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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

THE FRANCHISING CONTRACT

Survey of the answers to the Questionnaire submitted by the Secretariat to Governments, professional associations and experts in the field

(Secretariat memorandum)

Rome, June 1988

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INTRODUCTION

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 Work Programme for the triennial period 1987 to 1989. This report was considered by a sub-committee of the Governing Council at its 65th session in April 1986.

A number of problems connected with franchising came to light in the preparation of the preliminary report. These ranged from the actual nature of the contract which, being of a hybrid character, is not easily equated with other more traditional contracts, to the abuses which exist and to the conflicts with existing, mandatory legislation such as competition law. A large number of divergences between the different countries examined, as well as a general lack of legislation (with only a few exceptions), were encountered. The different solutions which have been experimented with in certain countries, such as the full disclosure procedures of the United States Full Disclosure Act (1979) were considered, as also was their suitability as providing elements for an international instrument.

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 of the Governing Council recommended that the subject be included in the new Work Programme. This recommendation was endorsed by the Governing Council which requested the Secretariat to submit the preliminary report, together with a questionnaire (see Annex I) designed to elicit further information, to Governments, professional circles and recognized experts in the field.

By the beginning of April 1988 answers had been received from the following:

(1) the Governments of Australia, Austria, Canada, Chile, Denmark, the Federal Republic of Germany, Italy, Japan, Luxembourg, Mexico, South Africa, Sweden, Switzerland, Venezuela and the United Kingdom. The Government of the United States of America indicated that the answers of the American based International Franchise Association should be taken as representing the position of the United States;

(2) Directorate-General IV, Competition, of the Commission of the European Communities;

(3) professional associations from Australia, Italy, the Netherlands, Sweden, the United Kingdom and the United States of America;

(4) individuals (including corresponding collaborators) from Argentina, Canada, France, Italy, Morocco, Sweden, Thailand, the United Kingdom, the United States of America, Venezuela and Yugoslavia (see Annex II for a list of those cited in the report).

The findings of the first report may be summarised as follows:

(1) There is a general lack of legislation on franchising, the exceptions being various state laws, the Full Disclosure Act and the Federal Trade Commission Rules and Guidelines in the United States, and the Alberta Franchises Act in Canada.

(2) The divergences encountered concerned:

(a) the nature of the agreement (whether it is a distribution, production, collaboration, association, or licensing contract or a particular business agreement);

(b) the parties to the contract (which may be either producer/wholesale dealer, producer/retailer or wholesale dealer/retailer but not two wholesale dealers - although this restriction was queried by one of those who replied to the questionnaire);

(c) the bargaining strength of the parties - one is generally stronger than the other - which at times leads to abuses and to unequal contract terms;

(d) the form of the contract, whether it is express or implied and whether or not it has to be in writing;

(e) the nature of the goods or services offered or supplied by the franchisor, which should include know-how, and may include training, the method and/or organisation of the business to be followed, and advertising;

(f) what it is the franchisee is to exploit, i.e. a trademark or tradename, an emblem, a procedure, a formula or trade secret;

(g) the conditions under which the franchisee has the right of exploitation, which may include set procedures, the franchisor's control (continuing interest), a fixed period of time and mutual exclusiveness (which is mostly territorial);

(h) the franchise fees and financial investment, which may be either substantial or small, and may comprise an entrance fee and/or royalties;

(i) the financial independence of the franchisee from the franchisor, i.e. they must not take the form of a holding company

and its subsidiary, nor should they be subsidiaries of the same holding company;

(j) the organisational dependence or independence of the franchisee vis-à-vis the franchisor, whether they are part of a distribution network or are an association of equal companies.

(3) Other elements of great importance which should be carefully considered were found to be: the originality of the invention or product owned by the franchisor, the necessity of the goods or procedures having been previously experimented by the franchisor in pioneer establishments, the necessity of continuously up-dating know-how, the problems associated with abuses (the most common of which is pyramid selling) and the termination of the contract (the fate of stock, non-competition clauses, the "indemnité de clientèle") and, as mentioned above, conflicts with anti-trust legislation.

The points raised in the questionnaire concerned the following:

(i) the incidence of the different forms of franchising (including a specification in percentages) and the possible difference in incidence between national and international franchising;
(ii) the existence, or non-existence, of legislation, whether aimed at franchising in general, at the protection of the franchisee's rights against arbitrary rescission of the franchising contract or resale of the franchise by the franchisor, or at other problems which are of importance also to franchising - which may assume particular importance when it is considered that there is a general lack of legislation specifically on franchising;
(iii) any other legal principles applied by the courts;
(iv) cases decided on franchising, and the abuses which occur most frequently;
(v) the fees the franchisee pays the franchisor and their calculation;
(vi) the codes of ethics and their importance;
(vii) the particular difficulties encountered in international franchising as against purely national franchising, and differences between the two, such as differences in the obligations of the parties;
(viii) the need for individual treatment for the different forms of franchising, or the possibility to cater for them all in one instrument;
(ix) the form most fitting for an international instrument on franchising.

The answers to the questionnaire will be considered in relation to each of the above points. A few answers were, however, accompanied by general considerations as to the approach followed. As some of these are of particular interest they will be examined separately, in Chapter I.

CHAPTER I : GENERAL CONSIDERATIONS

The general considerations accompanying the answers to the questionnaire vary widely in scope. The **International Franchise Association (IFA)**, which appears to read into the preliminary report several affirmative answers to questions raised in that report in relation to the feasibility and desirability of some form of international instrument for franchising (affirmative answers which the authors of the report were unaware of having supplied), submits "that the Study fails to focus adequately on the fundamental question : Is it necessary or desirable to develop international guidelines or model legislation applicable to franchising contracts?". Clearly, although hardly surprisingly, the IFA does not consider this necessary or desirable, although it does admit that "/d/eveloping a uniform definition of franchising would be a significant contribution to the development of international law affecting franchising", and that "/o/ther words, familiar in the lexicon of franchising, should be carefully defined, to facilitate the development of a uniform and consistent body of international law and commercial practice regarding franchising", to which purpose the International Bar Association's Section on Business Law (Committee X : International Franchising) is developing a Compendium of Franchising Terms, to which we will return in the chapter on the activities of other organisations.

The **Amsterdam Chamber of Commerce** appears to think along the same lines as the IFA, in that it finds no necessity for the international regulation of franchising as "it has not been shown to us that franchising is being abused to such an extent that international regulation is required. Nor has it become obvious to us that the branches of trade and industry in question have need of international regulation on other grounds".

The **Dutch Association of Company Lawyers** (Nederlands Genootschap van Bedrijfsjuristen (NGB)) also doubts "if a uniform arrangement of franchising is a real possibility because in practice franchising occurs in many forms".

The many forms in which franchising occurs leads the **Italian Government** to observe that the statistical data on the incidence of franchising are not completely dependable and cannot be compared, as the phenomena they refer to may, in fact, differ.

Extremely interesting, and constructively critical, observations on the approach adopted in the first study were submitted by Mr J. **Adams**, of the Faculty of Social Sciences of the University of Kent at Canterbury, who suggests that franchising is best studied with the assistance of a management science model. Mr Adams begins by stating that the "fundamental weakness" of the study is that it "ignores the distinction between legal definitions on the one hand, and ideal

types/models which are the basic tools of explanation of social/economic phenomena on the other. Legal definitions differ from ideal types or models, in that although legal definitions may be based on ideal types/models (they must be), they are not formulated as instruments of explanation. They are "triggers" for other legal consequences. Thus the first stage in all enquiry into a phenomenon such as franchising must be to construct adequate ideal types/models. These are empirically derived, but do not necessarily correspond to any institution in the real world. They are, as it were, necessary lenses to enable us to perceive the social/economic landscape. In intent, therefore, they are quite different from legal definitions, which must be constructed and evaluated through them. The same phenomenon can, moreover, be viewed through a variety of such "lenses" and in this way a variety of definitions constructed for different purposes".

Mr Adams illustrates the point he makes by making a series of observations on the study, the first of which coincides with that of the Italian Government and relates to the effective value of the statistical data given in the study on the incidence of franchising. He considers the figures to be meaningless, as "we are not told on the basis of what concept of a "franchise" they were compiled". The point may, however, be made that, while it certainly is true that the data given is unsatisfactory, and that a comparison between the figures of the different countries is difficult, it is the only data which is available, at least from published sources, and that until agreement is reached on what constitutes a franchise and new data is collected on the basis of such a new definition, it must of necessity be used.

Furthermore Mr Adams considers that the discussion of the problems raised by a franchise does not "take us much further forward" as no adequate theoretical model has been developed, and because of a lack of awareness of the fact that "definitions are dependent upon the consequences it is desired to trigger". In particular he considers that the four factors identified by the Uniform Law Conference of Canada as creating an atmosphere in which abuses can flourish[1] could apply to the purchase of almost any business, and not just to franchises

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(1) Study LXVIII - Doc. 1, p.37:
"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".

(although it could be argued that they are of particular importance to franchising). Mr Adams goes on by stating that "/i/t is also important to realise that the way in which the subject is approached from within the logical imperatives of antitrust law, has no necessary bearing on how we would wish to approach it for other purposes. In fact the object of our enquiry (anti-competitive practices, abuses of the kind listed on page 37 or whatever) has an important bearing on how we view the phenomena in the social/economic world".

After illustrating this point by giving examples of the approaches an economist and a management scientist could be expected to adopt, Mr Adams goes on to state that "/a/t the outset, a legislator must adopt the social scientist's methodology in order to identify the object of the legislation he is drafting. For example, if his concern is consumer (i.e. franchisee) protection, he might not need to distinguish pyramid selling from format franchises, since some of the abuses are rather similar (/.../ the example is purely hypothetical)".

The model which Mr Adams considers to be the most relevant as being a model "upon which any uniform law might be based" is, however, a management scientist's model which is concerned to identify the motives of both parties for entering into a particular type of relationship. "From this point of view, a business format franchise is a system in which the parties, by means of the law of contract, construct a sort of managed outlet (though possibly not in the legal sense of creating the relationship of employer/employee) in which the franchisee risks his capital. That capital risk is in part a control device in addition to the contractual legal controls, for if the franchisee steps out of line, he loses his investment. It is also a capital raising device, but looked at from the point of view of the franchisor, it is relatively expensive as such since any profits made by the franchisee which might have accrued to the franchisor in a company owned arrangement, must be added in to ascertain the true rate of interest on the notional "borrowing" by the franchisor of the franchisee's investment. Assuming that this analysis is correct, the reasons why franchisors are prepared to pay this high "rate of interest" are worth enquiring into. They almost certainly turn out to be (inter alia): 1) that the franchisor cannot raise capital in any other way (and hence like others in a similar position is prepared to pay a high rate of interest for it); 2) employee behaviour is difficult to monitor - hence franchising has spread very rapidly in the catering industry; 3) labour problems are emdemic in the industry - by splitting up the "front end" of a business into independent outlets, the possibilities of collective bargaining are much reduced".

Mr Adams concludes his comments by stating that "/i/f UNIDROIT is to make progress towards a draft international instrument on franchising, a much more sophisticated methodological approach needs to be adopted at the outset towards identifying the nature of the phenomenon to which that instrument is to apply. To this end, it is

necessary to have regard to the work of, and techniques of social scientists, and in particular economists and management scientists. Only after adequate preliminary analysis of this sort, will it be possible to begin to identify at all adequately the ground which a draft instrument needs to cover".

The considerable interest of these observations of a social scientist has led to their being reported at length. The approach Mr Adams suggests may be considered with more or less favour, particularly by lawyers who are not always trained to adopt an inter-disciplinary approach, but they should definitely be kept in mind when considering any future activities in relation to franchising.

CHAPTER II : SURVEY OF THE ANSWERS TO THE QUESTIONNAIRE

(i) Frequency of different forms of franchising - national and international

The first question in the questionnaire concerned the frequency of different types of franchising. Ten different types were given as examples, the order and percentage of each being requested. Question 10 furthermore requested an indication of possible differences in the frequency of the different forms of franchising for international franchising, which several answers did not consider to exist (Governments of Canada and Luxembourg; Franchisors Association of Australia, Associazione italiana del franchising, Swedish Franchise Association and British Franchise Association; Professor W. Keating (USA) and Mr T. Coshnear (Italy)).

A first observation to be made on the answers received to these questions is that the difficulties of comparing the different statistics are increased by the fact that several nations collect statistics for each branch of activity, and not for each type of franchising. This is the case for **Australia**, the **Government** of which submits statistical tables in which the categories are different types of activity. These tables refer to franchising in small non-manufacturing firms, to sales under franchise agreements as percentages of annual turnover, as well as to capital and turnover for new vehicle dealer operations in Australia. These statistics, compiled following a survey conducted by the Bureau of Industry Economics in June 1978, indicate that a total of 18.9% of non-manufacturing firms were then engaged in a franchised activity, the figures for each industry being as follows: 57.1% of motor trades firms, 33.9% of wholesale distribution firms, 17.9% of retailing firms, 11.3% of accommodation firms, 10.2% of travel agents and real estate agents, 8.9% of building and construction firms, 7.4% of road transport firms and 5.2% of personal services firms. The **Franchisors Association of Australia** gives no statistical estimates at all, limiting itself to the definition of a typical business format franchise, as opposed to the impliedly incorrect terminology used in the list.

A certain difference between national and international franchising is noted by Mr **O. Marzorati (Argentina)** as regards the incidence of the different forms of franchising, the figures for national franchising being: distribution franchising (45%), trademark licensing franchising (30%), service franchising (20%) and business opportunity ventures (5%); while for international franchising trademark licensing franchising and service franchising prevail (no percentages given).

The **Government of Austria** has submitted two different answers for most questions, one from the **Federal Chamber of Trade and Industry**, the other from the **Ministry of Justice**. According to the first of these the

most common form of franchising in Austria is a combination of service, distribution and trademark licensing franchising (no figures given).

The **Government of Canada** states that it is unable to provide statistical information as to which form of franchising is the most commonly employed in the Common Law provinces of Canada, although it would appear that in 1983 distribution and service franchising were those most commonly used. In Québec franchising cannot be classified into set types: the parties enter into a contract which contains everything necessary to describe the form of franchising. It is thus possible to find service, production, distribution and other forms of franchising in the province of Québec. Mr **Zaid (Canada)** makes a slightly different estimate, while pointing out that "the terms set forth in this question do not generally have meaning in Canada". He goes on to state that generally, in business format franchising, there is a predominance of service franchising followed by production franchising; there is also a significant amount of distribution arrangements, and trademark licensing arrangements.

The situation in **Chile** appears to be quite different, in that the only statistics which exist are those of the Central Bank which has to authorise the exportation of foreign currency for the payment of royalties. By way of example the Chilean Government indicates that in 1985 42 contracts were authorised for Chemical and Petrol Laboratories and Industry; 16 for Food and Drink; 8 for Textiles and Clothes; 9 were authorised for a variety of services; 8 for metallurgy; 5 for construction and 5 for intellectual property (discos, publishing houses etc.).

The **Danish Government** submits data furnished by the Danish Association of Franchisors, according to which the most common forms of franchising in Denmark are business format franchising and a combination of distribution franchising and trademark licensing franchising (no figures given).

Unfortunately, no answers were received from the **French Government.** Mr **F. Pollaud-Dulian** of the Institut de droit comparé of Paris, however, places production franchising, distribution franchising and conventional franchising on the same level, followed by service franchising and, lastly, by industrial franchising.

The **Government of the Federal Republic of Germany** does not have any official statistical data at its disposal, and does not consider an estimate of the importance of the single forms of franchising to be possible. It presumes, however, that distribution and service franchising play a major role in the Federal Republic.

