NGUYEN THI THANH HUYEN

Agreements in restraint of competition in franchise agreements in the perspectives of Vietnamese and EC competition law

SUPERVISORS:
Prof. Dr. Katarina Olsson
Dr. Le Net
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1. Introduction

1.1 Research questions and purposes of this thesis

Competition is considered as one of the principles of the market economy where the freedom to business is acknowledged and the legal grounds for fair competition is set up. In practice, the establishment of fully worked-out competition law framework is significant for the development of the market economy. However, the deficiency of such framework in Vietnam adversely affects business activities. The subject regarding to research on agreements in restraint of competition in franchise agreements is chosen due to the economic effects of vertical franchise agreements towards the economy. As the franchising concept is a recent transplant into Vietnamese legal system and Vietnam has only recently received formal legal recognition in the Commercial Law which came into effect in 2006, research on agreements in restraint of competition in franchise agreement is still not mentioned in many aspects. In franchise agreements, the agreements with indication to breach competition law constitute an indispensable part thereof. Therefore, in order to ensure a fair competition environment for franchise activities in the process of economic transition in Vietnam, research on franchise agreements in the perspective of competition law is an essential one.

By studying the topic “Agreements in restraint of competition in franchise agreements in the perspectives of Vietnamese and EC competition law”, the thesis aims to provide an in-depth knowledge about the application of competition law to franchise agreements in European Union as well as in Vietnam. The legal questions arising out of the application of competition law to franchise agreements are (i) whether franchise agreements with agreements in restraint of competition are prohibited and (ii) whether franchise agreements are entitled to any exemption as well as (iii) the conditions for granting such exemption. Through this research, the thesis will figure out different approaches between two legal systems mentioned above on agreements in restraint of competition in franchise agreements and try to explain the reasons thereof. Since Vietnamese competition law is still in its early stages, competition rules on agreements in restraint of competition do not cover all cases, for instance, the application of Vietnamese competition law to the franchise agreement irrespective of its specific characteristic. Therefore, through this research, the reception of EC experiences can be considered in order to improve Vietnamese competition law on the matter concerned. Such reception of foreign experiences shall be taken into consideration in conformity with legal conditions of Vietnam.

1.2 Thematic delimitation and materials

The thesis focuses on the application of competition law to franchise agreements in European Union as well as in Vietnam in comparative perspective. It follows from the topic that the research is only limited in two main legal systems, including European Union and Vietnam. This thesis does not, however, cover exhaustively all aspects of competition law on franchise agreements but just focuses on agreements in restraint of competition under Article 81 EC or Article 8 Vietnamese Competition Law. In particular, the thesis researches competition law on
vertical restraints in franchise agreements, including but not limited to territorial restrictions, customer restrictions, non-compete obligations, exclusive purchasing requirements, and resale price maintenance. To the extent that such vertical agreements might result in the abuse of a dominant position, contrary to Article 82 EC or Article 13 Vietnamese Competition Law, however, an analysis in terms of this aspect is beyond the scope of this thesis. Instead, the thesis is concerned with the application of Article 81 EC or Article 8 Vietnamese Competition Law - collusion that restricts competition - to vertical restraints in franchise agreements. Following from this, the thesis is limited to the extent how such vertical restraints in franchise agreements are dealt with in the perspectives of Vietnam and EC competition law and whether they fall within the prohibition or granted exemption from such prohibition as provided in competition regulations thereof. The thesis substantially focuses on exemption for franchise agreements which should be considered the shortcomings of Vietnamese competition law. By evaluating competition law towards franchise agreements, in particular regulations on exemption for franchise agreements learned from EC competition law, the thesis will make proposals for amendments in Vietnamese competition law on franchise agreements.

In the process of writing the thesis, the materials on the application of EC competition law to vertical agreements are plentiful and available at the library of Law Faculty of Lund University, however, the in-depth materials which directly focus on the subject of the thesis are rather limited. The sources for this thesis also extend to relevant materials from academic websites, including but not limited to Westlaw, Heinonline, Elin and Europa. In Vietnam, the research on the application of Vietnamese competition law to agreements in restraint of competition are also numerous; some of which have directly mentioned to the subject of the thesis, namely the work on “Anti-trust law in the US and Competition Law in EU” written by LL.D Le Net or the article “Commercial franchising as viewed from the competition law’s perspective” written by LL.M Nguyen Thanh Tu. However, it has been found in the thesis the most endeavour to intensify the research in more profound degree.

1.3 Methodology

Pursuant to the aims as mentioned above, the methods used in this thesis consist of analytical, systematic, comparative methods and case law analysis. Based on analyzing Vietnamese competition law applicable to agreements in restraint of competition in franchise agreements, the thesis will clarify particular problems set forth in such regulations on vertical agreements in restraint of competition in which franchise agreements’ specific characteristics are taken into consideration. Such problems will also be discussed under EC competition law via systematic, comparative methods and case law analysis. The thesis will not only clarify different approaches between Vietnamese and EC competition law in order to deal with such problems but also explain the reasons therefor. The solution for the problems accumulated from EC legislative experiences shall be assessed in both sides, including the effect of such solution and the conformity in the context of Vietnam. Based on the critical reception of EC experiences, the thesis will clarify the extent to which Vietnamese competition law may avail itself of the EC’s breakthroughs.
1.4 Structure of thesis

In accordance with the purposes and delimitation mentioned above, the thesis has been divided into five parts:


- Part 2: Franchise agreements and competition law issues – represents the concept of franchise agreements from the perspective of competition law, specifying the substance of franchise agreements which are distinguished from other distribution agreements as well as clarifying the direct relevance to competition law issues and thence, pointing out the main problem therein.

- Part 3: Franchise agreements under EC competition law – focuses on analyzing the application of the EU competition law to franchise agreements, in particular the exemption granted for such agreements.

- Part 4: Franchise agreements under Vietnamese competition law and the critical reception of EC experiences – concentrates on analyzing the application of Vietnamese competition law to franchise agreements, in particular legal issues arising out of the application of Vietnamese competition law to franchise agreements. Moreover, the thesis also assesses the effect and the conformity of the EC competition law on franchise agreements in the context of Vietnam in order to suggest some solutions to the application of Vietnamese competition law to franchise agreements based on a critical thinking.

- Part 5: Conclusion – sums up the thesis with some proposals and conclusions.

2. Franchise agreements and competition law issues

2.1 Franchise concept under the competition law’s perspective

As being limited in the scope of the thesis, the definition of franchise agreement shall be approached from competition law perspective, focusing on such definition in EC competition law. Accordingly, this approach means that the definition not only contains factors that would be indicative of an agreement being a franchise agreement, but also has direct legal significance for the application of competition law. Practically speaking, franchise agreements can be defined for a variety of purposes and in a different manner, narrowly or broadly, from one country to another. Many countries do apply even a general competition law towards vertical agreements without defining whether the agreement constitutes a franchise relationship. Hence, there is lack of a uniform definition of franchise agreement as officially accepted among different countries. However, for the purpose of applying competition law for franchise agreements in the European Community countries, there was a broad consensus that the franchise agreement, which was the subject of a specific block exemption regulation, that is, Regulation 4087/88\(^1\), should be defined

in order to apply a separate treatment. Although this separate treatment is ended by
the new block exemption regulation, that is, Regulation 2790/99\(^2\), the definition
contained in Regulation 4087/88 has remained its practical value. Through this
definition, the essence of franchise agreements can be elucidated and the elucidation,
in its turn, results in the fact that the application of competition law on franchise
agreements is, to some extent, considerably ameliorated.

Conceptually, a ‘franchise agreement’ is defined as ‘an agreement whereby
one undertaking, the franchisor, grants the other, the franchisee, in exchange for
direct or indirect financial consideration, the right to exploit a franchise for the
purposes of marketing specified types of goods and/or services’\(^3\). Taken together with
the definition of a franchise agreement, a ‘franchise’ is also defined as ‘a package of
industrial or intellectual property rights relating to trade marks, trade names, shop
signs, utility models, designs, copyrights, know-how or patents, to be exploited for the
resale of goods or the provision of services to end users’\(^4\).

It follows from the definition that the following elements identifies a franchise
agreement: (i) the ownership by the franchisor of the rights to a package of industrial
or intellectual property rights which is characterized as franchise; (ii) the grant of a
license to the franchisee to exploit the franchise for the purposes of resale of goods or
the provision of services to end users; and (iii) the payment by the franchisee to the
franchisor in consideration of the rights to use such franchise. Analysing the elements
in further detail, it should be noted that the grant of a license to the franchisee to
exploit the franchise, indeed, establishes a close and continuing relationship between
the franchisor and the franchisee. Such relationship is deeply embedded in a franchise
system, being clarified through the expression of the Guidelines on Vertical
Restraints\(^5\) which accompanies the Regulation 2790/99. Accordingly, in addition to
‘the licence of intellectual property rights relating to trade or signs and know-how for the
use and distribution of goods or the provision of services’, ‘the franchisor usually
provides the franchisee during the life of the agreement with commercial or technical
assistance, such as procurement services, training, advice on real estate, financial
planning etc. The licence and assistance are integral components of the business
method being franchised’\(^6\). The fact that the right to use such license is made
available to the franchisee, hence, enables the franchisor to protect his ownership
against its competitors by imposing necessary restrictions on the franchisee. Thus, the
question is to what extent such restrictions are to be obviously inimical to competition
and thereby infringe competition law.

As mentioned above, the rationale of the argument that the imperative of
protecting the franchisor’s ownership regarding intellectual property rights continues
to accelerate is based on the high risk of being infringed by the franchisee. This point
is emphasized, namely that the infringement by the franchisee, if any, is more likely

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\(^2\) Commission Regulation (EC) No 2790/99 on the application of Art 81(3) of the Treaty to categories
of vertical agreements and concerted practices (Vertical Restraints Block Exemption Regulation)
\(^3\) Article 1(3)(b) Regulation 4087/88.
\(^4\) Article 1(3)(a) Regulation 4087/88.
‘Guidelines on Vertical Restraint’).
\(^6\) Guidelines on Vertical Restraint, para 42.
to be advocated by the integration of the franchisee into the franchisor’s network. In this respect, it is more likely to refer to a close and continuing relationship between the franchisor and the franchisee which is characterized as a significant element of a franchise system. In order to clarify such relationship, a description of franchise systems by the European Court of Justice in the case Pronuptia\textsuperscript{7} may be cited for reference. Accordingly, franchise agreements do involve ‘the use of a single business name, the application of uniform business methods or the payment of royalties in return for the benefits granted’\textsuperscript{8} as well as ‘the franchisee’s obligation to apply the business methods developed by the franchisor’\textsuperscript{9} as being considered a means of the control exerted by the franchisor. This characteristic makes the franchise relationship being not exactly a form of a fully integrated vertical structure but just rather than a de facto integration. Indeed, the franchisee is an independent undertaking but, once integrated, ‘adopts the appearance of a subsidiary or division or branch of the franchisor’\textsuperscript{10}. For that reason, the franchisor ‘must be able to take the measures necessary for maintaining the identity and reputation of the network bearing his business name or symbol’\textsuperscript{11}.

As a consequence of this analysis above, a franchise agreement is distinguished by the close relationship between the franchisor and the franchisee. Such relationship is continuously maintained by the substantial transfer of know-how and continuing assistance by the franchisor and the control exerted by the franchisor, namely in form of highly standardized business methods imposed on the franchisee. Taken together with the benefits granted by the franchisor, parallel with the payment of consideration, the franchisee is also obliged to strictly conform to restrictions imposed by the franchisor as a shield of the franchise system. Such restrictions should be duly examined under the competition law’s perspective for the compliance with relevant competition regulations.

It is on the basis of the summarized that franchise agreements exhibited, to a greater degree, some characteristics generally found in other agreements, such as exclusive distribution agreements, selective distribution agreements and patent and trade-mark licensing. However, franchise agreements remained inherently distinct from such agreements due to the following characteristics: (i) the closer relationship as being equated as a de facto integration between the franchisor and the franchisee, (ii) the utilization of a package of intellectual property rights and the application of uniform commercial methods which gives the network its uniform appearance; and (iii) the payment of financial consideration by the franchisee in exchange for the benefits granted by the franchisor. Specifically with regard to patent and trademark licensing, the primary object is aimed at transferring these licenses, whereas in franchise agreements, these licenses are often merely ancillary to the whole package of intellectual property rights and the transfer of these licences does not constitute the primary object thereof. Subsequently, the differences between franchise agreements

\textsuperscript{7} Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis (Case 191/84) [1986] ECR 353 (hereinafter referred to as ‘the Pronuptia case’).

\textsuperscript{8} The Pronuptia case, para 15.

\textsuperscript{9} The Pronuptia case, para 18.


\textsuperscript{11} The Pronuptia case, para 17.
and each of the exclusive and selective distribution agreements are addressed separately in more detail.

In the exclusive distribution agreement, in a broad sense, the supplier appoints one distributor as an exclusive dealer to resell his products, either for a defined territory or for a particular class of customers\textsuperscript{12}. It should be noted that the Commission distinguishes between “exclusive distribution agreement” and “exclusive customer allocation agreement”, which refers only to those agreements by which the distributor is allocated for a defined territory\textsuperscript{13} and for a group of customers\textsuperscript{14}, respectively.

It follows from the above that a franchise agreement shares the characteristics of an agreement conferring partial or absolute territorial exclusivity and requiring a distributor to sell goods under the supplier’s trademark, as being in some way analogous to that of an exclusive distribution agreement. However, as opposed to an exclusive distribution agreement in which the appointed independent distributor, irrespective of partial or absolute territorial exclusivity granted by the supplier, is free to determine sales policy within the territory, such as the right to sell from whatever outlets and in whatever way it choose, in case of a franchise agreement, the franchisee, despite acting as an independent undertaking and taking all the risks of resale, has to operate in conformity with a highly standardized framework set out by the franchisor. There is no latitude at all for the franchisee to comply with sales policy imposed by the franchisor as the uniform commercial standards. In other words, whilst an exclusive distribution agreement straightforwardly depicts a vertical agreement between independent undertakings, a franchise agreement represents a vertical structure in which the franchisee is appointed to operate ‘in a manner far more closely integrated with the franchisor’\textsuperscript{15}. Accordingly, the cooperation between the franchisor and the franchisee may contribute substantially a close relationship, more akin to de facto integration.

As regards selective distribution agreement, it is defined as an agreement where ‘the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorized distributors’\textsuperscript{16}. In other words, owing to specified criteria, the supplier may limit the resale of goods within the selected distributors. As opposed to the exclusive distribution agreement, the restriction of the number of distributors does not depend on a protected territory or a customer group allocated to distributors, but on selection criteria set out by the supplier. Moreover, in selective distribution agreement, the restriction on resale is not imposed on a territorial basis and is not limited in active selling to a territory but a restriction on any sales to unauthorized distributors.

\textsuperscript{13} Guidelines on Vertical Restraints, para 161.
\textsuperscript{14} Guidelines on Vertical Restraints, para 178.
\textsuperscript{16} Regulation 2790/99, Article 1(d).
Similar to a selective distribution agreement, a franchise agreement, by its very nature, is entered into by the franchisor and the franchisee who is selected on the basis of specified criteria for allowance to become the member of the franchise system. The distribution of goods is normally limited within the approved list; the only exception to this limitation would be if a distributor sells to final consumers at a retailer level. In selective distribution agreements, distributors are not entitled to broaden the resale of their goods to unauthorized dealers. The limitation could be applied, by analogy, to franchisees in franchise agreements. In particular, restrictions on resale of goods to dealers outside the franchise network and requirements that the franchisees sell only products supplied by the franchisor or by suppliers designated by the latter, indeed, mirror the characteristic of a selective distribution agreement. Nevertheless, in contrast with a franchise agreement, the essence of selective distribution system is the network of agreements neither precluding the right to sell competing goods by the distributor nor restricting the resale of goods based on allocating territorial areas. Another difference should be mentioned, albeit being thought of having economically, rather than legally sense. In a selective distribution network, the supplier relies mainly on the know-how developed by already established traders at their own discretion, with an experience in the sector, whilst the franchisor in a franchise network is more likely to contract with new entrant who has always remained loyal to the methods developed by the franchisor. The commitment to apply such methods, together with financial resources, becomes an essential part of the criteria for selection set out by the franchisor. It leads to a slightly different point as compared to purely qualitative or quantitative selective criteria set out by the supplier in a selective distribution system.

