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**New Challenges for International Franchising**

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**HOW ONLINE SALES, INTERNET PLATFORMS AND MARKETING TECHNIQUES  
INFLUENCE FRANCHISING**

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## HOW ONLINE SALES, INTERNET PLATFORMS AND MARKETING TECHNIQUES INFLUENCE FRANCHISING

### 1. Introduction

Due to the rapid increase in e-commerce and digitalization of the global economy, traditional franchise chains have had to rapidly and continually adjust their methods of transacting business to react to ever-changing consumer demands, including the way in which the consumer wishes to receive information and make purchasing decisions. In particular, in cross border franchising, the regulatory frameworks vary in the areas of consumer laws, privacy, and competition laws. This provides considerable challenges in addition to the already-complex regulatory environments that vary from jurisdiction to jurisdiction, such as tax, zoning, product compliance, labor law, workplace safety and public order.

This paper takes a closer look at how online sales, internet platforms and marketing techniques influence cross border franchising, and considers the following questions: (i) What are the causes of the rapid changes? (ii) What are the policy trends? and (iii) What are the most common business responses? The paper also discusses innovation going forward, and business over the next few years. As regulatory frameworks expand, the paper considers which parties will be more or less constrained by these frameworks in their entrepreneurial freedom.

A primary consideration in this area is the role of Big Data, including the collection and processing of the data, the privacy aspects of collecting the data, and the economic value it brings to the parties in control of such data. While privacy, data protection and security concerns are still highly relevant, the most recent legal trends in the EU focus on the competition aspects of data. Therefore, this paper includes a description of the recent cases of the European Commission and national competition authorities in the EU that have dealt with anticompetitive aspects of data.

Online sales restrictions pose not only difficult questions at a commercial level. In North America, in Europe and certain other parts of the world, online sales restrictions may be competition sensitive. Not only are direct and indirect prohibitions on franchisees against selling or advertising online problematic, restrictions on the use of third party platforms have been subject to litigation in the EU. For the services industries, such as travel and hospitality, best price clauses are of key importance and have been the subject of competition law discussions and investigations. The paper also considers influencers and social media. The impact of influencers, brand ambassadors and social media in general on the popularity of brand is a given. Traditional forms of advertising are being complemented and integrated with new marketing techniques, and the paper notes certain legal aspects and pitfalls. In the EU, this area of law is left to national law more so than most of the other competition topics discussed in this paper. Finally, the paper draws some conclusions regarding trends and developments of digital marketing and sales in cross border franchise systems.

## 2. Big data and consumer privacy in franchise systems

The importance of personal data, and Big Data, in the current economic climate is accepted as true. Data protection issues (including the European General Data Protection Regulation<sup>1</sup>) have been at the regulatory forefront.

The GDPR applies to data processing, storage and transfer in franchise systems with some inextricable link to the EU and cannot be avoided by a choice of law or forum selection clause outside the EU. Moreover, the GDPR applies to entities located outside the EU if they offer goods or services to EU data subjects or monitor the behavior of EU data subjects. To determine the applicability of the GDPR, it must be ascertained whether it is apparent that the system aims to offer services to data subjects in one or more Member States in the Union. The mere accessibility of the website in the Union, of an email address or of other contact details, or the use of a language generally used in the third country where the controller is established, is not sufficient to infer such intention. However, factors such as the use of a language or a currency generally used in one or more Member States with the possibility of ordering goods and services in that other language, or the mentioning of customers or users who are in the Union, may make it apparent that the controller envisages offering goods or services to data subjects in the Union.

The GDPR sets forth *inter alia* that personal data is so be collected for specified, explicit, and legitimate purposes and is not to be further processed in a manner that is incompatible with those purposes.<sup>2</sup> Data processing should be limited to what is necessary for these purposes. Controllers must promptly take every reasonable step to ensure that incorrect personal data is erased or corrected. The GDPR prohibits retaining personal data in a form that permits identification of the subject for longer than is necessary considering the purposes for which the personal data is processed. Data controllers are responsible for, and must be able to demonstrate compliance with, the regulation. Data processors also have an obligation to comply with the GDPR.

Often both franchisor and its franchisees collect, process, and share data with each other. The GDPR assesses the real-world arrangement and not just the arrangement designed on paper. Franchisors should therefore have a clear vision and strategy regarding how personal data is handled within the franchise network and what roles and responsibilities all parties involved will have. For example, will the franchisor and its franchisees act as independent data controllers or be joint data controllers? On the other hand, will the franchisees process personal data on behalf of the franchisor solely in accordance with the franchisor's instructions? The data controller should bind the processor to a data processing agreement that sets out in sufficient detail the processing and requirements for data protection. Processing is lawful if the data subjects have given consent to the processing of their data for specific purposes or if the processing is necessary to perform a contract to which the data subjects are party, to comply with EU or member state laws, or to fulfill a legitimate interest of the controller or a third party. A stricter regime applies to "special" data, such as data related to religion, race, sexual orientation, or health. Based on the transparency requirement of GDPR, consent must also be informed. This means that it is necessary to

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<sup>1</sup> The European Parliament and the Council adopted on 27 April 2016 the *Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC* (the "General Data Protection Regulation" or "GDPR")

<sup>2</sup> In 2017, the Article 29 Working Party published several guidelines to provide clarity on certain concepts of the GDPR, such as consent, data breach and transparency.

inform the data subject of certain elements that are crucial to make a choice.

Controllers must implement technical and organizational measures to protect personal data and to limit, by default, processing to only what is necessary. Data processors must promptly notify controllers after learning of a data breach, and failure to do so is subject to sanctions. Given the data breach notification obligations, it is important for franchisors and franchisees to determine their respective roles as controllers or processors. Failure to report a breach to either a supervisory authority or data subjects may result in a possible sanction to the controller.