The **Government of Italy** estimates that conventional franchising, which it defines as a mixture of the production and distribution of products and services together with patent licences and concessions for

the use of the tradename, trademark and know-how of the franchisor, is the form of franchising most common in Italy. It is not, however, in a position to furnish any figures. A certain difference is noted with regard to international franchising, in that industrial and production franchising are more common, even if mixed forms with licences for industrial property continue to prevail. The **Associazione italiana del franchising (Assofranchising)**, while considering that the list contains forms of franchising which overlap, states that Italian business practice knows mainly distribution franchising (60% of the networks), service franchising (35%) and production franchising (5%). The figures given by Mr **T. Coshnear**, however, vary, in that he assigns 80% to distribution franchising, 15% to service franchising and 5% to business opportunity ventures.

The data furnished by the **Government of Japan** also considers the incidence of franchising in different trade sectors, rather than for the various types of franchising. The data given is that of a survey conducted in 1986 by the Japan Franchise Association, according to which, as at 31 March 1986, the merchandise retail trade had 195 franchise chains (32.7% of the total), the food catering trade had 267 chains (44.8%) and the service trade had 134 chains (22.5%), for a total of 596 franchise chains.

The **Government of Luxembourg** does not have statistics on the incidence of the various forms of franchising, although it considers that practice would seem to indicate that distribution franchising is the form which is most widely spread, followed by production franchising and business format franchising, which it calls "franchise intégrée".

The **Government of Mexico** indicates that service franchising, with the exploitation of a trademark, is the type of franchising which occurs most frequently, adding that there are approximately 150 such contracts registered with the Mexican authorities.

Professor **A. Boudahrain** of **Morocco** gives a list of the different types of franchising in order of size, without commenting thereupon: international franchising; distribution franchising; trademark licensing franchising; conventional franchising; industrial franchising; production franchising, and lastly service franchising.

Again, the **Government of South Africa** considers it to be impossible to fix percentages for the different types of franchising "since such widely-varying contracts are sometimes known as franchising contracts. Whilst they are known as franchising contracts, they may in fact more correctly fall within some other category of contract. Because franchising covers such widely-varying contracts, it is impossible, without a comprehensive definition, to understand which contracts are to be categorised as franchising contracts or not". After stating the consideration that the forms of franchising and the most usual types of franchising obviously differ depending on whether or not one is dealing

with international or local franchising, the most usual forms of franchising in South Africa are given in the following order: conventional franchising; business opportunity ventures; other forms or combinations; trademark licensing franchising; production franchising; service franchising; distribution franchising; industrial franchising; capitalisation franchising and, lastly, itinerant franchising.

The **Government of Sweden** states that "/i/n Sweden franchising (i.e. Business Format Franchising) is practised primarily in service and distribution trades" (this equation of franchising in general with business format franchising is yet another way of classifying the phenomenon). On the other hand it states that franchising is rare in production and industries. Yet again, "/i/t is not possible to specify the occurrence of the different forms of franchising in percentage". The **Swedish Franchise Association** does, however, do precisely this, giving the following figures: distribution 54%; service 33%; itinerant 9%, and production 4%, underlining, however, that trademark licensing is not included in statistics. This contrast is all the more curious as the person who answered the questionnaire for the Government was a member of the Parliamentary Commission appointed to investigate franchising in Sweden, and to examine the need for legislation in the field[2], and since one of the experts called in as consultants to the Commission was Mr Stig Sohlberg, General Counsel of the Swedish Franchise Association who answered the questionnaire on its behalf. The Commission, which investigated all the different aspects of franchising, including the frequency of the phenomenon, completed its work in June 1987, and published a detailed report of its findings[3], to which we will return under the next point.

The **Government of the United Kingdom** does not divide franchising into different types; rather it indicates the general categories where it is concentrated : services to business and private customers (25%); home improvements (20%); food and drink preparation and supply (15%); health and beauty products (10%); leisure products and services (10%); vehicle servicing etc. (10%); transport (taxis and parcels) (5%); and clothing and fashion (5%). The **British Franchise Association**, on the other hand, states that it "does not recognise the categories of "forms of franchising which are listed. There are two basic types of franchise:- (a) the first generation franchises (b) business format franchises which are the most recent development and the most prevalent. It is not considered helpful to suggest that business types e.g.: service, production etc. affect the nature of the franchise. In Business Format Franchising there are many categories of business activity. Franchising transcends the normal industry divides. In the UK the Business Format Franchise is the most prevalent. Business op-

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(2) See Study LXVIII - Doc.1, pp. 32 - 33.

(3) Franchising - Betänkande av Franchiseutredningen, SOU 1987:17, Stockholm, 1987.

portunity ventures not amounting to franchises are common causes of confusion and again it is not considered helpful that Unidroit categorises such ventures as a "form of franchising"". This observation regarding the generic value of the term "business opportunity ventures" was shared by other respondents, although they expressed themselves somewhat less forcefully. It is, however, a term which is used by the United States Federal Trade Commission in its "Rule and Guides" on "Franchising and Business Opportunities", which describes the provisions of the Federal Trade Commission's trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (16 C.F.R. § 436).

Professor **Keating (U.S.A.)** also refers to the question of the classification of business opportunity ventures in his reply on this point, which would appear to indicate a certain discrepancy between terminology used within the United States. In fact, Professor Keating states that "/w/hile "business opportunity ventures" are listed with franchises, they are not generally considered to be true franchises. The true franchise involves the franchisee's right to use the franchisor's trademark". The fundamental importance of the trademark is stressed also by Mr **A. Jaglom (U.S.A.)**, who states that "/i/n my experience, the trademark license is very often of the essence in the franchise transaction. In such cases, the principal value conferred on the franchisee by the franchisor is the good will and name recognition conveyed by the trademark". As regards the incidence of the different types of franchising, Professor **Keating** states that distribution franchising is the most common form of franchising, production franchising the second most common, and business opportunity ventures the third.

The observations submitted by **Directorate General IV, Competition, of the Commission of the European Communities** are interesting, in that they encompass information which comes from all of the twelve countries composing the European Communities. Admittedly the data is based on the notifications enterprises make to DG IV, which means that it is of necessity incomplete, as notification is not compulsory. The available data does, however, indicate that distribution franchising is the most frequent form, with production franchising second.

(ii) Legislation on or influencing franchising

The information received from the respondents confirm the findings of the first study as regards the existence, or better, the non-existence, of legislation on franchising. As was found at the time of the first study, only a number of states and the Federal Trade Commission of the United States, as well as the province of Alberta in Canada, have adopted legislation specifically on franchising. The only novelties of note in this respect are the draft law of the Swedish Parliamentary Commission on franchising, which it includes in its report (see below,

in the section on Sweden), and the news of the withdrawal of the Franchise Agreements Bill in Australia (see below, section on Australia). Very interesting, and at times very detailed, information was, however, supplied as regards other legislation which has, or may have, a bearing upon franchising[4].

As regards **Argentina**, Mr **Marzorati** states that there is no legislation on franchising or, for that matter, any official control thereof, except by way of the Transfer of Technology Law N° 22.246, which provides that licensors and licensees must seek registration in a Government Registry of any agreement between a non-resident and a local resident, whereby the local resident is, against payment, offered trademarks, patents, technical assistance, engineering services and know-how from foreign sources. Furthermore, this law limits the rights of non-independent parties to export profits, and lays down certain other limitations relating to the applicable law, export jurisdiction clauses, proprietary rights on new improvements, etc. In addition the terms of a franchise contract are subject to the provisions of the Civil Code.

The withdrawal of the **Australian** Franchise Agreements Bill in August 1987, together with the removal of franchising from the definition of "prescribed interest" in the Australian Companies and Securities Code, has led to there being no legislation either at a federal or at a state level specifically directed to franchising, the Common Law relating to trade practices, tenancy, contracts, agreements, etc., being the determining legal factor (so the **Franchisors Association of Australia**). The **Australian Government**, however, in addition to Division 6 of Part IV of the Commonwealth Companies Act and the State and Territory Companies Code containing "prescribed interest" provisions, to the National Companies and Securities Commission Release 118 and to the Franchise Agreements Bill which was still to be withdrawn when the Australian Government answered the questionnaire, also refers to the Petroleum Retail Marketing Franchise Act 1980 (Cth), which applies to the specific sector of franchise agreements relating to sites which an oil company either owns or head-leases where a company allows use of the premises by the franchisee in connection with the retail sale of motor fuel. What effect, if any, the withdrawal of the Bill and the removal of franchising from the definition of "prescribed interest" will have on this last sector should be further considered. It would be particularly interesting to find out more about this, as the Petroleum Retail Marketing Franchise Act provides an exception to the general rule that unilateral terminations under contractual provisions are given effect to by the courts as a consequence of freedom of contract. In

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(4) For a detailed review, see the "Survey of Foreign Laws and Regulations affecting International Franchising" compiled by the Franchising Committee of the Section of Antitrust Law, American Bar Association, 1982. A second edition is due shortly.

fact, the Act is designed to provide reasonable security of tenure for franchisees in the petroleum industry. Unless the franchisee breaches a condition of the franchise agreement, or otherwise engages in conduct which would constitute, under the Act, a ground for the termination of the agreement, the minimum term of an agreement is three years (s. 13). The grounds upon which a franchisor may terminate or fail to renew a franchise agreement are set out in ss. 16 and 17. Furthermore, the Act enables an aggrieved franchisee to challenge an unlawful termination by applying to the court for an injunction (s. 21) or compensation (s. 22). The Trade Practices Act 1974 (Cth) may in some cases apply to termination or refusal to deal. Refusals to supply for exclusive dealing reasons will, if there is a substantial lessening of competition, contravene s. 47 of the Act which prohibits exclusive dealing. A termination or refusal to deal for resale price maintenance reasons is in contravention of s. 48 of the Act, irrespective of competitive effects and the business efficacy of maintaining constant prices among all franchises. If the franchisor is in a position substantially to control a market and the termination is held to be taking advantage of his power, for a prohibited purpose, there will be a breach of the monopolisation prohibition of s. 46 of the Act. Lastly, unfair termination of franchises in New South Wales may be redressed pursuant to s. 88F of the Industrial Arbitration Act 1940 (NSW).

The **Federal Chamber of Trade and Industry** of **Austria**, while confirming that there is no legislation on franchising, and that there is full freedom of contract, adds that there are no requirements as to form for the contracts concerned. However, as the franchising contract incorporates elements of other types of contract, regulations referring to those other types of contract, such as the law on trademarks, would be applicable. The **Ministry of Justice** states that the franchising contract is to be considered as a mutually binding consensual contract to which the general provisions of the Civil Code are to be applied: §§ 861 et seq. for the valid creation of the contract; §§ 871 et seq. for the avoidance of the contract; § 879 for the partial or total nullity of the contract. In particular, the general principles developed by legal writing and caselaw for long-term contracts (Dauerschuldverhältnisse), such as that derived from §§ 1162 and 1117 of the Civil Code which, for important reasons, allows early termination independently of the agreed duration of the contract, would be applicable. With reference to long-term contracts, there is preponderate support for the opinion that, once the exchange of performances has begun, avoidance of, and withdrawal from, the contract does not result in the contract being null and void ab initio, but rather in a termination ex nunc as a result of the difficulties of reversing the transaction (see §§ 870 et seq. and 918 et seq. with reference to avoidance of and withdrawal from the contract respectively). Furthermore, the provisions of the Civil Code (§§ 1064, 1048 et seq.) and of the Commercial Code (Art. 8 N° 20 of the Act introducing the Commercial Code) may be applied to the sales components of the franchise contract. The provisions of the Law on commercial representatives could apply when considering the grounds for the early

termination of a contract, claims for damages resulting therefrom, and non-competition clauses (§§ 21 - 27 Law on commercial representatives). The Federal Chamber of Trade and Industry considers that the position of the franchisee can be safeguarded by means of the general provisions on controls regarding validity and abuse at the conculsion of contracts by means of standard contracts (§§ 864a and 879 of the Civil Code), on early termination of the long-term contract in particularly important circumstances, on protection from obligations which are too one-sided, from the point of view of their violating moral principles (§ 879 of the Civil Code and § 1 of the Law on unfair competition). The Ministry of Justice adds that the franchisee may request compensation for an unjustifiable breach of contractual obligations, and that an application by analogy of § 24 of the Law on commercial representatives could be considered for unjustifiable early termination of the franchise agreement.

As mentioned above, the Canadian province of Alberta has regulated franchising in the Franchises Act (R.S.A. 1980, c. F-17). The **Government of Canada** summarises the provisions of the Act by stating that it "requires a franchisor to register with the Alberta Securities Commission and to provide a prospective franchisee with the information required to make an informed investment decision. The information is provided by way of a prospectus which has three basic parts: 1) the disclosure document which contains, among other things, a brief history of the franchisor and its directors, a summary of the obligations of the franchisee and the franchisor, and a summary of the assistance provided by the franchisor; 2) Financial Statements - Franchisor's current audited financial statements must be attached to the prospectus; 3) Franchise Agreement - A copy of the Franchise Agreement for use in the Province of Alberta must be attached to the prospectus". The Franchises Act does not directly address the subject of arbitrary rescission or other relationship. However, as s. 12 allows for consideration to be given to the public interest, "rescission and resale provisions which are offensive may be either objected to or necessitate risk disclosure in the prospectus". One interesting point when compared to the position in Australia, is that a bill was tabled in Québec to allow the Securities Commission to regulate franchising. Although this bill was passed and assented to it never came into force, as it was felt that a franchise could not be defined as a security. As to the question of arbitrary rescission or resale of the franchise, in Québec the courts might use the theory of abuse of rights to compensate the franchisee. On the point of arbitrary rescission and resale Mr **Zaid** states more generally that franchise disputes are generally decided "according to the laws of contract interpretation, subject to some equitable principles of fair dealing, unconscionability, and inequality of bargaining power, in extreme cases". As far as other legislation which could apply to franchising is concerned, the **Canadian Government** states that "the general principles of contract law, common law and legislation governing trademarks would all apply to any franchise contract as they would to any other contract. Moreover, under the Competition Act (R.S.C. 1970,

c. C-23 as amended) section 38, which prohibits price maintenance behaviour, specifically enjoins those who hold an intellectual property right from imposing an enforceable price direction on any subordinate rights holder (or any reseller) regarding the price that the subordinate holder charges in any subsequent disposition of the product. [...] Also, section 29 of the Act provides for judicial intervention and remedial action in cases where exclusive patent or trade mark rights are used, generally speaking, to limit competition unduly." In Québec the Civil Code contains the general principles applicable to franchising contracts, including Arts. 991 - 1000 for nullity in case of error, fraud, violence or fear (see also Arts. 1001 - 1012). In addition, section 229 of the Consumer Protection Act (RSQ, c P-40.1) can be used in cases of false representations as to the profitability of the business opportunity offered to consumers. This possibility of applying the Consumer Protection Act in Québec is particularly interesting when one considers that, at the meeting of the International Bar Association Section on Business Law Committee on International Franchising in London in September 1987, cases of German judges having treated franchisees as consumers were noted with concern by the participants. Clearly, if such a tendency is developing, this is also due to the lack of any specific legislation on franchising.

In **Chile**, the principles and general provisions contained in the Civil and Commercial Codes are applied to franchising contracts, depending on whether the contract is civil or commercial in nature. Furthermore, a number of other provisions exist, which apply to franchising while not specifically referring to it: Acuerdo number 1381 of the Central Bank of Chile of 22 April 1981, which amends the provisions of Chapter XVI of the compendium of international exchange regulations ("Compendio de Normas de Cambios Internacionales"); Art. 59 of the law on income; the regulation of trademarks in Decree N° 2 of the Ministry for economy, public works and reconstruction (Diario Oficial, 8 March 1982); Arts. 2 - 21 of the Decreto Ley 958 (1931) Law on industrial property; and the Decreto Ley 511 of the same Ministry (Diario Oficial, 17 September 1980) containing anti-trust provisions.

