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U N I D R O I T
I N T E R N A T I O N A L I N S T I T U T E F O R T H E U N I F I C A T I O N O F P R I V A T E L A W
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M O D E L F R A N C H I S E D I S C L O S U R E L A W

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Comments submitted by Germany

Rome, March 2002

PREAMBLE

The Preamble proposed in Alternative 2 creates the impression, particularly in its paragraphs 3 to 5, that the Model Law is not there to serve the purpose of unifying the law but merely to function as a “quarry” for national legislatures, confined to those states that still want to acquire know-how. Also, the impression is created that the criteria a legislature is supposed to heed before passing legislation were not heeded on adoption of the Model Law. It is not, however, the defects in the Model Law that need to be pointed out; the point is rather to eliminate them. Alternative 1 ought to be chosen as a preface to be put in the text of the Model Law.

ARTICLE 1 (SCOPE OF APPLICATION)

The German Delegation sticks to its view that a pre-sale franchise disclosure law cannot only be applied in circumstances where an effective franchise agreement is in place. Such a law should apply also in those cases where the prospective franchisee was deceived or was not informed about material facts and the franchise agreement is therefore, in terms of applicable national law, null and void, revocable or contestable. To avoid misunderstandings, it is therefore suggested – following Article 4 of the United Nations Convention on Contracts for the International Sale of Goods – that there be clarification to the effect that the Model Law does not regulate questions regarding the validity of the franchise agreement.

Moreover, it would seem desirable to bring the wording of Article 1 into line with Article 10. It is therefore suggested that Article 1 be worded as follows:

ARTICLE 1 (SCOPE OF APPLICATION)

(1) This law applies whenever a franchise agreement is entered into or renewed and according to which the franchised business shall be operated within the [State adopting this law].

(2) Except as otherwise expressly provided in this law it is not concerned with the validity of the franchise agreement or any of its provisions.

ARTICLE 3 (DELIVERY OF THE DISCLOSURE DOCUMENT)

The time-limit in paragraph 1 is not particularly practical. This is because under letters (A) and (B) it is only up to the franchisee to decide whether the time-limit will be observed. If non-observance of the time-limit is to be backed up with sanctions for the franchisor, reference must also be made under letters (A) and (B) also to acts carried out by the franchisor.

The exception of agreements relating to confidentiality in paragraph 1 letter (A) should, moreover, be extended to include purely optional agreements since the latter grant the franchisee the right to enter into a franchise agreement but do not yet bind him financially.

Paragraph 1 letters (A) and (B) should therefore be amended to read as follows:

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

(B) the payment on demand of the franchisor or an affiliate of the franchisor by the prospective franchisee to any of these persons 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.”

In the Explanations regarding paragraph 2 sentence 1 it should be stated with greater emphasis than hitherto that the time-limit set should not be shorter than the disclosure deadline in force pursuant to the applicable law in the fields of commercial, tax and disclosure law. Consequently, the sentence beginning with the words “At the very least” under Number 61 of the Explanations should be worded as follows:

“At the very least, the time period selected should not be shorter than the time period required for the disclosure of the annual account or financial statement under the applicable accounting or tax law.”

ARTICLE 5 (EXEMPTION FROM OBLIGATION TO DISCLOSE)

Under Number 66 of the Explanations the exemption under letter (A) is based on the view that a person referred to in the provision “can be expected to have all the information he/she needs to make an informed decision”. But this objective is only incompletely realised in terms of letter (A), for there are also persons other than a franchisor’s officers or directors – including the franchisor’s staff – or the officers or directors of a franchisor’s affiliate, who are closely associated with business operations and who may be very well acquainted with all the information that has to be included in the disclosure document. To the extent that the franchisor, who is obliged to make disclosure, can prove that the other contracting party is already in possession of all the necessary information, there is no apparent reason for adhering to the obligation to disclose information solely on the ground that the other contracting party is not an officer or director. Here the general principle of good faith (venire contra factum proprium) already necessitates dispensing with the – formalised – obligation to disclose. It is therefore suggested that letter (A) be worded as follows:

“(A) in case of the grant of a franchise to a person who has been an officer or director of the franchisor or of an affiliate of the franchisor for at least one year immediately before the signing of the franchise agreement or to any other person who is familiar with all the information to be disclosed according to article 6;”

The provision in the first alternative under letter (B) is preferable, for in the event of modification of individual terms of the agreement, it will probably no longer be a matter of taking over the agreement as a whole.

Under letter (D) the words put in square brackets “[financial investment]” should be deleted.