The GDPR's strict rules for processing of personal data affect franchise systems not only within the EU, but potentially worldwide. If a franchise system has business units in the EU or envisions offering services to data subjects in one or more Member States, monitors behavior of consumers in the EU, *e.g.* by tracking technologies and subsequently targeting advertising to consumers in the EU, then the GDPR is likely to apply. To ensure compliance with the GDPR, franchisors and franchisees should map the data processing performed in their franchise systems. This may include data related to customers, employees, visitors to the premises, and third-party service providers, among others.

It is important to note that the European Commission proposed on January 11, 2017 an ePrivacy Regulation to particularize and complement the GDPR by laying down specific e-privacy rules. These would replace a current patchwork of e-privacy regimes in Member States. Many aspects of e-marketing techniques will be affected by the ePrivacy Regulation.

### **3. Competition aspects of Big Data**

Currently, there are two highlight cases in the EU dealing with the collection and use of data by important online platforms: the Facebook case by the German Bundeskartellamt and the investigations against Amazon by the European Commission.

In its Facebook decision, the Bundeskartellamt found that Facebook has a dominant position in the market for social networks. The Bundeskartellamt accused Facebook of abusing this dominant position by making the use of Facebook conditional upon the consent of the user to allow Facebook to collect data from different sources (including Facebook's own services like WhatsApp, Instagram, but also third-party websites and apps) and to combine them with the data of the Facebook account (see below 2.1.1.).

In its proceedings against Amazon, the European Commission is currently investigating whether Amazon might have infringed the prohibition of cartels and/or the prohibition of an abuse of a dominant market position. Amazon acts both as a provider of an e-commerce marketplace for retailers and as a retailer itself (in competition with the other retailers) on its own platform. The Commission is investigating whether Amazon is collecting data from the other retailers, enabling Amazon to gain competitive advantage. The Commission hypothesized that Amazon might use such data collected to benefit its own retail sales (including the selling of Amazon branded products) and to impede other retailers on the platform. In addition, the collection of the retailers' data might constitute a prohibited exchange of competitively sensitive information (see below 2.1.2.).

The Facebook decision is relevant to the collection and use of data on the internet by franchisors and franchisees who have market power in their respective markets. The Amazon investigations by the European Commission could have an impact on franchisors and franchisees that compete in the services or products that are franchised (for example, if the franchisor also has company-operated businesses that

would compete for customers with its franchisees). An exchange of information by such franchisors and franchisees – for example via external or internal online platforms – might constitute an infringement of competition law if the data collected was used to benefit the company-operated locations unfairly (see below 2.2).

The questions of market power of online platforms and data exchange on the internet will probably have an impact on the current revision of the European Commission’s Vertical Block Exemption Regulation (“VBER”) and the corresponding Vertical Guidelines. The VBER provides the competition law framework for vertical business relations and, in particular, for distribution and franchise systems in the EU. In addition, the German legislator is considering the introduction of a new concept of market dominance of intermediaries (i.e. in particular third-party online platforms) in German competition law (see below 2.3.).

### **3.1. Theory of harm**

#### **3.1.1. Facebook decision by the Bundeskartellamt**

The Bundeskartellamt took the position that Facebook abused its dominant position on the market for social networks (see below (i)) by having collected user data from different apps and internet websites and combining this user data with the data of the Facebook account (see below (ii)).

##### **(i) Dominant position**

Internet platforms such as Facebook or Amazon usually serve different customer groups. For example, Facebook is, on the one hand, a platform for private users who have Facebook accounts, but also for companies who use Facebook for advertising. In the same vein, both customers and retailers use Amazon as an online marketplace. Each of those platforms is therefore active on multi-sided markets. Even if one side of the market is not subject to monetary compensation (the users do not have to pay Facebook for their accounts), competition authorities deem these free services to be a market activity.

When assessing if an internet platform has market power, competition authorities not only take into consideration quantitative factors such as market shares or market concentration. Authorities also take into consideration qualitative factors such as the interrelations between the different sides of the platforms, in particular, the so-called network effects. Direct network effect means that the more users there are on one side of the market, the more attractive the use of the platform becomes for these users. In other words, the more “friends” I can find on Facebook, the more attractive using Facebook becomes for me. Indirect network effect means that the number of users on one side of the platform makes it more attractive for the other side of the platform to use it. In other words, the more Facebook accounts there are, the more attractive it becomes for a company to advertise on Facebook. In addition, competition authorities consider: (1) economies of scale that are related to these network effects; (2) the access of the platform to data that is competitively relevant; (3) barriers to entry; and (4) competitive pressure due to innovation; and the ability for users to engage in multi-homing, meaning that the user can easily switch to a different platform to find the product or service on the internet (for example, different travel booking platforms such as Booking.com, Expedia.com and HRS.com, in addition to the brand sites).

In the Facebook proceedings, the Bundeskartellamt concluded that Facebook has a dominant position in the German market for social networks for private users.

##### **(ii) Abuse of a dominant position**

The Bundeskartellamt considers Facebook's data policy, which allows Facebook to collect user and device-related data from sources outside of Facebook (such as other sources owned by Facebook like WhatsApp and Instagram, but also from third-party websites and apps) and to merge it with data collected on Facebook, to be an abuse of a dominant position.

The Bundeskartellamt considers this practice to be an exploitative abuse towards private users of Facebook. It concluded that the respective terms and conditions of Facebook infringe European data protection law (the General Data Protection Regulation – GDPR). In the Bundeskartellamt's opinion, there was no effective consent of the users to Facebook's data policy in the sense of the GDPR. The reasons for this include the fact that, in view of Facebook's dominant position in the market, users consent to Facebook's terms and conditions for the sole purpose of having access to Facebook. The Bundeskartellamt took the alleged infringement of the GDPR as an indication that the terms and conditions are detrimental for the consumers and are therefore exploitative.

In addition, the Bundeskartellamt found that the excessive collection of data also impeded competitors because Facebook gained competitive advantages by inappropriate processing of data and their combination with the Facebook accounts.

