

JUDGMENT OF THE COURT
28 January 1986 *

In Case 161/84

REFERENCE to the Court under Article 177 of the EEC Treaty by the Bundesgerichtshof [Federal Court of Justice] for a preliminary ruling in the proceedings pending before that court between

Pronuptia de Paris GmbH, Frankfurt am Main,

and

Pronuptia de Paris Irmgard Schillgalis, Hamburg,

on the interpretation of Article 85 of the EEC Treaty and Commission Regulation No 67/67/EEC of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements (Official Journal, English Special Edition 1967, p. 10),

THE COURT

composed of: Lord Mackenzie Stuart, President, U. Everling, K. Bahlmann and R. Joliet (Presidents of Chambers), T. Koopmans, O. Due and Y. Galmot, Judges,

Advocate General: P. VerLoren van Themaat

Registrar: D. Louterman, Administrator

after considering the observations submitted on behalf of

the plaintiff in the main proceedings, by Dr Rainer Bechtold,

the defendant in the main proceedings, by Dr Eberhard Kolonko,

* Language of the Case: German.

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the French Republic, by S. C. de Margerie, acting as Agent,

the Commission of the European Communities, by Dr Norbert Koch, acting as Agent,

after hearing the Opinion of the Advocate General delivered at the sitting on 19 June 1985,

gives the following

JUDGMENT

(The account of the facts and issues which is contained in the complete text of the judgment is not reproduced)

Decision

- 1 By an order of 15 May 1984, which was received at the Court on 25 June 1984, the Bundesgerichtshof referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty a number of questions regarding the interpretation of Article 85 of the EEC Treaty and Commission Regulation No 67/67/EEC of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements (Official Journal, English Special Edition 1967, p. 10) in order to ascertain whether those provisions are applicable to franchise agreements.
- 2 Those questions arose in proceedings between Pronuptia de Paris GmbH, Frankfurt am Main, (hereinafter referred to as 'the franchisor'), a subsidiary of the French company of the same name, and Mrs Schillgalis, who carries on business in Hamburg under the name Pronuptia de Paris and is referred to hereinafter as 'the franchisee', regarding the franchisee's obligation to pay to the franchisor arrears of royalties on her turnover for the years 1978 to 1980.
- 3 The franchisor's French parent company distributes wedding dresses and other articles of clothing worn at weddings under the trade-mark 'Pronuptia de Paris'. In the Federal Republic of Germany those products are distributed through shops

operated directly by its subsidiary and through shops belonging to independent retailers under franchise contracts concluded by the subsidiary in its own name and in the name of the parent company.

- 4 By three contracts signed on 24 February 1980 the franchisee obtained a franchise for three separate zones, Hamburg, Oldenburg and Hanover. The three contracts are virtually identical in their wording. More specifically, they include the following provisions.
- 5 The franchisor:
 - (a) Grants the franchisee, in respect of a territory defined by means of a map attached to the contract, the exclusive right to use the trade-mark 'Pronuptia de Paris' for the marketing of her goods and services and the right to advertise;
 - (b) Undertakes not to open any other Pronuptia shops in the territory in question or to provide goods or services to third parties in that territory;
 - (c) Undertakes to assist the franchisee with regard to the commercial aspects of her business, advertising, the establishment and decoration of the shop, staff training, sales techniques, fashion and products, purchasing and marketing and, in general, everything which, in its experience, is likely to help to improve the turnover and profitability of the franchisee's business.
- 6 The franchisee, who remains sole proprietor of her business and assumes all its risks, is obliged:
 - (a) To sell the goods, using the trade name and trade-mark 'Pronuptia de Paris', only in the shop specified in the contract, which must be equipped and decorated mainly for the sale of bridal fashions in accordance with the franchisor's instructions, in such a way as to enhance the brand image of the Pronuptia chain, and cannot be transferred to another location or altered without the agreement of the franchisor;