The conclusion flows directly from the analysis above, namely that franchise agreements are hybrids of various forms of distribution, including but not limited to exclusive and selective distribution agreements. Clearly speaking, a franchise agreement may be treated as a combination of exclusive and selective distribution agreements, where typical obligations such as the non-compete obligation relating to goods that are the subject matter of the franchise, the obligation not to resell goods to unauthorized dealers or the obligation to limit the resale of goods based on a location clause or exclusive territory are closely incorporated in such franchise agreement. The differences are deeply rooted in the communication of know-how and continuing technical assistance by the franchisor as well as a highly standardized business methods imposed on franchisees in order to protect the identity and reputation of the franchise system. However, such differences, from the practitioner’s perspective, do not imply the considerable discriminated treatment on franchise agreements as compared with that of exclusive or selective distribution agreement. The fact that franchise agreements, albeit not being legally equated with exclusive distribution, selective distribution agreements, and intellectual property licences, may share the characteristics of such distributional forms, is of particular significance in the context of EC competition law once the regulation on vertical agreements has undergone fundamental reform. Instead of applying separate regulations for vertical agreements based on the legal form of the transaction, the treatment for vertical agreements under EC competition law in force do not rely upon the legal form but focus on the restrictive clauses actually incorporated into such agreements. Each of which is examined under the general criteria laid down in the new block exemption regulation. Put simply, the franchise agreement is no longer treated separately on the basis of the legal form. To what extent the franchisor may impose restrictions on his franchisees
depends on the essence of the franchise system. For instance, the franchise system is of a selective nature may lead to the specific treatment that deviates from one which shares the characteristic of exclusive distribution agreement. The analysis in further detail shall be discussed later in Chapter 3.

2.2 The main problem of the application of Competition law to vertical restraints in franchise agreements

Inherent in franchise agreements are a great number of clauses which, by their very natures, restrict competition at somewhat different levels. Such clauses which are labelled as ‘vertical restraints’ could be more obviously inimical to inter-brand as well as intra-brand competition. Generally, the following vertical restraints, irrespective of being somehow expressed, are normally incorporated in franchise agreements.

First of all, franchise agreements may involve resale price maintenance – which aims at fixing a final price for resale. This restriction may be laid down in forms of a price ceiling, a price floor or non-binding recommended retail price or any recommended prices advertised by the franchisor. Accordingly, the franchisee is obliged or induced not to sell below a price floor, at a fixed price or not above a price ceiling. Such restriction may reduce intra-brand competition, even contribute to a total elimination of intra-brand price competition and increase transparency on prices.

Second, it deserves mentioning territorial or customer restrictions which limit the territory or the customers allocated to franchisees. The territorial restriction is normally combined with customer restriction, but either the former is included in the agreement without the latter and vice versa. It can be found that the degree to which clauses containing territorial or customer restrictions may restrict competition, indeed, varies with the target set by the franchisor in order to determine the economic efficiency of the franchise structure. Accordingly, less strict restrictions imposed on the franchisee do not completely prevent the franchisee from selling customers outside his territory, but stricter restrictions may completely do so. At the strictest level, such restrictions may contribute to an absolute market partition between franchisees under which the franchisee is limited to sell contract goods only to customers of his specified territory at named location and, even only to groups of customers allocated exclusively to him. As a result, such restrictions may foreclose the purchase market, limit or even eliminate intra-brand competition and weaken inter-brand competition.

Third, the restriction which is normally found in the franchise agreement relates to exclusive dealing – as being so-called non-compete obligations. Accordingly, the franchisee is prevented from dealing in any competing goods or, more leniently, is allowed to deal with them only to a limited extent. Accurately, the latter situation is more equivalent to full line forcing – or being labelled as exclusive purchasing requirement, which forces the franchisee to purchase the whole ranges of products only from the franchisor or third parties designated by the franchisor. The stricter restriction occurs where the exclusive dealing obligation is associated with full line forcing. In parallel, a separate obligation which is more akin to non-compete obligation is quantity forcing which specifies the minimum quantity to be bought by the franchisee. Another variant of quantity forcing is a restriction which imposes a
minimum sales quota on the franchisee. A minimum sales quota forces the franchisee to achieve a certain level of sales revenues. It may be alleged to indirectly force the franchisee to purchase in excess of a certain rate set out by the franchisor. Such restrictions implicitly foreclose the market to competitors, make market shares more rigid, as well as limit in-store inter-brand competition. The reduction in inter-brand competition may be alleviated by the strong competition between the franchisor and other suppliers, but the longer the duration of the non-compete obligation, the more likely that the reduction in inter-brand competition cannot be weighed out.

Lastly, the non-exhaustive list of restrictions other than those mentioned above implies that the franchisor may, by some ways or other, impose obligations in restraint of competition on his franchisees in order to protect franchise system. The purpose of the franchise network set out by the franchisor determines how vertical restraints can be used, ranging from the purpose to protect intellectual property rights or to maintain the identity and reputation of the network or even to maximize the profits of the network. Since the variants of such restrictions created by the franchisor continuously alter from time to time and adapt to legal circumstances, any rigid principles are more likely to be circumvented. On the other hand, it is argued that a positive attitude towards franchise agreements should be adopted by virtue of the pro-competitive aspects of the restrictions of competition concerned. Accordingly, a number of justifications for the application of such vertical restraints which does not purport to be exhaustive are recognized, namely to solve a ‘free-rider’ problem, to open up or enter new markets, to deal with the ‘certification free-rider issues’, the ‘hold-up problem’, especially the ‘specific hold-up problem that may arise in the case of transfer of substantial know-how’, or to exploit ‘economies of scale in distribution’, as well as to achieve ‘uniformity and quality standardization’. Many supports on the pro-competitive aspects of such vertical restraints, but the most remarkable things are (i) the ability to enables the franchisee as a new entrant to compete strongly with other outlets, (ii) the contribution to the reduction of prices for the contract products without prejudice to the quality thereof, and in it turns, strengthen the ‘brand image’ by producing products with the same quality throughout the market and (iii) the recognition of the products which enables the costs to be kept lower and therefore, reduce prices. For that reason, such vertical restraints should be examined under exemption, if appropriate. Competition law in many countries itself contains provisions on exemption for such vertical restraints. For instance, such vertical restraints may be covered by the exemption under EC competition law, namely under block exemption regulations or individual exemption in the sense of Article 81(3) EC. The correlation between the restrictions with pro-competitive effects and the exemption is also found in Vietnamese competition law.

Hence, the legal question arises whether any of these clauses restricts competition under applicable competition law and if so under what circumstances exemption will be available. However, such legal question is rather extremely complicated in the context of franchise agreements. As stated above, the franchise network, by its very nature, illustrates a degree of external integration, albeit not being a de jure integration. A particular contract provision – for instance an exclusive dealing obligation which prevents the franchisee from purchasing competing products and the full line forcing obligation which requires the franchisee to obtain the contract products only from the franchisor or third parties designated by the franchisor – may seem restrictive compared to more loosely integrated distribution arrangements, but
neither unusual nor particularly restrictive compared to the alternative of internal integration in which the manufacturer owns his own retail outlets\textsuperscript{17}. Such characteristic should be considered when evaluating the compatibility of vertical restraints which are created to improve the vertical co-ordination between the franchisor and the franchisees. In addition, the hybrid essence of the franchise network as discussed above seems to blur the distinction of treatment which is generally made among different distribution arrangements. For instance, the franchise system is of a selective nature may lead to the specific treatment that deviates from one which shares the characteristic of exclusive distribution agreement. However, in case where the franchise network is a particular kind of hybrid between selective distribution and exclusive distribution, it would be difficult to reconcile the contradiction arising out of the different treatment applicable to such distribution agreements. The analysis in the following chapters will focus on clauses contained in franchise agreements which are restrictive of competition but merit exemption under EC and Vietnamese competition law with attaching great importance to the specific characteristic of such franchise agreements.

Finally, it deserves mentioning that the issues discussed above should be examined from different perspectives, since the protection of franchisors or franchisees in parallel with the protection of consumers and other competitors are two sides of a coin. Competition law on vertical restraints which makes more concessions to franchise agreement might be accountable for the consumers’ and other competitors’ benefits as being lost under such treatment. Conversely, any intervention of competition law in a stringent and dogmatic manner can deter the development of franchise agreements. Therefore, the most important task of competition law on franchise agreements is to establish the barrier to determine to which extent vertical restraints as incorporated in franchise agreements, in one hand, enable the franchisor to protect the franchise system, and in other hand, are without prejudice to, or at least, reconcile with the benefits of consumers and other competitors.

3. Franchise agreements under EC competition law

3.1 Franchise agreements before Regulation 2790/99

The application of Article 81(1) to franchise agreements was officially mentioned in the Court of Justice’s judgement in the \textit{Pronuptia} case. Accordingly, Pronutia acting as the franchisor had entered into a franchise agreement with Mrs Schillgalis acting as the franchisee in Germany in order to grant the latter an exclusive right to sell wedding dresses and other wedding items under the trade mark ‘Pronuptia de Paris’ in a defined territory. In particular, the territory allocated for the franchisee covered three separate areas, including Hamburg, Oldenburg, and Hanover. Such franchise agreement contained restrictions on both the franchisor and the franchisee; among them are those which may fall within the scope of Article 81(1). Accordingly, the main restrictions on the franchisor are as follows\textsuperscript{18}:

\textsuperscript{18} The Court’s judgement in \textit{Pronuptia} case, para 5.
The franchisor grants the franchisee the exclusive right to use the trade-mark ‘Pronuptia de Paris’ for the marketing of the contract goods in a specific territory defined by means of a map attached to the contract;

The franchisor undertakes not to open any other Pronuptia shops in that territory or to provide the contract goods to third parties in that territory;

The franchisor undertakes to assist the franchisee with regard to all commercial aspects for her business in order to improve the turnover and profitability of the franchisee’s business.

In return, the franchisee is obliged:

1. To sell the contract goods under the trade-mark ‘Pronuptia de Paris’ only in the shops specified, which must be equipped and decorated exactly as the franchisor required and cannot be transferred to another location or altered without the agreement of the franchisor;

2. To purchase from the franchisor 80% of wedding dresses and accessories and to purchase the remainder only from suppliers approved by the franchisor;

3. To regard the prices suggested by the franchisor as recommended retail prices, without prejudice to her freedom to fix her own prices;

4. To refrain, during the period of validity of the contract and for one year after its termination from competing in any way with Pronuptia outside her allocated territory.

In the court of first instance, when the franchisee was sued for substantial royalty arrears by the franchisor, she argued that the agreement infringed Article 81(1) (ex Article 85(1)) and therefore, was void under Article 81(2) (ex Article 85(2)). On appeal, the German Supreme Court referred a number of important questions with regard to the application of Article 81(1) to the franchise agreement. It follows directly from the restrictions contained in the franchise agreement that such restrictions are indicative of at least the territorial restrictions, non-compete obligation and exclusive purchasing requirement. As convenient to follow-up, the question whether such restrictions imposed on the franchisee as well as on the franchisor infringe Article 81(1) will be elucidated based on the Court’s judgement, as follows:

In Pronuptia case, the Court held that in order for the franchise system to work, restrictive clauses could be identified as falling outside Article 81(1) to the extent that they are necessary for the legitimate protection of the franchisor’s know-how and expertise against the competitors and the maintenance of the identity and reputation of the franchised network. On the ground that the franchisor must be able to transfer his know-how to the franchisee and provide them with the necessary assistance to apply his methods without running the risk that this might benefit its competitors, even directly, a clause prohibiting the franchisee, during and for a reasonable period after its expiry, from opening the shop of the same or similar nature in an area where he may compete with other franchisee does not constitute restrictions

19 The Court’s judgement in Pronuptia case, para 6.
20 The Court’s judgement in Pronuptia case, paras 15, 16 and 17.
on competition for the purposes of Article 81(1)\textsuperscript{21}. The same may be said of the franchisee’s obligation not to transfer her shop to another party without the prior approval of the franchisor\textsuperscript{22}. Thus, the last restriction which is imposed on the franchisee in the \textit{Pronuptia} case as mentioned above is accepted as falling outside Article 81(1).

In addition, the second restriction which imposed on the franchisee the obligation to purchase from the franchisor 80% of wedding dresses and accessories and to purchase the remainder only from suppliers approved by the franchisor could be justified on the ground that it is necessary for the franchisor to protect the identity and reputation of the franchised network. Accordingly, in order to make sure the goods of the same quality can be obtained from each franchisee, a provision requiring the franchisee to sell only products supplied by the franchisor or by suppliers selected by him could not constitute restriction of competition in the sense of Art 81(1)\textsuperscript{23}.

As regards the third restriction, the fact that the franchisor simply provides the franchisee with price guidelines is allowed provided that there is no concerted practice between the franchisor and the franchisee or between the franchisees themselves for the actual application of such prices. Hence, the provision of recommended prices without prejudice to her freedom to fix her own prices is not restrictive of competition in the sense of Art 81(1)\textsuperscript{24}.

As a general rule, the franchisor can contractually agree to abstain from competing with its franchisee and not to appoint additional franchisees within a territory allocated to the franchisee. However, that provision, in combination with the provision which obliges the franchisee to sell goods covered by the contract only in the premises specified therein, may fall within the scope of Article 81(1)\textsuperscript{25}. Such combination results in a sharing of markets between the franchisor and the franchisee or between franchisees and thus restricts competition within the network\textsuperscript{26}. However, the franchisor may argue that the franchisee would not risk entering the network and investing his own money, paying a relatively high entry fee and a substantial annual royalty on the purchase of the franchise without such a benefit from an exclusive territory. For that reason, according to the Court, an examination of the agreement in the light of the conditions laid down in Article 81(3) is called for\textsuperscript{27}.

From the analysis above, it can be drawn from the Court of Justice’s statement that the obligations in the franchise agreement which were necessary to advocate the essential ingredients of the franchising relationship, i.e. the protection of know-how and expertise and the protection of network identity and reputation, should not fall within the ambit of Article 81(1). The exception would be in case that the combination of clauses whereby the franchisee is obliged to sell contract goods only from the premises specified in the agreement and the franchisor undertakes not to compete with the franchisee and not to appoint additional franchisees within a

\textsuperscript{21} The Court’s judgement in \textit{Pronuptia} case, para 16.
\textsuperscript{22} The Court’s judgement in \textit{Pronuptia} case, para 16.
\textsuperscript{23} The Court’s judgement in \textit{Pronuptia} case, para 21.
\textsuperscript{24} The Court’s judgement in \textit{Pronuptia} case, para 25.
\textsuperscript{25} The Court’s judgement in \textit{Pronuptia} case, para 24.
\textsuperscript{26} The Court’s judgement in \textit{Pronuptia} case, para 24.
\textsuperscript{27} The Court’s judgement in \textit{Pronuptia} case, para 24.
territory allocated to the franchisee. Such agreement was treated by the Court as a restriction of competition in the sense of Art 81(1) EC and therefore, is considered for exemption in accordance with Article 81(3).

Following an important decision of the Court of Justice in *Pronuptia* case, a number of Commission decisions on applications for individual exemption for franchise agreements were adopted to advocate the preliminary rule set out in *Pronuptia* case. Accordingly, regarding to the first ingredient to enable the franchise network to work as mentioned in *Pronuptia* case, the Commission held that an obligation for one year after termination not to solicit customers of the franchised business in the previous two years fall outside Article 81(1) and indeed, can be justified on the ground that the protection of the franchisor’s know-how and reputation can be ‘even more essential.’ A similar decision can be found in the *Computerland* decision, namely that the franchisee's obligation not to carry on competing activities during the term of the agreement and not to engage in competing activities for one year after termination of the agreement within a radius of 10 kilometres of his previous outlet. Such obligations are also accepted as falling outside Article 81(1).

