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STUDY GROUP ON FRANCHISING

Drafting Committee

Report on the meetings held in
Rome, 10 - 11 September 1997 and
Washington, 22 - 23 September 1997

(prepared by the Secretariat)

Rome, November 1997

The meeting of the *Drafting Committee* of the *Unidroit Study Group on Franchising* was divided into two parts. The first was held in Rome on 10 and 11 September, 1997, the second in Washington on 22 and 23 September, 1997. A list of participants is annexed to this report.

A number of general points were examined. The first of these concerned the title of the future Guide. The Secretariat had proposed "*Unidroit Guide to International Master Franchise Arrangements*" and this was accepted by the majority of the Drafting Committee.

As to terminology, the Drafting Committee was asked to consider the appropriateness of certain choices that had been made in the course of the editing. In the end, the following was approved:

- ◆ the term "third party" should be retained and preferred to "third person", but a definition should be included in the Glossary;
- ◆ the term "target country" should be avoided and "prospective host country" or "host country" used instead, depending on the context;
- ◆ "operational units" should be preferred to "franchise premises" and "franchised premises", but where either of the latter were used, which one was selected should depend on the context.

A general observation on the language of the draft Guide was that despite the editing that had already been done considerable linguistic differences still remained between the different chapters. It was therefore decided that an even more radical editing should be undertaken, with a view to eliminating linguistic discrepancies and differences in style between the chapters.

The policy adopted as to cross-referencing was also discussed. At present cross-references were made by referring to the number of the chapter, rather than to the number of the page concerned. The main reason for this was that prior to the final formatting of the Guide it was not possible to determine the number of the page on which a particular section would be found in the final publication. Furthermore, there were cases in which cross-references were best made by referring to the section concerned. The Drafting Committee therefore felt that a decision on the most appropriate form of citation should be made on a case-by-case basis.

The decision of the Study Group to include a Glossary in the Guide was recalled. In this connection it was decided that the authors of the chapters should be requested to provide the Secretariat with a list of the terms that they had used in their chapters and that they would like to see in the Glossary, together with a definition of each of the terms.

To a great extent the modifications proposed by the members of the Drafting Committee were in the form of deletions where they felt that a subject-matter either had been or was best dealt with in another chapter. A number of paragraphs were re-drafted, as it was felt that they were either insufficient or inaccurate. The present report lists only the major changes proposed by the members of the Drafting Committee.

INTRODUCTION

At the third meeting of the Study Group, held in April 1997, it had been decided that the statistical material contained in the Introduction should be made into an annex, as should the description of franchising in general. This re-arrangement of the material had left a rather odd distribution of the remaining material. What was left in the Introduction had therefore in the course of the editing been moved partly to Chapter 1 and partly to Annex 1, the Preface consequently becoming the new Introduction. No objections were raised to this new arrangement of the materials in the chapters.

Hesitations were expressed as to the paragraph beginning "[t]he most obvious reason", as it was felt that it might be interpreted as invoking the need for legislation and this was considered to be the wrong message. It was therefore suggested that a re-drafting of the paragraph would be necessary.

A majority of the Drafting Committee however felt the Introduction to be the exclusive competence of Unidroit, as, through the Unidroit Governing Council which would authorise its publication, the Guide was to be a publication endorsed by Unidroit.

CHAPTER 1 - FUNDAMENTAL CONCEPTS AND ELEMENTS

It was suggested that the titles of the sections dealing with the advantages and disadvantages of master franchising should be modified, as there was too much emphasis on the disadvantages, to the point where a reader might wonder for what reason master franchising should be resorted to. It was suggested that the sections should be divided into one on "Principal Benefits of Master Franchising" and one on "Common Problems associated with Master Franchising".

The section on "Franchise Agreements and other Agreements" was considered still to be too long. The sub-section on "Commercial Agency Agreements" should be considerably reduced and only a succinct description maintained. It was also suggested that transfer of technology agreements should not be separated from the general descriptions of licence agreements.

As regards the section dealing with "Other Forms of International Franchise Arrangements", it was agreed that, with the exception of the sub-section on "Area Representation Agreements", this whole section should be deleted, the forms of international franchise arrangements dealt with being instead inserted very briefly as examples after the first sentence of the section on "Methods to Franchise Internationally".