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- (b) To purchase from the franchisor 80% of wedding dresses and accessories, together with a proportion of cocktail and evening dresses to be set by the franchisee herself, and to purchase the remainder only from suppliers approved by the franchisor;
- (c) To pay the franchisor, in return for the benefits granted, a single entry fee for the contract territory of DM 15 000 and, throughout the duration of the contract, a royalty of 10% of total sales of Pronuptia products and all other goods, including evening dresses purchased from suppliers other than Pronuptia;
- (d) To regard the prices suggested by the franchisor as recommended retail prices, without prejudice to her freedom to fix her own prices;
- (e) To advertise in the contract territory only with the franchisor's agreement, and in any event to harmonize that advertising with the franchisor's international and national advertising, to distribute catalogues and other publicity material provided by the franchisor to the best of her abilities and in general to apply the business methods imparted to her by the franchisor;
- (f) To make the sale of bridal fashions her main purpose;
- (g) To refrain, during the period of validity of the contract and for one year after its termination, from competing in any way with a Pronuptia shop and in particular from opening a business of a nature identical or similar to that carried on under the contract, or participating directly or indirectly in such a business, in the Federal Republic of Germany, in West Berlin or in an area where Pronuptia is already represented in any way;
- (h) Not to assign to third parties the rights and obligations arising under the contract or the business without the prior approval of the franchisor, it being understood that the franchisor will not withhold its approval if such an assignment takes place for health reasons and if the new contracting party shows that he is financially sound and is not in any way a competitor of the franchisor.

7 In the court of first instance judgment was given against the franchisee in the amount of DM 158 502 for arrears of royalties on her turnover for the years 1978 to 1980; the franchisee appealed to the Oberlandesgericht Frankfurt am Main, where she argued, in order to avoid payment of the arrears, that the contracts were contrary to Article 85 (1) of the EEC Treaty and were not covered by the block exemption granted to certain categories of exclusive dealing agreement under Commission Regulation No 67/67. By judgment of 2 December 1982 the Oberlandesgericht upheld the franchisee's argument. It held that the mutual obligations of exclusivity constituted restrictions on competition within the common market, since the franchisor could not supply any other dealers in the contract territory and the franchisee could purchase and resell other goods from other Member States only to a limited extent. Since they were not eligible for exemption under Article 85 (3) the contracts must, in its view, be regarded as void under Article 85 (2). With regard to the issue of exemption, the Oberlandesgericht considered that it was not obliged to decide whether franchise contracts are in principle excluded from the scope of Commission Regulation No 67/67. In its view, the agreements in question in any event contain undertakings which go well beyond those described in Article 1 of the regulation and give rise to restrictions of competition not covered by Article 2.

8 The franchisor appealed against that judgment to the Bundesgerichtshof, arguing that the judgment of the trial court should be upheld. The Bundesgerichtshof considered that the outcome of the appeal depended on the interpretation of Community law. It therefore asked the Court to give a preliminary ruling on the following questions:

'(1) Is Article 85 (1) of the EEC Treaty applicable to franchise agreements such as the contracts between the parties, which have as their object the establishment of a special distribution system whereby the franchisor provides to the franchisee, in addition to goods, certain trade names, trade-marks, merchandising material and services?

(2) If the first question is answered in the affirmative: Is Commission Regulation No 67/67/EEC of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements (block exemption) applicable to such contracts?

(3) If the second question is answered in the affirmative:

- (a) Is Regulation No 67/67 still applicable if several undertakings which, though legally independent, are bound together by commercial ties and form a single economic entity for the purposes of the contract participate on one side of the agreement?
- (b) Does Regulation No 67/67, and in particular Article 2 (2) (c) thereof, apply to an obligation on the part of the franchisee to advertise solely with the prior agreement of the franchisor and in a manner that is in keeping with the latter's advertising, using the publicity material supplied by him, and in general to use the same business methods? Is it relevant in this connection that the franchisor's publicity material contains price recommendations which are not binding?
- (c) Does Regulation No 67/67, and in particular Articles 1 (1) (b), 2 (1) (a) and 2 (2) (b) thereof, apply to an obligation on the part of the franchisee to confine the sale of the contract goods exclusively or at least for the most part to particular business premises specially adapted for the purpose?
- (d) Does Regulation No 67/67, and in particular Article 1 (1) (b) thereof, apply to an obligation on the part of the franchisee — who is bound to purchase most of his supplies from the franchisor — to make the rest of his purchases of goods covered by the contract solely from suppliers approved by the franchisor?
- (e) Does Regulation No 67/67 sanction an obligation on the franchisor to give the franchisee commercial, advertising and professional support?

The first question

- 9 Pronuptia de Paris GmbH, Frankfurt am Main, the franchisor, argues that a system of franchise agreements makes it possible to combine the advantages offered by a form of distribution which presents a uniform image to the public (such as a system of subsidiaries) with the distribution of goods by independent retailers who themselves bear the risks associated with selling. The system is made up of a network of vertical agreements intended to ensure uniform presentation to

the public and reinforces the franchisor's competitive power at the horizontal level, that is to say, with regard to other forms of distribution. It makes it possible for an undertaking which would not otherwise have the necessary financial resources to establish a distribution network beyond the confines of its own region, a network which enables small undertakings to participate as franchisees while retaining their independence. In view of those advantages Article 85 (1) does not apply where the franchise agreements do not include restrictions on the liberty of the contracting parties which go beyond those which are the necessary concomitants of a franchise system. Exclusive delivery and supply obligations, in so far as they are intended to ensure a standard selection of goods, uniform advertising and shop layout and a prohibition on selling goods supplied under the contract in other shops, are inherent in the very nature of the franchise contract and are outside the scope of Article 85 (1).