The second ingredient as mentioned in *Pronuptia* case was also supported by the Commission’s decision that the franchisee is obliged to order the goods connected with the essential object of the franchise business exclusively from the franchisor or from suppliers designated by the franchisor, without prejudice to the franchisee's purchase the contract goods from any other franchisee. In addition, the Commission also accept the ban on the franchisee reselling the contract goods to resellers who do not belong to the franchise network, since other obligations under the franchise agreement would be made meaningless if the franchisee could freely pass over the goods covered by the contract to resellers who by definition have no access to the know-how and are not bound by the same obligations, which are necessary in order to establish and maintain the originality and reputation of the network and its identifying marks.

Following the Court’s judgement in *Pronuptia* case regarding to the conjunction of the location clause, which obliges the franchisee to operate from the premises specified in his contract and thus prevents him from opening further outlets, and the exclusivity clause, which assures him of a protected territory in which no other franchisees can be appointed, the Commission also conclude that such conjunction results in a certain degree of market-sharing between the franchisor and

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29 *Service Master* decision, para 6.

30 *Computerland* decision, para 22(i) and (ii).

31 *Computerland* decision, para 28 and *Pronuptia* decision, para 25(ii).

32 *Yves Rocher* decision, para 46 and *Charles Jourdan* decision, para 28.
the franchisees or between the latter, thus restricting competition in the sense of Art 81(1)33, although exemption were granted in each case.

Generally speaking, the Commission’s decisions above reinforced the important decisions of the Court of Justice in Pronuptia case for the application of Article 81(1) to restrictions contained in franchise agreements. Under the pressure of enforcing franchise agreements, the Commission intended to adopt an exempting regulation applicable for such agreements. Such regulation was adopted in 1988, less than four years after Pronuptia case, named at Regulation 4087/88 on the application of Article 81(3) (ex 85(3)) of the Treaty to categories of franchise agreements, and in its turn, has been replaced by Regulation 2790/99 as further discussed in the following part.

The pattern of Regulation 4087/88 is modelled upon those of previous block exemption regulations. Accordingly, Regulation 4087/88 covers the definition of its scope as well as lists of exempted provisions and lists of whitelisted provisions as specified in Article 1(3), Article 2 and Article 3 thereof, respectively. Neither article 2 or 3 exempts agreements with obligations of the same kind but more limited scope. This does not matter for Article 3, since the list is expressed not to be exhaustive, but may give rise to difficulties in relation to Article 1 and 234. In addition, Regulation 4087/88 also includes the list of relevant conditions that prevail throughout the duration of exemption as prescribed in Article 4 thereof and lists of the blacklisted provisions which are prohibited per se as laid down in Article 5 thereof. Other provisions concern the opposite procedure, the confidentiality of the agreements notified to the Commission (which is no longer valid according to Regulation 1/200335) and the right to withdraw the exemption by the Commission.

It is remarkable that the exclusive right of the franchisee to exploit his franchise only from the contract premises and the obligation on the franchisee to refrain, outside the contract territory, from seeking customers for the contract goods as well as the non-compete obligation are also reiterated in Regulation 4087/88 as exempted restrictions36. The obligations which are necessary to protect the franchisor’s industrial or intellectual property rights or to maintain the common identity and reputation of the franchised network, including but not limited to obligations on the franchisee to obtain contract goods only from the franchisor or third parties designated by the franchisor, and the obligation to sell contract goods only to end users or other franchisees within the franchise network as well as non-compete obligations, are also identified in Regulation 4087/8837 as whitelisted provisions.

Nevertheless, it is shown that the inclusion of both the permitted restrictions and prohibited restriction in Regulation 4087/88 made the parties concerned reluctant

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33 Computerland decision, para 25; Service Master decision, para 22 and Charles Jourdan decision, para 32.
36 Regulation 4087/88, Article 2(c), 2(d) and 2(e).
37 Regulation 4087/88, Article 3(1)(b), Article 3(1)(e) and Article 3(1)(c).
to insert other restrictions although the compatibility of which with Article 81(1) might be otherwise reasonably expected. This approach forces the franchisor to paraphrase the wordings of the applicable block exemption regulation and benefit its safe harbour for certainty and therefore, results in more form-bases restrictions contained in franchise agreements. For that reason, Regulation 4087/88 operates as a straitjacket and limits the creativity of the parties concerned in franchise agreements. In addition, the scope of Regulation 4087/88 is considered as being too limited, which covers only agreements between two parties, not multi-party agreements and covers only the resale of contract goods or the provision of services to end-users, not the wholesale franchises and industrial franchises. Moreover, Regulation 4087/88 does not contain any market share ceiling for application of the block exemption, which is more likely to be abused by significant market power players. For those reasons, the Commission’s objective is to adopt a block exemption regulation which broadens the scope of application of the former and overcomes a number of shortcomings in the former’s rules on vertical restraints. As a result, Regulation 4087/88 has been superseded by Regulation 2790/99 with a new approach as being further discussed in the following part.

3.2 Franchise agreements under Regulation 2790/99

Regulation 2790/99, as being an umbrella regulation which confers a single block exemption for vertical restraints, does not contain any specific provisions concerning franchise agreements. Franchise agreements will not be given any preferential treatment under Regulation 2790/99 as it is a combination of vertical restraints. Each of which will be treated according to the general criteria set forth in Regulation 2790/99.

In order to determine that a franchise agreement is actually block exempted under Regulation 2790/99, the following issues require a more in-depth review:

(i) First, the determination of whether or not the franchise agreement falls within the governing scope of Regulation 2790/99; and

(ii) Secondly, the determination of whether or not the franchise agreement benefits from the block exemption.

3.2.1 Determination of whether the franchise agreement falls within the governing scope of Regulation 2790/99

With regard to the first issues, it should be emphasized that the governing scope of Regulation 2790/99 is broader than that of the previous block exemption regulation applicable to vertical restraints. Practically speaking, the assessment of whether or not the franchise agreement falls within the scope of application of Regulation 2790/99 can be done on the basis of the following checklists of questions:

(1) Does the franchise agreement affect trade between the Member States in the sense of Art 81 EC?

(2) Does the franchise agreement which is regarded as a vertical agreement contain vertical restraints in the sense of Art 81 EC?

(3) Is the franchise agreement covered by another block exemption regulation?

(4) Does the franchisor’s market share exceed 30%?

(5) Are provisions on intellectual property rights contained in the franchise agreement ancillary?

The first question focuses on the ‘effect on trade’ concept between the Member States which is of significance to determine the application of EC competition law in general and the Regulation 2790/99 in particular. In the absence of the effect on trade between Member States, the franchise agreement cannot be challenged on the basis of EC competition law and therefore, not be covered by Regulation 2790/99. Such agreement is subject to national competition law. The assertion that an agreement which does not affect trade between Member States is not caught by the material scope of EC competition law flows directly from the wording of the Guidelines on the effect on trade concept\(^{40}\), namely that ‘Community competition law is not applicable to agreements and practices that are not capable of appreciably affecting trade between Member States’\(^{41}\). Thence, only agreements which are capable of affecting trade between Member States in an appreciable manner are covered by the ‘effect on trade’ concept and thereby fall within the scope of EC competition law. It should be emphasized that both of the following conditions must be fulfilled, that is the probability of the effect on trade and the attainment of ‘appreciable’ criteria. The mere fact that the franchise agreement is ‘capable’ of affecting trade between Member States is sufficient, irrespective of actually having such effect. Thus, it is necessary to determine (a) to which degree the probability of effect on trade between Member States is sufficient and (b) to what extent a franchise agreement is deemed to affect inter-State trade in an appreciable way. It is possible to infer from the Guidelines on the effect on trade concept that the following agreements are ‘by their very nature’ capable of affecting trade between Member States: (i) distribution agreements prohibiting exports\(^{42}\); (ii) agreements which cover two or more Member States that concern imports and exports\(^{43}\); (iii) agreements that impose restrictions on active and passive sales and resale by buyers to customers in other Member States\(^{44}\); (iv) agreements between supplier and distributors which provide for resale price maintenance and which cover two or more Member States\(^{45}\). By narrowing, any franchise agreement is in some way analogous to any such agreement as depicted in the Guidelines on the effect on trade concept can be regarded as being capable of affecting trade between Member States.

\(^{40}\) Guidelines on the effect on trade concept contained in Arts 81 and 82 of the Treaty [2004] OJ C101/81 (hereinafter referred to as ‘Guidelines on the effect on trade concept’).

\(^{41}\) Guidelines on the effect on trade concept, para 12.

\(^{42}\) Guidelines on the effect on trade concept, para 16.

\(^{43}\) Guidelines on the effect on trade concept, para 62.

\(^{44}\) Guidelines on the effect on trade concept, para 63.

\(^{45}\) Guidelines on the effect on trade concept, para 72.
On the other hand, as regards the notion of appreciability, two presumptions are mentioned in tandem, so-called negative and positive presumptions. The former refers to a non-appreciable affectation of trade rule (‘NAAT rule’) which establishes a ‘safe harbour’ for agreements not being considered to appreciably affect inter-State trade. Conversely, the latter identifies those agreements which are presumed to do so in an appreciable way. Accordingly, the NAAT rule will apply to the franchise agreement if two cumulative conditions are met:\footnote{46 Guidelines on the effect on trade concept, para 52.}

(i) The aggregate market share of the franchisor and the franchisees on any relevant market within the Community affected by the agreement does not exceed 5%; and

(ii) The aggregate Community turnover during the previous financial year of the franchisor in the products covered by the agreement does not exceed € 40 million.

The fact that the NAAT rule is applied to franchise agreements in the sense of Article 81(1) EC provided that such agreements comply with the conditions above, regardless of the nature of the restrictions contained therein, is of practical relevance. Thus, by extension, it means that even a franchise agreement which contains hardcore restrictions but complies with conditions set out in NAAT rule is not covered by the prohibition provided in Article 81(1) EC on the ground that it does not affect trade between Member States in an appreciable way.

Conversely, the positive presumption prescribes the conditions where an agreement is presumed to appreciably affect trade between Member States, as follows:\footnote{47 Guidelines on the effect on trade concept, para 53.}

(i) The agreement is, by its very nature, capable of affecting inter-State trade; and

(ii) The aggregate Community turnover during the previous financial year of the undertakings concerned in the products covered by the agreement exceeds € 40 million; or

(iii) The aggregate market share of the parties on any relevant market within the Community affected by the agreement exceeds 5%,

unless the agreements covers only part of a Member State.

Noticeably, the mere fact that the criteria of the negative presumption are exceeded is insufficient to determine the vertical agreement concerned is covered by the positive presumption. Instead, the agreement should be assessed on the basis of the case-by-case analysis.

The second question focuses on whether the franchise agreement contains vertical restraints in the sense of Art 81(1) EC. It should be emphasized that the exemption provided in the Regulation 2790/99 shall apply ‘to the extent that such agreements contain restrictions of competition falling within the scope of Art 81(1) (‘vertical restraints’)\footnote{48 Regulation 2790/99, the last sentence of Article 2(1).}. Logically, there is no need for an exemption if the franchise
agreement is not caught by the prohibition of Art 81(1) EC. It can be approached from the opposite angle that the Regulation 2790/99 does not apply to franchise agreements, albeit appreciably affecting trade between Member States, containing vertical restraints outside the scope of Article 81(1) EC.

To be on the safe side, the determination of whether restrictions of competition fall outside the scope of Article 81(1) EC should be based on the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community⁴⁹ and the ancillary restraints doctrine.

In line with the Commission’s *De Minimis* Notice, an agreement does not appreciably restrict competition in the sense of Article 81(1) EC⁵⁰:

(i) If the aggregate market share held by the parties to the agreement does not exceed 10% on any of the relevant markets affected by the agreement, where the agreement is made between undertakings which are actual or potential competitors on any of these markets (agreements between competitors); or

(ii) If the market share held by each of the parties to the agreement does not exceed 15% on any of the relevant markets affected by the agreement, where the agreement is made between undertakings which are not actual or potential competitors on any of these markets (agreements between non-competitors).

Based on the market share thresholds, the agreement which is considered to be of minor important shall be excluded from the scope of Article 81(1) EC and thereby, from the scope of Regulation 2790/99. Accordingly, there are different market share thresholds provided for different agreements as laid down in the *De Minimis* Notice, i.e. a combined market share threshold of 10% for agreements between competitors and an individual market share threshold of 15% for agreements between non-competitors. In case of a franchise agreement as frequently being concluded between non-competitors, such agreement, albeit appreciably affecting inter-State trade, will not be caught by Art 81(1) EC if the franchisor’s and the franchisee’s individual market shares does not exceed 15% on any of the relevant markets affected by the agreement.

It is also necessary to distinguish between the notion of appreciable effect on trade as prescribed by the Guidelines on the effect on trade concept above and the notion of appreciable restriction of competition under the *De Minimis* Notice. Accordingly, an appreciability standard as being applied in the *De Minimis* Notice deviates from that of the Guidelines on the effect on trade concept as follows: (i) the separate treatment of the *De Minimis* Notice, is not based on the differentiation between horizontal agreements and vertical agreements, but based on the differentiation between agreements between competitors and agreements between non-competitors; (ii) the presumptions created by the *De Minimis* Notice only rely on

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⁴⁹ Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community [2001] OJ C368/13 (hereinafter referred to as ‘*De Minimis* Notice’).

⁵⁰ *De Minimis* Notice, para 7.
the market share thresholds, whereas those established by the Guidelines on the effect on trade concept rely on both of market share thresholds and turnover.\footnote{Frank Wijckmans, Filip Tuytschaever, Alain Vanderelst (2007), \textit{Vertical agreements in EC competition law}, Sweet & Maxwell Limited and Contributors, para 2.127.}

It should be noted that the individual market share threshold applicable for the franchisor and the franchisee mentioned above will be reduced where the competition on a given relevant market may be restricted by virtue of cumulative foreclosure effects, from 15% to 5% for the purpose of application of the \textit{De Minimis Notice}. In accordance with the \textit{De Minimis Notice}, 'a cumulative foreclosure effect is unlikely to exist if less than 30% of the relevant market is covered by parallel networks of agreements having similar effects'.\footnote{\textit{De Minimis Notice}, para 8.} Furthermore, individual franchisor or franchisee with a market share not exceeding 5% are generally not considered to contribute significantly to a cumulative foreclosure effect\footnote{\textit{De Minimis Notice}, para 9.} and therefore, makes their agreements being covered by the benefit of \textit{De Minimis Notice}. Finally, the application of the \textit{De Minimis Notice} cannot be ruled out with the respective individual minor-importance threshold ranging from 15% to 17% in general case and from 5% to 7% in case of the presence of cumulative foreclosure effects during two successive calendar years.\footnote{\textit{De Minimis Notice}, para 9.} In summary, the \textit{De Minimis Notice} adopts an appreciability standard under which agreements between the franchisor and the franchisee whose individual market share is below the minor-importance ceilings as mentioned above will not be appreciably restrictive of competition under Article 81(1) EC.

Nevertheless, franchise agreements which contain hardcore restrictions can no longer benefit from the \textit{De Minimis Notice}, irrespective of the market share of the franchisor and the franchisee concerned.\footnote{\textit{De Minimis Notice}, para 9.} Such hardcore restrictions are expressly listed in the \textit{De Minimis Notice}, which in turn, indeed reiterates those contained in the black lists of Regulation 2790/99 as being discussed in the following part. It should be emphasized that franchise agreements containing hardcore restrictions will also be deprived of the benefit of block exemption under Regulation 2790/99. Given the Commission’s Guidelines on the application of Article 81(3) of the Treaty,\footnote{Commission’s Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C101/97 (hereinafter referred to as ‘Guidelines on the application of Article 81(3) of the Treaty’).} it is also extremely hard for hardcore restrictions to qualify for application of Art 81(3) EC. Deservedly mentioning, the finding that the franchise agreement appreciably restricts competition in the sense of Art 81(1) EC cannot be solely attributable to the fact that such agreement does not qualify the condition of market share thresholds as prescribed in the \textit{De Minimis Notice}. Such a franchise agreement may fall outside the scope of Art 81(1) EC for certain reasons, for instance, (i) it does not have the restriction of competition as its object or effect or (ii) it does not in itself appreciably restrict competition.

