II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 14 November 1988

relating to a proceeding under Article 85 of the EEC Treaty

(IV/32.358 — ServiceMaster)

(Only the English text is authentic)

(88/604/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty [1], as last amended by the Act of Accession of Spain and Portugal, and in particular Articles 4, 6 and 8 thereof,

Having regard to the application for negative clearance and notification submitted on 3 June 1987 by ServiceMaster Limited (England) of a standard form franchise agreement concerning the provision of housekeeping, cleaning and maintenance services in the Community,

Having regard to the summary of the application and notification published [2] pursuant to Article 19 (3) of Regulation No 17,

After consulting the Advisory Committee on Restrictive Practices and Dominant Position,

Whereas :

I. THE FACTS

(1) ServiceMaster has notified a standard form service franchise agreement for use in all the EEC Member States. The agreement concerns the supply of housekeeping, cleaning and maintenance services to both commercial and domestic customers. ServiceMaster has applied for a negative clearance or alternatively an exemption decision under Article 85 (3) of the Treaty.

(2) Following observations made by the Commission, ServiceMaster has agreed to make certain amendments to its notified agreement. The amended agreement was communicated to the Commission on 10 May 1988.

(3) Reference is made to the notice published pursuant to Article 19 (3) of Regulation No 17 [3], for a more extensive description of the ServiceMaster franchise system and its relevant clauses which are mentioned of discussed hereinafter only in so far as is necessary for the reasoning of the Commission. The facts set out in the Article 19 (3) notice form part of this Decision.

(4) The Commission did not receive any observations from interested third parties following publication of the said notice.

II. LEGAL ASSESSMENT

A. Article 85 (1)

(5) The franchise network set up by ServiceMaster by means of the notified standard form agreement is a service franchise ; it concerns the supply of housekeeping, cleaning and maintenance service to commercial and domestic customers according to the instructions of ServiceMaster and, on an ancilliary basis, the supply of goods directly linked to the provision of those services. The Service-

[1] OJ No 13, 21. 2. 1962, p. 204/62.
[2] OJ No C 218, 20. 8. 1988, p. 3.

[3] And notified annexed to the present Decision.

Master franchise includes a uniform presentation of the contract services based on the use of a common name, a substantial pacage of technical, commercial and administrative know-how relating to the provision of the services and continuing assistance provided by ServiceMaster. The franchisees are proprietors of their businesses, which they operate for their own account and at their own risk. In exchange for the right to exploit a ServiceMaster franchise and certain ServieMaster intellectual property rights related to trade marks and copyrights, the franchisees have to make various financial contributions and are bound by obligations aimed a preserving the uniformity and quality standards of the ServiceMaster system.

(6) The Commission considers that, despite the existence of specific matters, service franchises show strong similarities to distribution franchises and can therefore basically be treated in the same way as the distribution franchises already exempted by the Commission (1). This basic premise relies on the fact that the EEC competition rules apply without distinction to both products and services. This does not prevent the Commission from taking into account in individual cases certain specific characsteristics relating to the provision of services.

In particular, know-how is often more important in the apply of service than in the supply of goods because each service requires the execution of particular work and creates a close personal relationship between the provider of the service and the receiver of the service. Therefore, the protection of the franchisor's know-how and reputation can be even more essential for service franchises than for distribution franchises where mainly the goods advertise the business by carrying the trademark of the producer or distributor. Also certain services, as for instance the ServiceMaster services, are executed at the customer's premises, while goods are usually sold at the premises of the retailer. Services of this type further reinforce the link between the provider of the services and the customer.

Provisions not falling within Article 85 (1)

The following provisions of the ServiceMaster franchise agreement do not fall within Article 85 (1).

(1) See Commission Decision 87/407/EEC, Computerland (OJ No L 222, 10. 8. 1987, p. 12); 87/14/EEC, Yves Rocher (OJ No L 8, 10. 1. 1987, p. 49); 87/17/EEC, Pronuptia (OJ No L 13, 15. 1. 1987, p. 39).

