

Unidroit

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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STUDY GROUP ON FRANCHISING

Report on the second session

(Rome, 29 to 31 January 1996)

(Prepared by the Unidroit Secretariat)

Rome, June 1996

The second session of the **Unidroit Study Group on Franchising** was held from 29 to 31 January 1996 at the Seat of the Institute. A list of participants to the meeting is annexed to this report.

Opening the meeting, **Mr Malcolm Evans, Secretary-General of Unidroit**, welcomed the participants in the name of the President of the Institute, **Professor Luigi Ferrari Bravo**. In particular, he welcomed the newcomers to the Study Group, **Mr István Kiss**, Secretary-General and Chief Executive Officer of the Hungarian Franchise Association, **Mr Martin Mendelsohn** of Eversheds, London and **Mr Guillermo Jiménez**, Head of Division of the International Chamber of Commerce in Paris.

Mr Evans recalled the history of the Unidroit project on franchising, the examination of which had been first proposed in 1985. A number of preparatory studies had been prepared by the Secretariat but, due to other commitments, franchising had not been included among the priority items until 1993, when the Governing Council of Unidroit had requested the President of the Institute to set up a Study Group. The terms of reference of the Study Group, as laid down by the Governing Council, were to examine different aspects of franchising, 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. 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 which might be envisaged. The Study Group had met for the first time from 16 to 18 May 1994.

In relation to international franchising the Study Group had focused its attention on master franchise agreements. It had considered in particular the nature of the relationship between the master franchise agreement and the sub-franchise agreements, applicable law and jurisdiction, the settlement of disputes, problems associated with the tripartite nature of the relationship between franchisor, sub-franchisor and sub-franchisees, particularly in relation to termination, and disclosure.

As concerns domestic franchising, the Study Group had concentrated on the question of disclosure, examining also the experiences of countries which had, or had attempted, some form of regulation in this area, the role of franchise associations and the importance of the codes of ethics adopted by these associations.

The Study Group had arrived at the conclusion that international franchising did not lend itself to regulation by an instrument such as a convention, and had decided to recommend to the Governing Council that a legal guide be prepared for international franchising, in particular for master franchise agreements. It had further decided to recommend that for the time being consideration of the possibility to do anything in addition to a guide be postponed. This approach had been proposed also for the reason that it presented a number of attractions for a subject such as franchising, among which were the fact that it would permit an identification of the problems that might arise in connection with issues that already were regulated in one way or another by national legislation, typically not directed at franchising as such, but which nevertheless affected franchising transactions. Equally, it had been felt that such a guide could illustrate the drawbacks and the advantages of the different options open to operators, and alert potential parties to franchising agreements of the various pitfalls that they might come across. Another reason which militated in favour of a legal guide was the fact that it could be prepared within a reasonably short time span, unlike a convention which would take many years to elaborate. The preparation of a legal guide would not in necessity preclude the preparation, or even the consideration at a later stage of the preparation, of another type of instrument, possibly a model law.

The Governing Council of the Institute had endorsed these recommendations at its 74th session held from 29 March to 1 April 1995. A number of Council members had insisted on the potential significance of franchising as a very flexible instrument for the development and liberalisation of their economies with a view to their integration in world trade. Attention had been drawn to the need for the guide to be drawn up in such a way as to avoid any notion of bias between the different parties, and so as to give the maximum benefit to all the parties involved.

Mr Evans regretted the absence of Mr Burst, from Strasbourg, who had been prevented from attending at the last minute, and of the Chairman of the Study Group, Mr Sevón, whose duties at the Court of Justice of the European Union did not permit him to attend. As it was tradition at the Institute

that the meetings of Study Groups were chaired by a member of the Unidroit Governing Council, he suggested that **Mr Alan Rose**, President of the Australian Law Reform Commission and a distinguished member of the Council, take the Chair, also in view of the particular importance of franchising in Australia.

Taking the Chair, **Mr Rose** recalled that the aim of the Study Group was to have the guide ready for approval by the Unidroit Governing Council at its June 1997 meeting and suggested that the Secretary to the Study Group, **Ms Lena Peters**, Research Officer of the Unidroit Secretariat, give a general overview of the work that needed to be done and the time-span within which it was hoped that it could be done.

Ms Peters indicated that the Study Group had before it the draft chapters of the legal guide (Study LXVIII - Doc. 10), a document with comments submitted by Mr Calus and relating to franchising, the legal guide and Eastern Europe (Study LXVIII - (SG) Misc. 1), as well as a document with tables listing, chapter by chapter, the content as proposed in the outline prepared by the Study Group at its first session, the actual content, queries and comments and integrations necessary submitted for consideration of the Study Group by the Secretariat (Study LXVIII - (SG) Misc. 2). The chapters were very different from one to the other in style, in slant and in overall approach. There were a certain number of general points which had to be considered by the Group, and these were summarised at the beginning of document Misc. 2. The schedule was very tight. As Mr Rose had stated, the aim was to prepare the guide on time for the Governing Council to endorse its publication at its June 1997 session. The Council met only once a year, so if there were any delays the risk was putting back publication by a whole year. The timetable proposed was the following:

29 - 31 January 1996:	Study Group Second Session
June 1996:	Deadline revised version
September 1996:	Deadline editing
November 1996:	Editorial Board meeting
January 1997:	Study Group Third Session
June 1997:	Approval by Governing Council followed by publication

The Study Group thereupon proceeded to examine the general points raised in document Misc. 2. The points raised in document Misc. 1 were taken into consideration throughout the discussions.

DISCUSSION OF THE GENERAL POINTS RAISED IN DOCUMENT MISC. 2

1. THE ADDRESSEES OF THE LEGAL GUIDE

In relation to the question of the addressees of the legal guide, **Mr Jiménez (ICC)** considered that the addressees would differ depending on method of distribution. The ICC was a non-governmental organisation and consequently did not have the same responsibility towards the tax payers as an inter-governmental organisation. He suggested that if Unidroit were to have a role in legal publishing, it should be where there was a market failure in the book market, because to some extent, if Unidroit was issuing something for sale commercially, it was entering a market where there were private providers of the same information. The legal book market was a fairly efficient market, lawyers usually knew where to get books if they needed information, whereas franchisees might have less of an access to information, or be less accustomed to looking for legal advice through publications.

The **Secretary-General** stated that although Unidroit was an inter-governmental organisation, it was not a convention-making factory. Unidroit was also a research institute which over 70 years, generously funded by governments, had attempted to introduce a specific element of quality into the international process. That meant that the governments of its member States did not expect every piece of work the organisation did to take the form of an international convention, it could take the form of a comparative law study and the organisation would feel that it had given the tax payers their due. The considerations made reminded him of arguments raised when Unidroit had prepared the *Principles of*

International Commercial Contracts. The Max Plank Institute or the Institute of Comparative Law in Lausanne could just as easily have been asked to put together ten or twelve of the leading experts in the world to prepare a restatement of the law of contract, but there was a belief that a certain prestige went with a product developed by an intergovernmental organisation, that the product would hopefully be seen as being very neutral in presentation, in that it was not taking up the cudgels of one side or the other in whatever the area concerned might be. Lastly, it was not seen as a money-making project. If it did make money for the Institute, it would simply permit Unidroit to do research on another subject or to pursue research on franchising.

The Group considered the main addressees of the Guide to be lawyers who had international business experience even if they were not very knowledgeable in franchising. The public was neither the franchisee who enters the business for the first time, nor the lawyer with no experience of international business. While the Guide was drafted with above all the users from developing countries and economies in transition in mind, where, in fact, the work produced by Unidroit was likely to be looked upon as more authoritative and neutral than the writings of any private venture, the lawyers addressed should include also the lawyers working for Western franchisors, as in many countries, such as the USA and Canada, the experience of the lawyers of the franchisors related almost exclusively to domestic franchising. This resulted in a tendency to impose their domestic agreements in the drafting of international contracts and this did not work. Potential sub-franchisees, who were very sophisticated business people, should also be considered to be among the addressees.

2. AGREE ON WHAT A MASTER FRANCHISE AGREEMENT IS

It was observed that the concept of the master franchise agreement as described in the different chapters was not always the same. In one chapter what was described was more a representation agreement, in another chapter the description indicated that there was a direct relationship between the franchisor and the sub-franchisees and that only sometimes would it be appropriate for the sub-franchisor to step in to deal with certain issues. This departed from the traditional concept of a master franchise relationship as being a franchisor in one country granting rights to a sub-franchisor in another country to open its own outlets or to sub-franchise to sub-franchisees. The Group agreed that the traditional master franchise relationship was what was being considered in this guide. It was also stressed that the fact that the guide dealt with international master franchising as opposed to domestic master franchising should be emphasised, as certain aspects of an international agreement would not necessarily come into play domestically.

3. DISCUSS THE ISSUES TO BE COVERED

In the course of the drafting of the chapters several members of the Group had arrived at the conclusion that the outline as agreed at the first session needed to be modified. There were several points indicated in that outline that should be moved from one chapter to another, there were several issues that were not dealt with and instead should be dealt with, and there were others that instead were inappropriate. It was therefore agreed that the issues should be examined for each chapter with the assistance of the tables contained in document Misc. 2 and a new outline determined where necessary.

4. WHEN THERE ARE DIFFERENT WAYS OF DEALING WITH DIFFERENT ISSUES THEY SHOULD BE SET FORTH AND, WHERE APPROPRIATE, THE ADVANTAGES AND DISADVANTAGES OF EACH DISCUSSED

At the last meeting of the Study Group it had been agreed that each chapter should describe the options that were open and the advantages and disadvantages of each option to all parties concerned, not only to franchisors. Very few chapters had actually gone into an examination of the different options that were open and hardly any at all had gone into the advantages and disadvantages of the solution or point that was being discussed. It was agreed that this was a general integration that had to be made throughout the draft. In relation to the indication of the advantages and disadvantages of certain solutions, the question was raised whether these advantages and disadvantages should be both the economic and

the legal advantages and disadvantages or only the economic ones. The conclusion was that both economic and legal advantages and disadvantages should be considered.