To determine whether a franchise agreement which is not covered by the \textit{De Minimis Notice} contains vertical restraints in the sense of Regulation 2790/99, it is necessary to assess whether or not such agreement has the restriction of competition
as its object or effect. It should be noted that the assessment is carried out according to priority, namely that if the franchise agreement ‘has as its object the restriction of competition, there is no need to take account of its concrete effects’\textsuperscript{58}. Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulation, guidelines but obviously, hardcore restrictions are generally considered to constitute restrictions by object\textsuperscript{59}. Specifically as regards franchise agreements, the restrictions by object may include fixed and minimum resale price maintenance; and restrictions providing absolute territorial protection, including restrictions on passive sales\textsuperscript{60}. If the franchise agreement is not restrictive of competition by object, it must be examined whether it has actual or potential restrictive effects on competition\textsuperscript{61}. Accordingly, negative effects on competition are normally found in the franchise agreement where (i) the franchisor and the franchisee, individually or jointly have, or obtain some degree of market power as defined in the Guidelines on the application of Article 81(3) of the Treaty and (ii) the franchise agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties concerned to exploit such market power\textsuperscript{62}.

If the franchise agreement is restrictive of competition as its object or effect and is not covered by the \textit{De Minimis} Notice, it is necessary to examine whether it restricts competition in an appreciable manner. The case would not be if it does not in itself appreciably restrict competition and therefore, is not accused of infringing Article 81(1) EC and is not covered by Regulation 2790/99. As regards franchise agreements which have the restriction of competition as their object, as mentioned above, the case would be if they contain hardcore restriction. With regard to franchise agreements which have the restriction of competition as their effect, the following relevant factors for the assessment are non-exhaustively listed in the Guidelines on Vertical Restraints: (i) the market position of the franchisor, (ii) the market position of the competitors, (iii) the market position of the franchisee, (iv) entry barriers, (v) the maturity of the market, (vi) the level of trade, and (vii) the nature of the product\textsuperscript{63}. Moreover, the pro- and anti-competitive effects of an agreement must be weighed to determine whether such agreement is prohibited under Article 81(1) EC.

In line with the ancillary restraints doctrine, if the main transaction covered by the franchise agreement is not restrictive of competition, it is relevant to examine whether individual restraints contained in the agreement are ancillary to the main non-restrictive transaction\textsuperscript{64}. If this is the case, such ancillary restraints are also compatible with Article 81(1) EC. It should be noticed that if it is shown that the main transaction in the franchise agreement is restrictive of competition within the meaning of Article 81(1) EC, then bypassing the ancillary restraints doctrine. Here, the question arises in the context of franchise agreements that under which conditions an individual restraint is likely to be considered as ancillary to the main non-restrictive transaction. Based on the criteria set out by the Guidelines on the application of Article 81(3) of

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{58} Guidelines on the application of Article 81(3) of the Treaty, para 20.
\item\textsuperscript{59} Guidelines on the application of Article 81(3) of the Treaty, para 23.
\item\textsuperscript{60} Guidelines on the application of Article 81(3) of the Treaty, para 23.
\item\textsuperscript{61} Guidelines on the application of Article 81(3) of the Treaty, para 24.
\item\textsuperscript{62} Guidelines on the application of Article 81(3) of the Treaty, para 25.
\item\textsuperscript{63} Guidelines on Vertical Restraints, paras 121 to 133.
\item\textsuperscript{64} Guidelines on the application of Article 81(3) of the Treaty, para 28.
\end{itemize}
\end{footnotesize}
the Treaty\textsuperscript{65}, this would be the case only if such individual restraint is directly related and necessary to the implementation of a main non-restrictive transaction. The Guidelines on the application of Art 81(3) EC refer to the 1986 \textit{Pronuptia} judgement to clarify that if the main object of a franchise agreement does not restrict competition, then restrictions, which are necessary for the proper functioning of the agreement, such as obligations aimed at protecting the uniformity and reputation of the franchise system, also fall outside of Art 81(1) EC\textsuperscript{66}. It should be paraphrased that the franchise agreement, in order to function properly, may furthermore include certain ancillary restraints which are compatible with Article 81(1) EC based on the application of ancillary restraints doctrine. According to the European Court of Justice’s judgement in \textit{Pronuptia} case, these included:

(1) Restrictions which are strictly necessary to ensure that the know-how and assistance provided by the franchisor do not benefit competitors\textsuperscript{67}, namely (i) a prohibition on the franchisee, during the period of validity of the contract and for a reasonable period after its expiry, from opening a shop of the same or a similar nature in an area where he may compete with other franchisees in the network\textsuperscript{68}; (ii) a prohibition on the franchisee from transferring its shop to another party without the prior approval of the franchisor\textsuperscript{69}; and

(2) Restrictions which establish the control strictly necessary for maintaining the identity and reputation of the franchise network identified by the common name and symbol\textsuperscript{70}, namely (i) the franchisee’s obligation to apply the business methods developed by the franchisor and to use the know-how provided\textsuperscript{71}; (ii) the franchisee’s obligation to sell only products supplied by the franchisor or by suppliers selected by him provided that such obligation this obligation does not prevent the franchisee from obtaining those products from other franchisees\textsuperscript{72}; and (iii) even the provision of price recommendations to the franchisee, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the application of such prices\textsuperscript{73}.

From the formal point of views as just mentioned, the Court of Justice, indeed, conceived of what nowadays so-called ancillary restraints doctrine which still remains its practical relevance. Following from that, the Guidelines on Vertical Restraints is more likely to succeed the principles created in \textit{Pronuptia} case regarding ancillary restraints. Indeed, the Guidelines on Vertical Restraints allow the franchisor to impose the obligations which are necessary to protect his intellectual property rights. Such obligations are, as follows\textsuperscript{74}:

\begin{itemize}
\item \textsuperscript{65} Guidelines on the application of Article 81(3) of the Treaty, para 29.
\item \textsuperscript{66} Guidelines on the application of Article 81(3) of the Treaty, para 31.
\item \textsuperscript{67} The Court’s judgement in \textit{Pronuptia} case, para 27(2).
\item \textsuperscript{68} The Court’s judgement in \textit{Pronuptia} case, para 16.
\item \textsuperscript{69} The Court’s judgement in \textit{Pronuptia} case, para 16.
\item \textsuperscript{70} The Court’s judgement in \textit{Pronuptia} case, para 27(3).
\item \textsuperscript{71} The Court’s judgement in \textit{Pronuptia} case, para 18.
\item \textsuperscript{72} The Court’s judgement in \textit{Pronuptia} case, para 21.
\item \textsuperscript{73} The Court’s judgement in \textit{Pronuptia} case, para 25 and para 27(5).
\item \textsuperscript{74} Guidelines on Vertical Restraints, para 44.
\end{itemize}
(i) An obligation on the franchisee not to engage, directly or indirectly, in any similar business;

(ii) An obligation on the franchisee not to acquire financial interests in the capital of a competing undertaking if such an acquisition would give the franchisee sufficient power to be able to influence the economic conduct of the competing undertaking;

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

(iv) An obligation on the franchisee to communicate to the franchisor any experience gained in exploiting the franchise and to grant it and other franchisees a non-exclusive licence for the know-how resulting from that experience;

(v) An obligation on the franchisee to inform the franchisor of infringements of licensed IPRs, to take legal action against infringers or to assist the franchisor in any legal actions taken against infringers;

(vi) An obligation on the franchisee not to use the know-how licensed by the franchisor for purposes other than the exploitation of the franchise; and

(vii) An obligation on the franchisee not to assign the rights and obligations under the franchise agreement without the franchisor’s consent.

The third question relates to the applicability of other block exemption regulations. The Regulation 2790/99 states that it ‘shall not apply to vertical agreements the subject matter of which falls within the scope of any block exemption regulation’ \(^{75}\). It means that Regulation 2790/99 ceases to apply to a franchise agreement whose subject matter comes within the scope of application of another block exemption regulation. It can be paraphrased that if such an agreement is covered by a specific block exemption regulation and does not qualify for block exemption hereof, then such agreement is also precluded from being block exempted under Regulation 2790/99.

The fourth question relates to the franchisor’s market share limit for the application of Regulation 2790/99. A franchise agreement will only come within Regulation 2790/99 if the franchisor’s market share does not exceed the threshold of 30% \(^{76}\). Taken together with the franchisor’s individual market share of 15% required by the De Minimis Notice as mentioned above, it can be inferred that the Regulation 2790/99 applies to franchise agreement in which the franchisor’s market share ranges between 15% and 30% of the relevant market. The exception to this rule would be if the market is foreclosed by the application of parallel networks of similar vertical agreements. In this case, a franchise agreement in which the franchisor’s market share ranges from 5% to 30% is subject to the scope of Regulation 2790/99. Noticely, the franchise agreement may still rely on the safe harbour under Regulation 2790/99 where the franchisor’s market share in excess of the permitted threshold qualifies the

\(^{75}\) Regulation 2790/99, Article 2(5).
\(^{76}\) Regulation 2790/99, Article 3(1).
rule set out in Article 9(2) of Regulation 2790/99. Schematically the application of Regulation 2790/99 can be presented as follows:77

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<td>≤ 30</td>
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<td>&gt; 35</td>
<td>✓</td>
<td>-</td>
<td>Art 9(2)(d)</td>
</tr>
<tr>
<td>≤ 30</td>
<td>&gt; 30/ ≤ 35</td>
<td>&gt; 30</td>
<td>✓</td>
<td>-</td>
<td>Art 9(2)(c)</td>
</tr>
<tr>
<td>≤ 30</td>
<td>&gt; 35</td>
<td>&gt; 30</td>
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<td>Art 9(2)(d)</td>
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<tr>
<td>&gt; 30</td>
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<td>&gt; 30</td>
<td>-</td>
<td>-</td>
<td>Art 3</td>
</tr>
</tbody>
</table>

Thus, Article 3 of Regulation 2790/99, in conjunction with Article 9 thereof, provides the market share limit test which examines whether a franchise agreement is eligible for the block exemption under Regulation 2790/99. Unlike Regulation 4087/88 which was devoid of any provision on the market share ceiling as a condition indispensable for exemption, Regulation 2790/99 with the market share limit test is intended to prevent franchise agreements between powerful market players from benefiting the block exemption and is considered to remedy the shortcoming of the former.

The fifth question centres round the role of intellectual property rights. Art 2(3) Regulation 2790/99 applies to ‘vertical agreements containing provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers. The exemption applies on the condition that, in relation to the contract goods or services, those provisions do not contain restrictions of competition having the same object or effect as vertical restraints which are not exempted under this Regulation’.

Accordingly, the scope of application of Regulation 2790/99 is limited to the extent that the franchise agreement containing IPR provisions intellectual property rights (‘IPRs’) can only be covered by the block exemption if the following cumulative conditions are fulfilled:78

(i) The IPRs provisions must be part of the franchise agreement;
(ii) The IPRs must be assigned to, or for use by, the franchisees;
(iii) The IPRs provisions must not constitute the primary object of the franchise agreement;
(iv) The IPRs provisions must be directly related to the use, sale, or resale of goods or services by the franchisee or his customers; and

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78 Guidelines on Vertical Restraint, para 30.
(v) The IPRs provisions, in relation to the contract goods or services, must not contain restrictions of competition having the same object or effect as vertical restraints which are not exempted.

In practice, subject to the fifth condition, which is discussed further below, a franchise agreement generally complies with these former conditions. With regard to the first condition, the IPRs provisions, indeed, are part of the franchise agreement concerning the assignment or licensing of IPRs for the purpose of purchase, sale or resale of contract products and therefore, will be able to benefit from the block exemption under Regulation 2790/99. As regards the second condition, it is self-evident that IPRs are assigned to, or for use by, the franchisees. However, the wording of Article 2(3) of Regulation 2790/99 makes it unclear that whether the inclusion in the franchise agreement of a grant-back provision under which the franchisee is obliged to assign or license any derivations, improvements, or further developments to the franchisor leads to the exclusion of the franchise agreement from the scope of Regulation 2790/99. For the third condition, IPRs must not constitute the primary object of the franchise agreement. Here, there are two questions concerned, namely that (i) what is a ‘primary object’ and (ii) at what point do IPRs amount to the primary object of a franchising agreement and thereby exclude the application of Regulation 2790/99. In line with the Guidelines on Vertical Restraints, the primary object must be the purchase or distribution of goods or services and the IPR provisions must serve the implementation of the franchise agreement. If the franchise agreement only or primarily concerns licensing of IPRs and know-how, it will infringe Article 2(3) of the Regulation 2790/99 and accordingly loses the block exemption. Subsequently, the fourth condition is also fulfilled where the franchisor sells to the franchisee goods for resale and in addition licenses the franchisee to use its trademark and know-how to market the goods.

As to the fifth condition, IPRs must not contain restrictions of competition having the same object or effect as vertical restraints which are not exempted. The Guidelines on Vertical Restraints clarifies that the IPRs provisions should not have the same object or effect as (i) any of the hardcore restrictions listed in Article 4 of Regulation 2790/99 or (ii) any of the restrictions excluded from the coverage of Article 5 of Regulation 2790/99.

It should be noted that, first, only franchise agreements which have as their object, but not as their effect, the infringement of any hardcore restriction listed in Article 4 of Regulation 2790/99 fall outside the benefit of the block exemption. In contrast, if taken literally, Article 2(3) of Regulation 2790/99 implies that the IPRs provisions contained in franchise agreements, irrespective of having as their object or effect the infringement of any hardcore restriction listed in Article 4 of Regulation 2790/99, will be considered not to qualify the fifth condition and therefore, in such a case, franchise agreements concerned will be excluded from the scope of Regulation 2790/99. Second, using the term ‘vertical restraints which are not exempted under this Regulation’, the Commission would like refer both to (i) the hardcore restrictions under Article 4 and to (ii) the restrictions excluded from the coverage of the block.

79 Guidelines on Vertical Restraints, para 34.
80 Guidelines on Vertical Restraints, para 35.
81 Guidelines on Vertical Restraints, para 36.
exemption by Article 5. Accordingly, Article 5 of Regulation 2790/99, as being discussed below, refers to the block exemption for non-compete obligations which fulfil the conditions attached. The most important thing is that the rule of severability does apply to the conditions set out in Article 5 of Regulation 2790/99. Contrariwise, the fact that IPRs provisions have the same object or effect as restrictions excluded from the coverage of Article 5 of Regulation 2790/99 results in the benefit of block exemption being lost for the agreement in its entirety. It should be better that the deprivation of the benefit from block exemption should be limited to the specific obligation, not the entire agreement, which infringes Article 5 of Regulation 2790/99, irrespective of the infringement by IPRs provisions or not.

### 3.2.2 Determination of whether or not the franchise agreement benefits from the block exemption

If the franchise agreement falls within the scope of the Regulation 2790/99, the second step is to determine whether or not such franchise agreement benefits from the block exemption. In the same vein, the second step involves the assessment whether or not the franchise agreement contains provisions which are blacklisted in accordance with Article 4 of the Regulation 2790/99 or which do not comply with conditions imposed on the non-compete obligation as given in Article 5 thereof. Instead of providing a further analysis of these Articles which apply to all types of vertical agreements, the purpose of this part is rather to analyse how the restrictions of competition which are typically imposed in the franchise agreement are dealt with under Regulation 2790/99. Such restrictions are as follows:

(i) Territorial restriction;
(ii) Customer restriction;
(iii) Non-compete obligations;
(iv) Exclusive purchasing requirements;
(v) Resale price maintenance; and
(vi) Other vertical restrictions contained in a franchise agreement

#### 3.2.2.1 The first restriction – territorial restriction

On the one hand, it is compatible with the block exemption that the franchisor is entitled to impose upon itself the obligation not to directly compete with its franchisees via direct sales. It may be paraphrased as the territorial protection against the franchisor. On the other hand, the franchisor may impose the territorial restriction on his franchisees. To what extent such restriction is imposed depends on whether the franchise system is of a selective nature. It should be noted that a franchise system is of a selective nature if it qualifies the definition of ‘selective distribution system’ as stipulated in Article 1(d) of Regulation 2790/99. The distinction is of practical relevance by virtue of a sharply different treatment regarding the imposition of territorial restrictions for selective distribution system and exclusive distribution system under Regulation 2790/99. It should be emphasized that territorial restriction imposed on the franchisee qualifies as hardcore restriction and is blacklisted in Article 4(b) of Regulation 2790/99. A franchise agreement containing hardcore restriction

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82 Guidelines on Vertical Restraints, para 67.
will lose the benefit of the block exemption in its entirety. The prohibition against the imposition of territorial restriction is strictly applied with only four limited exceptions as expressly prescribed in Article 4(b) of Regulation 2790/99.

