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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A
MODEL FRANCHISE DISCLOSURE LAW

First session
(Rome, 25 - 29 June 2001)

Comments on the Draft Model Law and Draft Explanatory Report thereto
submitted by the World Franchise Council (WFC)

Rome, June 2001

WORLD FRANCHISE COUNCIL

Submission to UNIDROIT on the proposed Model Law on Franchising

INTRODUCTION ..

1. The World Franchise Council (WFC) was established by the Major Franchise Associations in Europe, North America and the Pacific Rim in 1996 so as to represent and promote the standards of good franchising being established around the world.
2. The WFC is particularly aware of, and involved in, the wide variety of developmental stages reached in franchising in different countries and the different kinds of business methods which are regarded as falling within the scope of franchising in different countries.
3. The WFC supports the need to ensure that the legislative environment around the world is conducive to good franchising in all its various forms. The WFC is equally concerned to ensure that the legislative environment in any one country does not stifle legitimate “franchising” activity in that country for the sake of a worldwide uniformity that is not a characteristic of the franchising sector.

WFC RESPONSE TO THE PROPOSAL FOR A MODEL LAW

4. The WFC recognises that there are many countries in the world where franchising is in its infancy and where inappropriate legislation is a real danger. In this context an appropriate and practical “Model Law” would be of real benefit in guiding legislators towards a sensible working balance between the rights that franchisors require to protect their “know how” and brands, and the rights of potential investors in their system. Similarly, in those countries where inappropriate legislation has already been enacted, a “Model Law” could be of benefit in seeking change for the better.
3. It must also be recognised that in many countries of the world, franchising has already become a well-developed business system, representing a significant proportion of economic activity and employment, and where the legislative environment is already finely tuned to the needs of both franchisors and investors franchise systems. In some countries this is achieved through

6. The experience world-wide in countries where franchising is already a successful and established sector is that the legislative environment for franchising needs to reflect the general legislative context in each country, the scope of franchising in that country and the level and nature of abuse that occurs in that country. In a number of very prominent examples, not least within the European Union, the European Union Block Exemption Regulation for Distribution together with general commercial legislation at a national level continues to be a more than adequate basis for the regulation of franchising together with other distribution systems. Indeed, one of the underlying reasons for the replacement of the Block Exemption Regulation for Franchising with a more general Distribution Exemption was the need to ensure that businesses did not artificially adopt a franchising framework simply to enjoy a specific legislative environment for franchising.
7. The World Franchise Council's conclusion in this context is that an appropriate and practical "Model Law" could and should be promulgated by the franchise sector providing it is recognised and clearly stated that the "Model" is not a recommendation for franchise specific legislation, but a "Model" to be used where a national legislative body has concluded in their particular circumstances that franchise specific legislation is necessary. In the WFC's view this condition is not clearly stated in UNIDROIT's "Introduction" to the "Model".
8. In the "Introduction" to the "Model Law" there is extensive and initial description of the obligations on a signatory State to adopt a "Convention", but only a modest and subsequent description of the role of a "Model Law". That description is ambiguous in presenting the freedom which States have to conclude that no such law is desirable, and concentrates instead on the freedom which States have to modify the "Model" for adoption in their countries. The introduction also makes strong reference, in the same context, to UNIDROIT's role in the harmonisation of legislation internationally, leaving a general impression that the adoption of the "Model Franchise Law", or a variation of it, is to be regarded as the proper objective of legislators.
9. If it is made clear that the "Model Law" is only appropriate where a State or legislative body has concluded that a franchise specific law is required in their dominion, then the World Franchise Council will support such a "Model" providing it is an appropriate and practical model for franchise legislation.

WFC RESPONSE TO THE MODEL LAW ITSELF

10. The proposed UNIDROIT "Model Franchise Law", whilst in general representing an appropriate approach, has a number of provisions that make it either inappropriate or impractical for the regulation of franchising.

Disclosure of Supply Arrangements

11. Firstly, the draft "Model Law" requires the disclosure of information concerning the relationship between a Franchisor and its suppliers. In a

number of industry sectors a Franchisor's relationships with its suppliers (and in particular its financial relationships) are a material part of the “know how” which supports that franchisor's competitive position. The difference must be stressed here between the information that is made available to contracted Franchisees of the Franchisor, and the information that is to be made available to prospective Franchisees. In the absence of a confidentiality agreement, disclosure to prospective franchisees is, in effect, to put the information into the public domain. In practice, a confidentiality agreement will offer no real protection to a Franchisor whose competitors choose to act as “prospective franchisees” for the purpose of securing commercially confidential information on supply arrangements with no intention of signing a franchise agreement. Thus, these provisions of the “Model Law” are inappropriate, neither will the more widespread (and expensive) adoption of pre-contractual confidentiality agreements make them practical.

