

FRANCHISE DISCLOSURE LAWS IN THE EUROPEAN UNION

by

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I. Introduction

Franchising has grown rapidly in Europe in recent years and should continue to grow in the foreseeable future. In Europe, the franchise industry is largely unregulated. Unlike the United States, in which the offer and sale of franchises is regulated by the Federal Trade Commission and by the legislatures of half of the states, the European Union has yet to adopt a uniform franchise disclosure policy. The law of franchising in most individual EU member states is mainly controlled by traditional contract law and the concept of good faith. However, the trend appears to be toward the specific regulation of franchises.

Five member states of the European Union now have franchise-specific laws which impose pre-sale disclosure obligations on franchisors. France was the first European state to enact a law applicable to franchising in 1989.¹ Spain enacted its franchise law in 1996.² Italy in 2004³ and Belgium in 2005⁴ were the latest EU members to enact laws regulating the sale of franchises. Romania, which joined the EU in January 2007, has had a franchise-specific law since 1997⁵. In addition to these five national franchise disclosure laws, the Code of Ethics of the European Franchising Federation (EFF), which imposes pre-sale disclosure requirements on franchisors, is self-enforced in seventeen European states where their national franchise associations are EFF members, and UNIDROIT, in 2002, adopted its Model Franchise Disclosure Law.

The purpose of this paper is to provide an overview of these laws and rules and to propose a model for a uniform European Union franchise disclosure law. There are two areas of concern to be addressed in formulating such a

proposal. First, the scope of such a law must be decided, i.e. what types of business arrangements should be classified as franchises. And second, the type and manner of disclosures that should be required must be selected.

II. Franchise Disclosure Laws of the European Union Member States

A. France

The Loi Doubin⁶ on Pre-contractual Disclosure was enacted in 1989. It was the first legislation in Europe to be adopted relating to franchising, although it applies to other business arrangements as well as franchises. The law applies to the licensing of trademarks, trade names or logos in an exclusive or quasi-exclusive territory. Its purpose is to make information known to the potential licensee/franchisee prior to executing the contract so that he can make an informed decision.⁷ The disclosure document must be delivered at least twenty days before the execution of the agreement or before the payment of any monies required prior to the execution of the agreement.⁸

The specific disclosures to be made were laid out by decree in 1991.⁹ They include the following:

a) the date of the founding of the franchisor's enterprise and a summary of its business history and all information "necessary to assess the business experience of the enterprise",¹⁰

b) a description of the market in general, the local market for the goods and services which are the subject of the franchise and the prospects for the development of the market,

- c) franchisor's financial statements for the previous two years,
- d) a description of the franchise network including a list of all other franchisees currently in the network¹¹ and all franchisees which left the network during the proceeding year, whether by termination or non-renewal, and
- e) a description of the terms of the proposed franchise agreement including the conditions for renewal, assignment, termination and the scope of exclusivity.

B. Spain

Spain was the second European country to enact franchise legislation in 1996. Unlike the French law, Spain's legislation requires the franchisor to enter a National Register of Franchises. Foreign franchisors are required to register in a separate registry. The purpose of the two registries is to centralize data on all franchises operating in Spain.

Under the Spanish Retail Trading Act, a franchise is characterized by a franchisor granting to a franchisee the right to utilize a "tested business model", where the business model includes: 1) the use of franchisor's trademark or other business identifier, 2) the transfer of "know-how"¹², and 3) continued commercial or technical assistance by the franchisor.¹³ The potential franchisor is required to submit disclosure documents to the franchisee twenty days prior to the execution of the contract or the payment of monies by the franchisee. The disclosure must include the following:

- a) a description of the franchised business including its structure,

- b) the nature of the system, and
- c) the essential terms of the franchise agreement.

The Spanish law does not provide for remedies for its violation.

