UNIDROIT 1986
Study LXVIII - Doc. 1
(Original: English/French)

Unidroit

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

THE FRANCHISING CONTRACT

Preliminary study prepared by Ms Lena Peters (Rome) and Ms Marina Schneider (Strasbourg) and Questionnaire drawn up by the Unidroit Secretariat

Rome, October 1986

PREFACE

At its 64th session, held in May 1985, the Governing Council requested the Secretariat to draw up a preliminary report on the franchising contract with a view to deciding whether the subject should be included in the new Work Programme for the triennial period 1987 to 1989.

The report was considered by a sub-committee of the Governing Council during its 65th session in April 1986. While recognizing that franchising raises a wide variety of legal problems, some of which it might not be feasible to regulate at international level, the sub-committee came to the conclusion that the subject should be included in the new Work Programme.

The Governing Council endorsed this recommendation of the sub-committee and requested the Secretariat to submit the report, together with a questionnaire designed to elicit further information, to Governments, professional circles and recognized experts in the field. The questionnaire is attached hereto as an Annex to the report.

TABLE OF CONTENTS

INTRODUCTION

The term 'franchising' indicates a relatively new type of agreement in Europe. There is no exact definition of a franchise agreement - every author, law (when there is one) and court defines it differently. This situation is effectively illustrated by the Report of the U.S. Ad Hoc Committee on Franchising which states:

> "The term 'franchise' as used in the business world, has been applied so indiscriminately, and to such diverse business arrangements, as to defy consistent definition. At one extreme it is a simple grant from one party to another to sell the granting party's goods. At the other extreme, a franchise relationship is a comprehensive business arrangement in which the franchisor licenses his trade name and trademark; imparts, in confidence, his know-how, and on a continuing basis, provides guidance and details concerning the precise manner in which the franchisee must operate his establishment"(1).

The Report continues:

> "While the term encompasses a broad range of marketing systems, much of the business community has come to think of a 'franchise' as primarily a device for exploiting an established trademark or tradename..."(2).

Originally, franchising was introduced from the United States, where it developed as a system for marketing products and services. It is thought to have begun after the American Civil War, when it was both dangerous and difficult for a producer from the East Coast to distribute his products directly in the West or the South of the country. The real boost came after the Second World War. This was due to the lack of financial means which considerably hindered the commercial expansion of small and medium sized enterprises.

After its considerable success in the United States, franchising came also to Europe, at first as a form of exploitation of the European market by American franchisors (Coca-Cola, Hertz, Avis), later as a contract registered between only European partners (Prénatal, Pronuptia, Standa, Coin, Rinascente, Sarma, Nordsee)(3).

Every European State has, however, adapted franchising to the needs of its market and to the taste of its consumers, as well as to the provisions of its legal system(4). This in part explains the differences found when examin-

---

(1) Report of the Ad Hoc Committee on Franchising (1969) CCH Trade Reg Supp Dec. 15, 1969, p. 5, in Austin J. STICKELLS, Federal Control of Business, Antitrust Laws, Rochester/San Francisco 1972, p. 237 note 1.

(2) Ibid., p. 7.

(3) Aldo FRIGNANI "Nuove riflessioni in tema di franchising", Giurisprudenza italiana, Jan., 1980, Part Four, Col. 204.

(4) Ibid.

ing the definitions of what a franchising agreement actually is. For the purpose of this study, which is, in brief, to analyse the franchising phenomenon with a view to a possible uniform law, it is necessary to attempt a definition of franchising. Clearly, at this stage it will be more in the nature of an explanation of what has been called franchising, including an illustration of the differences between the definitions which have emerged in the course of the examination of the phenomenon.

The study will go on to examine the various problems which arise with franchising as, for example, the most common abuses, the problem of the independence, or dependence, of the franchisee, the fate of the stocks on termination of a contract etc.. Finally, it will illustrate the remedies that have been adopted by the legislation that exists, or by that proposed, in different countries, as well as refer to the regulations of the franchising associations as declared in the Codes of Ethics they have adopted.

Considering the difficulties involved in any attempt at the adoption of a uniform law or convention on franchising, the questions naturally arise firstly, of whether it is possible at all, and secondly of whether it is worth the effort. This study will attempt to furnish the elements necessary to answer the first of these questions. The second can best be answered by an examination of the economic importance of the phenomenon.

Great Britain In Britain franchising turnover in 1984 reached £1 billion. It consists of 8000 operations employing over 70,000 people. Franchising has trebled in the last 5 years, and is confidently expected to grow fivefold in the next five. It is expected that turnover will reach £5 billion by 1989 providing employment for 350,000 people.(1) Increase in franchised businesses is 12% per year.(2) It is estimated that franchising accounts for nearly 10% of the retail market.(3)

France In France, it was estimated that, at the beginning of 1981, the number of franchisors had reached 330 and that of franchisees 13,891. The figures for 1971 were 34 and 2000 respectively. Franchising turnover in 1980 was estimated at between 44 and 50 billion FF, representing 6-7% of the total turnover of the distribution sector.(4)

---

(1) Tony DUTFIELD, Franchising in Great Britain, info vol. 7 No. 2, March/April 1985, p. 5.

(2) Jean-Louis BARROIS, Franchise-Franchise, info vol. 7 No. 2, March/April 1985, p. 7. As total turnover for franchising Barrois gives the figure of £1,041,000,000.

(3) Andy POLLOCK, Expanding your Business by Franchising, info vol. 7 No. 2, March/April 1985, p. 25.

(4) Bulletin financier de la Banque Bruxelles Lambert, Le franchising: une formule insuffisamment exploitée, 17 December 1982, also published by Problèmes économiques, 6 Jan. 1983 No.1.805, p. 23 under the title "Le franchisage, avantages et contraintes".

Belgium. In 1981 there existed in Belgium 64 franchisors and some 2000 franchisees with a business turnover of more than 50 billion BF. In 1980, sales through franchised businesses represented 3% of the sales of the retail market and almost 4% of that of independent commerce.(1)

Netherlands. In the Netherlands at the end of 1983 there were 185 franchisors and 5796 franchisees. These two figures represent an increase since 1981 of 6.3% and 63.6% respectively. In the same period of time the number of people employed by franchisees went up by 69.6% to 24,925, and the sales of franchisees almost doubled, the increase being 94.1%, to reach the figure of NFL 8.793.900.000,(2) the automotive services, industrial activities and soft drink bottlers being excluded from these statistics.

Sweden. There are about 50 franchisors in Sweden with around 490 franchisees. In 1983 the turnover of the 410 franchisees and the 90 branches of the 30 franchisors members of the Swedish franchise association was almost 1.2 billion SKr.(3)

Federal Republic of Germany. In January 1984 there were more than 310 franchisors, and over 60,000 franchisees in the Federal Republic of Germany. The turnover of the known systems in 1982/1983 was around 93 billion DM, which, taking into consideration also a certain unknown factor, is around 105 billion DM. The franchise business represents around 22-25% of the turnover of the total retail market. It is estimated that in the period 1984-1994 this share of the market will increase to 33%.(4)

U.S.A. At least one third of all retail sales in the USA is carried out via franchising, with approximately 2000 companies currently offering franchise opportunities.(5) Admittedly this large figure includes automobile vendors and petrol pumps, which most often is not the case in Europe. In the former the franchise share of the market is 80%.

The above figures give an idea of the extent of the phenomenon today. Where possible, the growth rate has also been indicated. Franchising

---

(1) Bulletin financier de la Banque Bruxelles Lambert, Le franchising: une formule insuffisamment exploitée, 17 December 1982, also published by Problèmes économiques, 6 Jan. 1983 No. 1.805, p. 23, under the title "Le franchisage, avantages et contraintes".

(2) Dutch-Franchising Association, Franchising in the Netherlands, Year: 1983, Based on: Business Format Franchising.

(3) Kommittédirektiv, Franchising, Dir. 1984: 37, exposé by the Head of the Department of Justice, Wickbom MP.

(4) Dr Knigge Franchise Management GmbH, Pressenotiz, München 19 January 1984.

(5) Tony DUTFIELD, Franchising in Great Britain, info Vol.7 No. 2, March/April 1985, p. 5.

is a system which has spread to the most diverse businesses. Mendelsohn in his "Guide to Franchising", gives 65 main areas, with a few subdivisions, particularly in "Food Operations".(1) This list includes the following areas, amongst others: Accounting/Tax Services; Agribusiness; Art Galleries, Auto Diagnostic Centres; Auto Rentals/Leasing; Beauty and Slendering Salons; Building and Construction; Campgrounds; Chemical Maintenance Products; Cosmetics; Dispensing Equipment (Food and Beverages); Entertainment; Food Operations; Health Clubs; Industrial Supplies/Services; Motels; Pest Control; Printing/Duplicating Services; Publishing; Schools/Instruction; Sport/Recreation; Travel Agencies; Water Conditioning Systems and Miscellaneous Products and Services.

(1) Martin MENDELSOHN, The Guide to Franchising, Third Edition, Oxford, 1982, p. 38ff.

CHAPTER I - THE DEFINITION OF FRANCHISING

A major difficulty when considering the possibility of uniform provisions on franchising is without doubt the lack of an exact definition. As indicated in the Introduction, every author, court or law (where one exists) gives its own definition, incorporating items which are needful for its own legal system, but which do not have a corresponding importance, or even sense, in another legal system. In the preparation of this study over thirty definitions were found.

In essence, franchising may be considered a system for marketing a product or service. It is a contract between one party (the franchisor) and a second party (the franchisee) by which the former permits the latter to market a certain product or service under his trademark, tradename or symbol, against the payment of an entrance fee or royalty, or both. It is, however, the franchisee that makes the investment necessary to the business - he is a businessman in his own right and not an employee of the franchisor. Characteristic of a franchise is the transfer of know-how. This takes the form of an obligation for the franchisor to train the franchisee in the conduct of the business, in the organisation of the shop and work. The franchisee must in turn follow the instructions he has received and act in conformity with his training. These instructions may even refer to the layout of the shop and/or to the uniforms of the employees (see, for example, McDonald's).

The reasoning behind this is simple: the franchisor offers the franchisee the possibility of using his trademark, tradename or symbol. This trademark, name or symbol is a well-known one, which means that the franchisee benefits by already having potential clients. At the same time the franchisee is his own master; he has invested his own money and is therefore not an employee of the franchisor. As, however, he enters into and becomes part of a network of shops organised in a similar manner, he is obliged to maintain the standards and procedures set by the franchisor, in order not to discredit his fellow franchisees and the franchisor. This explains the necessity for the training provided by the franchisor and the uniformity of the business set-up between the parties involved; to the public, they appear as belonging to a chain with the same owner.

Clearly, the franchisor will wish to have some means of controlling the compliance of the franchisee with the standards and procedures he has set. The franchise contract therefore provides for such a control, or "continued interest". Here a problem arises which concerns the nature of the control. If it is too stringent, the risk is that the independence of the franchisee is so underminded that he can in effect be considered an employee of the fran-

chisor rather than an independent businessman. A balance must therefore be struck between the need of the franchisor to control the franchisee and the latter's independence (see the section on the independence of the franchisee).

There are only a few laws on franchising. Thirty-six States in the U.S.A., Alberta in Canada and Japan have adopted regulations. As yet there are no specific regulations in Europe, even if proposals have been made in France and the possibility, or necessity, of introducing legislative measures has been discussed, or is being discussed, in other countries. Most of the laws which have been adopted in the United States are specific to certain categories, e.g. for automobile dealers, agreements which would not be considered franchising in Europe. The Uniform Law Conference in Canada has elaborated a Uniform Franchises Act which is of particular interest to this study, as it attempts to create a Uniform Law for a federal State which includes provinces with both Common and Civil Law traditions.

The various Codes of Ethics which have been adopted by the national franchise associations, including the one adopted at European level, are also of interest, but do not attempt a definition of franchising.

