GAZDASÁGI VERSENYHIVATAL
HUNGARIAN COMPETITION AUTHORITY
20 years in serving fair competition for consumers

GEKKO concluded restrictive agreements

The Hungarian Competition Authority (Gazdasági Versenyhivatal – GVH) established that GEKKO Garden Kft. (GEKKO) that provides playschool services, suitable for developing talent of children, violated the prohibition of agreements restricting economic competition with several provisions of the standard franchise contracts that were applied by GEKKO and its franchisees between 2001 and 2008. Considering that the GVH didn't find it reasonable, there has been no fine imposed on the undertaking.

GEKKO is an undertaking engaged in complex and integrated playschool services that are supplied to normal children and all those children who need a special treatment between the newborn status and age 14. The educational concept of the undertaking aims to survey all the function fields of the children and then to induce their collective development. Parents generally enrol their children for a certain period of time to the playschool (several moths, one year). Courses that are coordinated by professional educators, conductors and psychiatrists are resorted usually once a week for one hour each time. Therefore those undertakings can be regarded as competitors of GEKKO services (playschools that provide courses that take each time 1-2 hours, are supervised by professionals and operate in complex method with different age groups) that provide services with the following features: courses have to be taken every week in a complex method, operating with different age groups and providing cheerful activities. GEKKO is one of the leading players on this market with its estimated 30-40% market share. Those undertakings that operate as babysitting (e.g. playschools in restaurants or in supermarkets), or concentrate on a narrow age group (e.g. courses in an early age between 0-3 years), also those undertakings that provide services that aim to improve a special subplot (e.g. focusing on the improvement of musical, linguistic and kinetic skills) can not be regarded as competitors of the services provided by GEKKO.

In order to establish its extensive franchise-network, GEKKO concluded several standard franchise contracts with the partners who operate playschools. In these contracts that are subjects of the investigation of the GVH and were concluded between 2001 and 2008, GEKKO supplied, for consideration, its self-developed integrated educational concept, the software evolved directly to the concept, and also the educational guidance to the contracting partners. In these contracts GEKKO applied vertical price-fixing and in addition to a non-compete clause territorial exclusivity was also stipulated.

According to the standard franchise contracts, the contracting partners had to provide the services and supply the products mentioned above on the prices and discounts that were determined by GEKKO, and moreover without the prior authorisation of GEKKO the contracting partners were not allowed to deviate from these prices and discounts.

The contracting partners were obliged to pay an amount of 5 million HUF (approx. EUR 18 thousand) +VAT as a single subcontractor fee for the exclusive application of GEKKO's

know-how package, however this right to use covered a certain area (that meant in Budapest a certain district or a radius of 2-10-20 kilometres around certain playschools).

It also appeared as a non-compete clause that under the scope of the standard franchise contract and within two years from the expiry of the contract the contracting partners were not allowed to provide or convey services and products that could compete with the services and products provided by GEKKO.

Since it is presumable that the non-compete clauses mentioned above might have anticompetitive effects on the relevant market, the GVH initiated a competition supervision proceeding against GEKKO.

Although there are two relevant block exemption regulations (BERs) concerning this case, the GVH highlighted that during the evaluation of the behaviour of GEKKO neither of these applicable regulations would establish immunity to the undertaking from the alleged infringements. The first BER for standard franchise contracts that was repealed on 9 April 2002 may not be applied where franchisees – in this case the contracting partners of GEKKO – are restricted to participate in the determination of the prices of the services and products. According to the GVH, there is no possibility of the application of the other BER concerning vertical agreements either, that repealed the regulation mentioned above and came into force on 10 April 2002. The reason of the non-applicability of this latter BER is that it can only apply to those cases where the purchaser is not restricted to decide in which area and to what clientele he wants to supply the service in question.

One of the provisions of the standard franchise contracts under investigation was the resale price maintenance that was regarded as the most serious anticompetitive infringement by the GVH. The GVH emphasized that in those cases where the prices are fixed or are kept down on a minimum sum by the undertaking under investigation, the violation of the Competition Act would be established because via these practices the salesman would be deprived from the effective application of one of the most important tools of competition. GEKKO aimed at certifying the necessity of vertical price-fixing by underlining that it was necessary in order to maintain high quality and to ensure uniform marketing and business action, however GEKKO did not provide relevant evidences to underpin its arguments. According to the GVH, vertical price-fixing does not guarantee high quality by all means on the market, because turnover that is fixed on a certain level cannot induce the supply of higher quality services.

As for the territorial exclusivity stipulated by the standard franchise contracts, the GVH referred to the fact that in a case where the undertaking does not possess overly high market share (it is less than 30%), the territorial exclusivity that applies to a reasonable area can be regarded justified since it is the only way to ensure the encouragement of the franchisees to enter the market. This may lead to the establishment of new potential franchise-networks and thus is capable to contribute to the more reasonable organizing of services and to the promotion of economic growth. In this particular case the anticompetitive effects of territorial exclusivity are weakened because some GEKKO playschools could have welcomed customers from outside of their own exclusive territory, from anywhere in the country. Furthermore, high customer demand could have triggered the establishment of new playschools with new contracting partners that would have also weakened the anticompetitive effects of the territorial exclusivity.

According to the GVH, GEKKO has the power to control and restrict the market entry and also the investments of the competitors by stipulating of the two-year long non-compete clause. In line with the competition law enforcement practice, in order to protect the owner of the intellectual property right non-compete clauses of that kind can be regarded as reasonable, in so far as it does not extent more than one year after the expiry of the contract. Namely, if the right to utilize the intellectual property right was not guaranteed to the owner – at least for a certain period of time –, he would not be interested to develop new products and to effectuate new investments anymore. At the same time, GEKKO attempted to justify its two-year long immunity only with the general reasoning that usually the educational concept becomes obsolete in a longer term, but did not mark clearly what was the evidence of that – moreover, GEKKO did not clarify how much information does he share with its contracting partners and what kind of method does he use for that in every second year.

When calculating the amount of the fine, the GVH considered the following circumstances. The restriction of the potential of the contracting partners to determine the variety of prices – considering the territorial separation of the playschools and also to the local feature of the market – was just one step in the course that led to the elimination of the intra-brand competition. The GVH also contemplated that due to the decrease of the number of GEKKO playschools the anticompetitive price-fixing could only have a minor factual effect on the market. Also, referring to the current market structure where competitors usually possess low market shares – the vertical price-fixing of GEKKO does not tend to induce collusions. Taking into account all the above-mentioned, no fine was imposed on the undertaking, because the GVH attributed a minor importance to the effects of the vertical price-fixing in the field of both intra-brand and inter-brand competition. The GVH applied the same approach during the determination whether the non-compete clause in connection with the two-year long exclusivity was an infringement.

In line with the competition law enforcement practice, the competition supervision proceeding was not extended to the behaviour of the franchisees – although they were also involved in the infringement concerning the standard franchise contracts – because they did not take the lead during the establishment and the observance of the non-compete clauses.

The case number is: **Vj-60/2009.**

Budapest, 3 June 2010

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