C. Romania:

Romania, which became an EU member in 2007, enacted in 1997 its Government Ordinance No. 52/1997 Regarding the Legal Status of Franchise. Under the Ordinance, a franchise is defined as a marketing system where the franchisor grants to the franchisee the right to operate or develop a business, product, technology or service. In addition to requiring minimum provisions of the franchise agreement and regulating the post-sale franchisor-franchisee relationship, the Romanian act requires certain pre-sale disclosures. Among these disclosures are:

- a) the financial terms of the proposed franchise agreement, including royalties to be paid and purchases the franchisee is obligated to make,
- b) a description of franchisor's gained and transferable experience,
- c) the franchisee's area of granted exclusivity,
- d) the duration of the agreement, and
- e) the terms of the agreement governing renewal, termination and assignment.

There is no requirement under Romanian law for the registration or filing of franchises with the government.

D. Italy

Under the Italian franchise law, enacted in 2004, a franchise is defined as an arrangement between two financially independent parties where a franchisee is granted, in exchange for consideration, the right to market goods and services utilizing a set of intellectual property rights. In addition to Article 3 of the act, which dictates the form and content of the franchise agreement, Article 4 defines the disclosure documents that must be made available to the potential franchisee thirty days prior to execution of the franchise agreement. The franchisor must disclose the following:

- a) details of all trademarks used in the franchise system,
- b) a summary of the franchise activities and operations,
- c) a list of franchisees currently operating in the franchise system *in Italy*,
- d) year-by-year details of the changes in the number of franchisees for the previous three years *in Italy*,
- e) a summary of any court or arbitral proceedings *in Italy* related to the franchise system, whether instigated by a franchisee, third party or public authority, and
- f) *if requested by the franchisee*, copies of franchisor's balance sheets for the previous three years, or, since start-up if less than three years.

In addition to Article 4, Article 6 imposes upon the franchisor the duties of goodwill, fairness, and good faith in dealing with a potential franchisee. Under this duty, the franchisor is required to provide, in a timely manner, any information the franchisee considers "necessary or useful for the purposes of the

franchise agreement."¹⁴ The franchisor can withhold this information if it is of a confidential nature or if disclosure would infringe on third-party rights. Article 6 also imposes the same duty of goodwill, fairness, and good faith on the *franchisee*. Under the Italian act, if one party supplies false information the other party may rescind the agreement and can sue for damages.¹⁵

E. Belgium

Belgium was the last of the European Union states to enact a law governing franchises in 2005. Article 2 of the law states that it applies to agreements of "commercial partnership" between two parties whereby one party concedes to the other party, in exchange for consideration, the right to use a commercial formula in the sale of goods or services under one of the following: 1) a common brand, 2) a common commercial name, 3) the transfer of "know-how", or 4) the providing of commercial or technical assistance. Although it is not strictly franchise specific, it is clear that the language applies to franchises.

Article 3 provides that "the party who concedes the right" (the franchisor) must provide the "other party" (the franchisee) at least one month before the conclusion of the agreement a particular disclosure document which the act outlines in Article 4. The disclosure document consists of two parts: a section outlining contractual provisions of the agreement, and "facts contributing to the correct appreciation of the agreement". These facts include:

- a) the nature of the activities of the franchisor,
- b) the intellectual property rights granted to the franchisee,

c) the franchisor's annual financial reports for the three years proceeding the agreement,

d) the franchisor's other franchise experience and his independent experience operating the system which is the subject of the franchise,

e) the history, present state, and prospective of the market, and the market share of the franchise network, from both a general and a local point of view,

f) the number of franchisees belonging to the franchise network both in Belgium and internationally for the previous three years, as well as the prospects for expanding the network,

g) a list of franchise agreements entered into during each of the previous three years, including the number of franchises terminated or allowed to expire at the end of their term,

h) the expenses and investments agreed to by the franchisee at the beginning and during the course of execution of the franchise agreement.

The act also allows for the government to determine the form of the disclosure documents and to elaborate on the disclosure requirements. If the franchisor fails to provide the disclosure documents, the franchisee may rescind the franchise agreement within two years.¹⁶

III. European Code of Ethics for Franchising

The European Franchise Federation (EFF) is a non-profit organization created in 1972. Its aims are to promote and encourage the development of

franchising in Europe and to represent the interests of the franchise industry before the European Commission and European Parliament. The EFF is a self-policing organization with a membership composed of national franchising associations in Europe. Franchising associations from non-European member states may also join the EFF as associate members. Currently, the EFF consists of seventeen member European franchising associations. Fifteen of the current twenty-seven EU members belong to the EFF including Belgium, France, and Italy. The other two European members of the EFF, although not members of the European Union, are Croatia and Switzerland.