As regards the franchise system without a selective nature, the franchisor is capable of imposing active sales restriction on the other franchisees in order to grant territorial protection to the franchisee who qualifies as an exclusive distributor. Such restriction is only block exempted under Regulation 2790/99 if the following conditions are met:

(i) The restriction of active sales must be directed at the exclusive territory reserved to the franchisor or allocated by the franchisor to another franchisee;
(ii) The restriction of active sales is imposed on the franchisor and all other franchisees in parallel inside the Community; and
(iii) The restriction of active sales does not limit sales by the customers of the franchisee.

The first condition derives from the wording of Article 4(b), first indent, underlining the exclusivity condition. Accordingly, the first condition relates to the restriction of active sales into the territory reserved exclusively to the franchisor or allocated exclusively to another franchisee. For a territory to be exclusively allocated, the franchisor must agree to sell his product only to one franchisee for distribution in a particular territory. The first condition, therefore, is not fulfilled in case of shared exclusivity or in the case where the franchisor has currently appointed one franchisee but has the right to appoint others. In other words, active sales outside the franchisee’s territory must be allowed if they concern sales to territories other than sole exclusivity.

The second condition does not stem from Article 4(b), first indent, of Regulation 2790/99 but from the Guidelines on Vertical Restraint, paragraph 50, which clarifies that the exclusive franchisee is protected against active selling into his territory by the franchisor and all the other franchisees inside the Community. Hence, an active sales restriction must be accompanied by the parallel imposition of such restriction on the franchisor and all the other franchisees (the ‘buyer’ of the franchisor) inside the Community. Presumably, the condition of parallel imposition implies that the active sales restriction is applied across the entire network in a horizontal direction. It is unlikely to offer any clarification of the condition in the context of a multi-layered network where the franchisees, in their turn, may be entitled to sub-franchise within their territories. In this case, the sub-franchisees will not qualify as the ‘buyer’ of the franchisor, but the ‘buyer’ of the franchisees. The question is that whether the franchisor is entitled to impose the same active sales restriction on the sub-franchisees. The wording of the Guidelines, if taken literally, states that these sub-franchisees are not subject to such active sales restriction. The statement, however, is without prejudice to the right to impose such restriction by the franchisees on their sub-franchisees, provided that the conditions mentioned above are fulfilled. Notwithstanding what has been said before, the uncertainty that whether the

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83 Regulation 2790/99, Article 4 and Guidelines on Vertical Restraint, para 66.
84 Regulation 2790/99, Article 4(b), first indent and Guidelines on Vertical Restraint, para 50.
85 Guidelines on Vertical Restraint, para 50.
franchisor is entitled to impose the same active sales restriction on the sub-franchisees according to the second conditions still remains since the Guidelines do not analyse it in further detail. For the compatibility of such active sales restriction with the block exemption, this question is of practical relevance since the failure to comply with the condition of the parallel imposition results in the safe harbour of the block exemption being lost for the entire agreement.

The third condition, as provided in Article 4(b), first indent, of Regulation 2790/99, eliminates the limitation of sales by the customers of the franchisee. It follows from the third condition that the customers of the franchisee are not bound to limit their sales pursuant to the franchisor’s request. Relating to the situation where the franchisees are entitled to sub-franchise within their territories as mentioned above, in order to comply with the third condition, the franchisor must abstain from requiring the franchisees to impose the same active sales restriction on sub-franchisees. Regrettably, given the fact that the sub-franchisees may escape the active sales restriction, the imposition of any active sales restriction on the franchisees may be neutralized by the appointment of sub-franchisees. It is possible to circumvent the condition of parallel imposition as set out by the second condition where the active sales restriction imposed on the franchisees can be weakened via the sub-franchisees. Hence, in this respect, the condition of parallel imposition as supplemented by the Guidelines on Vertical Restraints become meaningless and, therefore, not being consistent with the third condition as mentioned above. Obviously, the Guidelines on Vertical Restraints interprets the Regulation 2790/99 in a way which is not in conformity with the latter’s express wording. Although the Guidelines on Vertical Restraints are not legally binding, they may have legal effects on the franchisor’s own EC competition law assessment of their vertical agreements. By further adding extra condition for the block exemption to apply, the Guidelines on Vertical Restraints not only endangers the probability of blacklisting an active sales restriction imposed by the franchisor, but also advocates the circumvention of the second condition as mentioned above and, therefore, makes it become redundant in the context of a multi-layer franchise network.

It is furthermore noteworthy that it is impossible to impose any restriction on passive sales. Incidentally, it is useful to clarify the distinction between active sales and passive sales. ‘Active’ sales is defined as ‘actively approaching individual customers inside another distributor’s exclusive territory or exclusive customer group or customers in a specific territory allocated exclusively to another distributor through advertisement in media or other promotions specifically targeted at those customer groups or targeted at customers in that territory; or establishing a warehouse or distribution outlet in another distributor’s exclusive territory’86. Accordingly, sales effort at the initiative of a franchisee towards individual customers inside another franchisee’s exclusive territory will be classified as active sales. Contrariwise, ‘passive’ sales mean ‘responding to unsolicited requests from individual customers including delivery of goods or services to such customers’87 and ‘general advertising or promotion in media or on the Internet that reaches customers in other distributors’ exclusive territories or customer groups but which is a reasonable way to reach customers in non-exclusive territories or in one’s own territory, are passive sales’88.

86 Guidelines on Vertical Restraint, para 50.
87 Guidelines on Vertical Restraint, para 50.
88 Guidelines on Vertical Restraint, para 50.
Indeed, in practice, it is difficult to differentiate active sales from passive sales on the basis of a targeted sales effort initiated by the franchisee towards customers inside another franchisee’s exclusive territory. However, it is said for certain that the establishment of a franchise outlet in another franchisee’s exclusive territory is characterized as active sales. It is very significant to assess whether a location clause which prevents the franchisee from determining the location of his premises or opening a new outlet outside his exclusive territory is compatible with Regulation 2790/99. Based solely on Article 4(b), first indent, of Regulation 2790/99, it is also sufficient to state that the imposition of the location clause regarding to territories outside the franchisee’s exclusive territory must comply with the conditions set forth in Article 4(b) as mentioned above.

As regards the franchise system with a selective nature, the approach of the Regulation 2790/99 is however somewhat different. In this case, the franchisor is not entitled to impose territorial restriction, other than a location clause, on his franchisees. Article 4(c) of Regulation 2790/99 blacklists ‘the restriction of active or passive sales to end users by members of a selective distribution system operating at the retail level of trade, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorized place of establishment’. Accordingly, the franchisor is capable of imposing a limited degree of territorial restriction on his franchisee, i.e. the limitation on franchisee’s ability to set up outlets in each other’s distribution territories. This rule is advocated by the statement of the Guidelines on Vertical Restraints which clarifies that selective franchisees may be ‘prevented from running their business from different premises or from opening a new outlet in a different location’89. As compared with the treatment of location clause in the context of the franchise system without a selective nature, it remains inherently distinct from that of location clause in franchise system based on selectivity. The stringent application of the former on the basis of strict conditions for location clause to be block exempted deviates from that of the latter, at least from the language of Article 4(c) of Regulation 2790/99, without any condition.

From the analysis mentioned above, it may be assumed that the treatment of territorial restriction which derives from Article 4(b), first indent, of Regulation 2790/99 in the context of the franchise system without a selective nature leads to a straitjacket approach in contradiction with the new approach pursued by the Commission through the adoption of the very Regulation. As regards the straitjacket approach in previous block exemption regulations, instead of focusing on restrictions which are not prohibited, they aimed at the exempted restrictions. Accordingly, restrictions other than those whitelisted may not be exempted and, therefore, may not benefit from the safe harbour of the block exemption. As a consequence of this approach, the franchisor was reluctant to insert any restriction outside this whitelist for fear of losing the benefit of the block exemption. Instead, the franchisor was inclined to copy or paraphrase the restriction contained in the whitelist into the franchise agreement. Such the straitjacket approach, indeed, lessens the contractual creativity of the parties in their agreement. Fortunately, it has been remedied by the blacklist approach in Regulation 2790/99 which emphasizes the rule that everything which is not prohibited would be allowed, instead of everything which is not expressly allowed would be prohibited. Accordingly, Article 4 of Regulation 2790/99

89 Guidelines on Vertical Restraints, para 54.
contains a list of restrictions which qualify as hardcore restriction and therefore, falls outside the block exemption. Any restriction other than hardcore restriction must be allowed. However, contrary to what one could expect, a different approach in Article 4(b) of Regulation 2790/99 has been thought of as being in some way analogous to the straitjacket approach as mentioned in the past. Article 4(b) of Regulation 2790/99 blacklists customer and territorial restriction in general and only accepts four exceptions with stringent conditions accompanied. There must be no latitude at all for the franchisor as to the drafting of such restrictions in duplicate of the four exceptions.\(^9\) The consequence is that the franchisor’s ability to impose the territorial restriction in the context of franchise system without selective nature is limited. Regrettably, this limitation reiterates or mirrors the constraint following the straitjacket approach which had to be surmounted by the Commission.

### 3.2.2.2 The second restriction – customer restriction

With regard to the franchise system without selective nature, in accordance with Article 4(b) of Regulation 2790/99, the franchisor may prevent his franchisees from actively selling to certain customers or customer group reserved exclusively to the franchisor or allocated exclusively to another franchisee provided that the conditions set forth in Article 4(b), first indent, of Regulation 2790/99 as mentioned above are complied with. By contrast, passive sales must be allowed without any limitation.

With regard to the franchise system with selective nature, Article 4(c) of Regulation 2790/99 clarifies that the franchisor cannot impose the restriction of active or passive sales to end users by franchisees at the retail level of trade. It means that in the context of a selective distribution franchise, franchisees are free to actively approach end-users irrespective of any customer restriction. Nevertheless, the approach of Regulation 2790/99 is somewhat different at the cross-supplies between franchisees. Obviously, in accordance with Article 1(d) of Regulation 2790/99, the franchisees are obliged not to sell, either actively or passively, to unauthorized distributors who are not members of the system. However, franchisees are entitled to sell to other franchisees without any limitation. It follows from Article 4(d) of Regulation 2790/99 that the restriction of cross-supplies between franchisees within a selective distribution franchise system qualifies as hardcore restriction.

It is on the basis of these summarized that to what extent the franchisor may impose territorial or customer restrictions on the franchisees depends on whether or not the franchise system is based on the selectivity as defined in Article 1(d) of Regulation 2790/99. However, a separate treatment for each as differentiated by the Regulation, in practice, may lead to complicated problems challenged by the franchisor in order to protect, on the one hand, the franchise system but in the other hand, not infringe the specific conditions for block exemption laid down in the Regulation. The problems are discussed as follows:

First, unless the franchise system is of selective nature, the Regulation cannot compel the franchisor not to impose restriction of cross-supplies between franchisees

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pursuant to Article 4(d) thereof, whereas the freedom to cross-supplies by franchisees within the franchise system constitutes an essential requirement for individual exemption as being discussed below.

Second, in case the franchise system is not of selective nature, the territorial restriction, first and foremost a location clause which prevents the franchisee from establishing a franchise outlet in another franchisee’s exclusive territory is only block exempted provided that the conditions as set forth in Article 4(b), first indent, of Regulation 2790/99 are complied with. Such conditions are so stringent that the infringement is more likely to be inevitable, especially in case of an extensive franchise network.

Third, if the franchise system is not of selective nature, it is hard to prevent the franchisee from reselling to non-franchised distributors albeit such restriction is an integral part of a franchise agreement.

Finally, if the franchise system is of selective nature as defined in Article 1(d) of Regulation 2790/99, active sales restriction outside the franchisee’s territory qualifies as hardcore restriction and therefore, falls outside Regulation 2790/99 regardless of the fact that such restriction is commonly found in a franchise agreement.

Furthermore, in many cases, a franchise system, as mentioned above, is a combination of exclusive and selective nature and therefore, has given rise to a practical problem with territorial or customer limitation clause. In line with Article 4(b), first indent, of Regulation 2790/99, the imposition of an active sales restriction cannot be prohibited. It means that the franchisees may be restricted in the customers to whom they sell or the territories in which they sell, where those customers or territories allocated to another franchisee, respectively. This rule is in contradiction with that of Article 4(c), by virtue of selective nature, which prohibits any restriction of active or passive sales to end users by franchisees at the retail level of trade, with the only exception relating to location clause. In practice, Article 4(c) implies that undertakings drafting a retail exclusive-distribution agreement including a customer limitation clause must ensure that it cannot be interpreted as being part of a selective distribution system within the meaning of Article 1(d), otherwise the whole agreement will lose the benefit of exemption under Regulation 2790/99. It means that the combination of selective distribution and exclusive distribution in a franchise system will neutralize territorial or customer restriction accompanied therein. Therefore, the Commission states that ‘selective distribution may be combined with exclusive distribution provided that active and passive selling is not restricted anywhere’. Although it is hard for a franchise system which is a hybrid between selective and exclusive distribution to qualify the conditions set out in Regulation 2790/99 and the Guidelines on Vertical Restraint, it may be subject to the individual exemption as being discussed below.

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92 Guidelines on Vertical Restraints, para 53.
3.2.2.3 The third restriction – non-compete obligations

The notion of ‘non-compete obligation’ in franchise agreements encompasses two different types of restrictions, i.e. (i) any direct or indirect obligation causing the franchisee not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services (hereinafter referred to as ‘the first type of non-compete obligation’); and (ii) any direct or indirect obligation on the franchisee to purchase from the franchisor or from another undertaking designated by the franchisor more than 80% of the franchisee’s total purchases of the contract goods or services and their substitutes on the relevant market, calculated on the basis of the value of its purchases in the preceding calendar year93 (hereinafter referred to as ‘the second type of non-compete obligation’). Put these in parallel, it is noteworthy that there are differences between two types of restrictions, as follows:

First, if the first type of non-compete obligation is imposed on the franchisees, it is impossible to require the franchisees to purchase the contract products from the franchisor or from another undertaking designated by the franchisor. Conversely, the imposition of the second type of non-compete obligation requires the franchisees to do so.

Second, the first type of non-compete obligation strictly prohibits the franchisees from manufacturing, purchasing, selling or reselling competing products, whereas in case of the second type of non-compete obligation, the franchisees are entitled to sell products which compete with the contract products.

As a consequence of this distinction, it would ‘seem more accurate to refer to restrictions of the first type as non-compete obligations and to restrictions of the second type as exclusive purchase obligations’94. The third restriction as analysed in this part, therefore, refers to non-compete obligation of the first type. The non-compete obligation of second type which is so-called exclusive purchase obligation will be discussed later in the following part.

It is widely accepted that ‘a non-compete obligation on the goods or services purchased by the franchisees falls outside the scope of Art 81(1) EC when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 81(1), as long as it does not exceed the duration of the franchise agreement itself’95.

However, even if the non-compete obligation is covered by Article 81(1) EC, it may be block exempted under the conditions of Article 5 of Regulation 2790/99. Accordingly, Article 5(a) of Regulation 2790/99 excludes from the block exemption ‘any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years. A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed concluded for an indefinite duration’. From this provision, it may be assumed that non-compete obligations during the term of the

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93 Regulation 2790/99, Article 1(b).
95 Guidelines on Vertical Restraints, para 200.
agreement is block exempted only if their duration is fixed and does not exceed five years. The only exception to this rule would be if the contract goods or services are sold by the franchisee from premises and land owned by the franchisor or leased, by the franchisor from third parties not connected with the franchisee, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the franchisee. The rationale of this exception is that it is normally unreasonable to expect the franchisor to allow competing products to be sold from premises and land owned by the franchisor without his permission. However, it is also emphasized that ‘artificial ownership construction intended to avoid the five-year limit will not benefit from the exception’.