1. Legislation

How, in fact, has franchising been defined? If we first consider the definitions existing in laws already adopted, we may quote the following:

California Franchise Investment Law (1970)[1]

Sec. 31005.(a) "Franchise" means a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

(1) A franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and

(2) The operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and

(3) The franchisee is required to pay, directly or indirectly, a franchise fee."

This same section, under (h), goes on to include also contractual

---

(1) California Corporations Code, Division 5, Parts 1 through 6, Sections 31000 through 31516, added by California Laws of 1970, Chapter 1400, approved September 18, 1970, effective January 1, 1971.

agreements between petroleum corporations or distributors and gasoline dealers as well as similar agreements, under the term "franchise".

The definition of a "franchise" contained in the Wisconsin Franchise Investment Law (1971) is almost identical to that of the California Franchise Investment Law, the difference not being of substantial importance ("franchisor's business and trademark" instead of just "franchisor's trademark" in (2)).

This law, however, goes on to indicate that, unless specifically stated otherwise, "franchise" includes area franchise, defined as "any contract or agreement between a franchisor and a subfranchisor whereby the subfranchisor is granted the right, for consideration given in whole or in part for such right, to sell or negotiate the sale of franchises in the name or on behalf of the franchisor".(1)

Before considering the next law, several observations on the above definition may be made. First of all, the definition specifically includes both express and implied, oral and written agreements, whereas oral and implied agreements are more often than not excluded, a written agreement being a prerequisite:

New Jersey Franchise Practices Act

" "Franchise" means a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trade mark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise".(2)

This express inclusion of an oral agreement is difficult to understand when considering franchising. How indeed, can a franchise agreement, with all it entails, be "oral" or even implied? Admittedly, the validity of such agreements is admitted under the general law of contract, but the possibility of applying this general principle to franchising in practice may be considered to be only negligible, if that.

Secondly, both franchisor and franchisee may be either a physical or a juridical person. However, certain relationships are excluded: a franchise cannot be a transaction between a holding company and its subsidiary or between subsidiaries of the same holding company or between an individual and a company controlled by him.(3) Of course, here the problem of the definition of "control" comes up: when shall such a control be deemed to exist? This question is often faced in two ways - by percentage of shares in the company,

---

(1) Wisconsin Franchise Investment Law 1971 553.03 Definitions, (2) (4) (a).
(2) New Jersey Franchise Practices Act 1971 Sec. 3a.
(3) See the defintion of franchising given by the British Franchise Association.

and by an examination of the actual control exercised by the franchisor over the policy and conduct of the business of the franchisee. The latter is in essence a question of degree of control, as a certain amount of control is necessary in the interest of all those using the trademark, tradename or symbol.

Thirdly, the definition of an area franchise raises the question of territorial exclusivity. This may or may not form part of the franchise contract, but as a rule there is a clause relating to the exclusive rights of a franchisee over a specific area assigned to him by the franchisor. The franchisor then undertakes not to grant any additional franchises in that particular area, and the franchisee undertakes not to extend his business outside his area. This clause has often been examined from the point of view of restrictive practices, most recently by the Court of Justice of the European Communities in the case Pronuptia de Paris GmbH, Frankfurt am Main v. Pronuptia de Paris Irmgard Schillgallis, Hamburg.(1) In this case the Court came to the conclusion that clauses in a contract the consequence of which is a division of the market constitute a restriction of competition within the meaning of Article 85 (1) of the Treaty of Rome, and further that they may affect trade between the States members of the European Communities.

Fourthly, the activity of a sub-franchisor - the sale of more franchises - comes dangerously close to one of the abuses most commonly occurring and condemned in connection with franchising, i.e. the so-called "vente à la boule de neige" or pyramid selling (see the section on abuses).

The Uniform Law Conference of Canada has elaborated a Uniform Franchises Act which contains the following definition:

" "franchise" means either or both of the following in respect of which a franchise fee is payable:

(a) the right to

(i) engage in a business of offering, selling or distributing goods or services under a marketing plan or system prescribed or controlled by a franchisor, and

(ii) engage in a business that is associated with the franchisor's trademark, service mark, trade name, logotype, advertising or any business symbol designating the franchisor or its associate, or

(b) the right to sell or negotiate the sale of a franchise described in

---

(1) Case 161/84, decided 28 January 1986 by the Court of Justice of the European Communities. See the section of this study on anti-trust legislation for more details.

clause (a) for a stipulated area;".

Further:

" "franchise agreement" means a contract, agreement or arrangement, either expressed or implied, whether oral or written, between two or more persons whereby a person is granted a franchise, but does not include contracts, agreements or arrangements between manufacturers;".(1)

Two points of interest may be noted here. Firstly, the "marketing" plan or system" mentioned also in other definitions. Presumably this includes both the "chain" of franchises, and the methods adopted by the franchisor-which brings us back to the question of the training of the franchisee and of the necessity of the franchisee adopting these methods as well as the outer appareil of the business. Secondly, the question of the parties involved. According to the above definition a franchise agreement does not include contracts, agreements or arrangements between manufacturers. This is, however, in contrast to what is implied by other definitions, according to which franchising is "a system for collaboration between a producer (or seller) of goods or offering services (franchisor) and a distributor (franchisee), legally and economically independent the one from the other, but tied by a contract by virtue of which the former grants the latter the capacity to become part of his chain for distribution, with the right to exploit, under certain conditions and against the payment of a sum of money, patents, trademarks, tradename, emblem or even also a simple formula or trade secret belonging to him."(2) It is clear that the use of a formula or trade secret is granted by one manufacturer to another, yet such a relationship would fall outside the Canadian Uniform Act.

One of the authors consulted states, and most other authors agree with him, that parties to a franchise agreement may be:

(a) manufacturer and wholesale dealer;

(b) manufacturer and retailer;

(c) service enterprises and retailer;

(d) wholesale dealer and retailer,

but not two wholesale dealers.(3) The reason would appear to be that wholesale

---

(1) Uniform Law Conference of Canada Proceedings 66th Annual Meeting, August 1984, Appendix G, pp. 108-109.

(2) See Aldo FRIGNANI, Factoring, Franchising, Concorrenza, Torino 1979, p. 35. Our italics.

(3) Aldo FRIGNANI, Factoring, Franchising, Concorrenza, Torino 1979, p. 38.

dealers handle goods coming from many sources, and are therefore unable to give the franchisor's product the attention and relevance a franchise agreement would demand. The same reasoning may be applied to the situation of two manufacturers described above, but one might well imagine a situation, particularly in international franchising, where both these types of franchising would be possible.

Of course, as stated earlier, the main interest of the Canadian Uniform Franchises Act is that it can constitute an example of the attempt of jurists with different legal backgrounds to come to an agreement on franchising. To date, only Alberta of the Canadian provinces has a law on franchising, The Franchises Act of 1971. Before its amendment in 1982 the "Loi sur les valeurs mobilières" of Quebec also referred to franchising, to which it could only with difficulty be applied today.

The Alberta Franchises Act begins its section on definitions by stating that in this Act:

> " "area franchise" means any contract, agreement or arrangement between a franchisor and a subfranchisor whereby the subfranchisor for consideration given or agreed to be given in whole or in part for that purpose, is granted the right to trade in the franchise;"

It continues:

> " "franchise" means a contract, agreement or arrangement, either expressed or implied, whether oral or written, between two or more persons by which a franchisee is required to pay directly or indirectly a franchise fee in consideration for any of the following:
>
> (i) the right to engage in the business of offering, selling or distributing the goods manufactured, processed or distributed or the services organized and directed by the franchisor, or
>
> (ii) the right to engage in the business of offering, selling or distributing any goods or services under a marketing plan or system prescribed or controlled by the franchisor, or
>
> (iii) the right to engage in a business which is associated with the franchisor's trademark, service mark, trade name, logotype, advertising or any business symbol designating the franchisor or its associate, or
>
> (iv) the right to engage in a business in which the franchisee is reliant on the franchisor for the continued supply of goods or services, or
>
> (v) the right to recruit additional franchisees or subfranchisors;

but excluding contracts, agreements or arrangements between manufacturers or where the franchisor is the Crown, a Crown agency or a municipal corporation;".

An additional definition given by the Alberta Act which is of interest here is that of a pyramid sales franchise:

" "pyramid sales franchise" means any scheme, arrangement, device or other means whereby a participant pays a franchise fee and

(i) is required or receives the right to recruit one or more other persons as participants who are subject to a similar requirement or who obtain a similar right, and

(ii) has the right to receive money, credits, discounts, goods or any other right or thing of value where the amount thereof is dependent upon the number of participants;".

As stated above, pyramid selling is regarded as one of the most common abuses in the franchising context. It will be examined more in detail in the section on abuses.

In France there are two proposals for a law on franchising which are of interest to us here. One was presented by Messrs Glon and Couste to the National Assembly N. 891 at the first ordinary session of 1973-1974, while the second was presented by M. Jean Turco to the National Assembly N. 979 at the second ordinary session of 1973-1974. The first of these attempts to regulate the legal position of franchisees and concessionaires, the second that of distributors.

The Glon/Couste proposal does not define franchising as such, stating instead :

"Sont considérés comme franchisés les acheteurs-revendeurs fermes et éventuellement cosignataires d'une partie de leur stock, les franchisés fabricants et les franchisés prestataires de services à condition qu'ils soient propriétaires de leurs fonds de commerce, qu'ils exercent leur activité sous l'enseigne du franchiseur en utilisant son savoir-faire technique ou commercial original et son assistance commerciale élaborée et qu'ils soient enfin liés par une clause d'exclusivité totale ou partielle.".(1)

The second proposal is more general, dealing with distributors gene-

(1) Proposition de loi tendant à règlementer la situation juridique des franchisés et concessionaires, présentée par MM. Glon et Couste, Art. 1 al. 2.

rally. In fact, the first article simply refers to

> "Les contrats d'exclusivité de vente qui comportent l'obligation pour le commerçant de vendre de façon exclusive ou quasi exclusive les produits du même fournisseur dans un local fourni ou agréé par lui aux conditions et prix imposés, relèvent des dispositions de la loi du 21 mars 1941",

to which the proposed law would presumably be applicable. It is interesting to note that often, when considering the possibility of adopting legislation for franchising, authors deem adoption of legislation on concessionnaires to be more of interest.

Another interesting point is that these two French draft laws contain no reference to an entrance fee or to a royalty, to which, instead, the definitions examined above (except that in the New Jersey Act) attach particular importance. This could possibly be because the proposals do not define the franchising phenomenon as such, the first turning its attention to the franchisee and the second to the distributor. Admittedly, however, this ought not to preclude the mentioning of the forms of payment involved for the rights.

What is covered by the fees payable to the franchisor varies. The Alberta Franchises Act states that

> "'franchise fee" means any consideration exchanged or agreed to be exchanged for the granting of the franchise agreement and (...)
>
> (i) the consideration may include,
>
> (A) any fee or charge that a franchisee or subfranchisor is required to pay or agrees to pay, or
>
> (B) any payment for goods or services, or
>
> (C) any service which the franchisee or subfranchisor is required to perform or agrees to perform, or
>
> (D) any loan, guarantee or other commercial consideration exigible from the franchisee or subfranchisor at the discretion of the franchisor or subfranchisor for the right to engage in business under a franchise agreement". (1)

Point 8 of Article 1 (1) goes on to state under (ii) what are not to be considered franchise fees:

> "(ii) (...)
>
> (A) the purchase of or agreement to purchase goods at the current

---

(1) Alberta Franchises Act, 1(1) (8) (i) and (ii).

wholesale market rate;

(B) the purchase of or the agreement to purchase services at the current market rate;

(C) the payment of a reasonable service charge to the issuer of a credit card by an establishment accepting or honouring the credit card;".

The Uniform Franchises Act follows the Alberta Act closely, making only the slightest variations to the texts cited above, and adding a phrase as to what are not to be considered franchise fees:

" "the payment, directly or indirectly of a franchise fee which, on an annual basis, does not exceed $1000".