5. DECIDE HOW MUCH TO HAVE ON MASTER FRANCHISING AND HOW MUCH TO HAVE ON UNIT FRANCHISING

It was observed that although the guide did not deal specifically with unit franchise agreements, it was nevertheless true to say that the rights granted under the unit agreement were derived from the master franchise agreement. Furthermore, there were franchisors who tried to impose their unit agreements on the sub-franchisees also in cross-border franchising. It was therefore necessary to consider the unit agreement, even if not in detail. The emphasis of those chapters that concentrated almost exclusively on unit agreements should therefore be modified and excessive detail on the unit agreement eliminated.

6. REFERENCES TO INTERNATIONAL INSTRUMENTS WHERE APPROPRIATE

In view of the fact that franchising covered a considerable number of different areas of law, there would be numerous international instruments that would be applicable in any given situation. At the first session of the Group it had therefore been decided to give readers indications of which international instruments should be taken into consideration when deciding whether or not they might be applicable. A number of chapters did refer to international conventions, but the members of the Group were encouraged to re-examine the issues dealt with in their chapters to make sure no additions had to be made.

The exact nature of the international instruments that should be considered was also discussed, in particular in relation to the European Community Exemption Regulation. The Regulation could be considered an international instrument in that fifteen States were concerned, but it was pointed out that its nature was quite different from that of, for example, the 1980 Rome Convention on the Law applicable to Contractual Obligations. Furthermore, it was an instrument which was of limited duration. It was therefore agreed that the Regulation should be mentioned in the annex which would contain information on national legislation, but not in the body of the guide, except for very brief references if this was necessary.

7. REFERENCES TO LEGAL DOCTRINES SHOULD BE AVOIDED

In relation to legal doctrines, it was pointed out that several chapters referred to specific legal doctrines, such as the Calvo doctrine, without explaining what was being referred to. As the purpose of the guide was to be understood by as many people as possible, such references should be either avoided or explained in simple terms.

The question was raised whether such references should be made in footnotes. While it was admitted that this could be done, it was recalled that it had been agreed that footnotes should be used as sparingly as possible to avoid interrupting the flow of the narrative.

8. INFORMATION ON THE SITUATION IN DIFFERENT COUNTRIES SHOULD BE AVOIDED

A number of chapters described the domestic situation of different countries, including also references to national legislation. Considering the objective impossibility to provide information on the situation of all the countries in the world, as well as the fact that any information given in this respect would quickly become out of date, it was decided that the introductory chapter should contain a general reference to the areas of law that were of relevance to franchise agreements and that any more specific information, including references to any national legislation regulating franchising and to the European Union Exemption Regulation, should be included in an annex to the guide. Readers should at the most be alerted to the fact that there were jurisdictions in which a certain question might be an issue and that they should consult local counsel for advice.

9. AMICABLE PARTING OF WAYS SHOULD BE TREATED IN THE CHAPTER ON TERMINATION

The amicable parting of ways was a specific issue mentioned in the Chapter 23, Ancillary Documents. The question was raised whether it should not also be mentioned in the chapter on termination. It was observed that the issues relating to termination or expiry were sufficiently complex to create a risk that any clause that was drafted would not properly allow the parties to separate completely and without problems. It might therefore be serve a useful purpose to mention that the parties could and had to work together to make the parting as smooth as possible.

10. NEUTRAL LANGUAGE:

- **NO PERSONAL REFERENCES**
- **GENDER-NEUTER LANGUAGE**

The need to avoid making any evaluations in the drafting of the chapters was stressed. The legal guide was not written merely for franchisors or their advisers, it was written for all interested parties. The taking of a position as to what alternative was to be preferred, or as to how good a certain solution was, should therefore be avoided. This was essential also considering the fact that the guide was not intended to provide any ready-made solutions - indeed, it would not be possible to do so as any solution adopted had to be suited to the facts of the case in hand - it was intended to reflect the issues that existed and the different alternative solutions that might be applicable to the particular issues considered, examining the advantages and disadvantages of each. The guide was intended to provide information to all parties concerned in a balanced manner, so that the parties and their legal advisers would be in a position to determine the points and issues they had to consider for their particular case, so as to enable them to ask the right questions in the course of the negotiations. It was therefore essential that personal evaluations and appraisals be excluded. This was agreed by the Group.

The need to write in gender-neutral language did not elicit any comments from the members of the Group, it being an accepted standard in drafting.

11. SPARING IN FOOTNOTES

Although the possibility of providing references to, for examples, international conventions and legal doctrines, in the footnotes was examined, it was in general agreed that footnotes should be used as sparingly as possible. This was also due to the fact that the guide was intended to be an instrument for the parties and their legal advisers to consult when they were considering a master franchise arrangement and was therefore more practical than academic in nature.

12. NATIONAL CONCEPTS

It was recalled that at the first session the Group had agreed that national concepts should be avoided. Consequently, terms such as "consideration" and "breach" should be removed from the text. To facilitate the drafting of the chapters it was suggested that the Secretariat might make a list of recommended terminology that could be used instead of such terms.

13. GLOSSARY: FINE, BUT NOT SUFFICIENT, DIFFICULT TO READ SO NEED MORE EXPLANATIONS IN TEXT

In the course of the preparation of the first draft a proposal had been made for the drawing up of a glossary of economic and financial terms such as "mark-ups" and "aggregate amount of the gross network sales to the ultimate consumer". This was seen as an alternative to explaining the terms in the chapters themselves.

The idea of a glossary was considered to be good but not sufficient. It would still be necessary to give a certain amount of explanation in the text to ensure that all readers understood and did not have to jump from one section of the book to another. Considering the different categories of users addressed, the guide should be drafted in a simple and easily accessible manner.

In general terms, the terminology used should be as uniform as possible. Before the Group had started to draft the first version of the guide, a paper that attempted to introduce uniform terminology which had been prepared by A. Konigsberg for the International Bar Association had been distributed to all members of the Group. The terminology suggested in that paper had in fact not been followed by the drafters of the chapters. The invitation to all to use the terminology in the document was reiterated.

14. SUMMARIES

It was noted that most of the chapters did not have summaries. The nature of the summary was discussed. There were basically two alternatives: pure check-lists of points dealt with in the chapter or a more narrative type of summary briefly summarising the content of the chapter. It was decided to use the lists in the tables of document Misc. 2 to arrive at a clear idea of what exactly should be included in the different chapters and to leave the final format of the summaries to be decided at a later date.

15. CONTRACT CLAUSES NOT TO BE INCLUDED

It had been agreed at the first meeting of the Group that contract clauses were to be avoided. This concept was reiterated and the drafters of the chapters invited to delete any clauses they might have inserted in their chapter. In this regard concern was expressed that if there were no clauses and if legal terminology was to be avoided, the guide would be more an economic guide than a legal one.

In reply it was recalled that the reason contract clauses were to be excluded from the guide was to avoid an inconsiderate use of the examples given, in that the risk was that some readers might simply lift the clauses from the guide and insert them into a contract, whether or not the clause was appropriate for that particular contract. This should be avoided at all costs and examples of clauses had therefore *per force* to be excluded from the guide.

16. NO TAKING OF POSITION: OFTEN TOO BIASED IN FAVOUR OF FRANCHISOR. THE CHAPTERS MUST CONTAIN A SUFFICIENT AMOUNT OF INFORMATION TO PERMIT A LAWYER IN A DEVELOPING COUNTRY, IN A COUNTRY IN TRANSITION TO A MARKET ECONOMY OR IN GENERAL WITHOUT EXTENSIVE KNOWLEDGE OF FRANCHISING TO OPERATE

It was noted that many chapters appeared to view the issues dealt with and the alternatives that were available exclusively from the point of view of the franchisor. As franchisors were not the main, or indeed the only, target group of this guide, any such bias had to be removed. Several chapters therefore had to add the points of view of the sub-franchisor and, where necessary, of the sub-franchisees, so as to give a balanced picture.

Furthermore, the guide had to provide sufficient information to assist lawyers in developing countries, in countries in transition to a market economy as well as lawyers from industrialised nations without extensive knowledge of franchising to operate and to ask the right questions.

17. SEVERAL CHAPTERS NEED MORE DETAIL

It was pointed out that several chapters needed more detailed explanations. They often raised the issues that were relevant for the topic dealt with in that particular chapter, but did not enter into sufficient details, did not give examples illustrating what the author intended and did not discuss the advantages

and disadvantages of the different solutions that might be contemplated for a particular issue. It was agreed that this would be done.

18. PROPOSAL FOR EDITORIAL BOARD: FIRST EDITING BY UNIDROIT, AFTER WHICH THE MEMBERS OF THE EDITORIAL BOARD SHOULD BE CONVENED

The legal guide was intended to be a harmonious whole and as such its language had to be uniform. It would therefore be necessary to edit the contributions extensively. This was best done by the Unidroit Secretariat, also in view of the fact that as the guide was being prepared and published by Unidroit, Unidroit would be responsible for its content and for the way this content was expressed. An Editorial Board, composed of a couple of members of the Study group together with the Unidroit Secretariat, would thereupon examine the draft as edited, with a view to making proposals for further integrations, deletions or moving of parts from one chapter to another. The Editorial Board would also have the task of ensuring that there were no factual mistakes in the text.

ADDITIONAL GENERAL POINTS RAISED IN THE COURSE OF THE DISCUSSIONS

IMPLIED RIGHTS AND OBLIGATIONS

A general point which arose in the course of the discussions concerned implied rights and obligations, in particular as they related to the differences in drafting technique of common law and civil law countries. Thus, for instance, in civil law countries the right to injunctive relief would be available even if not specified directly in the contract, as that particular right was provided directly by law. Similarly the notion of implied covenants should be considered. This was of particular importance with reference to the implied covenant of good faith and fair dealing. It was felt that the chapter that dealt with drafting would be the best place to deal with these issues, although reference should also be made in any other chapter as relevant.