As regards the non-compete obligation after termination of the agreement, the conditions under which such non-compete obligation may qualify for block exemption are different from that of the non-compete obligation during the term of the agreement. In particular, the franchisor is entitled to impose a post-term non-compete obligation if the cumulative conditions are fulfilled:

(i) Such obligation relates to goods or services which compete with the contract goods or services, and
(ii) Such obligation is limited to the premises and land from which the buyer has operated during the contract period, and
(iii) Such obligation is indispensable to protect know-how transferred by the franchisor to the franchisee, and provided that the duration of such non-compete obligation is limited to a period of one year after termination of the agreement; this obligation is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain.

In practice, such conditions are in some respects quite simply fulfilled by the franchisor but in other respects are circumvented by the franchisee. On the one hand, the franchise agreement, by its very nature, usually involves the imperative of protecting know-how transferred by the franchisor to the franchisee. Presumably, for this reason, irrespective of the limitation of one year as mentioned above, a post-termination restriction on a franchisee from using or disclosing know-how which has not entered the public domain is unlimited in time. On the other hand, the failure to impose a post-term non-compete obligation may derive from the second condition which, on a literal reading, forces the franchisee not to trade in or produce goods which compete with the contract goods in the vicinity of the contract premises. The fact that the franchisee need not do anything but only moves premises after the termination of the franchise agreement can neutralize a post-term non-compete obligation. In this case, Article 5(b) withholds exemption from such a post-term non-compete obligation imposed on the franchisee. For that reason, the second condition may be recognized as a drawback of the imposition of a post-term non-compete obligation by the franchisor. In addition, it is rather difficult for the franchisor to

96 Regulation 2790/99, Article 5(a).
97 Guidelines on Vertical Restraints, para 59.
98 Guidelines on Vertical Restraints, para 59.
99 Regulation 2790/99, Article 5(b).
prove a derogation under which the former franchisee uses or discloses the know-how previously transferred by the franchisor. Therefore, a post-term restriction which aims at protecting the confidentiality of know-how for an indefinite period, indeed, has little practical value.

In addition, it should be noted that a non-compete obligation in a franchise agreement, albeit meeting the conditions as mentioned above may not be block exempted if parallel networks of similar vertical restraints do not cover more than 50% of the relevant market\textsuperscript{100}. Indeed, such condition is generalized from the European Court of Justice’s judgement in case of Stergios Delimitis v Henninger Brau\textsuperscript{101}. In order to determine whether a non-compete obligation falls within the scope of application of Article 81(1) EC, the two following cumulative conditions must be considered: (i) having regard to the economic and legal context of the agreement at issue, it is difficult for competitors to gain access to the relevant market for the distribution of the contract goods; and (ii) the agreement must make a significant contribution to the sealing-off effect brought about by the totality of those agreements in their economic and legal context\textsuperscript{102}. Thus, it is significant for the Court to determine the degree of foreclosure of the market and the extent to which the franchise agreement contributes to the sealing-off effect. It should be noted that the latter is regarded as a supplement to the rule on cumulative effect as prescribed in Regulation 2790/99 and the accompanied Guidelines on Vertical Restraints. In analysis of significant contribution to the sealing-off effect by the agreement, the market position of the franchisor and the duration of the franchise agreement must be taken into consideration\textsuperscript{103}. It may be assumed that a franchisor with a relatively small market share may make significant contribution to cumulative foreclosure effect in case of the non-compete obligation imposed on the franchisees for many years. In conclusion, a non-compete obligation imposed by the franchisor on his franchisees would be prohibited if the cumulative effect of parallel networks of similar agreements entered into by competing suppliers and buyers on the relevant market prevents participation by new competitors.

Finally, it is remarkable that in the case of a franchise system with selective nature, apart from the conditions as mentioned above, the condition as provided in Article 5(c) of Regulation 2790/99 must be satisfied. Article 5(c) of Regulation 2790/99 expressly denies exemption for ‘any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers’. It would not be the case if the franchisor imposes an obligation causing his franchisees not to sell the brands of general competing suppliers. In this case, Article 5(c) of Regulation 2790/99 seems to intend to prevent a targeted collective boycott through a selective franchise system.

3.2.2.4 The fourth restriction – exclusive purchasing requirements

\textsuperscript{100} Regulation 2790/99, Article 8(1).
\textsuperscript{101} Case Stergios Delimitis v Henninger Brau C-234/89 [1991] ECR I-935 (hereinafter referred to as ‘Delimitis case’).
\textsuperscript{102} The Delimitis case, para 27.
\textsuperscript{103} The Delimitis case, paras 25 and 26.
As stated above, the exclusive purchasing requirement refers to ‘any direct or indirect obligation on the franchisee to purchase from the franchisor or from another undertaking designated by the franchisor more than 80% of the franchisee’s total purchases of the contract goods or services and their substitutes on the relevant market, calculated on the basis of the value of its purchases in the preceding calendar year’. Noticely, the exclusive purchasing requirement is subject to Article 5 of Regulation 2790/99 not only where the franchisee is obliged to buy 100% of its total purchases from the franchisor but even where such purchase obligation accounts for more than 80% of its total purchases. In what follows, the minimum purchase quotas imposed on the franchisee will be challenged on the basis of Article 5 of Regulation 2790/99 if such quotas amount to more than 80% of the franchisee’s total purchases. It should be noted that since the franchisee remains free to sell competing products, the total purchases by the franchisee include the purchase of both contract products and competing products.

First and foremost, a franchise agreement with an exclusive purchase obligation attached may not infringe Article 81(1) EC if such obligation qualifies as an ancillary restraint as explained above. If it falls within Article 81(1) EC, it may be block exempted under Regulation 2790/99. Whether or not an exclusive purchasing requirement imposed on the franchisees is permitted under Regulation 2790/99 depends upon the selective nature of the franchise system. In the case of the franchise system with selective nature, it is impossible to impose an exclusive purchasing requirement on the franchisee because any restriction on cross-supplies between appointed franchisees must be blacklisted pursuant to Article 4(d) of Regulation 2790/99. It means that the appointed franchisees remain free to obtain the contract goods from other franchisees rather than only from the franchisor or third party designated by the franchisor. Conversely, in the case of the franchise system without selective nature, the franchisor is entitled to impose exclusive purchasing obligation on his franchisees. For such exclusive purchasing obligation to be block exempted under Regulation 2790/99, the same conditions as those explained in the context of non-compete obligation also apply here.

In practice, instead of imposing an exclusive purchasing obligation, the franchisor is more likely to impose a minimum sales quota which is probably tantamount to a de facto exclusive purchasing obligation. Outwardly, a minimum sales quota is deemed to indirectly force the franchisee to purchase in excess of a certain rate set out by the franchisor, as being analogous to exclusive purchasing obligation. However, a minimum sales quota deviates from an exclusive purchasing obligation on the ground that a minimum sales quota still leaves room for the franchisee to choose its sources of supply. Accordingly, the franchisee is not limited to obtain contract products only from the franchisor or the third party designated by the franchisor. Therefore, an obligation to achieve a minimum sales quota normally escapes the prohibition of Article 5 of Regulation 2790/99, but otherwise may be excluded from the block exemption if the sales quota are so high that the franchisees are not, concurrently, capable of purchasing other products than contract products and meeting its minimum sales quota as well as the franchisees cannot turn to other sources of supply than the franchisor or the third party designated by the franchisor\textsuperscript{104}.

Finally, it deserves mentioning that the rule of severability does apply to the conditions set out in Article 5 of Regulation 2790/99. It means that the benefit of the block exemption is only lost for the non-compete obligation, whereas other restrictions contained in the agreement may still benefit from the exemption\textsuperscript{105}. It sharply contrasts with the situation where franchise agreement contains hardcore restriction as set out in Article 4 of Regulation 2790/99, which results in the benefit of the block exemption being lost for the entire agreement.

3.2.2.5 The fifth restriction – resale price maintenance

Article 4(a) of Regulation 2790/99 excludes from the benefit of block exemption the restriction of the franchisor’s ability to determine its sale price, without prejudice to the possibility of the franchisor’s imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties. In view of this, resale price maintenance – a so-called vertical price fixing – occurs where the franchisee is obliged to comply with a fixed or minimum sale price imposed by the franchisor. As a result, the franchisee is not capable of applying or adjusting its own prices below such a given level. Such resale price maintenance, under whatever form it shelters, is blacklisted in accordance with Article 4(a) of Regulation 2790/99. In addition direct or indirect means of achieving price fixing, the Commission also refers to ‘supportive’ measures which are probably practiced by the franchisor, such as the implementation of a price monitoring system, or the obligation on the franchisee to report other franchisees of the distribution network who deviate from the standard price level\textsuperscript{106}. Similarly, direct or indirect price fixing can be made more effective when combined with other indirect measures, such as printing recommended retail prices on the products or obligating the franchisee to apply a most favoured-customer clause in order to prevent the franchisee from lowering the resale price\textsuperscript{107}. It should be noted that such ‘supportive’ measures and indirect measures when combined with recommended or maximum prices may amount to resale price maintenance\textsuperscript{108}. However, recommended or maximum prices set out by the franchisor must be allowed. In practice, an individual franchisee seems to be very loath to break recommended prices as being considered as a standard for the whole system. In this case, despite the acknowledgement of the impact of such recommended prices, it is difficult to conclude that recommended prices set out by the franchisor, indeed operates as a fixed price. Thus, the strict prohibition on resale price maintenance without any exception, to some extent, seems to become meaningless in case of a franchise network. This practice makes it possible to turn back to the question that whether or not it should maintain the per se rule applicable for the resale price maintenance.

3.2.2.6 Other vertical restrictions contained in a franchise agreement

\textsuperscript{105} Regulation 2790/99, Article 5 and Guidelines on Vertical Restraint, para 67.
\textsuperscript{106} Guidelines on Vertical Restraints, para 47.
\textsuperscript{107} Guidelines on Vertical Restraints, para 47.
\textsuperscript{108} Guidelines on Vertical Restraints, para 47.
As stated above, the new approach of Regulation 2790/99 is that restrictions in a franchise agreement that comes within its scope of application which are not specifically prohibited are permitted per se. Thus, any vertical restriction contained in a franchise agreement other than the blacklisted or grey-listed restrictions laid down in Article 4 and Article 5 of Regulation 2790/99 is covered by the block exemption provided for in Article 2 thereof.

3.2.3 Individual exemption for franchise agreements under Article 81(3) EC

A franchise agreement may fall outside the scope of Regulation 2790/99 on the grounds that (i) it may have one or more hardcore restrictions as its objects; (ii) it may exceed the market share limit set out by Article 3 thereof; or (iii) it may contain IPRs provision as being incompatible with the requirements thereof. However, it should be noticed that for franchise agreements outside the scope of Regulation 2790/99 due to the franchisor’s market share, the examination of the application of Article 81(1) EC should take priority over the examination for individual exemption under Article 81(3) EC. Even a franchise agreement contains hardcore restrictions which are assumed to affect competition in the sense of Article 81(1) EC, it is not completely self-evident that they always affect trade between Member States in an appreciable manner. As mentioned above, the negative presumption which establishes a ‘safe harbour’ for agreements not being considered to appreciably affect inter-State trade will be applied irrespective of the nature of restrictions contained in such agreement. In this case, if the franchise agreement qualifies the conditions set out by the NAAT rule, it is not covered by EC competition law, irrespective of whether it contains one or more hardcore restrictions. However, if it is ascertaining that the franchise agreement infringes Article 81(1) EC and falls outside the block exemption under Regulation 2790/99, it is necessary to consider the application of Article 81(3) EC to such agreement. It means that the franchise agreement concerned will be examined in order to determine whether the four conditions of Article 81(3) EC are fulfilled. Noticeably, all four cumulative conditions must be fulfilled, as follows: (i) the franchise agreement must contribute to improving distribution or to promoting technical or economic progress; (ii) the franchise agreement must allow consumers a fair share of these benefits; (iii) the franchise agreement must not impose on the undertakings concerned vertical restraints which are not indispensable to the attainment of these benefits; and (iv) the franchise agreement must not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question. Guidance for the application of Article 81(3) EC to franchise agreement in individual cases where the block exemption is inapplicable can be found in Guidelines on Vertical Restraints. Such guidance is indispensable for the franchisor to make its own assessment of whether such franchise agreement merits individual exemption under Article 81(3) EC.

As regards hardcore restrictions, it is unlikely that individual exemption of franchise agreements containing such restrictions is granted. In practice, the

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109 Guidelines on Vertical Restraints, para 134.
110 Guidelines on Vertical Restraints, Sec.VI.
111 Guidelines on Vertical Restraints, para 46.
franchisor is more likely to impose territorial restrictions or price restraints as being essential to the operation of the franchise agreement. It is argued that such restrictions only restrict intra-brand competition and may be imposed in order to induce the franchisee to invest in pre-sales services, marketing, and advertising and to prevent free-riding on those investments and/or to enable the franchisor to penetrate a market and to increase inter-brand competition on a market. Despite such economic justification, the franchise agreement containing hardcore restrictions is unlikely to fulfil the terms of Article 81(3) EC. Indeed, the Commission has been unwilling to accept that the franchise agreement which confers resale price maintenance or absolute territorial protection on the franchisee or which otherwise operates to prevent parallel imports fulfils the requirements of Article 81(3).

For non-compete obligation and other restraints, the Commission expressly states that a non-compete obligation on the contract products purchased by the franchisee falls outside Article 81(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 81(1), as long as it does not exceed the duration of the franchise agreement itself.

In general, the determination whether or not the franchise agreement meets the requirements of Article 81(3) must be made with regard to the justifications for vertical restraints as described in the Guidelines on Vertical Restraints. Accordingly, a variety of reasons may justify the application of vertical restraints in franchise agreements, for instance, it is necessary to help solve a free-rider problem, to deal with the hold-up problem or to create brand-image by imposing a certain measure of uniformity and quality standardisation. Specific guidance is given on the application of Article 81(3) to franchise agreements at the Guidelines on Vertical Restraints paragraphs 199 to 201. As the specific remark for the evaluation, it should be emphasized that the more important the transfer of know-how, the more easily the vertical restraints fulfil the conditions for exemption. In practice, the franchise agreements involve a combination of vertical restraints. In the one hand, a combination of vertical restraints aggravates their negative effects, but in the other hand, certain combinations of vertical restraints are better for competition than their use in isolation from each other. Hence, it needs a balanced approach to the assessment of combinations of vertical restraints. For instance, the use of quantity forcing or the setting of a maximum resale price may limit the increase in price as intrabrand competition has been induced in the context of franchise system with exclusive nature. Another instance is the case in which the grant of territorial exclusivity is combined with the imposition of non-compete obligation. The negative effect of foreclosing the market when competing suppliers or potential entrants may face difficulties in appointing distributors to market their products may be balanced

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114 Guidelines on Vertical Restraints, para 200(2).

115 Guidelines on Vertical Restraints, para 116.

116 Guidelines on Vertical Restraints, paras 199-201.

117 Guidelines on Vertical Restraints, para 200(1).

118 Guidelines on Vertical Restraints, para 119(6).

119 Guidelines on Vertical Restraints, para 119(6).
by the positive effect that aims at increasing the incentive for the distributor to focus his efforts on the sale of products concerned. In this case, such combination may also justify the non-compete obligation lasting the full length of the agreement120.

In conclusion, although there are certain defects remaining, the treatment of vertical restraints in franchise agreements of EC competition law, as being apparent from the analysis above, constitutes a radical change towards a more economics-based approach121. Regulation 2790/99 provides a more rational “safe harbour” for agreements under Article 81(3) EC and individual exemption for such agreements can be obtained even such agreements infringe Article 81(1) EC and fall outside the block exemption under Regulation 2790/99. It may be ascertained that the legal reform applicable to vertical agreements under EC competition law is a considerable contribution to competition law researches on this issue and may be of value to Vietnamese competition law.

4 Franchise agreements under Vietnamese competition law and the critical reception of EC experiences

4.1 Franchise agreements under Vietnamese competition law

This Chapter reviews the application of Vietnamese competition law to franchise agreements, evaluates competition law regime towards agreements in restraint of competition and makes proposals for developments in a better model of competition law. However, instead of comparing different approaches adopted by Vietnamese and EC competition law in order to suggest remedies tailored for the alleged flaws of Vietnamese competition law by transferring the model of EC competition law, the purpose of this Chapter is rather to contextualize EC legal experiences and assess the value of insights drawn from EC law based on a critical thinking. In other words, Vietnamese competition law may be ameliorated to some extent by receiving the potential value of EC experience but not incorporating into Vietnamese competition law of a system modelled upon EC experience as its own. Vietnam has adopted EC experiences in the sense in which such experiences are in conformity with the former’s legal context. Indeed, even pre-eminent legal tools lose effectiveness, if being extracted from the context in which they have been used.

