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STUDY GROUP ON FRANCHISING

Model Franchise Disclosure Law

Text of the Preliminary Draft as adopted by the Study Group at its
Fourth Session, held in Rome from 9 to 10 December 1999,
with Draft Explanatory Report prepared by the UNIDROIT Secretariat

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DRAFT UNIDROIT MODEL FRANCHISE DISCLOSURE LAW

PART I: TEXT OF THE DRAFT MODEL LAW

ARTICLE 1 (SCOPE OF APPLICATION)

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

ARTICLE 2 (DEFINITIONS)

For the purposes of this law:

affiliate of the franchisor means a legal entity which directly or indirectly controls or is controlled by the franchisor, or is controlled by another party who controls the franchisor;

development agreement means an agreement under which a franchisor in exchange for direct or indirect financial compensation grants to another party the right to acquire more than one franchise of the same franchise system;

disclosure document means a document containing the information required under this law;

franchise means the rights granted by a party (the franchisor) authorising and requiring another party (the franchisee), in exchange for direct or indirect financial compensation, to engage in the business of selling goods or services under a system designated by the franchisor which includes know-how and assistance, prescribes in substantial part the manner in which the franchised business is to be operated, includes significant and continuing operational control by the franchisor, and is substantially associated with a trademark, service mark, trade name or logotype designated by the franchisor. It includes:

(A) the rights granted by a franchisor to a sub-franchisor under a master franchise agreement;

(B) the rights granted by a sub-franchisor to a sub-franchisee under a sub-franchise agreement;

(C) the rights granted by a franchisor to a party under a development agreement

For the purposes of this definition “direct or indirect financial compensation” shall not include the payment of a bona fide wholesale price for goods intended for resale;

[franchisee includes a sub-franchisee in its relationship with the sub-franchisor and the sub-franchisor in its relationship with the franchisor;]

franchise agreement means the agreement under which a franchise is granted;

franchised business means the business conducted by the franchisee under a franchise agreement;

[franchisor includes the sub-franchisor in its relationship with its sub-franchisees];

master franchise means the right granted by a franchisor to another party (the sub-franchisor) to grant franchises to third parties (the sub-franchisees);

material fact means any information that can reasonably be expected to have a significant effect on the decision to acquire the franchise;

misrepresentation means a statement of fact that the person making the statement knew or ought to have known to be untrue at the time the statement was made;

omission means the failure to state a material fact of which the person making the statement was aware at the time the statement ought to have been made;

and

sub-franchise agreement means a franchise agreement concluded by a sub-franchisor and a sub-franchisee pursuant to a master franchise.

ARTICLE 3

(EXEMPTIONS FROM OBLIGATION TO DISCLOSE)

No disclosure is required:

(A) in case of the grant of a franchise to a person who has been an officer or director of the franchisor or of an affiliate of the franchisor for at least six months immediately before the signing of the franchise agreement;

(B) in case of the assignment or other transfer of a franchisee's rights and obligations under an existing franchise agreement, where the assignee or transferee is bound by the same terms as the assignor or transferor;

(C) in case of the grant of a franchise to sell goods or services to a person who has been engaged in the same or a similar business for the previous two years, if the sales of the franchise, as reasonably anticipated by the parties at the time the franchise agreement is entered into, will not during the first year of the relationship exceed 20% of the total aggregate sales of the franchisee's combined business;

(D) in case of the grant of a franchise pursuant to which the franchisee commits to a total investment in excess of [X];

(E) in case of the grant of a franchise to a franchisee who together with its affiliates has a net worth in excess of [Y];

(F) in case of the renewal or extension of a franchise on the same conditions;

- (G) where the total of the payments contractually required to be made every year by the franchisee to the franchisor is less than [Z]; or
- (H) if the transaction is pursuant to an offer directed by the franchisor to only one person or entity for the entire jurisdiction.

ARTICLE 4
(FORMAT OF DISCLOSURE DOCUMENT)

- (1) Disclosure must be provided in writing.
- (2) The franchisor may use any format for the disclosure document, provided that the information contained therein meets the requirements imposed by this law.

ARTICLE 5
(DELIVERY OF DISCLOSURE DOCUMENT)

- (1) A franchisor must give every prospective franchisee a disclosure document, to which the proposed franchise agreement must be attached, at least fourteen days before the earlier of
 - (A) the signing by the prospective franchisee of any agreement relating to the franchise, with the exception of agreements covered by Article 7; or
 - (B) the payment by the prospective franchisee of any fees relating to the franchise.
- (2) The disclosure document must be updated within [X] days of the end of the franchisor's fiscal year. Where there has been a material change in the franchisor or relating to the franchise business of the franchisor, the disclosure document must be updated within [Y] days of the occurrence of that material change.

ARTICLE 6
(INFORMATION TO BE DISCLOSED)

- (1) The franchisor shall provide the following information in the disclosure document:
 - (A) the legal name and address of the franchisor;
 - (B) any name other than the legal name under which the franchisor carries on or intends to carry on business;
 - (C) the address of the principal place of business of the franchisor if different from that indicated in lit. (a);
 - (D) the legal form of the franchisor;
 - (E) a description of the business experience of the franchisor, including:
 - (i) the length of time during which the franchisor has run a business of the type to be operated by the franchisee; and

(ii) the length of time during which the franchisor has offered franchises for the same type of business as that to be operated by the franchisee;

(F) the names, business addresses, positions held, business experience and qualifications of any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise;

(G) relevant details relating to any criminal convictions or any finding of liability in a civil action involving franchises or other businesses relating to misrepresentation, unfair or deceptive acts or practices or comparable actions of:

(i) the franchisor;

(ii) any affiliate of the franchisor who is engaged in franchising; and

(iii) any of the persons indicated in lit. (f)

for the previous five years, as well as the relevant details relating to any pending actions of the same nature;

(H) relevant details concerning any bankruptcy, insolvency or comparable proceeding involving the franchisor and/or the legal entities and persons indicated in lit. (f) for the previous five years;

(I) the total number of franchisees in the network;

(J) the names, addresses and phone numbers of the franchisees whose outlets are located nearest to the proposed outlet of the prospective franchisee, but in any event of not more than 50 franchisees in the country of the franchisee and/or contiguous countries, or, if there are no contiguous countries, the county of the franchisor;

(K) information about the franchisees that have ceased to be franchisees of the franchisor during the three fiscal years before the one during which the franchise agreement is entered into, with an indication of the reasons for which the franchisees have ceased to be franchisees of the franchisor. Disclosure of the following categories would fulfil the disclosure requirement: voluntarily terminated or not renewed; reacquired by purchase by the franchisor; otherwise reacquired by the franchisor; refused renewal by the franchisor; terminated by the franchisor;

(L) the following information regarding the franchisor's intellectual property relevant for the franchise, in particular trademarks, patents, copyright and software:

(i) the application for registration and/or the registration, if any, and

(ii) litigation or other legal proceedings, if any, which could have a material effect on the franchisee's legal right, exclusive or non-exclusive, to use the intellectual property under the franchise agreement in the national territory in which the franchised business is to be operated;

(M) information on goods and/or services that the franchisee is required to purchase or lease, indicating

(i) which, if any, have to be purchased or leased from the franchisor, affiliates of the franchisor or from a supplier designated by the franchisor;

(ii) those for which the franchisee has the right to recommend other suppliers for approval by the franchisor;

(iii) information on pricing practices with regard to those goods and/or services; and

(iv) information as to the treatment of revenue or other benefits that may be directly or indirectly received by the franchisor or any of the affiliates of the franchisor from any supplier of goods and/or services to the franchisee;

(N) financial matters, including:

(i) (a) any estimates of the franchisee's total initial investment and of the minimum working capital required for the first year of operation;

(b) financing offered or arranged by the franchisor, if any;

(c) audited or otherwise independently verified financial statements of the franchisor, including balance sheets and statements of profit and loss, for the previous three years. If the most recent audited financial statements are as of a date more than 180 days before the date of delivery of the disclosure document, then unaudited financial statements as of a date within 90 days of the date of delivery of the disclosure document;

(ii) (a) If information is provided to the prospective franchisee by or on behalf of the franchisor concerning the historical or projected financial performance of outlets owned by the franchisor, its affiliates or franchisees, the information must:

(aa) have a reasonable basis at the time it is made;

(bb) include the material assumptions underlying its preparation and presentation;

(cc) state whether it is based on actual results of existing outlets;

(dd) state whether it is based on franchisor-owned and/or franchisee-owned outlets; and

(ee) indicate the percentage of those outlets that meet or exceed each range or result.

(b) If the financial information referred to in the preceding subparagraph is provided, the franchisor must state that the levels of performance of the prospective franchisee's outlet may differ from those contained in the information provided by the franchisor.

(2) The following information shall also be included in the disclosure document. However, where the information is contained in the franchise agreement, the franchisor may in the disclosure document merely make reference to the relevant section of the franchise agreement:

(A) a description of the franchise to be operated by the franchisee;

(B) the term and conditions of renewal of the franchise;

(C) a description of the initial and on-going training programmes;

(D) the nature and extent of exclusive rights granted, if any, including exclusive rights relating to territory and/or to customers;

- (E) the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination;
 - (F) the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination;
 - (G) the limitations imposed on the franchisee, if any, in relation to territory and/or to customers;
 - (H) in-term and post-term non-compete covenants;
 - (I) any reservation by the franchisor of the right
 - (i) to use, or to license the use of, the trademarks covered by the franchise agreement;
 - (ii) to sell or distribute the goods and/or services authorised for sale by the franchisee directly or indirectly through the same or any other channel of distribution, whether under the trademarks covered by the agreement or any other trademark;
 - (J) the initial franchise fee;
 - (K) other fees and payments, including any gross-up of royalties imposed by the franchisor in order to offset withholding tax;
 - (L) restrictions or conditions imposed on the franchisee in relation to the goods and/or services that the franchisee may sell; and
 - (M) the conditions for the assignment or other transfer of the franchise.
- (3) Where the franchise is a master franchise, the sub-franchisor must, in addition to the items specified in paragraphs (1) and (2), disclose to the prospective sub-franchisee the information on the franchisor that it has received under paragraphs (1)(A), (E), (H), and (2)(D), (G) and (I) of this article, as well as inform the prospective sub-franchisee of the situation of the sub-franchise agreements in case of termination of the master franchise agreement and of the content of the master franchise agreement.

ARTICLE 7
(CONFIDENTIALITY)

The franchisor may require the prospective franchisee to sign a statement acknowledging the confidentiality of the information relating to the franchise or to the franchisor.