*(iii) Remedies*

The Bundeskartellamt decided that Facebook had to take measures to end the alleged abuse of a dominant position:

- (a) Facebook-owned services such as WhatsApp and Instagram may continue to collect data. However, assigning the data to Facebook user accounts will only be possible subject to the users' voluntary consent. This consent must not be a condition to use Facebook or other services.
- (b) Collecting data from third-party websites and assigning them to Facebook user accounts will also only be possible if users give their voluntary consent in the above sense.

**3.1.2. Investigations against Amazon by the European Commission**

The European Commission is currently investigating whether the collection of data by Amazon might constitute an abuse of a dominant position or an infringement of the prohibition of cartel. Amazon is both a provider of an online marketplace and a retailer on the same marketplace. This means that Amazon is not only a service provider to third-party retailers, but also a competitor of these retailers at the same time. The Commission is investigating the type of data that Amazon collects from the retailers, including average prices, quantities sold, specific conversion rates, rebate campaigns and quantities stocked and what it does or may do with that data. Although the case is in very early stages and the Commission has only sent out questionnaires so far, the Commission possibly will be looking at the following aspects:

*(i) Abuse of a dominant position*

Amazon, as an online platform, is, like Facebook, active on multi-sided markets. Therefore, the Commission will take into consideration the different sides of the market when assessing if Amazon has a dominant position. In addition to quantitative factors such as market share and concentration, the Commission will also consider the qualitative factors as outlined above (network effects, economies of



scale due to the network effects, multi-homing, access to competitively relevant data, barriers to entry and competitive pressure by innovations.

As in the Facebook case, the collection of data from retailers, including customer data, can constitute an exploitative abuse of a dominant position. In addition, the European Commission might also investigate exclusionary abuses. It might allege that Amazon uses the data collected to benefit its own retail sales to the detriment of other retailers using the platform. The Commission might investigate if Amazon impedes customers from finding better or cheaper products offered on Amazon. It might also investigate if Amazon uses the data collected to adjust its own products or the products it sells in quality, features and/or prices to gain competitive advantages. Such a practice might be considered leveraging, meaning the (ab)use of a dominant position on an upstream market for e-commerce marketplace services to improve the position on the downstream retail markets and ultimately to force competitors out of the market.

*(ii) Prohibition of cartels*

The European Commission might also investigate an infringement of the prohibition of cartels. In European law, an exchange of competitively sensitive information between competitors is generally prohibited. Competitively sensitive information is information that enables an undertaking to adjust its own business behavior to the behavior of competitors. Amazon, as a retailer, is also a competitor of the retailers using Amazon as a marketplace. Therefore, the exchange of competitively sensitive information between these retailers and Amazon might infringe the prohibition of cartels. Even if the exchange of information was necessary for Amazon to operate the marketplace, the European Commission might ask Amazon to effectively ring-fence the operation of its marketplace from its retail activities.

*(iii) Possible remedies*

If the Commission will draw the conclusion that Amazon either abuses a dominant market position or infringes the prohibition of cartels, a conceivable remedy might be a ring-fencing between the Amazon unit operating the marketplace and the Amazon unit in charge of retail. Both units would have to be held separate from one another. In particular, the Amazon unit in charge of the marketplace would not be allowed to exchange any competitively sensitive information with the Amazon retail unit.

**3.2. Consequences for franchise systems**

**3.2.1. Facebook decision**

While the Bundeskartellamt's decision in the Facebook case is limited to private users of Facebook residing in Germany, it is conceivable that other competition authorities worldwide will follow the Bundeskartellamt's approach. Therefore, some general conclusions can be drawn from the Bundeskartellamt's case for franchisors and franchisees:

(a) First of all, the Facebook case concerns unilateral behavior. For unilateral behavior to infringe competition law, the acting company needs to have a dominant (or, in German law, at least a strong) market position. Therefore, franchisors or franchisees can only be subject to the requirements of the Facebook case if they have a dominant (or strong) market position in at least one of the markets on which they are active.

(b) If a franchisor or franchisee has a dominant market position, the following consequences can be drawn from the Facebook case:

- Infringements of laws other than competition law that protect consumers from the dominance of the business partner can constitute an abuse of a dominant position. This applies to data protection law as in the Facebook case. Yet the Bundeskartellamt, referencing the German Supreme Court, stressed in its decision that an infringement of, for example, the law on general terms and conditions can also constitute an abusive behavior.

- A private user's consent to the (excessive) collection and use of data can be invalid if it is a condition for using the service of the dominant company. It can constitute an infringement of data protection law and, as a consequence, an abuse of a dominant market position. This can be the case if (i) the company has a dominant market position and (ii) asks the users for excessive data that is not indispensable for its business model (as in the combination of data from different sources).

These types of decisions become more concerning for franchisors and franchisees, depending on how narrowly the market and market share is defined. For example, if the market is defined locally or regionally, or if the market is defined to include only those business or services offering substantially the product or service on a branded basis, this can have a material effect for determining market dominance. Obviously, the more narrow the market is defined the greater the risk is to the franchisor that he will be viewed as dominant as a result of its own success in market penetration.

### **3.2.2. Investigations against Amazon**

The investigations of the European Commission against Amazon could have consequences for franchise systems in cases where the franchisor is in direct competition with the franchisee. This is, for example, the case if the franchisor grants franchises and also operates a company-owned business in the same market that competes with the franchised location, if data is collected and used in an anti-competitive manner to benefit the company operated business versus the franchised business.

In this example, an exchange of competitively sensitive information regarding the markets in which the franchisor and franchisee are competitors, can amount to an infringement of the prohibition of cartels. Such an exchange of information can, for example, take place via an internet platform as in the Amazon case. Even if the exchange of information is necessary for the organization of the franchise system, competition authorities might ask the franchisor to ring-fence the unit in charge of the franchise system from the unit that operates its own downstream business. Ring-fencing and holding separate of the franchise unit and the downstream business unit might generally be a solution to avoid competition law concerns but this may not be a practicable solution in all circumstances. It is difficult to imagine how such a solution might be implemented in most franchise systems where both the franchisees and the company-operated units rely on the same systems and platforms, and share information.

