The Commission for Protection of Competition has received a request for issuing opinion concerning implementation of competition policy regulations submitted by company (hereinafter referred to as 'Company') active on the market of the Republic of Serbia in the field of imports, wholesale and retail trade of particular products procured from its holding company. Those products are marked as "own products". At the same time, the Company procures and places on the market "products of another manufacturer".

The Company plans to approach negotiations and enter into several agreements (contracts) on franchising with business partners, for now remained unnamed.

According to the assessment from the request concerned, the relevant market share of the Company is approx. 3%, while its holding company is only indirectly present on the relevant market, i.e. via business operations of the Company. Also, it is assessed that the relevant market share of each potential partner does not exceed 3%.

The future franchise users would acquire rights and obligations "typical" for franchise relation, including the obligation to procure "own products" exclusively from the Company.

In the request concerned, the Commission was requested to issue opinion concerning the submitted question: is it permissible to obligate partner (franchise user/franchisee) that by entering into franchising agreement procure "products of another manufacturer" exclusively from the Company (franchise provider/franchisor)?

On the basis of previously listed relevant circumstances, as well as on the presumption of accuracy of all statements presented in the request concerned, pursuant to Article 21, Item 8 of the Law on Protection of Competition ("Official Gazette of the RS", no. 51/2009, hereinafter referred to as 'Law'), the Commission has issued the following

Opinion

In accordance with the provided description of planned business activity, determined to be lacking in sufficient number of relevant data, it could be concluded that the party intends to enter into series of agreements – contracts with future business partners, which would primary have a "vertical nature" although described as franchising agreements.

On the basis of the facts presented in the request pertaining to the assessment of market share of both franchisor and franchisees, it could be concluded that such contract fulfils conditions from Article 14 of the Law, or respectively that this specific instance could relate to the case of agreements of minor importance. In accordance with the provisions of mentioned article, agreements of minor importance are allowed, unless the purpose of vertical agreements is price

setting or division of market.

Within the meaning of previously mentioned, the Commission underlines the importance of provisions of Article 14(1/4) of the Law as relevant for the party concerned, stipulating two cumulative conditions – total maximum and individual market share on each individual market where the effects of agreements are manifested, if related agreements concluded between various participants have similar impact on the market.

In the concrete case, under assumption that planned contracts would fail to satisfy the conditions set for "agreements of minor importance", it would be necessary for the requesting party to implement the "self-assessment method" in evaluating the fulfilment of all conditions from the Regulation on agreements between undertakings operating at the different level of production or distribution chain exempted from prohibition ("Official Gazette of the RS", no. 11/2010, hereinafter referred to as 'Regulation'), or respectively to assess the fulfilment of conditions for the so-called "exemption per category of agreements" or "block exemption". If assessed that such agreement would fulfil all conditions stipulated in the Regulation, while also fulfilling all necessary conditions laid down in Article 11 of the Law, notification on individual exemption to the Commission would not be required. The Commission herewith emphasizes that parties to such agreement would bear all risks associated with appropriate self-assessment on the fulfilment of conditions.

If an individual restrictive agreement fails to fulfil conditions from Article 14 of the Law (is not considered to be agreement of minor importance) and conditions from the Regulation, it would be necessary that parties to the agreement submit a request to the Commission for individual exemption of restrictive agreement from prohibition (individual exemption), and to evidence in the proceeding conducted by the Commission on the fulfilment of envisaged, cumulative conditions stipulated in Article 11 of the Law.

When processing the request concerned and while preparing related opinion - reply to the presented question, the Commission has instituted from the finding that the unit agreement on franchising (submitted request provides sufficient evidence on the master franchise agreement, and later on the sub-franchise agreement) as innominate complex agreement, in addition to autonomous elements, also contains elements of some other nominate agreements such as: license agreements, trade secret agreements, (selective) distribution agreements, lease agreements, etc.

Also, the Commission has instituted from the finding that typical commitments of franchisees are as follows:

- conducting business activities while strictly observing norms set within the franchise "package";
- keeping trade secretes;
- enforcing the non-compete clauses which prohibit the franchisee from operating a business

that competes with the franchised business (fully enforced during the term of the agreement, while upon the expiry is limited to keeping trade secrets – referring to a reasonable limited time period and geographic scope);
- delivering to the franchisor all business concept developments, while keeping the non-exclusive rights to use such developments;
- executing franchise royalty payments;
- paying franchise advertising "contributions"
- non-entitlement of franchisees to transfer agreement or property in relation to the franchise without prior approval of the franchisor (during the term of the agreement)
- etc.

The following clauses can be listed as typical restrictive clauses from the agreements on franchise, considered as acceptable from the competition policy perspective until they go beyond what is "necessary" for achieving objectives set in the agreement – which may differ on a case-by-case basis:
- exclusive or protected franchise territories;
- location clause;
- obligation to sell only certain type of goods;
- restricting sales of items or provision of services to particular customer groups;
- non-compete clause;
- exclusive purchase obligation from the franchisor or other designated/branded suppliers;
- etc.

In terms of the Agreement on franchising, similar to selective distribution agreements, it can always be questioned on the imposition of certain "measures" of uniformity and quality standardization on the distributors, contributing to the creation of "brand image", thereby increasing the "attractiveness" of the product to the final consumer and increasing its sales.

Concerning anti-competitive provisions established toward "tying" of franchisees in terms of "exclusive purchase" of all products from the franchisor, as well as obligatory procurement of products of another manufacturer exclusively via the franchisor, they would be assessed in the light of creating possibilities for "efficiencies" arising from "joint production" or "joint distribution".

Where the "tied" product is not produced by the supplier (franchisor), an "efficiency" may also arise from the supplier buying large quantities of the "tied" product. The Commission sees this situation as one referred to in the request concerned.

For tying to be exemptible from prohibition, it must, however, be shown that at least part of these cost reductions are passed on to the consumer. Tying is therefore normally not exemptible when

the retailer (franchisee) would be able to obtain, on a regular basis, supplies of the same or equivalent products on the same or better conditions that those offered by the supplier (franchisor) which applies the “tying practice”.

Another “efficiency” may exist where “tying” helps to ensure a certain uniformity and quality standardization.

However, it needs to be demonstrated that the “positive effects” cannot be realized equally efficiently by requiring the buyer/retailor (franchisee) to use or resell products satisfying “minimum” quality standards, without requiring the buyer to purchase these from the supplier (franchisor) or someone designated by the latter.

Where the franchisor (supplier of the “tying product”) “imposes” on the buyer (franchisee) the suppliers from which the buyer must purchase the tied product, for instance because the formulation of minimum quality standards is not possible, this may also fall outside competition policy regulations, especially where the supplier (franchisor) of the tying product does not derive a direct (financial) benefit from designating the suppliers of the “tied” product.

The Agreement on franchising, as per its nature, implies the “need” to contractually arrange particular anti-competitive provisions against the franchisee, as well as against the franchisor, thus is necessary that the requesting and other parties involved closely consider all previously mentioned when negotiating and entering into such agreement.