ARTICLE 8
(ACKNOWLEDGEMENT OF RECEIPT OF DISCLOSURE DOCUMENT)

As a condition for its signing the franchise agreement, the franchisor may require the prospective franchisee to acknowledge in writing the receipt of the disclosure document.

ARTICLE 9
(LANGUAGE OF DISCLOSURE DOCUMENT)

The disclosure document must be written in a clear and comprehensible manner in the official language of the principal place of business of the prospective franchisee or in the mother-tongue of the franchisee.

ARTICLE 10
(REMEDIES)

(1) If the disclosure document is not delivered at all or is not delivered within the period of time established in Article 5, the franchisee is entitled to terminate the franchise agreement and/or any pre-contractual arrangement, unless the franchisor can prove that at the time of the conclusion of the franchise agreement the franchisee had the information necessary to make an informed decision.

(2) If the disclosure document contains a misrepresentation or if there is an omission of a material fact required to be disclosed under Article 6, the franchisee is entitled to terminate the franchise agreement unless the franchisor can prove that the franchisee did not rely on the misrepresentation or that the investment decision of the franchisee was not influenced by the omission.

(3) The right to terminate the franchise agreement in accordance with paragraphs (1) and (2) of this article must be exercised no later than the earlier of:

(A) two years of the act or omission constituting the breach upon which the right to terminate is based; or

(B) one year of the franchisee becoming aware of facts or circumstances that reasonably indicate that a breach entitling the franchisee to terminate has occurred; or

(C) within 90 days of the delivery to the franchisee of a written notice providing details of the breach accompanied by the franchisor's then current disclosure document.

(4) The right to terminate in accordance with paragraphs (1) and (2) of this article does not derogate from any other right the franchisee may have under the applicable law.

ARTICLE 11
(TEMPORAL SCOPE OF APPLICATION)

This law applies with respect to a franchise agreement entered into after the entering into force of this law, as well as to the renewal or extension of a franchise agreement entered into before the entering into force of this law.

PART II: DRAFT EXPLANATORY REPORT

I. BACKGROUND TO THE DRAFT MODEL LAW

1. The origins of the *Draft Model Franchise Disclosure Law* go back to a proposal made by the Canadian member of the Governing Council of UNIDROIT in 1985. In those years UNIDROIT was engaged in the preparation of what were to become the *UNIDROIT Conventions on International Financial Leasing* and *International Factoring*,¹ and the Council member saw the preparation of uniform rules on franchising as a natural development in the process of preparation of uniform rules for the new types of agreement that were emerging at the time. There had furthermore been a number of instances of sharp practices within Canada that it was feared might spread also in other countries with the international expansion of franchising.

2. Acting on this proposal, the Governing Council requested the UNIDROIT Secretariat to draw up a preliminary report with a view to deciding whether franchising should be included in the Work Programme of the Institute. This preliminary study was presented to the Governing Council at its 65th session in 1986.² At the time, franchising was still in its infancy in Europe and hardly used or heard of in other parts of the world, with the exception of North America where it had originated. The information gathered was therefore not vast, particularly when compared to the information available today.

3. It was therefore with a view to eliciting further information that the Governing Council requested that the report, together with a questionnaire, be submitted to Governments, professional circles and recognised experts in the field. At its 67th session the Governing Council was seized of a survey of the answers to the questionnaire.³ Following an examination of this report, and taking into consideration also the imminent adoption of what was to become the franchising Block Exemption Regulation by the European Communities,⁴ the Governing Council decided to postpone any decision on future work on franchising and requested the Secretariat to submit a paper examining the actual terms used in franchise agreements to its 68th session (1989).⁵

4. For a certain number of years thereafter the main activity on the part of UNIDROIT in the field of franchising was the monitoring of both national and international developments. There were a number of reasons for this. A prime factor was that at the time there was still a quite considerable opposition among the legal advisers of the operators (mainly franchisors) to the development of an international instrument. It was therefore felt advisable to await developments to see whether the need for an international instrument that had been perceived by the proponent was found to be less urgent than anticipated, taking into consideration the sharp practices that had led to the proposal in the first place and how these sharp practices had been dealt with, or whether the developments in the industry had not

¹ Adopted in Ottawa in 1988.

² See C.D. 65 - Doc. 12, also published as Study LXVIII - Doc. 1, UNIDROIT 1986.

³ See C.D. 67 - Doc. 9, also published as Study LXVIII - Doc. 2, UNIDROIT 1988.

⁴ Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, in OJ EEC L 359/46 of 28 December 1988.

⁵ See C.D. 68 - Doc. 11, also published as Study LXVIII - Doc. 3, UNIDROIT 1989.

instead occasioned an even greater need. Internal, organisational reasons also played their part in the decision to await developments, in that other projects that had started earlier were given higher priority.

5. At its 72nd session, held in June 1993, the Governing Council of the Institute decided that the time had come for a *Study Group on Franchising* to be set up. The terms of reference of the Study Group as defined by the Governing Council were to examine different aspects of franchising and in particular disclosure of information between the parties before and after the conclusion of a franchise agreement and the effects of master franchise agreements on sub-franchise agreements, in particular in case of termination of the master franchise agreement. The Study Group was also requested to make proposals to the Council regarding any other aspects of franchising that might lend themselves to further action by the Institute and, as soon as practicably possible, to indicate the form of any instrument or instruments that might be envisaged.

6. The first meeting of the Study Group was held from 16 to 18 May 1994. The Group examined both national and international franchising, analysing the problems that existed and considering whether these problems could be solved by an international instrument prepared by UNIDROIT.

1. *INTERNATIONAL FRANCHISING*

7. In relation to international franchising the Study Group focused its attention on master franchise agreements, which it recognised as the vehicle most commonly adopted for international expansion. It considered in particular

- ◆ the nature of the relationship between the master franchise agreement and the sub-franchise agreements;
- ◆ problems associated with the three-tier structure of the relationship between franchisor, sub-franchisor and sub-franchisees, particularly in relation to termination;
- ◆ the settlement of disputes;
- ◆ applicable law and jurisdiction; and
- ◆ disclosure.

8. The Study Group reached the conclusion that the items examined did not lend themselves to being dealt with in an international convention. Although nothing would actually prevent the elaboration of an international convention, the proposed subject-matters would require a considerable number of mandatory provisions. The stringent nature of an international convention would furthermore not permit adaptations that some States might feel to be essential for the adoption of the convention. The combination of the mandatory nature of the provisions and the binding nature of the convention would not augur well for the adoption of the convention by the different nations of the world. The utility of such an instrument might therefore seriously be questioned. A broad consensus was instead reached on the fact that a guide would serve a useful purpose for international franchising and would be of invaluable assistance to business community and legal advisers alike.

2. DOMESTIC FRANCHISING

9. As concerns domestic franchising, the Study Group concentrated on the question of disclosure. In this context it examined

- ◆ the experiences of countries which have, or have attempted, some form of regulation in this area;
- ◆ the role of franchise associations; and
- ◆ the importance of the codes of ethics adopted by those associations.

10. The Study Group reached a lesser degree of consensus on the question of whether any initiative should be undertaken in relation to domestic franchising, although there was consensus on the fact that the information gathered in the process of the preparation of the legal guide to international franchising would be of considerable assistance in clarifying the issues involved.

11. As regards the subject-matter to be dealt with, the Study Group observed that one of the characteristics of franchising was that a large number of areas of law were involved, a majority of which had already been regulated. It would be extremely difficult to justify adopting a discipline specifically for franchising in relation to, for example, contract law, choice of law and jurisdiction, or intellectual and industrial property law. The Group noted that the States that had adopted legislation on franchising had adopted either disclosure legislation, which was limited to the regulation of the information that a franchisor should provide a prospective franchisee with in order to permit the prospective franchisee to make an informed decision as to whether or not to acquire the franchise, or what are known as relationship laws, which regulate specific terms of the franchise relationship (questions such as, for example, whether the franchisee has a statutory right to renew the agreement, and whether the franchisee has a right to cure when he/she breaches the contract). In some countries the legislation was often furthermore linked to a registration requirement, which considerably increased the burden that was placed on the franchisor. In general terms the Group felt that the experience of States with relationship laws had been negative, whereas experience with disclosure legislation had on the whole been positive. In consideration of the above, the Group concluded that the areas in which a regulation would be possible and effective were to all intents and purposes limited to one, namely disclosure, although the issues raised as a result of what could be termed the three-tier structure of master franchise arrangements, such as for example the effects of the termination of the master franchise agreement or of its coming to an end on sub-franchise agreements, should also be considered. Furthermore, these were areas that were of more direct relevance to franchising and which might indeed be considered peculiar to it and should therefore be more closely considered in relation to the possibility of drafting legislation.

12. As regards the instrument to be adopted, the Study Group felt that if the decision were to be taken that an instrument should be prepared, then a model law would be more appropriate than an international convention. The Study Group therefore in the end decided to recommend to the Governing Council that the question of the possible preparation of an international instrument for domestic franchising be deferred, and that it be taken up again once work on the guide had been completed.

13. In February 1998 the Governing Council of UNIDROIT authorised the publication of the *UNIDROIT Guide to International Master Franchise Arrangements*, which appeared in

September 1998. At that same session, the Council accepted a proposal by the Secretariat of the organisation that the Study Group on Franchising should proceed with the preparation of a model law.

14. The proposal submitted by the Secretariat was based upon the growing interest in the preparation of an international legal instrument demonstrated by members of the Study Group, even by a number of members who had been sceptical or even contrary to the initiative when it had first been proposed in 1986. This growth of interest was largely due to the increasing attention devoted to franchising by legislators and the consequent proliferation of franchise laws. The members of the Study Group felt that the legislation that had been adopted in a number of countries demonstrated a certain lack of understanding of franchising and risked severely hampering its development. Consequently, they felt that the adoption of similar legislation in other countries should, if possible, be avoided. If UNIDROIT prepared a model law, which by definition would be a balanced instrument considering the nature of the organisation and the guarantees offered by its past history, this would make available to legislators an instrument that would promote and not hamper the development of franchising.

15. In consideration of the above, the Governing Council accepted the proposal put forward by the Secretariat and decided to authorise the Study Group on Franchising to proceed with the preparation of a model law. The proposal was finally endorsed by the General Assembly of the Institute at its 52nd session on 27 November 1998, in the context of the approval of the Work Programme for the triennial period 1999 – 2001.

16. Following the decisions taken by the Governing Council and General Assembly of the Institute, a Drafting Committee of the Study Group on Franchising met in Rome from 14 to 16 January 1999 to prepare a first draft of the future model law. This first draft was submitted to the Governing Council of the Institute at its 78th session in April 1999, and was examined in detail by the Study Group in Plenary at its Fourth Session on 9 and 10 December 1999.