Under letter (E) determining the threshold beyond which a disclosure document can be dispensed with should not relate solely to the net worth but also, by way of alternative, to the turnover. Letter (E) should therefore be worded as follows:

“(E) in case of the grant of a franchise to a prospective franchisee who together with its affiliates has a net worth in excess of [Y] or turnover in excess of [Z];”.

The wording used under letter (G) “payments ... to the franchisor” raises the question whether payments are also covered for contractual goods obtained by the franchisee from the franchisor, or whether this includes a surcharge payable on the prices of the goods. In addition to this, the question also arises as to why payments are not also covered when they are made by the franchisee to third parties as rent or for contractual goods delivered by third parties. Hence this provision gives rise to misgivings, especially on practical grounds. Furthermore, there is also the question whether it is not, in particular, the small-scale franchisee who is in special need of protection through receipt of information. It is therefore suggested that this provision be deleted.

The reasons given under Number 72 of the Explanations in respect of letter (H), according to which the provision is mainly aimed at master franchises, which are normally intensively negotiated, is not reflected in the text. Also, the statement to the effect that “this exemption is not applicable if there is a chance that other franchises might be granted in the future” is not documented in the text of letter (H). On the contrary, in terms of the present version of letter (H), the franchisor will always be exempted from his obligation to disclose pursuant to the Model Law if he only makes an offer to one person. This, however, will normally be the case because, as a rule, the franchisor will make a – binding – offer to individuals only. To the extent that this provision is based solely on the notion that extensive investments will usually be made when franchise agreements are intensively negotiated, letter (H) is already dispensable for the reason that this case is covered under letter (D). Letter (H) should therefore either be deleted for the purpose of avoiding legal abuses or otherwise be reformulated, as proposed below:

“(H) if the agreement is reached after detailed negotiations.”

ARTICLE 6 (INFORMATION TO BE DISCLOSED)

In the introductory sentence in paragraph 1 it should be made clear that the disclosure document must provide information on all material facts. The list contained in Article 6 should be one which is open-ended in both directions. Accordingly, in the introductory sentence in Article 6, the second bracket should be selected and worded as follows:

“(1) The disclosure document shall contain all material facts such as the following:”

Moreover, only those particulars should be put in the list in paragraph 1 that clearly illustrate what is understood by a “material fact”. Hence formulations like “description of the business experience” or “relevant details” should be avoided because they do not contribute to the legal certainty that the list is intended to create. What is more, this information should, on principle, be of decisive importance to the franchisee and not just useful. Information on the franchisor’s business activity in countries other than the country where the franchisee will be operating in future should therefore not be demanded. Such information should be taken into account in paragraph 1 letters (B), (E), (F), (I) and (K).

Detailed comments on the list contained in paragraph 1 are made as follows:

In paragraph 1 letter (B) there should be a more precise statement of what is meant by the words “any name other than the legal name”. Furthermore, a qualification should be included to the effect that only those “names”, i.e. the trademarks, trade names or similar names, have to be disclosed under which the franchisor carries on business or intends to carry on business in the state where the franchisee will be operating the franchise business in future. Hence paragraph 1 letter (B) should be worded as follows:

“(B) the trademark, trade name, business name or similar name, under which the franchisor carries on or intends to carry on business in the state in which the prospective franchisee will operate the franchise business;”

In paragraph 1 under letter (E) the words “business experience” are imprecise and do not lead to the desired clarification of the question of what is meant by a “material fact”. These words should therefore be avoided. Furthermore, the information to be given – similar to the case of paragraph 1 letter (B) – should, on principle, relate solely to the state where the franchisee will be operating in future. Information on “affiliates” should therefore not be demanded. The information could be misleading particularly where there is no clear distinction made between the franchisor and affiliates, and the franchisor does not yet have any business experience in the country of the prospective franchisee.

Accordingly, paragraph 1 letter (E) should be worded as follows:

“(E) the length of time during which the franchisor _

(i) _ has run a business of the type to be operated by the prospective franchisee and

(ii) _ has granted franchises for the same type of business as that to be operated by the prospective franchisee

in the state in which the prospective franchisee shall operate the franchise business;”

In relation to paragraph 1 letter (F) it is suggested that the wording “any person who has senior management responsibilities for the franchisor’s business operations in relation to the franchise” be given greater precision so as to avoid legal uncertainty and perhaps unreasonable risks for the franchisor. Furthermore, as is already the case in relation to letter (E), the imprecise phrase “business experience” should be avoided.