4.1.1 Current regulations on agreements in restraint of competition in franchise agreements

It is widely accepted that Vietnam has made great efforts to transform its economy from a centralized economic planning one into a market-based economy. Together with this process, Vietnam has undergone fundamental legal reforms, the purpose of which is to establish the institution of socialist-oriented market economy, an economic model which both conforms to principles of the market economy and is

120 Guidelines on Vertical Restraints, para 158.
guided by principles and nature of socialism. The socialist-oriented market economy can be perceived as a specificity of Vietnam as it conforms to the country’s specific conditions and characteristics. In such context, the most significant challenge for Vietnamese competition law is to harmonize the rising demands of a market economy and the pursuit of the socialist ideology with the necessary State control. The important task of competition law is to strengthen this economic and social cohesion by establishing a legal barrier against anti-competitive practices. This Chapter does not cover exhaustively all types of anti-competitive practices as provided in Vietnamese competition law, but just limits to agreements in restraint of competition as narrowly incorporated in franchise agreements. Accordingly, the Vietnamese Law on Competition\(^{122}\) sets out a list of agreements in restraint of competition as expressly provided in Article 8 thereof, most of which are normally incorporated in franchise agreements, namely:

(i) Agreements to share consumer markets or sources of supply of goods and services\(^{123}\);
(ii) Agreements either directly or indirectly fixing the price of goods and services\(^{124}\);
(iii) Agreements which prevent or impede other enterprises from entering the market or developing business or agreements which exclude other enterprises from the market\(^{125}\).

First, as regards agreements to share consumer markets or sources of supply of goods and services, more detailed guidance is provided in the Decree on Competition providing detailed regulations for implementation of a number of articles of the Vietnamese Law on Competition\(^{126}\). Accordingly, agreements to share consumer markets are precisely construed as agreements on the quantity of goods or services, the location of purchase and sale of goods and services, or the group of customers allocated for each of the parties\(^{127}\). Concomitantly, agreements to share sources of supply of goods and services means agreements which refer the obligation to purchase goods and services from one or more specified sources of supply\(^{128}\). From this, (i) any restriction of sales into the territory or to customer group reserved exclusively to the franchisor or allocated exclusively to another franchisee or (ii) any obligation on the franchisee to purchase goods and services from the franchisor or from third parties designated by the franchisor could be perceived as agreements to share consumer market and agreements to share sources of supply of goods and services, respectively. Indeed, such agreements are the closest equivalent to territorial or customer

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\(^{122}\) Law on Competition No 27/2004/QH11 was passed by Legislature XI of the National Assembly of the Socialist Republic of Vietnam at its 6th Session on 3 December 2004 and became effective as of 1 July 2005 (hereinafter referred to as “Vietnamese Law on Competition”).

\(^{123}\) Vietnamese Law on Competition, Article 8.2.

\(^{124}\) Vietnamese Law on Competition, Article 8.1.

\(^{125}\) Vietnamese Law on Competition, Articles 8.6 and 8.7.

\(^{126}\) Decree on Competition No 116/2005/ND/CP providing detailed regulations for implementation of a number of articles of the Law on Competition as adopted by the Government on 15 September 2005 (hereinafter referred to as “Decree 116”).

\(^{127}\) Decree 116, Article 15.1.

\(^{128}\) Decree 116, Article 15.2.
restrictions and exclusive purchasing requirements mentioned above in EC competition law.

Secondly, agreements either directly or indirectly fixing the price of goods and services can be jointly reached under various forms, such as agreements to apply uniformly a price to certain or all customers, agreements to increase or reduce the price by a fixed amount, agreements to apply a uniform pricing formula or agreements not to reduce prices without notification to other members of the system. This restriction would approximate the resale price maintenance in EC competition law, which imposed on the franchisees the obligation to comply with a fixed or minimum sale price laid down by the franchisor.

Thirdly, agreements which prevent or impede other enterprises from entering the market or developing business or agreements which exclude other enterprises from the market means reaching agreements in which the franchisees not to conduct purchase and sale of goods with or use the services of enterprises not being parties to the agreement. In essence, such restrictions, irrespective of whatever form they might be verbalized, are similar to non-compete obligations imposed on the franchisees as widely recognized in EC competition law.

According to the Vietnamese Law on Competition, the first two agreements are only prohibited if the parties have a combined market share of 30 per cent or more of the relevant market. Since franchise agreements are recognized as vertical agreements, it should be construed that such restrictions are only prohibited if the franchisor’s market share greater than or equal to 30 percent of the relevant market. Nevertheless, such agreements shall be entitled to exemption for a definite period if they satisfy one of the following criteria aimed at reducing prime costs and benefiting consumers: (a) rationalizing an organizational structure or business scale or increasing efficiency, (b) promoting technical or technological progress or improving the quality of goods and service, (c) promoting uniform applicability of quality standards and technical ratings of product types, (d) unifying conditions on trading, delivery of goods and payment but not those relating to price or any pricing factors, (d) increasing the competitiveness of small and medium-sized enterprises, or (e) increasing the competitiveness of Vietnamese enterprises in the international market. It should be noted that such exemption can not be automatically applied, but just be granted in accordance with the order and procedures as prescribed in the Vietnamese Law on Competition. The manner in which the exemption for prohibited agreements in restraint of competition are implemented according to the Vietnamese Law on Competition is indeed more akin to individual exemptions as analysed above in EC competition law.

Compared to the first two agreements, the third agreement receives even harsher treatment under the Vietnamese Law on Competition, namely that it is prohibited per se, regardless of the franchisor’s market share on the relevant

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129 Decree 116, Article 14.
130 Decree 116, Articles 19.1 and 20.
131 Vietnamese Law on Competition, Article 9.2.
132 Vietnamese Law on Competition, Article 10.1.
133 Vietnamese Law on Competition, Article 10.2.
market\textsuperscript{134}. In case of franchise agreements, such exclusionary agreements are per se illegal and are prohibited under the Vietnamese Law on Competition without being eligible for exemption on the ground that they reduce downward pressure on the price for goods and services, eliminate intra-brand competition as well as adversely affect inter-brand competition and, therefore, are inimical to market development.

\textbf{4.1.2 Different approaches between Vietnamese and EC competition law on dealing with agreements in restraint of competition in franchise agreements and the reason for this}

A conclusion can be derived from the overview of Vietnamese competition law relating to agreements in restraint of competition as being incorporated in franchise agreements, namely that the Vietnamese approach to vertical restraints in franchise agreements, in some respects, is similar, but not identical, to that of EC competition law. The Vietnamese Law on Competition sets out the general provisions for agreements in restraint of competition, the scope of which are considered as being so broad enough to embrace a wide range of vertical restraints in franchise agreements without giving any preferential treatment therefor. Moreover, Vietnamese competition law also shows a strong inclination towards the advanced legislative method which emphasizes the rule that ‘everything which is not prohibited would be allowed’. Following from this rule, the Vietnamese Law on Competition sets out the list of agreements in restraint of competition which are prohibited and the bifurcation in treatment for such agreements, including the per se prohibition and the prohibition in the light of exemption, if appropriate. Practically speaking, the analogies between Vietnamese and EC competition law are after all consistent with the proposition that the different legal system faces essentially the same problems, and solve these problems by quite different means though very often with similar results\textsuperscript{135}. This proposition is gradually perceived as a working rule than a firm conclusion of comparative legal analysis. It should be inferred from this proposition that Vietnamese competition law remains inherently distinct from EC competition law by virtue of the great differences in their development and different means expected to be congruent with their own legal system, however, the solution for similar problems amounts to the same results where the two legal systems converge.

Nevertheless, it is also found that there is a divergence between VN and EC approaches to the treatment of vertical restraints in franchise agreements, as follows:

First, agreements to share consumer markets or sources of supply of goods and services and agreements on price-fixing are not prohibited under Vietnamese competition law provided that the franchisor’s market share is less than 30\% on the relevant market, whereas such agreements, even being committed in the same case, are more likely to be caught under EC competition law if they qualify as hardcore restrictions analysed above.

\textsuperscript{134} Vietnamese Law on Competition, Article 9.1.

\textsuperscript{135} Konrad Zweigert, Hein Kötz (1998), \textit{An Introduction to Comparative Law}, 3\textsuperscript{rd} edition, Oxford University Press Inc., New York, p.34.
Secondly, in contrast, Vietnamese competition law prohibits per se agreements which prevent or impede other enterprises from entering the market or developing business and agreements which exclude other enterprises from the market, irrespective of the franchisor’s market share on the relevant market. Such foreclosure agreements as specified in form of non-compete obligations are perceived as illegal per se. Meanwhile, non-compete obligations are not prohibited per se under EC competition law and may be covered by the block exemption provided that they comply with the conditions attached. Even they cannot benefit from the block exemption, they may be subject to the individual exemption as discussed above.

Thirdly, the exemption as listed in the Vietnamese Law on Competition still completely lacks further elucidation. The regulation on block exemption for vertical restraints as more detailed as Regulation 2790/99 in EC competition law cannot be found in Vietnamese competition law. The lack of such regulation in order to clarify the exemption granted under Vietnamese competition law might offer hardly any room for the imposition of restrictions by the franchisor and the franchisee since they cannot make sure whether such restrictions fall into the scope of application of exemption as laid down in the Vietnamese Law on Competition.

It follows from these above that the Vietnamese Law on Competition is in some respects more lenient and in other respects more stringent in application of treatment to vertical restraints in franchise agreements. It should be conceded that the VN approach towards agreements in restraint of competition as incorporated in franchise agreements leads to the alleged flaws of Vietnamese competition law as analysed in further detail below. However, it is rather dogmatic to affirm that EC approach to vertical restraints in franchise agreements is better since it depends on the objectives pursued by EC competition law which are capable of being congruent or not with that of Vietnamese competition law. Indeed, different approaches between Vietnamese and EC competition law in order to deal with vertical restraints in franchise agreements is derived from ‘the great differences in their historical development, conceptual structure and style of operation’ and, above all, the objectives pursued by them. It is widely recognized that EC competition law views market integration as its paramount objective. This market integration-oriented objective aims to (i) eliminate any barriers compartmentalizing the European market into separate national markets; (ii) protect parallel imports and (iii) stimulate trade interpenetration of markets by different Member States. It deserves mentioning that the achievement of the unification of the national markets of Member States is primarily attainable through the development of intrabrand competition and the preservation of parallel imports. Since in the European market, the agreements conferring absolute territorial exclusivity contributes to the partition of the unified European market and contract territories often coincide with national territories, the development of intrabrand competition is perceived as the most important factor to maintain the market integration goal. Moreover, the restriction of parallel imports or the prevention of cross-sales among Member States impede the market integration by virtue of breaking through the equalization of pricing disparities throughout the European and, therefore, obstructing European unification. The overemphasis on protecting market integration explains why EC competition law adopted stringent objectives.

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137 The Treaty of Rome, Articles 2 and 3.
regulations on vertical restraints as normally incorporated in vertical agreements. This point of view is explicitly illustrated in the strictness of provision on territorial restriction as prescribed in Regulation 2790/99 mentioned in the previous Chapter. As stated above, Regulation 2790/99 blacklists, in general, customer and territorial restriction as provided in franchise agreements and only accepts active sales restriction with stringent conditions, including the condition of exclusivity; the condition of parallel imposition; and the condition of the limitation of sales by the franchisee’s customers. Indeed, such conditions, especially the second condition, are too rigid to strictly adhere and display the straitjacket approach to the provision on customer and territorial restriction. The failure of any condition endangers the probability of blacklisting such restriction and, therefore, deprives the parties of any exemption. However, the strictness of such provision would be justified by the overriding importance of market integration objective. In addition, the pursuit of this objective also explains why several vertical agreements which contain the restrictions regarding to the resale price maintenance, the territorial or customer restriction other than four exceptions as mentioned above and the cross-supplies between franchisees in the franchise system with selective nature are blacklisted under Regulation 2790/99 even when the franchisor’s market share does not exceed the threshold of 30%. Such stricter approach to restrictions as blacklisted under Regulation 2790/99 has been forced into a greater orientation towards the aim of excluding any obstruction of market integration. Having said this, it is to be expected that such objective accounts for the strictness of EC regulations on vertical restraints in vertical agreements in broad terms and franchise agreements in particular. It is argued that ‘how far competition law is capable of furthering all the goals without a considerable loss in efficiency is controversial’\textsuperscript{138}. However, it is more likely that the market integration objective is considered to be more important than efficiency\textsuperscript{139} and, therefore, in case of the conflict between the pursuit of efficiency and market integration where EC competition law is given the alternative of the former or the latter, the latter will prevail.

In short, EC competition law on vertical restraints in franchise agreements is consistent with its objective, namely the promotion of European unified market. However, this market-integration orientation has not been central to the development of Vietnamese competition law. European Union strives for the unification of national markets of Member States while Vietnam is a fully integrated market. The reduction of intrabrand competition is, therefore, of less significance in Vietnam market than in EU market. It should be noted that the objectives pursued by Vietnamese competition law may be in some way analogous to those of EC competition law, but the priority of such objectives could be an inherent feature to differentiate the former’s model from that of the latter and may explain differences between VN and EC postures toward vertical restraints in vertical agreements. This point of view once again criticizes the reception of any experience modelled upon EC competition law without considering its conformity with Vietnam legal conditions.

Practically speaking, to some extent the specific characteristics of Vietnamese competitive markets are truly reflected in Vietnamese competition law on agreements.


\textsuperscript{139} Ibid., p.1-23.
in restraint of competition as systematically introduced since 2004. As mentioned
above, Vietnam has undergone an economic reform, replacing the former central-
planned and subsidized economic system which abolished all competitive motivation
and isolated Vietnamese economy from the active world economy for a long period
with the economy operating according to the market mechanism and legislative rules.
The fact that enterprises remain passive in adapting to the latter is still a remnant of
the subsidized economic mechanism which once covered the Vietnamese economy
for a long period. Following from this, it seems that the picture of Vietnamese
competition market with its specificity can be depicted as follows: (i) Vietnamese
enterprises, most of which are classified as small and medium-sized enterprises whose
capital is under 10 billion VND and labor force is under 300 workers\textsuperscript{140}, are still at
their first stage of capital accumulation process with limited economic potential and
are not well-prepared to face restrictions of competition, from simple to sophisticated;
(ii) the transgression beyond the bounds of fair competition by foreign competitors
with powerful economic capacity to distort competition could harm smaller
Vietnamese competitors and brought, in practice, such competitors to the verge of
bankruptcy; and (iii) the enforcement of Vietnamese competition law is more
vulnerable to infringement due to the lack of experience and adequate qualification of
competent authorities regarding to the discovery of anti-competitive practices and the
control thereof. In such context, there is no other alternative but the determination of
the selected targets as protected by Vietnamese competition law in order of
precedence and based on the priority level assigned for them, the competition rules
and its concomitant enforcement mechanism are gradually set up following the
determined route. In practice, Vietnam faces the challenge that foreign enterprises
with experience and powerful economic potential take advantage of trade
liberalization to impose their own restrictions of competition in order to exclude
Vietnamese enterprises from the market while the lack of experience of competent
authorities to deal with infringement exacerbates the problem. Therefore, from certain
angle, the fact that Vietnamese competition law prohibits per se agreements which
prevent or impede other enterprises from entering the market or developing business
or agreements which exclude other enterprises from the market may be tolerated.
Unlike EC competition law, Vietnamese competition law is far less forgiving of such
agreements in order to save and support small and medium-sized enterprises which
account for a great number of existing enterprises of all sectors and play a very
significant role in the Vietnamese economic reform.