Pre-Disclosure Refundable Deposits

12. Secondly, the “Model Law” requires the provision of a disclosure document before the payment of any fees relating to the purchase of a franchise. In many countries, refundable deposits are common as a practical means of ensuring a prospective franchisee's real interest in a franchise and to help ensure their compliance with any pre-contractual confidentiality agreement. To meet this function and properly protect a Franchisor's “know how” such deposits are sought before full disclosures of the kind required under the “Model Law” are made. In many jurisdictions Franchisors are also entitled to deduct from deposits, costs justifiably incurred in pursuing a prospective franchisee's application. There is no evidence of widespread abuse of such arrangements and they have a worthwhile utility in the economics of franchisee recruitment. Thus, the WFC would want the “Model Law” to accommodate pre-contractual refundable deposits in advance of full disclosure.

Up-to-Date Financial Information

13. Thirdly, the “Model Law” asks for the disclosure of financial information on the Franchisor which is audited, less than 180 days old, and which covers the previous three years. National legislation ordinarily determines the period available to a business for the submission of annual audited accounts; it ordinarily specifies the level of breakdown so as to oblige “group” companies to put into the public domain no more than consolidated accounts for the group as a whole. The provision in the “Model Law” for supplying unaudited financial statements that are less than 90 days old will present major companies with a substantial policy conflict on disclosure and will lead to substantial compliance costs in many companies of all sizes. Under the “Model Law” as it stands a company's annual audited accounts will not fulfill its disclosure requirements for 185 days in each year when more recent unaudited accounts must be provided. In the WFC's view this requirement as it stands is inappropriate and impractical.

Disclosure of “Nearest” Franchisees

14. Fourthly, the “Model Law” requires the disclosure of “the names, addresses and phone numbers of the franchisees located nearest to the proposed outlet of the prospective franchisee”. This does not seem to be a well thought through or well-expressed provision in its application to mobile franchisees or to franchisees who do not acquire territorial rights. Moreover, it goes beyond a requirement to provide access to franchisees freely selected by a prospect from all of the Franchisor's franchisees, which enables a Franchisor whose Franchisees have legitimate security concerns to operate a system of free selection before the disclosure of contact details. The WFC would want to see here a more practical disclosure requirement.

Disclosure of Renewal Terms

15. Fifthly, the “Model Law” requires the disclosure of “the term [of the franchise agreement] and conditions of renewal of the franchise”. In dealing with a similar provision in the European Code of Ethics for Franchising, the European Federation accepted that some major businesses offered 15 year or longer agreements without renewal. The WFC therefore proposes the addition of “if any” in this requirement as indeed it has been included in the disclosure requirement on territorial or allocated customer rights.

Procedure for Franchisee Termination

16. Sixthly, the World Franchise Council fully recognises the need for remedies for franchisees in the case of material disclosure failures. It is equally necessary for Franchisors to protect their know-how during and after the process of termination. In consequence, Franchise agreements ordinarily contain termination arrangements that, for example, oblige Franchisees to return proprietary operations manuals and branded merchandising and other material and, most importantly, post termination non-compete provisions that protect a franchisor from the unlicensed use of know-how by a competitor. In

many jurisdictions such termination arrangements are provided for under Regulations governing franchising (though not necessarily franchise specific Regulations: for example the European `Block Exemption Regulation for Distribution. As the “Model Law” stands there is no termination procedure to protect a Franchisor's know-how, neither is there any mention of a Franchisor's rights to impose post termination non compete restrictions. One solution may be to require termination under the provisions of the franchise agreement, but this aspect of the “Model” clearly needs more detailed scrutiny.

CONCLUSION

17. The World Franchise Council stands ready to endorse the “Model Franchise Law” proposed by UNIDROIT providing it is made clear that the model is only applicable where a legislative body has judged it necessary to introduce franchise specific legislation and providing that the “Model Law” itself can be improved (in line with the six points made above) so as to offer an appropriate. and practical basis for such legislation where it is needed.

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