The California Franchise Investment Law takes a slightly different stand, stating in Sec. 31011 that

"'Franchise fee" means any fee or charge that a franchisee or subfranchisor is required to pay or agrees to pay for the right to enter into a business under a franchise agreement, including, but not limited to, any such payment for such goods and services."

This section also continues by stating what shall not be considered the payment of a franchise fee:

"(a) The purchase or agreement to purchase goods at a bona fide wholesale price if no obligation is imposed upon the purchaser to purchase or pay for a quantity of such goods in excess of that which a reasonable businessman normally would purchase by way of a starting inventory or supply or to maintain a going inventory or supply.

(b) The payment of a reasonable service charge to the issuer of a credit card by an establishment accepting or honoring such credit card.

(c) (...)".

The Wisconsin Franchise Investment Law similarly defines a franchise fee as meaning

"any fee or charge that a franchisee or subfranchisor is required to pay or agrees to pay for the right to enter into a business under a franchise agreement, including, but not limited to, any such payment for goods and services"(1),

going on to specify what should not be considered the payment of a franchise

---

(1) Wisconsin Franchise Investment Law (1971), 553.03 Definitions, (5m).

fee in much the same terms as those of the California law.

Michigan has adopted Regulations referring to franchising complementary to Act No. 269 of the Public Acts of 1974, "being § 445.1501 et seq. of the Michigan Compiled Laws".(1) These Regulations contain detailed definitions, also of the words " "fee or charge" as used in section 3(1) of the act", which are to include, but are not to be limited to,

"(a) Present payments, deferred payments, and royalty payments required of the franchisee by the franchisor arising from sales of goods or services offered by the franchisee or its agents or affiliates, or payments as a condition to maintaining the franchise relationship other than payment for goods at a bona fide wholesale price.

(b) Payments for a lease or sale of real property in excess of a fair rental or market value. (...)

(c) Payments for services. These payments are presumed to be in part for the right granted to the franchisee to engage in the franchise business. Ideas, instruction, training, and other programs are services and not goods, (...)

(d) Payments for ownership. (...)

(e) Minimum purchase or minimum inventory requirements other than at a bona fide wholesale price for which there is a well established market in this state".(2)

" "Initial and deferred franchise fee" means the amount of the franchise fee charged at the time of entry into the business, whether paid in full upon commencement or paid on a deferred basis. For purposes of rule 801, it does not include royalties or other franchise fees measured by the amount of goods or services sold during the operation of the franchise".(3)

At a federal level, the United States Federal Trade Commission in its Rule and Guides to Franchising and Business Opportunities details the payments required. It fixes a minimum of $500 as an entrance fee:

"The franchisee must be required to pay to the franchisor (or an affiliate of the franchisor), as a condition of obtaining or commencing the franchise operation, a sum of at least $ 500 during a period from any time before to within six months after commencing operation of the franchisee's business."

---

(1) Michigan Administrative Code, Supplement No. 87, Commerce Department, Corporation and Securities Bureau, R 445.101 through 445.901 (Rules 101 through 901), R 445.101 Definitions and Explanations of Terms.

(2) Ibid., Rule 101 (2) (a)-(e).

(3) Ibid., Rule 101 (3). Rule 801 refers to "Contents of Advertisement".

A franchisee may further be required to make to the franchisor or to an affiliate, either by contract or by practical necessity, payments not part of the fee. Payments required by contract would include not only those stipulated by the franchise agreement, but also those required in any companion contracts which the parties may execute, such as a real estate lease. Payments made by necessity include, among others, those for equipment which can only be obtained, in fact, from the franchisor or its affiliate. Examples of the payments a franchisee has to make are: rent, advertising assistance, required equipment and supplies - including those from third parties where the franchisor or its affiliate receives payment as a result of such purchases - training, security deposits, escrow deposits, non-refundable bookkeeping charges, promotional literature, payments for services of persons to be established in business, equipment rental, and continuing royalties on sales.(1)

As may be seen from the above, there is no real uniformity as to the fees that the franchisee must pay to the franchisor. They vary also from country to country - in some countries no "entrance" fee is required at all. The payment of some form of "consideration" for the right granted to the franchisee to exploit the trademark, trade name or symbol of the franchisor is considered of fundamental importance by the authors consulted. How much else is included in these payments (such as for example costs for advertising) varies greatly.

The definitions cited above all endeavour to give a single, all-embracing definition of franchising. Another solution has, however, been attempted, namely that of differentiating various types of franchising. Here again, differences exist among the authors.

The Court of Justice of the European Communities, in the Pronuptia case referred to above, distinguishes between "franchise de service", "franchise de production" and "franchise de distribution" as follows:

> "(...) les contrats de franchise de service en vertu desquels le franchisé offre un service sous l'enseigne et le nom commercial, voire la marque, du franchiseur et en se conformant aux directives de ce dernier; les contrats de franchise de production en vertu desquels le franchisé fabrique lui-même, selon les indications du franchiseur, des produits qu'il vend sous la marque de celui-ci; (...) les contrats de franchise de distribution en vertu desquels le franchisé se borne à vendre certains produits dans un magasin qui porte l'enseigne du franchiseur".(2)

The Centre français du commerce extérieur identifies three different types of franchising:

---

(1) Federal Trade Commission, Franchising and Business Opportunities Rule and Guides, p. 5.

(2) Case 161/84, paragraph 13.

"La franchise industrielle, à laquelle est adossé un produit. Non seulement le franchiseur cède le droit d'utiliser son nom mais il donne également les éléments techniques de savoir faire pour la fabrication du produit. (...)

La franchise de distribution permet de céder un savoir faire commercial de gestion et un nom dont la notoriété est forte, l'un ou l'autre des deux éléments pouvant être déterminant. (...)

La franchise de service concerne la cession de savoir faire de service avec le plus souvent l'adjonction d'une marque connue dans ce domaine."(1)

The Centre continues its discussion on franchising by stating that these three forms of franchising have three main points in common:

- a rapid multiplication of the influence of the franchisor without too heavy an investment on his part;
- the creation of an export route;
- the facilitation of control as a result of the contractual links.(2)

One author goes so far as to identify five different types of franchising:

- industrial franchising (two industrialists, e.g. Coca-Cola)
- franchising of distribution (producer/wholesale dealer; producer/retailer; wholesale dealer/retailer);
- service franchise (e.g. Hertz, Avis)
- hotel franchise (e.g. Holiday Inn, McDonald's, related to service franchise)
- capitalisation franchise (i.e. where the creation of stocks means a gain in value e.g. numismatics).(3)

When considering the possibility of subdividing franchising most authors follow the above line of thought, with only a few variations. What may be considered a major variation is to be found in an American article. In this case two major classes of franchises are indentified: product and service franchise systems, and trademark licensing franchise systems.

---

(1) Centre français du commerce extérieur (CFCE), Comment distribuer à l'étranger, Collection l'Exportateur 1985, p. 114.

(2) Ibid., p. 115.

(3) Michel KAHN, La Franchise-Guide du Candidat franchisé, pp. 22-26.

"In the former, the franchisor contributes by license the right to distribute the franchisor's products under the franchisor's trade name and trademark. (...) In the latter, the franchisor contributes by license to the franchisee the right to produce and sell goods or services under the franchisor's trademark or trade name. In turn, the trademark franchisor retains the right to control the manner in which the franchisee conducts his business."(1).

Yet another way of subdividing franchises is the following suggested by an Italian author,(2) who divides franchising into conventional franchising, in which the franchisee has the exclusive right to sell the product or service of the franchisor within a specific area, and itinerant franchising in which the franchisee operates always within a specific territory, but without constituting a fixed point of sale, moving by means of vehicles either bought or hired. Conventional franchising is further divided into two subcategories: territorial franchising in which sub-franchising is permitted, and operative franchising in which the franchisee may not conclude sub-franchising agreements but is instead limited to selling the goods or services offered by the franchisor. The author goes on to examine different types of financial investment which in his view characterise franchising: joint ownership, in which franchisor and franchisee invest in the enterprise together; joint direction, in which the franchisor takes upon himself the financial burden of the necessary investment, thereafter handing over the management of the enterprise to the franchisee; and a lease, in which case the franchisor leases an enterprise and then hands over its management to the franchisee. Lastly, the author mentions the "Absentee Ownership Plan" under which the so-called franchisee, who does not appear vis-à-vis third parties, takes upon himself all the expenses necessary for the preparation of the sales-point and for the payment of the franchise fees (initial fee and/or royalties), in exchange for the profits made, while the franchisor provides, either directly or indirectly, for the management of the sales-point.

The United States Federal Trade Commission divides franchises into two main groups, package and product franchises and business opportunity ventures:

"A package franchise adopts the business format established by the franchisor and identified by the franchisor's trademark. The franchisee's method of operation in producing the goods or services sold by him are subject to significant controls instituted by the franchisor, or, alternatively, the franchisor promises to render significant assistance to the franchisee in the operation of the business. The franchisee is re-

---

(1) See Donald S. CHISUM, State Regulation of Franchising: The Washington Experience, Washington Law Review, vol. 48, No. 2, 1973, p. 294-295, on D. THOMPSON, Franchise Operations and Antitrust 10-17, (1971), where the above distinction is to be found.

(2) Aldo FRIGNANI, Factoring, Franchising, Concorrenza, Torino 1979, pp. 36-38.

quired to pay money to the franchisor".(1)

> "A product franchise distributes goods that are produced by the franchisor (or under his control or direction) and which bear the franchisor's trademark. The product franchisor exercises significant control over the franchisee's method of operation or, alternatively, promises to provide a significant degree of assistance in the franchisee's method of operation. The franchisee is required to pay the franchisor for the right to sell the trademarked goods, either by required purchases of equipment, supplies, etc., or by paying an initial fee for the right to sell the goods."(2)

In business opportunity ventures,

> "the franchisor puts the franchisee into a business of distributing certain goods or services, usually those of a well-known third party (...), by providing or suggesting a supplier for the goods and representing that the franchisor will establish retail accounts or place vending machines or rack displays in suitable locations. In some cases, the franchisor obtains the services of another person to secure accounts or locations. (...) The franchisee of a business opportunity venture is required to pay a fee or purchase goods or equipment (...) in order to participate in the business opportunity offered by the franchisor".(3)

2. Definitions of the franchise associations

Several countries have franchise associations grouping together franchisors. Codes of Ethics have been adopted by the following:

International Franchise Association (U.S.A.)
British Franchise Association
The Japan Franchise Association
Associazione italiana del franchising
Fédération Française de Franchisage
Deutscher Franchise -Verband e. V. München
Association Belge du Franchising
Svenska Franchise Föreningen

The European Franchising Federation, together with its members, the associations

---

(1) See Federal Trade Commission, Franchising and Business Opportunities, Rule and Guides, p. 2. These interpretative guides describe the provisions of the F.T.C.'s trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" ("the rule"), 1978, effective 21 October, 1979 (16 C.F.R. § 436).

(2) Ibid., p. 2.

(3) Ibid., p. 6.

of Belgium, France, the Federal Republic of Germany, Italy, the Netherlands, Norway, Sweden and the United Kingdom and in concert with the services of the Commission of the European Communities, has adopted a European Code of Ethics for franchising.

Of these Codes only that of the Federal Republic of Germany contains also a definition of franchising as such. Other Associations have indeed adopted a definition of franchising, but have kept the definition separate from the Codes. These definitions vary greatly. We will here quote four, beginning with that of the:

International Franchise Association (U.S.A.)

"A franchise operation is a contractual relationship between the franchisor and franchisee in which the franchisor offers or is obligated to maintain a continuing interest in the business of the franchisee in such areas as know-how and training; wherein the franchisee operates under a common trade name, format and/or procedure owned or controlled by the franchisor, and in which the franchisee has or will make a substantial capital investment in his business from his own resources".