The **Government of Denmark's** answers to the questions on legislation are very brief: a simple "no" to the question on any specific legislation on franchising; an indication of the Contracts Act and the Marketing Act to that on other legislation relevant to franchising, and a reference to the possibility of utilising usages concerning the termination of distribution contracts as a guideline in cases concerning the termination of franchising contracts to that specifically on the unjustified termination of the franchise contract.

Mr **Pollaud-Dulian** is also very brief in answering for France, as he refers to civil and commercial law in general for legislation which could apply to franchising, and limits himself to making the observation that a minimum protection of the franchisee is possible in cases of the fixing of prices and, exceptionally, of abuse of rights, etc.

The **Government of the Federal Republic of Germany** states that the courts have not as yet in their decisions considered the analogous application of legal provisions adopted for other purposes to franchising. They have so far simply decided that the franchise contract belongs to the group of contracts which is to be judged by referring to similar types of contracts which have been regulated by law. Thus, in a case concerning a non-competition clause, the court had recourse to the provisions on commercial assistants (§§ 74 et seq. of the Commercial Code) and on commercial representatives (§ 90a of the Commercial Code)(5). Similarly, legal writing also advocates the analogous application of the provisions on commercial representatives (§§ 84 - 92c of the Commercial Code) to franchising(6).

The **Government of Italy** offers detailed information as regards the provisions which apply to franchising in the absence of specific legislation. As the franchising contract is atypical, in principle all provisions on contracts in general are directly applicable to the contract (Arts. 1321 - 1469 of the Civil Code). Furthermore, as regards those aspects of the franchising contract which belong to specific types of contract, also the provisions relating thereto may be applicable: provisions on sale (Art. 1470 et seq. of the Civil Code); on exchange (Arts. 1552 - 1555 Civil Code); on contracts for sale or return (Arts. 1556 - 1558 Civil Code); on supply contracts (Arts. 1559 - 1570 Civil Code); on the lease of movable goods (Arts. 1571 - 1606 Civil Code); on the lease of productive property - general provisions (Arts. 1615 - 1627 Civil Code); on independent contracts (Arts. 1655 - 1677 Civil Code); on irregular deposits (Art. 1782 Civil Code); and on the comodato (Arts. 1803 - 1812 Civil Code). **Assofranchising** considers that in addition to the provisions on supply contracts cited above, also "the rules concerning the business activity (restrictions on competition(7), unfair competition, etc.)" are applicable, as are "the rules concerning the distinctive signes (Civil Code, and trademarks law) and licensing". Mr **Coshnear** is more precise, in that he refers to Arts. 2563 - 2568 of the Civil Code on the tradename and store sign; Arts. 2569 - 2574 on trademarks; Royal Decree 21 June 1942, N° 929 - special law on trademarks; Law 11 June 1971, N° 426 - Law regulating wholesale and retail sales. Professor **Longo** is, however, considerably more detailed: in addition to the provisions already listed, he refers to the provisions concerning agency contracts (Civil Code Arts. 1742 - 1753); to provisions on brokerage (Civil Code Arts. 1754 - 1765) and to the Presidential Decree of 8 May 1948, N°. 795. He also touches upon the

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(5) See Kammergericht Berlin, decision of 10 July 1973, in Monatschrift für Deutsches Recht 1974, pp. 144 et seq.

(6) See WEBER, "Franchising" - Ein neuer Vertragstyp im Handelsrecht, Juristische Arbeitsblätter 1983, pp. 347, 352 et seq. referred to by the Government of the Federal Republic.

(7) It should, however, be observed that Italy does not as yet have any anti-trust legislation - its adoption is currently under discussion.

thorny problem of labour law, making the point that where the contract has given the franchisor such an extraordinary control over the management of the franchisee (physical person) that his being considered the real employer of the latter cannot be avoided, then the general provisions on employment contracts should be applicable[8]. As for the arbitrary rescission of the franchising contract by the franchisor, the **Italian Government** considers that in such a case, where the duration of the contract is limited in time, the franchisee may, as a result of the franchisor's breach, either demand specific performance or the termination of the contract, and also have a right to compensation for damages (Art. 1453 et seq. of the Civil Code). **Assofranchising** considers that arbitrary rescission may be contrasted with the principle of good faith, and adds that "the rescission for breach of contract implies that the "breach" concerns an important term of the contract". Professor **Longo**, on the other hand, refers specifically to the resale of the franchise, considering that the provisions on unfair competition (Arts. 2598 - 2600 Civil Code) could be applied vis-à-vis the new franchisee, while the provisions concerning non-performance of contracts (Arts. 1453 - 1462 Civil Code) could be applied vis-à-vis the franchisor.

The **Government of Japan** gives a detailed exposé of the situation in Japan. While there is no legislation specifically on franchising, several other laws are of importance. Firstly, the Law Concerning Development of Middle and Small Scale Retailers (Law N° 101, 1973), which "is designed to provide a certain preferential treatment to small retail stores over large stores, such as department stores or supermarkets" (which also contains a definition of franchising in terms of a "Specific Chain Business"), under which, subject to certain conditions, "a middle or small scale retailer /.../ or an organization of such retailers, may seek the government "authorization" of its Chain Business Plan being in conformity with the standards established by the government, as a franchisor /.../. If the Plan is authorized, it may then receive preferential loans from the local authorities /.../ will receive preferential treatment under the tax system, such as accelerated depreciation on certain depreciable assets provided for in the plan". These incentives are interesting to note and are, in fact, the only ones so far come across. The Retailers Law further contains certain disclosure requirements which, however, must not compulsorily be filed with the Government: a franchisor may, it is true, be advised by the Minister of International Trade and Industry, and by other competent Ministers, to comply with the obligation to provide the information required if he has not done so already, but there are no coercive

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(8) The question of the applicability or non-applicability of labour law to the franchise relationship is one which is much debated, notably in the Federal Republic of Germany and in Sweden. It is, however, also an extremely controversial point, which would require a further, more in-depth study.

measures to which the Government may resort, the only measure it may take being to make the failure to abide by the law public. In Japan, as in other countries, franchising is subject to anti-trust legislation. The main provisions in this respect are to be found in the Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade (Law N° 54, 1947), and in the Fair Trade Commission's Notification N° 15 of 1982, on "Unfair Business Practices". Furthermore, franchising is subject to the provisions of the Civil and Commercial Codes. The Japanese Government further describes the Franchise System Manual of the Japanese Small and Medium Enterprise Agency which, it states, although it does not have any legally binding power, does reflect Government policy and guidelines "concerning what activities with respect to franchising are not in contravention of the laws".

The **Government of Luxembourg** confirms that there is no legislation on franchising in Luxembourg, and states that the principle of party autonomy applies. As far as other legislation which might be applied to franchising is concerned, it considers that, as franchising is a sui generis contract, the regulations adopted for other, similar contracts, such as concessions, branches, voluntary chains, affiliations or trademark licensing, could only with difficulty be applied by analogy. However, as it is a contract, the fundamental principles of the law of contracts laid down in the Civil Code would appear to be applicable. With reference to the termination of the franchising contract in particular, it considers it difficult to say whether or not the principles applicable to the breach of any contract are to be applied by analogy also to franchising contracts, in view of the fact that no cases have been decided by the courts.

The **Government of Mexico** states that although there is no legislation specifically on franchising, under the Law on the control and registration of the transfer of technology and of the use and the exploitation of patents and trademarks, the contracts are registered, and their lawfulness controlled.

The terminology used by Professor **Boudahrain (Morocco)** is rather surprising, in that he states that in the absence of specific legislation, the courts first of all apply the franchising contracts, if this is the name which has been given them (instead of, for example, distribution contracts, licensing agreements or association agreements)[9], which would appear to indicate that franchising is not considered to be a specific type of contract. He goes on to state that the legal principles are those of the Code des obligations et contrats (Civil Code) in relation to sales (Art. 478 et seq.) or to rental con-

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(9) "En l'absence de textes législatifs, les juridictions du royaume appliquent d'abord les contrats de franchisage, si tel est le nom qu'on leur a donné (au lieu de contrats de distribution, de concession de licence ou d'association par exemple)".

tracts (Art. 619 et seq.). The provisions on aleatory contracts and associations are, however, not applicable. Although there are no provisions protecting the franchisee from an unjust termination of the contract, in such cases there is nothing to prevent him from asking for compensation. Lastly, he adds that the courts may also look to the legal writing and to the decisions of the courts of other countries, particularly of the country of the franchisor.

As to the **Netherlands**, the only information, received from the **Amsterdam Chamber of Commerce** (Kamer van Koophandel en Fabrieken voor Amsterdam), indicates that, as there is no legislation specifically on franchising, the provisions of, for example, the Civil Code, the Rent Act, the National Insurance Laws, the Economic Competition Act, and the Shop Hours Act could be applicable.

The **Government of South Africa** confirms that there is no law in South Africa specifically on franchising, although there is legislation on trademarks, copyright, etc. It considers that perhaps the most important legislation which does affect franchising, although it does not specifically refer to it, are the regulations under the Maintenance and Promotion of Competition Act, N° 96 of 1979, and "in particular those regulations in Government Gazette N° 10211 of 2 May 1986, which prohibit the entering into or being a party or continuing to be a party to any agreement under arrangement, understanding, business practice or method of trading, which constitutes resale price maintenance, horizontal price collusion, horizontal collusion on conditions of supply, horizontal collusion on market sharing and collusive tendering." In general, the legal rules which apply to a franchising contract are the same legal rules as those which apply to any other form of contract, both as regards legislation and as regards common law. The Government of South Africa further considers that the general principles of contract provide an adequate remedy for any unilateral repudiation of the contract, in which case the innocent party is entitled to claim damages and the measure of damages would be a sum sufficient to put that party in the position in which he would have been had the contract run its course.

The situation in **Sweden** as regards legislation on franchising is likely to change in a not too distant future. While there is at present no legislation specifically on franchising, the Swedish Parliamentary Commission appointed on 27 September 1984 to enquire into franchising and into the necessity of adopting legislation in the field, has included a draft law in its report. The Swedish Franchise Association considers that "chances are fair that the Bill will advance through Parliament during the 1988 spring session and become law as of Jan 1, 1989"(10). In particular, the Commission was "entrusted with the task

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(10) See S. SOHLBERG, A Franchise Law?, Report presented to the 8th Conference of the IBA Section on Business Law, Meeting of Committee X "International Franchising", London, 14 - 18 September 1987.

of conducting an open-ended investigation of the forms of franchising occurring in Sweden, charting their scope and extent and analysing the advantages and drawbacks of this form of cooperation in terms of entrepreneurial policy. [...]. The Commission's remit has included a declaration, in the light of its survey, as to whether franchising legislation is needed - and - if so, what its purview should be - or whether pre-existing legislation in those fields is sufficient"(11). A question which was considered to be of particular interest, and therefore to merit the particular attention of the Commission, was "the extent to which labour legislation safeguards for employees should apply to franchising relations, and the applicability of the employer concept to franchisees"(12), to which brief reference was made above, when considering the comments on the situation in other countries(13). The conclusions of the Commission are interesting, and would merit in-depth examination. With regard in particular to the latter point the Commission "found that the status of the franchisee in relation to the franchisor must be appraised with reference to the circumstances of each individual case. Certain franchisees may be more closely tied to the franchisor through their terms of agreement than others. In some cases these ties can be so powerful that the franchisee should not be regarded as an independent entrepreneur but as an employee or equal agent in relation to the franchisor. In other cases the ties are less strong and an appraisal of the circumstances may lead to the conclusion that the franchisee should be considered an independent entrepreneur. The Commission concludes that it is impossible to make generalisations about the status of the franchisee. This question is left for legal precedent to decide. The franchisee's commitment to the franchisor can also preclude the meaningful exercise by his employees of the powers of codetermination conferred by legislation and collective agreements. [...] Decisions affecting employees are very often made by the franchisor, not by the franchisee. To assure employees of powers of codetermination at the level where the real decisions are very often made, the Commission recommends that the franchisor, before making decisions which will lead to important changes in the franchisee's business activity, be required to negotiate with a union organisation to which the franchisee is linked through a collective agreement"(14). There are therefore in substance two questions as far as labour law is concerned: first, the relationship between franchisor and franchisee, and second, the relationship between the employees of the franchisee and the franchisor. If the Swedish Parliament decides to adopt the Bill, to which the Swedish Franchise Association has already expressed its opposition, the likelihood is that, in view of the close cooperation

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(11) See Franchising - Betänkande av franchiseutredningen, SOU 1987:17, Stockholm, 1987, p. 17.
(12) Ibidem.
(13) See the considerations of Professor Longo (Italy), above.
(14) See Franchising - Betänkande av franchiseutredningen, op. cit., pp. 20 - 21.

which exists between the Nordic countries, similar legislation will be adopted also in Denmark, Finland, Iceland and Norway. It is also to be expected that developments in Sweden will be closely monitored by observers in the Federal Republic of Germany, where a similar debate is being conducted. Until any such legislation is adopted, however, recourse must be had to existing legislation. This includes § 36 of the Contracts Act, which is a general clause according to which a condition may be modified or set aside if it is improper, and the Act on Contract Terms between Business Enterprises (1984:292), the main purpose of which is to strengthen the legal protection of small firms. Under this Act the Market Court is able to prohibit a business enterprise which has used an improper contract term in offering a contract to another enterprise from using the same, or essentially the same, condition in a similar case in the future. Such a prohibition can only be issued if it is required as being in the public interest. Special attention must be given to the need for protection of the weaker party when the assessment of the impropriety of the term in question is made. An application for such a prohibition may be made not only by the enterprise to which the improper contract term was offered, but also by trade associations. As regards the arbitrary rescission or resale of the franchise, general legislation referring to unfair dealing, to the abuse of a dominant position etc. may be applied.

The **Government of Switzerland** confirms the lack of legislation on franchising in the Confederation, and states that, according to legal writing, the franchising contract is a sui generis contract to which the provisions on licensing contracts, mandate, agency and société simple are applicable; in certain cases the provisions dealing with the public and private aspects of labour law could be applicable. Furthermore, as franchising contracts often include standard conditions, they would also be subject to the principles which are applicable to such conditions.

The **Government of the United Kingdom** refers briefly to the common law, equity, various statutory provisions relating to intellectual property rights, taxation, competition etc., and to directly applicable European Community Law when illustrating what laws apply in the absence of a law on franchising. The **British Franchise Association** goes into more detail, stating first of all that "/t/he general commercial laws apply to franchise transactions as they do to all forms of commercial activity. Since franchising crosses normal industry categories franchise transactions have to take into account, where relevant, any special industry laws", adding a list of legal topics which might apply depending on the commercial structure: trademarks/service marks; trade names and goodwill; patents (though not very often); confidential information; trade secrets; know-how; contract law; tort; company law; partnership law; real and personal property laws; tax; landlord and tenant laws; special industry laws; competition law (both domestic and EEC); and dispute resolution (arbitration). Mr **Adams** mentions his book on franchising, in which he refers to the Misrepresentation Act 1967, the Unfair Contract Terms Act 1977, the Trade Descriptions Act 1968, the

Fair Trading Act 1973, the Consumer Credit Act 1974, the 1973 Pyramid Selling Schemes Regulations, the Financial Services Act 1986 and the British Code of Advertising Practice, analysing the effects of each on franchising, and their possible inter-relationship[15].