If the franchisor has a dominant market position, for example towards its franchisees, the collection of competitively sensitive information can also constitute an abuse of such a dominant position if franchisees feel pressured to share such data. As explained above, the collection of data might be an exploitative abuse. It could possibly depending on the circumstances also be an exclusionary abuse if a dominant franchisor uses the data to favor its own downstream business to the detriment of the business of its franchisees. In particular, this might be the case if a dominant franchisor operates a website offering both its own and its franchisees' services to the customers.

### 3.3. Future developments

In the EU, the VBER provides the competition law framework for vertical business relations and, in particular, for distribution and franchise systems. The VBER and the corresponding Vertical Guidelines are currently under revision because the VBER will expire on May 31, 2022 and it seems likely that a new VBER will become effective.

Based on the results of its e-commerce sector inquiry, the European Commission is currently conducting a consultation process with interested stakeholders on the revision of the VBER. The Commission has mentioned in its Evaluation Roadmap that the role of internet platforms might be taken into consideration in the revision of the VBER. In its final report on the e-commerce sector inquiry, the Commission mentions the exchange of sensitive data on the internet as a main concern. It is an open issue as to whether there will be specific rules on internet marketplaces and data exchange in the new VBER. An expert report prepared for the European Commission that was recently published sheds some light on the direction the Commission is heading. The report indicates that novel theories of harm regarding the conduct of dominant market players in the context of strong network effects need more research. It highlights that, for internet platforms, the concept of market power needs to shift from merely being a measurement of market shares to encompass the consideration of network effects. Interestingly, the experts suggest that for platforms with double roles as operators and retailers, these platforms should bear the burden of proving that self-preferencing has no long-run exclusionary effects on product markets. They also suggest structural remedies for such platforms, namely legal unbundling, operational unbundling, informational unbundling or even ownership unbundling. As a less vigorous remedy, the Commission could, however, prescribe setting up ring-fencing mechanisms as explained above. Without further guidance involving true franchisor and franchisee relationships, insofar as these could even qualify as internet platforms that have both the role of operator and retailer, however, it is still uncertain how any of those structural remedies would work without materially affecting the operations of the typical franchise business.

In the same manner, the German legislator is currently amending the German competition law to fit it to the digital economy. One topic being discussed is the introduction of a new concept of market power of so-called intermediaries that particularly aims at internet marketplaces and social networks.

## 4. Third party platforms: Can brands legally restrict the use of internet platforms or social media by the franchisees?

### 4.1. Summary

If and under which conditions producers can restrict the use of third-party online marketplaces and social media by their distributors, is one of the most discussed questions in European competition law. The European Court of Justice (“ECJ”) recently gave guidance on this question in its Coty judgement.<sup>3</sup> It made clear that prohibitions to use third-party marketplaces in a selective distribution system are not generally prohibited by competition law. However, the scope of the judgement is unclear. Currently, it is being heavily discussed whether the judgement only applies to so-called luxury goods, or also to other goods if the characteristics of the respective goods necessitate such prohibitions (see below 3.2.).

The Coty judgment and its interpretation are also significant for the question whether franchisors can legally restrict the use of internet platforms or social media by the franchisees. While the Pronuptia

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<sup>3</sup> Case C-230/16, Coty Germany GmbH v. Parfümerie Akzente GmbH, ECJ (2017).

judgment of the ECJ<sup>4</sup> has already provided guidance for distribution<sup>5</sup> and arguably for service franchises,<sup>6</sup> the Coty judgment is of major importance for product franchises<sup>7</sup> (see below 3.3.).

The European Commission might clarify the interpretation of the Coty judgment in the revision of the VBER and of the Vertical Guidelines, in particular to counter demands for a different interpretation of the EU competition rules in different Member States (see below 3.4.).

#### **4.2. European case law and theory of harm**

While the German Bundeskartellamt has usually considered third-party platform<sup>8</sup> bans as hardcore restrictions of competition,<sup>9</sup> the ECJ took a different approach in its Coty judgment.<sup>10</sup>

The ECJ concluded that third-party marketplace bans can be compliant with competition law, if they fulfill the criteria for the competition law compliance of selective distribution systems (the so-called Metro criteria<sup>11</sup>). Applying these criteria, a selective distribution system is compliant with European competition law,<sup>12</sup> if:

- resellers are chosen based on objective criteria of a qualitative nature;
- these criteria are uniformly laid down for all potential resellers and are applied in a non-discriminatory fashion;
- the characteristics of the product in question necessitate a selective distribution system in order to preserve its quality and to ensure its proper use;
- and the criteria laid down do not go beyond what is necessary.

The Coty case concerned third-party platform bans for luxury perfume products. The Court stated that the quality of luxury goods does not only result from their material characteristics, but also from the aura of luxury resulting from the allure and prestigious image of such products.<sup>13</sup> The prohibition against selling these products on non-authorized third-party platforms<sup>14</sup> is appropriate and does not go beyond what is necessary to achieve the objective of preserving the luxury image of the products in question. First, such prohibitions provide the supplier with a guarantee that the luxury goods will be exclusively associated with the authorized distributors. Second, it enables the supplier of luxury goods to check that the goods will be

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<sup>4</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis, ECJ (1986).

<sup>5</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 13, ECJ (1986).

<sup>6</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 13, ECJ (1986).

<sup>7</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 13, ECJ (1986).

<sup>8</sup> In line with the Coty Case, our following analysis is based on third-party platforms that are discernible for consumers.

<sup>9</sup> Bundeskartellamt [Federal Cartel Office], Aug. 26, 2015, B2-98/11 (“Asics”) at para. 252 (2015).

