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UNIDROIT
INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A
MODEL FRANCHISE DISCLOSURE LAW

First session
(Rome, 25 - 29 June 2001)

REPORT
(prepared by the Secretariat)

Rome, September 2001

1. The first session of the *Committee of Governmental Experts* convened to examine the draft *Model Franchise Disclosure Law* prepared by the UNIDROIT *Study Group on Franchising*, met from 25 to 29 June 2001 at the seat of the Institute in Rome. A list of participants is annexed to this Report.

2. The following documents were submitted to the Committee:

Study LXVIII – Doc. 30 Draft Articles for a Model Franchise Disclosure Law with Draft Explanatory Report as adopted by the UNIDROIT Study Group at its Fifth Session, held in Rome on 7 December 2000;

Study LXVIII – Doc. 31 Comments on the Draft Model Law and Draft Explanatory Report thereto submitted by the International Chamber of Commerce (ICC);

Study LXVIII – Doc. 32 Comments on the Draft Model Law and Draft Explanatory Report thereto submitted by the World Franchise Council (WFC);

Study LXVIII – Doc. 33 Comments submitted by the Government of Australia;

3. The following documents were submitted during the meeting:

Study LXVIII – Doc. 34 Comments on the Draft Model Law and Draft Explanatory Report thereto submitted by the World Franchise Council (WFC);

Study LXVIII – Doc. 35 Comments submitted by the United States (available only in English during the meeting).

4. In addition, a number of proposals for modification of the single articles were submitted in the course of the discussions. For reasons of time, and so as not to delay the discussions, three of the proposals thus submitted were not translated and were submitted only in English.

5. The President of UNIDROIT, **Mr Berardino LIBONATI**, opened the meeting. He thanked the members of the Study Group, a number of whom were present as members of the delegations of their countries of origin, for the work accomplished and for their dedication to the project. He expressed the hope that the meeting would be constructive and fruitful.

6. The meeting thereupon proceeded to the election of the Chairperson and Vice Chairperson.

7. **Ms Hernany VEYIA (Mexico)** was elected Chairperson and **Mr Souichirou KOZUKA (Japan)** was elected Vice Chairperson.

8. In the course of the meeting a **DRAFTING COMMITTEE** was nominated. The members of the Drafting Committee were Canada, China, France, Germany, Japan, and the United States. The Drafting Committee elected **Ms Beate CZERWENKA (Germany)** to act as Chairperson. The Chairperson of the Plenary was invited by the Drafting Committee to participate in its deliberations.

9. Before entering into the examination of the draft, the Chair requested the Secretariat to illustrate the history of and background to the project.

10. The *Secretariat* recalled that the proposal to include franchising on the Work Programme of the Institute had been made in 1985, by the then Canadian member of the Governing Council of the Institute. At the request of the Council a preliminary study had been prepared and submitted to it at its following session, in 1986. Thereafter the Secretariat had mainly continued to monitor both national and international developments, in particular as at the time the European Community had been preparing what was to become the Franchising Block Exemption Regulation.¹ In 1985 the situation had been quite different from the present one, in that the support for an international instrument that now existed had not existed at the time.

11. It was in 1993 that the Governing Council had decided that the time had come to start work actively and had therefore authorised the setting up of a Study Group. As is customary in

¹ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements (OJ EEC L 359/46 of 28 December 1988).

UNIDROIT, the Study Group was composed of experts in the field who did not represent their States of origin, who were invited to participate simply because they were experts and the organisation wished to enlist their assistance. The Study Group had examined both international and domestic franchising and had come to the conclusion that it would be very difficult to prepare an international convention for international franchising, in particular considering the enormous variety of franchise arrangements that existed. It was decided that the best way to proceed as regards international franchising would be to prepare a guide that would be made available to operators. The *Guide to International Master Franchise Arrangements* that was before the members of the Committee was the result of that endeavour. The Guide concentrated on master franchise arrangements, as it was recognised by the members of the Study Group that master franchise arrangements were those used most often in international expansion.

12. The question of whether or not an instrument should be prepared for domestic franchising was deferred until after the preparation of the Guide. The situation had however changed rather rapidly with the adoption of legislation by an increasing number of States. The legislation that had been adopted had in some cases raised the concern of members of the Study Group, in that it sometimes regulated the relationship between the parties, at others introduced very restrictive norms that they feared would have a negative impact on the development of franchising. The result was that a number of the members of the Study Group who had not been keen to develop an international instrument had begun to press for such an international instrument, as they had felt that it was preferable if a model were prepared at international level that could be offered to the international community, to those States which had decided that they wanted to adopt legislation. The document before the Committee was the model developed by the Study Group. As to the process, a Drafting Committee had been set up in January 1999 to prepare a first draft which had subsequently been examined by the Study Group in Plenary in December 1999 and in December 2000. The draft was limited to disclosure as that was what the Study Group had felt to be most suitable for regulation. The Study Group had of course considered whether or not other aspects such as termination and its consequences should be dealt with, but had excluded this, deciding instead that the most suitable subject for an international instrument, one on which a consensus could usefully be attained, was disclosure.

13. Referring to the documents before the Committee, the Secretariat explained that in documents Study LXVIII – Doc. 30 and Misc.1 the definitions in Article 2 followed English alphabetical order also in the French version. This was simply to facilitate the discussions, in that if the order of the definitions were changed, the comments relating to the definitions would also have to change order and be renumbered, and this might create confusion in the discussions. Furthermore, document Misc. 1 had the English and French versions of the text side by side to facilitate comparison between the two language versions and this would not be possible if the order were different in English and French. Once the Model Law had been finalised, the definitions would of course be in the correct alphabetical order in both English and French.

PRELIMINARY REMARKS

14. Several delegations expressed appreciation for the work done by the Study Group. The importance of franchising for developing countries was stressed. Franchising offered a way of spear-heading economic development, of creating enterprises and of transferring skills. The Model Law was therefore important for developing countries which might want to ensure that franchising worked in a manner that was fair to all parties and did not become a hindrance to entrepreneurship and growth.

15. It was noted that the text of the provisions often referred to the “franchisee” when in effect the person referred to was the “prospective franchisee”. The Secretariat was therefore requested to examine the text and to insert the word “prospective” when necessary.

16. In the course of the meeting a number of inconsistencies between the French and English versions were drawn to the attention of the Committee. The Secretariat was consequently requested to examine and to align the two language versions of the draft.

17. A number of preliminary questions were discussed before the Committee began to examine the text of the draft.

(i) *THE TITLE OF THE INSTRUMENT*

18. The non-mandatory nature of the instrument was stressed by a number of delegations. While the majority felt that the title "Model Law" was sufficient to indicate this, one delegation suggested that the title should be modified to "Guide to Legislators". It further stressed that the Model Law should in no way modify the hierarchy of the legal instruments of the States that would use it as a source of inspiration.

19. It was pointed out that if the title, and consequently the nature, of the instrument were modified, the whole document would have to be reconsidered, as a guide was written in a manner that was quite different from a model law. Comments on all the provisions would need to be inserted and specific comments addressed to legislators would also need to be inserted in the text itself. It was stressed that the indication "Model Law" was sufficient to ensure that its non-mandatory nature were made clear. Furthermore, it was pointed out that one of the reasons for preparing a Model Law was to ensure a certain degree of uniformity. The document should therefore not be so flexible that no one adopted it in the end.

20. The suggestion to modify the title of the instrument was therefore not accepted by the Committee and the title remained "Model Law".

(ii) *PREAMBLE*

21. A number of delegations suggested that a Preamble be added to the Model Law to stress the non-mandatory nature of the instrument and the fact that it was not a recommendation to introduce legislation, that it was a guide and that legislators needed to consider article by article what the appropriate disclosure requirement for their country was. This proposal echoed that submitted by the *World Franchise Council* in Doc. 32.

22. In the course of the discussions essentially three different proposals were made: the first was to add a provision as Preamble to the text of the Model Law; the second (as agreed by the delegations of the *United States* and *France* and reproduced on p. 1 – 2 of Doc. 35) was to move Parts 1 (Preface) and 2 (Background to the Draft Model Law) of the present Explanatory Report to the front of the document, before the text of the Model Law, and to add the following at the very beginning, before the Preface (the proposed new text is in italic):

"This model law exists in order to provide guidelines to the States that have determined that there is a need for adoption of a pre-sale franchise disclosure law.

This Model Law is not intended to be a recommendation that there is a need for a particular State to adopt a franchise specific law and must be considered as an example that is not compulsory for State legislators.

[The following paragraph is the present paragraph 8 of the Explanatory Report] In the legislative process, national legislators may wish to consider a number of different elements, including

- whether it is clear that there is a problem, what its nature is, and what action, if any, is necessary;
- whether there is a pattern of widespread abusive conduct, or whether this conduct is isolated or limited to particular industries;
- what the nature of the evidence of abuse is, whether it is empirical or only anecdotal;
- whether existing laws address the concerns and whether they are adequately applied;
- whether a system of self-regulation exists and if so whether or not it is sufficiently effective to address the concerns;
- what financial burden the new legislation will place upon franchisors and the extent to which this financial burden will be passed on to franchisees and ultimately to consumers;
- whether the proposed legislation will constitute a barrier to entry to small and new franchisors, including foreign franchisors, and if so what the effects may be in terms of job-creation and investment;

and

- what the views of the national franchise association are.

Further, the Model Law is intended to encourage the development of growth of franchising as a vehicle for conducting business. As a pro-commerce document, it recognises that franchising offers the potential of increased economic development, especially among countries seeking access to know-how.

A disclosure law may be considered as a means to create a secure legal environment between all the parties in a franchise agreement.

To that end, the Model Law ensures that investors receive material information about franchise offerings with which to make an informed investment decision.

Furthermore, the Model Law brings security to franchisors in their relationships with franchisees, administration and courts.

State legislators should also consider that some disclosure requirements may discourage foreign investors from expanding into their market. Therefore, legislators should weigh the interests of both the franchisor and franchisee when considering whether to adopt any specific disclosure requirement. For example, the imposition of specific accounting standards may inhibit franchisors from expanding. The State should weigh the importance of requiring its accounting standard with the desire for greater foreign expansion in their market.”

23. The third position was that what was presently in the law and in the Explanatory Report was sufficient and that no additions were required.

24. At the end of the discussion there was general agreement that a Preamble should be added, although the form the Preamble should take was not finally decided upon.

(III) SCOPE OF THE MODEL LAW

25. There was general agreement that the Model Law should relate only to disclosure, with the exception of one delegation which expressed the regret that the behaviour of the parties was not also regulated.

(IV) PROCEDURE

26. Whereas the absence of submissions of comments by delegations before the meeting had led to the conclusion that only one session of the Committee of Governmental Experts would suffice to finalise the Model Law, in the course of the meeting it became clear that a second session would be necessary. In view of the fact that some delegations felt that a number of issues that had been discussed before it was decided to hold a second session would need to be re-examined, it was decided that the Secretariat should send delegates the draft Report by e-mail, to permit them to check that any proposals that they had made and that had received a certain degree of support, even if they had not been accepted, were included in the next draft in square brackets for further consideration. In the course of this review process a number of proposals were made by a couple of delegations and are reproduced in this Report.

ARTICLE 1

27. In relation to **Article 1** two main issues were discussed: firstly, whether the Model Law was intended to cover both the case in which a franchise agreement was concluded at the end of the negotiations, as well as the case in which none was, or whether only the case where a franchise agreement actually was concluded should be covered, and secondly what the nature of the words in square brackets was and whether or not they should be retained.

(I) SCOPE OF APPLICATION OF THE MODEL LAW

28. Five delegations felt that both the case when a franchise agreement was concluded and the case where no franchise agreement was concluded should be covered. If both cases were not covered, there might be cases in which the Model Law would not apply, such as in case of intentional misrepresentation which in some jurisdictions led to the avoidance of the contract. Article 10(1) and (2)

of the Model Law stated that if the provisions of the Law were not complied with, the prospective franchisee might terminate. On the other hand, Article 10(4) indicated that the right to terminate did not derogate from any right the franchisee might have under the applicable law. Consequently, if the Model Law applied only if a franchise agreement were concluded, then in cases where the national law provided for avoidance the Model Law would no longer apply. Thus, it was necessary for the Model Law to apply also to cases where no franchise agreement was concluded at the end of the negotiations, and the words “to be” should therefore be inserted before “granted”. The Explanatory Report should also be amended, as it spoke only of territorial scope. It was a question of avoiding a general obligation being created for franchisors and then, perhaps twenty days or even several months later, when a contract was not concluded, different consequences ensuing.

29. It was however pointed out that the reasoning that had led the Study Group to decide that the Model Law should apply only in cases where a franchise agreement was concluded was precisely the inter-play between Article 10(1) and (2) and Article 10(4): if a franchise was granted, then if prior to the grant certain obligations had not been met, liability attached under this law. If no franchise was granted, no liability attached under this law, but under Paragraph (4), if other remedies were available under the applicable law the franchisee could take advantage of such remedies. It was added that furthermore pre-contractual liability continued to be regulated by the laws and case law of each country.

30. As a compromise, it was suggested that both options might be retained, and the wording be “granted or to be granted”. One delegation supported this, pointing out that the Model Law should provide as much information as possible to legislators, bearing in mind that the legal framework of the different countries of the world had reached different levels of development and that there would therefore be nothing wrong with adding “to be granted”. The States that did not have legal principles, statutes or case law that covered pre-contractual aspects could then benefit from the law and decide to apply it to both situations, whereas States that had norms covering such aspects would be free to delete the words “to be granted”. A comment might be added to the Explanatory Report telling legislators that if their system covered these aspects they did not have to provide “to be granted” and that if it did not, they could apply the law also to those aspects if they so wished.

31. It was objected that if “to be granted” were added, it would also be necessary to indicate when the obligations of the Model Law should start, whether for example on the occasion of the first contact, upon the first exchange of correspondence, or when the franchisor produced a pamphlet. It was however pointed out that Article 3 to a large extent dealt with this problem.