(a) *Provisions aimed at preventing the know-how and other assistance given by the franchisor from benefiting competitors.*

(7) The franchisee's obligation to preserve, before and after the termination of the agreement, the secrecy of all information and know-how and to impose a similar obligation on his employees. The commercial value of know-how is dependent on its secrecy. The obligation not to disclose the know-how is a necessary condition for maintaining such value and for enabling ServiceMaster to grant it to other potential franchises.

(8) The franchisee's obligation to use the know-how and intellectual property rights licensed solely for the purposes of exploitation of the ServiceMaster franchise. This field-of-use restriction is necessary to protect the franchisor's know-how because it lends itself to use with competitive services provided by either the franchisee or other competitors.

(9) The franchisee's obligation, after termination of the agreement, to cease using the know-how package of ServiceMaster unless this know-how package as a whole has fallen into the public domain otherwise than in breach of obligation. This post-term use ban on know-how is essential for the protection of the franchisor's right to this know-how. As long as its know-how has not become accessible to the public, the franchisor has the right to limit the transfer thereof to a fixed period of time, in this case to the lifetime of the franchise agreement. If the franchisor lost the exclusive right to make use of its know-how after expiry of the franchise agreement, it could not prevent competitors from using its know-how.

(10) The franchisee's obligation, during the term of the agreement, not to be engaged in a competing business, except through the acquisition of a financial interest not exceeding 5 % in the capital of a publicly-quoted company. This non-competition obligation is necessary to avoid the risk that the know-how supplied by ServiceMaster to its franchisees might benefit competitors, even indirectly. The limitation of the acquisition of a financial interest in a publicly-quoted ccompany to 5 % of the share capital is intended to ensure that the franchisees do not become involved in the operation of such a company, with the risk of transferring know-how to a competing business. Although the prohibition against acquiring

non-controlling financial interest in the capital of a competing publicly-quoted company can be a restriction of competition falling within Article 85 (1), in this particular case it is not considered to be an appreciable restriction because the franchisees are generally small undertakings for which the prohibition against acquiring more than 5 % of a publicly-quoted company does not normally constitute a real hindrance in the development of their own activities. Furthermore, the franchisees are completely free in the acquisition of financial interests in non-competing companies.

(11) The franchisee's obligation, after the termination of the agreement, not to be engaged, for a period of one year, in a competing business within any territory within which he has provided services prior to the termination of the agreement. In addition, the franchisee may not solicit, for a period of one year, customers who have been, during the period of two years prior to the termination of the agreement, his customers.

This post-term non-competition and non-solicitation obligation is acceptable both as regards its duration and its geographical extent. This obligation is necessary to prevent the ex-franchisee from using the know-how and clientele he has acquired for his own benefit or for the benefit of ServiceMaster's competitors. It is further necessary to allow ServiceMaster a limited time period to establish a new outlet in the ex-franchisee's territory. This assessment does not prejudice any relief available to franchisees under national law upon termination of the contract.

(12) The prohibition on the franchisee against selling the franchised business or against assigning the franchise agreement to a third party without ServiceMaster's approval. This prohibition is clearly indispensable to protect the know-how and assistance provided by the franchisor.

(b) *Provisions which allow the franchisor to safeguard the common identity and reputation of the franchise network*

(13) The franchisee's obligation to use ServiceMaster's know-how and to apply the trading methods developed by ServiceMaster is an obligation which is inherent in the franchise system and ensures the standards of uniformity and quality of the franchise network.

(14) The franchisee's obligation to communicate to ServiceMaster any improvements he makes in the operation of the business. This grant-back obligation is made on a non-exclusive and reciprocal basis. It will improve the efficiency of the ServiceMaster franchise network by creating a free interchange of improvements between all franchisees.

(15) The franchisee's obligation to obtain ServiceMaster's prior approval for the location his franchise premises. This obligation is necessary to ensure that a bad choice does not damage the reputation of the network which is a concern of the whole franchise network.