ORIGINS OF FRANCHISING

It was felt that the readers of the guide should be made aware of the fact that franchising had originated in the United States and that it therefore was based on certain assumptions proper to that legal system. Although this should not be over-emphasised, it was information that would be useful to readers from other parts of the world. Similarly, the fact that the members of the Study Group came from civil law and common law traditions should also be mentioned, so as to make readers aware of the backgrounds against which the legal guide had been prepared. The guide was not a binding document, the authors and Unidroit believed it to be useful to all those concerned with franchising all over the world, but it was not possible to test it against all existing legal traditions.

CONSULTATION PROCEDURE

In relation to the need to take the different legal traditions of the world into consideration, the Secretariat indicated that it would initiate a consultation procedure once the edited version of the second draft was available. It would circulate the text to lawyers and other interested persons and bodies, such as the national franchise associations, asking for comments which would then be submitted to the Study Group at its next session.

PROMOTIONAL ACTIVITIES

Some members of the Study Group expressed concern regarding the exposure that would be given to the guide once adopted. The Secretariat assured the Group that Unidroit would do everything in its power to ensure that the guide became well-known all over the world. It would promote seminars and conferences, it would write papers and it would also do as much as possible to promote the use of the legal guide as teaching material in the universities. In order to assist it in these endeavours, the Secretariat would count on the members of the Group, who would be invited as speakers and who, it was hoped, would be prepared to promote the guide whenever possible.

In this connection the possibility of using the meetings of the *International Bar Association* as a vehicle for this promotion was stressed, as was the possibility of publishing articles and papers in the *Journal of International Franchising and Distribution Law* and in the section *Global Franchising Alert* of the *CCH Business Franchise Guide*. The members of the Group were invited to submit any proposals they might have to the Secretariat, so as to permit the Secretariat to prepare a list on promotional activities to submit to the Governing Council of the Institute.

ORDER OF THE CHAPTERS

In the course of the discussions proposals were made for a change in the order of the chapters, as well as for the drafting of new chapters. The order established in the end was the following (the numbers refer to the number of the chapter in the first draft):

Introduction

Chapter 1 (incorporating the old Chapters 1, 1A, 2 and parts of 3)

New section on risks (final location to be decided)

New Chapter on negotiating and drafting

Chapters 4, 5, 6

New Chapter on the tri-partite nature of the master franchise relationship

Chapters 7, 8, 12, 10, 11, 13, 14, 15, 9, 17, 18, 20, 19, 21, 22, 23, 24

Annex dealing with legislation, including protective legislation, representations and warranties etc.

The present report examines the draft chapters following the **old chapter numbers**, although the tables summarising the content of each chapter also gives the new chapter number. The tables also give the content of the first draft and any comments or queries that the authors of the chapters might wish to consider. The latter are taken from document Misc. 2.

DISCUSSION OF THE DRAFT CHAPTERS OF THE LEGAL GUIDE

CHAPTER 1:	INTRODUCTION
CHAPTER 1A:	ALTERNATIVES TO FRANCHISING
CHAPTER 2:	OPTIONS FOR INTERNATIONAL DISTRIBUTION AND
PARTS OF CHAPTER 3:	GENERAL QUESTIONS CONCERNING THE DRAFTING

A proposal was put forward for the merging of **Chapters 1, 1A, 2 and parts of 3**, as there was considerable over-lap between them. This proposal was accepted and the chapters were consequently discussed together.

The present Chapters 1 and 1A both dealt with **different type of agreements as alternatives to franchising**. The amount of detail with which these should be described was discussed, as was the question of whether or not the advantages and disadvantages of each alternative should be dealt with.

The importance, in particular for developing countries, of some indication being given of the advantages and disadvantages of the different forms of business was stressed. It was however considered that the guide should not go into too much detail, but should indicate the main alternatives that existed, specifying that they might be more viable than master franchising, but that this particular guide was concerned with master franchise arrangements. An indication of the advantages of master

franchise agreements over these other types of agreement was considered to be useful, even if too much detail was again felt not to be desirable. A discussion of the advantages and disadvantages of master franchising in general was also considered to be desirable.

In addition to the advantages and disadvantages of master franchising, the benefits of franchising as such should also be dealt with. It was considered that the benefits of franchising were best discussed in the section on "Franchising in the Economy".

Whether or not the **model franchise agreement** presently being prepared by the *International Chamber of Commerce* in Paris should be mentioned was also discussed. According to one opinion it should be mentioned, as by the time the guide was published the model law would have been adopted and it was important that readers should not feel that the guide was unreliable because this instrument was not mentioned. The considerable difficulties associated with the preparation of a model franchise agreement, not only within the same branch of trade but also for the activities of the one and same company, were stressed and grave concern was expressed that a model contract might be used indiscriminately irrespective of the facts of the case to which it was being applied, in particular in view of the disastrous effects such an indiscriminate use could have especially for the weaker party. Some members of the Group therefore felt it necessary to ensure that any mention of the model contract would not read as an endorsement thereof. In the end, it was decided that the Introduction, in the section on the history of the project, should indicate that a number of options had been considered by the Study Group when it had examined the question of the most appropriate instrument for franchising, including the drafting of an international convention and the preparation of a model contract. Both alternatives had been rejected by the Group as inappropriate, also in view of the fact that the guide was to concentrate on master franchise agreements which were almost entirely negotiated agreements. The existence of the ICC and other model agreements should be mentioned, but not described in detail. This was justified also considering the fact that the model franchise agreement only concerned unit franchise agreements and not master franchise agreements.

As regards **distributorship agreements**, it was pointed out that there were differences or nuances of meaning that should be reflected in the guide. The term "distributorship agreement" in fact in one country had the notion of concessionaire, in another of dealership or contractual distributorship. What, for example, in Belgium was a *concessionaire de vente* could not necessarily be translated by "distributorship".

The **different types and methods of franchising** should be described in the introductory chapter, although it should be stressed that the subject-matter dealt with in the guide was master franchising.

The division of franchising into five different types contained in Chapter 1 was considered to be misleading. A division into two, direct franchising and master franchising, was considered to be more appropriate, with franchising through a branch office or through a subsidiary and area development agreements being sub-divisions of direct franchising. Joint ventures should be dealt with separately, as in a franchising context they were always combined with either a development agreement or a master franchise agreement which was negotiated at arms length between the franchisor and the joint venture. It was possible for the joint venture agreement to terminate, but for the master franchise agreement to continue to have a life on its own.

It was pointed out that very often in the draft chapters what was referred to was **domestic franchising** and not **cross-border franchising**. This was felt to be inevitable, as experience with franchising was mostly with domestic franchising and not cross-border franchising. It was therefore necessary to extrapolate from the domestic experience when dealing with cross-border franchising. It was suggested that it should be stated very clearly at the beginning that although what was referred to was domestic franchising, what was being suggested, if any suggestions were made, was the possible application of that experience to cross-border franchising.

Chapter 1 presently contained a section dealing with what were termed problems: **pyramid selling, applicable law and jurisdiction, labour regulations** and the **renewal of the agreement**. As these were dealt with in other chapters of the guide, they were considered to be redundant here, and

were consequently deleted. It was further decided that the **additional undertakings** listed in Chapter 1 (*inter alia* territorial exclusivity and product exclusivity) should also be deleted as they were dealt with in other chapters.

It was pointed out that practice was changing, in that franchisors from the United States rarely imposed that the law applicable to the sub-franchise agreement should be the law of the United States. They still imposed their contract **forms**, but generally these were now translated into the language of the country concerned. The sub-franchise agreement would be placed under the **national law** of the sub-franchisees, whereas the master franchise agreement would be placed under the law of the franchisor. The statement in Chapter 1 on the imposition of US law on sub-franchise agreements should therefore be modified.

Another point to modify in Chapter 1 was the reference to **arbitration** and to how and why arbitration courts were used, the question of the choice of law in an arbitral proceeding and the possible disadvantages for franchisees in choice of law clauses associated with arbitration. It was felt that that statement was too drastic, as even with an arbitration clause the parties could still choose which law should apply to their contract, and public policy national legislation would always apply.

In the end, the Group decided that there should be an **Introduction** which should give the history of the Unidroit project, illustrating how and why the decision to prepare a legal guide had been reached and the purposes of the guide. It should also contain a section on "Franchising in the World Economy", which would contain a general discussion of the benefits of franchising as a form of business.

This Introduction would be followed by a **new Chapter 1**, resulting from the merging of Chapters 1, 1A, 2 and parts of 3. Of these Chapters, the parts that were in duplicate would be deleted. This new Chapter 1 would contain a descriptive definition of franchising with its basic elements, a description of the different types of franchising used in international franchising and of alternatives to franchising.

A question that the guide should deal with was further the fact that in some countries it would not be possible to have a full master franchise agreement. This might be due to a variety of reasons, including legal prohibition against this type of business. In these cases only a selection of the clauses a master franchise agreement would normally contain would be included.