As was stated above, the **United States of America** is the one country where any substantial regulation of franchising has been undertaken, the only other legislation existing being the Franchises Act of the Canadian province of Alberta. Franchising is directly regulated in fifteen states[16]. Furthermore numerous states have laws that have been interpreted to include franchises, as well as other types of commercial relationships that may be used to protect the franchisee from overreaching or misrepresentation by franchisors, and legislation has also been adopted for franchise relationships in particular fields of activity, such as the automotive and petroleum fields. In the past few years there have also been a number of state laws that have prevented the franchisor from termination or non-renewal of the franchise without a just cause. However, the major legislation covering the business system-type franchise is the Federal Trade Commission Rule ("Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures", 16 C.F.R. § 436), the Guide to which we referred to above[17]. As is pointed out by Professor **Keating**, the Rule is basically a disclosure requirement, which "places a very heavy duty on the franchisor to provide the franchisee with complete and accurate information with respect to all aspects of the franchise system before the franchisee is committed"[18]. The Rule does not require pre-registration approval, and only applies to franchises engaged in interstate commerce, although this has not diminished its importance, considering also that the term "engaged in interstate commerce" has been interpreted to cover purely local activities which have an effect on interstate commerce[19]. The situation in the USA, with the different types of law and the FTC Rule, would require an extensive examination, the interest of which could be enhanced by a consideration of the practical results of this legislation. The comments heard in the course of the IBA meeting in London would indicate that practitioners consider such, or similar, legislation to hamper the development of trade, but perhaps this view is not altogether surprising, coming as it does from the representatives of the franchisors. An interesting observation is

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(15) See J. ADAMS and K.V. PRICHARD JONES, Franchising - Practice and precedents in business format franchising, 2nd edition, London, 1987, pp. 277 - 294.

(16) California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin.

(17) See p. 12.

(18) See W.J. KEATING, Franchising Adviser, Colorado Springs, 1987, pp. 43 - 44.

(19) Ibid. p. 44.

made by the **International Franchise Association** with reference to the question of the relationship between franchising and anti-trust regulations, which is normally considered to be a considerable problem for franchising. The IFA considers that in general "it does not appear that antitrust problems are inherent in the franchise contract, nor that such agreements raise unique antitrust issues not present in other types of business agreements, which issues should be separately addressed by a Unidroit proposal applicable only to the franchise contract". Although the IFA thereafter refers to the Pronuptia decision of the European Court of Justice and to the draft block exemption regulation for franchising issued by the Commission of the European Communities, the relevance of such a statement when considering the situation in the USA cannot be disregarded.

The situation in **Venezuela** is illustrated by Professor **Parra Aranguren**, who states that certain aspects of the franchising contract are subject to special regulations which must be taken into consideration: Decision 24 of the Comisión del Acuerdo de Cartagena, approved by a Law of 26 September 1973, which includes provisions on contracts for the import of technology, on patents and on trademarks (see especially Arts. 18 - 20 and 25); Chapter XII of Decree N° 1200 of 16 July 1986 regulating the import of technology and the use and exploitation of patents and trademarks (see, in particular, Arts. 65 - 79), and Decree N° 746 of 11 February 1975, which indicates some restrictive clauses which are unacceptable. Furthermore, if the termination of the franchise contract constitutes an offence, Art. 1185 of the Civil Code, could be applied, which provides for a right to compensation for damages caused either intentionally, or negligently or imprudently, or where one party, in the exercise of his rights, has exceeded the limits set by good faith or by the purpose for which he was granted these rights.

(iii) Other legal principles applied by courts

The purpose of this question was to find out if Courts have recourse to legal principles which have not been laid down in legislation, but are commonly applied or adhered to in practice, when making their decisions. As will be seen in the following review of the answers, several overlap with the answers to the questions regarding legislation, particularly when the legislation which, although not directly applicable to franchising, has an impact on it, was considered.

As far as **Austria** is concerned, the **Federal Ministry of Justice** states that no Supreme Court decisions on franchising are known as such. In one published decision the Supreme Court only considered whether or not a franchisee could be considered an employee. Nor have decisions of other courts been published, which may be a consequence of arbitration clauses agreed between the parties. Reference is then made to §§ 870 and 871 of the Civil Code, described in the answer to the question on legislation.

According to the **Government of Canada**, it would seem that courts give consideration to the sophistication of each party, and to whether or not the parties were represented by independent advisors with relevant expertise. Furthermore, with reference to Québec it states that, pursuant to section 229 of the Consumer Protection Act, the courts look for false representations concerning the profitability or any other aspect of a business opportunity offered to a consumer. Where this Act does not apply, the courts should ascertain whether or not one of the causes of nullity in contracts may apply (error, fraud and violence or fear - Arts. 991 - 1000 of the Civil Code), as well as if there subsists an abuse of rights. Mr **Zaid** instead, states that "/t/he legal principles which affect franchise disclosure are general common law principles involving misrepresentation, collateral warranty, detrimental reliance and fraud".

The **Government of Denmark** considers that the principle of fair marketing according to § 1 of the Marketing Act would be applicable, as would § 36 of the Contracts Act, which is similar in content in all the Nordic countries, being a product of the cooperation between the countries concerned. According to the Danish version of this section, a contract may be amended by the court if its maintenance would be unreasonable or contrary to honest and fair conduct.

The **Government of the Federal Republic of Germany** is more detailed in its answer, which begins by stating that so far the case law has not developed any general principles regarding the duty of information and notification of the franchisor. However, in one case where the franchisor had in the contract taken it upon himself to train and instruct the franchisee in his duties, the Federal Labour Court stated that whoever stresses his own great expertise, and praises an established system, also promises expert counselling and the protection from commercially wrong investments[20]. This decision is in conformity with older decisions referring to commercial representatives which, on the basis of § 86a of the Commercial Code, laid down a general duty for the entrepreneur to take those concerns of his representative which are worthy of protection into consideration.

Italian courts have applied the provisions indicated in the section on legislation (provisions on tradename and store sign, and on trademarks) as well as provisions on patent rights for industrial inventions (Civil Code Arts. 2584 - 2591 and Royal Decree N° 1127 of 29 June 1939) and for improvement processes and for ornamental models and designs (Civil Code Arts. 2592 - 2594 and Royal Decree N° 1411 of 25 August 1940). Furthermore, with reference to the different economic importance of the parties to the franchise and to the necessity of protecting the weaker party, courts have considered the provisions of

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(20) See Bundesarbeitsgericht, decision of 24 April 1980, in Arbeitsrechtliche Praxis, N° 1 on § 84 of the Commercial Code.

Law 533 of 11 August 1973 to be applicable, having equated franchisees to collaborators who perform continuing and coordinated work, mainly personal in nature, even if not of a subordinate character (see Art. 409 of the Code of Civil Procedure, as modified by Law 533). In other words, the caselaw[21] has assimilated the franchisee to the commercial representative for the purposes of the special procedure before the judicial authorities, with the consequence that: (a) judgments in favour of the franchisee may be provisionally enforced (Code of Civil Procedure Art. 431); (b) clauses which refer conflicts in the franchise relationship to arbitration are no obstacle to the possibility of having recourse to the judicial authorities (Code of Civil Procedure Art. 808(2) and Art. 5 of Law 533 of 1973); (c) the sums awarded the franchisee by the judgment of the judicial authorities are de jure re-evaluated on the basis of the indices of the devaluation of the currency calculated by the Institute for statistics (ISTAT)(Art. 150 of the provisions introducing the Code of Civil Procedure); (d) judgments regarding relationships specified in Art. 409 of the Code of Civil Procedure are exempt from the taxes which usually have to be paid (Art. 10 of Law 533 of 1973); and (e) making these judgments is the competence of specialised sections established with the competent judges. Mr **Coshnear**, when considering other principles which could possibly be referred to franchising, emphasises the principle of good faith: in the conducting of the negotiations and in the preparation of a contract (see Civil Code Art. 1337); in the interpretation of the contract (Civil Code Art. 1366); and in the performance of the contract (Civil Code Art. 1375).

The **Amsterdam Chamber of Commerce** indicates the principle of good faith as being applied by the courts, although it points out that the chapter in the New Civil Code on general terms and conditions relates only to consumer protection.

The **Swedish Government** makes a direct reference to its answer to the question on legislation, stating that the courts apply the legal principles of the Contracts Act and of the Act on Contract Terms between Business Enterprises. The **Swedish Franchise Association**, on the other hand, states that in the absence of disclosure provisions the courts would apply the principles of fair dealing.

An interesting note in this context is that the answer from the **European Communities** indicates that the Commission applies the same principles as it does for know-how contracts, although it does not specify what these principles are.

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(21) See, in particular, Decision N° 4405 of the Supreme Court of Cassation in the case Holiday Magic v. Maroni of 22 November 1976.

(iv) Cases on franchising and abuses

Mr **Marzorati (Argentina)** states that courts have so far not had "the opportunity to set any ruling on disclosure, since franchising so far is not yet a business offered through mailing or public offerings, but rather a commercial arrangement currently made between existing local entrepreneurs (industrial or commercial) and a foreign licensor or subsidiaries or affiliates of foreign companies /.../." Consequently, he states, courts have not dealt with disclosures, having had to decide only termination cases, considering whether termination was just or unjust for the purposes of awarding damages, and also annulling provisions of franchise distribution agreements which are too one-sided, too much in the franchisor's favour. Mr Marzorati cites three cases of particular importance, unfortunately without detailed references: Dellon v. Ford, (which he terms a "landmark"); Cilam v. Renault, (the damages awarded included compensation for goodwill and for the expected profits); and Automoviles Saavedra v. Sevel. Despite the fact that the cases decided in relation to franchising concern termination, Mr Marzorati considers that the most common abuse is the right of the franchisor "to change the percentage on turnover" at his discretion.

In **Australia** the most common abuses instead appear basically to be of two kinds, first, the case where, in the words of the **Australian Government**, "/a/ bogus, fraudulent, negligent or inexperienced franchisor makes representations concerning a franchise and the franchisee pays a fee only to find that: there is no substance to the franchise; the franchisor's representations concerning prospective franchise income are grossly misleading; the franchisor does not provide training and promotion and back up services as promised; the franchisor company is only a shell and little or no money is recovered by those affected", and secondly, ""/r/elationship problems" such as termination on short notice without compensation for goodwill". The **Franchisors Association of Australia** instead, considers that "/o/ne of the major causes of abuse or discontent would be the franchisee who feels he "knows it all" having served his apprenticeship and objects to paying his commitment in terms of commissions". A long list of cases, with details on each, is furnished by the Australian authorities as a selection of decisions on the acts which apply to franchising, although they are not always specifically for franchising. The decisions cited include: on the Petroleum Retail Marketing Franchise Act 1980: J & M O'Brien Enterprises Pty Ltd v. The Shell Company of Australia Ltd (1983) 76 FLR 1; Mobil Oil Australia Ltd v. Brian Brindle (1984) 56 ALR 541 and Trade Practices Commission v. BP Australia Ltd (1985) 62 ALR 151; on the Trade Practices Act 1974: Ducret v. Colourshot Pty Ltd (1981) 35 ALR 503; Ron Hodgson (Holdings) Pty Ltd v. Westco Motors (Distributors) Pty Ltd (1980) ATPR 40 - 143 and Bateman v. Slatyer (unreported, Federal Court, Burchettt J, 25 February 1987); on s. 88F of the Industrial Arbitration Act 1940 of the State of New South Wales: Burnett v. Big Al's Sandwich Joints Pty Ltd (1982) ATPR 40 - 279; Delohery v. Brian Walpole, Trading as Rockland Traders, heard in the Industrial Commission of NSW (N° 160 of 1980) and

A & M Thompson Pty Ltd v. Total Australia Ltd /1980/ 2 NSWLR 1; NSW Crimes Act 1900: R v. Freeman; R v. Sargent /1981/ 2 NSWLR 686; and, in the instance of Whale Car Wash (International) Ptd Ltd, Attorney-General v. Chambers (1983), unreported; Victoria Crimes Act: R v. Ferguson, O'Brien, Nicol and Jackson (County Court, Victoria, unreported, 1982).

In **Austria** not many cases have been decided on franchising. The **Federal Chamber of Trade and Industry** refers to a decision of 12 November 1979(22), in which the Supreme Court considered whether the relationship between the franchisor and the franchisee was not more like that between employer and employee. Furthermore, the question of the exclusivity of the franchise relationship, and the implicit restriction of competition therein, has been discussed by the Higher Restrictive Practices Court(23).

The abuses the **Government of Canada** indicates as being the most common are fraud, misleading or incomplete information about the franchise and the imposition of "unfair" or "harsh" terms, e.g. arbitrary termination, failure to renew, restrictive covenants. The indications for the province of Québec are almost identical, despite the fact that abuses have not been the subject of special study, and are, firstly, fraud (where a franchise broker disappears with the franchisee's initial payment), and incomplete information. Clearly, the objection may here be made that the fraud described is not restricted to franchising, and should therefore not be considered as an abuse pertaining to franchising, although it must be admitted that franchising does offer considerable opportunity to those who wish to commit fraud. Mr **Zaid** instead considers abuses on the part of both franchisor and franchisee, stating that the most common abuses are found in the area of financial representations with respect to the franchised units and failure to provide services as contracted for by the franchisor, and that franchisees tend to default in the area of failure to make payments as required in the franchise agreement, and in some cases franchisees may attempt to operate independent units utilising the franchisor's trade secrets and system. He states that there have been many cases decided on franchising in Canada, and that these involve principles of misrepresentation, fraud, unfair dealing, unconscionability, interpretation of restrictive covenants, injunction applications, labour law decisions involving the franchise relationship, remedies in the event of a default by a franchisee and real estate related issues. By way of examples of cases on franchising, the **Canadian Government** cites the following: Jirna v. Mr Donut of Canada Ltd., (1973) 40 D.L.R. (3d) 303; R.E. Lisler Ltd. v. Dunlop Canada /1982/ 1 S.C.R. 726; Hillis Oil and Sales Ltd. v. Wynns Canada /1986/ 1 S.C.R. 57 and, for Québec, Son et Image Inc v. Kle Selek Ltée, Galipeau J, SC St-François,

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(22) See EvBl 64/1980

(23) See Kartellobergericht, Decision in the Coca Cola case, in JBl 1979, 103.

450-05-000015-855, 4/12/86, JE-87-145; Godbout v. Provi-soir, CA, 10/02/86, JE-86-266; Franchise plus Inc v. Dépanneur Bitter et Fils Inc, /1984/ CS 394; Triber Investments (OCR) Inc v. Skalbania, SCSM, 6/05/83, JE-83-607; R v. Kenitex Canada Ltd (1981), 51 CPR 103; Director of Investigation and Research v. Bombardier Ltd, /1981/ CPR 261 and Automobiles Nobel Ltée v. Volkswagen Canada Inc, SCM, 28/08/81, JE-81-906.

In **Chile** the only court which has decided cases related to franchising is the Comisión Antimonopolios. These cases mainly concerned the question of exclusive distribution, and contract terms conferring this have been considered invalid in franchising contracts. The main abuses cited by the **Chilean Government** are those of the recipient claiming that the goods were defective, of the supplier claiming that the defects or the deterioration are the result of incorrect handling on the part of the recipient (both of which again are not confined to franchising) and of the recipient contracting for the exclusive distribution or production of a product, knowing that the anti-trust legislation prohibits this.

The **Government of Denmark** has no information on abuses or cases, and simply states that, as a result of arbitration clauses in franchising contracts, most cases are settled by arbitration.