\textbf{4.1.3 The flaws of Vietnamese Competition law on agreements in
restraint of competition and the critical reception of EC experiences}

Nevertheless, since Vietnamese Competition law is still in its early stages, it is
inevitable that there would be the flaws of competition rules on agreements in
restraint of competition and in some respects, EC experiences may be of value to
Vietnamese competition law. As regards agreements in restraint of competition as
normally incorporated in franchise agreements, such flaws may deprive the franchisor
and the franchisees of the right to minimize the high risk as being inherent in

\textsuperscript{140} Standing Committee of the National Assembly, The Report on explaination, recognition and
amendment of the Draft of Law on Competition submitted to the National Assembly for approval as of
franchise relationship and therefore, may attenuate the proliferation of franchise agreements. Accordingly, it is useful to clarify the flaws of Vietnamese competition law on agreements in restraint of competition as normally incorporated in franchise agreements in somewhat greater detail in order to make proposals for amendment, if possible.

First, agreements which prevent or impede other enterprises from entering the market or developing business or agreements which exclude other enterprises from the market as listed in the Vietnamese Law on Competition are prohibited per se. According to Decree 116, non-compete obligations are ‘by their very nature’ capable of preventing or impeding other enterprises from entering the market or developing business or excluding other enterprises from the market. Presumably this means that they are prohibited per se, even if they are not actually restrictive of competition. At first, the fact that such agreements are illegal per se in compliance with the Vietnam legal context as recently discussed may be justified. Afterwards, the counter-effect of the harsh treatment on such agreements is really acted as a deterrent to franchise agreements as long as non-compete obligations imposed by the franchisor serve a gatekeeper function against the high risk as being inherent in franchise relationship. The per se prohibition of such restriction do attenuate the franchisor’s desire to grant a franchise to the franchisees without running the risk that this might benefit its competitors and do prevent the franchisees from entering the franchise network and investing his own money to operate franchise outlets. On account of the high risk as being inherent in franchise relationship and the need of encouraging franchise activities, it should be necessary to establish the boundary between the foreclosing agreements which are actually not restrictive of competition and all the rest rather than putting them in the per se prohibition. In this case, EC experiences are likely to be more instructive to Vietnamese competition law on the ground that EC competition law is rather successful in establishing such boundary. One of the most considerable contributions of EC competition law to legal researches on competition law issues is the construction of the block exemption regulation which contains a list of blacklisted restrictions as a dividing line to determine whether the agreements in restraint of competition are legal or not.

Second, according to the Vietnamese Law on Competition, agreements on price-fixing and agreements to share consumer markets or sources of supply of goods and services are only prohibited if the franchisor’s market share achieves the threshold of 30% of the relevant market. This means that such agreements imposed by the franchisor having 25% market share on the relevant market are not caught under the Vietnamese Law on Competition although they actually have as their object or effect the restriction of competition. Regrettably, the franchisor concerned is given free rein to impose such restriction irrespective of anti-competitive effects on the market. In practice, it should be conceded that even territorial restriction or customer restriction or resale price maintenance imposed by the franchisor not exceeding the market share of 30% of the relevant market may adversely affect competition in an appreciable manner. The fact that the Vietnamese Law on Competition has relaxed the treatment on such agreements results in a clear potential for abuse by the parties concerned and therefore, adversely affects competition on the market. In this case, Vietnamese competition law may still rely on EC experience in establishing a ‘safe

141 Decree 116, Articles 19.1 and 20.
harbour’ for agreements which do not contain hardcore restriction. Moreover, the EC experience in establishing the rule on cumulative effect which emphasizes the sealing-off effect caused by parallel networks of similar agreements entered into by competing suppliers and buyers on the relevant market may be instructive for Vietnamese competition law. Indeed, Vietnamese competition law has missed out the case in which the franchisor with a relatively small market share may make significant contribution to cumulative foreclosure effect.

Setting it aside, as regards agreements to share consumer markets or sources of supply of goods and services, the provision begins with the term “agreements to” and follows with the result “share consumer markets or sources of supply of goods and services”. Thus the provision is more likely to direct at agreements entered into with the purpose to achieve the result. It seems that agreements with anti-competitive effects are still not caught by such provision provided that the object of such agreements is not to restrict competition. It may be far from the initial thinking of the drafters; however, if taken literally, it would be regrettable that this would narrow the scope of such provision by virtue of the exclusion of agreements with anti-competitive effects as recently mentioned from the coverage thereof. For this reason, the fact that Article 81 EC covers agreements ‘which have as their object or effect the prevention, restriction or distortion of competition within the common market’ may be of reference for Vietnamese competition law.

Third, the Vietnamese Law on Competition and Decree 116 do not offer any clarification of the exemption for agreements in restraint of competition qualifying the conditions as exhaustively listed therein. Indeed, the failure of the Vietnamese Law on Competition to provide further details relating to the criteria for exemption would enable the parties concerned to have a potential for abuse and also leave room for them to circumvent the provision on prohibited agreements in restraint of competition. In addition, an agreement in restraint of competition shall be entitled to exemption if it satisfies one of the criteria as exhaustively listed in Article 10 of the Vietnamese Law on Competition. This means that the agreement falls outside the listed criteria does not benefit from the exemption irrespective of its pro-competitive effect. Following from this, it is hardly to assure that restrictions other than those as listed in Article 10 of the Vietnamese Law on Competition, which are imposed by the franchisor in order to benefit consumers as well as the members of franchise system, such as restriction aimed to deal with free-rider problem or specific hold-up problem could merit individual exemption. In these cases, the limited scope of such provision accounts for the fact that the franchisor may be deprived of his benefit from individual exemption. Indeed, Article 10 of the Vietnamese Law on Competition only needs to be slightly altered so that it can extend the coverage of agreements with pro-competitive effects as qualified for the examination of individual exemption. It merely stipulates the conditions for individual exemption rather than listing the kind of agreements that might fall under the benefit for individual exemption. Instead, it should focus on providing further details regarding the relevant factors for the assessment that whether such agreements merit individual exemption.
4.2 Proposals for amendments in Vietnamese Competition law on agreements in restraint of competition in franchise agreements

It follows from the above that EC experiences, in some respects, may be of value to Vietnamese competition law in establishing the latter’s legal framework for agreements in restraint of competition. Roughly speaking, given that the analogies between two legal systems can be found, EC experiences are more likely to be applicable to Vietnamese competition law, as follows:

First, Vietnam relies primarily on the legislative process in articulating law and therefore prefers an administrative control model of competition law – the system which gives primary responsibility to the executive to provide detailed regulations for implementation of rules and principles of competition law as adopted by the legislative and to enforce those laws. In addition, given that Vietnam’s legal culture is based primarily on the interpretation of statutory text by administrative authorities, the reliance on judges to articulate rules and principles of competition law is not officially accepted in Vietnam. In such context, detailed implementing regulations and guidelines as provided by the executive in order to articulate rules and principles of competition law in the same way as being developed by the European Commission in EU are more likely to be appropriate for Vietnamese competition law. The regulation on block exemption for vertical restraints as more detailed as Regulation 2790/99 in EC competition law may be of value to Vietnamese competition law.142

Second, EC competition law has been developed in pursuit of a variety of goals, including not only the pursuit of market integration, the concerns about economic efficiency, but also the protection of small and medium-sized enterprises, the issues of fairness as being in some way analogous to the objectives of Vietnamese competition law. In some respects, the objectives of EC competition law closely resemble to that of Vietnamese competition law, namely that they trends to develop a market economy but emphasize societal benefits143. Moreover, it should be conceded that the market – integration objective does not come highest on the list of priorities of Vietnamese competition law; however, the reduction of artificial barriers that restrict competition is also significant in Vietnam context. Therefore, the proposals made in this Chapter, albeit inspired by EC competition law, which focuses on the market – integration objective, are likely to be, in some respects, in conformity with the characteristics of Vietnamese competition law.

Thus, based on the analysis on the similarities between two legal systems as just mentioned, Vietnamese competition law may inherit EC experiences in a critical manner. As stated, the Vietnamese Law on Competition is in some respects more lenient and in other respects more stringent in application of treatment to vertical restraints in franchise agreements. Such treatment, in practice, constitutes the flaws of Vietnamese competition law on agreements in restraint of competition as normally incorporated in franchise agreements as analysed above. As a result, the amendment

142 Le Net, Anti-trust law in the US and Competition Law in EU, Ministrial level Researching Project of Vietnamese Competition Law, Ho Chi Minh City Law University, 2002, p.70.
143 Le Net, Anti-trust law in the US and Competition Law in EU, Ministrial level Researching Project of Vietnamese Competition Law, Ho Chi Minh City Law University, 2002, p.70.
of such treatment to vertical restraints in franchise agreements as set out in the Vietnamese Law on Competition should be implemented as follows:

First, it should be conceded that the per se prohibition of foreclosure agreements as specified in form of non-compete obligations as laid down in Vietnamese competition law, irrespective of the franchisor’s market share on the relevant market, is so stringent that it deters the development of franchise relationship. In EC competition law, such agreements as qualified specific conditions as analysed above in Chapter 3 may be subject to the block exemption regulation and even the individual exemption, if possible. Vietnamese competition law may follow this tendency, namely that Article 9 of the Vietnamese Law on Competition should be adapted accordingly to add agreements as stipulated in Articles 8.6 and 8.7 thereof in the list of agreements as being capable of benefiting exemption as provided in Article 9.2 thereof, and concurrently, exclude such agreements from the list of agreements as provided in Article 9.1 thereof. Conversely, the agreements in restraint of competition other than those which are prohibited per se under Article 9.1 of the Vietnamese Law on Competition should not be excluded automatically under Article 9.2 thereof. Following the current language as prescribed in Article 9.2 of the Vietnamese Law on Competition, “[w]hen the parties to the agreement have a combined market share of thirty (30) per cent or more of the relevant market”, an additional clause similar to the following should be included: “however, such agreements entered into by the parties having a combined market share of less than thirty (30) per cent of the relevant market shall even be subject to the prohibition stipulated in this Article when they are capable of appreciably restricting competition”. The question on how to determine whether such agreements are capable of appreciably restricting competition or not should be partly dealt with under the reception of EC experiences on constructing a list of blacklisted restrictions and therefore, any agreement containing any blacklisted restriction shall be subject to the prohibition laid down in Article 9.2 of the Vietnamese Law on Competition.

Second, it is of significance to offer guidelines on the exemption for agreements in restraint of competition qualifying the conditions as listed in Article 10 of the Vietnamese Law on Competition. In addition, it is also necessary to broaden the coverage of agreements with pro-competitive effects as qualified for the examination of individual exemption as prescribed in Article 10 of the Vietnamese Law on Competition. Accordingly, instead of listing the kind of agreements that might fall under the benefit for individual exemption in the current language, Article 10.1 of the Vietnamese Law on Competition should be slightly modified to read as follows: “agreements in restraint of competition stipulated in Article 9.2 of this Law shall be entitled to exemption for a definite period if they aim at reducing prime costs and benefit consumers, in particular those which: (a) rationalize an organizational structure or a business scale or increase business efficiency; (b) promote technical or technological progress or improve the quality of goods and services; (c) promote uniform applicability of quality standards and technical ratings of product types; (d) unify conditions on trading, delivery of goods and payment, but do not relate to price or any pricing factors; (d) increase the competitiveness of small and medium-sized enterprises, or (e) increase the competitiveness of Vietnamese enterprises in the international market.”
Third, the regulation on block exemption for vertical restraints as more detailed as Regulation 2790/99 in EC competition law may be of value to Vietnamese competition law. In such regulation, the establishment of the dividing line to distinguish between agreements in restraint of competition which are legal and the rest and, further provide a separate treatment for each is of extremely significance. In addition, such regulation should follow a strong inclination towards the blacklist approach in Regulation 2790/99 which emphasizes the rule that everything which is not prohibited would be allowed. Accordingly, this approach means that even agreements which are indicative of restricting competition will not be caught by competition law, unless they are actually blacklisted and therefore, fall outside the block exemption. Being successful in establishing this boundary, such regulation not only bolsters investors’ confidence, stimulates the development of franchise activities, but also promotes and maintains fair competition in the market.

5. Conclusion

Together with the Renovation process, Vietnam has undergone a major legislative reform in almost two decades, the focus of which is to contribute the market economy and foster a competitive economic environment. In practice, Vietnam faces the challenge of creating competitive market and adopting comprehensive and fully worked-out competition law framework. Within the limited scope of this thesis, the research on the application of Vietnamese and EC competition law to agreements in restraint of competition in franchise agreements partly contributes to the establishment of a more coherent and effective competition law on franchise agreements. As stated above, franchise agreements are characterized by (i) the closer relationship as being equated as a de facto integration between the franchisor and the franchisee as well as (ii) the utilization of a package of intellectual property rights and the application of uniform commercial methods which gives the network its uniform appearance. Such characteristics enable the franchisor to impose restrictions on franchisees in order to protect franchise system. It explains why inherent in franchise agreements are a great number of restrictions, such as territorial restriction, customer restriction, non-compete obligations as well as resale price maintenance, which restrict competition at somewhat different levels. However, in some respects, it should be conceded that such restrictions imposed by the franchisor acted as a shield of the franchise system. Without it, the ability to minimize the high risk as being inherent in franchise relationship has been weakened. It should be emphasized that the application of competition law to the franchise agreement irrespective of its specific characteristics may attenuate the proliferation of franchise activities. Therefore, the most important task of competition law on franchise agreements is to establish the barrier which prevents, in one hand, the agreements as being actually restrictive of competition and releases, in other hand, those as being indicative of restricting competition but necessary to protect the franchise system as well as being in compliance with competition law.

After showing the characteristics of franchise agreements and emphasizing the requirement to take such characteristics into consideration when examining franchise agreements under the competition law’s perspective, the thesis analyzes EC and Vietnamese competition law applicable to agreements in restraint of competition in franchise agreements, figures out different approaches between two legal systems and
also explains reasons for the differences. It should be conceded that based on the critical reception of EC experiences on dealing with agreements in restraint of competition in franchise agreements, the thesis clarifies the extent to which Vietnamese competition law may avail itself of the EC’s breakthroughs. However, as stated above, although EC competition law, in historical perspective, has obtained an unmistakable advance in dealing with vertical restraints in franchise agreements, it still has its own weaknesses, namely that some provisions are too rigid to strictly adhere and display, in some respects, the straitjacket approach which lessens the contractual creativity of the parties in their agreement. Therefore, it is necessary to assess the value of insights drawn from EC competition law based on a critical thinking.

Nevertheless, it deserves mentioning that one of the EC’s breakthroughs on dealing with vertical restraints in franchise agreements in particular is to establish the barrier to distinguish between those which are actually restrictive of competition and those which are indicative of restricting competition but in compliance with competition law as mentioned above and further, provide a separate treatment for each – the one which is still a deficiency in Vietnamese competition law. Indeed, the shortcoming of Vietnamese competition law on agreements in restraint of competition, if applicable to the franchise agreement, is without taking its specific characteristics into consideration. In this case, EC experiences may be instructive for Vietnamese competition law, because the latter has many similarities to EC model, such as the characteristics rooted in civil law tradition, the preference in an administrative control model of competition law or the pursuit of objectives as being recognized as the harmonization of economic efficiency and societal benefits. However, it should be emphasized that the reception of any experience modelled upon EC competition law without considering its conformity with Vietnam legal conditions will result in counter-effect. The adoption of the competition law framework which reflects exactly Vietnam’s legal context is, after all, of paramount importance.

It follows from the above that Vietnamese competition law on agreements in restraint of competition should be restructured so that it is neither too lenient nor too stringent in application of treatment to vertical restraints in franchise agreements, namely that foreclosure agreements as specified in form of non-compete obligations should not be prohibited per se, or conversely, agreements on price-fixing and agreements to share consumer markets or sources of supply of goods and services should not be excluded automatically only if the franchisor’s market share is less than 30% on the relevant market. Moreover, the requirement for the establishment of the regulation on block exemption for agreements in restraint of competition as more detailed as Regulation 2790/99 in EC competition law or the requirement for the elucidation of the individual exemption for agreements in restraint of competition are also reckoned as important ones.

Finally, it is necessary to look back on the thesis to recognize that the lack of making more-detailed proposals on (i) how to establish the regulation on block exemption for agreements in restraint of competition in conformity with Vietnam legal conditions as well as (ii) how to create the evaluation regime on agreements in restraint of competition which are eligible to individual exemption could be considered the shortcomings of the thesis that need to be improved in my following research.
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