It was also felt that Section B "Expanding Internationally" should be reduced to five or six pages, if it were to be retained in this Chapter.

CHAPTER 2 - NATURE AND EXTENT OF RIGHTS GRANTED AND RELATIONSHIP OF THE PARTIES

There was a certain amount of discussion on the manner of presentation of the rights that were granted in a franchise. It was suggested that this section of the chapter should be structured so as to deal first with what was being granted (the use of the trademarks, the know-how of the system, the right to use the franchise system) and only thereafter with the limitations (exclusivity, territory, reservations of rights by the franchisor).

The section on trademarks was considerably shortened, in view of the fact that they were dealt with extensively in the chapter on intellectual property. A new section on "Other Intellectual Property Rights" was however added.

In relation to Section D ("Exclusivity v. Non-Exclusivity") it was suggested that what was already dealt with elsewhere should be deleted.

The title of Section E should, it was suggested, refer to the three-tiered *structure* of master franchise arrangements, rather than to the three-tier *relationship*.

Section H ("Problems with Several Sub-franchisors in the Same Territory") was felt to be problematic by a majority of the Drafting Committee and it was therefore suggested that it should be deleted.

CHAPTER 3 - TERM OF THE AGREEMENT AND CONDITIONS OF RENEWAL

In relation to the term of the agreement, it was suggested that the respective advantages and disadvantages of long terms and short terms should be examined in more detail, as they had not been sufficiently explained.

CHAPTER 4 - FINANCIAL MATTERS

Differences of opinion were expressed as to whether the content of Section A ("What provides Income?") corresponded to its title.

It was suggested that the order of Sections B (“The Sources of Income Available to Sub-Franchisors”) and C (“The Sources of Income of the Franchisor”) should be inverted, although the opinion was also expressed that it was too late to make such a change.

The last paragraph of the chapter, which dealt with the money paid into advertising funds, was a subject of some controversy as to its placing. One opinion was that it should remain in the chapter dealing with financial matters, whereas the majority felt that it was best moved to Chapter 8 and that at most a reference to this problem, with a cross-reference to Chapter 8, should be made in Chapter 4.

CHAPTER 5 - OBLIGATIONS OF THE FRANCHISOR

The title of the chapter was queried and the alternatives “The Role of the Franchisor”, “Range of Services provided by the Franchisor” and “Rights and Obligations of the Franchisor” suggested. It was also suggested that the title should remain as it stood, but that the chapter should stress at the beginning that it did not deal only with mandatory obligations.

The possibility that much of the first two paragraphs might be covered by Chapter 12 (“System Changes”) was aired.

A suggestion was also made that Section C (“Manuals”) should be moved to Chapter 19 (“Ancillary Documents”), although it was recalled that the Study Group in plenary had decided to split the old chapter on manuals and to place the section that dealt with manuals as a means to transmit know-how in the chapter on the obligations of the franchisor, and the section that dealt with manuals as a means to introduce modifications to the system in the chapter on system changes.

With reference to the section on “Assistance and Other Services”, the suggestion was put forward that training and assistance might conveniently be treated together, as training might be considered a form of assistance.

Of Section E (“Other Obligations of the Franchisor”), it was suggested that Sub-Sections I - III might be reduced to one sentence each. Section F (“Remedies for Non-Performance by the Franchisor”) might on the other hand be deleted as there was a whole chapter on remedies for non-performance. Certain hesitations were also expressed with reference to Section G (“Rights of the Franchisor”).

CHAPTER 6 - OBLIGATIONS OF THE SUB-FRANCHISOR

Sub-titles were inserted in this chapter, which was the only one not to have any.

In relation to Section B (“Pilot Operations”) it was suggested that it should be structured in such a manner that the first paragraph describes the pilot operations that are company-owned, and the second paragraph indicates that although pilot projects are normally conducted by the franchisor, they might be set up in such a way that the sub-franchisor participates.

It was suggested that the first paragraph of Section E (“Language Issues”) should be deleted as it referred to an obligation of the franchisor more than to one of the sub-franchisor.