<sup>10</sup> Case C-230/16, Coty Germany GmbH v. Parfümerie Akzente GmbH, ECJ (2017).

<sup>11</sup> Case 26-76, Metro SB-Großmärkte GmbH & Co. KG v. Commission of the European Communities, ECJ (1977).

<sup>12</sup> Note, that selective distribution systems can also be exempted if they do not meet these criteria, but other conditions of the Commission Vertical Block Exemption Regulation are fulfilled, that is, particularly if the threshold of 30 % market share is not exceeded.

<sup>13</sup> Case C-230/16, Coty Germany GmbH v. Parfümerie Akzente GmbH at para. 51, ECJ (2017).

<sup>14</sup> In Coty however, the Court only had to decide on the effects of platforms that were discernible to others as third-party platforms. An application of the Court’s findings thus requires the existence of such a platform.

sold online in an environment that corresponds to the qualitative conditions that it has agreed to with its authorized distributors. The online sales of luxury goods via platforms that do not belong to the selective distribution system involve the risk of deterioration of the online presentation of those goods, which is likely to harm the luxury image and thus their very character. Third, online marketplaces constitute a sales channel for goods of all kinds. Therefore, the fact that luxury goods are not sold via such platforms (but only in authorized online shops) contributes to the luxury image among consumers.<sup>15</sup>

In addition, the ECJ held that platform bans do not constitute hardcore restrictions of competition in the sense of the VBER. They are not a restriction of passive sales to a certain group of customers.<sup>16</sup>

Customers who buy products on third-party platforms are not a distinguished group of customers within the group of online purchasers.<sup>17</sup> Furthermore, the third-party platform bans do not constitute a restriction of members of a selective distribution system to passively sell the products to end-users.<sup>18</sup> This is at least the case if authorized distributors are able (under certain conditions) to advertise on the internet on third-party platforms and to use online search engines with the result that customers are usually able to find the online offer by using such engines.<sup>19</sup>

However, the exact interpretation of this judgment is still subject to various discussions. First, it is unclear as to whether the judgment only applies to luxury goods or also to other products that necessitate a selective distribution system to preserve their quality and ensure their proper use.<sup>20</sup> Since the Court explicitly applied the Metro criteria in the Coty case, the arguments for the latter interpretation, *i.e.* no limitation of the judgment to luxury goods, prevail in our opinion. It is likely that there are high quality products other than luxury goods that require platform bans to preserve their quality and reputation and to ensure their proper use.

Second, some infer from the Court's judgment the conclusion that, while third-party marketplace prohibitions can be admissible, the combination of third-party marketplace prohibitions with additional restrictions of online sales might amount to an inadmissible "prohibition to be found on the internet".

There are statements that, in Germany, a prohibition of the use of third-party marketplaces as such (without further restrictions of online sales) might amount to an inadmissible "prohibition to be found on the internet". The reason is the importance of third-party marketplaces in Germany. In its e-commerce sector inquiry, the European Commission found that 62% of the German retailers questioned in the sector inquiry used online marketplaces, whereas, for example, only 4% of the retailers in Belgium did so.<sup>21</sup>

Yet there are very strong arguments against this approach. Classifying prohibitions to use third-party marketplaces as hardcore restrictions in one EU Member State, but not in the other, would endanger the unity of the legal system in the EU and might even be detrimental to the internal market.

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<sup>15</sup> Case C-230/16, *Coty Germany GmbH v. Parfümerie Akzente GmbH* at para. 50, ECJ (2017).

<sup>16</sup> Commission Regulation 330/2010 Article 4c (Vertical Block Exemption Regulation).

<sup>17</sup> Case C-230/16, *Coty Germany GmbH v. Parfümerie Akzente GmbH* at 53, ECJ (2017).

<sup>18</sup> Commission Regulation 330/2010 Article 4c (Vertical Block Exemption Regulation).

<sup>19</sup> Case C-230/16, *Coty Germany GmbH v. Parfümerie Akzente GmbH* at 67, ECJ (2017).

<sup>20</sup> See *i.e.* Pautke/Schultze, *WuW* 2019, 2, at p. 9.

<sup>21</sup> European Commission, *Final report on the E-commerce Sector Inquiry*, page 11, available at [http://ec.europa.eu/competition/antitrust/sector\\_inquiry\\_final\\_report\\_en.pdf](http://ec.europa.eu/competition/antitrust/sector_inquiry_final_report_en.pdf).

### 4.3. Consequences for franchise systems

The Coty judgment and its interpretation are also important for the question whether franchisors can prohibit the use of third-party marketplaces or social media by their franchisees.

Regarding service and distribution franchises (as for example hotels, restaurants, etc.), there are good arguments that such restrictions are compliant with European competition law anyway and independent of the current Coty discussion, at least if they do not amount to a “prohibition to be found on the internet”.

In 1986, the ECJ already decided that, in the case of distribution franchises (that should apply to service franchises accordingly), the franchisor must be able to take the measures necessary for maintaining the identity and reputation of the franchise system bearing its business name or symbol. Thus, provisions which establish the means of control necessary for that purpose do not constitute restrictions of competition.<sup>22</sup>

In its 1986 judgment, the Court made clear that the franchisor can ask the franchisee to sell only from premises laid out and decorated according to the franchisor’s instructions. The same applies to the location of the shop, the choice of which is also likely to affect the franchise system’s reputation.<sup>23</sup> In our opinion, this reasoning can be applied to online marketplaces accordingly as the virtual “premises of sales”. Therefore, we think that the Coty criteria do not necessarily have to be fulfilled, if a franchisor prohibits the use of third-party platforms in a distribution or service franchise.

We believe this also applies to restrictions of online advertising (e.g. via social media). The Court stated in its Pronuptia judgement that a provision requiring the franchisee to obtain the franchisor’s approval for all advertising is also essential to the maintenance of the network’s identity, if that provision only concerns the nature of advertising. In this case, the provision does not restrict competition. Consequently, the franchisor must be allowed to also prohibit the franchisee from certain forms of online advertising.