- 10 Mrs Schillgalis, the franchisee, submits that the first question should be answered in the affirmative. The most significant characteristic of the contracts in question is the territorial protection given to the franchisee. They cannot be compared with agency agreements, since franchisees, unlike agents, act in their own name and on their own account and bear all trading risks. The system of franchise agreements at issue gives rise to significant restrictions of competition, having regard to the fact that Pronuptia is, as it itself asserts, the world's leading French supplier of wedding dresses and accessories.
- 11 The French Government states that Article 85 (1) may be applicable to franchise agreements for the distribution of a product but should not necessarily be applied to such agreements, in view of their positive aspects.
- 12 The Commission emphasizes that the scope of Article 85 (1) is not restricted to particular types of contracts, and infers that in appropriate circumstances Article 85 (1) applies also to contracts for the assignment of business names and trade-marks, registered or not, and the provision of services, as well as the supply of goods.
- 13 It should be pointed out first of all that franchise agreements, the legality of which has not previously been put in issue before the Court, are very diverse in nature. It appears from what was said in argument before the Court that a distinction must be drawn between different varieties of franchise agreements. In particular, it is

necessary to distinguish between (i) service franchises, under which the franchisee offers a service under the business name or symbol and sometimes the trade-mark of the franchisor, in accordance with the franchisor's instructions, (ii) production franchises, under which the franchisee manufactures products according to the instructions of the franchisor and sells them under the franchisor's trade-mark, and (iii) distribution franchises, under which the franchisee simply sells certain products in a shop which bears the franchisor's business name or symbol. In this judgment the Court is concerned only with this third type of contract, to which the questions asked by the national court expressly refer.

- 14 The compatibility of franchise agreements for the distribution of goods with Article 85 (1) cannot be assessed *in abstracto* but depends on the provisions contained in such agreements. In order to make its reply as useful as possible to the Bundesgerichtshof the Court will concern itself with contracts such as that described above.
- 15 In a system of distribution franchises of that kind an undertaking which has established itself as a distributor on a given market and thus developed certain business methods grants independent traders, for a fee, the right to establish themselves in other markets using its business name and the business methods which have made it successful. Rather than a method of distribution, it is a way for an undertaking to derive financial benefit from its expertise without investing its own capital. Moreover, the system gives traders who do not have the necessary experience access to methods which they could not have learned without considerable effort and allows them to benefit from the reputation of the franchisor's business name. Franchise agreements for the distribution of goods differ in that regard from dealerships or contracts which incorporate approved retailers into a selective distribution system, which do not 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. Such a system, which allows the franchisor to profit from his success, does not in itself interfere with competition. In order for the system to work two conditions must be met.
- 16 First, the franchisor must be able to communicate his know-how to the franchisees and provide them with the necessary assistance in order to enable them to apply

his methods, without running the risk that that know-how and assistance might benefit competitors, even indirectly. It follows that provisions which are essential in order to avoid that risk do not constitute restrictions on competition for the purposes of Article 85 (1). That is also true of a clause prohibiting 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 a member of the network. The same may be said of the franchisee's obligation not to transfer his shop to another party without the prior approval of the franchisor; that provision is intended to prevent competitors from indirectly benefiting from the know-how and assistance provided.

- 17 Secondly, 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. It follows that provisions which establish the means of control necessary for that purpose do not constitute restrictions on competition for the purposes of Article 85 (1).
- 18 The same is true of the franchisee's obligation to apply the business methods developed by the franchisor and to use the know-how provided.
- 19 That is also the case with regard to the franchisee's obligation to sell the goods covered by the contract only in premises laid out and decorated according to the franchisor's instructions, which is intended to ensure uniform presentation in conformity with certain requirements. The same requirements apply to the location of the shop, the choice of which is also likely to affect the network's reputation. It is thus understandable that the franchisee cannot transfer his shop to another location without the franchisor's approval.
- 20 The prohibition of the assignment by the franchisee of his rights and obligations under the contract without the franchisor's approval protects the latter's right freely to choose the franchisees, on whose business qualifications the establishment and maintenance of the network's reputation depend.