32. It was suggested that the text might be left as it stood, and that the Explanatory Report should refer to the different views expressed in the course of the discussion, to the problems relating to pre-contractual liability, and should indicate to States that if they so wished they might cover also these aspects. This suggestion met with the favour of a number of delegations.

33. In the course of the review process the proponent delegation however requested that the words “to be” be placed in square brackets for further consideration by the Committee.

(ii) *THE NATURE OF THE WORDS IN SQUARE BRACKETS*

34. The Explanatory Report (para. 34) specified that Article 1 was intended to concern the territorial scope of application of the Model Law. The last words of the paragraph (“within the national territory of the State adopting this law”) were in square brackets to permit each State to use the formulation usually adopted in its legislation to indicate the territorial scope of application.

35. A discussion ensued on the actual meaning of the words in brackets. It was suggested that the words might be understood to imply that an international franchise agreement would be subject to the disclosure rules of a State that had enacted the Model Law even if the franchise agreement was subject to the law of another State. It was pointed out that paragraph 34 point 3 of the Explanatory Report stated clearly that “[...] it applies to franchises that are operated in the national territory irrespective of whether they originate as a domestic franchise or as a foreign franchise. It is not intended to apply to franchises that are exported from a country that has adopted the Model Law into a country that has not”. The words in square brackets therefore merely meant to clarify that there was no question of extra-territorial application. Nor did they intend to create a conflict of laws rule.

36. A question raised concerned whether the place of reference should be the place where the franchise was to be exploited, or the place where the contract was signed. There was general agreement that the place of reference should be the place where the franchise was to be exploited and it was suggested that the Explanatory Report should state this clearly.

37. It was pointed out that the English and French versions of the text in square brackets differed, and it was suggested that the two versions should be aligned, one delegation preferring the French version, another the English, as it considered that the French version added nothing to the Model Law.

38. Three proposals were made: to delete the brackets, to delete the words in the brackets and to leave the text as it stood. A couple of delegations preferred to delete the words in brackets as they felt that they caused confusion and that clarification was only obtained from the Explanatory Report. Furthermore they added nothing to the Model Law. Others opposed this deletion as the purpose of the words in brackets was merely to permit States to use the formulation they habitually used to indicate the territory of application of the law.

39. The question of the extra-territorial application of the Model Law was again raised in connection with the words in brackets and paragraph 36 of the Explanatory Report, as the issues raised in paragraph 36 were not dealt with in the words in brackets and it was therefore suggested that this was an added reason for their deletion. It was however pointed out that paragraph 36 instead referred to a different question, i.e. the possible mandatory nature of the Model Law, and that it had been the specific intention of the Study Group not to deal with this issue.

40. In the light of the discussions, a revised text of Article 1 reflecting the intentions of the Study Group was submitted to the Committee. This text read as follows (modifications in italic):

**"ARTICLE 1
(SCOPE OF APPLICATION)**

This law applies to franchises granted for the operation of one or more franchised businesses *within the [State adopting this law]*".

Paragraph 34 of the Explanatory Report would be modified as follows:

"34. Article 1 delimits the territorial scope of application of the Model Law by specifying that:

1. [...]
2. [...]
3. [...] The last words of the Article are left in square brackets to permit States to *identify the territory within which the law applies* in a manner consistent with the formulation normally adopted in their country."

41. The new texts submitted were considered acceptable and were therefore adopted.

ARTICLE 2

42. The Committee decided to examine the definitions contained in **Article 2** as the words defined appeared in the course of the examination of the draft. The comments made in relation to the definitions were the following:

(i) "**AFFILIATE OF THE FRANCHISOR**"

43. With reference to the definition of "**affiliate of the franchisor**", one delegation suggested referring a "natural or legal person" instead of to a "legal entity". This proposal was accepted by the Committee.

44. Another delegation suggested that it would be preferable to define the concept of "control". As, however, the difficulties in arriving at a definition that would be satisfactory to all was pointed out, it was decided that the Explanatory Report should alert the national legislator to the need to define what was intended by "control".

(II) "DISCLOSURE DOCUMENT"

45. With reference to the definition of "**disclosure document**", one delegation proposed deleting the definition which it considered to be superfluous as the following articles stated what a disclosure document must contain.

46. This proposal was opposed by one delegation which recalled that the Model Law was intended to fit into a broad legal framework, and that there was legislation that related to other areas of law that also required disclosure documents to be provided. The definition made it clear that when the Model Law referred to a disclosure document the document was only the one that had to be prepared for the purposes of the Model Law. The definition therefore served a useful purpose. Three other delegations agreed with this point of view.

47. The definition of "disclosure document" was examined also in the context of the discussions on Article 4. The delegation of the *United States* proposed that the word "single" be inserted before "document" (Doc. 35), as the reference in Article 4 to "any format" might create ambiguity as to whether or not all the information had to be provided at the same time. The intention was to ensure that the prospective franchisee obtained all the material and information it wanted. This modification to the text should be accompanied by a modification to the third sentence of paragraph 39 of the Explanatory Report as follows (Doc. 35, modifications in italic):

"The information to be disclosed *must be provided* in a single document, as opposed to several. *Nonetheless*, items such as financial statements might usefully be annexed to *the disclosure document*."

48. This proposal however raised the concerns of another delegation, which felt that saying that there must be a single disclosure document, but that attachments were admissible, created confusion. The question of what exactly was meant by attachments would immediately arise: would they have to be fixed to the disclosure document itself or could they be separate, for example. Furthermore, Article 9 stated that the disclosure document had to be written in a clear and comprehensible manner and if there were such a great number of documents that the prospective franchisee could no longer find the information, it would no longer be comprehensible. The present formulation was sufficient without there being any need for additions.

49. One delegation observed that in the course of its consultations with franchise circles the opinion had been voiced that adopting a standard form for the disclosure document would be a good idea. This would considerably assist the prospective franchisee in comparing the data received from different franchisors. This standard form should not be included in the Model Law itself, a reference should merely be made to a form that could be adopted by different countries.

50. It was observed that if this idea were adopted, the standard form should be prepared by an international organisation, as had been the case in the field of the carriage of goods. In the case of franchising the organisation would probably be UNIDROIT, assisted by private entities. If this task were given to the national associations, it would not be necessary to have a reference in the Model Law.

(III) "FRANCHISE"

51. The definition of "**franchise**" was discussed mainly in the context of the discussions on Article 3. A first observation was that contrary to many texts on franchising, the definition did not include the concept of the independence of the franchisee from the franchisor. It was therefore suggested that this concept be introduced, either in the text itself, or in the Explanatory Report. In this connection reference was made to the UNIDROIT *Guide to International Master Franchise Arrangements*, which on page 9, third paragraph, stated very clearly that "[i]n franchising [...] the franchisor and the franchisee are two independent businesspersons who invest and risk their own funds. Franchisor and franchisee are not liable for each other's acts or omissions".

52. Attention was drawn to paragraph 46 of the Explanatory Report which indicated that it was only if the control exercised by the franchisor went beyond a certain level that the relationship could be defined a franchise.

53. The *Belgian* delegation submitted a written proposal for modification with two alternatives. Alternative A was to modify the text of the definition of a franchise to read (modifications in italic):

“**franchise** means [...] to engage in the business of selling goods or services *in its own name and for its own account* under a system [...]”,

54. Alternative B was to add the following at the end of paragraph 42 of the Explanatory Report (modifications in italic):

“[...] not covered by the Model Law. *It is intended to cover only situations where the franchisee is selling in its own name and for its own account*”.

55. The observer from the *International Bar Association* recalled that one of the hallmarks of a franchise was that the franchise business was operated under or substantially associated with the trademark of the franchisor. If the definition incorporated an additional provision stating that the franchisee operated under its own name, this might cause confusion as to whether the franchisee was operating under its own name or under the franchisor's name.

56. One delegation observed that the comment of the IBA illustrated a difference in the understanding of terminology between lawyers from the common law and civil law traditions. Whereas for a lawyer from the civil law tradition "in its own name" would merely indicate that the franchisee and not the franchisor was the counterpart of the customer, for a lawyer from the common law tradition the impression was that the franchisee was not using the trademark of the franchisor, but its own trademark and that was not the intention of the proponent. The simplest way to deal with the problem might be to incorporate into the Explanatory Report the explanation that was given in the *UNIDROIT Guide*, which stated that the franchisee had no liability for the obligations of the franchisor and vice versa.

57. It was suggested that "in its own name" might be modified to read "on its own behalf", which however would be "*pour son propre compte*" in French, which in the proposal corresponded to the English "for its own account". The proposal was accepted, although delegations felt that the formulation required further consideration.

58. Another point raised concerned the control exercised by the franchisor. The English text stated that the franchise “includes significant and continuing operational control by the franchisor”, whereas the French text used the words “*incluant l’exercice par le franchiseur d’un contrôle permanent et approfondi des opérations*”, “*approfondi*” meant in depth, and it would then be possible for a franchisor to remove himself from the application of the law by stating that the control exercised was not “in depth”, it did not actually continue on a day to day basis, but was exercised regularly once in a while. It was therefore suggested that the French terminology should be modified to read “*continue et significatif*” rather than “*permanent et approfondi*”. This suggestion was accepted.

59. It was observed that the definition of franchise stated that it included know-how and assistance, without a qualifying adjective. It was suggested that it might be appropriate to add “significant” before “know-how and assistance”.

60. It was however recalled that the intention of the Study Group had been to avoid that franchises which offered little or no assistance escaped the application of the law. The omission of a qualifying adjective had therefore been intentional. Furthermore, it was observed that the common law traditional definition of franchising included three elements, namely the payment of money, the association with the franchisor's trade mark and control, but not know-how. If know-how were added, a large number of what otherwise might be constituted as franchises risked being excluded. It was therefore suggested that the reference to “know-how and assistance” might be deleted.

61. Two delegations indicated that they opposed both proposals.

62. A discrepancy between the text of the definition and paragraph 45 of the Explanatory Report, which stated “in fact, there even are franchises in which no assistance, or no assistance apart from the initial assistance, is offered by the franchisor”. It was therefore decided to delete the words “no assistance, or”.

63. It was pointed out that the elements of the definition were cumulative. This fact narrowed the application of the Model Law, as there were relationships which in countries such as the United States were classified as franchises but which would be excluded from the application of the Model Law. This observation led to the question of the types of agreement that were intended to be covered by the Model Law. If a broader application were intended, the “and” should perhaps be changed to “or”.

64. It was explained that the Study Group had intended to cover business format franchises and not, for example, industrial franchises, even if the Group had considered that also new forms of franchising that might develop in the future should be covered by the law. The elements in the definition of the franchise made that clear. Business format franchising had been chosen by the Group because the principal activity of franchising took place in business format franchising and consequently it was in business format franchising that the principal potential for abuse existed.

65. Voting on the scope of application, five delegations voted in favour of business format franchising only, and five voted in favour of a broader scope of application.

66. In the light of the result of the vote, it was suggested that each State might decide the scope of application of the law when it adopted legislation. This had happened, for example, in the case of the *UNCITRAL Model Law on International Commercial Arbitration*, which a number of States had decided should apply to arbitration in their countries in general, and not only to international commercial arbitration.

67. It was therefore decided that the definition should be left as it stood as regards this point, and that the Explanatory Report should state that in applying the definition legislators might wish to consider whether they wanted to require both know-how and assistance or only one or the other.

(IV) "*FRANCHISEE*"

68. One delegation observed that the definition of "*franchisee*" seemed incomplete. The *Secretariat* recalled that the Study Group had felt that it had defined both the term "franchisee" and the term "franchisor" indirectly in the definition of "franchise", but that it was not without utility to specify further that also the master franchise relationship was covered. The delegation suggested that the definition might be modified to state that the franchisee was a party to whom a franchise was granted, including the sub-franchisee. This proposal however received no support and was consequently rejected.

(V) "*MATERIAL CHANGE*"

69. In the context of the discussions on Article 3, it was suggested that a definition of "*material change*" should be added to the definitions in Article 2. It was decided that it should be formulated along the lines of the definition of "material fact".

70. The Drafting Committee submitted a proposal to the Committee in Plenary (Misc. 3) reading as follows:

material change in the information required to be disclosed means a change which can reasonably be expected to have a significant effect on the franchisee's decision to acquire the franchise.

71. This proposal was accepted by the Committee.

ARTICLE 3

72. Introducing **Article 3** the *Secretariat* recalled that Paragraph (1) specified when the disclosure document had to be delivered. Fourteen days had been chosen by the Study Group as a compromise, as there was legislation in which the time period was as long as 20 days or a month, and other legislation in which it was as short as five or seven days. Two moments in time were identified as triggering the disclosure obligation. Firstly, the signing by the prospective franchisee of any agreement relating to the acquisition of a franchise. The words “any agreement” were intended to refer to any agreement that indicated a commitment on the part of the franchisee. Agreements covered by Article 7, i.e. confidentiality agreements, were excluded from this provision and therefore did not trigger the disclosure obligation. These agreements had been excluded because the Study Group had felt that the confidentiality of the information provided should be maintained even if no agreement were finally entered into. Secondly, the payment by the prospective franchisee to the franchisor or an affiliate of the franchisor of any fees relating to the franchise. Again, the intention was to make sure that there was a firm commitment on the part of the franchisee and the fees referred to were thus, for example, a lease of premises.

(i) *NUMBER OF DAYS*

73. It was suggested that also this article might leave the number of days open, and that the reference to “fourteen” should be modified to “[X]”. The Explanatory Report might in such a case indicate that fourteen days might be a useful compromise. While this proposal received the support of two delegations, another suggested that the Model Law should set some standards and that a longer period of thirty days would be justified. This was however opposed.

74. In the end, non consensus having been reached on the proposed modifications, the Committee decided to leave the reference to fourteen days.

