

# FRANCHISE DEVELOPMENTS IN EUROPE

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## Newsletter EFL December 2023

### Chair's Column

We present our first extraordinary newsletter on the occasion of John Pratt's work regarding the United Kingdom's New Block Exemption on Vertical Agreements. As a consequence of Brexit, EU competition law is no longer applicable within the UK territory and franchise agreements having effect on the UK market do not benefit from the exemption provided by the EU Block Exemption Regulation on Vertical Agreements but to the UK's Vertical Agreements Block Exemption Order. After the expiry of the transitory period for adaption of those agreements to the UK domestic rules, ended on June 1, 2023, franchisors operating in the UK market should make sure that their franchise agreements are fully compatible with British brand new rules.

John's contribution provides for a very clear summary on the main differences between the EU and British rules which we thought could be useful to franchisors operating or wishing to operate within the UK.



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### United Kingdom

#### THE UNITED KINGDOM'S NEW BLOCK EXEMPTION ON VERTICAL AGREEMENTS

##### I. INTRODUCTION

The United Kingdom (UK) is no longer part of the European Union. Accordingly, the UK has the freedom to produce its own block exemption which sets out the provisions that must not be contained in vertical agreements, such as franchise agreements, for those agreements to be exempted from UK competition law regulation. The UK's Vertical Agreements Block Exemption Order (VABEO) became effective on June 1, 2022. As with the EU Block Exemption Regulation on Vertical Agreements (VBER), guidelines explaining the provisions of the VABEO were also published, on July 12, 2022. There was a one year period whereby UK agreements previously exempted by the EU's block exemption continued to be exempted, but on June 1, 2023, this period expired.

The purpose of this article is to highlight the main differences between the VBER and the VABEO which are relevant to franchising, although the EU and the UK's competition authorities have adopted a broadly similar approach in producing their block exemptions.

##### II. BASIS OF UK COMPETITION LAW

The UK's Competition Act 1998 (Competition Act) is modelled on EU competition law to reduce compliance costs on businesses who trade both in the UK and in the EU. The Competition Act prohibits and regulates written or oral agreements that prevent, restrict, or distort competition, and which may affect trade within the UK and not, as with EU law, trade between member states of the EU. Infringing agreements are void or their offending provisions are unenforceable. The parties to the agreement may be liable to penalties of up to 10% of their UK turnover. Third parties who have been harmed by

such agreements can bring claims for damages due to breach of a statutory duty.

The Competition Act, as with the EU's competition laws, allows for agreements that prevent, restrict, or distort competition to be exempted. This is if, subject to safeguards, the agreements improve production or distribution or promote technical or economic progress.

The VABEO exempts vertical agreements, including franchise agreements, provided they do not contain certain prohibited restrictions set forth in the VABEO. An agreement that satisfies the requirements of the block exemption will be automatically exempt without the need for individual notification to the Competition and Markets Authority (CMA), the UK's competition body.

In addition to the VABEO, limited immunity from fines is given to "small agreements" - agreements between undertakings with a combined applicable turnover of less than £20-million. Exemption from fines does not apply to "small agreements" containing price fixing provisions. However, businesses that are immune from financial penalty are not exempt either from the other available enforcement actions or from third-party civil actions for damages. This is why franchisors operating in the UK generally seek to ensure that their franchise agreements satisfy the requirements of the VABEO.

### **III. VABEO AND FRANCHISING**

The VABEO itself does not refer to franchising, but according to the Guidelines:

"Vertical restraints contained in franchise agreements will be assessed under the guidance applicable to the distribution system that most closely corresponds to the nature of the particular franchise agreement. For instance, a franchise agreement that gives rise to a closed network since franchisees are prohibited from selling to non-franchisees are to be assessed under the principles applicable to selective distribution. In contrast, a franchise agreement that does not create a closed network but which grants geographical exclusivity and protection from active sales by other franchisees shall be assessed under the principles applicable to exclusive distribution". Franchising agreements that do not benefit from the block exemption provided by the VABEO require an assessment to see if they fulfill the conditions for exemption under section 9(1). This assessment under section 9(1) should take into account that the more important the transfer of know-how, the more likely it is that the vertical restraints create efficiencies and/or are indispensable to protect the know-how."

