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From the
Franchise & Distribution Law Group

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European Union Adopts New Block Exemption

The European Union ("EU") has adopted a new block exemption on so-called "vertical restraints" imposed by one member of a supply chain on another member at a different level in the chain. Many of the restrictions in franchise agreements are vertical restraints; e.g., exclusive territories; confidentiality covenants; transfer restrictions; noncompetition clauses and sourcing restrictions. The new regulation replaces several existing block exemptions, including the one for franchising.

Under EU law, agreements and concerted practices which restrain trade among member countries of the EU are void. Under the new exemption, vertical restraints are generally exempt where the market share of the supplier (i.e., the franchisor) in the relevant market does not exceed 30%. Where a franchisor or other supplier has a market share above 30%, it will still need to consider applying for an individual exemption.

The Commission calculates market share on the basis of the sales value of those goods or services sold in the relevant market by the franchisor (and other goods or services sold by the franchisor) which are regarded as "interchangeable or substitutable by the buyer by reason of the product's characteristics, prices and intended use." A company's market share includes any goods or services supplied to "integrated distributors" for purposes of sale. These market share provisions leave many unanswered questions for franchisors. Should a franchisor be concerned both about its share of the market for franchises and its share of the market for the goods and services sold by its franchisees? What is the relevant market for a restaurant chain that features pizzas? Is it the quick serve restaurant market or only the pizza restaurant market?

The exemption does not apply to any direct or indirect in-term noncompete obligation that has a duration greater than five years or that is of indefinite duration. An in-term noncompete which is "tacitly renewable" beyond a period of five years is also not exempt. A post-term noncompete will be exempt if it: (1) applies for no more than one year and it relates only to goods or services of the type sold under the franchise agreement; (2) is limited to the premises from which the franchisee operated; and (3) is indispensable to protect know-how transferred by the franchisor to the franchisee. Obviously, this new approach to noncompetes will raise serious concerns for franchisors. It may be that franchise agreements will have to be limited to a duration of five years.

The regulation also states that vertical agreements between competitors are not exempt. This could pose problems for certain co-branding arrangements if the parties to it are considered competitors. However, the exemption will apply to "non-reciprocal" vertical agreements between competitors where: (1) the party who is subject to the restraint has gross revenue of less than 100 million euros; or (2) the party imposing the restraint is a manufacturer and a distributor of goods, whereas the party who is subject to the restraint is a distributor which does not manufacture goods competing with those being sold pursuant to the arrangement; or (3) the party imposing the restraint is a provider of services at several levels of distribution, while the other party does not sell competing services at the level of trade where it purchases services under the arrangement in question.

The exemption contains certain transition rules. First, agreements entered into on or before May 31, 2000 can take advantage of either the old franchise block exemption or the new block exemption for vertical restraints. Furthermore, existing agreements which comply with the old franchise block exemption will continue to be exempt until December 31, 2001. Thus, in effect, franchisors have until the end of 2001 to amend their existing agreements to comply with the new exemption.

The new block exemption raises some troubling questions. The Commission is to issue companion guidelines in the coming months and it is hoped they will ease some of the concerns for franchising.

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