(ii) *EVENTS TRIGGERING THE DISCLOSURE OBLIGATION*

75. In relation to **Article 3(1)(A)**, it was pointed out that confidentiality agreements were referred to only in this sub-paragraph, and that this was done by a cross-reference to Article 7. The delegations of *Japan*, *Russia* and the *International Bar Association* therefore proposed that Article 7 be deleted, and that the reference to Article 7 be changed to “with the exception of agreements relating to confidentiality of information delivered or to be delivered by the franchisor” (see document Misc. 6). This proposal was accepted by the Plenary.

76. In relation to **Article 3(1)(B)**, the question of the definition of the term “fees” arose. It was felt that what exactly was intended should be more clearly defined in the Explanatory Report, as when the term “fee” was translated into other languages it might be translated in different ways, becoming for example a payment or royalty, so which payments were intended should be clearly identified.

77. A proposal was made to exclude explicitly the payment of out-of-pocket expenses of the franchisor that might be reimbursed by the franchisee. These were expenses incurred, for example, when the franchisor undertook exploratory trips to the country of the franchisee for preliminary talks. The reason the exclusion of such out of pocket expenses was proposed, was that franchisors might be discouraged from conducting exploratory trips to potential new markets if the disclosure requirement were triggered by a potential franchisee reimbursing the franchisor for out-of-pocket travel expenses. It was suggested that this might be addressed by modifying paragraph 52 of the Explanatory Report as follows:

“52. *Paragraph (1)* indicates when the disclosure document must be given to the prospective franchisee. [...]Two moments in time are identified as triggering the disclosure obligation: the signing by the prospective franchisee of any agreement relating to the acquisition of a franchise, [...] and the payment by the prospective franchisee to the franchisor or an affiliate of the franchisor of any fees relating to the franchise. *However, the phrase “any fees relating to the franchise” should not be read to include reimbursements made by a potential franchisee to a franchisor for actual out-of-pocket expenses incurred in connection with exploratory visits to the prospective franchisee or preliminary meetings during which the franchise system or possible sale of a franchise is discussed. Nor would they include reimbursements made for such things as*

due diligence investigations or market or legal research related to the market where the prospective franchisee proposes to operate the franchise. This paragraph also specifies that the franchise agreement must be attached to the disclosure document, as it will normally be an exhibit of that document."

78. This proposal was opposed by three delegations. The first stated that as a representative of a country which would be considered a high-risk country, it did not feel that such an exemption was necessary. The second pointed out that the purpose of the Model Law was to ensure that prospective franchisees received adequate information before they entered into a relationship they might later wish to get out of. If they were able to get out of it once they had seen the disclosure document by receiving their refundable deposit back, then that goal had been achieved. If, however, they had been required to reimburse what might be very considerable expenses, travel and accommodation and the like, they might feel financially bound to an arrangement. When they subsequently received the disclosure document they might discover that they were fundamentally dissatisfied with a number of things, but not so dissatisfied that they wanted to forego the money they had invested. They might therefore decide to stay in the relationship even if they were not satisfied with it.

79. The third delegation felt that if the prospective franchisee paid a certain amount and did not get it back at all, it was in effect an investment: it was an investment that the franchisor did not want to make, that he wanted the franchisee to pay part of, and for which he did not want to take the risk. To all intents and purposes it was a type of entrance fee and as such it should not be excluded in this context.

80. The proponent nevertheless requested that its proposal be included in brackets in the revised version of the document, as it felt this issue to be of considerable importance.

81. The *German* delegation submitted a written proposal that non-refundable fees and any form of security or bond that was given in order to secure the confidentiality agreement should be added to Article 3(1)(B) by a formulation such as "[...] of any non-refundable fees relating to the acquisition of a franchise, with the exception of a security (bond or deposit) given on the conclusion of a confidentiality agreement" (Misc. 2). This proposal was supported by another delegation, which added that also refundable fees that were so limited by conditions as to render them to all intents and purposes non-refundable should be added as triggers for the disclosure obligation. There was agreement that these types of fees should be added to the provision. It was decided that the Drafting Committee should redraft the provision to include these types of fees. One delegation suggested that the word "conclusion" be changed to "execution", as in American English "conclusion" could be understood as referring to the end of the agreement and not the beginning. This suggestion was accepted by the Committee.

82. A question raised concerned the means of delivery taken into consideration by the provision, which stated that the franchisor "must give" the prospective franchisee a disclosure document. The *Secretariat* recalled that the Study Group had considered different means of delivery, in particular electronic means, but had decided to leave it to each State to determine what was appropriate. Furthermore, even when the information was contained in electronic format, the Group had felt that it would be easy for the franchisor to hand the prospective franchisee a print-out.

(III) *UPDATING OF THE DISCLOSURE DOCUMENT*

83. Introducing **Paragraph (2)**, the *Secretariat* recalled that the provision dealt with the updating of the disclosure document. A general rule was given in the first sentence, namely that the disclosure document had to be updated within [X] days of the end of the franchisor's financial year. If, however, there had been a material change in the information required to be disclosed under Article 6, the disclosure document had to be updated within [Y] days of the occurrence of that material change. The number of days had been left open, so as to permit each State to decide the number of days, considering that the applicable rules differed from country to country. The intention was to avoid placing a burden on the franchisor that would be disproportionate to the benefit gained by the franchisee.

84. In this connection one delegation proposed that a definition of “material change” be added to the list of definitions in Article 2. This proposal was accepted and such a definition consequently adopted (see above, under the section dealing with Article 2).

85. As regards the number of days, one delegation suggested that it would be useful to provide legislators with some guidance and therefore to specify a number, explaining in the Explanatory Report that the figure in brackets was merely an indication.

86. As regards the time period, two delegations suggested that an addition should be made to the Explanatory Report to the effect that the number of days had to be sufficient for the annual accounts to be produced. The delegation of the *United States* submitted the following wording to modify paragraph 54 of the Explanatory Report (Doc. 35) (proposed modifications in italic):

“54. *Paragraph (2)* introduces the requirement that the disclosure document be updated within a certain number of days of the end of the franchisor’s fiscal year. [. ..] However, although the updating is tied to the end of the franchisor’s fiscal year and therefore to the production of annual financial statements, the *formula* is left flexible, as the applicable rules differ from country to country. The intention is to avoid placing a burden on the franchisor that would be disproportionate to the benefit gained by the franchisee. *At the very least, the time period selected should be reasonable to allow sufficient time for the franchisor to complete its financial audit.*”

87. The proposed addition was accepted by the Committee.

88. It was observed that the comments made by delegations seemed to indicate that the provision was open to misinterpretation as to the type of updating involved. In fact, the Study Group had not intended to introduce a full continuing disclosure obligation, which would have been justified if registration were required. The disclosure obligation of the franchisor ended when the agreement was signed. It was therefore necessary to provide for what should be done to reflect the changes that took place before the transaction. Consequently, in relation to the second sentence of Paragraph (2), the delegations of *Canada* and the *United States* submitted a written proposal to modify the formulation as follows:

“Where there has been a material change in the information required to be disclosed under Article 6, notice in writing of such change should be delivered as soon as practicable after *the change has occurred, and in any case before either of the events described in Sub-Paragraphs (1)(A) or (1)(B) has occurred.*

89. The Canadian delegation explained that the notion of a “notice in writing” was sufficiently broad to cover different options, i.e. a simple notice saying paragraph so-and-so of the document had been changed, a notice attaching a totally new document, or a document with modifications appearing in red.

90. This proposal was accepted, subject to redrafting. Consequently, the Drafting Committee submitted a proposal for the reformulation of Article 3 which read as follows (Misc. 4 Rev.) (modifications and additions in italic):

ARTICLE 3 (DELIVERY OF DISCLOSURE DOCUMENT)

- (1)** A franchisor must give every prospective franchisee a disclosure document, to which the proposed franchise agreement must be attached, at least fourteen days before the earlier of **(A)** the signing by the prospective franchisee of any agreement relating to the franchise, with the exception of agreements covered by Article 7; or **(B)** the payment to the franchisor or an affiliate of the franchisor by the prospective franchisee of any fees relating to the acquisition of a franchise *that are not refundable or the refunding of which is subject to such conditions as to render them not refundable, with the exception of a security (bond or deposit) given on the execution of a confidentiality agreement.*
- (2)** The disclosure document must be updated within [X] days of the end of the franchisor’s fiscal year. Where there has been a material change in the information required to be disclosed

under Article 6, *notice in writing of such change should be delivered to the prospective franchisee as soon as practicable before either of the events described in sub-paragraphs (1)(A) or (1)(B) has occurred.*

91. One delegation proposed that the wording "or the refunding of which is subject to such conditions as to render them not refundable" be placed in the Explanatory Report instead of in the text of the Article. This proposal was opposed by three delegations. Consequently, the draft proposed by the Drafting Committee was accepted. However, following the deletion of Article 7, the reference to Article 7 was changed to a direct reference to confidentiality agreements (see the report on the discussion on Article 7, below). The final formulation of Sub-Paragraph (1)(A) of the provision was therefore the following:

(A) the signing by the prospective franchisee of any agreement relating to the franchise, with the exception of agreements *relating to confidentiality of information delivered or to be delivered by the franchisor*, or

ARTICLE 4

92. Introducing **Article 4** the *Secretariat* recalled that it was divided into two paragraphs. **Paragraph (1)** stated that disclosure had to be made in writing. This was to permit the prospective franchisee to evaluate the information he/she was given, and also to enable the franchisor to prove that the prospective franchisee had received the information the franchisor had to provide. The Explanatory Report in addition referred to disclosure by electronic means, which was not directly dealt with by the provision. Whether or not electronic disclosure should be permitted was left to the national legislator, as policies in this respect differed from country to country. **Paragraph (2)** permitted any format to be used, as long as the information required was contained in the document. This was a reference to such formats as the *Uniform Franchise Offering Circular (UFOC)* prepared by the North American Securities Administrators Association. The intention was to permit franchisors to use formats that they already complied with, so as to avoid placing an unnecessary financial burden upon them.

(I) ARTICLE 4(1)

93. One delegation indicated that it had problems with the statement that the document had to be in writing, as the information might be on video tapes, might be photographs and might be provided electronically, considering that measures to protect the security of such information had been developed. It therefore proposed that the wording be modified to read: "Disclosure may be provided in writing or by any other means guaranteeing an equivalent reliability".

94. This proposal was opposed by another delegation, which felt that the reference to the *UNCITRAL Model Law on Electronic Commerce* contained in the Explanatory Report was sufficient.

(II) ARTICLE 4(2)

95. The delegation of the *United States* proposed that it be specified clearly in **Paragraph (2)** that the disclosure had to be delivered at one time, so as to avoid that the franchisor provide the franchisee with material which might be sensitive far later than other material, and thereby distract the franchisee's attention from it. It therefore proposed that the specification that disclosure had to be made in a single document be added in Paragraph (2). Furthermore, the definition of "disclosure document" in Article 2, and paragraph 39 of the Explanatory Report should also be modified to state that the information to be disclosed must be provided in a single document, although items such as financial statements might usefully be annexed to the disclosure document (see Doc. 35).

96. As regards the proposed addition in Article 4(2), the Drafting Committee was requested to produce a draft for the consideration of the Plenary. This draft read as follows (Misc. 5) (proposed additions in italics):

"(2) The franchisor may use any format for the disclosure document, provided that the information contained therein *is presented as a single document at one time and* meets the requirements imposed by this law"

97. This proposal was accepted by the Committee.

98. For a discussion of the proposed modification to the definition of “disclosure document”, see above, under Article 2.

ARTICLE 5

99. Early in the discussions on **Article 5**, the Committee decided to proceed with an examination of Article 6 before turning to Article 5 in detail. This decision was prompted by the fact that one delegation proposed to abolish Article 5, which it considered to empty the Model Law of its significance: either there should be a general statement of principle stating the obligation of the franchisor to disclose and no exemptions, or the list of exemptions should be severely limited to include only those cases in which it was absolutely certain that there was no need for the prospective franchisee to receive disclosure. Two delegations supported this proposal and one opposed it.

100. It was recalled that the intentions of the Study Group had been to create a balance between the obligations of the franchisor and the right to information of the prospective franchisee, so as to avoid what in some cases could be considered an unnecessary burden for the franchisor. One delegation also observed that there were instances in which the investment of the franchisor would be lost to the country adopting legislation unless there was a balance between franchisor and prospective franchisee. This was particularly the case when the franchisee was important and had considerable bargaining power, as no exemptions would result in a strong franchisee having more bargaining power than the franchisor.

101. Another delegation indicated that if Article 5 were abolished, Article 6 would probably have to be reconsidered. One alternative was for Article 6 to contain a general statement that the franchisor had to provide the prospective franchisee with all material and significant information and that the information had to contain what was specified in a list of examples. If this option were opted for, it would probably be possible to delete Article 5. However, in such a case there would be less certainty as it would not be exactly clear what was meant by “significant information”.

102. Attention was also drawn to the fact that having a list would provide some guidance to States that wanted to provide exemptions as regards exemptions that made sense.

103. The proposal to delete Article 5 was briefly re-examined after the Committee had completed its consideration of Article 6. Two delegations stated that they were in favour of keeping a provision with exemptions. One delegation, while favouring the retaining of the article, proposed deferring the final decision on the existence of the article to such time as the delegation which had proposed its deletion, which unfortunately had had to leave, was present, and that the individual paragraphs of the article might be examined without taking a decision on the existence of the Article as such. No further comments having been made, the discussion continued with an examination of the individual provisions of the Article.

104. In view of the fact that Article 5 had been examined before Article 6, the Committee also considered whether the order of the two articles should be inverted, but decided against this.

105. In relation to the chapeau of Article 5, one delegation suggested that the word “disclosure” be replaced by the words “disclosure document” in order to make it clear that this article dealt only with the presentation of a disclosure document and not with the general obligation to disclose information. This suggestion was supported by five delegations. No objection having been raised, this proposal was accepted.