However, if the franchisor imposes provisions that amount to a “prohibition to be found on the internet” on the franchisees, this might exceed the permissible scope and constitute hardcore restrictions of competition.

The Pronuptia case law only applies to distribution franchises.<sup>24</sup> However, there are good arguments that it applies to service franchises. Service franchises (such as hotel and restaurant franchises) and distribution franchises are very similar in the setting-up of a distribution network under the business name and symbol of the franchisor.

The situation is, however, different with product franchises. The interests of the product franchisor regarding the reputation of its brand can be compared to the interests of brand owners that produce under this brand. Both the franchisor and the producer are interested in keeping up the image and the reputation of the brand and of the branded product. This image should not be damaged by distribution channels that neither represent nor ensure high quality. Therefore, there are good arguments to apply the Coty criteria to product franchising.

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<sup>22</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 17, ECJ (1986).

<sup>23</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 19, ECJ (1986).

<sup>24</sup> Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis at para. 13, ECJ (1986).

#### 4.4. Future developments

As explained above, the interpretation of the Coty judgment is still subject to various discussions. There are even ideas for differentiating the competition law classification of third-party marketplace bans depending on the Member States where they are applied. Such tendencies are a risk to the unity of the legal system in Europe and to the internal market. The Commission will hopefully take the chance to clarify its approach to third-party platform bans in the future VBER that is likely to become effective on June 1, 2022.

### 5. Best Price Clauses (also referred to as pricing parity clauses) - What are best price clauses and what is the impact of these clauses on franchise chains?

#### 5.1. Summary

Best price clauses are traditionally evaluated based on their breadth and competitive effect. Most of the case law has focused on wide and narrow best price clauses related to third-party platforms.

Wide best price clauses obligate a seller on a platform to always offer the lowest prices for customers on this platform. This implies that the respective seller is neither allowed to offer lower prices on third-party platforms nor on its own website.<sup>25</sup>

A narrow best price clause, on the other hand, is one where a third-party platform prohibits the seller from selling the products for lower prices on its own websites than the third-party platform (while it is permitted to sell its products for lower prices on other third-party platforms).<sup>26</sup>

Third-party hotel reservation platforms that use best price clauses have been investigated by European competition authorities. While some authorities consider only wide best price clauses problematic, the German Bundeskartellamt has also prohibited narrow best price clauses by third-party hotel reservation platforms with market shares of more than 30% (see below 4.2).

Franchise systems in the hotel market, and also in other markets, may be subject to best price clauses by third-party internet platforms. Against this background, the different approaches of European competition authorities to best price clauses are relevant for franchisors and franchisees (see below 4.3).

From a competition perspective, these circumstances are distinguishable from brand companies that require, for purposes of their loyalty programs and as a condition of participating in the brand, that the franchisee offer prices that are not higher on the brand's website than it offers on other third-party platforms. The intent being that the consumer should be able to rely on purchasing on the brand's website that it will not pay more by purchasing on the brand's website than if it goes to a third-party platform. These branded rate guarantee programs in the hotel industry typically offer the consumer the right to be paid back the difference if the price at which the consumer books is higher on the branded website than the amount that a comparable room is booked at the same time on other third-party platforms. For purposes of brand integrity, it is important to the relationship of the brand and the consumer that the consumer can trust the

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<sup>25</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13, at para. 22 (2015) *available at* [https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Kartellverbot/2015/B9-121-13.pdf?\\_\\_blob=publicationFile&v=4](https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Kartellverbot/2015/B9-121-13.pdf?__blob=publicationFile&v=4).

<sup>26</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para. 8 and 29 (2015).

pricing buying the product directly. These programs typically apply to both franchised and company-operated hotels on an equivalent basis.

It seems possible that the European Commission will use the revision of the VBER and of the Vertical Guidelines to clarify the competition law classification of best price clauses to restore the unity of the interpretation of EU competition law (see below 4.4).

## **5.2. European case law and theory of harm**

There are different approaches by European competition authorities and legislators to deal with best price clauses.

In general, wide best price clauses are considered anti-competitive, at least if they are applied by a platform whose market share exceeds 30%.

Wide best price clauses can cause the following restrictions of competition (in the following, we use the examples of best price clauses on hotel reservation third-party platforms in order to illustrate the theories of harm):

First, best price clauses may restrict competition in the market of hotel reservation third-party platforms. Best price clauses prohibit hotels from offering lower prices on other platforms. If the other platform providers lower the commissions, hotels cannot pass on these cost savings in the form of lower prices to customers on these other platforms. This reduces the incentive for other platform providers to lower their commissions, because it does not make their platform more attractive to customers in the form of lower hotel prices.<sup>27</sup> Therefore, best price clauses can also lead to barriers to market entry. New providers of hotel reservation platforms would not be able to make their platform attractive for customers offering lower hotel prices to guests.<sup>28</sup>

Second, best price clauses can restrict competition in the markets for hotel rooms. The restrictive clauses of some of the third-party platforms prohibit hotels from offering rooms for cheaper prices either on their own websites or on other third-party platforms. In this regard, it must be considered that hotels must pay commission for third-party platforms. Not being able to offer cheaper prices on their own websites might therefore generally raise the price level on the market.<sup>29</sup>

The German Bundeskartellamt even considers narrow best price clauses restrictive of competition. It believes they can have similar effects as wide best price clauses. For the Bundeskartellamt, third-party platforms that prohibit hotels from offering cheaper prices on their own websites is deemed a restriction of competition. This might also impede them from offering cheaper prices on third-party platforms in the Bundeskartellamt's opinion.<sup>30</sup>

However, if the market shares of both the third-party platform and the hotel do not exceed 30%, one can argue that best price clauses are block-exempted from the prohibition of cartels by the VBER. The German OLG Düsseldorf decided that a hotel must be regarded as a supplier in the sense of the VBER and

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<sup>27</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para. 167 and 214 (2015).