British Franchise Association

"A contractual licence granted by one person (the franchisor) to another (franchisee) which:

(a) permits or requires the franchisee to carry on during the period of the franchise a particular business under or using a specified name belonging to or associated with the franchisor; and

(b) entitles the franchisor to exercise continuing control during the period of the franchise over the manner in which the franchisee carries on the business which is the subject of the franchise; and

(c) obliges the franchisor to provide the franchisee with assistance in carrying on the business which is the subject of the franchise (in relation to the organisation of the franchisee's business, the training of staff, merchandising, management or otherwise); and

(d) requires the franchisee periodically during the period of the franchise to pay to the franchisor sums of money in consideration for the franchise or for goods or services provided by the franchisor to the franchisee; and

(e) which is not a transaction between a holding company and its subsidiary (as defined in Section 154 of the Companies Act 1948) or between subsidiaries of the same holding company or between an individual and a company controlled by him."

Fédération Française de Franchisage

"Le FRANCHISING se définit comme une méthode de collaboration entre une Entreprise Franchisante d'une part et une ou plusieurs Entreprises Franchisées d'autre part.

Elle implique pour l'Entreprise Franchisante:

1. La propriété d'une Raison Sociale, d'un Nom Commercial, de Sigles et Symboles, d'une Marque de Fabrique, de commerce ou de service, ainsi qu'un savoir-faire mis à la disposition des Entreprises Franchisées.

2. Une collection de Produits et/ou de Services
   . offerte d'une manière originale et spécifique,
   . exploitée obligatoirement et totalement selon des techniques commerciales uniformes préalablement expérimentées et constamment mises au point et contrôlées.

Cette collaboration a pour but un développement accéléré des Entreprises contractantes, par l'action commune résultant de la conjonction des hommes et des capitaux, tout en maintenant leur indépendance respective, dans le cadre d'accords d'exclusivité réciproque.

Elle implique une rénumération ou un avantage économique acquis au Franchiseur propriétaire de la Marque et du savoir-faire".

Deutscher Franchise - Verband e. V. München

"Franchising is a vertical-cooperatively organized sales system of legally independent enterprises, based on a contractual continuing obligation relationship, appearing in the market as a whole and characterized by the common performance program of the system partners as well as by a system of instructions and controls to assure a pattern of behavior in conformity with the system.

The operating program of the Franchisor is the franchise package; it consists of a purchase, sales and organization concept, the use of protected rights, the training of Franchisees and the continuing assistance by the Franchisor of the Franchisee in an efficient and continuing way and to develop the concept permanently.

The Franchisee acts in his own name and on his own account; he has the right and the duty to use the franchise package for a remuneration. As his contribution, he puts work, capital and information at the disposal of the Franchisor".(1)

---

(1) Code of Ethics, Art. 2. Translation by the European Franchising Federation.

One question which should here be referred to is the size of the investment made by the franchisee. Most authors agree with the International Franchise Association that a "substantial capital investment" is needed. Yet there are those who do not consider this to be a point of major importance. A certain capital investment is, however, definitely required. Considering the expenses the franchisor has to face - the cost of the equipment, of the wares, of the hiring of employees, of the renting or buying of the premises and their maintenance as required, as well as the franchise fees themselves - the capital investment may be considered substantial. All depends on what meaning is given to the word "substantial", and also on the degree of independence of the franchisee: if he is a truly independent businessman his investment will be greater than if he depends on the franchisor, although some facilitations may be included in the franchise agreement.

3. Judicial definitions

The courts have encountered problems dealing with cases related to franchising, often because there is no legislation in the field. Sometimes the courts have themselves defined franchising, while on other occasions they have considered the franchise agreement to be a distribution agreement and have applied the laws concerning the latter by analogy. Yet again, some courts have simply described the phenomenon, relating it specifically to the case in hand (as, for example, the Oberlandesgericht München in the case Firma Gem-Collection Cosmetics GmbH, of 12 September 1985[1]).

The Court of Justice of the European Communities has, as indicated above, distinguished between three different types of franchising in the recent Pronuptia case. In that specific case it examined distribution franchises, explaining how they operate in practice:

> "Dans un système de franchises de distribution (...), une entreprise, qui s'est installée dans un marché comme distributeur et qui a ainsi pu mettre au point un ensemble de méthodes commerciales, accorde, moyennant rémunération, à des commerçants indépendants, la possibilité de s'établir dans d'autres marchés en utilisant son enseigne et les méthodes commerciales qui ont fait son succès. Plutôt que d'un mode de distribution, il s'agit d'une manière d'exploiter financièrement, sans engager de capitaux propres, un ensemble de connaissances."[2]

The Paris Cour d'Appel has also given a detailed definition of franchising in one of its judgments:[3]

---

(1) 5 U 4430/85, 7 O 8258/85 LG München I.

(2) Court of Justice of the European Communities, Case 161/84, 28 January 1986, paragraph 15.

(3) Cour d'Appel, 28 April 1978.

"Considérant que le franchising se définit comme une méthode de collaboration entre deux ou plusieurs entreprises commerciales, l'une franchisante, l'autre franchisée, par laquelle la première, propriétaire d'un nom ou d'une raison sociale connus, de sigles, symboles, marques de fabrique, de commerce ou de services, ainsi que d'un savoir-faire particulier, met à la disposition de l'autre le droit d'utiliser, moyennant une redevance ou un avantage acquis, la collection de produits ou de services, originaux ou spécifiques, pour l'exploiter obligatoirement et totalement selon des techniques commerciales expérimentées, mises au point et périodiquement recyclées, d'une manière exclusive, afin de réaliser un meilleur impact sur le marché considéré et d'obtenir un développement accéléré de l'activité commerciale des entreprises concernées; que ce contrat peut être assorti d'une aide industrielle, commerciale ou financière permettant l'intégration dans l'activité commerciale du concédant franchiseur et d'un certain contrôle du franchiseur à l'égard du franchisé initié à une technique originale et à un savoir-faire hors du commun, permettant le maintien de l'image de marque du service ou du produit vendu et le développement de la clientèle à moindre coût et avec une plus grande rentabilité pour les deux parties, qui conservent juridiquement une indépendance totale."

The above quotation raises a number of points worthy of consideration. Firstly, the importance of the ownership of the subject of the franchise. At times the franchisor is required to prove this ownership, often by means of documents that have to be "disclosed" to the franchisee before he enters into the agreement (see, for example, all the documents listed for disclosure in the Canadian Uniform Franchises Act and in the rules of the United States F.T.C.).

The second major point of interest is the requirement of originality- the subject of the franchise must be original and must have been experimented by the franchisor before being offered to prospective franchisees. This is particularly true of the know-how transmitted. This point is stressed above all by the French sources consulted, beginning with the Fédération Française de Franchisage, which refers to a:

"Collection de produits et/ou de services offerte d'une manière originale et spécifique, exploitée obligatoirement et totalement selon des techniques commerciales uniformes préalablement experimentées et constamment mises au point et contrôlées".(1)

The European Code of Ethics expresses itself in a similar manner, as do the courts, the Cour de Paris in one case reaching the conclusion that the franchising enterprise did not have

---

(1) See the section on "Definitions of the franchise associations" above, for the whole text.

"aucun système de prestations de services présentant une originalité propre, inconnue de non initiés, et sans présenter un savoir-faire qui sorte du domaine public, ni une technique de vente ou de transport uniforme vraiment expérimentée"

and thus held the contract which had been incorrectly presented as a franchise contract not to be one.(1) Similarly, the Tribunal de Commerce of Rennes, in a decision of 16 October 1981, followed the same reasoning as the Cour de Paris.(2) It should be noted that French courts have been particularly insistent on this point.

The transfer of know-how is of particular importance in a franchise contract; indeed, it has been considered an essential component of the contract without which there is no franchise agreement. The above quotation from the FFF specifies the three elements which characterise this know-how:

(a) original and specific know-how: the originality may be evaluated in concreto in the franchisor/franchisee relationship. The Cour de Cassation admits the value of know-how as from the time when the beneficiary of the transmission of the know-how benefits from it, even if third parties already share the knowledge transmitted(3):

"il faut, mais il suffit que ce savoir-faire soit nouveau pour celui qui l'acquiert de telle sorte qu'il lui procure une économie de temps et d'argent".(4)

On the other hand, the know-how has no value vis-à-vis the franchisee if he already knew of the techniques transmitted, by reason of their lack of originality.

The specificity of the know-how may be judged in the global context of the information transmitted, and not in relation to each item of information. It is not required that all the component parts of the know-how be particular to the franchisor - indeed, this would be impossible. Instead, the model to be followed is:

"le système franchisé que nous définissons comme l'ensemble des connaissances, structures d'organisation, plans, schémas, techniques, procédures et modes opératoires constitutifs du savoir-faire spécifique du franchiseur et transmis au franchisé aux fins de réitération fidèle par celui-ci".(5)

---

(1) Paris, 20 April 1978, Cahier de droit de l'entreprise 1980, No. 5, comment by Jean Marie Leloup.

(2) Not published.

(3) Cass. com., 13 July 1966, J.C.P. 67, 81684.

(4) CAppel Colmar, 9 June 1982, Dalloz Sirey 1982, "Jurisprudence", p. 556, comment by J.-J. BURST.

(5) Jean Marie LELOUP, Franchising et savoir-faire, Cahiers de droit de l'entreprise, Paris, Ed. Com. et Ind., December 1982, No. 5/6, pp. 16-20.

Two comments may here be made. Firstly, the degree of originality of the different elements of the system is not the same for all. It may be great (e.g. methods for investigation into the potential clientèle), less marked (the control over management, for example) or even non-existent (billing). A specific know-how is, however, an integral part of the system as a result of the adaptation of each element to this system and of the global system itself to the type of activity selected: e.g. a hotel of specific capacity and standing. Consequently, the system must be reproduced in its entirety in order to repeat the success of the franchisor. Secondly, in cases where each component part of the know-how taken separately is universally known, the system itself constitutes a know-how. It is a common feature of intellectual property that the whole may be protected even if each of its component parts separately would not be so - the end result as a whole is sufficient.

The value of the know-how cannot, however, be estimated in the abstract. There are no advantages for competition unless the know-how has been tested;

(b) tested know-how: the definition of the FFF adopted by the Cour de Paris in 1978 expressly indicates that franchising implies, for the franchisor, techniques which have been tested. To prepare a franchise is to express as great an experience as possible in the form of a system. It is the duty of the franchisor to prove that his know-how has been tested and to estimate, in financial terms, the results deriving from the competition advantages obtained.

The term "pioneer" is usually used to describe the establishments the franchisor has used in the development of his know-how. In order to be of importance, this pioneer operation must have been operated under the same conditions as the future operations, and its geographical location must also have been carefully considered.

With reference to this point, the authors of a recent volume[1] recommend future franchisees to verify whether the franchisor can demonstrate what they call the "three-two rule", that is, the success of three commercial enterprises launched by the franchisor (the "pioneer") with two years of activity, one of which is located in Paris (or in one of the five largest French urban conglomerations, although Mendelsohn also includes those of other countries), the second in a large town and the third in a medium sized town. It is evident that the success of these "pioneer" ventures ought to vouch for the credibility of the formula created by the franchisor. The "pioneer" must be created and directed with the constant concern of a potential transfer of what is tested. It serves as a "laboratory", and only in the event of satisfactory results will the innovation be communicated to the members of the fran-

(1) O. GAST and M. MENDELSOHN, Comment négocier une franchise, Éd. de l'Usine Nouvelle, 1983;

chise chain; each franchisee will benefit immediately, entering at a stage when the product or procedure is perfect, operational and profitable.

It should be noted that there is no valid franchise contract in the absence of tested know-how, and that in such a case a contract incorrectly termed a franchise contract will be null and void.

If the franchisor, having perfected original, specific and tested know-how, fails to improve upon this know-how for the duration of the contract, he is guilty of an ommission in relation to one of his fundamental obligations; the sanction is then not the nullity of the contract on grounds of "défaut de cause", as this must be evaluated at the formation of the contract, but rather the recission of the contract for non-performance. It is in fact the duty of the franchisor to keep his franchise system up-to-date.