17. The discussions at the Fourth Session of the Study Group opened with a consideration of the decision to prepare a model law. Although a majority of the members of the Study Group were clearly in favour of the preparation of such an instrument, a couple of members questioned the decision, suggesting instead that UNIDROIT could make a more valuable contribution to the development of franchising by assisting Governments in a consultant capacity. While not discarding this idea, the majority of the Study Group in the end came out strongly in favour of the adoption of a model law, in part for the reasons specified above, and in part in consideration of the fact that the recent trend towards legislation was not likely to abate and that it therefore made good sense to elaborate a uniform instrument.

18. At its 79th session (April 2000) the Governing Council was seized of the text of the draft as revised by the Study Group at its Fourth Session. The Fifth Session of the Study Group, at which the draft text of the model law, plus the Explanatory Report that is to accompany the text, will be finalised with a view to their submission to a Committee of Governmental Experts, is due to be held in December 2000.

II. GENERAL CONSIDERATIONS

1. THE SCOPE OF APPLICATION OF THE MODEL LAW

19. The territorial scope of application of the Model Law is specified in Article 1, and the temporal scope of application in Article 11 (see below). As regards the subject-matter dealt with, the Model Law is limited to pre-contractual disclosure. The Model Law does not deal with the relationship between the parties, nor does it deal with the consequences of termination.

20. The Study Group at its Fourth Session examined proposals that had been tabled for the broadening of the scope of application of the Model Law. There was however a clear majority in favour of limiting the model law to pre-contractual disclosure and against dealing with questions relating to the relationship between the parties in view of the inherent difficulties in establishing a uniform regulation of such relationships. This consideration was due to the numerous differences that exist between different franchises, not only between trade sector, but also between franchise systems within the same trade sector. While there are a number of provisions that are to be considered essential to any franchise relationship and that are normally present in the franchise agreement, it is next to impossible to state that they have to be couched in certain terms or have to contain certain elements. On the other hand, it is possible in a disclosure law to require that information regarding those terms be disclosed to the prospective franchisee. This will indirectly result in a requirement that the agreement or disclosure document contain those elements. In favour of disclosure-only legislation was also the realisation that, while constituting what apparently is only a small part of franchising, disclosure is crucial. It was observed that a major issue in the majority of cases dealing with franchising is the allegation by the franchisee that the franchisor has not provided the franchisee with adequate information prior to the conclusion of the agreement.

21. The Model Law is intended to apply to both domestic and international franchising, and to different types of franchise agreement, such as traditional unit agreements, master franchise agreements and development agreements. The Model Law is also intended to cover any new forms of franchise arrangements that might develop in the future.

22. The Model Law does not require disclosure on the part of the franchisee, only on the part of the franchisor. The reason for this is that the experience and economic size of franchisors, which permit them to have access to legal counsel, do not make it necessary to provide franchisors with the same degree of protection as franchisees. Furthermore, as is the case with other entrepreneurs, it is normal business practice for franchisors to ask prospective franchisees for information. Franchisors will naturally want to be able to assess the capabilities and reliability, as well as the financial conditions, of prospective franchisees before entrusting them with the development of a business that carries their trade name.

23. The instrument opted for by the Study Group is a Model Law and not an international convention. Of the different types of instrument that are possible, international conventions are the most rigid. The intention with an international convention is that it more or less as it stands should become part of the national law of the Contracting States. The possibility to vary the contents of conventions is very limited, as States will only be able to make reservations to specific provisions, and even that may not be possible if the provisions of the convention itself specify that no reservation is possible. How international conventions

are incorporated into the national legislation will vary from country to country, as will the position of international conventions in the hierarchy of laws. The main advantage of stringent instruments such as international conventions is the fact that they provide for as great a legal certainty as is reasonably possible precisely because the texts adopted are incorporated into the legislation of the Contracting States essentially without modification. The other face of the medal is that States may consider certain modifications to be imperative, and that as Contracting States they would not be able to make these changes to the text. The result may be that instead of ratifying or acceding to the convention, they take inspiration from it, just as if it were a model law, and introduce the changes they need.

24. Model laws are more flexible than international conventions. In this case the intention is from the beginning to permit States to make the changes they consider to be necessary to cater for the specific needs of the country. A further advantage is that it is possible to include in a model law a number of provisions that the experts preparing the law deem to constitute the most appropriate solution to a specific problem, even if some States may want to modify the suggested provision when they take inspiration from it for their national legislation. Whether or not a State does modify a model law, and the extent to which it does so, will depend on the reasons for which it has decided to introduce legislation. The price to pay for this greater flexibility is of course less uniformity, as a number of provisions will differ from country to country. The underlying principles should however remain the same.

25. The requirements of the Model Law as presently drafted, in particular Article 6, are listed in great detail. How detailed the law should be was discussed at length by the Study Group, the members from the civil law countries having a distinct preference for a shorter text. In the end, the importance of each single item that was discussed was such that the text of Article 6 remained rather longer than a uniform law text would normally be. This Explanatory Report to the Model Law illustrates the purposes of the single provisions and explains the reasons for which the Study Group considers disclosure of a certain item important. The legislature of each individual country will decide whether or not it is necessary to include a particular item, or whether it is for instance already adequately covered by other legislation applicable in the country.

2. THE ADDRESSEES OF THE MODEL LAW

26. The different instruments that may be adopted have different addressees. Model laws, as international conventions, are clearly addressed to legislators. The *Model Franchise Disclosure Law* is in the first instance designed to assist the legislators of countries that have decided to adopt legislation for the first time. However, it cannot be excluded that it may eventually replace existing legislation, should the national legislator decide that the law of his or her country is unsatisfactory for any particular reason and that the regulation proposed by the Model Law is to be preferred.

27. There is one further use that the Model Law might have, which is additional to the main purpose but which may still be of considerable importance, and that is that it may serve as a point of reference when an evaluation has to be made as to whether or not a franchisor has provided adequate information. The model law lists a considerable number of items that are of importance to a prospective franchisee in the evaluation of the franchise it is considering buying, and the fact that the Model Law lists these items draw them to the attention of the judges that have to evaluate whether or not adequate disclosure has been

made. It will thereafter be up to the judge to evaluate where, in the particular case at hand, one or other of the items should have been disclosed.

3. PURPOSE OF THE MODEL LAW

28. It is not always easy to identify exactly why a particular subject-matter is the subject of attention on the part of the national legislator. The most obvious reason for the introduction of legislation is a desire to take care of problems that have arisen, to redress the balance between the parties to an agreement where the necessary balance either does not exist or has been distorted, and of course to make sure that abuses either do not occur or, where they have occurred, that they do not occur again. Other motivations cannot however be excluded, such as economic motivations (the desire to protect domestic industry or to levy fees or taxes, for instance).

29. In the legislative process the national legislators will naturally weigh a number of different elements, including an analysis of the problem that the intended legislation is to deal with and whether or not there is legislation that can and is used to deal with the problem, and of course the effectiveness of that existing legislation and whether or not the courts apply it. One important question is the impact that the proposed legislation will have, whether it will only deal with the problem or whether it might have also other, collateral effects. The legislation that is adopted must be suited to the problem at hand. This holds true irrespective of the origin of the proposed legislation, be it domestic or international.

30. The purpose of the Model Law is to provide legislators with an instrument that they may consult and use as a model or blueprint should they deem it appropriate when they consider adopting legislation in their country. It is a model, and therefore in no way binding. Should the legislators of a State decide to make use of this Model Law, they will be completely free to decide which provisions to adopt. They may omit those that they deem incompatible with their legal system or inappropriate in their country, and they may modify those that they feel require modification to be acceptable. The comments that accompany each article specify the reasons for which a particular provision has been adopted, and in some cases explain how they should be interpreted. Where a provision is self-explanatory, no comment has been provided.

III. COMMENTARY ON THE PROVISIONS OF THE DRAFT MODEL LAW

31. The Model Law has a total of eleven articles. As it is a disclosure law, all the provisions are linked to disclosure, even if they go beyond merely listing the items to be disclosed. Article 1 specifies the territorial scope of application of the Model Law, and Article 11 the temporal scope of application. Article 2 provides definitions of terms used in the Model Law. Article 3 lists a number of cases in which a franchisor is exempted from the obligation to disclose. Article 4 deals with the format of the disclosure document, Article 5 with its delivery, Article 8 with the acknowledgement on the part of the franchisee that he/she has received the document, and Article 9 with the language of the disclosure document. Article 6 is the core provision of the Model Law and lists the items of information that a franchisor must disclose to a prospective franchisee. Article 7 deals with the confidentiality of the information the prospective franchisee receives relating to the franchise or the franchisor and Article 10 deals

with the remedies available to the franchisee in case of breach on the part of the franchisor of his/her duty to disclose.

1. *ARTICLE 1 - SCOPE OF APPLICATION*

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

1. the Model Law is intended to apply to franchises (which are defined in Article 2), and therefore not to other types of agreement;
2. it is to apply to franchises granted for the operation of one or more franchised businesses, which clearly indicates that the franchises covered include both simple unit franchises and master franchise or development arrangements; and
3. it is to apply in the national territory of the State adopting the Model Law. In other words, it applies to franchises that are operated in the national territory irrespective of whether they originate as a domestic franchise or as a foreign franchise. It is not intended to apply to franchises that are exported from a country that has adopted the Model Law into a country that has not. The last words of the Article are left in square brackets to permit States to formulate the scope of application provision in a manner consistent with the formulation normally adopted in their country.

2. *ARTICLE 2 - DEFINITIONS*

“affiliate of the franchisor”

33. The definition of “affiliate” corresponds to the standard definition of affiliate used for corporate law purposes. The Model Law uses the term “affiliate” to cover also those who in other legislation are called “associates”.

“development agreement”

34. Development agreements are agreements that are used to develop large territories. They are often used as an alternative to master franchising. The distinction between the two is that in master franchising the franchisor grants the sub-franchisor (also called the “master franchisee”) the right not only to operate franchise outlets itself, but also to grant sub-franchises to sub-franchisees in the territory the franchisor has granted it the right to develop. The sub-franchisor therefore to all intents and purposes acts as franchisor in that territory. There are in such cases normally no relations between the franchisor and the sub-franchisees, except in exceptional cases (for instance for the purposes of the granting of intellectual property rights in some countries). In the case of development agreements, the franchisor grants the other party (in English normally called the “developer”) the right to develop more than one franchise in the territory. Often, there will be a framework development agreement covering the arrangement as a whole, and separate unit agreements for each unit.