(16) The franchisee's obligation to devote the necessary time and attention to the ServiceMaster business and to use his best endeavours to promote and increase the turnover of that business. This promotion obligation is intended to oblige the franchisee to concentrate his efforts on the development of his business. This obligation is acceptable in the light of the concern to preserve the reputation and uniform identity of the network by creating an efficient franchise system devoting all its efforts to the provision of the ServiceMaster services.

(17) The franchisee's obligation to purchase certain cleaning equipment and certain chemicals used in the operation of the business from ServiceMaster or other suppliers nominated or approved by ServiceMaster. This purchase obligation is essential for the efficient working of the business and acts as a form of quality control. The obligation does not prevent franchisees from obtaining supplies of equipment and goods of equivalent quality from third-party suppliers. ServiceMaster will not withhold its approval of suppliers proposed by franchisees if the goods of those suppliers chemicals, the requirements of safety, non-toxicity, biodegradability and effectiveness. The franchisee is also free to purchase the required goods from any other ServiceMaster franchisee.

(18) The franchisee's obligation to obtain the approval of ServiceMaster for the carrying-out of advertising. This control concerns the nature of advertisements, but not selling prices, with the object of ensuring conformity with the ServiceMaster brand image.

(19) The franchisee's obligation to submit to inspections of his premises by ServiceMaster and to present financial statements. This obligation allows the franchisor to verify whether the franchisee is operating in accordance with the ServiceMaster methods of operation and is fulfilling his financial obligations. In so far as this right of inspection is not abused to discipline franchisees in their sales activities outside their own territory or in the determination of their sales prices, it cannot be considered restrictive of competition.

(c) *Other provisions*

(20) The recommendation of sales prices to franchisees is not a restriction of competition since franchisees remain entirely free to determine their own prices for the supply of services and home-care products.

(21) The franchisee's obligation to resell home care products only with the consent of ServiceMaster and only to customers serviced by the franchisee. This restriction on the resale of home-care products is based on the legitimate concern that the franchisee must concentrate on his primary business which is the provision of services, rather than the resale of goods.

Provisions falling within Article 85 (1)

The following provisions of the ServiceMaster franchise agreement fall within Article 85 (1).

(22) The combined effect of the clause which prohibits the franchisee from setting up further outlets outside his own territory, and the territorial protection clause which prevents the franchisee from actively seeking customers outside his territory, results in a certain degree of market-sharing between the franchisees, thus restricting competition within the ServiceMaster network.

This territorial protection is, however, limited by two elements : the franchisee holds a non-exclusive right only within his territory with regard to ServiceMaster itself and each franchisee is entitled to provide services to non-solicited customers outside his territory.

(23) Trade between Member States is affected by the prohibition imposed upon franchisees against setting up outlets in other Member States and against actively seeking customers in territories of franchisees of other Member States. These prohibitions lead to market-sharing between the franchisees of the different Member States. This effect on intra-Community trade is likely to be appreciable. ServiceMaster has notified a standard form agreement which it will use for the establishment of a European-wide franchise network. At the present time, ServiceMaster is only developing this network. However, when assessing the appreciable effect on trade between Member States the Commission must also take into account the likely future development of such a network. In this respect it must be considered that ServiceMaster is an important competitor in the market which is capable of setting up a great number of outlets throughout the EEC as it has done before in the United States and Canada where ServiceMaster has over 2 900 franchisees. ServiceMaster already has a 6 % market share in the United Kingdom and reckons that its EEC market share will exceed 5 % in the near future. Given this context, the Commission considers that there exists a sufficient probability that the restrictions contained in the notified standard form agreement are, at the least, such as to affect intra-Community trade appreciably. The notified standard form franchise agreement therefore falls within Article 85 (1). It is thus necessary to examine whether that agreement can be granted an exemption under Article 85 (3).