Hence paragraph 1 letter (F) should be worded as follows:

“(F) with regard to the executive director, chief executive officer or any other person in a similar position who has senior management responsibilities for the franchisor’s business operations in relation to the franchisee

(i) the names, business addresses and positions held, and

(ii) the length of time during which each has, in the state in which the prospective franchisee shall operate the franchise business,

(a) ___ run a business of the type to be operated by the prospective franchisee and

(b) ___ granted franchises for the same type of business as that to be operated by the prospective franchisee;”

Paragraph 1 letter (G) gives rise to considerable misgivings regarding data protection and constitutional law. In particular, details relating to any criminal convictions are particularly sensitive data. What will have to suffice here is the submission of a police certificate of good conduct. But there are also misgivings to the extent that the provision requires “relevant details relating to ... any finding of liability in a civil action”. The provision is too imprecise and is scarcely amenable to implementation where the franchisor has to give information on affiliates or on senior management. The statement on this provision in the Explanations, namely that some states will not be in a position, because of their constitutional law, to implement this provision in their national law do not invalidate the misgivings about this provision. A Model Law that does not meet constitutional requirements is not acceptable.

Paragraph 1 letter (G) should therefore be deleted. By way of alternative, this provision should be supplemented with the following alternative provision:

“or the assurance of good conduct of the prospective franchisor and the persons indicated in lit. (F); such assurance shall, on request of the prospective franchisee, be proven by a police certificate of good conduct;”

In paragraph 1 letter (H) the information should be restricted to the franchisor and affiliates. The obligation to provide information on staff gives rise to misgivings in terms of data protection and constitutional law. Moreover, the words “relevant details” should be avoided. Paragraph 1 letter (H) should rather be amended as follows:

“(H) whether the franchisor or affiliate of the franchisor who is engaged in franchising was involved in any bankruptcy, insolvency or comparable proceeding ___ for the previous five years;”

The details required pursuant to paragraph 1 letter (I) are intended to give information regarding both the size of the network and therefore also the success of the franchise system, so that the franchisee will be able to assess the business risk. Particularly as regards successful franchise systems, paragraph 1 letter (I) goes beyond this objective and leads to unreasonable burdens on the franchisor, since in relation to franchise systems operating on a global scale there will, on the basis of the provision proposed here, be a considerable need for consultation between the franchisor and affiliated companies and parallel systems operating abroad. Hence reference should be made solely to persons who are in the state where the franchisee will be operating. The following version is therefore proposed for paragraph 1 letter (I):

“(I) the total number of franchisees and company-owned outlets

(i) of the franchisor and

(ii) of affiliates of the franchisor granting franchises under substantially the same trade name

in the state in which the prospective franchisee will operate the franchised business;”

In paragraph 1 letter (J) the text in square brackets should be deleted. Reference should be made solely to the franchisees of the prospective franchisor. Also, the limitation to 50 franchisees seems too high. A total of 20 would seem to be enough. Hence the following version is proposed for paragraph 1 letter (J):

“(J) the names, business addresses and business phone numbers of the franchisees of the prospective franchisor whose outlets are located nearest to the proposed outlet of the prospective franchisee, but in any event of not more than 20 franchisees in the State in which the prospective franchisee will operate the franchised business, and in contiguous States, or, if there are no franchisees in these States, in the State of the franchisor;”.

In paragraph 1 letter (K) it should be made clear that the information required therein is of a general nature and is not required to contain personal data. Given that the reason for this provision, as stated in the Explanations, is to inform the potential franchisee whether a large number of franchise agreements have been terminated, it will suffice to state the number of terminated agreements. As for franchisees of affiliates, who are to be taken into consideration by virtue of the bracket, it seems sufficient for reference to be made solely to persons who are in the state where the franchisee will be operating. Furthermore, it would seem expedient to adopt sentence 2 in a separate provision and – as proposed in Option 2 – just to list examples of the reasons for termination. Paragraph 1 letter (K) should accordingly read as follows:

“(K) the total number of the franchisees of the prospective franchisor and of affiliates of the franchisor granting franchises under substantially the same trade name during the three fiscal years before the one during which the franchise agreement is entered into; such number does not

need to cover franchisees of affiliates of the franchisor that are not located in the state in which the prospective franchisee will operate the franchised business;

(K1) an indication of the reasons for which the franchisees which have been taken into consideration according to lit. (K) have ceased to be franchisees, such as “terminated due to _bankruptcy or insolvency”; “terminated by a decision of a court or arbitrator”; “terminated by the franchisor”;

With reference to letter (L) the question arises whether the provision is practicable so far as it concerns information on “copyright and software”.