Chapter	Title	Content first draft	Content as revised
Introduction (new) [Peters]			History of the Unidroit project (ex Ch. 1) <ul style="list-style-type: none"> • legal background of the members of the Study Group Franchising in the world economy (ex Ch. 1) <ul style="list-style-type: none"> • Origins of franchising • Benefits of franchising (including the privatisation process) (ex Ch. 1) Purpose of the Guide (ex Ch. 1) Description of the guide and its basic characteristics

Chapter	Title	Content first draft	Content as revised
Chapter 1 (ex Chs. 1, 1A, 2 and parts of 3) [Peters]	Introduction	<p>Franchising in the world economy with examples of what can be franchised and an indication of problems and disputes which might arise:</p> <ul style="list-style-type: none"> pyramid selling applicable law and jurisdiction labour regulations renewal of agreement <p>History of the Unidroit project</p> <p>Purpose of the Guide</p> <p>Definition of Franchising</p> <p>Basic elements of franchising</p> <p>Additional undertakings</p> <p>Franchise agreements and other agreements:</p> <ul style="list-style-type: none"> agency distribution licence transfer of technology <p>International franchising and the different methods used:</p> <ul style="list-style-type: none"> direct franchising franchising through a branch or subsidiary development agreements master franchise agreements joint ventures <p>Benefits of franchising</p> <p>The form of franchising dealt with in the Guide</p> <p>Legal environment</p> <ul style="list-style-type: none"> General legislation Specific legislation 	<p>Definition of Franchising with a description of the basic elements of franchising</p> <p>Franchise agreements and other agreements:</p> <ul style="list-style-type: none"> • agency • distribution incl. specification differences in terminology different countries • licence • transfer of technology <p>International franchising and the different methods used:</p> <p>1) direct franchising:</p> <ul style="list-style-type: none"> • franchising through a branch or subsidiary • development agreements <p>2) master franchise agreements</p> <p>Joint ventures associated with area development agreements or master franchise agreements with an indication of why a joint venture is an option (economic conditions of the host country)</p> <p>Other forms of international franchise arrangements</p> <ul style="list-style-type: none"> • barebones licence agreements • scaled down version of MFA • hybrid franchise/licence agreement • area representation agreements (ex Ch. 1A) <p>Ref. to agreements that are not franchises even though they might be termed a franchise - sub-franchisor acting as middleman (ex Ch. 14)</p> <p>The fact that in some countries a fully blown franchise agreement is not appropriate</p> <p>The need to adapt the franchise system to local cultural needs and legal requirements</p> <p>The form of franchising dealt with in the Guide: Master Franchise Agreements</p> <p>1) Advantages and Disadvantages</p> <p>(a) Dissatisfaction with MFAs due to:</p> <ul style="list-style-type: none"> • lack of control by franchisor over franchised system • problems with terminating MFAs • splitting of fees between franchisor and sub-franchisor (ex Ch. 1A) <p>(b) Consideration of the great expenses involved in master franchising (ex Ch. 1A)</p> <p>(c) Consequences if the franchisor is a party to the agreement (ex Ch. 1A)</p> <p>2) Factors to consider in deciding whether or not to enter a country and in determining the most suitable vehicle (MFA or other agreement):</p> <ul style="list-style-type: none"> • economic circumstances affecting the choice of vehicle • legal factors in the host country • the size and nature of the potential market for the franchised units in the host country • the degree to which the franchisor will want to exercise control over the sub-franchisor • the sub-franchisor's experience, size, commitment • how the franchisor and sub-franchisor will divide responsibilities and revenue • cultural considerations • parties' identity and experience (ex Ch. 2) <p>with more details on:</p> <ul style="list-style-type: none"> • description of economic environment and its effects • reasonableness of commercial expectations of the parties • knowledge and experience of parties <p>Add section on attitude of host country to franchising</p> <p>[Effects on relationship between franchisor and sub-franchisees if the franchisor purchased or leased the premises of the sub-franchisees (ex Ch. 1A) - location to be decided]</p> <p>Legal environment</p> <ul style="list-style-type: none"> • General legislation • Specific legislation (reference to Annex)

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 1A [Konigsberg]	Alternatives to franchising	<p>Dissatisfaction with MFAs due to:</p> <ul style="list-style-type: none"> • lack of control by franchisor over franchised system • problems with terminating MFAs • splitting of fees between franchisor and sub-franchisor <p>Other forms of international franchise arrangements</p> <ul style="list-style-type: none"> • barebones licence agreements • scaled down version of MFA • hybrid franchise/licence agreement • area representation agreements <p>Conclusion</p>	<p>In a master franchise relationship, if the franchisor purchased or leased the locations of the sub-franchisees, how would that alter their relationship? What would the consequences be if the franchisor were a party to the agreement? Royalties payable directly to the franchisor by the sub-franchisees: what is the consequence for their relationship? Would the area representative be considered an employee where it has supervisory functions? Why would the area representative be paid a portion of the initial franchise fee for franchisor-owned outlets? Withholding taxes: clarification of why it would be appropriate to arrange for direct payment to the area representative by the franchisee - is that not the practice? Development schedule: what would the risk be for the area representative if the franchisor does not accept the candidates put forward?</p>	<p>Merged into a the Chapter 1</p> <p>Sections deleted:</p> <p>Royalties payable directly to the franchisor by the sub-franchisees: Development schedule Withholding taxes</p>

Chapter	Title	Content first draft	Content as revised
Chapter 2 [Zeidman]	Options for international distribution	<p>The types of commercial vehicle available for international franchising</p> <ul style="list-style-type: none"> unit by unit franchising traditional development agreements hybrid approaches (JV) master franchising <p>Factors to consider in entering into a MFA:</p> <ul style="list-style-type: none"> details of relationship franchisor-sub-franchisor-sub-franchisee the economics of the franchise agreement legal factors in the host country the size and nature of the potential market for the franchised units in the host country the degree to which the franchisor will want to exercise control over the sub-franchisor the sub-franchisor's experience, size, commitment how the franchisor and sub-franchisor will divide responsibilities and revenue cultural considerations parties' identity and experience 	Merged into the new Chapter 1

CHAPTER 3: GENERAL QUESTIONS CONCERNING THE DRAFTING

In the course of the discussions the Group at first decided to eliminate Chapter 3, which it felt was not necessary as most of the material it contained was better placed in other chapters. Subsequently, however, the Group realised that there were a series of questions that were best dealt with in a chapter on drafting and negotiation. It was therefore decided to re-institute the chapter with the contents as indicated in the table below.

Chapter	Title	Content first draft	Content as revised
Chapter 3 New chapter number: 2 [Peters, formerly Zeidman]	General questions concerning the drafting New title: General questions concerning negotiation and drafting	Definition of MFA Tripartite nature of the relationship Reasons for choosing MFAs Factors to evaluate: the nature and depth of franchising by other entities within the territory the sub-franchisor's knowledge of the franchised business reliance on the sub-franchisor relinquishing of control degree to which franchisor's system may need to be adapted to the local market financial structure of the MF relationship import restrictions multiple territories Language of the agreement, manual and other Documents The role of the Preamble to the agreement Sub-licence of trademarks: direct franchising to each franchisee modifying agreement enter into tripartite agreements appoint the sub-franchisees as agents Choice of Law and choice of forum Existence of several sub-franchisors in the same territory Negotiating the agreement.	Language of the agreement and other Documents The role of the Preamble to the agreement Negotiating the agreement. <ul style="list-style-type: none"> • an explanation of the statement that MFAs are negotiated more often than unit agreements. • the importance of the choice of the other party Comparison between a local and an international MFA Clauses of particular importance even if not necessarily limited to franchise agreements <ul style="list-style-type: none"> • clauses relating to severability • entire agreement clauses • waivers • force majeure and hardship • clauses relating to the nature of the agreement • cumulative rights and damages (ex Ch. 26) <ul style="list-style-type: none"> • representations and warranties • notice provisions Common law and civil law drafting techniques: trying to put every point into the contract and trying to imagine every potential conflict that might arise in the future, as opposed to drafting by reference, direct or indirect, to the Codes or statutory provisions Drafting alternatives: <ul style="list-style-type: none"> • comprehensive contract • written document with reference to other documents containing accessories • short contract with reference to legislation Whether to draft detailed clauses or to make references (e.g. arbitration clause - ICC arbitration only or specify whole clause) Implied obligations Implied covenant of good faith and fair dealing Pre-contractual disclosure Due diligence Need to think of future changes to the system from the start

SECTION ON RISK

The introduction of a section dealing with risk was proposed and accepted by the Study Group. It was felt that this section should be located early on in the guide, although the Group decided to postpone taking a final decision on location until a draft had been submitted. Proposed locations were the introductory chapter or the new chapter on drafting and negotiations. Mr Kiss accepted to draft this section.

The possible assistance that the franchisor might offer the sub-franchisor to establish the network, the need for any prospective sub-franchisor, or sub-franchisee, to make their own financial projections with extreme care and caution to cover a number of things, including the cost to develop the system in the country as opposed to the cost of any fees, needed to be considered among the risk factors. This was also the case of the cost to the sub-franchisor of setting up the pilot operation in the host country, alone or with the contribution of the franchisor.

Chapter	Title	Content first draft	Content as revised
Section on risk (new) [Kiss]			<p>From the point of view of all parties concerned, identification of risk factors that are peculiar to franchising and at what levels they exist</p> <ul style="list-style-type: none"> • political • commercial • those unique to franchising <p>Description of how franchising in some cases lowers risk, but with other risks, in fact creates new ones or expands them, i.e. in a master franchise arrangement certain risks will be exacerbated simply because of the constraints of the business format</p> <p>No guaranteed success Due diligence Need for advice of local counsel</p>

CHAPTER 4: NATURE AND EXTENT OF THE GRANT OF RIGHTS

In relation to Chapter 4, it was decided to add a discussion of the possibility to grant several master franchise agreements or development agreements in one territory, with an indication of the advantages and disadvantages of such situations for both the sub-franchisors and the sub-franchisees. Similarly, the question whether the sub-franchisor would have an option to distribute outside of franchising, within the territory should also be discussed. If there was a need or potential need to distribute the goods or services through channels other than that contemplated by the franchise, the franchisor might reserve that right to himself, or might reserve the right to grant that right to other people. This presented some legal and economic problems which would lead the sub-franchisor to consider very seriously whether it affected the value of its investment. Under some circumstances the franchisor and the sub-franchisor might negotiate a right for the sub-franchisor to distribute the goods and services through those other alternative channels either directly or as a right of first refusal. An alternative form in which this could be done was a joint venture.