B. Article 85 (3)

(24) The ServiceMaster standard form franchise agreement contributes, through the combined effect of all its provisions, to improving the supply of the services concerned for the following reasons :

— it helps ServiceMaster rapidly to penetrate new markets with only limited investments, in this case the markets of all 12 Member States,

— this rapid development of a European-wide service network increases inter-brand competition with other service providers in the various markets concerned,

— it helps a great number of small undertakings to enter a new market by allowing them to set up outlets more rapidly and with a higher chance of success because they receive the benefit of ServiceMaster's name and reputation, and of its technical, commercial and administrative know-how,

— it permits an intensive servicing of customers through the personal commitment of independent traders.

(25) The ServiceMaster standard form franchise agreement allows consumers a fair share of the benefit resulting from the above improvements in the supply of services. First, the network as a whole is intended to provide a better and uniformly high-quality service to consumers. Secondly, as already mentioned in the preceeding paragraph, consumers will benefit from the efficient service which the franchisee will be encouraged to provide as an independent trader who has a personal and direct interest in the success of his business. Thirdly, the freedom which consumers enjoy to obtain services elsewhere in the network will force franchisees to pass on to consumers a reasonable part of the benefits of this intra-band competition. Finally, because of strong inter-brand competition, the franchisees can be excepted to offer better services and prices.

(26) The provisions falling within Article 85 (1) are indispensable to the establishment and existence of the franchise network : the limited territorial protection granted to the franchisees is necessary to obtain and protect their investment, comprising

inter alia the cost of the establishment and maintenance of the business premises, the payment of the initial franchise fee, the acquisition of the necessary means of transport for the carrying out of the services at the customers' premises and the acquisition of special equipment. The limited territorial protection is also necessary to ensure that the franchisees will concentrate their service activity on their own territory. On the other hand, the franchisees retain passive service rights in other territories and remain free in the determination of their sales prices.

(27) The ServiceMaster standard form franchise agreement does not afford its members the possibility of eliminating competition in respect of a substantial part of the services concerned.

The inter-brand competition in the market concerned is both very strong and open : the market for cleaning, housekeeping and maintenance services is highly competitive, with a large number of firms supplying similar or identical services. It is also a market with no barriers to entry, with the result that new suppliers can at any time challenge any attempt by ServiceMaster or its franchisees to increase their prices.

Intra-brand competition within the ServiceMaster network itself is also preserved : the limited territorial protection does not grant the franchisees any marketing or customer exclusivity. Franchisees are free to provide services to non-solicited customers resident outside their own territory. This brings about a certain degree of price competition between franchisees, who are free to determine their sales prices.

(28) The notified agreement therefore meets all the requirements for an exemption under Article 85 (3).

C. Articles 6 and 8 of Regulation No 17

(29) The agreement as notified by ServiceMaster on 3 June 1987 contained a number of provisions which did not fulfill the conditions for an exemption, in particular provisions relating to the territorial protection which originally excluded any intra-brand competition between franchisees. Following observations made by the Commission, ServiceMaster agreed to make a certain number of amendments to its agreement. ServiceMaster communicated the amended agreement to the Commission on 10 May 1988. Therefore, the date on which the exemption can take effect is the date of communication of the amended agreement.

(30) It is appropriate in this case, in view of the highly competitive nature of the market concerned and the absence of any barriers to entry to that market, to grant the exemption for a period of 10 years

HAS ADOPTED THIS DECISION :

Article 1

Pursuant to Article 85 (3) of the EEC Treaty, the provisions of Article 85 (1) are hereby declared inapplicable from 10 May 1988 until 9 May 1998 to the standard form service franchise agreement which ServiceMaster concludes with its franchisees within the EEC.

Article 2

This Decision is addressed to ServiceMaster Ltd, 50 Commercial Square, Freeman's Common, Leicester LE2 7SR, United Kingdom.

Done at Brussels, 14 November 1988.

For the Commission

Peter SUTHERLAND

Member of the Commission