<sup>28</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para. 167 (2015).

<sup>29</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para 10 (2015).

<sup>30</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para 192 (2015).



that the platform is the buyer. The buyer, in the sense of the VBER, can also be an undertaking which sells goods or services on behalf of another undertaking, as in, the platform sells the rooms on behalf of the hotel. Since the VBER generally allows restrictions of the supplier, best price clauses are block-exempted from the prohibition of cartels in Article 101 TFEU if the market share threshold of 30% is not exceeded.<sup>31</sup>

On the contrary, if the market shares are exceeded, it is questionable if an individual exemption from the prohibition of cartels is possible. The Bundeskartellamt concluded,<sup>32</sup> which was then confirmed by the OLG Düsseldorf,<sup>33</sup> that there is no evidence of efficiencies that justify best price clauses in case of the Booking and HRS platforms. In particular, the Bundeskartellamt alleges that best price clauses are not indispensable for avoiding free rider problems. A free rider problem might arise if hotels use the hotel reservation platform only for advertising and offer cheaper prices on their own websites so that the customer will not make a reservation on the third-party platform. Consequently, the hotel would not have to pay a commission to the platform if the consumer booked direct. In the Bundeskartellamt's opinion, the parties can solve this free rider problem by using a different price mechanism that does not link the fees paid by the hotels for using the reservation platforms to only the successful sale of hotel bookings on this platform.

European competition authorities and legislators have chosen different approaches to deal with best price clauses. The Bundeskartellamt considers both wide and narrow best price clauses an infringement of the prohibition of cartels, if the conditions of the VBER are not fulfilled.<sup>34</sup>

The Italian, the Swedish and the Polish competition authorities, however, only prohibit wide best price clauses and not narrow best price clauses. The Austrian and the French legislators try to tackle the issue by means other than competition law, namely the Law on Unfair Trade Practices in Austria and Civil Contract Law in France. The Italian legislator lately passed a law similar to the Civil Contract Law solution in France.<sup>35</sup>

### **5.3. Consequences for franchise systems**

Franchise systems in the hotel sector (but also in other markets) that face best price clauses encounter the difficulty of different approaches and rules in Europe. Successful legal defense against best price clauses, required by third-party platforms, depends on (i) where the respective hotels are located (or where the respective services and goods are sold); (ii) the different relevant laws in the different Member States concerned; (iii) the different approaches of national competition authorities and courts; and (iv) the market shares of the parties. This leads to legal uncertainty in the EU and to the necessity of assessing the admissibility of best price clauses in every single case.

### **5.4. Future developments**

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<sup>31</sup> Oberlandesgericht Düsseldorf [Higher Regional Court Düsseldorf], December 4, 2017, VI-U (Kart) 5/17, U (Kart) 5/17 at para. 34 (2017) (Expedia).

<sup>32</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para. 254 (2015).

<sup>33</sup> Oberlandesgericht Düsseldorf [Higher Regional Court Düsseldorf], May 4, 2016, VI-Kart 1/16 (V), starting in para. 101 (2016).

<sup>34</sup> Bundeskartellamt [Federal Cartel Office], Dec. 22, 2015, B 9-121/13 at para. 18 (2015).

<sup>35</sup> Augenhöfer/Schwarzkopf, Bestpreisklauseln im Spannungsfeld europäischen Kartellrechts und mitgliedstaatlicher Lösungen, NZKart 2017, 446, p. 447.

The different national approaches to best price clauses in the European Union are detrimental to both the sellers and the platforms. They jeopardize the unity of the EU legal system and lead to legal uncertainty.

It may be beneficial if the European Commission uses the revision of the VBER and of the Vertical Guidelines to clarify how best price clauses are to be dealt with under European competition law by the different national authorities in order to create certainty in the market. The expert report “Competition policy for the digital era” highlights that effects of best price clauses strongly depend on the particular effects of the market they are used on, suggesting a case-by-case analysis. Weak competition could justify the prohibition of wide and narrow best price clauses. In markets with vigorous competition however, it could only be justified to prohibit wide clauses.

## 6. Influencers and social media

Social media fundamentally changed the way consumers search, find and trust information sources.<sup>36</sup> Brands in the make-up, food and beverage, clothing, hotel, restaurant and virtually every sector now use social media in their strategy for brand development. These sophisticated brand strategies seek so-called ‘influencers’ and brand ambassadors to enhance the brand’s image and the popularity to influence customer behavior. In these strategies, specific target audience groups are defined well in advance, and most brands work with multiple influencers to influence different target audiences. In light of these changes, there is a need to act against unwanted social media involving your brand by third parties, or by your own multi/mono brand retailers. In particular regarding the latter situation, it is helpful for both franchisors and franchisees to have in place social media guidelines, for example in selective distribution or a franchise network.

While there are EU rules on advertising, such as prohibiting misleading advertising and unfair trade practices, laws in the EU do not contain specific legislation on influencers and social media. Most of these rules are based on the principle that advertisements may not be misleading. This principle was raised recently when representatives of online platforms, leading social networks and the advertising industry agreed on a self-regulatory Code of Practice to address the spread of online disinformation. To give another example, there is Dutch law on advertising (Article 6:194 of the Dutch Civil Code) and unfair trade practices (Articles 6:193a until j of the Dutch Civil Code), which is largely an implementation of EU law. More recently, some specific national laws and/or practices on the permissibility of influencing have been implemented. In the Netherlands, the Advertising Code Committee has introduced a system of self-regulation, the Dutch Advertising Code, which contains a subcode applicable to influencing.