Finally, it was suggested that the last two paragraphs of Section F (“Intellectual Property”) should be deleted if the question of improvements was dealt with in Chapter 12. In the first paragraph, on the other hand, restrictive covenants and confidentiality clauses should be mentioned with a cross-reference to Chapter 11 where they were dealt with more extensively.

CHAPTER 7 - THE UNIT SUB-FRANCHISE AGREEMENT

A suggestion was made that the second, third, fourth, fifth and sixth paragraphs of Section D (“Enforcement of the Sub-Franchise Agreements”) should be deleted, as the emphasis of the Guide was on the master franchise relationship and what was stated was in excess of what was necessary.

CHAPTER 8 - ADVERTISING AND THE CONTROL OF ADVERTISING

The addition of a new Section A, dealing with "Sources of Revenue for Advertising Expenditure", was suggested.

CHAPTER 9 - SUPPLY OF EQUIPMENT AND OTHER PRODUCTS

An alternative title suggested for this chapter was "Supply of Products and Equipment".

It was remarked that the emphasis of the chapter was still the sub-franchise relationship, rather than the master franchise relationship which was what the Guide was supposed to deal with.

The addition was suggested of a reference to the need to examine the legislation relating to competition to see if it had an impact on the provisions that required specific suppliers.

CHAPTER 10 - INTELLECTUAL PROPERTY

An alternative title suggested for this chapter was "Trademarks, Service Marks and Copyright".

It was decided to delete the references to industrial property as the concept of intellectual property covers also industrial property.

A suggestion was made to shorten the description of the considerations necessary if either of the options that involved a direct relationship between the franchisor and the sub-franchisees for the intellectual property were opted for. Of these paragraphs, paragraph (a) had already been covered, and paragraphs (b) and (c) belonged in the chapter on the three-tier relationship of master franchise agreements.

A certain shortening of the section dealing with the international conventions was also suggested.

CHAPTER 11 - KNOW-HOW AND TRADE SECRETS

Alternative titles suggested for this chapter were "Know-How (including Trade Secrets and Confidential information)", "Know-How, Non-Competition and Confidentiality" and "Other Intellectual Property Considerations".

CHAPTER 12 - SYSTEM CHANGES

This chapter caused a certain amount of controversy, in that it was felt that it was completely different from the rest of the Guide. It was suggested that it really did not fit the discussion on master franchise relationships, that it should deal with how a franchisor plans for change and with how changes in the master franchise agreement should be dealt with. What was missing was changes during the term of the agreement, changes proposed by the sub-franchisor and how they were handled and improvements to the system. In any event it was considered to be far too long in proportion to the rest of the Guide.

It was suggested that Sub-Section III of Section A and Sub-Sections IV and VI of Section E should be deleted.

CHAPTER 13 - SALE, ASSIGNMENT AND TRANSFER

It was suggested that this chapter was too short and needed a certain amount of integration. The transfer of assets was for example not dealt with and should perhaps be considered.

CHAPTER 14 - VICARIOUS LIABILITY, INDEMNIFICATION AND INSURANCE

The section on vicarious liability was felt to be written in a manner that might not be easily understood by lawyers who were not of common law extraction. An alternative formulation was therefore suggested.

CHAPTER 15 - REMEDIES FOR NON-PERFORMANCE

An alternative order was suggested for the contents of this chapter, namely to start with termination and then to add a couple of paragraphs on what remedies might be resorted to short of termination. The order of the sections would therefore be: termination by the franchisor, termination by the sub-franchisor, remedies available to either party short of termination, other remedies the franchisor might find it prudent to consider, and special considerations for the licensor/licensee relationship.

Opinions were divided on the extent to which pure business advice, as opposed to a mere illustration of legal considerations, should be offered by the Guide.

Section B, Sub-Section I had a further Sub-Section entitled "Termination of Development Right". There was a suggestion that the title should be broadened, another that it should be deleted altogether and a third that it should be kept as it was.

It was suggested that the phantom royalties mentioned were in reality a form of liquidated damages, but this was disputed.

A suggestion was made that bankruptcy should be added to this chapter, but it was observed that that would create certain problems as bankruptcy laws differed from country to country.