The most common abuses in **France** are what Mr **Pollaud-Dulian** calls false franchises ("fausses franchises"), misrepresentation, clauses for impossible quotas, abusive non-competition clauses, etc. Furthermore, he considers that litigation ensues where the price has to be determined from caselaw. There are numerous precedents in this field, and although they have been criticised by several specialists, Mr Pollaud-Dulian considers that it still offers franchisees the best protection against possible abuses by the franchisor. By way of example of recent cases decided in relation to franchising, the following are cited: for price determination two decisions of the Paris Court of Appeal, the first of 14 June 1984[24], the second of 13 November 1984[25]; on termination and its effects a decision of the Commercial Section of the Court of Cassation of 12 October 1982[26]; and on imposed prices a decision of the Paris Tribunal correctionnel of 26 September 1985[27].

Although there have not so far been many decisions on franchising in **the Federal Republic of Germany**, those that there have been have dealt mainly with three questions: the admissibility of non-competition clauses in cases of termination of the franchising contract; the right

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(24) In JCP-G. 1985-II-20415, observations by B. Gross.
(25) In JCP-G. 1985-II-20466, comments by B. Gross and in G.P., July 1985, p. 8, comments by S. Daul.
(26) In JCP. 1984-II-20166
(27) In Lettre de la Distribution, 1985-11.

to early termination and the possibility to use the law on instalment sales enacted for the protection of the user (i.e. buyer). With reference to the first question a decision of the Kammergericht of Berlin of 10 July 1973 is indicated[28], for the second a case decided by the Federal Court of Justice of 3 October 1984[29], and for the third a decision of the Federal Court of Justice of 16 April 1986[30]. Furthermore, reference is also made to the decision of the Federal Labour Court cited above in the section on other legal principles applied by courts.

As regards **Italy**, the **Italian Government** indicates the most common abuses in so-called "sales of smoke", abuse of a dominant position in the conclusion of franchising contracts (which are often standard form contracts), discrimination between franchisees by their franchisor, pressures placed on the franchisee by the franchisor for more advantageous conditions at renegotiation of the contract (the alternative often being termination), and non-competition clauses. **Assofranchising** lists among the possible abuses first of all misrepresentation or insufficient disclosure on the part of the franchisor, unnecessary restrictions on the franchisee's freedom of activity, and termination clauses in favour of the franchisor. Mr **Coshnear** agrees on the last of these, but significantly considers an insufficiently prepared and tested system offered by the franchisor, and a rather limited contribution by the franchisor in terms of training, know-how and other benefits on an ongoing basis to be the other most common abuses. Again, there are few decisions specifically on franchising. The **Italian Government** refers to six decisions, the first being the decision of the Pretore of Milan of 7 April 1975, two being decisions of the Rome Tribunal, of 5 March 1975 and of 23 March 1975 respectively, one being of the Milan Tribunal of 6 May 1976, and the last two being decisions of the Court of Cassation in the case Holiday Magic (N° 3329 of 14 October 1975, and N° 3947 of 25 November 1975). It is interesting to note that in its decision of 5 March 1975 the Rome Tribunal understood franchising as being a whole composed of several distinct contracts, albeit connected with each other in order to produce comprehensive legal effects in addition to the legal effects of each of the different contracts, rather than as a single, atypical contract resulting from the fusion of several different types of contract. **Assofranchising** gives detailed information on the Standa and Schweppes/Sangemini cases, as well as on a recent decision of the Pretore of Palestrina in the case Bratti v. Ges.Com Srl and CIPAC S.p.A. in which the question of whether there was a franchising agreement or an employment contract between the parties was considered[31].

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(28) In Monatschrift für Deutsches Recht, 1974, 144.
(29) In Bundesgerichtshof, Neue Juristische Wochenschrift, 1985, 1894 et seq.
(30) In Bundesgerichtshof, Neue Juristische Wochenschrift, 1986, 1988.
(31) Decision of 14 February 1987, on case N° 145/86 R.G..

The **Japanese Government** indicates that the abuses which are most common in Japan are first of all the use of a trademark which is similar to the trademark of a franchisor, and secondly the arousing of too great expectations with the franchisee (i.e. misrepresentation). The most famous decision in Japan is that of the Tokyo District Court in Case (Wa) N° 14,027 of 1969, of 30 May 1972[32], commonly called the Pilovitan Case, which concerned both the franchise fees and unjust termination.

In **Morocco**, Professor **Boudahrain** concludes that, in view of the fact that the franchising contract is a standard form contract, the franchisor takes advantage of his stronger bargaining position at the conclusion of the contract, and also as regards fees and the control he may exercise over the franchisee.

The **Amsterdam Chamber of Commerce** considers that the most common abuses are firstly, insufficient disclosure, secondly, misrepresentation, in that the franchisor exaggerates the profits the franchisee can expect, and thirdly, unreasonable stipulations concerning the franchisee's position after the termination of the franchising contract, such as the compulsory transfer of the establishment and goodwill to the franchisor and non-competition clauses.

The **South African Government** considers the abuses most common in its country to be first of all the representation of certain agreements as franchising agreements although they are nothing of the kind, and secondly imbalance in performances, in that franchisees are expected to pay substantial sums where they are not actually getting anything from the franchisor.

The **Swedish Government** does not have any information on abuses, as no research has been conducted in this sense. The **Swedish Franchise Association** for its part claims that abuses are extremely rare. As to cases on franchising, three cases are known to the Ministry of Justice, two of which concerned the question franchise or employment (Decision 1983:89 of the Labour Court, and Judgment of the Fiscal Court of Appeal of 4 September 1986 in case N° 6305-1984) and the other the possibility of the franchisor being held responsible for the franchisee's debts (Judgment of the District Court of Linköping of 29 May 1984 (DT 283)). The SFA, on the other hand, claims that there is only one - which is not one of the above - concerning a (dismissed) claim for compensation as a result of misrepresentation (no data is given).

For the **United Kingdom** there is general agreement among the respondents that there are very few cases indeed. In fact, the **UK Government** cites only one English reported decision[33], albeit a

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(32) In Hanrei Taimuzu, N° 283, p. 274.
(33) See Office Overload v. Gunn (1977) F.S.R.39.

different one from the one cited by Mr **Adams**, as the only case directly on franchising[34]. As regards abuses, the **UK Government** states that "/i/t appears that potential franchisees are not always volunteered as much firm information as perhaps they need. This is part of a wider problem, although not an abuse, that potential franchisees do not always fully and properly research the proposition and seek appropriate professional advice at an early stage", which introduces the idea that the franchisee carries the burden of finding out all about the franchise, instead of his having a right to receive information from the franchisor - an interesting development, considering what is normally considered the unequal bargaining power of the parties concerned. The observations of the **British Franchise Association** are also of considerable interest. The BFA begins by stating that it "regrets the assumption inherent in the question that as a matter of course abuses exist", continuing with the observations that "/t/here is indeed little evidence to support such an assumption. There are failures by both franchisors and franchisees but franchising is not a risk free way of doing business. There is no such thing as a risk free way of doing business but levels of failure are, taking the franchise market as a whole, remarkably low. There is an abuse from which franchising suffers and it is perhaps significant in this respect that Unidroit chose to categorise Business Opportunity ventures as franchises. There are some such ventures which are not franchises and which are sold by their promoters as if they were thus causing harm to franchising. One of the problems with franchising is the difficulty in identifying the reason for a franchisee's failure since the franchisee is required to make a considerable effort to ensure his success. It is often difficult to draw the line in any given case although there are cases where the cause of failure is clear". The implications of this last part are that an accusation of abuse is made mostly, if not always, by dissatisfied franchisees who have failed largely through their own fault. Considering also the information provided from other countries, one may wonder how justified this view of the situation really is.

It is perhaps not surprising that the majority of cases on franchising are cases from the **United States of America**. Professor **Keating** mentions that he cites thirteen and a half pages of cases in his book "Franchising Advisor", although he believes the most instructive case probably to be Principe v. McDonald's Corp., 631 F. 2d 303 (4th Cir. 1980). He estimates the most common abuse to be the franchisor's overstating the profits to be made by the franchisee, and understating the amount of funds the franchisee needs to sustain the business. Mr **Jaglom** considers that there certainly are instances of abuses by franchisors that can be pointed to, that, indeed, such abuses are what have led to the proliferation of franchise regulation in the USA. It is, however, his view that many state franchise laws "have tipped the

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(34) Ready Mixed Concrete (South East) v. Minister of Pensions and National Insurance, /1968/ 2 QB 497, /1968/ 1 All ER 433.

balance too much towards the franchisee, so that the franchisor is unable properly to monitor the franchisee's conduct and to make franchisee changes when performance is unsatisfactory". With reference in particular to the arbitrary termination of the franchising contract by franchisors, he states that "/w/hile certainly there have been instances of such abuses, in my experience, the reverse is just as common, where a franchisee performing his duties inadequately hides behind the protections of franchise laws to avoid termination for his inadequacies. Most franchisors make decisions based on what they believe is best for their business, not out of arbitrary caprice or spite". The **International Franchise Association** points out that the assumption of an unequal bargaining power between franchisor and franchisee does not always correspond to reality, as "a significant number of prospective franchisees are sophisticated, financially sound business enterprises with experienced personnel fully capable of negotiating with the franchisor; in many instances, increasingly in recent years and especially in international franchising, franchisees are larger than their franchisors". The IFA is naturally enough interested in protecting the interests of the franchisors, and this is evident in a number of statements they make in their observations: "The authors /of the first study/ appear to be concerned that the franchisor's bargaining power, when coupled with its legitimate need for a degree of control over the franchise operation, may lead to a relationship more akin to that of employer/employee rather than an independent commercial relationship. We submit that this approach is not realistic, and the problem not significant. /.../ under the national laws of most countries, franchisors who exercise an unreasonable degree of control over the operations of their franchisees risk being /held/ liable for the negligent acts of their franchisees. Franchisors who become involved too deeply in the management of the franchised business may also incur liability under the local employment laws. Such potential legal liability provides the necessary incentive to assure that franchisors do not reserve to themselves an unreasonable degree of control"[35]. Clearly the practical experience which forms the basis of a statement such as this would have to be looked at closely before an evaluation of the statement is possible.

DG IV of the **European Communities** identifies the fixing of prices, prohibitions on buying or selling the franchised products to other franchisees, the duration of non-competition clauses after the expiry of the contract and the division of territory as the abuses most common in franchising. Understandably, it focuses its attention on the competition aspects of the phenomenon.

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(35) Italics supplied by the Secretariat.

(v) Franchise fees

The question on franchise fees concerned the criteria adopted for fixing the sum payable to the franchisor, and the extent to which clauses regulating such payments were held to be valid.

Mr **Marzorati** indicates that in **Argentina** different types of fees are requested for different types of franchising agreements. For trademark licensing and service franchising there is both an entrance fee and a percentage on turnover to be paid; for distribution franchising only a percentage on the turnover, but in the case of a business opportunity venture not only does the franchisee have to pay both an entrance fee and a percentage on the turnover, but profits are also shared. Mr Marzorati further states that a limit of 5% on the turnover exists for companies in which the franchisor directly or indirectly "holds a parent relationship", although most "deals are approved on a 2% to 3% basis" and "/n/on-related franchises are free to establish a royalty or remuneration without any official guidance". What exactly this means in practice, and what the "official guidance" involves, would need to be closer examined.

The **Australian Government**, referring to a variety of published sources, indicates that fee options include an initial (front end) lump sum fee and a continuing fee based on profit or turnover or a continuing fee fixed independently of profit or turnover. Furthermore, separate payments may be required for the provision of the site, for training or management services, for staff training and for all the individual obligations of the franchisor under the agreement. There are no set criteria with respect to the calculation of franchise fees - the level of an initial fee may depend on the actual or potential success of the franchisor's business or the location of the franchise outlet being taken up by the franchisee. Ongoing franchise fees are typically related to the value of gross sales, not net profit, for the ongoing assistance of the franchisor. The interesting observation is made that although the terms of franchise agreements (including those relating to the payment of fees) are governed by the general law of contract, and that as a general rule the principles of freedom and sanctity of contracts are so firmly entrenched in the common law that little regard is had to inequality of bargaining power, there does, however, exist an equitable doctrine whereby Australian courts are able to grant relief from unconscionable or unconscientious bargains. This is important if, as has been said, "unrealistic" franchise fees and royalties are one of the main reasons for franchise failures in Australia. The **Franchisors Association of Australia** states that generally speaking, the "determination of fees is based on "what the market commands" and also competitor activity. It is also related to the degree of knowledge, expertise, goods, equipment etc., which may be supplied to the franchisee. Percentage of turnover generally applied in the case of a Royalty fee of something around 3%, plus an advertising fee of around 5-6% or 7%. The entrance fee, or more correctly the franchise fee,

varies depending on the inclusion of supplies, plant equipment, real estate and know how".

The **Austrian Federal Chamber of Trade and Industry** merely states that in principle, as is the case for patent licences, all these different types of fee may be agreed upon by the parties.

The **Canadian Government** makes specific reference to the definition contained in the Alberta Franchise Act, according to which a franchise fee is any consideration exchanged or agreed to be exchanged for the granting of the franchise agreement, and which may include any fee or charge the franchisee or sub-franchisor is required to pay or agrees to pay, any payment for goods or services, any service which the franchisee or sub-franchisor is required to perform or agrees to perform, or any loan, guarantee or other commercial consideration exigible from the franchisee or sub-franchisor at the discretion of the franchisor or sub-franchisor for the right to engage in business under a franchise agreement. Although an indication is given of what are not franchise fees, nothing is said of the criteria for their determination. In Québec, on the other hand, the clauses of the contract and market forces alone govern the sums the franchisee must pay the franchisor. Mr **Zaid** instead states that "the criteria adopted in Canada for fixing franchise fees relate to some economic analysis of the investment by the franchisee, but generally market place competition will affect the fees. Clauses regulating the payment of an initial franchise fee, a resale fee, and ongoing royalties are definitely valid if agreed to in the contracts".

In **Chile** the determination of the sums to be paid is made by the Departamento Técnico de Comercio Exterior of the Chilean Central Bank, on the basis of ranges of internationally accepted percentages on sales. Normally for the use of trademarks a percentage of upto 1% is permitted, while for know-how contracts the percentage varies between 1 and 4%, depending, amongst other factors, on the need for the product and the availability of foreign currency.

In **Denmark** the system selected for payment varies with the trade. The entrance fee is often substituted by royalties of between 2 and 15%, again depending on which trade is concerned. In certain franchising systems, neither entrance fee nor royalties are paid, but the franchisee is under an obligation to buy products from the franchisor, in which case the profits made by the franchisor take the place of fees. The validity of clauses regulating such payment is decided according to § 36 of the Contracts Act.

In **France** also the fee, or the combination of fees, varies with the branch of trade concerned. Mr **Pollaud-Dulian** gives no criteria for the determination of the fees, but states that what is certain is that the contract must provide for the possibility of determining the price.

The **Government of the Federal Republic of Germany** considers that there is no uniform practice as regards fees in the Federal Republic. The most common fees are entrance fees, royalties (which at times are based on the turnover), and a division of the costs of the enterprise, either alone or in combination. It points out, however, that systems do exist that are financed by the sales of the goods alone.