“disclosure document”

35. The information that a franchisor must provide a franchisee with is normally included in a document that is separate from the franchise agreement, even if they are handed over together. Although the Model Law does not state so explicitly, to facilitate

consultation on the part of the prospective franchisee the information to be disclosed should by preference be contained in one document, as opposed to several, although items such as financial statements might usefully be annexed to that document.

“franchise”

36. The definition of a franchise, with the description of its essential elements, is intended to make it clear that for the purposes of the Model Law a franchise is what is known as a “business format franchise”, and not what is known as an “industrial franchise”, which has been defined as concerning the manufacturing of goods and as consisting in manufacturing licences based on patents and/or technical know-how combined with trademark licences, a “distribution franchise”, defined as concerning the sale of goods, or a “service franchise”, defined as concerning the supplying of services.⁶

37. In the definition of a franchise, “direct or indirect financial compensation” is qualified by the proviso at the end of the definition, which states that it shall not include the payment of a *bona fide* wholesale price for goods intended for resale. The intention is to exclude instances in which a simple sale of goods, as opposed to the granting of a franchise system, is involved. The need to make this distinction is the result of the proliferation in some countries of brand merchandising. In brand merchandising there are degrees of control over the operation of the business, but these controls are not such as to make the outlet a franchise, even if a certain amount of confusion might arise as they may include, for example, the business being permitted to place the franchisor’s trade name above the door, assistance on the part of the franchisor, or even a certain amount of control over how the outlet is operated. The qualifying term “financial” indicates that the form of compensation envisaged here is monetary, and not non-monetary.

38. The specification “selling goods or services” is intended to make it clear that cases in which services are not provided against financial compensation, in other words are not “sold”, are not covered by the Model Law.

39. Reference is made in the definition to “a system designated by the franchisor”. This terminology is used with a view to including cases in which the franchisor is not the owner of the trademarks or distinctive signs involved. There may, for instance, be cases in which the franchisor has designed a system, such as a fast food operation, in which a drink of a particular brand is an important part, even if the franchisor has nothing to do with its production and does not own the trademark. This idea is repeated further on in the definition, which specifies that the system designated by the franchisor “is substantially associated with a trademark, service mark, trade name or logotype designated by the franchisor”.

40. Know-how is a fundamental element of the franchise system. The term designates the knowledge acquired and experience gained by the franchisor in the years he/she has been engaged in the business of the franchise. It is the know-how that is transmitted to the franchisee that is particularly precious and permits the franchisee to engage successfully in the business without having to make unnecessary mistakes and without having to make unnecessary investments.

⁶ See Commission Regulation (EEC) No 4087/88 on the application of Article 85(3) of the Treaty to categories of franchise agreements, in OJ EEC L359/46 of 28 December 1988, Recitals 3 and 4.

41. Assistance is in most cases offered to the franchisee by the franchisor. The amount of assistance, whether the assistance is only the assistance required initially to start the business, or whether it will continue over time, with a more or less active role played by the franchisor and the franchisor's staff, will vary from franchise to franchise. There is no rule determining how much assistance is necessary, each franchise has its own requirements. In fact, there are even franchises in which no assistance, or no assistance apart from the initial assistance, is offered by the franchisor. The definition simply refers to assistance to indicate that also franchises that do not offer continuing assistance are covered by the Model Law.

42. The requirement that the system prescribe "in substantial part the manner in which the franchised business is to be operated" and "include significant and operational control by the franchisor" is intended to make it clear that what is intended is not merely the controls exercised over the use of the trademarks that would be exercised in a trademark licence agreement, but controls that the franchisor exercises over the very nature of the business, for example, controls over the hours of operation of the outlet.

43. The definition of a franchise further specifies that it includes the rights granted by a franchisor to a sub-franchisor under a master franchise agreement, the rights granted by a sub-franchisor to a sub-franchisee under a sub-franchise agreement and the rights granted by a franchisor to a party under a development agreement. The Model Law uses the word "party" in relation to the development agreement because of the near impossibility to translate the term "developer" into other languages.

"franchise agreement"

44. The definition of "franchise agreement" should be read together with the definition of "franchise". Considering that "franchise" includes also the rights granted under master franchise, sub-franchise and development agreements, the term "franchise agreement" includes also master franchise agreements, sub-franchise agreements and development agreements.

"material fact"

45. The Model Law defines a "material fact" by the effect it might have on the decision of the franchisee to acquire the franchise. Whether or not a certain item of information is considered to be material will therefore depend on the answer to the question would the franchisee have acquired the franchise even if he or she had been aware of the information? If the answer is yes, then in all likelihood the information will not be considered material, whereas if the answer is no, it probably will be.

"misrepresentation"

46. "Misrepresentation" is a concept that is well-known in the common law legal systems, less so in the civil law. As formulated the definition catches not only untrue statements wilfully made, but also statements that have been made without sufficiently careful consideration on the part of the person making the statement. The Model Law refers to the "person making the statement" because although in most cases that person will be the franchisor, statements may also be made, or information provided, by affiliates or officers or directors of the franchisor. It should be noted that the statements referred to are statements of material facts, not statements regarding matters of little or no importance, and that

“material facts” have been defined as information that can reasonably be expected to have a significant effect on the decision of the franchisee to acquire the franchise. The effects of negligent, or intentionally wrongful, statements of material facts may be quite considerable, not only because the franchisee might have been induced to acquire the franchise as a result of the misrepresentation, a decision he/she might not have taken had he/she been aware of the true state of affairs, but also because the franchisee might suffer loss or damage as a consequence. Article 10(2) of the Model Law therefore provides that a franchisee who suffers as a result of a misrepresentation is entitled to terminate the franchise agreement, unless the franchisor can prove that the franchisee did not rely on the misrepresentation. It should be noted that the right of the franchisee to terminate does not derogate from any other right the franchisee might have under the applicable law, such as for example claiming damages for the loss and/or damage he/she has suffered (Article 10(4)).

“omission”

47. The reasoning underlying the definition of “omission” is the same as that underlying the definition of “misrepresentation”: the effects of an omission may include the franchisee being induced to acquire a franchise he/she might not otherwise have acquired, with the franchisee suffering loss or damage as a consequence. Article 10(2) therefore provides that if there is an omission of a material fact in a disclosure document the franchisee is entitled to terminate the franchise agreement unless the franchisor can prove that the investment decision of the franchisee was not influenced by the omission. Again, the right of the franchisee to terminate does not derogate from any other right the franchisee might have under the applicable law, such as for example claiming damages for the loss and/or damage he/she has suffered (Article 10(4)).

3. *ARTICLE 3 - EXEMPTIONS FROM OBLIGATION TO DISCLOSE*

48. The purpose of the pre-contractual disclosure of information is to permit a prospective franchisee to take an informed decision as to whether or not to acquire a franchise. There are however a number of cases in which disclosure is not necessary, and these are listed in Article 3.

49. *Paragraph (A)* excludes disclosure where the prospective franchisee has been an officer or director of the franchisor or of an affiliate of the franchisor for at least six months immediately before the signing of the franchise agreement. The reason for this is evident: as an officer or director of the franchisor or of an affiliate of the franchisor, which as defined in Article 2 is a legal entity which directly or indirectly controls or is controlled by the franchisor, or is controlled by another party who controls the franchisor, the prospective franchisee can be expected to have all the information he/she needs to take an informed decision. If the list of items to be disclosed listed in Article 6 is examined, it is clear that an officer or director will have access to such information.

50. *Paragraph (B)* excludes disclosure in the case of an assignment or other transfer of a franchisee’s rights and obligations where the assignee or transferee is bound by the same terms as the assignor or transferor; where, in other words, the only change is the name of the franchisee who signs the agreement. The reason for this is that in such cases a franchisee who transfers or assigns a franchise agreement will pass everything over to the new franchisee, including the information he/she received at the beginning of his/her

franchise relationship with the franchisor, and if nothing is to change in the relationship except one of the parties, new disclosure is not required.

51. *Paragraph (C)* refers to what are known as “fractional franchises”. These are franchises in which the franchisee is not new to the situation, but has been active in the business concerned, or in a similar business, for a certain period of time (in the Model Law for the previous two years), and where the franchisee is intending to take over will represent no more than a certain percentage of his/her business; where, in other words, the franchisee is simply adding another line of products to his/her business. The provision also gives the parameters for deciding whether or not the conditions for exemption are fulfilled, namely if the sales of the franchise, as reasonably anticipated by the parties at the time the franchise agreement is entered into, will not during the first year of the relationship exceed 20% of the total aggregate sales of the franchisee’s combined business, i.e. if the expected sales from the proposed franchise will be less than 20% of the total sales of the franchise together with the sales of the business of the franchisee to which the franchise is added.

52. *Paragraphs (D) and (E)* are intended to exempt franchisees of substance, who either make a substantial investment, or who, together with their affiliates, have a net worth in excess of a certain amount. The net worth referred to is the real net worth of the person according to the principles of accounting that apply in his/her country. The figures in the provisions are intentionally left blank, as what is a large investment in one country may not be a large investment in another, and what is a large investment in one industry may not be large in another. For example, the investment needed for a retail outlet is considerably lower than that required for a hotel. Franchises in which large investments are required are invariably heavily negotiated, and it is to be expected that entrepreneurs who invest large sums and who negotiate deals of such financial importance do not require the protection of this disclosure law. It should be noted that the large investments which are intended are those where there is an effective commitment on the part of the prospective franchisee. In summary, it may therefore be said that the total investment aimed at in *Paragraph (D)* is an investment that suggests a person of such level of sophistication and knowledge that he/she has access to the advice of legal counsel and does not require the protection of this law, whereas the person considered in *Paragraph (E)* is one who by virtue of his/her net worth is assumed to have such a level of sophistication and prior business experience that he does not require the protection of this law.

53. Cases of renewal or extension of a franchise on the same terms are exempted in *Paragraph (F)*. In these cases the relationship continues without modification, and as the franchisee therefore has all the information he/she needs as he/she is already committed to the relationship, there is no need for disclosure.

54. At the opposite end of the spectrum to the exemptions for large investments and large franchisors, is the exemption contained in *Paragraph (G)* for cases where the total of the payments that the franchisee is contractually required to make every year to the franchisor is less than a certain amount. The intention is to exempt very small arrangements. A time requirement has been inserted to prevent abuse, i.e. to ensure that the franchisor does not circumvent the disclosure requirement by requiring very small payments for a period of time sufficient to benefit from the exemption, subsequently requiring substantial payments that permit him to recover all that he has forfeited during the initial period. Again, in *Paragraph (G)* as in *Paragraphs (E) and (F)* it is not possible to specify a specific sum, as the conditions vary from country to country and from industry to industry.