(i) ARTICLE 5(A)

106. In relation to **Paragraph (A)**, one delegation felt that the six-month time-period was too short, and suggested that it be lengthened to one year. This proposal was supported by two delegations. No objections having been raised, it was adopted.

107. In relation to the French rendering of “officer or administrator”, it was observed that “*dirigeant ou administrateur*” might create problems as under French law an “*administrateur*” was a member of the *Conseil d’administration* which was an organ of the *Société anonyme*, even if not all *sociétés anonymes* had *Conseils d’administration*. It was objected that the terminology used should not be too linked to a national legal system, and that therefore the terminology chosen was acceptable. It was suggested that the Explanatory Report might clearly explain the type of person meant, so as to permit States to use the term in their languages that corresponded to the intention of the drafters. In the end, it was left to the Secretariat to find the most appropriate terminology.

(II) *ARTICLE 5(B)*

108. With reference to **Paragraph (B)**, the question was raised of who would be required to transmit the information to the assignee or transferee. It was stated that it was the old franchisee who had to transmit the information to the prospective new franchisee, as to all intents and purposes the assignment was a transaction between the old franchisee and the prospective new franchisee which the franchisor did not enter into.

109. The delegation of the *United States* proposed modifications to both the text of Paragraph (B) and paragraph 60 of the Explanatory Report (Doc. 35). Its concern was that the formulation “bound by the same terms” might be interpreted or misinterpreted to mean literally identical terms and this was often not the case, as the term of the agreement might, for example, change. They therefore proposed adding “substantially” before “the same”. As, however, in some respects the exemption created a very large loop-hole, a condition should be added, namely that the franchisor did not have a significant role in the transfer, which would avoid the franchisor becoming involved in the process and making misrepresentations to lure the prospective transferee into going through with the deal. Paragraph 60 of the Explanatory Report should also be modified to reflect the proposed new formulation of the text. The proposed texts read as follows (proposed modifications in italic):

“(B) in case of the assignment or other transfer of a franchisee’s rights and obligations under an existing franchise agreement, where the assignee or transferee is bound by *substantially* the same terms as the assignor or transferor, *and the franchisor has not had a significant role in the sale other than approval (including qualification and training).*”

“60. *Paragraph (B) excludes disclosure in the case of an assignment or other transfer of a franchisee’s rights and obligations under specific conditions, both of which must be met in order for the exemption to apply. First, the assignee or transferee must be bound by substantially the same terms as the assignor or transferor; where, in other words, the only significant change is the name of the franchisee who signs the agreement. The reason for that is that in such cases a franchisee who transfers or assigns a franchise agreement may pass everything over to the new franchisee, including the information he/she received at the beginning of his/her franchise relationship with the franchisor, and if nothing significant is to change in the relationship except one of the parties, new disclosure is not required if the second condition is met. The second condition is that the franchisor must have been uninvolved in the transfer, other than merely approving the transfer, including qualifying the assignee or transferee as an acceptable franchise owner and providing some initial training. Where the franchisor is uninvolved, the transferee does not rely on any representations of the franchisor made to induce the transfer. However, where the franchisor makes new representations to the transferee, then the transaction is substantially similar to the sale of a new franchise, triggering the franchisor’s disclosure obligation.*”

110. One delegation supported this proposal.

111. It was objected that the proposal created more problems than it solved. In the understanding of a civil lawyer there was no doubt that in the case of a transfer or assignment, if a third party stepped into a contract that was still being performed, the duties and obligations that existed at that time, exactly the same duties, were transferred. That meant that if, for example, the contract had a term of ten years and five had gone by at the time of the transfer, the transferee would step into the contract for the five remaining years. Words like “substantially” were likely to cause problems because it would be necessary to define what they meant. Although a loop-hole might be

remedied, a grey zone would be created with consequent litigation and with judges finding that they had to intervene.

112. Three delegations shared this analysis of the consequences of a transfer and of an adoption of the proposal. A fourth delegation pointed out that the proposal was a modification of the whole conception of this exemption. The Study Group had intended the exemption to apply only in cases where the terms, all the terms, were identical. That had also been the reason for which no indication had been given of who had to provide the information in this case.

113. The delegation of the *United States* requested that its proposal be inserted in the revised version of the document in square brackets to permit States to take it into further consideration. One delegation indicated that it could agree to this, on condition that the fundamental change in policy were clearly indicated. It was so decided. In the course of the review process, the delegation of the *United States* requested that also the original text of the provision be placed in square brackets.

(III) *ARTICLE 5(C)*

114. As regards **Paragraph (C)**, one delegation proposed adding “and of its affiliates” at the very end of the provision. The proposed addition was intended to cover cases where the franchisee’s business was organised in a number of separate entities and the new franchise would not exceed 20% of the total aggregate sales of those entities combined.

115. In reply to a question whether the proposed modification would not risk creating too large a loop-hole, the observation was made that it was limited by the fact that the franchisee was engaged in the same or a similar business.

116. Two delegations supported the proposal. As no objections were raised, the proposal was accepted.

117. Consideration was given to the situation of the world mart, where the proposed franchise represented perhaps 1% or 2% of the total sales. As the franchise would not be in the same or a similar business, disclosure would have to be given in such cases. It was however observed that such cases would be covered by Paragraph (E), which referred to very large franchisees.

118. The delegation of the *United States* submitted a proposal for an addition to Paragraph (C) describing what kind of person was intended (Doc. 35):

“(or an entity controlled by such a person or an entity where such a person is primarily responsible for the day-to-day management of the franchisee’s business)”.

119. The intention was to clarify that both natural and legal persons were intended, in particular as the word “persons” when used in Paragraph (A) referred to only natural persons.

120. It was observed that in civil law systems when the word “persons” was not qualified, it would normally be taken to refer to both natural and legal persons.

121. In the end, it was decided that the words “natural or legal” should be added before the word “persons” in Paragraph (C).

(IV) *ARTICLE 5(D)*

122. As regards **Paragraph (D)**, one delegation proposed that the word “investment” be changed to “capital requirement”, as investment was too broad and might be understood to include also such factors as investment in time. Another delegation suggested to say “financial requirement” rather than “capital requirement” and this proposal was accepted by the Committee.

(V) *ARTICLE 5(E)*

123. With reference to **Paragraph (E)**, one delegation suggested that “net worth” be changed to “turnover”, as it was not always easy to establish the net worth. It was observed that the concept of

“turnover” was a very sensible standard if one spoke of a company that was already in the business that it was preparing to sell the franchise in, but if the prospective franchisee were, for example, Bill Gates, who would have a substantial net worth and therefore presumably be sophisticated enough not to need the disclosure, it would not be possible to use turnover as a standard.

124. In the light of this observation, the proposal was modified to read “net worth or turnover”. One delegation stated it preferred the language as it stood. No other observations were made on this proposal.

125. One delegation suggested that the term used would have to be read and understood in the light of the accountancy principles generally accepted in the place where the legislation would be introduced, and that this might usefully be indicated in the Explanatory Report.

(VI) *ARTICLE 5(F)*

126. In relation to Paragraph (F), one delegation suggested that the Explanatory Report indicate that the sums involved in renewals could be considerable as a result of the additional investments required.

(VII) *ARTICLE 5(G)*

127. In relation to **Paragraph (G)**, the delegation of the *United States* submitted a proposal to modify the Paragraph and paragraph 64 of the Explanatory Report as follows (Doc. 35) (modifications and additions in italic):

“(G) where the total of the payments contractually required to be made *by the franchisee to the franchisor or affiliate of the franchisor from any time before to within [x] months after commencing operation of the franchised business* is less than [Z]”.

“64. At the opposite end of the spectrum to the exemptions for large investments and large franchisors, is the exemption contained in *Paragraph (G)* for cases where the *total payments* that the franchisee is contractually required *to make to the franchisor or affiliate* are less than a certain amount. The intention is to exempt very small arrangements. *For example, it ensures that the franchisor does not circumvent the disclosure requirement by requiring very small payments pre-sale sufficient to benefit from the exemption, only to subsequently require substantial payments post-sale, permitting the franchisor to recover all that it has forfeited during the pre-sale phase. [...]*”

128. The reason this modification was proposed was that the provision might be interpreted as permitting the franchisor to require a significant, one-time, post-sale payment without triggering the disclosure obligation.

129. It was recalled that the intention of the Study Group had been to avoid that the franchisee, after several years in which the franchisor, to circumvent the disclosure obligation, had required the payment of small sums, might be required to pay large sums effectively permitting the franchisor to recover the money the franchisee had not paid the first few years.

130. It was observed that this problem might be solved if the wording were changed very slightly, by changing “every” to “any”. As the provision referred to the total of payments contractually required, when the contract listed the payments to be made and the schedule when the payments had to be made, the situation described would be covered. This proposal was accepted by the Committee.

131. One delegation wondered whether cases where payment was not made directly in money, but in the purchase of goods or services, would also be covered by the exemption in Paragraph (G). It was observed that as the language was “payments” and not “fees”, all forms of payment were covered. Thus, if a franchisee were required to do X or less, whether by writing a cheque or buying goods, the exemption would apply.

ARTICLE 6

132. Introducing **Article 6** the *Secretariat* recalled that the Article was divided into two paragraphs, the first of which required the disclosure of information that was normally not contained in the franchise agreement, whereas Paragraph (2) required the disclosure of information that was contained in the franchise agreement, specifying that if the agreement dealt with it adequately, a simple reference to the relevant provision of the agreement sufficed. The reason the Group had decided to include Paragraph (2) was that although the information was contained in the agreement, it very often was not dealt with adequately. This additional requirement had therefore been felt to be necessary.

133. The absence of a general statement of principle in Article 6 was noted. It was suggested that the list of items to be disclosed in Article 6 be deleted and that it be replaced by a general statement to the effect that "[t]he disclosure document shall contain all material facts". The list of items might be moved to the Explanatory Report or to an annex or appendix to the Law, with a reference being made to this appendix in the text of the law.

134. This proposal was supported by one delegation, but opposed by five. Article 6 was considered to be a core provision of the Model Law by three delegations. One of these delegations stressed the need to offer practitioners guidance as to what constituted a material fact, another stressed the need to provide legislators with guidance. A third stressed the importance of the Article for developing countries precisely because of the information it contained. It was therefore decided that the list of items to be disclosed in Article 6 should be retained. It was nevertheless suggested that the list should be preceded by a general statement of principle, considering also that Article 10 referred to remedies for the non-disclosure of material facts, when in effect there was no requirement to disclose material facts.

135. A second question concerned the nature of the list in Article 6. Whereas some delegations suggested that the list should be a minimum list, and should therefore be introduced by the word "including", others felt that the list should be merely illustrative and should therefore be introduced by "such as", considering also that paragraph 121 of the Explanatory Report, with reference to the remedies in Article 10, stated that it could not be excluded that in a given case information that was not required to be disclosed under Article 6 was material.

136. The suggestion to make the list into an illustrative list was opposed by one delegation. It recalled that the question had been discussed at length by the Study Group which had decided against the list being merely illustrative, as it had been felt that the franchisor needed to be in a position to know clearly what he/she had to do before concluding an agreement. Paragraph 121 indicated that the information that was not included in the list would give rise to civil liability on the basis of civil law and that might help mitigate the concern of those who considered a closed list too formalistic or limited.

137. It was pointed out that if the list were made into a minimum list, it was also made compulsory, whereas some of the items listed might not be material in all cases. If it were agreed that all material information must be disclosed, then in any given case it should be possible for a franchisor not to disclose those items listed which were not material. Another reading of the provision and of paragraph 121 of the Explanatory Report was that the requirement to disclose the items was mandatory, in other words that the items listed always had to be disclosed, but that there might also be items which were not listed, which were material, and which had to be disclosed.

138. Another delegation felt that it would be unfortunate if the list were open, although it was clear that national legislators did not have to reproduce all the items. It was true that there might be additional items that might require disclosure, but those were covered by other legislation, as stated in paragraph 121. There should not be any remedy in this law for information that, albeit material, was not required to be provided under this law and which had not been provided by the franchisor. Furthermore, if the law that a State adopted on the basis of the Model Law were to contain a provision saying that the franchisor had to provide information "such as", and then another provision (Article 10) saying that if the information required under Article 6 were not provided the franchisee could terminate the contract, it would not be possible to know which information was required to be disclosed under

Article 6 because the list would not be exhaustive. However, the delegation agreed that the list had to be open in the sense that the national legislator was free to adopt a shorter or longer version of it.

139. It was pointed out that, as the instrument was a model law, legislators were free to add items to, or to delete items from, the list. As, furthermore, the list of material items might differ from franchise to franchise, the list had to be illustrative. It was however also recalled that one of the intentions with the Model Law was to adopt international benchmarks against which countries could measure themselves. The illustrative or minimum character of the items listed should therefore not be exaggerated.

140. The observer from the *International Bar Association* pointed out that the people who used disclosure documents often used them not merely to evaluate a single franchise, but to compare two or more franchises, and the less prescriptive the provision, in particular in the absence of a specific form, the more difficult it would be to compare the different franchises. One delegation pointed out that it was for this reason, and also because it was impossible for a legislator to include all facts that a prospective purchaser would consider, that all material facts had to be disclosed.

141. The Drafting Committee was requested to look into the formulation. Time did not however permit the results of the deliberations of the Drafting Committee to be discussed in Plenary at this session.

142. Towards the end of the meeting the delegations of *Canada* and *Germany* submitted a written proposal to modify the chapeau of Article 6(1) as follows, to indicate that no consensus had as yet been reached on the nature of the list in Article 6(1):

"The disclosure document shall contain all material facts [such as] [including] the following: [...]"

143. It was decided to include this statement as well as the original text in square brackets in the next draft of the Model Law.