The **Italian Government** indicates that a preference exists in Italy for a low entrance fee, with more consistent royalties based on the turnover of the franchisee. These royalties are at times camouflaged as part of the price of the products the franchisor furnishes the franchisee. **Assofranchising** confirms this preference, stating that there is a certain reluctance on the part of franchisees to pay entrance fees, while a percentage on turnover is very common. Furthermore, in "pure distribution franchising (store chains), where the franchisee is bound to purchase from the franchisor all the goods to be resold, the sum payable to the franchisor comes out from the discount on the prices to the public". While Assofranchising claims that all the clauses concerning franchising fees are valid, Mr **Coshnear** explains that provided that "the clause regulating payment is in good faith, is reasonable and freely agreed to by the franchisee at the time of his entering into the contract, it will be upheld". This is confirmed by the **Italian Government** which indicates the articles of the Civil Code which might apply where this reasonableness is missing, where the "balance of power" between the parties is severely disturbed and there is no correspondence in value between the performances of the two. Mr **Coshnear**, when considering the criteria for determining the fees, states that generally, but not always, an initial entrance fee is required; that a percentage on turnover is used only, or primarily, when the franchisor is in a position to know with some degree of certainty the amount of the franchisee's turnover; and that some franchisors prefer specified annual lump sum payments pegged to a fairly wide band of minimum/maximum turnover of the franchisee, thereby relieving the franchisor of the need to effect close control of the franchisee's accounting books.

The **Japanese Government** explains that there are no specific regulations on franchise fees, and that the parties are free to agree on how they wish to arrange the matter, always within the limits of the general provisions of the Civil and Commercial Codes.

In **Mexico** royalties are normally of the order of 0.25 - 1% of net sales, but may in exceptional cases reach 3% thereof. Clauses related to the payment of the fees are considered valid by the Mexican authorities.

The **Amsterdam Chamber of Commerce** indicates four criteria on the basis of which the fees are calculated: "the (fixed) costs incurred by the franchisor on behalf of the organisation (required contribution to overhead and profit)"; "the variable costs incurred by the franchisor

(study re location place of business, publicity, etc.)"; "the employer's income considered reasonable by the franchisor (also in view of the risks to be borne by the franchisor, investments to be made)"; and "market conditions/competition/strength of the formula, etc". It adds that "against the entrance fee there should in principle be a quid pro quo on the part of the franchisor; if not, this fee might possibly be said to be in the nature of the (prohibited) "key money". Naturally the same applies to the variable fee" (no definition of "key money" is given).

In **South Africa** no specific criteria are applied for the fixing of franchise fees; unless they are unconscionable or otherwise invalid in accordance with the normal law of contract, they will be enforced by the courts. It is, however, interesting to note that, in respect of international franchising agreements, approval of the Reserve Bank is necessary for the payment of any sums to a foreign franchisor. The South African Government states that the Reserve Bank normally applies fairly arbitrary rules in respect of these matters, which do not necessarily take market forces and conditions into consideration.

The **Swedish Government** states that the franchisor and the franchisee enjoy full liberty in agreeing upon the contract terms, including the clauses regulating the fees, as long as they are not "improper". Most commonly there is an entrance fee and a percentage on turnover (often 5%). The **Swedish Franchise Association** first states that the criteria vary with the systems, and then makes the assertion that "/t/he clauses in the contract are, as a matter of course, held to be valid - "pacta sunt servanda"", which conviction might, however, need to be qualified by the need for their being conscionable (or "proper").

The **Government of the United Kingdom** merely states that the question of fees "is a matter esentially to be determined by the parties to the Franchising Contract". The **British Franchise Association** agrees, adding that in the case of most BFA members a front end franchise fee is usually charged as well as a percentage on turnover as a continuing fee, and that sometimes in appropriate cases a mark up on product supplies is also charged. Mr **Adams** refers directly to the criteria used to determine the fees by stating quite simply that there are none.

As regards the **United States of America**, Professor **Keating** states that the entrance fee, percentage on turnover and other sums payable are dependent on the industry and the degree of training the franchisor provides for the franchisee - initial payment fees from $ 5,000 to $ 15,000, and a royalty rate of 5% and a 1.5 % advertising contribution are common. The **International Franchise Association** refers specifically to international franchising, stating that the question of the fees is "strictly a business decision, to be resolved by the parties, who must consider such factors as the value of the knowhow provided to the Master Licensee, the extent to which the Master Licensee is responsible for providing services to the individual licensees, and the extent of the

importance of the Codes of Ethics is that they seem to lead to a voluntary "cleaning-up" among franchisors, whereas the **Swedish Franchise Association** considers their importance to be great, as they set standards for good behaviour.

The **British Franchise Association** considers the Code of Ethics it has adopted, and its disciplinary procedure, to be very important. It states that it has been able to influence members whose practices were unsatisfactory and bring them into line. The impression of Mr **Adams** is, however, that they have marginal effect only.

The impression Mr Adams has for the United Kingdom is echoed by Professor **Keating** for the **United States of America**, in that he states that they have "/v/ery little effect".

It is interesting to note the observation by **DG IV** of the **European Communities**, according to which the Codes of Ethics have a definite value as a source of inspiration for those operators who wish to abide by them, but that they are insufficient to avoid abuses.

(vii) International franchising: particular difficulties and differences with domestic franchising

Mr **Marzorati** indicates that the aspects of international franchising which usually cause problems in **Argentina** are firstly the transfer of payments abroad and "local income tax withholding rates which exceed for example current U.S. rates and therefore generate a non-usable tax credit", and secondly recourse to foreign law which, to the extent that the franchise agreement is to be performed locally, is often resisted by local counterparts. On the other hand, there appear to be no differences between international and domestic franchising as regards the obligations of the parties, as the contracts are often standard contracts.

The **Australian Government** instead considers that franchising problems are a feature of the franchise relationship itself, regardless of whether the franchising is locally or internationally based. Its impression is that the obligations arising under international franchising are much the same as those arising under purely domestic franchising. The **Franchisors Association of Australia** also considers there to be no difference between international and domestic franchising.

In **Canada** instead, the **Canadian Government** illustrates difficulties which have arisen in the Province of Alberta when dealing with franchisors which reside in a jurisdiction outside the province: firstly, "it is our experience that franchisees as well as the Alberta Securities Commission would have difficulties in seeking recourse against a franchisor which resides in another jurisdiction". Secondly, "/t/he franchisor which resides outside of the jurisdiction is likely to

encounter pragmatic problems in providing or passing on the expertise which constitutes the franchise system to a franchisee here in Alberta. This is more likely to be the case during the start-up when a franchisor is establishing itself for the first time in the Province of Alberta. These difficulties can be overcome for the most part by way of risk disclosure which warns the franchisee that it may incur additional costs or not be able to readily seek the advice or assistance of the franchisor because of geographic constraints". Mr **Zaid** refers specifically to international franchising, stating that the common difficulties are failure of the franchisor to adapt the system to the foreign country, and failure to give the domestic franchisee the responsibility to make the system conform to the importing country's standards. He adds that the obligations arising under international franchising are generally in the same category as those derived from domestic transactions, "but they must be modified to allow the international franchisee more opportunity to adapt the system to the cultural and business requirements of the franchisee's country. The international franchise agreement must be specifically drafted to contemplate less controls by the franchisor".

Mr **Pollaud-Dulian (France)** gives the examples of problems of the determination of the applicable law, and of the interpretation of the contract as particular difficulties of international franchising.

The determination of the applicable law is considered also by the **Italian Government**, which illustrates the provisions of the Code of Civil Procedure in accordance with which Italian judges would be competent to judge franchising cases under certain conditions. **Assofranchising** instead states that the first difficulty with respect to international franchising is caused by the divergencies between national disciplines, which enhances the importance of choice-of-law clauses, and, secondly, that problems are caused for EEC Member States by the application of EEC antitrust rules in addition to domestic antitrust rules, and by the differences between the two sets of rules. Furthermore, the contract law of different countries differs, which obliges the franchisor to "tailor different contracts in different countries". Mr **Coshnear** lists a number of difficulties to which international franchise operations give rise and which are not encountered in purely domestic franchising: "(a) since Italy currently has no internal antitrust law, international franchising is subject to antitrust restrictions (Article 85, EEC); (b) possible currency control limitations on export of profits; (c) lack of trademark and tradename recognition; (d) effective control over the network of franchisees rendered more problematical; (e) excessive adaptation of the franchise image to harmonize with local tastes may overly dilute a well established image". As regards the obligations of the parties, the **Italian Government** considers that the duty of the parties to furnish information is of particular importance, especially as regards the law and the market conditions of the countries concerned.

The **Japanese Government** states that problems of jurisdiction and applicable law are encountered from time to time in international franchising.

The problems of jurisdiction and applicable law are viewed also by the **Government of Luxembourg** as posing problems for international franchising. Furthermore, it states that the Member States of the EEC must ensure that the EEC competition rules are followed.

Professor **Boudahrain (Morocco)** also considers that international franchising poses the problem of the applicable law although, as he stated when referring to legislation and principles applicable to franchising contracts, courts would be able to take both the legal writing and the decisions of the country of origin of the franchisor into consideration when making their own decisions.

The **Amsterdam Chamber of Commerce**, while stating that "tomes can be written on this subject", identifies as problems which arise for international franchising those relating to differences in legislation, language, consumption patterns and national character.

The **Government of South Africa** states that the most important difficulties encountered in connection with international franchising operations are the exchange control regulations applicable in South Africa. Furthermore, it states that "it is important to decide and provide contractually which law will be applied in determining the rights and obligations under an international franchising agreement".

The **Swedish Government** considers that the main difficulty is that contracts drafted by international franchisors are often translated literally from the language of the franchisor into Swedish, with the result that the contract terms do not correspond to those of Swedish law. The **Swedish Franchise Association** instead sees the domestic customs and legal practices in other countries as the main problem for international franchising. As regards the obligations of the parties to the franchising contract, the **Swedish Government** notices a certain difference, in that the "obligations arising under international franchising often seem to be more favourable to the franchisors than those deriving from domestic transactions".

The **Government of the United Kingdom** states that "/n/o evidence has been produced so far that international franchising poses especial difficulties". This view is echoed by the **British Franchise Association** which considers that "/t/he only difficulties which arise are those which are relevant to any business contemplating international expansion. There are particular applications to franchise transactions but only within the framework of general principles". Mr **Adams** instead estimates that the most difficult aspect of international franchising is adapting the package for different markets. As regards the obligations of the parties, the **BFA** considers that the obligations are basically the

same in nature, but that given the different scope the extent is greater - this depends on the nature of the business relationship at international level. Mr **Adams** draws attention to another aspect which has so far hardly been touched, i.e. the fiscal situation, in that he states that "/u/sually international franchise arrangements are set up to maximise tax avoidance. This obviously has an effect on the package of rights offered and the franchisee's obligations as to payments".

The **International Franchise Association (U.S.A.)** does not appear to be impressed by the problem of the applicable law, stating that this problem "is not unique to franchise contracts; rather, it is a basic legal concern affecting most international business transactions. But there does not appear to be any reason for singling out franchise contracts for special or more uniform treatment". Professor **Keating** makes the more general consideration that a major problem with international franchising is that restrictions commonly found in U.S. franchise agreements may violate the laws of other countries, "particularly the terms of the Treaty of Rome which governs trade in Common Market countries". He considers the obligations of the parties to be more or less the same, except to the extent that they must be varied to conform to local law.

Lastly, DG IV of the **Commission of the European Communities** views the necessity of respecting national laws which differ, and which sometimes contradict each other, to be the major difficulty in international franchising.

(viii) International franchising - different forms of treatment?

The **Australian Government** in its answer to this question makes a direct reference to the (now withdrawn) draft Franchise Agreements Bill, which proceeded on the basis that the same rules should apply to international and domestic franchising. The **Franchisors Association of Australia** agrees with this approach, stating that basically the application "whether it be domestic or international, should not be any different, taking into consideration any variances in terms of product range, customs, law and monetary restrictions".

The **Government of Canada** makes the observation that the different forms of franchising might indeed require different rules, but that this would seem to be the case whether it is international franchising or domestic. It adds that "a lot would depend on how you regulate. If it is only disclosure possibly one set of rules would be sufficient, however, under a registration system, it would not seem that all forms of franchising could be handled under a single registration system".

The **Chilean Government** considers the product which is franchised rather than the different forms of franchising, stating that different treatments are necessary, taking into account the needs of the specific

products concerned.

Mr **Pollaud-Dulian (France)** makes no direct reference to whether or not the different forms of franchising could be covered by the same instrument, merely indicating that there should at least be an express indication of the applicable law, of the competent judge and of the methods of interpretation to be applied to the contract.

In view of the fact that franchising contracts are typically of an international character, the **Government of the Federal Republic of Germany** considers that one legal instrument could well cover both national and international franchising.

A decided vote in favour of a specific regulation of international franchising is cast by the **Italian Government**, which expresses the view that such a legal instrument should at least permit the determination of the law applicable to the obligations deriving from the franchising contract, and should regulate the duty of the parties to furnish each other with information, as well as indicate the legal consequences of not complying with such duties. The purpose of such a regulation would also be to furnish parties who are in good faith with adequate protection against the possibility of fraudulent manoeuvres on the part of the other party, facilitated by his lack of knowledge of the legal system involved. **Assofranchising** instead considers that the different forms of franchising can be "adequately and appropriately dealt with by the same rules", although specific rules or exceptions might be provided for in specific sectors of business activity. While suggesting that general rules could be thought of for the protection of the independence of the parties, Professor **Longo** also considers that specific provisions for each form of franchising could be provided for.

The **Japanese Government** considers it necessary to draw up guidelines for each business category, or alternatively to draft a model contract, "according to the situation of each country". It considers the question of a uniform rules irrespective of form to become relevant only after the drafting of such guidelines.

The **Government of Luxembourg** appears to think along the same lines as the Government of the Federal Republic of Germany, in that it states that as far as possible the different forms of international franchising should be regulated by identical rules and in the same international instrument.

Similarly, the **Government of Mexico** considers that a general regulation of the franchising contract should be adopted rather than a regulation of each single form of international franchising.

The **Amsterdam Chamber of Commerce** considers that the differences between the various forms of franchising are not such that specific rules should be made for each and every form - it actually does not

consider the regulation of franchising to be necessary at all.

The **Government of South Africa** merely states that "the same rules and the same instrument are adequate".

This view is shared by the **Swedish Government** which states that the Parliamentary Commission on franchising has not found there to be reason enough to adopt individual treatment for each of the different forms of international franchising. The **Swedish Franchise Association** also feels that as far as possible the rules should be the same.

Nor does the **British Franchise Association** consider any special treatment to be necessary, "although it is not widely recognised that the US laws particularly at State level can create a barrier to entry". Mr **Adams** merely states that it is essential to look at international franchising "if you intend to promulgate a uniform law".

Professor **Keating (U.S.A.)** also agrees with the majority of views expressed: "They could be dealt with adequately and appropriately by the same rules and in the same instrument".

Again, the **EEC** considers it desirable for the different forms to be dealt with in the same instrument, although this would not avoid problems arising as a result of the different fiscal and competition systems.

(ix) The form for an international instrument on franchising

Mr **Marzorati (Argentina)** does not feel any pressing need for the regulation of an international contract which has not yet been recognised domestically. He does, however, state that guidelines, because they are not mandatory, "could be welcomed or at least acknowledged".

The **Government of Australia** has "no firm view as to the most appropriate form of any international franchising rules that might be developed", although, in view of its own experience, it would appear to consider the task quite formidable. The **Franchisors Association of Australia** instead suggests that guidelines and a model contract, together with international uniform terminology, "would be the best contributors to uniformity on an international level".

The **Austrian Federal Chamber of Trade and Industry** does not consider it possible to answer the question on what kind of international instrument could be envisaged for franchising, as no official research into the subject has been conducted. Furthermore, it considers that this would to a certain extent depend upon the fate of the new competition law. The **Ministry of Justice** on the other hand feels that as far as possible unification of law should be aimed for, which in this case would mean international uniform legislation,

provided a need for a regulation of franchising exists in practice.