The need to explain the difference between proprietary and non-proprietary know-how was stressed, as this was a distinction that was not known in all jurisdictions. Patented know-how, copyrighted material, registered trademark assets were all proprietary, as they stayed with the owner as long as they were treated properly. Furthermore, the fact that in some jurisdictions a distinction was made between secret know-how and generally available know-how should be explained, even if only briefly as readers should be referred to the chapter on know-how for further details.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 4 New chapter number: 3 [Jesse]	Nature and extent of the grant of rights	<p>The granting of rights</p> <ul style="list-style-type: none"> - licence <p>What is granted</p> <ul style="list-style-type: none"> - the system and the trademarks - intangible assets - trademark licence - know-how and trademark licence combined <ul style="list-style-type: none"> - proprietary know-how - non-proprietary know-how <p>How the licensed assets may be used</p> <p>Where the rights may be employed</p> <ul style="list-style-type: none"> - territory - exclusivity v. non-exclusivity. 	<p>Qu. what mean by it is very common to also identify the trademarks by a separate definition as they identify and protect the system?</p> <p>Explain: "Although the territory granted is <i>identified</i> in the grant clause (with <i>territory</i> often <i>defined</i> in a separate clause ...")</p>	<p>The granting of rights</p> <ul style="list-style-type: none"> • licence <p>Product franchises</p> <p>What is granted</p> <ul style="list-style-type: none"> • the system and the trademarks • intangible assets • trademark licence • know-how and trademark licence combined <ul style="list-style-type: none"> - proprietary know-how - non-proprietary know-how <p>with an explanation of the notions</p> <p>Use of the licensed assets</p> <p>Where the rights may be employed</p> <ul style="list-style-type: none"> • territory (option for initial territory) • exclusivity v. non-exclusivity. <p>Existence of several sub-franchisors in the same territory:</p> <p>Implications of having several sub-franchisors in the territory for the sub-franchisors and sub-franchisees. (ex Ch. 3)</p> <p>Discussion of the qu. of the rights retained by the franchisor and the right of the sub-franchisor to own out-lets as well as to sub-franchise</p> <p>The need for the sub-franchisor to use another corporate entity for the purpose of owning units itself:</p> <ul style="list-style-type: none"> • legal issues as to whether that arrangement should be part of one document or there should be separate ones; • the grant in such a case including only a grant of the right to use trademarks in connection with the MF business, but not for operating the units. <p>Franchisor use of alternative methods of distribution</p> <p>Additional territories</p> <ul style="list-style-type: none"> • right of first refusal • option for additional territory <p>with advantages and disadvantages for both</p> <p>Warranties of sub-franchisor for rights that it grants</p>

CHAPTER 5: TERM OF THE AGREEMENT AND CONDITIONS OF RENEWAL

It was noted that the circumstances under which a sub-franchisor was or was not entitled to renew a contract had not been dealt with in the draft of this Chapter.

Furthermore, the problem of the master franchise agreement terminating before the termination or expiry of the unit franchise agreements was not dealt with in sufficient detail. There was a strong argument in favour of having a master franchise agreement with a term that went up until the end of the term of the last sub-franchise agreement granted by the sub-franchisor, namely that it avoided the problem of a master franchise agreement expiring while there were still sub-franchisees to whom obligations were owed. The simplest way of handling this issue was to say that the term of the master franchise lasted as long as the term of the last sub-franchise that the sub-franchisor granted, always assuming that the sub-franchisor was entitled to grant a sub-franchise of a term that went beyond the end of its own agreement. This method did however give rise to certain problems and it was felt that these should be pointed out and discussed.

One member of the Group had the impression that the chapter proceeded on the assumption that the development schedule remained in effect until the end of the master franchise agreement, which frequently was not the case, as once the development schedule had been met the development obligations ceased to exist. When the development agreement portion of the agreement ended, the sub-franchisor would be operating as a sub-franchisor vis-à-vis the sub-franchisees, and as a franchisee with respect to the units that it operated itself. One issue that arose out of the situation when the development obligations were split from the sub-franchisor obligations was that if there was going to be renewal in those circumstances, the only renewal there would be, would be of the development right. By definition it would extend the second period because more agreements would be granted and they would last longer. The sub-franchisor had to be granted the right to grant an agreement for longer than the term it had been given, or it would very quickly become a lame duck.

It was observed that in some countries there was a valid reason for having the term coincide with the last of the sub-franchise agreements to expire and this related to the post-term non-competition clauses. In these cases it was desirable from the franchisor's point of view to have the non-competition clauses start to run from the extended period of time and not from the expiry of the term.

In connection with the renewal of the agreement, the question of whether the same agreement should be renewed or a new agreement concluded had to be considered. This was particularly the case in the European Union, where know-how had to be granted to a franchisee for there to be a franchise and this know-how had furthermore to be secret. After ten or twenty years the question was whether the know-how could still be considered to be secret and therefore, under certain competition law conceptions, whether what was granted could still be considered to be franchising.

The chapter began with a strong statement in favour of long-term master franchise agreements, although that was a value judgment with which not all the members of the Group agreed. It was felt that the term should be as long as was necessary for that particular agreement. If a sub-franchisor was to develop a country and open 100 units in fifteen years, it would not be possible to give the sub-franchisor a five-year contract. Furthermore, it was necessary to give the sub-franchisor a period of time after the development time had expired within which it could make its own investments pay off. It was therefore agreed that such statements should be avoided.

It was pointed out that there was a body of opinion according to which international master franchise agreements should be short term agreements, generally with the option on the part of the sub-franchisor to renew the contract. The problem with that was that that only made sense if one said that the sub-franchisor would then execute the form of international master franchise agreement that was current at that time.

In the end it was agreed that the different options that were available should be pointed out, the advantages and disadvantages of each discussed and the factors that played a role in the decision of the length of the term examined. This included also brief references to possible national preferences that might be encountered, such as a preference for a long or a short term in developing countries depending on the policy adopted by the government. For example, in a country like India, where franchising arrangements required government approval, the arrangement would be viewed a little differently if it was a long-term arrangement from the point of view of, for example, the tax concessions that could be made. An indication should therefore be given that there were certain countries that fixed a maximum duration of the agreement, others that fixed a minimum duration. In certain countries this was coupled with the fact that at the end of the term of the agreement it was not possible to protect the know-how as the know-how would be deemed to be the property of the sub-franchisor.

The question of the right to renew was one which the Group felt should also be discussed, including whether the contract should or should not include the right to renew and if so under what conditions and whether this right should or should not be automatic.

The draft chapter contained a substantial discussion of what happened following the expiration of the term of the agreement, and it was decided that this should be dealt with only in the chapter dealing with the effects of the end of the contract.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 5 New chapter number: 4 [Königsberg]	Term of the agreement and conditions of renewal	Length of term of MFAs - reasons to have lengthy terms Effect of expiration of MFAs on existence of unit SFAs Assignment by sub-franchisor to franchisor of all sub-franchisor's rights Third party beneficiaries	Qu liability if franchisor intervenes in contract What benefit would the sub-franchisor reap from the arrangement whereby it continues to service the unit franchise agreements for the remainder of their term, even if the MFA has expired? The sub-franchisor is not allowed to compete, but has to service the sub-franchisees. How can the sub-franchisor establish its own practice? Explain at greater length the problem of the franchisor being obliged to accept an assignment	Different option for the duration of the term of the agreement: <ul style="list-style-type: none"> • long terms as opposed to short terms, • pros and cons • differences between different nations Circumstances in which a sub-franchisor is entitled to renew Problem of the MFA ending before the termination or expiry of the sub-franchise agreements: servicing of the units and who has to do this The development schedule and the effects of splitting the development part of the agreement and the sub-franchise part of the agreement Discussion on conditions of renewal: <ul style="list-style-type: none"> • right laid down in the contract • whether automatic or not

CHAPTER 6: FINANCIAL MATTERS

There was general agreement that although the draft chapter raised most of the main issues that were relevant, considerably more detail was required in their treatment.

The general question of the approach followed by franchisors should be discussed, in that some would deal with all fees together, whereas others would deal with the different fees separately. There were advantages and disadvantages associated with both approaches. Tax considerations would come into play, as would legal issues: if the fees were dealt with separately it would be easier for the sub-franchisor to sue a franchisor by claiming that the franchisor had promised, and was charging for an item or service that it was not providing. Furthermore, the question of fees should also be linked to that of services.

The Group felt that the tendency of many sub-franchisors to focus on the up-front fee instead of the on-going fees should be discussed. This tendency was a natural one, considering that up-front fees were frequently high and the sub-franchisor (and sub-franchisees) would perceive it as an important factor in the evaluation of the cost of setting up the business. It was also easier to compare the up-front fee with what others were paying for other territories or for other franchises in the same territory. In reality, however, especially if the franchise was successful, the amount that people were going to pay in continuing fees and service fees far exceeded the amount of money paid as an up-front fee. It was also felt that a discussion of variations in the up-front fee, such as compromise and entreaty, should be included, as should a discussion of all or part of the up-front fee as a non-refundable advance payment of royalties.

On the subject of royalties, it was pointed out that in some countries, for example Japan, contracts would often provide for royalties to be paid only after the franchise had become profitable. Considering the frequency of such provisions it was felt to be advisable to mention this in the guide. An

alternative to the up-front fee being used as an advance of royalties, was its being used as an advance of unit franchise fees. Furthermore, the fact that in some countries limits could be imposed upon the amounts that could be charged for the transfer of intellectual property rights should also be mentioned.

