“The Regulation of Franchising in the European Union”

Dr Mark Abell
Field Fisher Waterhouse, London
• Franchising is currently under performing in the EU

• The regulation of franchising in the EU is heterogeneous and so fails to encourage franchising to fulfil its full potential

• The EU presents exciting opportunities for well developed franchises
The Performance of Franchising in the EU compared to that in the USA and Australia

- EU
  - USA
    - 4½ x turnover per head
    - 3 x turnover
  - 3 x % GDP
- Australia
  - >9 x turnover per head
  - >5 x % GDP
<table>
<thead>
<tr>
<th></th>
<th>Population</th>
<th>GDP (US)</th>
<th>Turnover</th>
<th>%GDP</th>
<th>turnover per head</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>500m</td>
<td>16T</td>
<td>300b</td>
<td>1.86</td>
<td>600</td>
</tr>
<tr>
<td>USA</td>
<td>310m</td>
<td>14T</td>
<td>868b</td>
<td>5.96</td>
<td>2,792</td>
</tr>
<tr>
<td>Australia</td>
<td>22.5</td>
<td>1.2T</td>
<td>130b</td>
<td>10.83</td>
<td>5,777</td>
</tr>
</tbody>
</table>
## The spread of Franchising in the EU

<table>
<thead>
<tr>
<th></th>
<th>Turnover</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>US$ [18.7b]</td>
<td>US$ 2.2T</td>
</tr>
<tr>
<td>Germany</td>
<td>US$ 72.9b</td>
<td>US$ 3.3T</td>
</tr>
<tr>
<td>France</td>
<td>US$ 72.3b</td>
<td>US$ w2.5T</td>
</tr>
</tbody>
</table>
• That means there is a real opportunity for Australian and other franchisors in the EU
How does the Contractual & Regulatory Environment in the EU impact upon franchising?

- General law
- Franchise specific law
Civil Law vs Common Law
General Law

Civil Law

Shorter

General & abstract

General obligations e.g. Art 242 German Civil Code

Type Contracts

Franchise Agreements are "innominate" contracts

Contracts for co-operation are rarely nominate/type contracts

Mandatory rules

Common Law

Longer

Non-mandatory rules

Contracts for co-operation are rarely nominate/type contracts

Mandatory rules

Contracts for co-operation are rarely nominate/type contracts
Does this mean that civil law and common law franchise agreements are fundamentally different?

• Sample of 25 Agreements from civil and common law jurisdictions covering low to high value concepts suggests that the answer is “No”
Civil & Common Law Agreements have same Basic Clauses

- Grant
- Financial terms
- Terms and renewal
- Obligations
- Confidentiality
- Restrictive covenants
- Transfer
- Termination
What do franchise agreements achieve?

• Protect Franchisor’s economic drivers
• Protect some but not all of Franchisee’s economic drivers
• Reduce risk to Franchisors
• Reduce risk for Franchisees
Self Regulation in the EU

• The European Franchise Federation is composed of 16 national franchise associations member states

• 11 member states do not have a national Franchise Association

• 1,577 out of an estimated total of 9,971 franchised brands in the EU are members of national Franchise Association

• That means that only 16% of franchised brands in the EU are subject to any self-regulatory environment
A Case Study of Self Regulation

The BFA

- Disclosure: Failed
- Best Practice: Failed
- Dispute Resolution: Mediation partial success but arbitration failed
- Education: Limited success
- Failings

Conflict of Interest
- Enforcement
- Finance
- Impact of non members
- Competition between self regulated bodies
EU Member State Franchise Law

- **Pre-Contractual**
  - Franchise Specific
    - 6 Member States
  - Others

- **Ongoing Relationship**
  - Franchise Specific
    - 3 Member States
  - Others

- **Termination**
  - Others
## Impact of Franchise Laws in EU Member States

<table>
<thead>
<tr>
<th>EU Member State</th>
<th>Title of Law</th>
<th>Precontractual Disclosure</th>
<th>Specification of Contractual Terms</th>
<th>Registration of Documentation on a Public Register</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>Law No 89-1008 dated 31 December 1989 (the Loi Doubin). New Article 330 of Civil Code</td>
<td>20 days before executing contract</td>
<td>n/a</td>
<td>n/a</td>
<td>It does not refer to franchising but to “any person who places a commercial name, a trade mark or sign at the disposal of another person in consideration for an undertaking of exclusivity or quasi-exclusivity for the exercise of his business”</td>
</tr>
<tr>
<td>Spain</td>
<td>Article 62 of Act 7/1996 and Royal Decree 2485/1998</td>
<td>20 days before executing contract</td>
<td>n/a</td>
<td>Yes, at regional or central registries</td>
<td></td>
</tr>
</tbody>
</table>
| Italy          | Law No 129 – 6 May 2004                                                        | 30 days before executing contract | Details of the following must be provided:  
- Fee due  
- Investment requested  
- Territory  
- Details of know-how  
- Services to be provided by franchisor  
- Renewal  
- Termination  
- Transferability  