(c) up-to-date know-how: the French caselaw and the FFF require the techniques to be constantly perfected and controlled. This is easily understood, as the franchise contract is a contract for successive performance. In the course of the duration of the contract the component parts of the know-how will have to adapt to the development of techniques, of the market, etc.. To fix the system is to lose the advantage necessary for competition. Thus, a franchise brings with it a permanent obligation to inform and to assist the franchisee technically, as well as an obligation for the franchisee to follow the training necessary for the maintenance and the perfecting of his professional capability.

4. Franchising contracts and other distribution agreements

Franchising contracts have often been equated with concessions and with other distribution agreements. The differences between them will now be examined.

(i) The nature of the contract.

The franchise contract is a consensual contract, the existence of which depends solely upon the will of the parties. It is further a synallagmatic contract which provides for reciprocal obligations for each of the contracting parties. Most authors consider the franchise to be a distribution contract and a "sui generis" contract covering purely commercial agreements. (1)

If this contract is aleatory in that the profits (the performance of the franchisee) are proportional to the success of the enterprise, it may equally be stated that this is reciprocal for the performance of the other obligations of the parties.

---

(1) Christiane BARODY, Le franchising, Hommes et Techniques, Vol. 26, No. 314, December 1970, p. 1045.

Very often it is in fact a contract concluded on the basis of standard forms. A franchisor who already enjoys a certain reputation has the advantage of being able to choose his prospective franchisees. He imposes clauses which have been of advantage to him in that they have contributed to the success of his enterprise. For the franchisor, the interest of the client is to find, from one operation to the other, the same environment and the same quality of the products he has appreciated at another franchisee's. A prudent contracting party should therefore obtain information as to the profitability of the project, as to the advertising support offered and as to the relations the franchisor has with his franchisees before signing the contract:

> "Le contrat de franchisage ... se caractérise par l'absence de négociation, l'une des parties se voyant imposer d'avance toutes les conditions du contrat. Ce type de contrat se nomme un contrat d'adhésion.
>
> Le franchisé adhérera à la convention généralement sans avoir réussi a faire modifier le contrat type du franchiseur. La force économique du franchiseur, l'intégrité de la formule et la protection de sa spécificité, de même que le souci d'accorder un traitement identique à tous les franchisés portent le franchiseur à une intransigeance qui, à maints égards, s'avère essentielle".(1)

It is apparent from the above that there are as many different franchise contracts as there are enterprises working in franchising.

(ii) The franchise and other distribution contracts.

Franchising is part of a large category of distribution enterprises. But where exactly does it fit into this spectrum?

Discussion on the "concession", which is not known to American literature on franchising, is natural, in particular in Civil Law countries where the concession is either regulated by legislation (as is the case in Belgium, under the Law of 27 July 1961, modified by the Henckaerts Law of 21 April 1972), or became part of contractual practice a long time ago, as is the case in France and Italy. There is an inevitable problem in that in these legal systems franchising is superimposed or added to the concession, claiming autonomy at the latter's expense. The fact that the franchise contract has not yet been defined by law means that great care must be taken when comparing the two.

The extension of the application of the franchise contract with respect to the other distribution contracts, and to the concession in particular, must first be indicated. The purpose of the concession is only that of producing or distributing products, while that of the franchise is to sell a certain

---

(1) Comité d'étude sur le fonctionnement et l'évolution du commerce au Québec, by J. PROULX, Le commerce et la distribution au Québec, 1978, Government of Québec, Industry, Trade and Commerce, p. 137.

number of services (know-how, technical assistance etc.). This sale may or may not be accompanied by the sale of products, this furnishing of products being only a part of the contract as a whole. It is therefore a question of an organised marketing of products or services under the trademark or service mark of the franchisor. Another category of franchises also exists,(1) industrial franchising, in which the franchisee has the right to produce and distribute the products of the franchisor (this is the case with Coca-Cola, Yoplait, etc.). This category is much closer to the concession.

This is however not all; it is always necessary to start from the idea that a franchise contract presumes the legal independence of the franchisee, even if this is not always the case in practice. Working on this assumption there is no need to make any comparison with systems which do not offer this legal independence. Here the example of branches may be given. Apart from the common symbol and uniform appearance of the shops, the legal situation resulting from a branch contract is different, as those working in the branches are employed by the mother company and not by independent dealers. The whole economics of the contract derive from this fact, as does the management of the shop. If, then, we consider those contracts in the field of distribution which at the present time leave a greater or lesser degree of independence to the dealers, the problem arises of their collaboration, and of the possible control of one party by the other.

According to the authors of the Report of the Minister's Committee on Referral Sales, Multi-level Sales and Franchises, known by the name of the Grange Report, it is the very existence of control over the activities of the franchisee by the franchisor which permits the distinguishing of the franchise from other distribution contracts, and particularly from commercial contracts.

The franchise is situated between contracts for concessions (slight degree of, or no control) and agency contracts, branch contracts or simple contracts of employment, where the control covers a whole spectrum, from "developed" to "absolute".

Schematically, the following table may therefore be drawn up, with the degree of control exercised indicated in decreasing order:(2)

---

(1) See above, the discussion on different types of franchises at the end of the section on definitions in existing legislations.

(2) Notes de cours de droit commercial général, prepared by Claude SAMSON and Edith FORTIN, University of Laval, Faculty of Law, September 1985.

Degree of Control	Distribution Enterprise	Consequences
Full control	Distribution Agency or Branch distributing products	principal/agent or employer/employee relations
Relative control (depending on the clauses of the contract)	Franchise contract	Association of interests and not sub-ordination - legal independence
Small or no control	Concession of a licence to manufacture	Legal independence of the concessionaire vis-à-vis the licensor

The extension and the consequences of the control exercised upon franchisees in the context of the contracts negotiated will be illustrated below.

In French law, the distinction between a franchise and a concession is determined by special reference to the notion of "assistance" rather than to "control". Christine Barody expresses the concept as follows:

> "Le fait différenciateur entre le franchising et d'autres types d'exploitation commerciale demeurera, dans la majorité des cas, le fait de l'assistance technique permanente et omniprésente dans le cas d'un contrat de franchise ... de sorte que le franchising est un intermédiaire entre le succursalisme et la concession exclusive, dérivé de la chaîne volontaire et de l'affiliation".(1)

What is essential, but also original to, and characteristic of, a franchise contract is that the assistance is not one-way. The franchisor himself will not succeed unless the franchisees succeed. A form of cooperation between the activities of franchisor and franchisee will thus be created, the latter informing the franchisor of, for example, his ideas concerning the franchised procedures.

---

(1) C. BARODY, op. cit., p. 1043.

Jean Guyénot considers the adoption of uniform commercial techniques to be the distinctive feature of a franchise.(1) The Court of Justice of the European Communities, in its recent judgment of 28 January 1986 (case 161/84), considers the use of the same symbol, the application of uniform commercial methods and the payment of royalties in exchange for the advantages granted to be the essential elements of a distribution franchise contract, and that it is by these in particular that it differs from licence contracts.

On the other hand, it may be stressed that I. Berlinski considers clauses regarding territorial delimitation to be a criterion for the distinction between a franchise and a concession. According to this author the word "franchise" implies a field of operations which is geographically limited, which is not the case with a concession.(2) The facts would, however, appear to contradict the validity of this criterion.

Other authors distinguish the franchise from other distribution contracts by the obligation the franchisee has to pay an entrance fee, as well as royalties, which is not the case with the other contracts.

As far as the trademark licence is concerned, the distinction is easy to make: while a trademark licence is one of the component parts of the franchise, although not the essential one, it is the only component part of a contract for the granting of a trademark.

This is certainly essential and characteristic of a franchise, but if it were to eclipse the other component parts of the franchise, the contract would be nothing more than a simple trademark or tradename licence. In such a case, not only would only the rules regulating such licences have to be applied, but it would further be necessary to admit that the clients are not clients of the pseudo-franchisee, but of the pseudo-franchisor, which would definitely have consequences for the "indemnité de clientèle", which will be considered below.

Lastly, the franchise and the voluntary chain: in both of these cases there will be identity of symbol, territorial exclusivity and the conducting of the business on an independent basis. This independence is, however, in fact considerably greater in a voluntary chain than in a franchise, as a member of a chain deals with the other members as an equal: his management is not subject to inspection nor need it be submitted to control, and, if he pays royalties, these are for the payment of the purchase centre and for joint advertising. Lastly, he does not have to observe an identity of appearance with

---

(1) J. GUYENOT, La franchise commerciale, Revue trimestrielle de droit commercial , 1978, 12.

(2) I. BERLINSKI, Franchising in the U.S. and Canada, Revue Juridique Thémis 1978, 13, pp. 547-549.

the other shops in the chain. Naturally, however, he will not benefit from any know-how, assistance, aid or trademark.

That this chapter has been lengthy is due above all to the need to determine as clearly as possible what precisely is a franchise. If it is possible to arrive at a definition of the phenomenon which satifies the needs of the different countries in which it exists, then that might serve as a basis for an international instrument.

CHAPTER II - THE PROBLEMS RAISED BY A FRANCHISE

A legal situation as uncertain as that described in Chapter I is bound to raise problems. Abuses of varying kinds immediately spring to mind, although they are not the only ones, even if the others are often related to those abuses, as is the case with the problem of the independence of the franchisee vis-à-vis the franchisor.

1. Independence of the franchisee

The intention of the parties is that the franchise contract be concluded between persons or enterprises which are, or claim to be, independent. The specifying of the legal status of the franchisee is very important for the two contracting parties. It is this specification which will govern relations between the parties (freedom or non-freedom in contracting), vis-à-vis third parties (determination of the law regulating liability), as well as property relations (right to commercial property).

Their cooperation is expressed in legal terms by the obligations undertaken by the parties under the contract, but is not established on a basis of equality, the franchisor having a dominant position. This domination is apparent in the control over the franchised enterprises and in particular over management, accountancy and publicity. This control is, however, necessary - the effectiveness of the formula granted by the franchisor presupposes as great a degree of homogeneity as possible of procedures and standards within the chain (observance of provisions related to the quality of the products; uniformity of prices; advertising methods, sale, management, accountancy, location and equipping of operations, training of personnel, relations with clients, etc.). The control exercised over accountancy methods, for example, has several purposes: inspection of records may assist in the conducting of market surveys and in the fixing of royalties as well as in assessing the economic position of the franchisee.

Should the controls be too tight, with consequent demotivation of the franchisee, franchisors resort to a special tactic, namely stimulating the franchisee's motivation by bonuses proportional to the sales. This method has sometimes proved successful.(1)

The problem of the delicate balance between the cooperation which must fundamentally exist between franchisor and franchisee and the "vocation"

---

(1) Notes de cours de droit commercial général, prepared by Claude SAMSON and Edith FORTIN, University of Laval, Faculty of Law, September 1985.

to direct enjoyed by the former has arisen with respect to the latter. A situation must however be avoided in which the franchisee falls into a position of subordination to his franchisor, a situation which could in fact result in the contract not being recognized as a contract of franchising. It is always possible for a court to modify the description by the parties of their agreement as it is entitled to elucidate "l'économie générale du contrat", the facts of the case. If the franchisor's level of control is excessive, he runs the risk of being considered the employer of the franchisee, when the latter is a physical person.

In fact, French caselaw holds that there is a contract of employment when there is an organised service and when there is a relation of subordination between the person working in this service and the one organising it.(1)

If the franchisee is a company, then the risk the franchisor runs if he interferes in the management of the franchisee is that he may be considered to be the real manager of the franchised company, with all the consequences deriving therefrom, particularly that of his responsibility and his property being involved in the event of bankruptcy.(2)

In the United States, relations between employers and employees, as well as those between partners, are excluded from the application of the provisions of the Full Disclosure Act of 1979. The Federal Trade Commission applies the traditional test of the right of control to come to a conclusion in relation to the existence or non-existence of an employer/employee relationship: for example, it considers whether a sum of money paid to a certain person constitutes a salary or remuneration for work carried out, whether the employee may be dismissed without the principal having to pay damages, or again whether or not the employee is obliged to invest a sum of money in the enterprise before being employed. The Commission closely examines these contracts of employment or of association, as they are drafted in such a manner as to disguise their real nature and to permit the employer (franchisor) or the partner to evade his responsibilities to the detriment of his employee or partner (franchisee).(3)

This delicate problem of the dependence or independence of the franchisee has been a determining factor in initiating the parliamentary investigation currently underway in Sweden. The trade unions claim that the franchis-

---

(1) Chambres Réunies of the Cour de Cassation, 23 June 1966, Bull. Civ. Ch. Réun., p. 3.
CA Agen, 8 Nov. 1977 (J.C.P. 1979, éd. com., II, 13114)
CA Paris, 28 April 1978 (Bull. des Transports, 31 May 1978, p. 277).