CHAPTER 16 - THE END OF THE RELATIONSHIP AND ITS CONSEQUENCES

The formulation of the last bullet point listing the possible ways in which the master franchise relationship may come to an end was the subject of some debate. As it was formulated, it was not understandable to all lawyers, as the phrase "accepting a repudiation by the franchisor", which referred to repudiatory breach, was not something that was known to all legal systems. It was therefore suggested to refer simply to "a legal remedy which is otherwise available under the relevant legal system", rather than to have the list the bullet point presently contained. This solution was however not found to be acceptable to all, others preferring to delete the bullet point altogether.

It was suggested that the first paragraph and bullet point of Section B, Sub-Section III, belonged in Chapter 15, and that they should be moved there if they were not there already.

It was suggested that an addition should be made to the second lot of bullet points that referred to the situation of the sub-franchise agreements in the case of termination of the master franchise agreement, although the objection was raised that that was not a substantial issue. It was also suggested that the bullet points already listed should be deleted, but again it was objected that they listed issues that did arise.

It was suggested that Section B, Sub-Section III, should be expanded to include also post-term confidentiality clauses, but it was objected that that was not really necessary as they were dealt with elsewhere.

A suggestion was made that Sub-Section IV should be deleted as it was unclear. It was objected that what it referred to was specific performance and that it should therefore remain.

The addition of a new Sub-Section VI on damages was proposed, although it was objected that that was not an effect of termination and should therefore not be included.

CHAPTER 17 - APPLICABLE LAW AND DISPUTE RESOLUTION

A certain shortening of the sections dealing with the Brussels and Lugano Civil Jurisdictions and Judgments Conventions was suggested, as they were regional European instruments.

CHAPTER 18 - GENERALLY USED CLAUSES

It was suggested that the sections dealing with clauses relating to currency conversion and with clauses relating to damages should be deleted, the first already being dealt with in the chapter on financial matters, the second in the chapter on termination.

CHAPTER 19 - ANCILLARY DOCUMENTS

A majority of the members of the Drafting Committee felt that this chapter was too long and that it dealt with matters that were, or should be, dealt with in other chapters. A number of deletions were therefore suggested. It was suggested that if the chapter was found to contain details that the other chapters did not contain, then these details should be moved to the other chapter concerned.

There was a suggestion that the whole section on manuals might be placed in this chapter, although it was objected that manuals were not ancillary documents.

CHAPTER 20 - REGULATORY REQUIREMENTS

It was suggested that Sub-Sections V ("Agents of the Franchisor"), VII ("Export of Profits and Currency Restrictions") and VIII ("Withholding Tax") might be deleted as their subject-matters were dealt with elsewhere. A number of deletions in other sub-sections were also suggested.

ANNEX I - FRANCHISING: GENERAL NOTIONS

It was generally felt that this Annex was useful, although doubts were expressed as to whether it was appropriate to retain it as an annex at the very end of the Guide.

ANNEX 2 - FRANCHISING IN THE ECONOMY

In the revision of the statistical material presently included in Annex 2, a certain amount of data that was not of the most recent had been kept as a complement to the table that contained the most recent information available. Although there was a certain amount of over-lapping, the data at times referred to factors that were not included in the table. It was felt that only the most recent information available should be retained where there was an over-lap with the table.

ANNEX 3 - LAWS AND REGULATIONS RELEVANT FOR FRANCHISING

It was observed that the most recent legislative developments in Korea and Indonesia should be added. Proposed legislation should on the other hand not be included.

It was recalled that at the meeting of the Study group the question of the up-dating of this Annex had been discussed. At the time it had been suggested that the problem might be solved by making this chapter into a regularly up-dated and replaced pocket-part. There were however certain difficulties with such an approach. The Secretariat therefore proposed that this particular Annex should be made available on Unidroit's Internet web site and that it should be up-dated regularly on that site. An indication of the address of the site should be given in the published version of the Guide. This would permit those who acquired the Guide to be always up-to-date on the legislative situation throughout the world. This suggestion was accepted by the Drafting Committee, Mr Zeidman indicating that a co-operation might be established with his law firm for this purpose.

UNIDROIT STUDY GROUP ON FRANCHISING

Drafting Committee, Rome, 10 - 11 September 1997

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