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STUDY GROUP ON FRANCHISING

Model Franchise Disclosure Law

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1. GENERAL REMARK

It should be emphasized that this model law is based on the finding that “the experience of States with relationship laws had been negative, whereas experience with disclosure legislation had on the whole been positive.” (para. 11 of the explanatory report). It is not our intent to have this text considered as setting a minimum obligation of a franchisor and let legislators believe it is the better, the more stringent the regulation is. It is important to make it clear that this text indicates how to hit the balance of interests of all relevant parties, including franchisors and franchisees. Therefore it is suggested to express unambiguously in the explanatory report that we find this text as preferable to any other type of regulation of franchising and that the terms of franchise agreements are to be left to general principles of the law of contracts, the most important of which is freedom of contract, provided that necessary information is duly disclosed before such terms are agreed.

2. ARTICLE 3 (H)

A careful consideration might be required as regards the exemption of article 3 (H). It is true that, as is pointed out in para. 55 of the explanatory report, there will usually be held an intensive negotiation when a franchisor tries to sell only one franchise in a jurisdiction. However, this kind of transaction often entail a large amount of investment on the side of the franchisee and the franchisor in such a case will try to seek for a franchisee with sufficient financial stability. This implies the high probability that the transaction is covered by item (D) or (E) or both. In other words, item (H) has its meaning only where the investment that the franchisee is going to make is not so large (but not so small as to be covered by item (G)) and the amount of asset that the franchisee has is not great enough. It seems questionable whether an exemption from duty of disclosure is reasonable in such a case. Besides, an obligation to disclose in such a case does not impose too heavy a burden on a franchisor as far as no mandatory format for disclosure is required (article 4 (2)), since the items listed in article 6 will in any case be disclosed in the course of an “intensive” negotiation that is expected to take place.

3. EXPLANATORY REPORT, PARA. 32

When the franchise agreement is an international one, there comes up a question whether the model law applies only as far as it has been adopted by the governing law of the contract. Our intent expressed in para. 32 of the explanatory report is that it applies whenever the franchisee is located in a country that has adopted it, considering the its aim of protecting franchisees. It would make matters clearer, then, if we add to the explanatory note that the model law cannot be excluded by the agreement on the governing law between the franchisor and the franchisee.

4. EXPLANATORY REPORT PARA. 45

It is stated in para. 45 that the materiality is judged by considering the question “would THE franchisee have acquired the franchise even if he or she had been aware of the information?” (emphasis by Kozuka). This indicates that the test employed here is the subjective test, since it is the behaviour of the franchisee in question that matters. It may

worth considering whether to employ an objective test instead, by replacing the question to be asked with another one, that is, “would a reasonable franchisee under the same circumstances have acquired the franchise even if he or she had been aware of the information?” Otherwise the franchisor would have to first investigate the competence of the franchisee and then adapt its method of negotiation accordingly, which is usually not the case with business transactions like franchise agreements.

5. EXPLANATORY REPORT PARA. 60

Article 5 (2) provides the franchisor’s duty to update the disclosure document. In this relation, it is necessary to distinguish two situations: one is occurrence of a material event after the preparation of the most recent document but before its delivery, which is clearly dealt with in the present text. However, the explanatory report refers to another situation where a material event comes up after delivery of the disclosure document (but while the negotiation is still going on). If we decide to include this case as well in article 5(2) and impose on the franchisor the duty to supplement the already disclosed information, the text of the provision will have to provide so unambiguously.

6. EXPLANATORY REPORT PARA. 66

It is explained that article 6 (1) (C) has its relevance when the franchisor comes from a country different from the country of the franchisee and “the principal place of business” means a branch or a subsidiary in the country of the franchisee. It is questionable, then, that the present text is drafted correctly. One may take it as referring to the situation where the franchisor is incorporated in country A only nominally but has in fact its centre of business activity in country B. If the explanatory report reflects our understanding, we should rephrase the text in such a way as “... principal place of business of the franchisor in the State adopting this law if it is different from the address of the franchisor indicated in lit. (A)”.

7. EXPLANATORY REPORT PARA. 76

At the end of Article 5 (J) of the model law, it is provided that the franchisor has to make disclosure about franchisees located in the country of the franchisor “if there are no contiguous countries.” Then in the explanatory report it says “If there are no franchisees in countries close to the country of the prospective franchisee, ...” This does not seem to be precisely in accord with the text, since the text refers to a situation where the country of the prospective franchisee is isolated like Japan or Australia rather than a case where the country of the prospective franchisee does have contiguous countries but no existing franchisees are found in the latter countries.

8. EXPLANATORY REPORT PARA. 88

Recently more and more countries are considering or have already started providing financial statements of companies via electronic media including websites on the Internet. We should consider whether mere reference to the accessibility to such electronically disclosed financial statements suffices for the purpose of article 6 (1)(N) (i)(c), provided that they are included in an official database (as opposed to a website of the franchisor itself) and are easily accessible by anyone.

9. EXPLANATORY REPORT PARA. 110

It is stated that when a franchisee is a corporation, the “mother tongue” referred to in article 9 is the mother tongue of the CEO or the President. However, it does not sound so reasonable if, for example, a Japanese corporation most of whose employees are Japanese, when offered a franchise by an American franchisor, is entitled to require disclosure documents written in French merely because the CEO happened to be a French person. In the case where the prospective franchisee is a corporation, perhaps we can just disregard reference to the mother tongue and require the disclosure to be made always in the official language of the principal place of business.