(2) CA Rouen, 23 May 1978 (J.C.P. 1979, éd. gén., II, 19235, comment by G. NOTTE).

(3) O. GAST, Aperçu général de la loi américaine sur le franchising, Revue trimestrielle de droit commercial et de droit économique, 1982, pp. 225-239.

ing concept is used as a means to circumvent the employer/employee relationship. Such situations, they claim, often concern former employees of the franchisor who, upon the latter's initiative, have become active as franchisees. Furthermore, they claim that in practice the franchising system offers the franchisee a possibility to escape from his obligations as employer in certain respects. The franchisee has such a responsibility towards his employees, but at the same time he is closely tied to the franchisor through the franchise agreement. The questions which are regulated in the franchise agreement are not negotiable by the trade union which organises the employees of the franchisee (whereas normally representatives of the employees take part in the decision-making process in the enterprise for which they are working, by virtue of the "Medbestämmanderätt", or "Mitbestimmungsrecht" in German). If the franchisee were to change the franchise agreement in any respect the franchisor would have a claim for damages or could terminate the agreement. The franchisee therefore does not, in relation to his employees, enjoy that full negotiating freedom which labour law has determined employers should have. Amongst other things the Committee established by the Swedish Parliament will consider whether legal provisions preventing the franchisee from being too closely tied to the franchisor would be justified. Such a link may (they consider) constitute an obstacle to the employees of the franchisee exercising the influence they should have by law and pursuant to collective agreements.(1)

The considerations described above are quite typically Swedish - in the Federal Republic of Germany and Switzerland where laws similar to the Swedish one (the "Mitbestimmungsgesetz") have been enacted, they have not been raised.

If the courts consider the franchisor to have interfered in the management of the franchised enterprise, they will deduce two consequences therefrom:

- the characterisation of the franchisee's contract as a contract of employment, conferring upon him all the benefits granted to employees by the provisions of the Code du travail,
- the responsibility of the franchisor vis-à-vis third parties, and in particular vis-à-vis the clients and suppliers of the franchisee.

2. Franchising and anti-trust legislation

Anti-trust legislation belongs to the domain of public law. It is consequently outside the scope of this study as no uniform law in the private law sector can encroach upon this field. It is, however, clearly a problem-area where franchising is concerned, as it is easy to consider franchise sy-

---

(1) Sweden, Directive to the Committee, Dir. 1984:37, on franchising.

stems to be more in the nature of trusts than of cooperative arrangements between independent operators. Each country has its own anti-trust or competition legislation which franchisors have to bear in mind when considering the possibility of offering franchises. Such national legislation may at times have international effects. Furthermore, the European Community member States are subject to EEC competition law. Prospective franchisors should therefore have regard to these regulations, particularly when they are active in international franchising, or when their activities may affect trade between member States of the EEC.

This last point is clearly illustrated by the case of Pronuptia de Paris GmbH, Frankfurt am Main v. Pronuptia de Paris Irmgard Schillgallis, Hamburg of 28 January 1986.(1) In this case the Court of Justice of the European Communities was called upon to decide on the interpretation of Article 85 of the Treaty of Rome, and of Commission Regulation 67/67 of 22 March 1967 concerning the application of Article 85 para. 3 of the EEC treaty to certain categories of exclusivity agreements. In this particular case a distribution franchise was under discussion. The conclusions of the court are interesting, even if they do leave a number of questions unanswered. It will probably be difficult to apply them to other cases:

"1. a) la compatibilité des contrats de franchise de distribution avec l'article 85, paragraphe 1er, est fonction des clauses que contiennent ces contrats et du contexte économique dans lequel ils s'insèrent;

b) les clauses qui sont indispensables pour empêcher que le savoir-faire transmis et l'assistance apportée par le franchiseur profitent à des concurrents, ne constituent pas des restrictions de la concurrence au sens de l'article 85, paragraphe 1er;

c) les clauses qui organisent le contrôle indispensable à la préservation de l'identité et de la réputation du réseau qui est symbolisé par l'enseigne, ne constituent pas non plus des restrictions de la concurrence au sens de l'article 85, paragraphe 1er;

d) les clauses qui réalisent un partage des marchés entre franchiseur et franchisés ou entre franchisés, constituent des restrictions de la concurrence au sens de l'article 85, paragraphe 1er;

e) le fait pour le franchiseur de communiquer au franchisé des prix indicatifs n'est pas constitutif d'une restriction de la concurrence, à la condition qu'il n'y ait pas entre le franchiseur et les franchisés ou entre les franchisés une pratique concertée en vue de l'application effective de ces prix;

f) les contrats de franchise de distribution qui contiennent des clauses

---

(1) Case 161/84.

réalisant un partage des marchés entre franchiseur et franchisé ou entre franchisés, sont susceptibles d'affecter le commerce entre Etats membres".

Furthermore the court came to the conclusion that Regulation 67/67 was not applicable to cases such as the one in hand.

The outcome of this case was awaited with great expectation, but it is disappointing in that it leaves so much open. A franchisor who examines his potentialities from an anti-trust point of view in fact obtains very little guidance from the above since there is to begin with no indication of the criteria to be used when deciding that which is indispensable for the business and at the same time permissible.

3. International franchising

When the term "international franchising" is employed, what is generally understood is a situation where a franchisor offers franchises in another country. Very little literature exists in this connection and such as there is normally examines the national situation of the countries concerned.

The lack of legislation in this field does not facilitate matters, nor do the different ways of approaching the phenomenon, which vary from country to country. The operators themselves find this lack of uniformity a great difficulty in the exercise of their activities.

Authors writing on international franchising often refer to economic difficulties, to the adaptations to the economic realities of the country of the proposed franchise which the franchisor has to make. G.E. Boisvert, in his paper on "Aspects juridiques du franchisage international",(1) indicates the legal points prospective franchisors have to examine when considering the offering of franchises in other countries:

1) the protection of trademarks abroad;

2) the adaptation of the franchise contract to local laws and regulations;

3) laws relating to import of raw materials and finished products into the country chosen;

4) monetary and currency legislation;

5) laws relating to the formation of the legal institute which will be employed;

---

(1) Presented by the author at a Seminar on franchising held in Montreal 6-7 March 1981, under the auspices of the Government of Canada, Industry, Trade and Commerce, in "Documentation pour colloque pour l'expansion de votre commerce par le franchisage", Government of Canada, Industry, Trade and Regional Economic Expansion.

6) social laws;

7) laws governing relations between lessor and lessee;

8) laws concerning immovable property rights;

9) fiscal laws;

10) laws protecting the national wealth;

11) laws against monopoly, against unfair competition or providing for prohibitions restricting acquisitions and sales.

As may be seen above, the information required for an international franchise involves an examination of a variety of disciplines forming part of the legal system of the countries concerned. Other authors have stressed similar points in their exposé.(1)

Needless to say, the problems with international franchising do not end here. Should conflicts arise it will be necessary to decide which law is applicable, that of the franchisor or that of the franchisee, which involves intricate estimates of the nature of the contract. Such an evaluation is necessary, also at the beginning of the contractual relationship, particularly as regards the payment of royalties.

The payment of royalties is a problem also for another protagonist in international franchising, the "master-franchisee" or "subfranchisor". When a franchisor wishes to expand into a foreign market he often entrusts a large area (a country, for example) to a franchisee who has authority to offer subfranchises. This master-franchisee (sub-franchisor) receives from the franchisor all that is necessary for the conducting of the business (know-how, trademark, tradename licences, training, etc.). In return he acts as a substitute for the franchisor. The problem with royalties concerns their payment: to whom is the franchisee supposed to pay, to the master-franchisee or to the franchisor directly? According to Gast he pays the master-franchisee who then forwards the sum to the franchisor, retaining a certain percentage granted him in his contract.(2) This view is not, however, universally accepted.

Authors advise prospective franchisors to seek specialised legal assistance in the country in which they intend to operate in order to avoid mistakes when trying to find their way through the forest of laws and regulations which exists in each country. Boisvert even advises franchisors to have the franchise contract translated before going into the country, and to have their lawyers write a commentary on the terms of the contract, as well as on points of law raised by the contract which may not be easily understood in the other

---

(1) See O. GAST, Le concept du franchising comme méthode de développement international, Cahiers Juridiques et Fiscaux de l'Exportation, 1983, pp. 11-26.

(2) Ibid., p. 20.

country so as to ensure that all parties appreciate the exact meaning of the terms.(1) This practice would undoubtedly assist in avoiding problems caused by language difficulties, and by lack of knowledge of the legal terminology particular to the legal systems concerned.

4. Abuses

The desire to prevent abuses is the reason most often given by those who wish to introduce legislation on franchising. The Committee on Uniform Franchising Legislation of the Uniform Law Conference of Canada has identified four factors which create an atmosphere in which abuses can flourish:

"1. The assumption of significant financial and personal risks by prospective franchisees when entering into a franchise business;

2. The franchisee's relying on the franchisor's purported expertise and stability;

3. The informational imbalance between the parties pre-sale negotiations so that during the period prospective franchisees often never obtain complete or accurate information about the vital aspects about the proposed relationship of the risks being assumed;

4. The absence of a ready and reliable source of information for the prospective franchisee about vital aspects of the proposed franchise business.".(2)

The above quotation stresses the importance of adequate and precise information being given to the franchisee before he enters into the franchise agreement. Misrepresentation is, in fact, a common abuse with which the American authorities in particular have attempted to come to terms by regulations on disclosure (see, for example, the "Full Disclosure Act of 1979").

The need for such rules is illustrated by the conclusions of the Attorney General of New York after an investigation into franchise sales practices in his state:

"In almost every instance, the franchise - offering literature was either inaccurate, misleading, wholly lacking, or blatantly false as to material facts necessary to making an intelligent investment decision."(3)

---

(1) E. BOISVERT, op. cit., p. 7.

(2) Committee on Uniform Franchising Legislation, Report on a Uniform Franchises Act Background, Uniform Law Conference of Canada, Proceedings 1982, Appendix O, p. 248.

(3) Report of the Senate Select Comm. on Small Business on the Impact of Franchising on Small Business, Based on Hearing Before the Subcomm. on Urban and Rural Economic Development, 91st Cong., 2d Sess., at 13 (1970), in Donald S. CHISUM, State Regulation of Franchising: The Washington Experience, Washington Law Review Vol. 48, No. 2, 1973, p. 297 note 18.

The Federal Trade Commission has adopted a trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" ("the rule"), promulgated on 21 December 1978 and effective as from 21 October 1979.(1) This rule is extremely detailed, as are the guides which interpret it. It contains provisions as to the information which the franchisor must give ("disclose") to the franchisee so as to permit the latter to evaluate the real possibilities of the franchise.

Part II of the Uniform Franchises Act elaborated by the Uniform Law Conference of Canada is dedicated to disclosure, specifying the information which the franchisor must include in the "Statement of material facts" he has to give the franchisee. This information includes items such as a copy of the most recent audited financial statement of the franchisor; a statement of the franchise fee charged, the proposed application of the proceeds of the fee by the franchisor and the formula by which the amount of the fee is determined if the fee is not the same in all cases, together with a notation concerning the existence of any continuing royalties; a statement describing any payments or fees other than franchise fees that the franchisee is required to pay to the franchisor, including royalties and payments or fees that the franchisor collects in whole or in part on behalf of third parties, and the names of the third parties; statements related to the equipment and supplies and their acquisition, and a statement as to whether the franchisor provides continuing assistance in any form to the franchisee and, if so, the nature, extent and cost of the assistance, etc.. The Franchises Act of Alberta also contains detailed provisions on the contents of a statement of material facts.(2) It is hoped that requirements such as these will reduce the likelihood of misrepresentation of the nature "get rich quick".