It imposes  
(1) Mandatory conciliation before legal proceedings  
(2) The concept must be tested and the results disclosed to the franchisee |
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<tr>
<td>Sweden</td>
<td>The Disclosures Act 2006 (2006:484)</td>
<td>14 days before executing contract</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Belgium</td>
<td>Law Governing Pre-Contractual Information Within the Framework of Commercial Partnership Agreements – 19 December 2005, modified 27 December 2005 (Doc:511687/006)</td>
<td>One month before executing contract</td>
<td>n/a</td>
<td>n/a</td>
<td>It does not refer to franchising but to “commercial partnership”</td>
</tr>
<tr>
<td>Romania</td>
<td>Ordinance 52/1997 as modified by Law No. 79/1998</td>
<td>No time specified</td>
<td>Must specify</td>
<td>n/a</td>
<td></td>
</tr>
</tbody>
</table>

- Object of agreement
- Rights and obligations of parties
- Term
- Termination
- Financial provision
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| Estonia         | Law of Obligations Act 2002 Section 375-378 | n/a                       | - Duty of good faith  
- Grant of rights to franchisee by franchisor                                                       | n/a                                               | n/a                                                                      |
| Lithuania       | Civil Code Article 6.766-6.779 (200)      | n/a                       | - Duty of good faith  
- Automatic transfer of franchise to franchisee’s heir in the event of death  
- Franchisor can be held liable for claims against franchisee regarding the quality of goods or services supplied  
- Automatic right of renewal  | Yes, but it can be contracted out of (although this results in the agreement being unenforceable against third parties) | n/a                                                                      |
How does the General Law of EU Member States impact upon franchising?

- Pre-Contractual
  - Misrepresentation
  - Duty to Disclose
  - Confidentiality
  - Obligation to execute
  - Right to withdraw

- Ongoing
  - Good faith
  - Anti-trust
  - Unfair Competition
  - Consumer

- Termination
  - Good faith
  - Employment
  - Agency
  - Unfair Competition
How is the Pre-Contractual Relationship of EU Member States impacted by General Law?

- Obligation not to misrepresent
- Obligation to disclose
- Confidentiality
- Obligation to execute
- Right to withdraw
Obligation not to misrepresent
Common Law vs Civil Law

**English law**

- “Caveat Emptor” but Franchisor always makes representation
  - Fraudulent
    - Derry v Peek
      - Not merely opinion unless dishonest
        - Esso v Mardon
          - Can recover all direct loss
        - Voidable ‘abnito’
  - Negligent
    - Hedley Byrne v Heller
  - Innocent
    - Misrepresentation Act 1967 s.2

- UCTA imposes reasonableness test on attempts to avoid liability
  - Fleet Mobile Tyres
    - no reliance clause
    - not decisive
  - Quest 4 Finance
    - no reliance clause
    - can be upturned
  - MGB Printing
    - Franchisor owes duty of care which extends to misrepresentation so limits on contractual liability don’t exclude claim

**German law**

- Atypical Agreement: no specific misrepresentation

- Misrepresentation is breach of duty to take account of Franchisee’s interests – BGB 241
  - Place Franchisee back into which it would have been
  - Burden of proof with Franchisor
  - Rescission must be claimed within 12 months of Franchisee discovering the misrepresentation
  - Damages
  - Criminal offence if deliberate

Cf. BGB 241 in Germany
Duty to Disclose (a Civil Law Concept)

Arbitration 242 BGB

Pre-contractual duty of care

“Culpa in Contratendo”

All information about profitability of Franchise

Right to withdraw and damaged equal to expenses incurred

S311(3) BGB also imposes personal liability on individuals in Franchisor

3 year limitation on claims
Right to Withdraw

**Consumer Protection law applied**

- **Germany**
  - Individuals are consumers
  - Withdraw within 2 weeks
  - AF 507 BGB extends this to franchises if below €50k threshold
  - Franchisee must be notified of right to withdraw before conclusion
  - Failure → extended to 1 month from notice
  - If unclear → 6 months
  - If no notice → perpetual
  - Some suggest €50k threshold can be removed
  - Benincasa v Dentalkit
  - German Franchisee in German Court vs Italian Franchisee
  - ECG held Italian Code ruled – Franchisee ≠ Consumer therefore consumer protection law did not apply

- **UK**
  - CCA
  - Non-corporate franchisees
  - If Credit Agreement a “Cooling off” period is required

- **FTA**
  - Trading Schemes Act
Confidentiality (a Civil Law Concept)

German Unfair Competition Act Art 18
Obligation to execute (a Civil Law Concept)

- German law
  - Good Faith

- French law
  - Duty of Good Faith
  - Damages
The Impact of General Law on the Ongoing Relationship

- Good Faith
- Anti-trust
- Unfair Competition
- Consumer law
Good Faith

- UK
- Civil
UK

“pure heart empty head”

Equity

Mistake, misrepresentation, duress

Statutes

Franchise Cases

S.13GGA

UCTA Partnership Act

Cf. stream clean

Fleet Mobile

Court will look beyond strict wording of agreement

MGB v Kallkwik

“Business Efficacy” used to imply that Franchisor provides services to Franchisee using reasonable skill and care