55. The last case exempted by Article 3 is the case of the isolated transaction. There are cases in which companies that do not franchise in their country of origin decide to do so when they expand abroad. If they decide to grant just one franchise in a jurisdiction, irrespective of whether it is a unit franchise or a master franchise, they are exempt from the disclosure requirement (*Paragraph (H)*). This exemption is not applicable if there is a chance that other franchises might be granted in the future. The reason for this exemption is that transactions of this nature, particularly master franchises, are normally intensively negotiated.

4. *ARTICLE 4 - FORMAT OF DISCLOSURE DOCUMENT*

56. *Paragraph (1)* requires disclosure to be provided in writing. The need for written disclosure is both natural and evident, not only because the prospective franchisee must be in a position to examine and evaluate the information he/she is given, and he/she would be able to do so only with the greatest difficulty if the disclosure were oral, there is a need for both parties to be able to provide evidence of disclosure, and this evidence will exist only if the disclosure is written. This does not mean that the disclosure must be paper-based: Article 6(1) of the *Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (UNCITRAL)* states that “[w]here the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference”, where a data message is “information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy” (Article 2(a)). The provision included in the UNCITRAL Model Law represents modern international standards. Whether or not individual States are prepared to accept that also electronic documents fulfil the writing requirement will vary from country to country.

57. *Paragraph (2)* indicates that any format may be used for the disclosure document, provided that the information the document contains meets the requirements imposed by the Model Law. There are a number of institutions, both national and multi-national, that have adopted specific forms that must be followed and complied with for the disclosure requirements to have been met. This provision is intended to permit franchisors who have used such forms to utilise them to fulfil the requirements imposed by the Model Law with a minimum of expense being incurred and effort being invested in making the necessary adaptations.

5. *ARTICLE 5 - DELIVERY OF DISCLOSURE DOCUMENT*

58. *Paragraph (1)* indicates when the disclosure document must be given to the prospective franchisee. The specified time-period is a compromise between the twenty days that some national legislations require and the seven or five days required by others. Fourteen days are a time-period that permits the prospective franchisee to examine the document and also to obtain expert advice. Two moments in time are identified as triggering the disclosure obligation: the signing by the prospective franchisee of any agreement relating to the franchise, with the exception of agreements covered by Article 7, and the payment by the prospective franchisee of any fees relating to the franchise.

59. The agreements covered by Article 7 are confidentiality agreements. These are excluded as a trigger for the duty to disclose as they might operate very early on in the preliminary talks between the franchisor and the prospective franchisee, before the

prospective franchisee has made any commitment. The reference to “any agreement relating to the franchise” is a reference to any document that makes the prospective franchisee commit to an investment relating to the franchise. If there is no commitment on the part of the prospective franchisee, then the franchisor should not be under an obligation to transmit the detailed information that a disclosure document contains to the prospective franchisee, not the least because this information includes also confidential information that the franchisor should not have to risk being made public. As, however, a certain amount of confidential information must of needs be communicated to the prospective franchisee in the course of the preliminary talks, it is legitimate for the franchisor to require that the prospective franchisee keep this information confidential and that to this purpose a confidentiality agreement is entered into by the negotiating parties without the duty to disclose being triggered.

60. *Paragraph (2)* introduces the requirement that the disclosure document be updated within a certain number of days of the end of the franchisor’s fiscal year. The end of the fiscal year is a natural point in time, as the franchisor, as any other businessperson, will be required to fulfil the auditing obligations applicable in his/her country of origin, and audited financial statements are required by the Model Law to be attached to the disclosure document (Article 6(1)(N)(i)(c)). However, although the updating is tied to the end of the franchisor’s fiscal year and therefore to the production of annual financial statements, the formulation is left flexible, as the applicable rules differ from country to country. In any event, the intention is to avoid placing a burden on the franchisor that would be disproportionate to the benefit gained by the franchisee. Paragraph (2) however also provides that where there has been a material change in the franchisor or relating to the franchise business of the franchisor the disclosure document must be updated within a certain number of days of the occurrence of that material change. This proviso has been added to cover cases where material, or highly significant, changes occur that a prospective franchisee should be informed of but that for reasons of time have not been covered in the normal updating of the disclosure document. For example, if the franchisor in month ten after the updating changes the supplier of a product that is a cornerstone of the franchise system, the prospective franchisee should be informed of this change. Again, the time-frame within which the updating of the disclosure document must be carried out in such cases is left open and for the national authorities to decide. It should be noted that the obligation to update the disclosure document following the occurrence of a material change applies also where the material change occurs between the end of the franchisor’s financial year and the signing of the franchise agreement. In other words, if a prospective franchisee receives a disclosure document and a material change occurs subsequently, but before the franchise agreement is concluded, the prospective franchisee is entitled to receive a new disclosure document that reflects the situation after the material change has occurred.

61. In a number of countries the future parties to an agreement discuss a proposed agreement, introduce the changes they agree upon, and then again examine the draft as agreed upon, with the waiting period established for its examination starting to run again every time a modification is made to the draft. The most common situation in the case of franchising is that the prospective franchisee negotiates with a franchisor to obtain better conditions or concessions. The prospective franchisee will therefore be fully aware of what he/she has been successful in obtaining from the franchisor and will not need to receive a new agreement for consideration. Rather than introduce a chain of negotiation and waiting periods, Article 4(1) of the Model Law provides that the proposed franchise agreement must be attached to the disclosure document.

6. ARTICLE 6 - INFORMATION TO BE DISCLOSED

62. *Article 6* divides the information to be disclosed into two distinct groups: the first contains the information that the disclosure document *must* contain (Article 6(1)), the second indicates further information that the disclosure document *should* contain, but which may be omitted if the contract itself provides it in adequate detail (Article 6(2)). In other words, *Paragraph (1)* refers to information that is normally not included in the franchise agreement, most of which is information regarding the franchisor and the franchise network and does not relate to the rights and duties of the parties. *Paragraph (2)*, on the other hand, requires disclosure of information that is normally dealt with in the franchise agreement itself, as in most cases it is of the greatest importance to the relationship. The reason it is listed in this Article despite the fact that it will in most cases be contained in the agreement itself, is that it is not always adequately dealt with in the agreement.

63. Together, the two paragraphs require the franchisor to provide information on all the component parts of what is normally considered a franchise: the intellectual property, the control rights of the franchisor and the rights and obligations of the parties, as well as any other information that a prospective franchisee might require to make an informed decision as to the franchise. In addition, *Paragraph (3)* provides that in the case of a master franchise the sub-franchisor must not only provide the prospective sub-franchisee with information relating to itself, it must also pass on certain information relating to the franchisor that it has received from the franchisor.

64. The list of items of information to be disclosed contained in Article 6 is very detailed. The purpose of this is to ensure to the greatest extent possible that the attention of the users of the Model Law is drawn to most, if not all, items of importance in an evaluation of a franchise. The amount of detail that the legislator referring to the Model Law will include in any proposed legislation will depend on the drafting style of the country as well as on other legislation that already applies to franchise agreements in that country and that may cover any particular item listed in Article 6.

65. *Sub-Paragraphs (A), (B) and (C)* relate to the name and address of the franchisor. The “legal name” referred to in *Sub-Paragraph (A)* is the official name of the franchisor, i.e. if the franchisor is a company that requires registration, the name that is registered. The “legal address” is the address at which the franchisor is registered. The “name” referred to in *Sub-Paragraph (B)* is the name under which the business is conducted, irrespective of whether or not it is registered in a register, the intention being to make it possible for the prospective franchisee to research the franchisor company to discover whether, for example, it has any liens against it or not.

66. *Sub-Paragraph (C)* requires disclosure of the address of the principal place of business of the franchisor if it is different from the legal address under *Sub-Paragraph (A)*. This is relevant in particular in an international situation, if the franchisor has an independent branch or subsidiary in the foreign country. In this case the address of that branch or subsidiary would be the legal address whereas the headquarters of the franchisor in its country of origin would be the principal place of business.

67. The “legal form” referred to in *Sub-Paragraph (D)* refers to the structure of the franchisor. It is important for the franchisee to know whether the franchisor is, for example, a

limited liability company or a corporation, as this will give a clear indication of the liability of the franchisor vis-à-vis the franchisee and the clients of the franchisee.

68. *Sub-Paragraph (E)* requires the business experience of the franchisor to be disclosed, including the length of time the franchisor has run a business of the type to be operated by the franchisee (*Sub-Paragraph (E)(i)*) and the length of time the franchisor has offered franchises for the same type of business as that to be operated by the franchisee (*Sub-Paragraph (E)(ii)*). The difference between these two items may be illustrated by an example in which *Sub-Paragraph (E)(i)* refers to the length of time the franchisor has been active in the restaurant business in general, and *Sub-Paragraph (E)(ii)* refers to the length of time the franchisor has run a pizza restaurant in particular.

69. *Sub-Paragraph (F)* requires disclosure of information regarding any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise. The information to be disclosed is not only the name, business address, and the position such persons hold (Executive Director, Chief Executive Officer, etc.), it is also their business experience and qualifications. The term "senior management responsibilities" indicates the persons who exercise business functions. The official titles and the exact responsibilities involved will vary from country to country.

70. *Sub-Paragraph (G)* requires information to be provided on both criminal convictions and findings of liability in civil actions of the franchisor, any affiliate of the franchisor who is engaged in franchising and any of the persons indicated in *Sub-Paragraph (F)*, that is to say any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise. What the *Sub-Paragraph* requires to be disclosed are "relevant details [...] relating to misrepresentation, unfair or deceptive acts or practices or comparable actions". This means that if there are convictions or findings of liability that do not relate to misrepresentation, unfair or deceptive acts or practices or comparable actions, such as for example fining for throwing chewing gum paper on the ground, that need not be disclosed. What is important is information that might be important for an assessment of the character and general honesty of the people listed in the provision. That is the reason for which the requirement relates not only to franchises, but also to other businesses: a franchisor may have been engaged in another type of commercial enterprise before becoming a franchisor, and might have been found guilty of fraud. It is important for a prospective franchisee to be informed of such a conviction, as it would be very important for him/her to be able to decide whether or not he/she wants to trust the franchisor.

71. The time period relevant for the disclosure requirement under *Sub-Paragraph (G)* is five years. Furthermore, if there are any pending charges or actions, these must also be disclosed - again, if they relate to misrepresentation, unfair or deceptive acts or practices or comparable actions.