It should be noted that some of the abuses common in franchising are already penalised in other laws. For example, Section 2 (1) of the Misrepresentation Act, which applies in England and Scotland, provides as follows:

> "Where a person has entered into a contract after a misrepresentation has been made to him by the other party thereto and as a result thereof has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true".

J.-P. Clément in his article "De quelques problèmes posés par le franchisage aux rédacteurs de contrat"(3) considers fraudulent franchises, which

---

(1) 16 C.F.R. § 436.

(2) See Art. 4 (b).

(3) Gazette du Palais, 15 November 1977, pp. 543-550.

he identifies with pyramid chains, "la franchise bâtarde", in which one or more component parts of a franchise are missing, for example where technical assistance is reduced to a bare minimum, even if the other component parts are all present.

One aspect of franchising around which problems centre is that of the continuing relationship between the franchisor and franchisee (the "continued interest"). The franchisor is normally in an overwhelmingly stronger bargaining position, and he is the one to draft the contract.

Twelve areas of franchising managerial activities over which the franchisor normally exercises control have been listed: source of products; source of equipment; product assortment; resale pricing; quality of product or service; facilitating services such as business hours, credit and delivery; franchise advertising; sales quotas; training programmes; recordkeeping systems; use of registered trademark and architectural design of franchisee's place of business.(1)

Franchisors have used their stronger bargaining power to terminate franchises arbitrarily, to coerce franchisees under threat of termination, and to free franchisees to purchase supplies from the franchisor or approved suppliers at unreasonable prices, to carry excessive inventories, to operate long, unprofitable hours, and to employ other unprofitable practices.(2)

An abuse which concerns the public as well as franchisees is the so-called "pyramid selling" or "vente à la boule de neige". For this phenomenon there exist a number of different definitions. Two have here been selected for comparison:

"VENDRE A LA BOULE DE NEIGE

Qualifie une vente à la chaîne contractée sous la condition suspensive d'une revente. L'acheteur n'acquiert pas immédiatement la chose, mais des bons d'une valeur égale au prix, qu'il se charge de revendre à des tiers, moyennant quoi il aura droit à la chose, objet de la vente. (...) La vente à la boule de neige débouche très vite sur l'impossibilité d'exécuter la condition prévue: si, à la première opération, 10 acquéreurs suffisent, à la seconde il en faut 100, à la troisième 1000, à la quatrième 10000 ....; à brève échéance, le marché est saturé et les acquéreurs restent avec les bons qu'ils n'ont pu replacer, sans obtenir, en contrepartie, la livraison de l'objet souhaité."(3)

---

(1) S. GILLESPIE, An Analysis of Control in Franchise Distribution Systems, 1966 (unpublished thesis in University of Illinois, Urbana library), in D.S. CHISUM, op.cit., p. 297 note 19.

(2) D.S. CHISUM, op.cit., p. 297-8.

(3) H. ROLAND and L. BOYER, Dictionnaire des expressions juridiques, Lyons, 1983, p. 407-8.

"The typical multi-level distributorship plan involves the manufacture or sale by a company, under its own trade name, of a line of products through "franchises" which appear to be regular franchise distributorships. These plans may include three to five levels of nonexclusive distributorships, and individuals may become "franchisees" at any level by paying the company an initial fee based on the level of entry. Once a member of the plan, the individual earns a commission by selling the company's products and attracting new members. Each distributor pays less for the product than the price he receives from the public and from those at lower levels in the distribution chain to whom he sells. Since one profits merely by being a link in the product distribution chain, the emphasis is on recruiting more investor-distributors rather than on retailing products".(1)

In the United Kingdom pyramid selling has been recognised as containing elements which are dishonest. Thus, the 1973 Fair Trading Act contains provisions which prohibit pyramid-type schemes. The Act further contains provisions which permit the making of regulations:

"(a) to control or prohibit the issue, circulation, or distribution of documents which contain invitations to persons to participate in a scheme; and

(b) prohibiting the promoter of a scheme from performing functions which are vital to the operation of such a scheme, e.g. supplying goods or receiving payment for goods."(2)

A recent German case, Firma Gem-Collection Cosmetics GmbH,(3) concerns pyramid selling. The franchisee could in this case receive particular advantages, both financial and in terms of achieving an area franchise, if she recruited sub-franchisees. Several points were raised, including the excessive price of the products, but ultimately the contract was declared null and void. Criminal liability was also involved.

5. Termination of the contract

An important problem where franchising is concerned, and where abuses are far from unknown, is the termination of the contract. In addition to abuses such as arbitrary revocation or non-renewal of the contract, there are some questions which should be more closely examined. These are: (i) the fate of stocks; (ii) non-competition clauses and (iii) the "indemnité de clientèle".

---

(1) 61 Georgetown LJ 1257 (1973) at 1261 in J. ADAMS and K.V. PRITCHARD JONES, Franchising Practice and precedents in business format franchising, London 1981, p. 255.

(2) M. MENDELSOHN, The Guide to Franchising, 3rd edition, Oxford 1982, p. 63.

(3) 12 September 1985, Oberlandesgericht München, 5 U 4430/85, 7 O 8258/85 LG München I.

(i) The fate of stock

The franchise contract must provide for and regulate the possibility of recovery of the goods in stock. The abundance of cases dealing with this matter clearly indicates its importance. The car-concessionnaire whose contract is not renewed, or alternatively is abruptly terminated, finds himself with a stock of products of a make he no longer represents. The example may be applied mutatis mutandis also to franchising.

In the absence of a clause providing for the recovery of the stock held by the franchisee, the courts have in principle considered that the franchisor does not have any obligation to take back the stock at the end of the contract, except when the franchisor himself has terminated it abruptly, in which case there is an implied obligation.(1) Unsold wares are a risk consciously accepted by the franchisee by reason of the precarious nature of the contract. French case law has, however, attempted to mitigate this in relation to concession contracts, and judges have referred either to a tacit resolutive clause affecting sales made by the person granting the concession to the concessionnaire, or to an obligation to take back stock tied to the existence or to the maintaining of the exclusive concession contract, or, lastly, to the payment of an indemnity to compensate for the loss suffered by the concessionnaire obliged to keep an initial stock.

Italian case law has recently reconfirmed its position:(2) there is no legal obligation of an extracontractual nature for the franchisor to take back or to repurchase the stock. The remedy consists in authorising the franchisee to sell his stock, either until it is exhausted, or for a certain period of time, using of course the distinctive signs and symbols of the franchisor, but specifying two things: only the goods produced or bought by the franchisee before the termination of the contract are to be understood as stock, and not those produced or purchased thereafter; the franchisor could purchase part of these articles, which he could then resell to his new franchisee. This in no way signifies a continuation of the commercial cooperation agreement. The franchisee continues to use the trademark only to place his stock on the market.

The 1971 Franchise Investment Protection Act of the State of Washington provides in Article 18 (2) (i) that a franchisor may refuse to renew the franchise only if he pays the franchisee the fair market value of the inventory, supplies and equipment purchased from the franchisor. The purpose of this obligation is to avoid overloading the franchisee with specialised articles which

---

(1) Ed. Jupiter, Droit des affaires, Marché Commun, FRANCE, T.2 - Statut des personnes, up-date No. 155, June 1985, p. 43 ... (2).

(2) Pretura di Roma, Ordinanza, 11 June 1984, Giurisprudenza italiana, December 1985, Part One, Section II, Col. 710, comments by A. FRIGNANI.

are of little value to him without the franchise, but which are of significant importance to the franchisor. There is, however, no reason to limit the repurchase obligation to articles "purchased from the franchisor". Franchisors could, in numerous cases, avoid this obligation by having independent suppliers purchase their franchisee's equipment and other similar articles.

The second problem which the obligation to repurchase raises concerns the determination of the fair market value. The inventory and the supplies should normally be repurchased at cost price, but often there is only a very limited market for second-hand material, especially if it is highly specialised. The Franchise Investment Protection Act considers that in certain cases the franchise contract ought to provide a basis for the determination of this value.(1) The value thus determined must be reasonable.

The Uniform Law Conference of Canada declared in 1982 that if the franchisor is authorised to terminate his relationship with his franchisee, then there could be a legislative obligation to repurchase the franchisees inventory. The Conference considered that such a provision ought to take into consideration the circumstances from which such an obligation would derive, the contents of the inventory covered, its evaluation and, finally, whether it is a matter of terminating the contract or of not renewing it, or both.

The same Conference, meeting in August 1984, again considered this problem. If the franchisor terminates or refuses to renew the franchise contract in contravention of the Uniform Franchises Act he should offer to repurchase from the franchisee the stocks which conform to the present standards of the franchisor, and for which such repurchase is provided in the contract or in commercial practice, and which are held for use or sale in the franchise. The franchisor is to pay the lesser of the wholesale market value or the price paid by the franchisee. The franchisor will have no obligation to repurchase personal items of no value to him in the field in which he grants franchises.

Lastly, Article 6 of a French draft law, that of Messrs. Glon and Couste,(2) provides:

"Au cas où l'intermédiaire a acquis des marchandises chez son intégrateur, ce dernier peut:

---

(1) E.g. the agreement of the Baskin-Robbins 31 Ice Cream Store provides for the repurchase of the equipment at its cost minus 25% depreciation in the first year, 15% per year thereafter, but never for less than 30% of its cost.

(2) Proposition de loi tendant à réglementer la situation juridique des franchisés et concessionnaires, No. 891, Première session ordinaire de 1973-1974, Titre I, Art. 6.

- soit laisser l'intermédiaire écouler les stocks restant sous l'enseigne du réseau pendant une période de six mois à un an commençant à courir au jour de la cessation du contrat;

- soit reprendre dès la cessation du contrat les marchandises qu'il a vendues dans les douze mois qui précèdent le point de départ du délai de préavis, à condition que l'intermédiaire ait fait preuve d'une diligence normale pour les vendre à la clientèle. L'intégrateur reprend alors les invendus au prix initialement facturé lors de la livraison à l'intermédiaire.

Au cas où le concédant ou le franchiseur ne choisit aucune de ces deux solutions, il est redevable d'une indemnité égale à la valeur, taxes comprises, de l'intégralité du stock de l'intermédiaire au jour de la rupture du contrat."

This is the first time that the idea appears of an indemnification of the franchisee for stock with which he can do nothing as, since his contract has been terminated, he no longer benefits from the advantages of the contract, but is still bound by clauses which become operative on termination of the contract, amongst which are the non-competition clauses.

(ii) Non-competition clauses

It is in the interest of the franchisor to protect himself against possible competition by his franchisee on the expiry of the contract, whatever the reason, even if a non-competition clause is of no real value when the franchisor is at fault or when he abuses his rights. It is obvious that even if the franchise contract does not form part of the "fonds de commerce" it may still be greatly devalued upon expiry of the contract as a result of the existence of too restrictive a non-competition clause.

Gast and Mendelsohn[1] insist on the fact that such a clause should not be applicable if the termination of the contract is caused by the franchisor's non-compliance with one of his obligations. In fact, the franchisor would in such a case gratuitously take over clients which the franchisee had acquired through his own work. By the simple fact that the franchisor not only prohibits the franchisee from conducting any business identical to his in the zone of territorial exclusivity, but also causes his total ruin by taking away his sign, he obliges the franchisee to embark upon an entirely new activity. This risk must be kept in mind as French courts are as yet undecided on this point and tend rather to protect the interests of franchisors.

---

(1) O. GAST and M. MENDELSOHN, Comment négocier une franchise, Ed. du Moniteur, p. 57.

