further suggests that the Commission should check to what extent the application of Regulation 330/2010 could be improved through a mechanism of assessment within the European network of competition authorities. Finally, in paragraph 27 the Parliament stresses that it should be actively involved in all work on franchising in the retail sector, including when regulations and directives are adapted in order to achieve a more consistent and coherent regulatory framework on franchising.
Proposed action for the Commission: 1. Reserve sufficient time for the public consultation on the application of Regulation 330/2010. Twelve weeks will not be enough to give all stakeholders the opportunity to react. Please extend this period to, for example, 24 weeks. 2. Devote special attention to the position of vehicle dealers, who are since the abolition of regulation 1400/2002 and the entry into force of Regulation 330/2010 left without specific clauses that apply to their specific situation (please see the first annex to this letter). 3. Involve the Parliament in the process of revision of the Regulation and the accompanying Guidelines.

I am glad to see that in your response you already confirmed your willingness to raise the above mentioned issue in the European Competition Network. It is also good to see that you have presented a Roadmap on the planned evaluation of the Regulation. When discussing the Regulation in the ECN and in the public consultation and stakeholder workshop I would ask you to give specific attention to the Commission Guidelines on Vertical Restraints that accompany Regulation 330/2010. After all, the application of Directives and Regulations depends on their interpretation. In the case of Regulation 330/2010 the Commission's Guidelines on Vertical Restraints are a lot more specific than the Regulation and interpret the Regulation in a way that could favour the franchisor. For your information I have attached in Annex 2 detailed comments for modifications to the Guidelines made by SMEunited.

Unfortunately, there still remain a lot of problems relating to the functioning of franchising in the retail sector. Only recently the German Newspaper *Handelsblatt* reported* on the unfair trading practices McDonalds is using against its franchisees. During my work as rapporteur on franchising I heard the same stories about McDonalds in Italy. I also have many examples of practices in various franchising formulas in the Netherlands. This again stipulates the fact that these practices take place in various Member States and that the franchise sector is not performing at its full potential.

I therefore strongly urge you to step up your efforts and seriously follow-up the proposed action as proposed in this letter. It would be a loss of time if we would wait with concrete actions until this legislature is over. Action is needed at this very moment, and you could be the ones realising a fairer and more balanced franchising sector in the EU.

Yours sincerely,

Dennis de Jong

* http://www.handelsblatt.com/my/unternehmen/handel-konsumgueter/vorwuerfe-gegen-mcdonalds-wuchermieten-knebelvertraege-marktmissbrauch-/19617396.html?ticket=ST-4361093-05e79Z24bvedyaU6W0J7-ap1

ANNEX I

Specific problems for independent vehicle dealers in the franchising business:

Independent vehicle dealers acting as franchisees from the powerful car manufacturing brands face more and more stringent contract conditions. The 1400/2002 regulation of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector that was applied until the entry into force of Regulation 330/2010 recognised the unique way of doing business in the automotive industry and left more freedom for car dealers to work with multiple brands. It also had better protection for franchisees as regards the sudden termination of contracts. At the moment independent car dealers are being confronted with letters from the car manufacturers with the termination of contracts, after having invested a big sum of money in their dealerships. Contracts then can be prolonged, but under stricter and less favourable conditions. I have received testimonies from dealers in France, Germany and the Netherlands that they do not experience any freedom of contract. Dealers are being offered a contract and can either take it or leave it. The issue of margins and variable bonuses also causes a lot of problems. Another problem they are facing regards the use of data: some franchisors want to oblige their dealers to send the complete costumer database to them although the databases are managed and belong to the dealers. This, combined with the fact that franchisors want to be more and more in direct contact with the customers (despite the fact that they have a network of independent entrepreneurs -dealers and repairers-), is not justified and can create additional problems in the future as it increases the misbalance of power.

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# Proposals for modifications to the Commissions Guidelines on Vertical Restraints by SMEunited[1]

**Modifications to the Guidelines**

**Paragraph 45** of the Guidelines provides a detrimental starting point for franchisees. Several far-reaching obligations, such as non-compete obligations, are generally considered to be necessary to protect the franchisor's intellectual property rights. Moreover, these obligations are (apparently always) covered by Block Exemption Regulation in a franchising context.
While these obligations may indeed be justified in certain cases, the over-simplified statement that they are (always) covered by the Block Exemption Regulation sets the tone for an undifferentiated image of franchising, which seeps through the rest of the Guidelines.

In our opinion, paragraph 45 should make clear that the use of (a combination) of such clauses can lead to hard core restrictions that are not covered by the Block Exemption regulation and at least differentiate that the mentioned obligations are only justified if and when they are (proven) necessary in the light of the specific surrounding circumstances. The burden of proof should actually be on the user of the Block Exemption Regulation ex article 101 (3) TFEU.

Paragraph 45 also has a significant impact on the scope of paragraph 68 regarding the post-term non-compete obligation. Paragraph 68 states that such obligation is normally not covered by the Regulation 'unless the obligation is indispensable to protect know-how transferred by the supplier [franchisor] to the buyer [franchisee]'.