- 21 By means of the control exerted by the franchisor on the selection of goods offered by the franchisee, the public is able to obtain goods of the same quality from each franchisee. It may in certain cases — for instance, the distribution of fashion articles — be impractical to lay down objective quality specifications. Because of the large number of franchisees it may also be too expensive to ensure that such specifications are observed. In such circumstances a provision requiring the franchisee to sell only products supplied by the franchisor or by suppliers selected by him may be considered necessary for the protection of the network's reputation. Such a provision may not however have the effect of preventing the franchisee from obtaining those products from other franchisees.

- 22 Finally, since advertising helps to define the image of the network's name or symbol in the eyes of the public, a provision requiring the franchisee to obtain the franchisor's approval for all advertising is also essential for the maintenance of the network's identity, so long as that provision concerns only the nature of the advertising.

- 23 It must be emphasized on the other hand that, far from being necessary for the protection of the know-how provided or the maintenance of the network's identity and reputation, certain provisions restrict competition between the members of the network. That is true of provisions which share markets between the franchisor and franchisees or between franchisees or prevent franchisees from engaging in price competition with each other.

- 24 In that regard, the attention of the national court should be drawn to the provision which obliges the franchisee to sell goods covered by the contract only in the premises specified therein. That provision prohibits the franchisee from opening a second shop. Its real effect becomes clear if it is examined in conjunction with the franchisor's undertaking to ensure that the franchisee has the exclusive use of his business name or symbol in a given territory. In order to comply with that undertaking the franchisor must not only refrain from establishing himself within that territory but also require other franchisees to give an undertaking not to open a second shop outside their own territory. A combination of provisions of that kind results in a sharing of markets between the franchisor and the franchisees or

between franchisees and thus restricts competition within the network. As is clear from the judgment of 13 July 1966 (Joined Cases 56 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299), a restriction of that kind constitutes a limitation of competition for the purposes of Article 85 (1) if it concerns a business name or symbol which is already well-known. It is of course possible that a prospective franchisee would not take the risk of becoming part of the chain, investing his own money, paying a relatively high entry fee and undertaking to pay a substantial annual royalty, unless he could hope, thanks to a degree of protection against competition on the part of the franchisor and other franchisees, that his business would be profitable. That consideration, however, is relevant only to an examination of the agreement in the light of the conditions laid down in Article 85 (3).

25 Although provisions which impair the franchisee's freedom to determine his own prices are restrictive of competition, that is not the case where the franchisor simply provides franchisees with price guidelines, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices. It is for the national court to determine whether that is indeed the case.

26 Finally, it must be added that franchise agreements for the distribution of goods which contain provisions sharing markets between the franchisor and the franchisees or between the franchisees themselves are in any event liable to affect trade between Member States, even if they are entered into by undertakings established in the same Member State, in so far as they prevent franchisees from establishing themselves in another Member State.

27 In view of the foregoing, the answer to the first question must be that:

- (1) The compatibility of franchise agreements for the distribution of goods with Article 85 (1) depends on the provisions contained therein and on their economic context.

- (2) Provisions which are strictly necessary in order to ensure that the know-how and assistance provided by the franchisor do not benefit competitors do not constitute restrictions of competition for the purposes of Article 85 (1).
- (3) Provisions which establish the control strictly necessary for maintaining the identity and reputation of the network identified by the common name or symbol do not constitute restrictions of competition for the purposes of Article 85 (1).
- (4) Provisions which share markets between the franchisor and the franchisees or between franchisees constitute restrictions of competition for the purposes of Article 85 (1).
- (5) The fact that the franchisor makes price recommendations to the franchisee does not constitute a restriction of competition, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices.
- (6) Franchise agreements for the distribution of goods which contain provisions sharing markets between the franchisor and the franchisees or between franchisees are capable of affecting trade between Member States.

The second question

28 The second question, which was raised only in the event that the first question should be answered in the affirmative, seeks to ascertain whether Commission Regulation No 67/67 of 22 March 1967 on the application of Article 85 (3) of the Treaty to certain categories of exclusive dealing agreements is applicable to franchise agreements for the distribution of goods. Having regard to the foregoing remarks regarding provisions which share markets between the franchisor and the franchisees or between franchisees, that question remains relevant to a certain degree and must therefore be examined.

29 Pronuptia de Paris, the franchisor, submits that the Court should reply to the second question in the affirmative. Regulation No 67/67 applies, it says, to

exclusive supply and purchase agreements even where such agreements also involve the granting of licences to use an undertaking's trade-mark or other distinctive symbol. In a franchise agreement exclusive supply and purchase obligations present advantages of the kind referred to in the sixth recital in the preamble to Regulation No 67/67. Provisions other than those referred to in Article 2 of Regulation No 67/67 present no obstacle to exemption in so far as they do not restrict competition within the meaning of Article 85 (1).