Be that as it may, the non-competition clause is valid in principle, on condition that it is limited in time, space and sector of acticity, as it should not prevent the franchisee from exercising an activity.

The Cour d'Appel of Colmar[1] decided that the clause "est pleinement licite en matière de franchisage" as it answers the "intérêt légitime de la société bénéficiaire". It was "limitée dans le temps, dans l'espace et quant au secteur d'activité". It is to be observed that the court required the presence of both conditions of limitation in time and space. The Chambre commerciale de la Cour de Cassation, has instead abandoned this double requirement, deeming a limitation of either time or space to be sufficient, at least in respect of commercial contracts.[2]

Even if franchisors have an interest in providing for such clauses, the authorities in the United States dealing with competition are not favourable to them. Usually, the American courts do not permit them to be enforced unless trade secrets have to be protected, and they are "limited both as to time and territory to a scope which can be justified as necessary to protect trade secrets". Furthermore an agreement taking effect at the end of the contract which applies non-competition to "similar fields" may be ambiguous and, according to United States and Canadian legislation, may impose unreasonable restrictions.

The case law of Quebec has established that when

> "parties had agreed to refrain from competing with one another ... Such covenants are enforced if they are reasonable and not in restraint of trade. But even when not in restraint of trade in the sense of The Combines Investigation Act, they may be struck down on the grounds of public policy."[3]

It appears that the courts of Quebec attempt, as do their counterparts in the United States, to ensure that non-competition clauses, particularly those relating to the termination of the contract, are not unreasonable and that they are not contrary to "ordre public".

Some authors are shocked by the fact that this clause is applied to franchisees without giving them any right to compensation. Jean- Paul

---

(1) Cour d'Appel of Colmar, 9 June 1982, in Dalloz Sirey 1982, Jurisprudence, p. 554.

(2) Cour de Cassation, Chambre commerciale, 27 October 1981, in Bull. civ. IV, No. 371, p. 295; Dalloz 1982. IR. 204, comments by SERRA.

(3) C.A. SHEPPARD, The Enforcement of Restrictive Covenants in Quebec Law, 1963, in Revue du Barreau 311, p. 346, in I. BERLINSKI, Franchising in the United States and Canada, (1978) 13 Revue Juridique Thémis, Nos. 2-3, p. 584.

Clément[1] notes that in labour law collective contracts as a rule provide for the payment of a sum equal to part of the salary for the duration of the applicability of the clause. Instead, by virtue of the application of simple provisions of commercial law the franchisee has no right to such an indemnity. In the Federal Republic of Germany a non-competition clause has a limited duration of two years, but the franchisee has no right to financial compensation.[2]

The problem of the supposed or real taking-over of the clients of the franchisee by the franchisor arises here, as the consequence of the application of the non-competition clause and of the possible payment of an "indemnité de clientèle" to the franchisee.

(iii) The "indemnité de clientèle"

Whether or not the contract has a predetermined duration, the franchisee does not have a right to its renewal, as the parties are independent of each other. What, then is the fate of the clientèle, and to whom does it belong? In variable proportions depending on the franchise chain, the clientèle will be divided among the franchisor, the old franchisee and the possible new franchisee. It is for this reason that the courts have had difficulties in awarding franchisees an indemnity in respect of the clientèle. As Didier Ferrier remarks, franchisees

> "se trouvent exclus du bénéfice d'un régime d'indemnité de clientèle prévu uniquement pour des intermédiaires salariés ou mandataires, qui n'ont eux, aucun droit sur la clientèle créée pour le compte du mandant ou de l'employeur. En effet, l'indemnité d'un droit de clientèle n'est pas la sanction d'un droit patrimonial du représentant sur la clientèle, elle répare le préjudice causé au représentant par la rupture du contrat; elle est a cette fin calculée en tenant compte de l'importance en nombre et en valeur de la clientèle apportée, créée ou développée par le représentant".[3]

A practical consideration may be added to this legal reason, normally that the clientèle will go to the one to whom it is attached, to the franchisor who attracted it by means of his trademark and to the old franchisee whose qualities as a dealer and whose services it has appreciated. It would therefore appear to be in conformity both with law and equity that no indemnity be paid to the franchisee, to the extent of course that the **latter** may carry out a similar activity at the same place.

---

(1) J.-P. CLEMENT, De quelques problèmes posés par le franchisage aux rédacteurs du contrat, Gazette du Palais 1977, II, p. 543.

(2) Services commerciaux français en République fédérale d'Allemagne poste de Munich, March 1981.

(3) D. FERRIER, in J.-P. CLEMENT, op.cit., p. 547.

To limit the indemnity to the loss of clientèle is, however, too restrictive. It is the damage caused by the taking back of the franchise which must be compensated in its entirety. This cannot, however, be done unless the franchisor terminates the contract in an unjustified manner.

CONCLUSIONS

It is an arduous task to decide whether or not it is possible to draft an international instrument on franchising. Such a decision involves a variety of considerations and the assuming of certain positions, not least with respect to the exact definition of a franchise agreement. An examination of the different definitions alone indicates divergencies which are not always minor ones. These divergencies may be categorised and summarised as follows:

1. Nature of the agreement:
   - distribution
   - production
   - collaboration
   - association
   - licence
   - particular business
2. Parties to the contract:
   - producer/wholesale dealer
   - producer/retailer
   - wholesale dealer/retailer
3. Bargaining strength of the parties:
   - equal
   - one stronger than the other
4. Form of the contract:
   - express
   - implied
   - written
5. Nature of goods/services offered/supplied by franchisor:
   - goods/services
   - know-how
   - training

- method
- organisation
- advertising

6. What the franchisee is to exploit:
   - trademark/tradename
   - format
   - procedure
   - emblem
   - formula
   - trade secret

7. Conditions under which the franchisee has the right of exploitation:
   - set procedures
   - control by franchisor, his "continued interest"
   - fixed period of time
   - mutual exclusiveness (mostly territorial)

8. Franchise fees and financial investment:
   - substantial/small
   - entrance fee
   - royalties

9. Financial independence of franchisee from franchisor:
   - not holding company and subsidiary
   - not subsidiaries of the same holding company

10. Organisational dependence/independence of franchisee vis-à-vis franchisor:
    - distribution network
    - association of equal companies

Other elements of great importance which should be carefully considered are:

- the originality of the invention or product owned by the franchisor
- the necessity of the goods/procedures having been previously experimented by the franchisor in pioneer establishments

- the necessity of continuously up-dating know-how
- the problems associated with abuses and termination of contract
- conflict with anti-trust legislation

This last point is one which will have to be considered, even if it is beyond the scope of an international private law instrument, because of the great influence it has on franchising.

Furthermore, a clear demarcation between what is already the subject of national public law and private law has to be made before any international instrument is elaborated. The legislation relevant to civil and criminal liability also calls for examination. Overlapping with existing legislation must be avoided.

The type of international instrument to be adopted has to be carefully considered with reference to the peculiarities of franchising. The purpose of the instrument should be determined - should it primarily constitute a remedy for malpractice or should it go further and, if so, how and in what detail? Should it be designed to act mainly as a stimulant for the adoption of national legislation? To what extent can national remedies be adopted internationally?

In the national context the adoption of legislation on franchising undoubtedly commends itself in the present uncertain situation as regards the phenomenon. What this legislation should contain is a matter which could be controversial. Some form of provision on disclosure would appear to be indicated, although not in such great detail as the rule of the United States Federal Trade Commission or as the Full Disclosure Act of 21 October 1979 of the same country. The form suggested in the Canadian Uniform Franchises Act contains all the elements necessary but does not attempt to regulate all questions in detail - it thus represents a viable compromise solution. In any uniform law the chances are that the points taken up for disclosure would have to be more schematic than in a national system.

Registration is another remedy which may be suggested. In this case the franchisor is required to register with a regulatory body before offering franchises to the public. Registration would only be granted if the franchisor met certain standards of competency, solvency and integrity. Registration of the disclosure document may also be required, and modifications of this document may be requested if the information disclosed is not adequate. It is clear that problems could arise in international franchising - e.g. with which national authority would it be possible to register?

A combination of full disclosure and registration has been suggested, and could possibly be worked out.

Another problem in relation to legislation is the regulation of substantive terms. Should the law go so far as to regulate in detail termination of the contract, renewal and assignment of franchise rights, tie-in arrangements between franchisor and franchisee, prohibitions to sell at more than a fair or reasonable price etc? It is clear that an international instrument would be less detailed than national legislation.

The role of the codes of ethics also needs to be considered. These could serve as a basis for the development of legal instruments, both national and international, which raises the question of the normative value of the codes of ethics. In general the members of an association should be bound by internal regulations of the association. The codes of ethics, despite their considerable importance and the fact that they have been indicated as supplementing the law of the country,(1) appear to fall into this category of internal regulations. The courts apply general principles of contract law and do not admit that franchise contracts have a special character recognised by legislation, as there is none, or constitute a custom binding upon all professionals concerned.(2)

The growing economic importance of franchising, as well as the uncertainty of its situation both nationally and internationally, calls for certain measures to be taken. Whether these measures ought to be of a national or an international character, the form they should take and what is in fact feasible are matters for evaluation. Operators have expressed their apprehension with respect to possible legislation, fearing that it would restrict their activities excessively, particularly if it were to take a form similar to existing American legislation. If more liberal legislation were to be proposed they would be favourable to its adoption.

On the other hand there appears to be a need to regulate this economic phenomenon in order to avoid the problems it could create in the absence of any national or international rules.

---

(1) G.E. BOISVERT, op.cit., p. 4.

(2) F. CAQUELIN, La franchise et le droit, Gazette du Palais, 4 November 1982, p. 567.

ANNEX

QUESTIONNAIRE RELATING TO FRANCHISING CONTRACTS

1. Which is the form of franchising to which recourse is most usually had in practice (please indicate order and approximate percentage):

   (a) service franchising
   (b) production franchising
   (c) distribution franchising
   (d) industrial franchising
   (e) capitalisation franchising
   (f) trademark licensing franchising
   (g) conventional franchising
   (h) itinerant franchising
   (i) business opportunity ventures
   (j) other forms or combinations of the above?

2. Does there exist in your country legislation affecting franchising, e.g. concerning the relationship between franchisor and franchisee and any official control thereof, such as a disclosure act?

3. If there are no laws specifically governing franchising in your country, what laws are applied to franchising contracts by analogy?

4. If there are no specific legal provisions on disclosure, what legal principles are applied by the courts?

5. Please give examples of cases decided on franchising.

6. What criteria are adopted in your country for fixing the sum payable to the franchisor by the franchisee in terms of:

   (a) entrance fee
   (b) percentage on turnover
   (c) others?

   To what extent are clauses regulating such payment held to be valid?

7. What, in your experience, are the abuses most common in franchising?

8. Does legislation exist in your country which is designed to protect the franchisee's rights against arbitrary rescission of the franchising contract or resale of the franchise by the franchisor, or which may be applied to that effect?

9. What, in your view, is the practical importance of the Codes of Ethics adopted by the franchising associations?

10. Turning to specifically international franchising situations, would your answer to question 1 differ in respect of international franchising?

11. What, in your opinion, are the aspects of international franchising operations which give rise to especial difficulties and/or differ from those commonly encountered in purely domestic franchising transactions?

12. In particular, do the obligations arising under international franchising differ from, or are they much the same as those deriving from domestic transactions?

13. How far do you consider the various forms of franchising employed in international operations to merit special, individual treatment, or could they rather be dealt with adequately and appropriately by the same rules and in the same instrument?

14. To the extent that international rules are felt to be desirable in this field, which form would, in your view, be more fitting:

(a) international uniform legislation;
(b) some form of model law;
(c) a combination of (a) and (b), bearing in mind that certain subjects which are at present in practice normally covered by the franchisor's general conditions or standard forms of contract should perhaps be subjected to some form of mandatory regulation without prejudice, however, to the basic principle of party autonomy as to all other matters not subjected to such rules;
(d) guidelines, or
(e) model contract?