The EFF's European Code of Ethics on Franchising was adopted in 1972 and was last amended in 2003. The purpose of the Code of Ethics is to protect the franchising industry by promoting fairness in the franchisor-franchisee relationship. As a condition of membership in the EFF, all member national franchise associations must require *their* members to accept and comply with the EFF's Code of Ethics. Each member is required to institute a scheme with positive checks to ensure compliance.

Under the Code of Ethics, a franchise is defined as a system of marketing goods, services or technology in accordance with the franchisor's concept and under the franchisor's trademark, trade name, service mark, know-how or other intellectual property rights, supported by a continuing provision of commercial and technical assistance. The franchisee is also required to pay a direct or indirect fee. The EFF's definition of a franchise is substantially similar to that of the U.S. Federal Trade Commission.¹⁷

Under the Code of Ethics' "Guiding Principles" the franchisor is obligated, prior to offering a franchise system for sale, to have operated the business concept of the franchise, with success, for a reasonable time and in at least one "pilot unit". He is also obligated to provide the franchisee with initial training and continuing commercial and technical assistance during the "entire life of the agreement". In addition, a duty of fair dealing and good faith is imposed on the franchise relationship.

With respect to pre-sale disclosures, the Code of Ethics paints with a broad brush. Advertisement of the franchise must be free from ambiguity and misleading statements. The franchisor must not make any subjective or misleading statements with regard to future profits of the franchise. Prior to entering into any binding franchise agreement, the franchisor must provide the potential franchisee with a copy of the Code of Ethics and "a full and accurate written disclosure of all information material to the franchise relationship". This disclosure is to be provided "within a reasonable time prior to the execution" of the agreement. The Code does not elaborate on what specific pieces of information "material to the franchise relationship" should be provided.

IV. UNIDROIT Model Franchise Disclosure Law

The Model Franchise Disclosure Law was introduced in 2002 by the UNIDROIT Study Group on Franchising. The Study Group concluded that the problems associated with franchising lent themselves more to a model for regional and national law rather than an international convention.¹⁸ The Study

Group also found that while the experiences of the nations that had imposed franchise relationship laws was largely negative, the collective experience with disclosure law was overwhelmingly positive. The Model Franchise Disclosure Law is based on the realization that licensees require greater protection than licensors. Therefore, disclosure is only required of licensors.

Unlike the state laws which apply to franchises as well as other business arrangements, the Model Law is designed to apply to franchises only. A franchise is defined as a franchisee granted the right to engage in the business of selling goods and services under a system prescribed in substantial part by the franchisor which includes know-how, assistance, and significant and continuing operational control, and is substantially associated with a trademark, service mark, trade name or logo designated by the franchisor, in exchange for a direct or indirect franchise fee.

Every franchisor must give a potential franchisee a disclosure document within fourteen days of the signing of the franchise agreement or the payment of any monies prior to the agreement. The disclosure document must provide the following, among others:

- a) the trademark, trade name or business designator which the franchisee will use in the franchise,
- b) a description of the franchise to be operated,
- c) a description of the franchisor's business experience and its affiliates in granting franchises under substantially the same trade name,
- d) criminal convictions or findings of civil liability involving other franchises,

- e) any bankruptcy or insolvency of the franchisor for the previous five years,
- f) information regarding the goods that franchisee is required to purchase from the franchisor,
- g) information regarding intellectual property rights held by the franchisor,
- h) financial statements for the previous three years, and
- i) essential terms of the franchise agreement including those relating to termination and non-renewal.

V. Proposal for a Uniform European Union Franchise Disclosure Law

Currently, the only EU regulation specifically dealing with franchising is in relation to Article 81 of the Treaty of Rome. The Commission has issued a block exemption regulation for franchise agreements.¹⁹ However, there is no uniform law regulating the sale of franchises. With the advanced state of the franchise industry in the EU, and with the prospects of continued growth, the EU should adopt a franchise disclosure requirement which applies to all franchise agreements in which the franchisee's place of operation of the franchise is in a member state of the European Union. The trend is toward requiring disclosure. The two-year period from 2005 to 2007 has seen the number of EU states with franchise disclosure laws increase from two to five.