The **Canadian Government** would opt for a model law, but the legislation should be of a disclosure type, as it believes uniform disclosure requirements to be more desirable as they allow franchisors to expand their operation from one jurisdiction to another while at the same time minimising the cost of complying with the regulation of a particular jurisdiction. Mr **Zaid**, on the other hand, expresses the view that "to the extent that international rules may be desirable, the only practical format would be for guidelines. International uniform legislation, model law, and model contracts would not normally work due to the vast distinctions in international franchise arrangements and the various franchise systems involved".

The **Government of Chile** confirms what it already stated with reference to the necessity of catering separately for the different forms of franchising agreements, by stating that it would be necessary to lay down certain general provisions in addition to others more specific to the different types of franchise contracts.

For Mr **Pollaud-Dulian (France)** a model contract would appear to be a good solution, to the extent that it is possible to adapt it to different situations.

The **Government of the Federal Republic of Germany** considers it premature to give an answer to this question.

Perhaps the most decided answer in favour of uniform legislation is given by the **Italian Government**, which would like to see such a uniform law protecting the party in good faith. It considers that such a law ought to comprise only a limited number of provisions from which the parties cannot derogate, and which the States accepting it ought to incorporate into their national legislation. Surprisingly, also **Assofranchising**, alone among the professional associations, is in favour of international uniform legislation. Mr **Coshnear** is instead opposed to binding legislation at this stage, considering that franchising, in Europe in general and in Italy in particular, is still not a widely used business formula. His own personal choice, he states, would be for guidelines, coupled with the Codes of Ethics, at least until franchising has consolidated its position throughout the EEC and legislation could be based on the realities of the market place. Mr Coshnear is of the opinion that a model contract would be of little practical use, inasmuch as "(i) there are too many different forms of franchising and fields in which franchising can operate and (ii) a model contract would have little applicability in 12 different legal systems", thinking of the EEC. Professor **Longo** would instead opt for a combination of international uniform legislation and some form of model law.

The **Government of Japan** considers it desirable to establish international rules by drafting guidelines or a model contract, not by

uniform legislation.

Quite the reverse is the preference expressed by the **Government of Luxembourg**, which quite clearly opts for a uniform law or a model law.

The **Government of Mexico** would instead like to see a combination of a model law and international uniform legislation to cover the practices currently in use.

The **Amsterdam Chamber of Commerce** indicates that the most fitting instrument would be "guidelines or a code of conduct, possibly supplemented by a standard contract", although it has already in the answers to other questions indicated that it does not consider that the mere existence of a large diversity of legislation is a good reason to aim at international regulation, as once this is adopted differences will still remain regarding, e.g. the domain of the rent act legislation, national insurance legislation, labour law, etc. Furthermore, it states that the incidental abuses are abuses which are not limited to franchising, and "/i/f these should necessitate legal action (quod, in my opinion, non) these rules should not be confined to what is happening in franchising, but should be universally applicable in the retail trade or, as the case may be, in all society".

The **Government of South Africa** also expresses itself very briefly, stating that "/s/ome form of model law may be useful for those countries which wish to implement law relating to franchising".

The **Swedish Government** answered the questionnaire before the Parliamentary Commission completed its report, and consequently only states that, awaiting the results of the work of this Commission, it does not have "a firm view on the fitting form for possible international rules in this field". The **Swedish Franchise Association** has instead a very firm view indeed - against the creation of any international instrument which it considers "cannot serve any meaningful purpose, whatever the legal character of such an instrument", largely because of the great variety of forms in which franchising occurs. The SFA adds that "we have reason to believe that such an instrument could be counterproductive if the idea is to minimize conflicts, since we fear that the instrument would be used by lawyers unfamiliar with the peculiarities of franchising, and perhaps even by non-lawyers, to the detriment of clients and the general public", although it might be pointed out that any other legislation may suffer from the same dangers.

The **Government of the United Kingdom** states that the UK "does not accept the need or desirability at the present time for special "rules" either for domestic or for international franchising". The **British Franchise Association** is of a similar opinion, stating that it does not consider international rules to be desirable. Mr **Adams** is not that optimistic either as regards the possibilities of an international instrument, stating that "/g/iven the fact that there is quite a

diversity of law in different jurisdictions, I would have thought that the best that could be hoped for would be the promulgation of guide lines dealing with the disclosure, payments, termination, etc.", adding, however, that he thinks "this would actually be quite valuable as a set of standards towards which ethical franchising ought to aim".

Professor **Keating (U.S.A.)** also opts for guidelines, as "/d/ifferent customs and economic conditions in the various countries would make uniform international legislation, model law or model contract inappropriate".

Professor **Parra Aranguren (Venezuela)** instead considers that a combination of international uniform legislation with some form of model law is to be preferred, although a definite answer can only be given once the pros and cons of all the different alternatives are known.

DG IV of the Commission of the European Communities gives a scale of preference, indicating uniform legislation as the first choice, a model law as the second choice, and a combination of the two as the third.

CHAPTER III : DEVELOPMENTS IN THE EUROPEAN COMMUNITIES - A DRAFT REGULATION FOR FRANCHISING

The publication by the European Communities of a Draft Commission Regulation on the application of Article 85(3) of the Treaty to categories of franchising agreements[36] has generally been greeted with favour, although criticism has also been levelled against it. The draft block exemption would require an in-depth analysis, placed in the context of the aftermath of the Pronuptia Decision of the European Court of Justice, which, however, is outside the scope of this report. Certain of its characteristics may be briefly summarised as follows:

- the draft block exemption defines the categories of franchising agreements which, although they fall under Art. 85(1), can normally be considered as satisfying the requirements for an exemption under Art. 85(3);
- the scope of the block exemption is limited to "franchising agreements whereby one of the parties supplies goods or provides services to end users"[37];
- the concepts of a "franchise agreement", a "franchise" and "know-how" are defined[38] for the purposes of the draft regulation;
- the Commission, as also the Court of Justice in the Pronuptia Decision, distinguishes between industrial or production franchises concerning the manufacturing of goods; distribution franchises concerning the retailing of goods and service franchises concerning the supply of services. It further divides distribution franchises into producer franchises and distributor franchises;
- franchise agreements treated in the draft regulation include those which benefit automatically from the exemption from Art. 85(1) as they come under Articles 2 - 4; those which in any case are excluded from the exemption (Art. 5); and those which contain clauses which are not expressly exempted, and which consequently should be notified to the Commission for a case by case decision (Art. 6). This latter possibility is considered to be of particular importance, as a time-limit of six months is set for the Commission to decide, after which the agreement in question will benefit from the exemption;
- the draft regulation also provides for the possibility for the Commission to withdraw the benefit of the block exemption where it finds that the effects of an agreement are incompatible with the conditions for exemption in Art. 85(3), and in particular where competition is significantly restricted because of the structure of the relevant market (Art. 8).

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(36) OJ of the European Communities, N° C229/3, of 27 August 1987. The text of the draft regulation is annexed to this report as Annex III.

(37) See Recital 4 of the draft block exemption.

(38) See Art. 1(2)(a), (b) and (c).

CHAPTER IV : INITIATIVES OF OTHER ORGANISATIONS

The International Chamber of Commerce

In 1987 a proposal was put forward within the International Chamber of Commerce for work on franchising to be initiated by its Working Party on Commercial Representation. Any decision in the matter was, however, deferred, first of all because the same Working Party was scheduled to begin work on the EEC Directive on commercial agents, and secondly, because the ICC prefered to await the results of the research conducted at Unidroit which were considered to be of interest.

The International Bar Association

The Committee on International Franchising of the International Bar Association Section on Business Law is currently elaborating a Compendium on Franchising Terms, which is "intended to suggest to the international franchising community that it would be in the interest of all to attempt, as far as possible, to use common franchising terminology, whether the language be English, French, German, Japanese, Spanish or whatsoever, to describe (i) agreements regularly in use within the franchise business community, (ii) the parties to such agreements, and (iii) certain terms generally used in those agreements"(39).

The proposal is interesting, and will certainly be of great utility, provided the suggestions are not only accepted but also applied. Apart from certain doubts about the choice of some of the recommended terms, the one point which raises questions relates to the languages: the terms suggested in the document are all English terms. For international contracts drafted in English this would create no problems, but these terms would require translation into all the different languages of the countries where franchising is used, as foreign words are not always accepted(40). How the IBA Committee intends to go about this, or if indeed they plan to do so, is not indicated, although it is clear that they can count on a large number of members to assist them.

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(39) See A compendium of Franchising Terms, document of the International Bar Association, Section on Business Law, Committee X : International Franchising, draft revised after its meeting in New York, September 1986.

(40) See, for example, the French arreté of 29 November 1973 concerning the use of the term "franchisage" as opposed to "franchising".

CONCLUSION

This second report on the franchising contract is limited to an examination of the answers received by the Secretariat to the questionnaire annexed to the first study. While the response can be considered to be satisfactory, the information received is still not sufficient to determine in a definitive manner whether or not it is both feasible and useful to draw up an international instrument for franchising. In fact, the information received can almost be said to raise more questions than it solves, if only because of the contrasts between the information received from different sources in the same country.

There are several points which would require further consideration. These include: (i) the effectiveness of the existing legislation in solving disputes arising in connection with franchising contracts, which can only be done by examining the decisions of courts in different countries (consideration should here also be given to controversial cases, such as where the courts have equated franchisees with consumers); (ii) the whole question of labour law and its applicability or non-applicability to franchising; (iii) the role in practice of the Codes of Ethics; (iv) the differences between domestic and international franchising, and whether these, such as they are, warrant any regulation of the phenomenon. One point connected with this, and a point well taken, was raised by Mr **Mendelsohn** of the **British Franchise Association** in a private conversation: international franchising basically does not exist as a purely international phenomenon; what happens is that a franchisor active in one legal system enters the market of another country, where another legal system is in force. At this point he must take into consideration the national legislation of his country of origin and the national legislation of the country the market of which he has entered, which Mr Mendelsohn considers would obviate the need for international regulation. Clearly, it could be argued that uniformity in the principles applied, if not in the actual legislation, would considerably facilitate matters, particularly where countries are concerned where the courts apply other laws by analogy when there is no specific legislation to be applied, as the differences between the countries could lead to considerable uncertainty, if not to malpractices. Furthermore, while it is true that franchising has not as yet developed into a specific form, and that this might put in question the advisability of treating it at an international level already at this early stage, the contrary might also be considered to be true: a real uniformity could only be facilitated by elaborating an international instrument, even if in the form of guidelines, to which legislators might look when drafting their own domestic legislation. It should, in fact, be more difficult to have any influence on legislation which is already in force, as legislators would logically be more reluctant to amend existing laws.

The recent developments referred to, i.e. the proposed Swedish Bill for a law on franchising and the EEC draft regulation for the block exemption of franchising contracts from the application of Art. 85(1) of the Treaty of Rome, in particular the latter, would also need to be further monitored and studied. The influence of the Pronuptia Decision of the European Court of Justice, which led to the draft regulation, should also be carefully considered, and the literature published in connection with this decision examined. Furthermore, there is one document mention of which has not been made in this report, but which might be of interest, although so far no specific references to it have been encountered. This is the draft Uniform Franchise and Business Opportunites Act of the US National Conference of Commissioners on Uniform State Laws. It is a "draft for disscussion only", the fate of which is clearly uncertain, but which could be very interesting when considering the possibility of elaborating a uniform instrument on franchising.

An examination of different franchising contracts and of the terms contained in them, would also be both interesting and useful, particularly if it were to be accompanied by an examination of the application of existing legislation, also with a view to discovering loopholes and gaps in the law as it stands.

The question could nevertheless be raised of the effective utility of a further examination of a form of business which is as yet in its infancy, and which raises as many doubts as franchising does - one need only recall the difficulties of assessing the data concerning the entity of the phenomenon, and the observations of Mr **Adams** as to the approach adopted to be aware of entering a highly controversial field. It is, however, a form of dealing which is in such rapid expansion, and which has so great an importance in purely economic terms, that it cannot be disregarded: as discovered already in the course of the first study, 30% of the retail trade in the United States, 40% in Canada and around 8% in France, to mention only a few, is conducted through franchised outlets, and the figures are likely to increase. It is also a form of dealing which is likely to spread into all parts of the world and which may, in fact, be of some utility to developing countries, as it could bring with it the introduction of new business skills in a short period of time, and because the business could support other industries (e.g. the case of a franchised hotel which may be useful in increasing the tourist trade, or of an equipment rental franchise which may benefit farmers who cannot afford to buy agricultural machinery)[41].

Whatever decision is ultimately taken, a consideration of the missing pieces of the mosaic could be of considerable assistance in reaching a correct one.

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(41) See W. KEATING, Guide on the Franchising Activities of Enterprises in Developing Countries, 1988, pp. 14 - 15.

ANNEX I

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 appropriate 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 to be held 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?

ANNEX II

LIST OF PERSONS CITED IN THE REPORT WHO ANSWERED THE QUESTIONNAIRE

Mr John ADAMS, Senior Lecturer in Law, Faculty of Social Sciences, University of Kent at Canterbury, United Kingdom

Professor Abdellah BOUDAHRAIN, Faculty of Law of the University of Rabat and Attorney of the Casablanca Bar, Morocco

Mr Theodore A. COSHNEAR, Counsellor at Law, Member of the Bar of Washington, D.C., Milan, Italy

Mr Andre R. JAGLOM, Attorney, Partner in Stecher Jaglom & Prutzman, New York, U.S.A.

Professor William J. KEATING, The Dickinson School of Law, Carlisle, Pennsylvania, U.S.A.

Professor Giovanni LONGO, Secretary General of the International Association of Judges, Judge of the Supreme Court of Cassation, Italy

Mr Osvaldo J. MARZORATI, Attorney, Allende & Brea, Buenos Aires, Argentina

Mr Martin MENDELSOHN, Solicitor, Partner in Adlers; British Franchise Association, London, United Kingdom

Professor Gonzalo PARRA ARANGUREN, Universidad central de Venezuela, Member of the Unidroit Governing Council

Mr F. POLLAUD-DULIAN, Institut de droit comparé, Paris, France

Mr Stig SOHLBERG, Attorney, General Counsel of the Swedish Franchise Association

Mr Frank ZAID, Partner, Osler, Hoskin & Harcourt, Barristers and Solicitors, Patent and Trademark Agents, Toronto, Ontario, Canada

Communication pursuant to Article 5 of Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85 (3) of the Treaty to categories of agreements and concerted practices (1)

(87/C 229/03)

In accordance with the terms of Article 5 of Regulation No 19/65/EEC, the Commission invites all interested parties to send their comments on the attached draft 'Commission Regulation (EEC) on the application of Article 85 (3) of the Treaty to categories of franchising agreements' by no later than 1 November 1987 to the following address:

Commission of the European Communities,
Directorate-General for Competition,
Directorate for General Competition Policy,
rue de la Loi 200,
B-1049 Brussels.