The Advertising Code Social Media<sup>37</sup> contains several rules on social media advertising. Often an advertiser (the brand) asks the distributor (the blogger or influencer) to present or mention its product or service in exchange for a financial compensation or other advantage. This is called influencer marketing. According to the Advertising Code Social Media, it must at least be clear that it concerns advertising. In case of a Relevant Relationship (Article 2 sub d of the Advertising Code Social Media), the advertisement must be recognizable, and the distributor must state the compensation received (Article 3 Advertising Code

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<sup>36</sup> Evangelos Christou, *Social Media in Travel, Tourism and Hospitality*, 2-12 (2012).

<sup>37</sup> Dutch Advertising Code Social Media available at <https://www.reclamecode.nl/nrc/pagina.asp?paginaID=289%20&deel=2> (in Dutch).

Social Media). Sometimes it is unclear whether it concerns advertising for which the blogger or influencer got remunerated or whether a product or brand is visible coincidentally. In the first case the influencer must explicitly mention this. Depending on the social medium, this can be done by using hashtags as #spon or #adv. or by literally saying that product X has been received from brand Y. Article 3 of the Advertising Code Social Media offers suggestions for clearly identifying the content and nature of the Relevant Relationship.

## 7. Recent and future developments in (digital) franchise

Technology has influenced virtually every consumer sector. It affects how consumers choose their hotels, book flight tickets, make restaurant reservations and buy a cup of coffee, a car, make-up or a new pair of jeans. The growth of e-commerce is an opportunity for business development and affects how businesses manage their relationships with their consumers. The move to online platforms enable franchise systems to remain competitive but presents challenges regarding maintaining a system uniform, giving protected territories, and monitoring franchisee activity.

There are a number of specific do's and don'ts of e-commerce and omni-channel for brands and franchisors and franchisees.

A franchisor may have a concept of how its branded services and products should be perceived, but consumers now have ready access to actual ratings provided by other customers, putting increasing pressure on locations that underperform. Products and services are now more likely to be selected online – whether on a home computer or a mobile app – often eliminating the impact of a particular location, and channelling customers through reviews and competitive pricing. Customers are selecting businesses not because they just happened to drive by, but because they know in advance that they are likely to have a positive experience.

Given the above referenced changes, franchise concepts should pay more attention to digital initiatives, digital marketing, data protection, and security compliance and the role of third party platforms. In this regard, franchisors and franchisees should also pay attention to, cooperate and implement strategies regarding big data, use of algorithms, comparative advertising, dynamic pricing and ambient intelligence. To safeguard the uniformity and quality of the franchise concept, it is important that franchisors safeguard the franchisees' online presence to ensure that these shops offer the same consumer experience, and look and feel, as a franchisor's. Franchisors can create clear quality requirements for the websites of franchisees. To adapt franchise concepts to the growth of e-commerce, franchisors should come up with initiatives on connecting consumers' physical and digital worlds to create a seamless omni-channel customer experience, and to involve franchisees in a meaningful way in this process. To avoid conflicts about the revenues that will be earned through online sales and initiatives and seamless omni-channel customer experiences, franchisors and franchisees should make clear arrangements regarding these topics.

Conflicts may arise between franchisors and franchisees regarding "e-commerce". Franchisees sometimes have claimed a share of the earnings made online by the franchisor. In certain instances the franchisee can be qualified as a 'commercial agent' for the franchisor and can be paid a commission for this sale.<sup>38</sup> In order to regain control over brand image, reputation and pricing of products, some franchisors

<sup>38</sup> Martine de Koning and Hester de Vries, *Wat is de Impact van de Algemene Verordening Gegevensbescherming van de EU op internationale franchiseovereenkomsten*, Contracteren, Jan. 2018 at 21.

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have implemented 'genuine' agency or commissionaire models to replace existing franchise networks in Europe.<sup>39</sup> From the guidelines to the EU vertical restraints block exemption regulation it follows that certain types of agency fall outside the cartel prohibition (in the past the term 'genuine' agency was frequently used). The rule applies, if the agent is sufficiently integrated in the undertaking of the principal, as established by the fact that it bears all financial and commercial risks. The supplier may then maintain the resale price and determine the other commercial and legal terms applied by the retailer. The supplier may in 'genuine' agency or commissionaire situations, prohibit or keep for himself internet sales. The agent or commissionaire bears no or only insignificant risks and earns a commission for intermediary services he provides. Clearly, the retailer loses his status as an independent entrepreneur, because he sells for the account and risk (but in the case of commissionaire, not in the name) of the principal. This provides the supplier precisely the control over the brand and the interfacing with the consumer that it may find crucial to maintain the brand image in the digital market. Of course, the mandatory civil laws on commercial agents may be applicable, depending on the qualification of the agreement.<sup>40</sup> While commissionaire and other agency models were less prevalent in the market in the past decades, they have resurrected since the rise of e-commerce and omni-channel.

Sometimes, overcoming the challenges posed by the new economy may cause friction, when control over the direction and vision of the brand and/or profit models are concerned. To avoid conflicts, franchisors and franchisees should make clear arrangements regarding e-commerce, in particular the revenue and profit (sharing or not) models for online purchasing. For example, it could in specific circumstances be a good idea to negotiate that a franchisee gets a commission or service fee for services performed for the franchisor's direct online sales to customers. Or, in the case of an exclusive territory, it could be negotiated that the franchisee will receive a portion of franchisor's earnings of online orders of consumers in the territory of the franchisee. Any such arrangements may qualify as commercial agency within the meaning of EU law as implemented in its members states, even if the main agreement is a license or franchise agreement. Therefore, an analysis of its proper qualification, proper drafting and negotiating is helpful, even though some consequences of such qualification, such as mandatory goodwill compensation, may not be possible to contract away from if the agent is situated in the EU.

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<sup>39</sup>Commission Regulation 330/2010 of Apr. 20, 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practice OJ (L 102) and Commission Notice (Guidelines on Vertical Restraints) of May. 19, 2010 (Guidelines on Vertical Restraints (C 130)).

<sup>40</sup> Council Directive on the coordination of the laws of the Member States relating to self-employed commercial agents ((EEC) 86/653), 18 December 1986, OJ (L 382/17).