Stream Care v Portman

Services must be provided to Franchisee when reasonably required or requested

Law Commission 1999 recommend “good faith” principle
Germany
(three “Fallugrupen”)

Collateral
- Generally pre-contractual
- Art 311 BGB
- Culpa in Contrantendo (information must be true and complete)
  - Franchisee has right to withdraw “ab initio” and claim damages equal to expenses incurred
  - Commences when Franchisor presents his system
  - Targets individuals too therefore personal liability for Franchisor’s managers

Restrictive
- Common Art 138 BGB
- “Treu und Glauben”
  - Franchisor must perform duties in good faith taking account of ordinary usage
  - Can be substantial fetter to Franchisor acting in best interests of network

Adaptive
- Least common GE frustration
- Art 313 BGB
  - If [Grcs] substantially change so that parties would not have concluded deal

Targets individuals too therefore personal liability for Franchisor’s managers
France ("Bonne Foi")

Arbitration 1134 Civil Code

Only active in last 30 years

Legal profession advocating more intervention

Extended to cover pre-contractual relations

Judges do extend legal rights but prevents a party from exercising rights
The application of Good Faith to Franchising in other EU Member States

- Limited application
  - Denmark
  - Latvia
  - Slovenia

- More frequent application
  - Poland
  - Czechoslovakia
  - Finland
  - Netherlands
  - Malta
Conclusion on the application of the doctrine of Good Faith to Franchising in the EU

- Means different things in each jurisdiction
- Even if used in similar way (e.g. = dishonesty) each jurisdiction takes a different view on what is dishonest
- Places an arduous burden on franchisors
The Impact of Anti-Trust Law on Franchising in the EU

TFEU Art 101(1)

TFEU Art 101(2)

Potentially void plus fine

Crehan Case – Franchisees can sue for damages due to breach of 101(1)
Pronuptia

- Allows restrictions which
  - Protect Franchisor’s Know-how
  - Maintain identity and reputation of Franchisor
  - IF indispensable to achieve such protection
- Doesn’t allow restrictions which
  - Divide markets
  - Price fixing
Commission Decisions

- Pronuptia: Price fixing NOT allowed
- Yves Rocher
- Computerland
- Service Master
- Charles Jourdan

- Exclusivity, territorial restraints, post terms RCs allowed
Exemptions

**TFEU 101(3)**

**De minimis**
- Aggregate Market Share is less than 15%
- Price fixing & territorial restaurants ignored UNLESS local authority insists

**VRBE**
- Only if Market Share is 30% or less
- Not available if “hard core” restrictions exist
- Territory
- Price fixing
- Cross supply
- Black listed restrictions
  - e.g. non compete over 5 years stuck out
  - Passive sales
  - Exclusivity
  - Post term RCs over one year
- National authorities can withdraw benefit
Retail Price Maintenance

“Rule of Reason”

Chicago School

OECD

“price restrictions may promote efficiency by improving vertical co-ordination”

Leegin – price control not “per se” unlawful

“Per Se”

EU

VRBE guidance notes

Some OECD influence

GSK Spain showed some movement toward liberalisation
Unfair Contract Terms & Consumer Law

- Germany
- UK
Art 305 – 310 BGB

Protects Franchisee as it is the “weaker party”

Prohibits

Franchisor’s performance depends on its discretion

Restricting Franchisee’s freedom UNLESS necessary to protect Franchisor’s identity

Franchisor can end exclusivity or down size territory for missing targets UNLESS chance to remedy

Franchisor not to terminate on short notice

Offending clause struck out – no blue pencil

So, Courts effectively negotiate for Franchisee
Franchisee who signs “Standard Term Contract” can challenge unreasonable exclusion/limit on rights
The Impact of General Law upon the Termination of Franchises in the EU
Good Faith

Germany
- If upfront fee not to cover Franchisor's costs it is repayable
- Obligation to repurchase stock

France
- The longer the relationship the longer the notice

Employment law

Germany
- Franchisee can only be restricted so far as necessary to ensure proper functioning of Franchise.
- If more restrictions = "employee in disguise"
- Social insurance, PAYE, protection vs termination
- Freedom to determine prices, employ staff etc ensures it's not [?]

Commercial agency

Germany
- Some lower courts have ruled right to compensation applies to Franchisee if
  - Franchisee leaves Clients with Franchisor
  - Franchisor can use Clients after termination
- Compensation = average annual income over last 5 years less discount of pulling power
- Must be claimed within 1 year
Post term Restrictive Covenants

Must be reasonable – time x geography → Unenforceable

Dyno Rod v Reeve

- 12m in former territory

Prontaprint v London Litho

- No similar business within ½ mile for 3 years

Kallkwik v Bell

- 18 months
- Competing business
- 700 metres of centre
What do Franchisors think?

• Survey of a wide selection of EU franchisors suggests that they would prefer an EU wide franchise specific regime
Conclusion

• Franchising is under-developed in the EU
• That under-development is due to the EU’s lack of regulatory homogeneity
• There is real opportunity for Australian and other franchise concepts in the EU