Referring to paragraph 45, one could conclude that a post-term non-compete obligation is in fact always (or at least generally) covered by Regulation, as according to paragraph 45, a non-compete obligation is generally considered indispensable to protect the know-how of the franchisor. This is however not always (nor generally) the case. Why should it be reasonable and vital to a

[1] SMEunited subscribes to the European Commission's Register of Interest Representatives and to the related code of conduct as requested by the European Transparency Initiative. Our ID number is **55820581197-35**

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franchisor to prohibit a franchisee, which exploits a small shop as franchisee, to open his own shop at the same location after the termination of the franchise agreement by the franchisor? Why would he have to wait for one year, while at the same time paying rent for the vacant building? There is no other purpose than protecting the franchisors investments in the location (not the formula or IPR's). And who actually bore those investments? The former franchisee that is now pushed aside by the franchisor, maybe for another "investor".
Although post-term non-compete obligations may not be justified in many specific cases, franchisors are inclined to insert them anyway, because the Guidelines (seem to) allow the insertion thereof in the context of franchising.

Consequently, **paragraph 68** should be differentiated by clarifying that a post-term non-compete obligation may not be applied lightly and is only justified in specific circumstances. Again, the franchisor should be able to proof its necessity.

**Paragraphs 146 and 148**, which both apply in the context of most franchise agreements, are prone to misuse by franchisors. Franchisors can misuse these stipulations in order to justify non-compete obligations for the whole duration of the franchise agreement, even if the relation-specific investments are not 'high' (paragraph 146) and even if the transfer of know-how is not 'substantial' (paragraph 148).

Moreover, paragraph 148 even presumes that a non-compete obligation for the whole duration of the franchise agreement is justified in the context of franchising, without any further condition. Such over-simplified statements, which are not clearly defined nor made subject to scrutiny of the specific circumstances, again tend to incline franchisors to impose these obligations in all franchise agreements, irrespective of the context at hand.
Therefore, we suggest to clarify the meaning of 'high relationship-specific investments' and 'substantial know-how' and to insert at least in paragraph 148 'as for example in the context of franchising may be the case'.

**Paragraph 190** refers to an important restriction, i.e. the market share threshold of 30%. We are of course aware that most vertical restraints will only raise competition concerns if there is insufficient competition on the relevant market. The market shares of most franchising formulas appear to be under the 30% threshold, depending however on how the relevant market is determined. Most likely, it is (at least) the national product market of selling franchise services. However the current expansions by the bigger franchisors to abroad markets will ensure a bigger (European) relevant market.

We also suggest that if companies under the market share threshold synchronize their behaviour (homogeneous/cumulative entry and exit barriers) there is in fact reason for competition concerns. The Guidelines should foresee that franchise

agreements will be scrutinized more severely in function of the market share percentage, even if they remain below the 30% threshold. Given the market shares in retail, the current behaviour of franchisors and homogeneous use of hard core restrictions, the current threshold is simply too high to ensure sufficient competition scrutiny under the Block Exemption Regulation. Even when considering the relevant market shares are also based on the position of the franchisor on the market of sales thereby not automatically exempting the bigger franchisors. We would like to suggest to lower the threshold (i.e. 10%).

Furthermore, paragraph 190 states that 'the more important the transfer of know-how is, the more likely it is that the restrains [...] are indispensable to protect the know-how and that the vertical restraints fulfil the conditions of Article 101 (3)'. As was mentioned before, paragraph 45 should thus be more nuanced.

Finally, paragraph 190 once again bluntly states that a non-compete obligation may last during the duration of the franchise agreement if 'the obligation is necessary to maintain the common identity and reputation of the franchised network'. This is undefined criterion is being misused by franchisors. Consequently, we believe that these sorts of statements should be banned from the Guidelines or should at least be qualified and submitted to clearly defined conditions.

**Paragraph 191** pretends to contain a representative example of franchising, while projecting an image of franchising, which is no longer feasible in the current context of franchising.
Undoubtedly, franchisors (and particularly starting franchisors) deserve a certain degree of protection. This should however always be weighted against the rules of competition and the needs of the franchisee in the specific circumstances at hand.

The example in paragraph 191 is one of a starting franchisor, which heavily depends on franchisees to reach a bigger audience and is genuinely in need of protection of his know-how. As was mentioned before, most franchisors are bigger, well-known brands, which are in a more powerful position to impose restraints on potential franchisees.
Franchisors in the current market circumstances are not inclined (anymore) to take their responsibilities, simply because of the fact that there is no need to do so. Franchisors can refer to e.g. the Guidelines, which support the restraints in the franchise agreements.
Paragraph 191 however states that 'most of the [aforementioned] obligations in the franchise agreements can be deemed necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 101 (1)'.

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Although apparently only 'most of the obligations' are justified, the text does not mention which obligations may in circumstances not be justified.
Thereafter, there should also be a possibility to enforce these obligations, since franchisors are often well aware of the fact that franchisees are unable to raise their concerns as they strongly depend on their franchisor.

Overall, the example of paragraph 191 once again raises the impression that all imaginable obligations are justified in the context of franchising for the sake of protection of the franchisor, without even taking into account the specific circumstances of the actual franchise relationship. Consequently, we suggest rethinking the example of franchising and potentially installing an example in which not every obligation may be imposed upon the franchisee.

In conclusion
The Guidelines should not support the aforementioned general protection given to franchisors and they should even state that far-reaching obligations may only be justified if the franchisor also takes certain corresponding obligations upon himself ("remedies"). Always provided, however, that the agreement, decision or concerted practice takes fair account of the interests of franchisees, and neither imposes on the undertakings concerned any restriction not indispensable nor makes it possible for such undertakings to eliminate competition in respect of a substantial part of the concerned

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