(I) *ARTICLE 6(1)(A)*

144. In relation to the French version of **Sub-Paragraph (A)**, it was pointed out that in some jurisdictions the term "*raison sociale*" was not used any more, that the term "*dénomination sociale*" was used instead. It was therefore suggested that the formulation be modified to read "*raison ou dénomination sociale*". This proposal was accepted.

145. One delegation wondered whether the information in Sub-Paragraph (A) should always be considered material. It was explained that the purpose of Sub-Paragraph (A) was to ensure that the franchisee knew, for example, that the franchisor was a limited liability company, as this would permit the franchisee to know to what degree he/she had legal recourse and against whom. The information was therefore considered always to be material.

(II) *ARTICLE 6(1)(B)*

146. Following the modification made to the French version of Sub-Paragraph (A), it was decided to align **Sub-Paragraph (B)** by modifying the formulation to read "*raison ou dénomination sociale*".

(III) *ARTICLE 6(1)(D)*

147. In relation to **Sub-Paragraph (D)**, the delegation of the *United States* submitted a proposal in Doc. 35 to add the franchisor's affiliates, as they felt that the limitation to the franchisor might be too restrictive in the case of international franchising. The reason was that in some instances a franchisor who went into another country to do business would set up a local subsidiary that would be distinct from the franchisor. The franchisor might have no business experience to disclose, but the affiliate might. So as to make sure that not all affiliates were included under this provision, it should be limited to affiliates that conducted business under substantially the same name. The proposed wording was as follows (proposed modifications in italic):

(D) a description of the business experience of the franchisor *and its affiliates offering franchises under substantially the same trade name*, including:

- (i) the length of time during which *each* has run a business of the type to be operated by the franchisee; and
- (ii) the length of time during which *each* has offered franchises for the same type of business as that to be operated by the franchisee.

148. In relation to Sub-Paragraph (D)(ii), one delegation proposed changing "offered" to "granted", as it was possible to offer without the offer being accepted, and simply offering something said nothing of the experience of the franchisor.

149. The proposal of the United States as modified was accepted, as was the proposal relating to the word "offered" in Sub-paragraph (D)(ii).

(IV) *ARTICLE 6(1)(E)*

150. In relation to **Sub-Paragraph (E)**, it was suggested that the reference to qualifications should be deleted, firstly because the franchisor would in most cases be a corporation and it might not have the information required relating to its employees, thus it would not be possible to force the franchisor to provide information that he might not have, and secondly because the qualifications were information of a personal nature which it might not be possible for the franchisor to give even if he did have it available, in view of the laws on privacy.

151. The proposal was accepted and the words "and qualifications" consequently deleted.

(V) *ARTICLE 6(1)(F)*

152. Two opposite views were held in relation to **Sub-Paragraph (F)**, in particular as regards the reference to criminal convictions. In the view of one delegation, requiring the disclosure of criminal convictions would probably have constitutional implications in its country. It was a question of the protection of the individual and whether it was possible to oblige someone by law to reveal his/her criminal convictions or those of others. Furthermore, a requirement to disclose criminal convictions would not have any practical effect, as if a person did have criminal convictions he/she would be unlikely to reveal this fact.

153. The other view was that Sub-Paragraph (F) was critically important for a disclosure document, and in fact that the provision did not go far enough. The delegation of the *United States* submitted a proposal in Doc. 35 intended to expand upon the obligation contained in the Sub-Paragraph and to add a new paragraph 76 *bis* to the Explanatory Report. The reason it felt the provision to be of such importance was that if a franchisee was investing money in a franchise system with a franchisor the franchisee did not know much about, the money was at risk and the franchisee should know if there was litigation or bankruptcy that could affect the operation of the company or the ability of the franchisor to perform as promised. At present the draft focussed on fraud and misrepresentation, but there were a number of other areas for which it was critical for franchisees to know about litigation, such as violations of anti-trust or securities laws, fraud and unfair and deceptive practices. Furthermore, it was important for prospective franchisees to know about law suits filed by franchisees that pertained to the franchise relationship. In addition, it was all too easy for a franchisor who had problems to hide them and to defraud investors by setting up a second corporation that then sold franchises. It therefore proposed that disclosure of litigation of the franchisor's predecessor be added to the list. If this proposal were accepted, it would be necessary to include a definition of predecessor, and a proposed definition was also submitted in Doc. 35. The proposals submitted were as follows (proposed modifications in italic):

(F) *the following information regarding litigation or other legal proceedings:*

- (i) relevant details *concerning* any criminal convictions, or any finding of liability in a *material* civil action *or arbitration, within the last five years*, involving franchises or other businesses, *and* relating to a *violation of a franchise, antitrust, or securities law*, fraud, misrepresentation, *unfair or deceptive practices*, or similar acts or practices, *against any of the following:*
 - (a) the franchisor *and any predecessor of the franchisor*,

(b) any affiliate of the franchisor *which is offering franchises under substantially the same trade name and any predecessor of such an affiliate which is offering franchises under substantially the same trade name*; and

(c) any of the persons indicated in *sub-paragraph (E)*;

(ii) *relevant details concerning any finding of liability in a material civil action or arbitration involving the franchise relationship brought within the last five years by current or former franchisees against any of the persons or entities indicated in subparagraph (i); and*

(iii) *relevant details of any material pending matter of the same nature as set forth in subparagraph (i) or (ii).*

76 bis. *Sub-Paragraph (F) requires franchisors to disclose material lawsuits filed within the last five years by current or former franchisees against the franchisor that involve the franchise relationship. Typically, this will concern suits in which one or more franchisees allege that the franchisor has breached its contractual obligations under the franchise agreement either by failing to provide, for example, promised assistance, training, or advertising, or by unilaterally revising the existing franchise agreement's terms and conditions. It would not include suits by a franchisee against a franchisor for matters arising outside of the franchise agreement, such as a personal injury suit brought by a franchisee who happened to fall while visiting the franchisor's office.*

154. The proposed definition of "predecessor" read as follows (Doc. 35):

"Predecessor means any legal entity from whom the franchisor acquired directly or indirectly the major portion of the franchisor's assets."

155. It was suggested that both positions might be reflected in the Explanatory Report, rather than in the text of the provision itself.

156. This suggestion was supported by one delegation, even while favouring the second of the two views. The delegation suggested that for the Committee to propose to States the adoption of a Model Law without an item of such a fundamental nature would be to put the project seriously at risk.

157. It was observed that Article 6 was drafted very much in the common law style, and that quite apart from constitutional considerations there were many other principles in the civil law which would be against such a precise determination of what had to be disclosed.

158. In the course of the review process, one delegation requested that Sub-paragraphs (F)(ii) and (iii) be placed in square brackets for further consideration by the Committee, as it felt that the requirements therein stated were too broad.

159. In relation to the proposal in Doc. 35, it was suggested that the areas listed went too far, notably the reference to anti-trust and securities laws should be deleted. Furthermore, misrepresentation in the common law could be either fraudulent, negligent or innocent, so it was therefore too broad.

160. Another delegation proposed that the reference to securities laws be changed to "laws regulating fraudulent investment, and fraudulent consumer schemes".

161. The delegation of the United States indicated that it would accept the deletion of the reference to securities laws, as it felt that the substance was probably covered by the reference to "unfair practices".

162. In the end, one delegation supported the proposal submitted by the United States, whereas three opposed it.

163. It was suggested that the Explanatory Report indicate that some States may wish to consider enlarging the disclosure requirements as proposed by the United States. This suggestion was accepted by the Committee.

164. As regards the proposed inclusion of a definition of “predecessor”, in the course of the review process the delegation of the United States requested that it be included in square brackets in the text of Article 2 for further consideration by the Committee, and that the Explanatory Report include the appropriate comments thereon. It further requested that the words “or arbitration” be inserted in square brackets after the words “finding of liability in a civil action” and that in Sub-paragraph (F)(i) the words “or any predecessor of the franchisor” be inserted in square brackets after the words “the franchisor”, and that the Explanatory Report be adapted as a consequence.

(VI) *ARTICLE 6(1)(G)*

165. A first question raised with reference to **Sub-Paragraph (G)** concerned the meaning of “comparable proceeding”. It was explained that bankruptcy and insolvency proceedings differed from country to country and developed continuously. There were proceedings which resembled, but were not identical with, bankruptcy proceedings and it was to cover also such transactions that the term “comparable proceeding” had been included in the provision.

166. It was proposed that the provision should be limited to the franchisor. This proposal was supported by one delegation, which furthermore stated that the number of persons covered was too large, and that the provision would hit different persons or enterprises which were in financial difficulties. Furthermore, the specified time-period of five years was long. It was also striking that further on Sub-Paragraph (M) obliged the franchisor to disclose for only the three prior years. It suggested that it would be less stigmatising for the franchisor if the disclosure requirement were limited to cases where the bankruptcy or insolvency was limited to cases of bad management or fault on the part of the management of the franchisor. This proposal however did not meet with the favour of the Committee and was consequently rejected.

167. While agreeing that bankruptcy or similar proceedings against the franchisor should be disclosed, one of the delegations recalled that the concept of “franchisor” covered corporations, individuals and subsidiaries, as well as parent companies. To the extent that a franchisor was a corporate entity, especially in cases where it was a new corporate entity that had been created for the specific purpose of selling franchises in a particular country, the real people who were offering franchises were not the corporate entity but its controlling members. It was highly material for a person who was going to invest his/her life's savings in a franchise to know the financial background of who he/she was dealing with and that would be not just the franchisor, but all the others listed in Sub-Paragraph (G).

168. Voting on the proposal to limit Sub-Paragraph (G) to the franchisor, six delegations voted in favour and five voted against.

169. Following the even split in the voting, a discussion ensued on whether or not the text should be modified. One view was that it was important for the report to indicate the different concerns raised, but that the text should be modified only where there was a clear indication that a provision caused all delegations problems, such as the constitutional problems that had been discussed with reference to other provisions. As the instrument discussed was a model law, States would in any event be free to accept or reject any provision proposed, what was important was that they were alerted to the problem areas. Another view was that the Model Law aimed at a consensus, and that therefore modifications could and should be made.

170. In view of the discussion a compromise was suggested to the effect that only the reference to the persons in Sub-Paragraph (E) be deleted. It was however pointed out that that would leave only a reference to “legal entities indicated in Sub-Paragraph (E)” and there were no legal entities mentioned in (E), Sub-Paragraph (E) referred only to natural persons.

171. In this context reference was made to the proposed modification submitted by the *United States* in Doc. 35, which had recognised that Sub-Paragraph (E) referred only to natural persons and had therefore inserted a reference to Sub-Paragraph (F). The proposal read as follows (proposed modifications in italic):

"(G) relevant details concerning any bankruptcy, insolvency, or comparable proceedings involving *any of the* legal entities or persons *identified* in *sub-paragraph* (E) or (F) for the previous five years."

172. The delegation of the United States however pointed out that the proposal for modification of Sub-Paragraph (G) was related to the proposal for modification of Sub-Paragraph (F) that it had submitted earlier, and that as that proposal had been rejected, also this proposal was no longer on the table. There was however a problem with the reference to legal persons in Sub-Paragraph (E) which had to be solved.

173. Following a further discussion on whether or not the proposed deletions should be made, a second vote indicated that seven delegations favoured retaining the Sub-Paragraph as it stood. It was decided that the report on the meeting would reflect the discussions and that the Explanatory Report should indicate that States may consider whether or not to include natural persons under this Sub-Paragraph.

174. In the course of the review process one delegation requested that the words "natural and" before "legal entities" be placed in square brackets for further consideration by the Committee, so as to reflect the concerns expressed in the course of the discussions.

(VII) ARTICLE 6(1)(H)

175. In relation to **Sub-Paragraph (H)**, the delegation of the *United States* proposed the deletion of the reference to "network" (Doc. 35), as the term "network" would include franchisees of related systems of the franchisor as well as a number of others. The resulting disclosure could be extremely lengthy and would not be relevant to the franchise that was being offered. The text of Sub-Paragraph (H) with the proposed modification read as follows (proposed modifications and additions in italic):

"(H) the total number of franchisees *of the franchisor and of affiliates of the franchisor offering franchises under substantially the same trade name.*"

176. The proposed modification was supported by four delegations. One delegation however proposed that the word "offering" should be changed to "granting". This proposal was accepted.

177. A proposal to include also company-owned outlets was accepted by the Committee.

178. The proposal of the United States as modified was therefore accepted by the Committee.

(VIII) ARTICLE 6(1)(I)

179. Introducing **Sub-Paragraph (I)**, the *Secretariat* recalled that the purpose of the provision was to permit the prospective franchisee to contact franchisees already part of the network to ask them about their experience. The reference to contiguous States had been inserted because in continents such as Europe, where States were small and geographically close, the experience of franchisees in one State might be very relevant to franchisees in other States. The number of franchisees whose addresses had to be given had been limited to a maximum of fifty, as that had seemed a reasonable figure. The *Secretariat* also recalled that the *International Chamber of Commerce* had commented on this provision in Doc. 31.

180. The delegation of the *United States* submitted a proposal to include also franchisees of affiliates of the franchisor in the provision, and consequently also to modify paragraph 79 of the Explanatory Report (Doc. 35). The proposed additions to the text and Explanatory Report read as follows (proposed additions in italic):

"(I) the names, business addresses and business phone numbers of the franchisees *of the franchisor and of the franchisees of any affiliates of the franchisor which are offering franchises under substantially the same trade name* whose outlets are located nearest to the proposed outlet of the prospective franchisee [...]"