Different methods of calculating royalties should also be described. These included not only the usual calculation based on a percentage of gross or net sales, but also specific monetary amounts per unit of product sold, fixed annual fees where there was concern about whether the proper royalty could be audited, or a percentage of purchases as opposed to sales, particularly where there was a secured supplier. A method used more frequently in international franchising than domestic franchising was that of the sliding scale: the royalty would be $x\%$ up to a certain amount, then three-quarters of x after that, slowly diminishing as the amounts increased. It was also possible to have a reverse sliding scale, in that nothing was paid up to a certain amount, after which the percentage on which the royalties were calculated would progressively increase. The different methods of calculating royalties as a percentage should be dealt with: if the sub-franchisor had to pay x percent of net sales from the franchise system certain repercussions (e.g. even if the sub-franchisor did not collect the fees it would still be responsible for the payment to the franchisor) would flow from that and these had to be dealt with, if the sub-franchisor had to pay x percent of the fees it had received from sub-franchisees, other repercussions would flow. Advantages and disadvantages of both possibilities should be discussed. Furthermore, the need for a correlation between the fees and the services provided should also be considered.

In the end, the author of the chapter observed that all fee calculations revolved around an up-front fee, perhaps a share of the initial fees charged to sub-franchisees, a share of the continuing franchise fee and product mark-ups. Within that framework, there were ways of structuring the method of payment differently. He stated that he proposed to draft the chapter against this background and to mention some other methods that might be used as alternative structures, but without encouraging the readers to believe that they were the norm.

The problems associated with reporting and control needed to be examined, including what would happen if the control revealed that the results were wrong and who would bear the costs of the control.

Special mention should be made of the degree to which a percentage of revenues acted as a hedge against, for example, currency devaluation and inflation.

The issues connected with currency exchange and repatriation of profits should also be discussed, including how exchange was calculated if there was an obligation to pay in the currency of the franchisor's country of origin; once that problem had been solved how one exchanged, what happened if the exchange was blocked and what happened when there was no convertibility. Currency restrictions and provisions such as those in which the franchisor reserved the right to terminate the agreement if any currency restrictions were imposed should be discussed, as should the question of cost allocation when the cost of converting currency was extremely high. In this context also the case where the franchisor wished to be paid in a third currency should be considered.

The discussion on grossing-up provisions should also, it was felt, be enlarged upon, indicating the dangers of such provisions and the spiral that might develop in relation to taxation, as the tax authorities would always subject the whole amount to taxation, even if part of the sum was in fact intended to cover the amount due as taxes.

Issues such as the obligation of the sub-franchisor to make payments even if the sub-franchisees had not, and what happened if the sub-franchisees had made payments but it was discovered that the sub-franchisor had not remitted what was due to the franchisor also needed to be discussed, as did the allocation of revenue deriving from the sub-franchises between sub-franchisor and franchisor.

It was also felt that more details should be given in relation to the evaluation of the territory, including the criteria for that evaluation. Of the criteria listed in the chapter for the evaluation of the value of the franchise, it was suggested that the point that the franchisor had developed a system which had proved successful in its own country should be explained in terms accessible to all readers.

Chapter	Title	Content first draft	Queries /comments	Content as revised
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<p>Chapter 6</p> <p>New chapter number: 5</p> <p>[Mendelsohn]</p>	<p>Financial matters</p>	<p>Background on what provides income</p> <p>The sources of income available to franchisor</p> <ul style="list-style-type: none"> - initial master franchise fee - initial fees - continuing franchise fees - product supplies <ul style="list-style-type: none"> • product mark-ups • payments from producers or suppliers - advertising <p>Calculation of payments and procedures</p> <p>Fiscal considerations.</p>	<p>How are the costs for the setting up of the sub-franchise is divided between the franchisor and the sub-franchisor?</p> <p>What is intended by "the value of the territory as estimated by the franchisor"?</p> <p>Indicate that a percentage of the estimated aggregate amount of initial franchise fees would be transferred to the franchisor</p> <p>A description of the differences between the initial MF-fee and the initial franchise fee and of how they inter-act</p> <p>Examples of the different fees</p> <p>Explain why the initial franchise fees will provide a decreasing proportion of the franchisor's income when there are a number of franchisees paying continuing franchise fees</p> <p>Terminology: "aggregate amount of the gross network sales to the ultimate consumer", "bottom line", "mark-ups", "overrides or retrospective rebates", "grossing-up"</p> <p>Need to explain the division of the fees into percentages at end p. 3</p> <p>Explain why it is relevant that where a franchisor licences a manufacturer to make the products which will be supplied to franchisees the manufacturer will pay a licence fee to the franchisor</p> <p>Explain the relevance of the fact that the manufacturers and suppliers sometimes make contributions for advertising, marketing and promotional activities</p> <p>Organisation of advertising activities by the franchisor or by the franchisee for local advertising (ref. Ch. 10)</p> <ul style="list-style-type: none"> • allocation of the available funds to international advertising, • arrangement of marketing and promotion of the network between the parties <p>Examples of different methods of payment that are used</p> <p>What are the sources of income for services?</p> <p>Would the franchisor require payment for any consulting services?</p> <p>Would not the degree of importance to be attached to each factor vary also from trade to trade and not only from country to country?</p> <p>Explain that the fact that the franchisor has developed a system which has proved successful in its own country</p>	<p>Background on what provides income</p> <p>The sources of income available to franchisor</p> <ul style="list-style-type: none"> - initial master franchise fee - initial fees - continuing franchise fees - product supplies <ul style="list-style-type: none"> • product mark-ups (Ref. Ch. 11) • payments from producers or suppliers - advertising <p>Calculation of payments and procedures</p> <p>Different methods of calculating fees:</p> <ul style="list-style-type: none"> • per volume • percentage purchases • percentage sales • sliding scales • advance of royalties • fixed fee <p>Degree to which a percentage of revenues acts as a hedge against currency devaluation, inflation, etc.</p> <p>Methods of calculating royalties</p> <p>Exchange issues:</p> <ul style="list-style-type: none"> • how to calculate exchange • how to exchange • what happens if exchange is blocked • cost of conversion - who should pay • in case of imposition of currency restrictions - franchisor retaining right to terminate • payment in third currency <p>Reporting and control issues:</p> <ul style="list-style-type: none"> • what happens if the results are wrong • who bears the cost of the control <p>Allocation of revenue from sub-franchisees between franchisor and sub-franchisor</p> <p>Fiscal considerations.</p>
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CHAPTER ON TRIPARTITE RELATIONSHIP BETWEEN FRANCHISOR, SUB-FRANCHISOR AND SUB-FRANCHISEE (NEW)

In the course of the discussions the Group decided that the guide should examine and discuss both tri-partite agreements and the tri-partite nature of the master franchise relationship. The occasions on which tri-partite agreements might be necessary, or in which a direct lien would have to be established between the franchisor and the sub-franchisees (such as for the transfer of intellectual property rights) should be clearly evidenced. There were however numerous issues which derived directly from the tripartite nature of the relationship. These included the dependence of the sub-franchise agreements on the master franchise agreement, and consequently the effects of the end of the master franchise agreement on the sub-franchise agreements, and questions of liability as between the parties for actions or omissions of the other parties.

It was decided that a chapter dealing with the tri-partite nature of the master franchise relationship should discuss these questions in some depth, so as to avoid having to repeat the same discussion for every right or obligation that was identified in the chapters dealing with the rights and obligations of the franchisor and sub-franchisor. Considering the close relationship between the new chapter on the tri-partite nature of the master franchise relationship and the chapters on the rights and obligations of the franchisor and sub-franchisor, it was decided that the authors of these chapters should work closely together to decide exactly how to divide the material between the three chapters.

It was suggested that the outline of the chapter might be first a general introduction referring to the discussions contained in the earlier chapters on franchising in general and on master franchising in particular, on why the latter was a useful and commonly used approach, followed by the observation that there were unique aspects of master franchising that related to the tri-partite nature of the relationship and a discussion of what that meant and of how it manifested itself in the contractual arrangement of the parties. Reference should then be made to the discussions on the obligations of the franchisor and sub-franchisor as described in the relevant chapter(s). A consequence of this was the choice of the vehicle, which could be a contract between the franchisor and the sub-franchisor, a contract between the sub-franchisor and the sub-franchisee, a contract among all three parties or a contract between franchisor and sub-franchisee, which might differ depending on the circumstances.

The possibility of creating privity of contract between the franchisor and the sub-franchisees was an issue which it was felt should be referred to in the guide, as it might be of importance in the evaluation of the franchise.

Chapter	Title	Content first draft	Content as revised
Chapter 6 (new) [Schulz]	Tri-partite Relationship of MFAs		Tri-partite nature of the relationship (ex Ch. 3) Tri-partite agreements (ex Ch. 3) Appointment of the sub-franchisees as agents (ex Ch. 3) Sub-licensing of trademarks: in some jurisdictions a tri-partite agreement Implications for the sub-franchisors and sub-franchisees of having several sub-franchisors in the same territory Termination of MFA and effects on sub-franchisees Where franchisors deem it prudent to retain some measure of control directly over the sub-franchisees as opposed to relying on the sub-franchisor Liability in tri-partite agreements. Qu. statement in Ch. 3 "avoid direct privity of contract between franchisor and sub-franchisees"

CHAPTER 7: OBLIGATIONS OF FRANCHISOR

An extensive discussion was opened by the observation that there was a vacuum in the guide in that the rights of the franchisor and the sub-franchisor were not considered alongside their obligations. It was therefore suggested that the titles of Chapters 7 and 8 be changed to refer to the "Rights and Obligations of the Franchisor" and the "Rights and Obligations of the Franchisee" respectively. There might be certain rights that the franchisor would want to retain, such as the right to approve locations, the right to approve sub-franchisees, to appoint a director to the Board of Directors or to receive fees directly from the sub-franchisees as opposed to passing through the sub-franchisor. A right that the franchisor might retain, and which would be of particular importance if it did so, was the right to deal directly with the sub-franchisees irrespective of the decision taken by the sub-franchisor. This had special relevance where the taking action against sub-franchisees that did not perform was concerned.