The proposed Uniform European Union Franchise Disclosure Law, like the UNIDROIT Model Law, should be franchise-specific and exclude other types of business arrangements. The definition under this proposed law should consist of

three statutory elements, similar to that of the European Franchising Federation and the U.S. Federal Trade Commission. The three statutory elements should include:

1) a franchisor granting a franchisee the right to sell under a marketing plan or system subscribed in significant part by the franchisor,

2) goods and services substantially associated with franchisor's trademark, trade name, service mark or other business identifier, and

3) the payment of a franchise fee, either directly or indirectly.

The law should also include exemptions for certain arrangements that fall under this definition of franchise, such as where the franchise agreement merely adds a similar product to the franchisee's product line where such additional product accounts for less than 20% of the total sales.²⁰

For the disclosures required under the proposed law, the EFF's Code of Ethics disclosure requirements seem somewhat dated. More useful models are the recent Italian or Belgian franchise laws which provide a good number of disclosures to protect franchisees. These are in part:

a) details of all trademarks used in the franchise system,

b) a summary of the franchise activities and operations,

c) a list of franchisees currently operating in the franchise system,

d) year-by-year details of the changes in the number of franchisees for the previous three years,

e) a summary of any court or arbitral proceedings *in Italy* related to the

franchise system, whether instigated by a franchisee, third party, or public authority, and

f) copies of franchisor's balance sheets for the previous three years, or since start-up if less than three years.

VI. Conclusion

As franchising continues to grow and as the European Union continues to develop, the EU should follow the lead of its member states and enact regulations requiring uniform franchise disclosure laws. As more states continue to add their own laws, the field will become increasingly complex, for both EU franchisors and international franchisors wishing to expand to the European market. A uniform law will ease this growth.

¹ LOI n° 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social, in Journal Officiel, 2 January 1990.

² Ley 7/1996.15 Enero Ordenacion Comercio Minorista; Art. 62, Regulacion del regimen de franquicia

³ Legge 6 maggio 2004, n. 129 Norme per la disciplina dell'affiliazione commerciale

⁴ Law relative to pre-contractual information in the framework of commercial partnership agreements/ Wet betreffende de precontractuele informatie bij commerciële samenwerkingsovereenkomsten

⁵ Ordonanta nr. 52 din 28-8-1997 privind regimul juridic al francizei, Monitorul Oficial nr. 224 of 30 August 1997

⁶ The French law is commonly referred to as the "Loi Doubin" after the minister who introduced it.

⁷ Article 1 of Law of 31 December 1989

⁸ Id.

⁹ Decree No. 91-337 of 4 April 1991

¹⁰ English translation provided by the European Franchising Federation

¹¹ If the franchise network consists of more than fifty (50) franchisees, only the fifty franchisees closest in distance to newly proposed franchise need be included.

¹² "Know-how" is akin to trade secrets in the United States.

¹³ Real Decreto 419/2006 de 7 de abril por el que se modifica el Real Decreto 2485/1998 de 13 de noviembre

¹⁴ English translation provided by the European Franchising Federation

¹⁵ Article 8. Annulment of the agreement

¹⁶ Article 5

¹⁷ Under the Federal Trade Commission rule, a franchise is defined as: "continuing commercial relationship" created by an arrangement in which: 1) a franchisee offers, sells, or distributes goods or services supplied by a franchisor where either a) such goods are identified by franchisor's trademark, service mark, trade name, advertising or other commercial symbol, or b) such goods are required to meet quality control standards prescribed by the franchisor and the franchisee operates under franchisor's trademark; 2) the franchisor exercises "significant control" or provides "significant assistance" in the franchisee's business; and 3) the franchisee is required to pay the franchisor a franchise fee, either directly or indirectly, of \$500 or more within six months of the commencement of franchisee's operation. 16 C.F.R 436.

¹⁸ Model Franchise Disclosure Law, page 13.

¹⁹ Regulation 4087/88

²⁰ The so-called "fractional franchise" exception