"79. *Sub-Paragraph (I)* requires the franchisor to provide the prospective franchisee with the names, addresses and business phone numbers of the franchisees whose outlets are located nearest to the proposed outlet of the prospective franchisee in the State of the franchisee and/or contiguous States, i.e. in States that share a common border with the State of the franchisee, or, if there are no contiguous States, in the State of the franchisor. *Where a franchisor sells master franchises, the franchisor should also include in its disclosure document information about master franchisees and their franchisees. [...]*"

181. The reason for the proposed additions was the consideration that franchisors may set up independent entities for the purpose of selling franchises in the countries they were proposing to enter and that there would in such cases be no franchisees in that country to disclose the addresses of, even if there might be several hundred in contiguous countries. Furthermore, if affiliates were not included, it would be possible for a franchisor to reincorporate in a country where the franchise had not been successful and where franchisees had lost their investments, without disclosing this fact.

182. The proposal was felt to go too far by one delegation. The definition of "franchisor" included also sub-franchisors. If affiliates and sub-franchisors were included, the sub-franchisor of country A might have to provide information about franchisees of the sub-franchisors of countries B and C, and this would place a heavy burden on the sub-franchisor, who might not have access to this information in the first place. It would also be necessary for the sub-franchisor to keep this information up to date.

183. It was pointed out that the definition of "affiliate" (as modified) stated that it meant "a natural or legal person which directly or indirectly controls or is controlled by the franchisor, or is controlled by another party who controls the franchisor". Obtaining the information should therefore be merely a matter of a telephone call. It was not intended that the information to be disclosed should be open-ended, the affiliate concerned would have to be involved in the same business under substantially the same trade name. Furthermore, there was already a limitation in the provision, as it limited the information to be provided to fifty franchisees.

184. One delegation supported the proposal and three opposed it.

185. To solve the problem of the sub-franchisor, it was suggested that the definition of "franchisor" might be modified. It was however pointed out that modifying the term "franchisor" would affect also other provisions in which that term was used.

186. A proposal to explain the difficulties with the provision in the Explanatory Report was opposed on the grounds that the difficulties should be solved in the text and that it was not possible to deal with everything that caused problems in the Explanatory Report.

187. In the end, it was decided that the provision should be retained as it stood.

188. In the course of the review process, the delegation of the United States requested that the words ", and of the franchisees of any affiliates of the franchisor which are offering franchises under substantially the same trade name," be inserted in square brackets after the words "business phone numbers of the franchisees" for further consideration by the Committee.

(IX) *ARTICLE 6(1)(J)*

189. Introducing ***Sub-Paragraph (J)***, the *Secretariat* recalled that the purpose of the provision was to permit a prospective franchisee to evaluate whether the franchisor had a tendency to buy-out franchises to turn them into company-owned outlets, whether the franchisor terminated agreements easily, or whether there were many franchisees who on their own accord did not renew the agreement, which would indicate that they were not satisfied with the relationship. The Study Group had however felt that for the prospective franchisee to obtain the desired information it was sufficient if the reasons for which the franchisees had left the system were given in categories. In fact, they had considered that a table indicating how many franchisees had left the system for each of the reasons provided in the provision might be sufficient.

190. One delegation suggested that there were three more reasons that should be added, namely terminated due to insolvency, terminated by the franchisee and terminated in connection with litigation.

191. A discussion followed on whether the list was exhaustive or illustrative, and on whether it was desirable to have a list in the provision at all. One delegation reiterated the view that the preference for or against a list reflected different drafting styles, the civil law drafting style preferring short statements of principle, and the common law drafting style preferring detailed indications. The delegation thereupon suggested that the first sentence of the provision be retained, and the second deleted, as the first already required reasons to be given and that was sufficient. Another delegation suggested that the list might be transferred to the Explanatory Report. Three other delegations supported this view.

192. Another delegation expressed a preference for the list to be retained in the provision rather than in the Explanatory Report. The purpose of the Model Law was to give guidance to legislators and placing the second sentence in the Explanatory Report forced legislators who wished to retain it to redraft it. It was necessary to offer legislators a choice, and it was easier to delete what was not desired than to insert what was not there. This position was echoed by four other delegations who stressed the importance of the guidance offered by the provision to developing countries. One of the delegations stressed that the purpose of the second sentence was to provide guidance to franchisors, permitting them to evaluate whether or not they had provided the required disclosure.

193. One delegation urged the Committee to decide what kind of Model Law it wanted to result from its deliberations. It appeared as if the result would be a mixture of all the requirements of the common law and all the requirements of the civil law, so that legislators could pick and choose the provisions they wanted, whereas if a Model Law issued by UNIDROIT was to have any chance of success, it should be a model law that could be accepted and adopted by different countries with as few changes as possible. This view was shared by two delegations. One of these delegations however felt that particularly where a list such as the one in Article 6 was concerned, a certain flexibility had to be allowed for, so that the different national cultures and circumstances could be taken into consideration by the national legislators that decided to make use of the Model Law.

194. **Mr Herbert KRONKE**, *Secretary-General* of UNIDROIT, recalled the role of internationally prepared model laws in national legislation and indicated that developing countries were increasingly looking to international organisations such as UNIDROIT for guidance and assistance with national law reform.

195. One delegation felt that there might be more reasons for the ending of the relationship than those given and felt that it was not clear whether the franchisor had to list only those which had ended in one of the ways indicated, or all those that had been ended. It was observed that as drafted, it appeared as if in the intentions of the Study Group the list was an exhaustive one. Another delegation instead interpreted the provision as clearly open-ended.

196. In the end, there were three options: to retain the second sentence more or less as it stood, on the understanding that the list was a closed list, to delete the second sentence and place its contents in the Explanatory Report, and to retain the second sentence with the indication that the list was illustrative.

197. It was decided that the three alternatives should be given in the next draft in square brackets and that termination due to insolvency, termination by the franchisee and termination in connection with litigation should be added to the present list.

198. In the course of the review process, one delegation requested that the words “, of the franchisor and about franchisees of affiliates of the franchisor that offer franchises under substantially the same trade name” be inserted in square brackets after the words “information about the franchisees” for consideration by the Committee, and that the Explanatory Report be modified accordingly.

(X) *ARTICLE 6(1)(K)*

199. With reference to **Sub-Paragraph (K)**, one delegation felt that the requirement to disclose information regarding the franchisor's intellectual property "relevant for the franchise" was too broad. It suggested that "to be licensed to the franchisee" would be more precise. Four delegations supported this proposal and none opposed it. The proposal was consequently accepted.

200. Another delegation suggested that the information to be disclosed listed in Sub-Paragraphs (K)(i) and (ii) was insufficient, and that information on the ownership of the intellectual property as well as on the duration of the licenses granted should also be disclosed. It was suggested that the words "in particular" might cover this concern, as they opened the possibility that also other items of information might be disclosed. Furthermore, when information on the registration was obtained, it would be easy to include the duration of the licence and the ownership of the intellectual property among the relevant information regarding the registration.

201. While admitting that such a broad interpretation of the words "in particular" might be possible, the delegation proposing the additional items felt that there was no guarantee that they would be interpreted in a broad sense and suggested that it would be preferable to add a sub-sub-paragraph. Two other delegation agreed that it would be preferable to add a sub-sub-paragraph.

202. As an illustration of the importance of the proposed addition, one delegation recalled cases in which it had been uncertain who was the owner of the intellectual property, as more than one person claimed ownership and it had not been made clear who was the owner for the purposes of that particular country.

203. The importance of international conventions dealing with intellectual property in this regard was also recalled.

204. In the end it was suggested that a written proposal should be prepared by the delegation proposing the amendment. The proposal was discussed in the Drafting Committee, but there was no time for Plenary to consider the results of the deliberations of the Committee at this session.

(XI) *ARTICLE 6(1)(L)*

205. In relation to **Sub-Paragraph (L)** one delegation requested clarifications as to the meaning of the term "pricing practices". The *Secretariat* explained that by this term the Study Group had intended to indicate those financial benefits, such as rebates, that the franchisor might be getting from suppliers as compensation for enlisting them as suppliers. Such financial benefits might be kept by the franchisor, or might be used for the benefit of the network, and information on how the franchisor intended to use the money might be of interest to the franchisee. The intention was to permit the franchisee to evaluate whether the same products or goods were available at more reasonable prices from other suppliers or whether the deal was fair, considering also the rebates that the franchisor might be getting.

206. One delegation suggested simply saying "rebates", but two others felt that that would be too narrow, considering also that other financial benefits, such as bonds, might be obtained by the franchisor.

207. One delegation suggested saying "pricing arrangements" instead of "pricing practices". This suggestion was supported by three delegations, one of which suggested that the word "supply" be added. The words "supply" however caused some problems when rendered in French, a proposal being *"toute information concernant les conditions financières des accords de fourniture regardant cette marchandise"*. An alternative formulation of the English was "information on the pricing arrangements relating to the goods or services to be procured from the franchisor", but this proposal was not accepted considering the formulation of the remainder of the Sub-Paragraph. As a rendering of "supply arrangement" in French *"convention de fourniture"* was suggested.

208. In the end, it was decided that the Drafting Committee should provide a formulation. The Drafting Committee did examine the provision, but there was no time for Plenary to discuss the results of the deliberations of the Committee at this session.

209. As regards Sub-Paragraph (L), one delegation suggested that requiring the disclosure of all the goods that had to be purchased was too broad. This was particularly the case in franchises such as do-it-yourself networks, which had perhaps as many as 200,000 items on their list and perhaps 5,000 different suppliers. It therefore suggested that instead of a detailed list of individual goods, the franchisor should be required to disclose categories of goods and/or services. Four delegations supported this proposal.

210. The formulation of the chapeau of Sub-Paragraph (L) as adopted by the Committee therefore read "information on *the categories of goods and/or services* [...]".

(XII) ARTICLE 6(1)(M)

211. With reference to **Sub-Paragraph (M)(i)(a)**, the delegation of the *United States* submitted a proposal to modify paragraph 88 of the Explanatory Report as follows (Doc. 35) (proposed modifications and additions in italic):

"88. [...] The provision ~~therefore~~ requires only that the franchisor provide a reasonable estimate of the franchisee's total initial investment. The *precise* manner in which an estimate should be presented to the prospective franchisee is left to the franchisor to decide. *While disclosure of initial costs is obviously material to the franchisee, this may prove quite difficult for a franchisor to provide, especially a franchisor entering a foreign market for the first time. Indeed, in such circumstances, the local prospective franchisee may be in the best position to calculate costs, such as local real estate and labour costs, and the franchisor may be relying on the prospective franchisee to supply that information. Accordingly, the franchisor is required to provide the prospective franchisee with only a reasonable cost estimate based upon information the franchisor already possesses or can easily obtain. The franchisor need not incur the cost of preparing, for example, in-depth market analyses in the foreign country. Rather, an estimate could be based upon the sale of a substantially similar franchise in another identified country. Because the cost disclosures are only estimates at best, they should never be considered a guarantee, and prospective franchisees should understand that the ultimate cost of developing a franchise may be substantially revised during the course of negotiations.*

212. The reason this proposal was made was the consideration that the provision required the franchisor to provide an estimate of the prospective franchisee's total initial investment, whereas the prospective franchisee would probably be more familiar with local conditions than the franchisor. The concern was that the provision could lead to the franchisor being a guarantor for a particular estimate, or to the franchisor being excessively cautious and therefore providing estimates that were much higher than need be, so as not to be accused of misrepresentation at a later stage. The proposal was therefore to specify in the Explanatory Report that the estimates had to be "reasonable". This would permit the franchisor to provide the estimate based on the information the franchisor had available, without having to engage in an extensive fact-finding mission.

213. The proposal was supported by five delegations and was consequently adopted.

214. With reference to **Sub-Paragraph (M)(i)(c)**, the *Secretariat* recalled that extensive discussions had taken place within the Study Group in relation to the provision, which referred to "audited or otherwise independently verified financial statements". A concern expressed by the *World Franchise Council* at the last meeting of the Group had related to the time limits specified in the provision. The Group had however felt that, as the franchisee was being asked to make a substantial investment in the business, it was only fair for the franchisor to present financial statements that were reasonably up to date and had a certain authority, which was why the requirement that they be audited or otherwise independently verified had been inserted. Similarly, the desire for the prospective franchisee to have up to date information was the reason for the requirement that unaudited statements be presented in certain cases.

215. The observer from the *World Franchise Council* reiterated the organisation's concern as regards the unaudited financial statements that the franchisor was required to provide within 90 days of the date of delivery of the disclosure document, and wondered whether in certain countries where audited accounts were annual, this would not be placing an undue burden on the franchisor, as it

would be requiring the franchisor to provide the prospective franchisee with unaudited financial statements which might not be in keeping with the official statements the franchisor had made.

216. As regards the requirement that audited or otherwise independently verified financial statements of the franchisor be provided, one delegation indicated that, while there were no problems for franchisors on the stock market, the situation was different for many small enterprises, such as small franchisors. In some countries external audits were not required for small companies and a requirement under the Model Law for such companies to provide statements that were not otherwise required under the national law placed a heavy burden on the franchisors. In some countries corporations or companies furthermore had an internal organ, what in Italian was known as the "*collegio dei sindaci*" and in French the "*commissaires aux comptes*", whose task it was to verify the financial statements of the company once a year or every three months or so. The persons forming this organ were not managers of the company, they were outside persons, even if there was a debate in both case law and legal writing regarding whether or not these organs were truly independent bodies. Furthermore, there were limited liability companies which did not even need internal auditing, and to oblige them to produce audited statements placed an enormous burden upon them. Considering the above, the delegation proposed that the Explanatory Report specify that the statements of these organs would be sufficient for the purposes of this provision, also in view of the fact that Article 10 in any event sanctioned misrepresentations.

217. While four delegations supported this proposal and expressed similar concerns, another delegation drew attention to paragraph 91 of the Explanatory Report which it felt might cover this concern.

218. One delegation felt that the proposal did not go far enough, and that the text itself should be modified by deleting the reference to "audited or otherwise independently verified", leaving only the reference to "financial statements". This proposal was supported by two delegations, but strongly opposed by one. It was therefore decided that the text of the provision should place "audited or otherwise independently verified" and later references to "audited" and "unaudited" in square brackets.