72. It should be noted that the term "finding of liability" used in *Sub-Paragraph (G)* is intended to refer also to permanent injunctions, but not to interim or temporary injunctions.

73. In view of the importance of information on criminal convictions and findings of liability in civil actions in the evaluation of the character, honesty and reliability of the franchisor, there is no geographic limitation to the provision. This means that the franchisor must disclose such information irrespective of what country it relates to. In this context it should however be borne in mind that the information should always relate to

misrepresentation, unfair or deceptive acts or practices or comparable actions, which is a natural limitation given that an honest franchisor is not likely to be guilty of such offences. Furthermore, in countries that are geographically close decisions rendered in one country are highly likely to be of importance also in the neighbouring countries. The apparently unlimited scope of Sub-Paragraph (G) is to be considered together with Article 10(2), which deals with remedies for the omission of a material fact. An act which might be considered an offence in one culture, but which might not be an offence in another culture, need not necessarily be considered to be a material fact, in which case there would be no liability if it were omitted. In general, however, if the conviction or finding of liability relates to misrepresentation, unfair or deceptive acts or practices or comparable actions, however they are defined, this would be considered material and would therefore have to be disclosed.

74. *Sub-Paragraph (H)* requires the disclosure of information on any bankruptcy, insolvency or comparable proceeding involving the franchisor and/or the legal entities and persons indicated in Sub-Paragraph (F) for the previous five years. The “comparable proceedings” referred to in the provision include any State-run or State-controlled proceeding, any proceeding under the supervision of a State court, but not purely private reorganisations such as management buy-outs. The importance for a prospective franchisee to receive information of this nature is evident, again with a view to evaluating the reliability and honesty of the franchisor.

75. *Sub-Paragraphs (I), (J) and (K)* relate to the franchisees of the network. *Sub-Paragraph (I)* requires the disclosure of the total number of franchisees in the network. In this case the “network” is the network at world level. In the case of a master franchise the sub-franchisor would be required to disclose the number of franchisees in the world as a whole in compliance with Paragraph (3) of Article 6, according to which the sub-franchisor is required to pass on the information specified in the provision that he has received from the franchisor to the sub-franchisees, and that information includes also information on the total number of franchisees.

76. *Sub-Paragraph (J)* requires the franchisor to provide the prospective franchisee with the names, addresses and phone numbers of the franchisees whose outlets are located nearest to the proposed outlet of the prospective franchisee in the country of the franchisee and/or contiguous countries or, if there are no contiguous countries, in the country of the franchisor. The Sub-Paragraph provides a limitation in the information to be provided, in that it states that the maximum number of names and addresses to be given should in any event not be more than fifty. The purpose of this provision is to enable the prospective franchisee to contact franchisees already in the network to ask them for information about their experience with the franchise and the franchisor. Where there are few or no franchisees in the country of the prospective franchisee, it is important for the prospective franchisee to be able to contact franchisees who are located in other countries, particularly if the other countries are close and are not too different culturally. If there are no franchisees in countries close to the country of the prospective franchisee, then it might be useful for the prospective franchisee to be able to contact franchisees in the country of origin of the franchisor. For prospective franchisees it is important to have information as to the location of the franchisees of the network, particularly those close to the proposed outlets for their franchises, as this will give some indication of the assistance that the franchisor is able to provide. By extension, it is even more important for the prospective franchisee to be able to ascertain the assistance the franchisor actually provides to franchisees in the network, and

also what relations exist between the members of the network and in particular between the members of the network and the franchisor.

77. *Sub-Paragraph (K)* follows on from *Sub-Paragraph (J)*, in that it requires disclosure of information about franchisees that have ceased to be franchisees of the franchisor during the three fiscal years before the one during which the franchise agreement is entered into. The reasons for which they are no longer franchisees must be given. As the provision itself states, it is sufficient if the franchisor discloses which category the former franchisees fall into. The categories listed are: voluntarily terminated or not renewed by the franchisee; reacquired by purchase by the franchisor; otherwise reacquired by the franchisor; refused renewal by the franchisor; terminated by the franchisor. Information of this kind, even if succinct and without further detail, enables the prospective franchisee to understand if the franchisees are satisfied with the franchise they have acquired and with the franchisor, as franchisees that are not satisfied are unlikely to renew their agreements. Similarly, a franchisor who terminates large numbers of franchisees might be problematic to deal with, and it is important for the franchisee to know this. Furthermore, the type of policy that the franchisor company adopts towards its franchisees in terms of whether or not it systematically reacquires franchises and runs them thereafter as company-owned outlets, is important for the prospective franchisee to be informed of.

78. The franchisor's intellectual property is fundamental to the franchise relationship. It is the franchisor's trademark that the public recognises and it is the trademark that, together with the other intellectual property, including the know-how, make up the franchise system. As franchisees pay the franchisor to be able to benefit from the intellectual property relevant to the franchise, it is very important for the prospective franchisee to be informed of the exact limits of his/her rights, and also to know the rights, and the limits to the rights, of the franchisor or, in the case of master franchising, of the sub-franchisor. *Sub-Paragraph (L)* therefore requires the disclosure of information regarding the franchisor's intellectual property relevant for the franchise, in particular trademarks, patents, copyright and software. In particular, it requires the disclosure of information relating to the application for registration and/or the registration, if any, of the intellectual property, and to litigation or other legal proceedings which could have a material effect on the franchisee's legal right to use the intellectual property under the franchise agreement in the national territory in which the franchised business is to be operated.

79. This information is extremely important, in particular in countries in which the registration procedure takes a long time. If the franchisor grants franchises before the intellectual property (in particular the trademark) has been registered, then if the registration is refused, a situation could arise whereby the franchisor and all the franchisees of the network do not have the right to use the trademark. The consequence might be that the business is forced to change trademarks, with all the related expenses and with the risk of losing credibility with the public.

80. The provision refers to litigation or other legal proceedings "which could have a material effect on the franchisee's legal right [...] to use the intellectual property". This formulation is intended to cover cases where a franchisor or franchisee has brought an action to prevent a third party from using a trademark and has lost. The franchisor's right to use the mark would not be affected, but his/her business might be, as he/she would be unable to stop the third person using the mark.

81. *Sub-Paragraph (M)* deals with a very important aspect of the franchise relationship, namely the supply arrangements. The provision requires the franchisor to provide information relating to the goods and/or services that the franchisee is required to purchase or lease. It divides these goods and services into two categories and requires the disclosure document to specify which goods and services fall into which category. The categories are goods and/or services that have to be purchased or leased from the franchisor, affiliates of the franchisor or from a supplier designated by the franchisor (*Sub-Paragraph (M)(i)*), and those for which the franchisee has the right to recommend other suppliers for approval by the franchisor (*Sub-Paragraph (M)(ii)*). The reason this distinction is made, is that there are products, goods or services that are either characteristic of the franchise and are only available from the franchisor, its affiliates, or suppliers that the franchisor has a particular relationship with, or that are so linked to the quality of the goods or services presented to the public that the franchisor needs to be able to control that they are obtained from controlled sources, and that on the other hand, there are goods or services for which it is not as essential to use the sources of supply specified in *Sub-Paragraph (M)(i)*, but for which a certain control is necessary. In these latter cases it is sufficient for the franchisee to obtain the approval of the franchisor for these alternative sources of supply. If the franchisor is satisfied that the alternative suppliers meet the quality standards necessary for the franchise, then the franchisor would be able to refuse approval with difficulty. There is of course a third category, which is not mentioned in the *Sub-Paragraph*, and that is those goods for which it is neither necessary for the franchisee to purchase them from the franchisor or a supplier designated by the franchisor, nor to obtain the approval of the franchisor. These are goods or services that are not characteristic of the franchise or for which it is not necessary for the franchisor to maintain a certain control. This would be the case, for example, with the vegetables used in a restaurant business, for which the franchisee must use the normal care of a professional in his/her line of business, but for which a control on the part of the franchisor is not necessary.

82. It should be observed that in *Sub-Paragraph (M)(i)* the Model Law uses the term “purchase” also for services. This is to make clear that the services are not offered free of charge, but have to be paid for by the customers.

83. In addition to information on the goods or services, the franchisor is required to disclose also information on pricing practices relating to those goods or services (*Sub-Paragraph (M)(iii)*). The pricing practices referred to include rebates that the franchisor receives from suppliers. Similarly, *Sub-Paragraph (M)(iv)* indicates that the franchisor must provide information as to the treatment of revenue or other benefits that he/she or any of his/her affiliates might directly or indirectly receive from any supplier of goods and/or services to the franchisee. The provision states “directly or indirectly” as the franchisor might, for example, be getting an equity interest in a business instead of money.

84. *Sub-Paragraphs (M)(iii)* and *(iv)* are intended to provide the franchisee with information enabling him/her to make a proper evaluation of the ties that exist between the franchisor or the franchisor’s affiliates and the suppliers. If a franchisee is required to purchase from a particular supplier, he/she wants to know whether or not the terms he/she is offered are fair, and in order to make this evaluation he/she will want to be able to compare the price he/she is charged by the franchisor, the franchisor’s affiliates and other suppliers designated by the franchisor with the prices available freely on the market for equivalent goods and services. If the franchisor receives rebates from the designated suppliers, this might also be a factor that the prospective franchisee will want to take into consideration

when he/she evaluates the correspondence of what he/she is offered to how much the franchisor earns from him/her.

85. *Sub-Paragraph (N)* deals with financial matters. The items which the Model law requires to be disclosed are listed in a number of sub-paragraphs, the first of which lists “any estimates of the franchisee’s total initial investment and of the minimum working capital required for the first year of operation” (*Sub-Paragraph (N)(i)(a)*). Information on the franchisee’s expected total investment and the minimum working capital required is clearly important for the prospective franchisee to be able to evaluate whether or not he/she can afford to acquire the franchise. A period of one year was chosen because one of the issues is working capital, not merely the out-of-pocket expenses in building, acquiring or leasing a property or building equipment. What is intended is the reasonable estimates that the franchisor is able to make as to the working capital requirements.

86. *Sub-Paragraph (N)(i)(b)* requires disclosure of financing opportunities offered or arranged by the franchisor. There are franchisors who set up special financing schemes that they make available to their franchisees, or who come to an agreement with a bank under which the bank agrees to provide the franchisees of the franchisor with financing at particularly advantageous rates. If such schemes are available, the Model Law requires that they be disclosed.