Draft Commission Regulation (EEC) on the application of Article 85 (3) of the Treaty to categories of franchising agreements

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices (1), as last amended by the Act of Accession of the Kingdom of Spain and the Republic of Portugal, and in particular to Article 1 thereof,

After consulting the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas:

1. Regulation 19/65/EEC empowers the Commission to apply Article 85 (3) of the Treaty by Regulation to certain categories of bilateral exclusive agreements falling within the scope of Article 85 (1) which either have as their object the exclusive distribution or exclusive purchase of goods, or include restrictions imposed in relation to the assignement or use of industrial property rights;

2. Franchising agreements consist essentially of licenses of intangible property rights concerning trade marks or signs and know-how, which can be combined with restrictions relating to supply or purchase;

3. Several types of franchise can be distinguished according to their object: industrial franchise concerns the manufacturing of goods, distribution franchise, either by a producer or by a distributor, concerns the retailing of goods, and service franchise, concerns the supply of services;

4. It is possible on the basis of the experience of the Commission to define categories of franchising agreements which fall under Article 85 (1) but can normally be regarded as satisfying the conditions laid down in Article 85 (3); this is the case for franchising agreements whereby one of the parties supplies goods or provides services to end users; on the other hand, industrial franchise agreements shall not be covered by the present Regulation; such agreements, which relate to relationships between producers, present different characteristics than the other types of franchise; they consist of manufacturing licenses based on patents and/or technical know-how, combined with trade-mark licenses; some of them can benefit from the block exemptions relating to patent (2) or know-how (3) licences if they fulfill the conditions defined by those regulations;

(1) OJ No 36, 6. 3. 1965, p. 533/65.

(2) Commission Regulation (EEC) No 2349/84 of 23 July 1984 on the application of Article 85 (3) of the Treaty to certain categories of patent licensing agreements (OJ No 219, 16. 8. 1984, p. 15).

(3) Commission Regulation (EEC) No .../.. of ..... 1987, on the application of Article 85 (3) of the Treaty to certain categories of know-how licensing agreements (OJ No ... ., p. .)

5. For the purposes of this Regulation, franchise agreements are agreements whereby an undertaking, the franchisor, confers on another, the franchisee, in exchange for financial consideration, the right to exploit a franchise to retail goods and/or provide services to end users. A distinction can be drawn between producer's franchise, concerning the retail of goods manufactured or selected by the franchisor or on its behalf and bearing the franchisor's name or trade mark, distributor's franchise, concerning the retail of goods manufactured by third parties and selected by the franchisee in collaboration with the franchisor and, lastly, service franchise, concerning the provision of services according to the franchisor's instructions and on a subsidiary basis the supply of goods directly linked to the provision of the services; the franchise includes a uniform presentation of the contract installations based on the use of a common name or sign, a substantial know-how relating to the sale of goods and/or the provision of services to end users and a continuous commercial or technical assistance provided by the franchisor to the franchise; this Regulation shall also cover cases where the relationship between franchisor and franchisees is made through the intermediary of a third company, the master franchisee;

6. Franchising agreements can fall under Article 85 (1) when they include territorial protection of the franchisees, in particular where it is provided that neither the franchisor, nor other franchisees will be allowed to set up franchised installations in a determined area; such restrictions result in a sharing of markets between franchisor and franchisees or between franchisees, which is capable of affecting trade between Member States even if franchisor and franchisees are established in the same member state in so far as they prevent franchisees from setting up franchised installations in other Member States;

7. Franchising agreements as defined in this Regulation normally improve distribution as they give franchisors the possibility of establishing a uniform distribution network without the need for major investments, which may assist the entry of new competitors on the market, particularly in the case of small and medium-sized undertakings, thus increasing interbrand competition; they also allow independant traders to set up outlets more rapidly and with higher chance of success than if they had to do so without the franchisor's experience and assistance; they have therefore the possibility to compete efficiently with large distribution undertakings;

8. As a rule, franchising agreements also allow consumers and other end users a fair share of the resulting benefit, as they combine the advantage of a uniform distribution network with the existence of traders personally interested in the efficient operation of their business;

9. The limited territorial protection granted to the franchisees is indispensable to protect their investment and to guarantee that they will concentrate their activity on the contract territory;

10. The Regulation must specify the conditions which must be satisfied for the exemption to apply; to guarantee that competition cannot be eliminated for a substantial part of the products in question, it is necessary that parallel imports remain possible; therefore, cross deliveries between franchisees should always be possible; furthermore, where a franchise network is combined with a selective distribution system, franchisees should be free to obtain supplies from approved distributors; to ensure that consumers receive a fair share of the resulting benefits, it must be provided that where the franchisees have to honour guarantees for the products which are the object of the franchise, this obligation shall also apply to products supplied by other franchisees. Even if franchisees can be prohibited from competing with the franchisor, they should never be prevented from investing in competing companies, where they are not involved personnally, in particular, where they do not have the control, or are not a member of the board, of a competing company;

11. It is desirable to list in the Regulation a number of obligations that are commonly found in franchising agreements and are normally not restrictive of competition and to provide that if, because of the particular economic or legal circumstances, they fall within Article 85 (1), they are also covered by the exemption; this list, which is not exhaustive, includes clauses which are essential either to preserve the common identity and reputation of the network or to prevent the know-how made available and the assistance given by the franchisor from benefitting competitors;

12. The Regulation must also specify restrictions which may not be included in franchising agreements if these are to benefit from the exemption granted by the Regulation by virtue of the fact that such provisions are restrictions falling within Article 85 (1) for which there is no general presumption that they will lead to the positive effects required by Article 85 (3); this is the case in particular when the franchisee is restricted as to the determination of its prices by way of agreement or concerted practice;

13. Agreements which are not automatically covered by the exemption because they contain provisions that are not expressly exempted by the Regulation and not expressly excluded from exemption may nonetheless generally be presumed to be eligible for application of Article 85 (3). It will be possible for the Commission rapidly to establish whether this is the case for a particular agreement. Such agreements should therefore be deemed to be covered by the exemption provided for in this Regulation where they are notified to the Commission and the Commission does not oppose the application of the exemption within a specified period of time;

14. If individual agreements exempted by this Regulation nevertheless have effects which are incompatible with Article 85 (3), the Commission may withdraw the benefit of the block exemption, in particular in cases where competition is significantly restricted because of the structure of the relevant market;

15. Agreements which are automatically exempted pursuant to this Regulation need not be notified; undertakings may nevertheless in a particular case request a decision pursuant to Council Regulation No 17 (1), as last amended by the Act of Accession of Spain and Portugal;

16. Agreements to which this Regulation is applicable cannot benefit from the provisions of other block exemption regulations,

HAS ADOPTED THIS REGULATION:

Article 1

1. Pursuant to Article 85 (3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 85 (1) of the Treaty shall not apply to franchising agreements entered into between two undertakings, which include one or more of the restrictions listed in Article 2.

2 For the purposes of this Regulation:

(a) a franchising agreement means an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for financial consideration, the right to exploit a franchise for the purpose of marketing determined goods and/or services.

(b) a franchise means a package of intangible property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users and which includes at least:

— the use of a common name or sign and a uniform presentation of contract premises,

— the communication by the franchisor to the franchisee of a substantial know-how capable of conferring a competitive advantage on the latter, and

— the continous provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement.

(c) *Know-how* means a body of non-patented practical knowledge, resulting from experience and testing by the franchisor, which can be passed on to others and is not immediately accessible to the public, relating to the sale of goods or the provision of services to end users, and in particular to the presentation of goods for sale, the processing of goods in connection with the provision of services, methods of dealing with customers, and administration and financial management.

3. This Regulation applies also to franchising agreements of the kind described in paragraphs 1 and 2 whereby the franchisee agrees to retail certain goods supplied by the franchisor and bearing its name or trademark in a defined area of the common market (the contract territory).

4. The exemption provided for in paragraph 1 also applies to master franchise agreements, that is agreements between two undertakings whereby one, the franchisor, grants the other, the master franchisee, in exchange for financial consideration, the right to exploit a franchise in a specified territory for the purposes of concluding with third parties, the franchisees, franchising agreements as defined in paragraph 2. All references in this Regulation to relations between franchisor and franchisee must be understood as including also relations between master franchisee and franchisee.

(1) OJ No 13, 21. 2. 1962, p. 204/62.

Article 2

The exemption provided for in Article 1 shall apply to franchise agreements which include one or more of the following restrictions of competition:

(a) an obligation on the franchisor, in a defined area of the common market, the contract territory, not to
- give the right to exploit all or part of the franchise to third parties,
- exploit itself the franchise, or supply itself the goods or services which are the subject of the franchise under a similar formula,
- in the case of Article 1 (3), supply itself the goods which are the subject of the franchise to third parties,

(b) an obligation on the franchisee to exploit the franchise only from the contract premises;

(c) an obligation on the franchisee to sell the goods which are the subject of the franchise only to end users or to other franchisees, without prejudice to the right of the franchisee to resell them to third parties which may also obtain from other sources those goods for resale;

(d) an obligation on the franchisee, in the case of Article 1 (3), not to manufacture or distribute goods competing with the goods which are the subject of the franchise in the contract territory or in a territory allotted to another member of the franchised network.

Article 3

1. Article 1 shall apply notwithstanding the presence of any of the following obligations on the franchisee:

(a) in so far as it is necessary to protect the franchisor's know-how or to maintain the common identity and reputation of the franchised network, to sell exclusively goods matching minimum objective quality specifications laid down by the franchisor;

(b) in so far as it is necessary to protect the franchisor's know-how or to maintain the common identity and reputation of the franchised network, to sell goods which are manufactured only by the franchisor or by third parties designated by it, where it is impracticable, owing to the nature of the goods which are the subject of the franchise, to formulate objective quality specifications;

(c) not to engage, directly or indirectly, in any similar business in a territory where it would compete with a member of the franchised network;

(d) not to use the know-how and itellectual property rights licensed by the franchisor for purposes other that the exploitation of the franchise; the franchisee may be held to this obligation after the agreement has expired as long as the know-how confers a competitive advantage on it;

(e) not to disclose to third parties the know-how provided by the franchisor, and to impose the same obligation on its staff; the franchisee may be held to this obligation after the agreement has expired;

(f) to inform the franchisor of infringements of the licensed intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers;

(g) to attend or have its staff attend training courses arranged by the franchisor;

(h) to use its best endeavours to sell the goods or provide the services that are the subject of the franchise, achieve a minimum turnover, plan his orders in advance, keep minimum stocks and provide customer and warranty services;

(i) to pay to the franchisor a specified proportion of its revenue for advertising and obtain the franchisor's approval for the nature of the advertising it carries out itself;

(j) to apply the commercial methods devised by the franchisor and use the licensed know-how, trade marks and signs;

(k) to comply with the franchisor's standards for the equipment and general appearance of the contract installations;

(l) to allow the franchisor to carry out checks on its inventory and accounts and of the contract installations;

(m) not without the franchisor's consent to change the location of the contract installations;

(n) not without the franchisor's consent to assign the rights and obligations under the franchise agreement.

2. The exemption provided for in Article 1 shall also apply to franchise agreements which include obligations referred to in paragraph 1 where, because of particular circumstances, such obligations fall within the scope of Article 85 (1).

Article 4

The exemption provided for in Article 1 shall apply on condition that:

(a) the franchisee is free to obtain the goods that are the subject of the franchise from other franchisees; where such goods are also distributed through another network of authorized distributors, the franchisee must be free to obtain the goods from those;

(b) where the franchisor obliges the franchisee to honour guarantees for products bearing the franchisor's trade mark, this obligation applies also to such products supplied by other franchisees;

(c) the franchisee is free to acquire financial interests in the capital of competitors of the franchisor where this investment does not involve it personally in carrying on competing activities;

(d) the parties have described in as much detail as possible in the contract or any related document the know-how and other rights which are the subject of the franchise.

Article 5

The exemption granted by Article 1 shall not apply where:

(a) manufacturers of identical goods or goods which are considered by users as equivalent in view of their characteristics, price and intended use, enter into reciprocal franchising agreements in view of the distribution of such goods;

(b) in cases other than provided in Article 1 (3), the franchisee is prevented, for reasons other than protecting the franchisor's know-how or maintaining the common identity and reputation of the franchised network, from obtaining supplies of goods of equivalent quality to those offered by the franchisor;

(c) in cases other than provided in Article 1 (3), the franchisee is obliged to sell goods manufactured by the franchisor or third parties designated by the franchisor and the franchisor refuses, for reasons other than protecting the franchisor's know-how or maintaining the common identity and reputation of the franchised network, to designate as authorized manufacturers third parties proposed by the franchisee;

(d) the franchisee is restricted, directly or indirectly, in the determination of resale prices for the products or services which are the subject of the franchise;

(e) the franchisor prohibits the franchisee from challenging the validity of the intellectual property rights which form part of the franchise;

(f) one or both of the parties are obliged not to supply the products or services which are the subject of the franchise to end users because of their place of residence;

Article 6

1. The exemption provided for in Article 1 shall also apply to franchising agreements which fulfil the conditions laid down in Article 4 and include obligations restrictive of competition which are not covered by Articles 2 and 3 (2) and do not fall within the scope of Article 5, on condition that the agreements in question are notified to the Commission in accordance with the provisions of Commissions Regulation No 27 and that the Commission does not oppose such exemption within a period of six months.

2. The period of six months shall run from the date on which the notification is received by the Commission. Where, however, the notification is made by registered post, the period shall run from the date shown on the postmark of the place of posting.

3. Paragraph 1 shall apply only if:

(a) express reference is made to this Article in the notification or in a communication accompanying it, and

(b) the information furnished with the notification is complete and in accordance with the facts.

4. The benefit of paragraph 1 can be claimed for agreements notified before the entry into force of this Regulation by submitting a communication to the Commission referring expressely to this Article and to the notification, Paragraph 2 and 3 (b) shall apply *mutatis mutandis.*

5. The Commission may oppose the exemption. It shall oppose exemption if it receives a request to do so from a Member State within three months of the forwarding to the Member State of the notification referred to in paragraph 4. This request must be justified on the basis of considerations relating to the competition rules of the Treaty.

6. The Commission may withdraw the opposition to the exemption at any time. However, where the opposition was raised at the request of a Member State, it may be withdrawn only after consultation of the Advisory Committee on Restrictive Practices and Dominant Positions.

7. If the opposition is withdrawn because the undertakings concerned have shown that the conditions of Article 85 (3) are fulfilled, the exemption shall apply from the date of the notification.

8. If the opposition is withdrawn because the undertakings concerned have amended the agreement so that the conditions of Article 85 (3) are fulfilled, the exemption shall apply from the date on which the amendments take effect.

9. If the Commission opposes exemption and the opposition is not withdrawn, the effects of the notification shall be governed by the provisions of Regulation No 17.

Article 7

1. Information acquired pursuant to Article 6 shall be used only for the purposes of this Regulation.

2. The Commission and the authorities of the Member States, their officials and other servants shall not disclose information acquired by them pursuant to this Regulation of a kind that is covered by the obligation of professional secrecy.

3. Paragraph 1 and 2 shall not prevent publication of general information or surveys which do not contain information relating to a particular undertaking or associations of undertakings.

Article 8

The Commission may withdraw the benefit of this Regulation, pursuant to Article 7 of Regulation No 19/65/EEC, where it finds in a particular case that an agreement exempted by this Regulation nevertheless has certain effects which are incompatible with the conditions laid down in Article 85 (3) of the Treaty, and in particular where territorial protection is awarded to the franchisee and:

(a) access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar agreements established by competing manufacturers or distributors;

(b) the products or services which are the subject of the franchise do not face, within the contract territory, effective competition from identical goods or goods considered by users as equivalent in view of their characteristics, price and intended use;

(c) the parties prevent the end users, because of their place of residence, to obtain the products or services which are the subject of the franchise, within the contract territory;

(d) the franchisor uses its right to check the franchisee's inventory and accounts, or refuses its agreement to requests by the franchisee to move the contract installations or assign his rights and obligations under the franchise agreement, for reasons other than verifying that the franchisee abides by its obligations under the agreement.

Article 9

This Regulation shall enter into force on 1 January 1989.

It shall remain in force until 31 December 1999.

This Regulation shall be binding in its entirety and directly applicable in all Member States.