219. The delegation of the *United States* submitted a proposal for modification of the text of the provision to take the affiliates of the franchisor into account, and for an addition to the Explanatory Report to deal with the question of national accounting standards. The Model Law did not specify which State's standards had to be used, but attention should be drawn to the fact that a requirement that foreign franchisors apply the national accounting standards of the host country would greatly increase the costs faced by the franchisor. The proposals read as follows (Doc. 35) (proposed additions and modifications in italic):

"(M)(i)(c) audited or otherwise independently verified financial statement of the franchisor or affiliate of the franchisor that guarantees the obligations of the franchisor"

"The Model Law does not specify which State's accounting principles shall be used in preparing financial statements. A disclosure document conceivably could include financial statements prepared according to the accounting principles of the franchisee's State, the franchisor's State, or the State of the proposed franchised unit. Imposing specific accounting standards, however, may raise the franchisor's costs of conducting business, thereby discouraging expansion into new markets. A franchisor seeking to expand into a new market, for example, may have already expended substantial fees to have its financial statements audited in compliance with its home State's accounting principles. The additional cost of revising or preparing additional financial statements to satisfy a foreign State's accounting principles may be so high as to discourage many franchisors from offering new franchise opportunities there. At the same time, legislators may want to protect prospective investors from relying on financial reports which are difficult to understand or which present financial information in ways which differ materially from standard financial disclosures used in their home State. Therefore, when considering accounting standards, legislators should weigh the potential barriers to entry that imposing specific accounting principles might erect against the State's interest in facilitating access to franchise opportunities."

220. While the modification proposed for the text of Sub-Paragraph (M)(i)(c) did not obtain any support and was consequently rejected, eight delegations supported the proposed addition to the

Explanatory Report. It was consequently decided to adopt the proposed addition, subject to the redrafting that would be necessary following the decisions taken as regards the text of the provision.

221. As regards the text of Sub-Paragraph (M)(i)(c), a delegation proposed that it be modified to read "financial statements of the franchisor and when available audited or otherwise independently verified financial statements". This proposal was discussed by the Drafting Committee, but there was not sufficient time for Plenary to discuss the outcome of the deliberations of the Drafting Committee at this session.

222. With reference to **Sub-Paragraph (M)(ii)(a) and (b)**, one delegation wondered whether there was an obligation for the franchisor to provide the information referred to. The *Secretariat* replied that there was not, but that as many franchisors did provide such information, requirements had been inserted into the Model Law to cover such cases.

(XIII) **ARTICLE 6(2)**

223. In relation to **Article 6(2)**, one delegation recalled that as modified Article 4(2) referred to a single document, whereas this provision referred to two, namely the disclosure document and the agreement, and suggested that the two provisions should be made consistent with each other.

224. Another delegation felt that requiring a reference in the disclosure document to information that was already in the agreement went too far, also because the agreement would not have been finalised, so there would at best be a draft agreement. In this connection it was recalled that, as indicated in the Explanatory Report, the agreement was often appended to the disclosure document.

225. It was observed that the purpose was to provide the prospective franchisee with information about key issues. It was not necessary for the franchisor to repeat the information, a reference indicating that a particular issue was dealt with at point X of the agreement would be sufficient. It was necessary to consider the profile of the prospective buyer of a franchise. In many instances the buyer would not be a sophisticated buyer represented by legal counsel who would look through an agreement and understand all the provisions in the agreement. Franchise agreements could be both lengthy and complex and the idea was to provide a prospective franchisee with a guide so that he/she could easily find where an item was dealt with.

226. To the observation that it might be sufficient simply to state that all remaining information was in the franchise agreement attached to the disclosure document, and that the chapeau of Paragraph (2) might merely state "[t]he following information shall be contained either in the disclosure document or in the franchise agreement", it was objected that it would be easy for a franchisor to bury important provisions in an agreement by adding meaningless provisions to make it longer. This type of fraud was undesirable and the intention was to avoid this by giving a clear indication of what provisions the franchisee should look for and where. Furthermore, agreements were normally template agreements, even if some provisions might be individually negotiated, so the agreement would be available to hand over at the same time as the disclosure document, before the conclusion of the negotiations.

227. A general discussion on the list of items in Paragraph (2) took place. It was observed that not all the items were necessarily provided for in every agreement, and that their being placed in Paragraph (2) might lead legislators to believe that they had to be present for there to be a franchise. It was therefore suggested that the words "if any" should be added. Whereas two delegations suggested that the words "if any" might be placed after specific items, one delegation suggested that the chapeau of Paragraph (2) might instead include those words and thereby cover all the items listed.

228. One delegation however stressed that if "if any" were added, the franchisor would be under no obligation to disclose information in relation to the items if the agreement contained no provision covering them. The purpose of the provision was also to alert prospective franchisees to the importance of the items, so that they could check what was provided and could also discover that nothing had been provided. For example, Sub-Paragraph (F) referred to the conditions under which the franchisee could terminate the franchise agreement. If the franchisor were forced to indicate that nothing was provided, that the franchisee did not have any specific rights under this item, this was

important information for the franchisee to know. Another delegation, while supporting the proposal to modify the chapeau of the Paragraph, shared the concern that prospective franchisees be informed of the non-existence of certain rights, or of the fact that an item was not dealt with in the agreement, and added by way of example that if the franchisee had no right to sell the franchise, the franchisee should be alerted to this fact by a specific statement. This concern was supported also by two other delegations which stressed the need to ensure that the franchisee received information on the non-existence of certain items in the agreement.

229. It was suggested that this might be accomplished by adding a phrase at the end of the Paragraph stating "[i]n the event that there are no provisions in the franchise agreement on a particular issue that shall be affirmatively stated".

230. One delegation wondered what the relationship would be between the franchise agreement and the disclosure document if "if any" were added to the provision and if the franchise agreement were signed, for example, a year after the disclosure document had been issued, in particular as the agreement might be different at the time of signature from what it was when the disclosure document was handed over: a termination clause which had not been in it might have been inserted, for example. It was pointed out that in such cases there would have been a change of material fact and the franchisor would have to disclose that.

231. It was decided that the Drafting Committee should examine the formulation of the chapeau of Paragraph 2, taking into consideration the observations made. The Drafting Committee did examine this issue, but time did not permit the results of the deliberations of the Drafting Committee to be discussed in Plenary at this session of the Committee.

(XIV) ARTICLE 6(2)(A)

232. In the course of the discussion on the insertion of the words "if any" into the chapeau of Paragraph (2) or into the individual Sub-Paragraphs, the fact that **Sub-Paragraph (A)** was different in nature from the other items listed in the Paragraph was noted. It was felt that the description of the franchise to be operated was an essential item without which no agreement would be valid. It was therefore proposed to move the Sub-Paragraph into Paragraph (1) of Article 6. This proposal was accepted. It was decided that the Drafting Committee should consider the appropriate placing of the provision.

(XV) ARTICLE 6(2)(B)

233. With reference to **Sub-Paragraph (B)**, the observer from the *World Franchise Council* suggested that the words "if any" be added, because not all franchise agreements contained a renewal clause.

234. This proposal was supported by two delegations and objected to by none, so it was approved.

(XVI) ARTICLE 6(2)(D) AND (I)

235. In relation to **Sub-Paragraph (D)**, one delegation raised the question of its relationship with **Sub-Paragraph (I)**. The *Secretariat* recalled that Sub-Paragraph (D) was intended to cover the rights granted to the franchisee, in particular the rights the franchisee was granted as regards the territory and the clients, whereas Sub-Paragraph (I) referred to rights that the franchisor reserved for himself, in particular as regards the use of the trademarks.

236. The importance for the prospective franchisee to know the exact extent of the rights he/she was granted, and also to know if the franchisor intended to use the trademark for other purposes, was stressed by one delegation. The limits of the rights that a franchisee was granted was not always apparent, so information of this nature was of considerable importance.

237. A first suggestion to insert a cross-reference in the provisions was followed by a proposal to merge them. This last proposal was adopted.

238. In relation to the phrase "nature and extent of exclusive rights granted", one delegation observed that whereas in civil law systems the nature of a right was effectively spoken of, this was not the case in the common law. It therefore proposed that the words "nature and" be deleted. This proposal was supported by four delegations and consequently accepted.

239. The Drafting Committee was asked to consider the drafting of the new merged Sub-Paragraph, but there was no time for Plenary to consider the results of the deliberations of the Committee at this session.

(XVII) *ARTICLE 6(2)(E) AND (F)*

240. One delegation proposed merging **Sub-Paragraphs (E) and (F)**. It was however observed that the Study Group had intentionally placed the requirement to disclose information on the conditions under which the franchise agreement may be terminated by the franchisee as a distinct item to draw attention to it, as franchise agreements only rarely provided for such rights of termination on the part of the franchisee. The proposal was consequently withdrawn.

(XVIII) *ARTICLE 6(2)(J)*

241. In relation to **Sub-Paragraph (J)**, the delegation of the *United States* proposed adding the requirement that information be provided on whether or not any portion of the initial franchise fee was refundable. The proposal read as follows (Doc. 35) (proposed additions in italic):

"(J) the initial franchise fee, *whether any portion of the fee is refundable, and the terms and conditions under which a refund will be granted.*"

242. The proposal was accepted by the Committee.

(XIX) *NEW ARTICLE 6(2)(N)*

243. The delegation of the *United States* proposed adding a new Sub-Paragraph at the end of Paragraph (2) relating to choice of law and forum. The proposed text read as follows (Doc. 35):

"(N) *any forum selection or choice of law provisions, and any mandatory dispute resolution processes*".

244. This proposal was supported by three delegations. One delegation however proposed that the word "mandatory" be substituted by "selected", as the word "mandatory" appeared to refer to processes established by law, and not chosen by the parties. This proposal was accepted.

245. One delegation felt that it should in no circumstances be possible to avoid the application of the law of the place of the franchisee and that this should be stated clearly. Two delegations however declared their opposition to such an approach, as it would interfere with the relations between the parties, and the Model Law was a disclosure law and not a relationship law.

(XX) *ARTICLE 6(3)*

246. With reference to **Article 6(3)**, one delegation drew attention to the fact that a number of articles had been modified, and that therefore it would be necessary to re-examine this provision when the new draft of the Model Law was available.

ARTICLE 7

247. Two issues were raised in relation to **Article 7**. Firstly, whether the term "statement" was the appropriate one, or whether "agreement" might not be more appropriate, also in view of the reference in Article 3(1)(A) to "agreements covered by Article 7". In this connection it was observed that in the French version of Article 3(1)(A) the term "*accord*" might be more appropriate than "*contrat*". Secondly, the fact that the Article permitted the franchisor to require the franchisee not to divulge the information received, but said nothing about what else the franchisee was or was not entitled to do. So

as to prevent the franchisee from using the information for its own benefit, it was suggested that the words “and prohibiting the competitive use of such information” be added at the end of the Article.

248. As regards the proposed modification of the term “statement”, it was observed that in the intentions of the Study Group the “statement” referred to was a pure and simple acknowledgement of the confidential nature of the information received, it was not a contract. If there were undertakings such as the suggested addition, it would become a contract. A certain discrepancy between the English and French versions was noted in this regard.

249. Another delegation felt that the proposed modification was reasonable, but that a complete reformulation would be preferable. Such a reformulation could be that the prospective franchisee had to treat the information confidentially.

250. One delegation raised the objection that the two parties had at the preliminary stage in question not committed themselves to anything substantial, and that therefore the use of the term “agreement” was inappropriate.

251. Another delegation wondered what, if the document were a contract, the sanctions and remedies for non-performance would be, as the law was silent on this issue. It was therefore suggested that both options be left open, that the words “agreement” and “statement” be placed in square brackets as alternatives, and that an explanation of what the alternatives involved be inserted in the Explanatory Report.

252. As regards the proposed prohibition against the use of the information for competitive purposes, one delegation observed that if the provision stated that the prospective franchisee was prohibited from using the information for competitive purposes, this was in effect a limitation of the provision, as the prohibition would be limited to the competitive use of the information, whereas an acknowledgement of the confidential nature of the information was broader, as if information was confidential it was not possible for the prospective franchisee to broadcast it in any manner.

253. Another delegation opposed the proposed addition. Apart from such considerations as how long such a prohibition should last, which was not dealt with in the provision, it was in effect a horizontal agreement which might fall foul of the competition or anti-trust laws of a number of countries. The Explanatory Report might however deal with the issue.

254. It was observed that the proposed addition went against the philosophy of the original draft. The intention had simply been to ensure that a simple acknowledgement of the confidentiality of the information received did not trigger a disclosure obligation on the part of the franchisor.

255. Considering the original purpose of the provision and the discussion that had taken place, the delegations of *Japan*, *Russia* and the *International Bar Association* submitted a written proposal to delete Article 7 altogether and, instead of referring to Article 7 in Article 3(1)(A), to say “*with the exception of agreements relating to confidentiality of information delivered or to be delivered by the franchisor*” (Misc. 6). This proposal was accepted by the Plenary.

ARTICLE 8

256. Introducing **Article 8** the *Secretariat* recalled that it was a recognition of the fact that it would be very important for the franchisor to be able to prove that the prospective franchisee did actually receive the disclosure document. The Article therefore provided that the franchisor may require the prospective franchisee to acknowledge receipt of the disclosure document in writing. The franchisor may even make such an acknowledgement a condition for his/her signing the agreement.

257. A first proposal was to include the contents of Article 8 in Article 3, just as Article 7 had been included in Article 3. Article 3(1)(A) dealt with the signing of the franchise agreement by the prospective franchisee. With Article 7 an exception from the triggering of the disclosure obligation had been provided, and this had now been incorporated into Article 3. Article 8 could also be incorporated into Article 3. Logically, both the exceptions would be connected to the disclosure, whereas leaving

the second one in Article 8 was problematic, as it was connected with an event which might take place several months or even years later.