From the point of view of competition policy, paragraph 1 letter (M) still seems questionable, so far as it might lead to the inference that there is an obligation to disclose sensitive data. It should be made clear that just general information will suffice. Here it would seem expedient to combine subparagraphs (iii) and (iv). Hence it is suggested that paragraph 1 letter M be worded as follows:

“(M) information on the categories of goods and/or services that the franchisee is required to purchase or lease, indicating
(i) whether any of these have to be purchased or leased from the franchisor, affiliates of the franchisor or from a supplier designated by the franchisor;
(ii) whether the franchisee has the right to recommend other suppliers for approval by the franchisor; and
(iii) whether any revenue or other benefit_ that may be directly or indirectly received by the franchisor or any of the affiliates of the franchisor from any supplier of goods and/or services to the franchisee, such as rebates, bonuses, or incentives with regard to those goods and/or services, shall be passed on to the prospective franchisee or, if not, whether a price mark-up will be made by the franchisor or the supplier recommended by the franchisor;”

In paragraph 1 letter (N) subparagraph (i) letter (c) preference is given to Option 3. Having regard to the statements made under Number 103, the question arises, however, as to whether it makes any sense at all to require submission of audited or otherwise independently verified financial statements, without stating the applicable law according to which such accounting documents are to be drawn up and verified.

There are still misgivings about the requirement, in paragraph 2 sentence 2, for a reference to be made in the disclosure document to the relevant section of the franchise agreement. This provision seems too formalistic. Paragraph 2 sentence 2 should therefore be deleted.

ARTICLE 7 (ACKNOWLEDGEMENT OF RECEIPT OF DISCLOSURE DOCUMENT)

It does not make much sense to impose a legal duty on the *franchisor* to make a demand in this connection. In lieu of the proposed provision, a duty should rather be imposed on the *franchisee* to acknowledge in writing the receipt of the disclosure document, if the franchisor so demands. Hence Article 7 should be worded as follows:

“The prospective franchisee shall on demand of the franchisor acknowledge in writing the receipt of the disclosure document.”

ARTICLE 8 (LANGUAGE OF DISCLOSURE DOCUMENT)

As is apparent from Number 124 of the Explanations, this provision - with the words “where prohibited by applicable law” - is intended to make it clear that there should only be a rule determining whether the parties can reach agreement on the language of the disclosure document if such rule does not constitute a violation of internal law. Since the Model Law is specifically aimed at bringing about an amendment to internal law, this restriction does not make much sense. A state implementing Article 8 in domestic law would have to delete the words “where prohibited by applicable law” in any event. As the Model law is only supposed to contain provisions that are not in need of amendment from the very outset, the words “where prohibited by applicable law”, inserted for the purpose of reaching a compromise, therefore make little sense.

Moreover, the second part of the sentence in Article 8 does not appear to make much practical sense. The protection envisaged for the franchisee through the words “unless ... the prospective franchisee requests, and the franchisor agrees” is hardly likely to be enforceable. That the franchisor will refrain – only at the franchisee’s request - from not having his documents translated into the language of the franchisee’s country does not seem at all probable. Hence the second part of the sentence beginning with the word “unless” should be deleted.

ARTICLE 9 (REMEDIES)

From the German point of view, clarification of the terminology used in Article 9 is indispensable. It cannot remain an open question whether, in the case of a breach, the franchise agreement is to be terminated only with effect for the future (*ex nunc*) or with effect from the outset (*ex tunc*). Granting a right to terminate the contract (with *ex tunc* effect) seems the right course to take. Here the provision still needed could be modelled on Article 81 of the United Nations Convention on Contracts for the International Sale of Goods.

Paragraph 1 should, however, only impose a sanction for non-compliance with the time-limit for disclosure in circumstances where, as proposed for Article 3 para. 1, non-compliance with this time-limit is attributable to the franchisor. If indeed any non-compliance with the time-limit for disclosure is to be made subject to a sanction, then the exception made at the end of paragraph 1 (“unless the franchisor can prove that at the time of the conclusion of the

franchise agreement the franchisee had the information necessary to make an informed decision”) must be deleted.

The right of termination, dealt with in paragraph 2, should attach quite generally to non-compliance with the duty to disclose material facts.

Paragraph 3 letter (A) seems problematic to the extent that it relates to breaches of duties to disclose that are sanctioned pursuant to paragraph 1. The proposed three-year time-limit seems too long in this case.

With regard to paragraph 3 letter (C), the question arises as to the importance that ought to be attached to submission of a new disclosure document. What will happen if the new disclosure document proves to be incomplete or incorrect after the 90-day period has expired? Given that the time-limits under letters (A) and (B) are supposed to apply in the latter case, it is suggested that letter (C) be deleted.

ARTICLE 11 (WAIVERS)

This provision creates the impression that a waiver of rights shall be void also in cases where such rights are regulated, not in the Model Law, but in other legal provisions. This would, however, go too far. Article 11 should therefore be worded as follows:

ARTICLE 11 (WAIVERS)

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