87. *Sub-Paragraph (N)(i)(c)* requires the disclosure of audited or otherwise independently verified financial statements of the franchisor, including balance sheets and statements of profit and loss, for the previous three years. If the most recent financial statements are more than 180 days old at the time of the delivery of the disclosure document, then unaudited financial statements as of a date within 90 days of the date of delivery of the disclosure document should be disclosed. Normally these documents are attached to the disclosure document as annexes.

88. The term “audited or otherwise independently verified financial statements” is adopted in the Model Law in recognition of the fact that requirements differ considerably from country to country, in fact, in certain jurisdictions audited financial statements are not required at all. In some countries, for example, statements are “audited” if they are audited by a certified public accountant. In others, the corporations can have a director in charge of auditing, what in French is known as a “*commissaire aux comptes*”, the duties of such an officer differing from country to country. In others yet again corporations may have an official in charge, who however is not an employee even if the position he holds is similar to that of a director of the company. This official is legally independent from the executive officers.

89. Not only does the type of “auditing” differ from country to country, also the requirements for different types of business differ. For example, in some countries small and medium-size entrepreneurs are not obliged to make an official audit as only undertakings on the stock market are under an obligation to have their statements audited every year. Furthermore, in the case of companies that franchise for the first time, these might not have audited financial statements and might therefore be unable to supply statements for the previous three years.

90. For a prospective franchisee what is important is to be able to evaluate the financial solidity of the franchisor company and to assess the development and development potential of the network. The franchisee will therefore require statements that have a certain

official character, even if they have not been audited by a public official. This is the reason the Model Law uses the terminology “audited or otherwise independently verified”. Furthermore, the prospective franchisee requires information that is as up to date as possible, even if the laws of the different countries usually require financial statements to be made once a year. For this reason the provision requires unaudited financial statements not older than 90 days to be supplied to the franchisee when the audited financial statements are more than 180 days old.

91. A number of franchisors provide prospective franchisees with statistical information on the financial performance of outlets owned by the franchisor, the franchisor’s affiliates or the franchisees of the network. Such information can relate to both the financial performance of the past and to estimated or projected performance of the future (so-called “earnings claims”). As prospective franchisees often rely on such figures, also because a prospective franchisee will normally want to know how much he/she can be expected to earn before deciding whether or not to invest in the franchise, *Sub-Paragraph (N)(ii)(a)* provides that such information must have a reasonable basis at the time it is made (*Sub-Paragraph (N)(ii)(a)(aa)*); must include the material assumptions underlying its preparation and presentation (*Sub-Paragraph (N)(ii)(a)(bb)*); must state whether it is based on actual results of existing outlets (*Sub-Paragraph (N)(ii)(a)(cc)*); must state whether it is based on franchisor-owned and/or franchisee-owned outlets (*Sub-Paragraph (N)(ii)(a)(dd)*); and must indicate the percentage of those outlets that meet or exceed each range or result (*Sub-Paragraph (N)(ii)(a)(ee)*).

92. The reason for which the above requirements have been included under Sub-Paragraph (N) is that whatever the basis upon which the estimates presented by the franchisor have been made, the prospective franchisee is entitled to know what form of selectivity has been used, so as to place him/her in a position to decide whether or not to rely on, or pay attention to, the information the franchisor has provided him/her with. The requirements under Sub-Paragraphs (N)(ii)(a)(dd) and (ee) have been included because very often the outlets owned by the franchisor perform better than the outlets performed by franchisees, and if this is the case then the prospective franchisee is entitled to know. If the outlets of the franchisor perform 100 and those of the franchisees only perform 50 or less, this is relevant to the prospective franchisee, as is information on the income ranges of the franchisor-owned outlets compared with those of the franchisee-owned outlets.

93. Not all franchisors provide information on projected earnings, but where they do, it is important for the prospective franchisee to be made aware of the fact that no matter what the projections state, there is nothing to guarantee that he/she will be able to reach those levels of earnings. For this reason *Sub-Paragraph (N)(ii)(b)* states that if the financial information referred to in Sub-Paragraph (N)(ii)(a) is provided, the franchisor must state that the levels of performance of the prospective franchisee’s outlet may differ from those contained in the information provided by the franchisor.

94. As indicated above, *Paragraph (2)* of Article 6 lists a number of items of information which must be disclosed in the disclosure document unless they have been adequately dealt with in the franchise agreement, in which case the franchisor may in the disclosure document simply make reference to the relevant section of the franchise agreement. The information listed in this Paragraph is fundamental to the franchise and is therefore in most cases present in the franchise agreement itself, the question is whether or not it is adequate.

95. The Model Law does not specify what kind of treatment would be adequate for the purposes of this provision, as there is no absolute criterion that may be applied: what is adequate in one agreement may not be so in another. The Model Law has therefore opted for a greater flexibility which will permit the judges seized of the different cases to make a case-by-case assessment on the basis of the facts and circumstances of the case.

96. The first two items of the list are a description of the franchise to be operated by the franchisee (*Sub-Paragraph (A)*) and the term and conditions of renewal of the franchise, where “term” indicates the length of time for which the franchise has been granted (*Sub-Paragraph (B)*).

97. *Sub-Paragraph (C)* requires the franchisor to provide a description of the initial and on-going training programmes. The reason this item has been included in this Sub-Paragraph is that unfortunately franchisors often do not provide adequate information, even if they do provide some. As the franchisee pays sometimes large sums for the training programmes he/she has to follow, it is fair if the franchisor informs him/her of such matters as, for example, the duration of the training course, both in terms of days per week and hours per day, the cost of the courses, whether or not continuing training is compulsory and if so how often.

98. *Sub-Paragraph (D)* relates to the nature and extent of any exclusive rights that are granted by the franchisor to the franchisee, including exclusive rights relating to territory and/or to customers. In franchise relationships the exclusive rights granted by a franchisor to the franchisees of the network are normally considered fundamental. One very important exclusive right relates to territory. In this case the franchisor grants the franchisee the exclusive right to develop a certain territory, and undertakes not to grant other franchisees the right to open outlets within that territory. The provision refers to the nature and extent of the exclusive rights granted, because the territorial exclusivity might not relate only to the granting of rights to other franchisees, it might also extend to the franchisor himself, in that the franchisor might undertake not to open any company-owned outlets in that territory. Furthermore, the franchisor might also undertake not to sell the products or services being franchised through other types of distribution outlets, such as the local department store (see below, *Sub-Paragraph (I)(ii)*). The words “nature and extent” indicate that the franchisor should specify whether the exclusive right he/she grants extends also to include these other possibilities.

99. In accordance with *Sub-Paragraph (G)* the franchisor should furthermore disclose whether or not the exclusive rights he/she has granted are limited in any way. For example, the exclusive right that relates to the customers will normally take the form of an exclusive right to sell to customers in a particular territory and not to others. In other words, a franchisee within a territory would not be able to accept a telephone order from a customer in the territory of another franchisee. The franchisor should therefore specify what limitations a franchisee has as regards the customers to which he/she is entitled to sell. Other limitations that the franchisor should disclose to the prospective franchisee are restrictions or conditions that the franchisor imposes on the franchisee in relation to the goods and/or services that the franchisee may sell, for example whether the franchisee is under an obligation to sell only products with the franchisor’s trademarks, or whether he/she is entitled to sell also a number of other products, or whether the franchisee is prohibited from selling products of a certain brand (*Sub-Paragraph (L)*).

100. *Sub-Paragraphs (E) and (F)* relate to the termination of the franchise agreement, that is, to the wilful termination of the agreement, not to the agreement simply coming to an end as a result of the expiration of its term. *Sub-Paragraph (E)* requires the franchisor to provide information on the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination, and *Sub-Paragraph (F)* requires the franchisor to provide information on the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination. This double requirement is important, as all too often franchise agreements will provide a long list of instances in which the franchisor is entitled to terminate, and nothing at all on when the franchisee is entitled to terminate. It is also important for a prospective franchisee to know what the effects of such termination would be, whether or not he/she would retain rights to, for example, the clients, so as to enable him/her to evaluate the loss he/she might incur in the case of termination.

101. *Sub-Paragraph (H)* specifies that the franchisor should provide information on both in-term and post-term non-compete covenants. Non-compete covenants, also called non-competition clauses or agreements, prohibit franchisees from competing with the franchisor or the franchise network both during the franchise relationship (for example, the franchisee might not be permitted to be a shareholder in a competing business or to open a business of his/her own that competes with the franchise) and after the relationship has come to an end. The post-term non-compete covenant will specify a certain period of time (for example, the franchisee is not allowed to engage in a business that competes with the franchise for two years after the agreement has come to an end) and may also specify within which territory it applies (the former exclusive territory of the franchisee, or for example within an x-kilometre- range of franchises belonging to the network). The possible conflict of such provisions with the competition law applicable in States should be noted in this connection.

102. *Sub-Paragraph (I)* requires the franchisor to disclose whether he/she has retained the right to use, or to licence the use of, the trademarks covered by the franchise agreement (*Sub-Paragraph (I)(i)*) or to sell or distribute the goods and/or services authorised for sale by the franchisee directly or indirectly through the same or other channels of distribution, whether under the trademarks covered by the agreement or any other trademark (*Sub-Paragraph (I)(ii)*). Information on these items is important, as they might influence the business of the franchisee. In the case of *Sub-Paragraph (I)(i)*, for example, if the franchisor retains such rights, a franchisee who sells pizzas under a trademark may find that the franchisor has licensed the right to use that same trademark to a producer of flea-repelling dog collars, which might influence the franchisee's possibilities to sell pizzas. In the case of *Sub-Paragraph (I)(ii)* the franchisee might find that the franchisor distributes the goods or services through the department store at the end of the block, possibly at lower prices, or that the same products are distributed at a lower price under another trademark, thereby undercutting the sales of the franchisee. It is therefore of the utmost importance for the franchisee to be informed of any such retention of rights by the franchisor.

103. *Sub-Paragraphs (J) and (K)* relate to fees and other payments. *Sub-Paragraph (J)* requires disclosure of the initial fee (also called the "entrance fee"), which is the one-off sum of money that the franchisee pays for the right to franchise. *Sub-Paragraph (K)* instead requires disclosure of other fees and payments, including any gross-up of royalties imposed by the franchisor in order to offset withholding tax. Amongst the most important of the other fees referred to are advertising fees. These are fees paid to the franchisor for organising the

advertising of the network at national level. The costs of such national advertising are shared between the franchisor and the franchisees of the network, each of which pays a certain amount to the franchisor at pre-established intervals. Local advertising is normally entrusted to the franchisee directly. The “gross-up of royalties” are the sums of money that some franchisors require the franchisees to pay to compensate the franchisor for having to pay withholding tax on the royalties he/she receives. The sum will therefore correspond to the sum the franchisor has to pay as withholding tax. In this manner the franchisor will receive the full amount that he/she is owed as royalties, as the franchisee is the one who in effect pays the withholding tax. This increases the burden on the franchisee, who finds that he/she not only has to pay the royalties, he/she also has to pay the withholding tax on the franchisor’s behalf. It is therefore important for the prospective franchisee to have information on any such demands on the part of the franchisor.