258. It was objected that Article 3 stated very clearly that the disclosure document should be delivered 14 days before the earlier of two events, one of which was the signing by the prospective franchisee of any agreement relating to the franchise - an agreement, and not a unilateral acknowledgement. Secondly, as regards confidentiality, there might be cases in which agreements rather than unilateral acknowledgements were used to keep the franchise a secret, but Article 8 concerned merely proof of delivery, and as such it would always be a matter of a unilateral acknowledgement and never of an agreement. Article 8 should therefore not be linked to Article 3(1)(A). Another delegation agreed with this analysis, stating that Article 8 was merely a delivery issue and it would therefore be inappropriate to place it in Article 3(1)(A). It might however be placed as a new Paragraph (2). The sequence would therefore be Paragraph (1) containing the triggers for disclosure, Paragraph (2) the proof of delivery and Paragraph (3) the updating of the disclosure document. While one delegation favoured the placing of Article 8 as Paragraph (2) of Article 3, five delegations felt that keeping Article 8 separate was preferable. It was therefore decided to keep Article 8 as a separate article.

259. One delegation felt that it would be advisable to make the acknowledgement of receipt a mandatory requirement. Franchisees were the main target of the Model Law, as it aimed at protecting their interests. A duty to acknowledge receipt of the disclosure document should therefore be placed upon them before they were permitted to commit themselves in a franchise agreement. While two delegations supported this proposal, six others did not. The proposal was therefore not accepted. The proponent however requested that the proposal, which could be expressed by the word "shall", be placed in square brackets in the text and explained in the Explanatory Report. The Committee agreed to this.

260. One delegation raised the problem of what happened when no franchise agreement was concluded, and suggested that the acknowledgement of the receipt of the disclosure document should be made when it was delivered and not at the time of the signing of the franchise agreement. It therefore suggested that the words "As a condition for its signing the franchise agreement," at the beginning of Article 8 be deleted. This proposal was accepted.

ARTICLE 9

261. Introducing Article 9, the *Secretariat* recalled that this was an article that the Study Group had felt to be of considerable importance, as a number of the members of the Group had witnessed instances in which the franchisor had preferred to impose documentation in its own language in international situations, rather than use a language that to the franchisee might have been more comprehensible. A number of options had been discussed, including the possibility of permitting the parties to agree on the use of another language. This had however been felt to be open to abuse, as it would have been easy for the franchisor to impose its own language in the form of an agreement between the parties. The option of the official language of the principal place of business of the prospective franchisee had been selected as the option least open to abuse.

262. One delegation recalled that there were a number of countries that had legislation, possibly even at constitutional level, regulating the use of languages. Article 9 would be of less interest to such countries. The delegation therefore proposed that the Explanatory Report should refer to the fact that there were countries where such legislation existed, indicating that those countries might choose not to introduce Article 9. In this connection it was furthermore suggested that reference should be made in the Article to the need to comply with national legislation.

263. Two main problems were identified as regards Article 9. The first was that there were countries in which there was more than one official language, others in which there was one official language at federal level and others at local level, and the wording of the provision would not be suitable for such cases. Secondly, in practice the translations that were provided were often so bad that the franchisees requested and used the document in the language of the franchisor. There was furthermore the question of who should pay for the translation. In this connection it was suggested that reference should be made in the Explanatory Report to the *Guide to International Master Franchise*

Arrangements which contained an analysis of the factors to be taken into consideration in relation to the language to be used.

264. The delegation of the *United States* submitted a proposal for modification of Article 9 in Doc. 35, which however contained a mistake, in that "agrees" should be read "requests". The proposed modifications read as follows:

"The disclosure document must be written in a clear and comprehensible manner in the official language of the principal place of business of the prospective franchisee, *unless the prospective franchisee requests that it be written in the official language of its place of residence or domicile, or in the language principally used by the franchisor or by the franchisee in its business*".

265. One delegation stated that it did not support the US proposal. In particular, it could not agree with the last words "or in the language principally used by the franchisor or by the franchisee in its business", which it would be a problem verifying. The language would end up being imposed by the franchisor. Furthermore, Article 9 referred only to the language of the disclosure document and not to the language of the franchise agreement itself, which was perhaps more important and should also be taken into consideration.

266. While a couple of delegations agreed that the language of the agreement should also be considered, another felt instead that it would be dangerous to deal with the language of the agreement.

267. The observer from the *International Bar Association* suggested that the issue of the language might best be left to the market place and that the Article might consequently be deleted. While this proposal was supported by a couple of delegations, notably because of the difficulties in regulating the matter, another delegation opposed the proposal, as it felt it important for the Model Law to offer some guidance in this respect.

268. In the end it was agreed to request the delegation of the United States to modify its proposal to take into consideration the additional points raised, to leave that proposal in brackets, and also to include the option of deleting the Article in brackets. It was agreed that the Explanatory Report should refer to the question of the use of language being regulated in some countries by national legislation, at times as a constitutional issue.

269. The proposal submitted in Doc. 35 as modified read as follows:

"The disclosure document *and prospective franchise agreement shall* be written in a clear and comprehensible manner in the official language of the principal place of business of the prospective franchisee, *unless, where not prohibited by applicable law, the prospective franchisee requests, and the franchisor agrees, that it be written in the official language of the franchisee's place of residence or domicile, or in the language principally used by the franchisor or by the franchisee in their respective businesses*".

ARTICLE 10

270. A question on the correspondence of the French term "*résiliation*" with the English term "termination" initiated a lengthy discussion on the meaning of "termination". One delegation stated that it had had difficulties translating the term as it was unsure of what exactly was meant, whether what was intended was termination *ex nunc* or *ex tunc*.

271. The *Secretariat* recalled that an earlier version of the Model Law had used the word "rescission", but that it had been observed that that was a term that had different meanings in different countries. The Group had therefore opted for "termination", which was the term used by the *United Nations Convention on Contracts for the International Sale of Goods (CISG)*.

272. As regards the retroactivity of the remedy, opinions differed on whether it should be retroactive or not. The situation was further complicated by the fact that whereas non-retroactivity was appropriate in the case of Paragraph (1), it might not be appropriate in the case of Paragraph (2).

273. It was recalled that the Study Group had used the term "termination" in a broad sense, so as to permit each national legislator to decide what was appropriate in its country. The Study Group had not intended termination to be retroactive, and this could be understood from the fact that the right to terminate in Article 10 could be exercised within the time periods specified in Paragraph (3): the franchise agreement would be operational when the right to terminate could be exercised.

274. One delegation observed that if termination were not retroactive, then there would be problems with, for example, the entrance fee, as it would not have to be returned to the franchisee. Another delegation indicated that there were also a number of other problems that the delegations should consider, such as the fate of stocks that had been bought on the strength of the contract that was terminated, the fate of leasing arrangements entered into with a view to operating the franchise, and so on. There was furthermore the question of damages, and the right of the franchisee to obtain damages to cover the costs incurred as a result of the misrepresentation.

275. The Chairperson proposed adding a comment to the Explanatory Report saying that the national legislator had to pay the most careful attention to Article 10(1), and translate the term "termination" with the term that was the most appropriate according to national law, bearing in mind that the intention of the drafters was not to give retroactive effect to the term. This proposal was supported three delegations, one of which suggested it should apply also to Paragraph (2).

276. The observer from the *International Bar Association* submitted a written proposal (distributed only in English) to merge Paragraphs (1), (2) and (4) and to avoid using the word "termination" by saying:

"(1) A person injured by a violation of this law is entitled to (i) choose [by notice] [by judicial process] to be relieved of his future obligations under the franchise agreement, and any related agreements with the franchisor and its affiliates, and (ii) such other rights or remedies as may be provided under applicable law".

277. While two delegations supported this proposal, one delegation felt it made matters worse, as it restricted any additional rights that the franchisee might have in accordance with national law.

278. One delegation wondered whether the present proviso starting "unless" would be included in the proposal. Another delegation suggested that its contents would be covered by the term "injury", as if the franchisee had had the information necessary to make an informed decision, or if the franchisee did not rely on the misrepresentation, the franchisee would not have suffered injury. It was observed that this shifted the burden of proof to the franchisee, and four delegations stated that this was not desirable. Three delegations however suggested that the proviso should in any event be deleted, as it was a means by which franchisors could escape from their responsibilities.

279. The *Russian Federation* submitted a written proposal (distributed only in English) suggesting that the references to the non-delivery of the document and misrepresentation of a material fact be added at the beginning of the IBA proposal as follows:

"If the disclosure document is not delivered within the period of time established in Article 3 or contains a misrepresentation of a material fact or an omission of a material fact required to be disclosed under Article 6, the franchisee is entitled (i) to be relieved [by notice] [by judicial process] of his/her future obligations under the franchise agreement and any related agreements with the franchisor and its affiliates and (ii) such other rights or remedies as may be provided under applicable law".

280. Two delegations proposed deleting the whole Article if the meaning of the term "terminate" could not be clarified, but this was opposed by other delegations which felt it important that a Model Law such as this provide also for remedies in case of non-observance of the disclosure obligation, which, it was recalled, would be an obligation imposed by law and not merely an arrangement between the parties.

281. In the end, it was decided to keep three options for Paragraph (1), namely to place the whole article in square brackets; to place the word "termination" in brackets but to keep the proviso; and to place the word "termination" in brackets and to place also the proviso in brackets.

282. The Committee decided to retain the same three options also for Paragraph (2).

283. One delegation drew attention to the fact that the non-delivery in Paragraph (1) was essentially a breach of a public law obligation, whereas the misrepresentation and omission in Paragraph (2) were civil law concepts. Paragraph (3), the delegation felt, was oriented mostly towards the situation in Paragraph (1), and under some legal systems there might therefore be a conflict between Paragraph (3) and the general provisions of nullity of contract.

284. With reference to Paragraph (3), the delegation of the United States submitted a proposal to lengthen the time-periods which it deemed to be too short (Doc. 35) (proposed modifications and additions in italic):

"(3)(A) *three years after the act or omission constituting the breach upon which the right to terminate is based;*
(B) one year after the franchisee becomes aware of facts or circumstances reasonably indicating that it may have a claim for relief entitling the franchisee to terminate; or
(C) ninety (90) days after the delivery to the franchisee of a written notice providing details of the breach accompanied by the franchisor's then current disclosure document."

285. The proposal was accepted by the Committee.

ARTICLE 11

286. With reference to **Article 11**, one delegation suggested that this Article raised the same problems as Article 1, in that the conclusion might be reached that the law did not apply if the franchise agreement was not entered into after the negotiations. This concern was shared by three other delegations.

287. One delegation felt that the connecting factor should be the handing over of the disclosure document and not the entering into of the agreement, but this was felt to be odd by another delegation as there were other articles in the Model Law that referred to the non-delivery of the disclosure document.

288. It was recalled that the intention of the Study Group was simply that the law should have no retroactive effect. Two delegations suggested that it would perhaps be easier simply to state that the law had no retroactive effect. One delegation expressed the concern that a statement that the Model Law had no retroactive effect would have as a consequence that it no longer applied to renewals of franchise agreements.

289. In this regard attention was drawn to Article 5(F), which exempted the franchisor from the disclosure obligation in cases of renewal. It was however pointed out that the idea was that the law should apply also to renewals, and that as a second stage the agreement should be examined to see if it qualified for the exemption in Article 5(F), which applied in cases of renewal or extension of a franchise on the same conditions.

290. The observer from the *International Bar Association* stressed the importance of the application of the Model Law also in cases of renewal, as often substantial additional investment was required of the franchisee and this should be disclosed. Furthermore, the franchise system might have evolved considerably over the years and this rendered disclosure necessary.

291. The delegation of the Russian Federation submitted a written proposal (distributed only in English) which read as follows:

"This law applies whenever a franchise agreement is to be concluded after its entering into force".

292. The purpose of the proposal was to avoid giving the impression that the law applied only to franchise agreements that had been concluded, and it therefore stated that the law applied when a franchise agreement *had to be* concluded. The application of the law to renewals had been omitted, as he had certain doubts on this point.

293. The proposal was supported by three delegations, which however considered that renewals should be included. One delegation proposed that the formulation be modified to read "[t]his law applies whenever a franchise agreement is to be concluded or renewed after the law enters into force".

294. One delegation insisted that if renewal were added, then a reference to the exemption in Article 5(F) should also be included, as it should be made clear that "renewal" in this case meant only when the renewal was not at the same conditions. While one delegation supported this proposal, another agreed in principle, but felt that it was not necessary to say so, as the Article on exemptions took care of the problem.

295. One delegation felt that the words "is to be concluded" were problematic, as it might be possible for a franchisor to be penalised for not handing over a disclosure document when the law had not yet entered into force, as the negotiations might have started before the law entered into force. It therefore proposed modifying the formulation to read "[t]his law applies whenever a franchise agreement is entered into or renewed after the law enters into force".

296. This proposal was accepted, with the proviso that the formulation had to be considered further, also to consider the proposed reference to Article 5(F).

297. One delegation asked for clarifications as regards the meaning of the entering into of an agreement, whether it referred to the signature of the agreement or its entry into force, but the Committee did not enter into a discussion of this point.

NEW ARTICLE X

298. The delegation of *Canada* submitted a written proposal for a new article stating that

"Any waiver by a franchisee of a right given by this Act is void".

299. While supporting this proposal, the delegation of the *United States* drew attention to the proposal it had submitted in Doc. 35 to the effect that paragraph 36 of the Explanatory Report, which dealt with waivers, should be deleted. Another delegation however pointed out that the second part of paragraph 36 dealt with international situations and should therefore be kept.

300. The Committee decided to accept the Canadian proposal for a new provision, as well as the American proposal as modified.

CONCLUSION OF THE MEETING

301. Closing the session, **Mr Walter RODINÒ**, Deputy Secretary-General of UNIDROIT, thanked participants and indicated that the next session of the Committee would be held in April or May 2002.

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

FIRST SESSION

Rome, 25 – 29 June 2001

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