The problem with dealing with both rights and obligations was that in most cases the rights of one party was mirrored by an obligation of the other party. There was therefore a risk of duplication. As it was not possible to avoid a certain amount of over-lap, it was felt that only one of the chapters should deal in any detail with a right or obligation examined, whereas the other chapter should only mention it very briefly and then refer to the chapter in which that particular issue was treated at length. In this connection the issue of implied rights and obligations should be considered, and a reference made to the chapter on drafting in which this question would be dealt with more extensively.

In view of the potentially extensive over-lap between the chapters that dealt with the rights and obligations of the franchisor and that which dealt with the rights and obligations of the sub-franchisor, it was in the end decided that the authors of the chapters should consult extensively and examine the possibility of eventually combining the two chapters. It was therefore left to the authors to decide how they would present the second draft, as two chapters or as one. The Study Group would thereafter take a final decision on the basis of the conclusion reached by the authors.

It was suggested that a distinction should be made between the services compensated out of the original master franchise fee and subsequent services for which there might be special fees. This was related to the question of the division of the rights and obligations. There was in the guide a basic framework dealing with the inherent or typical obligations of a franchisor vis-à-vis the sub-franchisor, or where appropriate the sub-franchisee. There was further a separate chapter which dealt with those matters that were typically provided for outside the basic framework (the chapter on ancillary documents), but there were many situations in which issues that would be dealt with in the second category were treated as part of the first, and other situations in which the parties agreed to split off these issues. In this case there would be a skeletal licence agreement with all detailed provisions in a separate document. The parties could agree on how much to include in, or what to shift from, one or other document.

The discussion evidenced the fact that certain commitments of the parties might be viewed either as a right or as an obligation. There was in other words no clear dividing line between the two categories. This was true of, for example, the "right" to exercise remedies: in the case of the protection of trademarks, it was the right of the franchisor to take reasonable steps to protect the trademark; on the other hand it was also an obligation, as the franchisor would otherwise fail in its obligations to the network as a whole.

In relation to the obligations of the franchisor the question of disclosure was examined. This was an issue that the Group agreed was pre-contractual rather than contractual, although there might be instances in which there would be at least an implied obligation to inform. This would then not be linked to any obligation placed upon the franchisor by the legislator, but would rather be a general obligation to provide all the information the other party would need to perform the obligations under the contract.

It was suggested that the chapter on drafting and negotiation should refer to the pre-contractual duty to disclose that might exist in some countries, although specific references to legislation were to be reserved for the Annex. The guide should further express the hope that the parties would be wise enough to ask for as much information from the other party as they deemed appropriate for their contractual relationship, i.e. to carry out the business and to comply with government regulations. It was observed

that this might not be necessary in some jurisdictions, as it would be covered by the general principle of good faith, although this should perhaps also be indicated in the chapter.

It was pointed out that the need for information existed both ways, in that the sub-franchisor might also be under an obligation to provide the franchisor with information that would permit the latter to carry on its business. This was the case, for example, with intellectual property infringements: if the sub-franchisor became aware of any such infringements it should inform the franchisor so as to enable the franchisor to take action to protect the trademark and thereby to fulfil its obligations vis-à-vis the network.

Another issue that was raised in this connection concerned the possibility of providing in the contract that a sub-franchisor who issued information or prospectuses on the franchisor and the franchise would be obliged to submit this material to the franchisor. This was to avoid that the sub-franchisor misrepresent-represent the franchise and the franchisor, thereby creating liability where there should be none.

It was furthermore felt that the guide should point out that the franchisor should prepare itself for the need to modify the system to take account of cultural differences between its country of origin and the host country, as well as to ensure that the system complied with the legal requirements of the latter.

Chapter	Title	Content first draft	Content as revised
Chapter 7 [Schulz]	Obligations of franchisor New title: Rights and Obligations of franchisor	Preliminary remarks Time for provision of services Training programmes Provision of operations manual Provision of materials for up-dating of system and improvements Management, technical and operational assistance Pilot operations Standard plans and specifications Quality/service/safety/cleanlines inspections Franchisor providing products Franchisor determining product range Safety standards Promotion of the network Language of the materials Credit card system Contracts with Government agencies and public institutions Periodic meetings all sub-franchisors International or regional conventions for sub-franchisors and sub-franchisees Right to exercise remedies.	Preliminary remarks General discussion of the types of rights and obligations which the franchisor should, or normally would, take on <ul style="list-style-type: none"> • description in each case • discussion of advantages or disadvantages of having certain clauses and why should have them • disclosure • description of management, commercial and technical assistance by franchisor to sub-franchisor, and where appropriate to sub-franchisee Specific rights and obligations: Time for provision of services Training programmes Provision of operations manual Purchases for franchises for the sale of goods and for the provision of services, including the case when the franchisor supplies the products necessary for the services Provision of materials for up-dating of system and improvements Management, technical and operational assistance Distinction between those services that are paid out of the original master franchise fee and subsequent services for which there may be special fees Pilot operations Standard plans and specifications Quality/service/safety/cleanliness inspections Franchisor providing products Franchisor determining product range Safety standards Promotion of the network Language of the materials Credit card system Contracts with Government agencies and public institutions Periodic meetings all sub-franchisors International or regional conventions for sub-franchisors and sub-franchisees Right to exercise remedies.

CHAPTER 8: OBLIGATIONS OF THE SUB-FRANCHISOR

There was general agreement that although the issues dealt with in the draft of this chapter had been correctly identified, they needed to be discussed in greater detail. References were also required to other chapters where a more detailed discussion of particular issues was to be found, for example references to the chapter on the end of the agreement in relation to post-term confidentiality clauses. Furthermore, this chapter should deal with both the rights and the obligations of the sub-franchisor

An issue that was raised concerned the development schedules and the effects of the sub-franchisor not meeting the schedule. One view was that the development schedule was of such importance and was so hotly negotiated between the parties that it deserved to have a chapter of its own. This view was however not endorsed by the other members of the Group who, while recognising the importance of the development schedule, felt that it was one of several obligations and should therefore be dealt with in the chapter on the obligations of the sub-franchisor.

A problem faced by the drafter of this chapter was the delimitation of the contents of the chapter on the obligations of the sub-franchisor and of the chapter on termination, as there were several remedies short of termination that could be applied for default on the part of the sub-franchisor.

In the end it was decided that the chapter on termination should be transformed into a general chapter on remedies for non-performance. This chapter should therefore include a review of the different remedies that might be available also for failure on the part of the sub-franchisor to meet the development schedule. Furthermore, the chapter on the expiry of the master franchise agreement should be transformed into a chapter dealing in general with the end of the relationship and the effects of the end of the relationship, independently of whether the contract had come to an end as a result of termination for non-performance or expiry of the agreement. This would include references to post-termination obligations.

An issue that was raised in connection with this chapter was the allocation of responsibility between the parties. It was pointed out that, for example, it was suggested in the chapter that the sub-franchisor had prime responsibility for the use of the trademarks. While it was true that it was possible for the franchisor to place this responsibility on the sub-franchisor, ultimately it was the franchisor who had the responsibility for the marks and if the sub-franchisor did not perform the obligations delegated to it, the franchisor would have an obligation to protect those marks. This had to do with, for example, whether or not the sub-franchisor submitted its advertising and the advertising of the sub-franchisees to the franchisor for approval and it had to do with the existence or non-existence of third party beneficiary arrangements, although that was an issue which concerned both the obligations of the sub-franchisor and the tri-partite nature of the relationship. Other techniques employed in the allocation of responsibility included one party giving the other a power of attorney. These were all issues that had to be discussed, that were fundamental to the relationship between the parties and that were part of the concept of the relationship, even though the ultimate location of this discussion, whether in the chapter on the obligations of the sub-franchisor or in that on the tri-partite nature of the relationship, should be left until after the Group had seen a draft.

Two issues that the Group decided should be dealt with in the chapter on the obligations of the sub-franchisor were first, the degree to which the franchisor would want to exercise control over the sub-franchisor, and secondly, the question of the sub-franchisor warranting that it had the right to grant the rights that it was granting the sub-franchisees. Connected with this was also the question of the right to ownership in any improvements made to the system, and consequently of the risks to the uniformity of standards if prior approval by the franchisor was not required for the introduction of any improvements or modifications.

Further issues raised concerned whether or not the franchisor would have an obligation to ensure that its system was competitive and up to date, whether or not such an obligation could be implied and

the possible differences in this regard between different legal systems. If such an obligation existed, the question was whether or not this might lead to any liability if the franchisor did not fulfil the obligation. It was pointed out that it might be dangerous to raise the hopes of sub-franchisors and sub-franchisees to announce the possibility of such an obligation on the part of the franchisor as there was no legislative basis for assuming any such obligation. It was however felt that the issue should be discussed and the *status quo* of the law explained.

Chapter	Title	Content first draft	Content as revised
Chapter 8 [Mendelsohn]	Obligations of the sub-franchisor New title: Rights and Obligations of the sub-franchisor	Background Obligation to <ul style="list-style-type: none"> introduce the system develop the network service franchisees Development schedule Trial period Pilot operation Undertakings of sub-franchisor: <ul style="list-style-type: none"> franchisee recruitment criteria training agreements with sub-franchisees to take account of variations in law and business practice supervision of trademarks establishment of administrative and operational infrastructure pilot operations Manuals on how to be a franchisor Translation of materials and copyright over translations Language of communication Intellectual property	Background Obligation to <ul style="list-style-type: none"> introduce the system develop the network service franchisees Development schedule Trial period Pilot operation Undertakings of sub-franchisor: <ul style="list-style-type: none"> franchisee recruitment criteria training agreements with sub-franchisees to take account of variations in law and business practice supervision of trademarks establishment of administrative and operational infrastructure pilot operations adaptation of the franchise system confidentiality non-competition Manuals on how to be a franchisor Translation of materials and copyright over translations Language of communication Intellectual property Degree to which franchisor will want to exercise control over sub-franchisor (ex Ch. 2) Allocation of responsibility between the parties Warrant that sub-franchisor has the right to grant the rights it is granting Possible obligation to keep system up to date and competitive

CHAPTER 9: PROVISION ON MANUALS

Attention was devoted to the need for franchisors to provide sub-franchisors with manuals teaching them how to operate as a franchisor. Such a manual was not often provided by the franchisor, but the Study Group felt that a practice to this effect should be encouraged among franchisors. It was therefore decided that a discussion of this issue was appropriate in this chapter, what the chapter already contained should therefore be kept and perhaps even expanded upon.