104. *Sub-Paragraph (M)* requires the franchisor to disclose the conditions under which both the franchisor and the franchisee are entitled to assign or transfer the franchise to other parties. Such conditions include, for example, whether the franchisor’s consent must be obtained for an assignment or transfer, whether the franchisor must approve the new franchisee, or even if the franchisee must compensate the franchisor for the training that the new franchisee will be required to undergo before he/she begins to operate the franchise.

105. *Article 6 Paragraph (3)* specifically relates to the master franchise situation. In accordance with the definition of “franchisor” in Article 2, for the purposes of the Model Law “franchisor” includes also the sub-franchisor in the sub-franchise relationship. This means that the information that Article 6 requires the franchisor to disclose to the prospective franchisee must be disclosed by the sub-franchisor to the prospective sub-franchisee. This information will however relate to the sub-franchisor and to the sub-franchisor’s business, whereas it could be important for the prospective sub-franchisee to receive a certain amount of information also about the franchisor. For this reason Paragraph (3) identifies those items of information which a prospective franchisee should receive as regards the franchisor, and states that the sub-franchisor must pass on this information that he/she has received from the franchisor to the prospective sub-franchisees. In addition, the sub-franchisor is required to inform the prospective sub-franchisee of the situation of the sub-franchise agreements in case of the termination of the master franchise agreement (meaning whether or not they will be automatically terminated or whether the franchisor or a new sub-franchisor will take them over), and of the content of the master franchise agreement.

7. *ARTICLE 7 - CONFIDENTIALITY*

106. *Article 7* introduces a rule relating to the confidentiality of the information a franchisor transmits to a prospective franchisee. The information referred to is not only the information contained in the disclosure document, but also any other information that the franchisor transmits, whether written or oral. The signing of a confidentiality agreement may be a condition that the prospective franchisee must comply with in order to receive the disclosure document. This is justified considering the nature of the information contained in the disclosure document, which is not only statistical information relating to, for example, how many franchisees belong to the network, but also information on the franchise system, the methods developed by the franchisor to run the franchise and the intellectual property.

8. *ARTICLE 8 - ACKNOWLEDGEMENT OF RECEIPT OF DISCLOSURE DOCUMENT*

107. The purpose of the disclosure document is to provide the prospective franchisee with information permitting him/her to make an informed decision as to whether or not to acquire the franchise proposed to him/her. The information the disclosure document contains is therefore of vital importance. Furthermore, Article 10 permits the franchisee to terminate the franchise agreement if the franchisor does not disclose, or if the disclosure contains a misrepresentation or if there has been an omission. It is therefore important for the franchisor to be able to prove that the franchisee did receive the disclosure document. *Article 8* acknowledges this importance by permitting the franchisor to require the prospective franchisee to acknowledge in writing that he/she has received the disclosure document, and by permitting the franchisor make such an acknowledgement a condition for his/her signing the franchise agreement.

9. *ARTICLE 9 - LANGUAGE OF DISCLOSURE DOCUMENT*

108. *Article 9* deals with an issue that has caused a number of problems over the years and that has often been the subject of abuse, namely the language of the disclosure document. The purpose of the disclosure document is to provide the prospective franchisee with information so as to permit him/her to make an informed decision as to whether or not to acquire the franchise. The prospective franchisee must therefore be in a position to understand what is written in the disclosure document. Whereas sub-franchisors, who are normally entrepreneurs of a certain size as they are required to make substantial investments to develop the network, in most cases will understand and be able to negotiate in the language used by the franchisor, this will not be the case with franchisees or sub-franchisees. Franchisees or sub-franchisees will require the disclosure document to be in their language in order to fully understand the relationship they are entering into and its implications. Article 9 therefore provides that the disclosure document must be written in the official language of the principal place of business of the prospective franchisee or in the mother-tongue of the franchisee.

109. Article 9 refers to the principal place of business, rather than to the jurisdiction, as there are countries with more than one official language even if they are just one jurisdiction.

110. Franchisees are often companies, which naturally do not have a mother-tongue. In such cases the "mother-tongue" refers to the mother-tongue of the chief executive officer or the President.

111. The Model Law does not provide for an agreement between the parties as regards the language of the disclosure document. This is an intentional omission aimed at avoiding abuse. It would be very easy for a franchisor as the stronger party to impose his/her language on a prospective franchisee, who might not understand that language at all, or at least not understand it perfectly. There may be exceptional cases in which the prospective franchisee is from a third country and for which an agreement with the franchisor to another effect might make sense, but if that franchisee is engaged in business in a country of which he/she is not a national, he/she must be able to negotiate and deal in the language of his/her host country. The inconvenience caused such a prospective franchisee if he/she receives disclosure in the language of his/her host-country are therefore minimal, compared to the disadvantage at which local franchisees would be placed if they receive a document they are unable to understand.

112. A number of countries furthermore have registration requirements that might apply to the franchise agreement. In such cases it would be highly unlikely for it to be possible to register an agreement that is not in the official language of the country. At the very least the original agreement must be accompanied by a translation into the local language.

113. Franchisors will often oppose having to translate their agreements and documentation. This is natural considering not only the cost of translation, but also the inability of the franchisor in most cases to check the correspondence of the translation with the original text. Translation is however essential if a franchise is to be exported, not only for the disclosure document, but also for the franchise agreement itself and for any collateral agreements.

10. ARTICLE 10 - REMEDIES

114. The remedies available to the franchisee under *Article 10* for non-compliance on the part of the franchisor with the requirements of the Model Law are in essence limited to one, namely termination, although Paragraph (4) does indicate that the right to terminate does not derogate from any other right the franchisee may have under the applicable law, such as for example the right to claim damages, with or without the obligation to terminate the agreement. In addition to the Model Law, the scope of which is limited to disclosure, other laws may also govern the franchise agreement and the franchisee may have access to other remedies under those laws.

115. The article uses the term “termination” to indicate the wilful ending of the agreement. This terminology is that adopted by other UNIDROIT instruments such as the UNIDROIT *Principles of International Commercial Contracts*. The reason this terminology has been chosen is that other terms, such as “rescission”, have different meanings in different countries.

116. It is normal practice for the franchisor and prospective franchisee to enter into a number of pre-contractual agreements. At times, these will involve also the paying of sums of money. The right of the franchisee to terminate the franchise agreement under Article 10 refers also to the pre-contractual agreements that the franchisor and prospective franchisee have signed and for which sums of money might have been paid. The Model Law does not deal with the question of whether or not the sums of money that have been paid should be paid back, preferring to leave this issue to be decided in accordance with the applicable law. The only pre-contractual agreement that stands is the confidentiality agreement, which is designed to protect the know-how of the franchisor. This position reflects that of the UNIDROIT *Principles*, which in Article 2.16 state that “[w]here information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. [...]”.

117. *Paragraphs (1) and (2)* both state that the franchisee is entitled to terminate, but do not specify whether it is sufficient for the franchisee to communicate his/her intention to terminate to the franchisor, or whether the franchisee must apply to the court to have the agreement terminated. This question is left to the applicable law, by reason of the differences that exist between different legal systems.

118. *Paragraph (1)* deals with cases where the disclosure document either is not delivered at all, or is not delivered within the time-frame specified in Article 5. In such cases the franchisee is entitled to terminate, unless the franchisor can prove that the prospective franchisee had the information necessary to make an informed decision.

119. *Paragraph (2)* deals with cases in which the disclosure document contains misrepresentations or omits material facts required to be disclosed under Article 6. Also in this case the franchisee has the right to terminate the franchise agreement, unless the franchisor can prove that the franchisee did not rely on the misrepresentation when he/she decided to acquire the franchise, or that the franchisee's investment decision was not influenced by the omission. This provision is to be considered together with Article 6, which lists the items that must be disclosed. The right of the franchisee to terminate depends on whether the information misrepresented or omitted was material, that is, whether or not it was so important that the franchisee would not have entered into the agreement had he/she been aware of the misrepresentation or omission. What information is to be considered material will depend on the franchise concerned. Although the list in Article 6 aims at exhaustiveness, it cannot be excluded that in a given case information that is not required to be disclosed under Article 6 is material. In such cases the remedies available to the franchisee are those normally available under general contract law.

120. *Paragraph (3)* lists three time-limits within which the franchisee must exercise his/her right to terminate the franchise agreement under Paragraphs (1) and (2): two years of the act or omission constituting the breach (*Sub-Paragraph (A)*); one year of the franchisee becoming aware of facts or circumstances that reasonably indicate that a breach has occurred (*Sub-Paragraph (B)*); or within ninety days of the delivery to the franchisee of a written notice providing details of the breach, accompanied by the franchisor's then current disclosure document (*Sub-Paragraph (C)*). The franchisee must exercise his/her right to terminate within the time-limit that falls due first.

121. *Sub-Paragraph (C)* is designed to permit a franchisor who has blundered into an unintentional breach to inform his/her franchisees of the mistake and to offer them the opportunity to terminate the agreement if they so wish, or, if the franchisees decide not to terminate, to request written confirmation from them that they know what has happened. The Sub-Paragraph requires the franchisor to provide the franchisees with a current disclosure document. This requirement applies also if the franchisor no longer franchises, as it is by providing updated information that he/she remedies the fact that he/she earlier provided misleading information, or did not provide the information required at the time it should have been provided. In other words, the providing of a current disclosure document represents what in the common law is known as "cure". It is not sufficient for the disclosure document to be merely the most recent one, the disclosure document must be current as at the time the notice under Sub-Paragraph (C) is transmitted to the franchisee, because "the most recent" disclosure document may be several years old, whereas what is necessary is for the franchisee to have up to date information. This is particularly important if the franchisee is to be able to make an informed decision as to whether or not to terminate the agreement.

11. ARTICLE 11 – TEMPORAL SCOPE OF APPLICATION

122. *Article 11* deals with the temporal scope of application of the Model Law, and provides that it applies to franchise agreements that have been entered into after the Model Law has entered into force, but also to the renewal or extension of franchise agreements

entered into before the Model Law entered into force. There is in other words no obligation on the part of the franchisor to provide a disclosure document that fulfils the requirements of the Model Law for old agreements without there being a case of renewal or extension, clearly within the limits specified under Article 3.