30 Mrs Schillgalis, the franchisee, argues that Regulation No 67/67 is not applicable to franchise agreements. First of all, that regulation was drawn up on the basis of the Commission's experience at the time, which extended only to exclusive dealing agreements. Secondly, the franchisor has much more power over the franchisee than a supplier has over his distributors. Thirdly, the restriction of competition inherent in franchise agreements also has horizontal effects, since the franchisor generally has subsidiaries which carry on business at the same level of distribution as the franchisees.

31 The French Government merely observes that Regulation No 67/67 does not seem applicable to this type of contract.

32 The Commission begins by admitting that it does not yet have sufficient experience to arrive at a satisfactory definition of franchise agreements. It adds that Regulation No 67/67 is not intended to provide exemption for restrictions on competition contained in agreements for the grant of a licence to use a business name or symbol or a trade-mark; the grant of such a licence, together with the provision of know-how and commercial assistance, seems to the Commission to constitute the essential feature of franchise agreements. However, where licensing agreements of that kind include agreements for the supply of goods for retail sale and where the supply agreements are separable from the licensing agreements, Regulation No 67/67 may be applicable to the supply agreements in so far as the conditions laid down in the regulation are satisfied. The exclusive distributor may not, as such, be made subject to restrictions of competition other than those covered by Article 1 (1) and Article 2 (1) of the regulation. In the contracts which have given rise to the proceedings before the Bundesgerichtshof the provision regarding the place of business creates such a close relationship between the exclusive dealership portion

and the licensing portion of the franchise agreement that they make up an indivisible whole. The block exemption is therefore inapplicable, according to the Commission, even to the exclusive dealership portion of the contract.

- 33 Reference must be made in this respect to a number of points in Regulation No 67/67. First, the category of contracts covered by the block exemption is defined by reference to obligations of supply and purchase, which may or may not be reciprocal, and not by reference to factors such as the use of a single business name or symbol, the application of uniform business methods and the payment of royalties in return for the benefits provided under franchise agreements for the distribution of goods. Secondly, the wording of Article 2 expressly covers only exclusive dealing agreements, which, as has already been pointed out, differ in nature from franchise agreements for the distribution of goods. Thirdly, that article lists the restrictions and obligations which may be imposed on the exclusive distributor but does not mention those which may be imposed on the other party to the contract, while in the case of a franchise agreement for the distribution of goods the obligations undertaken by the franchisor, in particular the obligations to provide know-how and to assist the franchisee, are of particular importance. Fourthly, the list of obligations which may be imposed on the distributor under Article 2 (2) does not include the obligations to pay royalties or the obligations ensuing from provisions which establish the control strictly necessary for maintaining the identity and reputation of the network.
- 34 It must be concluded, therefore, that Regulation No 67/67 is not applicable to franchise agreements for the distribution of goods such as those considered in these proceedings.

The third question

- 35 In view of the reply to the second question raised by the national court there is no need to reply to the third question.

Costs

- ³⁶ The costs incurred by the French Government and by the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, in so far as the parties to the main proceedings are concerned, in the nature of a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions submitted to it by the Bundesgerichtshof by order of 15 May 1984, hereby rules:

- (1) (a) **The compatibility of franchise agreements for the distribution of goods with Article 85 (1) depends on the provisions contained therein and on their economic context.**

- (b) **Provisions which are strictly necessary in order to ensure that the know-how and assistance provided by the franchisor do not benefit competitors do not constitute restrictions of competition for the purposes of Article 85 (1).**

- (c) **Provisions which establish the control strictly necessary for maintaining the identity and reputation of the network identified by the common name or symbol do not constitute restrictions of competition for the purposes of Article 85 (1).**

- (d) **Provisions which share markets between the franchisor and the franchisees or between franchisees constitute restrictions of competition for the purposes of Article 85 (1).**

- (e) **The fact that the franchisor makes price recommendations to the franchisee does not constitute a restriction of competition, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices.**

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- (f) Franchise agreements for the distribution of goods which contain provisions sharing markets between the franchisor and the franchisees or between franchisees are capable of affecting trade between Member States.
- (2) Regulation No 67/67/EEC is not applicable to franchise agreements for the distribution of goods such as those considered in these proceedings.

	Mackenzie Stuart	Everling	Bahlmann	
Joliet	Koopmans	Due	Galmot	

Delivered in open court in Luxembourg on 28 January 1986.

P. Heim
Registrar

A. J. Mackenzie Stuart
President