## **IV. MAIN CHANGES AND DIFFERENCES BETWEEN UK AND EU APPROACHES TO FRANCHISE ISSUES**

The main differences between the UK and EU approaches are in the following areas:

### **(A) Resale Price Maintenance**

In both the VABEO and the VBER, resale price maintenance remains a "hardcore restriction." Hardcore restrictions are particularly serious and result in the block exemption not applying to the agreement as a whole. Nevertheless, the UK approach, reflecting the EU position, allows the imposition of resale prices by a franchisor in contracts entered into between the franchisor and a customer but which is fulfilled by franchisees. Such agreements are often referred to as "national accounts".

The VBER now includes specific lists of efficiency defences of resale price maintenance which is not reflected in the VABEO. These include incentivizing franchisees to promote products by imposing fixed minimum retail prices for a limited period, and imposing fixed retail prices for coordinated short term promotional campaigns. In the UK the prohibition of "free riding" is not expressly included in the VABEO as an efficiency defence for resale price maintenance.

The EU appears to be adopting a more nuanced approach than previously. It has indicated that placing recommended retail prices on packaging is not an indirect measure imposing resale price maintenance. Nor is recommended retail pricing considered price monitoring or reporting, provided it is not linked to other obligations concerning the setting of resale prices. It is not clear whether in the UK a similar or stricter approach will be adopted to resale price maintenance.

### **(B) Post-Termination Covenants Not to Compete**

Simply as a matter of judicial practice, English Courts have not sought to apply the VBER but instead have relied on the European Court of Justice's decision in Pronuptia and, as a result of that more flexible approach, have not struck down post-termination non-competes covenants on competition law grounds. That is likely to continue under the VABEO.

Further, the VBER exempts post-termination covenants not to compete which apply to the "premises and land from which the buyer has operated ...". In much of Europe, the vast majority of franchises relate to retail operations. In the UK, a substantial majority of franchisees are not retail based, provide

services and not goods, and are often not premises based. As a result, the equivalent provision in the VABEO is broader and also refers to the "... vehicle from which the buyer has operated ...".

### **(C) Purchase Obligation**

The EU has adopted a more flexible approach to that in the UK in relation to obligations on franchisees to purchase products from the franchisor or its nominated supplier. Now, under the VBER, purchase obligations and in-term non-compete covenants which are tacitly renewable beyond five years are, subject to certain conditions, exempted. Regulation 10(2)(a) of the VABEO and paragraph 9.5 of the Guidelines make clear that is not the approach in the UK.

However, the VABEO extends the exemption from the prohibition to a vehicle used by a franchisee which is owned by the franchisor.

### **(D) Exclusive Territory**

Both the VBER and the VABEO permit shared exclusive territories and shared customer groups where more than one franchisee is allowed to operate in an exclusive territory or customer group. The VBER allows this for up to five franchisees. The VABEO allows this, but does not set a maximum number of franchisees. Instead it has to be a proportionate number to preserve investment efforts.

### **(E) Dual distribution**

Vertical agreements between competing undertakings are outside the scope of the VABEO unless they are non-reciprocal and comply with the conditions set out in Regulation 3(5) of the VABEO. As a result of the increasing use of the internet to sell the franchisor's products as well as through franchisees (referred to as "dual distribution"), there have been increased competition law concerns about the exchange of information between franchisors and franchisees. In practice, obligations to provide information are usually imposed on franchisees and not franchisors. Effectively, in dual distribution franchisors and franchisees are competitors either on the internet or when a franchisor operates company-owned outlets. Therefore, vertical agreements containing information exchange obligations have "horizontal" effects. Horizontal agreements are considered much more problematic from a competition perspective, than pure vertical agreements. The VABEO takes a more relaxed approach to dual distribution than the VBER. In the UK information exchange is exempted if it is not a "restriction by object" and the information exchange is

necessary for the implementation of the franchise agreement.

Franchisors usually operate at a different level of trade to its franchisees but also at the retail level where they compete with their franchisees. Where franchisees only operate at the retail level and do not compete with the supplier at the level of trade where it purchases the contract goods or services, the Guidelines state, "competition issues are less likely to arise where the parties do not have market power and any potential negative impact on horizontal intra-brand competition between the parties at the retail level is considered of lesser importance than the potential positive impact of the parties' vertical agreement on general competition at the supply or distribution level." Further, "in principle, if any of the conditions in VABEO Article 3(5) are fulfilled in respect of a non reciprocal vertical agreement between competing undertakings then the benefit of the block exemption includes the exchange of information that is required to implement that vertical agreement."

In a section titled "Information exchange in the context of dual distribution," the Guidelines provide a list, on a non-exhaustive basis, of the information which may be exchanged and not prohibited "restriction by object" that are likely to be treated as genuinely vertical.

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