As regards the manuals of the franchise system, it was felt that more attention should be devoted to the role of these manuals and to their translation. This was particularly important in jurisdictions where franchise agreements might be considered contracts of adhesion. In these cases the advisability and possibility of the sub-franchisor and sub-franchisees being bound by the manual from the outset should be considered. The whole issue of the degree to which a (sub-)franchisee was bound by the manual, whether it was equally bound by the manual as by the franchise agreement even though one was an unchangeable legal document that the sub-franchisee had signed and the other was a document that was subject to change that the sub-franchisee did not sign, as well as the degree to which the franchisor could make changes and still have the sub-franchisee bound by it, needed to be examined in the guide.

A question to which it was suggested that attention should be devoted was one which, although not unique to the franchisor/sub-franchisor relationship was nevertheless a part of franchising, namely the degree to which a franchisor could use the manual to effect modifications in the system without modifying the franchise agreement. In this connection more attention should also be devoted to what actually was included in the manuals, with a list being given of what they ought to contain.

The statement presently in the chapter that the agreement should contain a clause to the effect that all the provisions in the manuals were deemed to form part of the master franchise agreement as if they had been incorporated into that agreement was questioned, as were other statements that members of the Group considered to take a position. It was agreed that such statements should be modified.

A suggestion to merge this chapter with the chapter on system changes was rejected, as manuals dealt with other matters besides change: they dealt with the implementation of the system in such a manner that everything did not have to be spelt out in the agreement itself.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 9 New chapter number: 15 [Königsberg]	Provision on manuals	Manual of the franchise system as opposed to a manual of the duties of the sub-franchisor Ownership of the manuals Return of the manuals at the end of the relationship Control of franchisor over changes and adaptations to the franchise system: <ul style="list-style-type: none"> • changes and adaptations only when clear differences • prior approval of franchisor of any changes, particularly changes in the nature or orientation of the franchise • changes required to comply with the law • changes to be reflected in manuals • changes acknowledged by sub-franchisor as being property of franchisor Cultural and other differences that exist between countries Changes to the system initiated by the franchisor Right of sub-franchisor to test-market the changes introduced by the franchisor Translation of manuals	Role of the manuals Greater detail on the question of the translation of the manuals The discussion on the sub-franchisor retaining ownership over changes it introduces should be made more neutral and should be explained from both angles - stress the integrity of the concept.	Manual of the franchise system as opposed to a manual of the duties of the sub-franchisor Ownership of the manuals Binding/non-binding nature of the manuals Contents of manuals Return of the manuals at the end of the relationship Control of franchisor over changes and adaptations to the franchise system: <ul style="list-style-type: none"> • changes and adaptations only when clear differences • prior approval of franchisor of any changes, particularly changes in the nature or orientation of the franchise • changes required to comply with the law • changes to be reflected in manuals • changes acknowledged by sub-franchisor as being property of franchisor Use of the manuals to effect changes Cultural and other differences that exist between countries Changes to the system initiated by the franchisor Right of sub-franchisor to test-market the changes introduced by the franchisor Language and translation of the manuals (ex Ch. 3)

CHAPTER 10: ADVERTISING AND THE CONTROL OF ADVERTISING

Chapter 10 was one of the chapters Mr Burst had unfortunately not been able to draft. Mr Zeidman accepted to provide the Group with a draft.

It was suggested that the fact that, depending on how the agreement was structured, the payment of advertising fees in cross-border transactions might be subject to withholding tax should be dealt with

in this chapter. Furthermore, it was suggested that the chapter should indicate that obligations might be placed on the sub-franchisor in relation to how it reported back to both the franchisor and the sub-franchisees on how the money charged for advertising were spent.

The allocation of responsibility for advertising when there were more than one sub-franchisor in a specific territory should also be considered. It was pointed out that the master franchise situation was different from the normal unit franchise, in that in a normal franchise the franchisor did not abdicate responsibility for advertising to the franchisee, whereas in a master franchise situation the franchisor usually granted responsibility for all advertising to the sub-franchisor, but once there was more than one sub-franchisor the situation changed and that should be pointed out.

Chapter	Title	Content first draft	Content as revised
Chapter 10 [Zeidman]	Advertising and control of the advertising	Not presented	Methods of payments Allocation of funds between local and international expenditure Control of the contents and use of the trademarks in adverts Provision by the franchisor of material generated for use in its home market - who pays for the costs Advertising in a three-tier system: differences between the different tiers, allocation of responsibility Situation when more than one sub-franchisor <ul style="list-style-type: none"> ● responsibility ● apportionment of fees Advertising fees may be subject to withholding tax

CHAPTER 11: SUPPLY OF PRODUCTS AND SERVICES

In general terms the Group felt that more details were required in the chapter on the supply of products and services.

Items to be discussed included indemnification provisions, which changed dramatically where the supply of products was concerned. There were, for example, frequently provisions in franchise agreements requiring the sub-franchisor to indemnify the franchisor for any damages suffered by the franchisor as a result of the sub-franchisor using a product that had actually been supplied by the franchisor. Arrangements that the franchisor might make for supplies by local producers should also be dealt with in considerably more detail. Cross-references to the chapter on financial matters were required in relation to a number of issues and it was therefore decided that the authors of the two chapters should consult extensively. It was decided that the chapter on the supply of products or services would mention the type of deal and refer to the chapter on financial matters for the financial consequences. Among the issues to which reference should be made were: the fact that there might be royalty payments from a local producer who had been granted a license; volume rebates; advertising allowances; product mark-ups and similar possibilities.

A situation which it was suggested should be described in greater detail was that of the franchisor giving the sub-franchisor the right to manufacture products that it used in the system and the sub-franchisor then sub-contract the manufacture to a third party supplier. In many instances the franchisor would insist that the sub-franchisor obtain a commitment which was attached to the agreement, i.e. a manufacturing document in which the manufacturer usually agreed to respect the trademarks and undertook to use the trademarks only in a particular way. The discussion that the chapter already contained on independent suppliers and their relationship with the parties to the franchise agreement should furthermore be considerably expanded.

It was also suggested that security agreements that accompanied supply agreements should be referred to in greater detail.

Agreements of relevance to the supply of goods and services that were dealt with in the chapter on ancillary documents, such as contracts of sale, should be mentioned in this chapter but the reader should be referred to the chapter on ancillary documents for further detail. This was also true of any international instruments that might be applicable to such agreements, for example the *United Nations Convention on Contracts for the International Sale of Goods*.

The problems raised by the regulation of restrictive trade practices and competition law, also as regards the tying of the purchase of products outside the host country, should furthermore be discussed, also in view of the increasing importance of the regulation of competition law in a number of countries, notably the countries of Central and Eastern Europe. Some countries had other laws that affected tie-arrangements and this fact should also be mentioned.

In relation to the franchisor receiving a commission from approved suppliers, it was suggested that it might be pointed out that this was perfectly valid if the sub-franchisor and the sub-franchisees derived a real benefit from the arrangement.

Problems that might arise where the franchisor supplied all the products, for example if the boat carrying the products sunk, or if quota restrictions were imposed, should also be considered, as should the advisability of the agreement containing a provision dealing with such occurrences. The fact that franchisors at times entered into arrangements under which they sub-contracted some of their obligations to provide services was also an issue that should be discussed in the chapter.

Chapter	Title	Content first draft	Queries / comments	Content as revised
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<p>Chapter 11 [Jesse]</p>	<p>Supply of products and services</p>	<p>Product franchising: products/components comprising products or services features as part of the franchised system Products or services of a general nature essential to conduct of operations:</p> <ul style="list-style-type: none"> ● maintenance of quality standards ● uniformity in product offering or operations ● assurance of availability of the product that is being supplied at a reasonable price ● additional profit for franchisor from provision of the products <p>Legislative regulation of provision of goods or services What product:</p> <ul style="list-style-type: none"> ● that identified with the TM and therefore unique to the system ● those important to assure that franchisee observes quality standards ● those generally necessary for the conduct of the franchisee's operations <p>Products supplied:</p> <ul style="list-style-type: none"> ● directly by franchisor ● by approved suppliers <p>Master franchise situation</p> <ul style="list-style-type: none"> ● initial supply of products <p>Agreement between franchisor and sub-franchisor:</p> <ul style="list-style-type: none"> ● initial supply of products ● eventual transfer of technology ● applicability of quality standards ● payment of royalties <p>Cost geographical distances Taxes Need to adapt products to local requirements Restrictions on franchisees US distributors US tie purchases EEC Separate supply agreement Degree of control of franchisor over supply Change of specifications</p>	<p>Why does the franchisor only to some extent have a duty to control quality? Office or store premises and bookkeeping services are not products Is it always legal for the franchisor to receive payment or commission from independent suppliers who are approved to supply the system? Terminology: "territory franchise" In MFA, what about cases where e.g. a formula or ingredient has to be transmitted right down to the sub-franchisees? Why would the sub-franchisor want to assume the role of supplier of essential services only when the unit franchisees reach an adequate scale? Why should it be the franchisor that enters into a licence and manufacturing agreement with an independent service provider and not the sub-franchisor? What countries impose restrictions on franchisees in relation to their purchase of products if hardly any countries have legislation on franchising? Qu quality control if parties do not address question of provision of products or services between them Qu tests and checking of quality, and liability therefor especially if franchisor has no control over sources Discussion on exclusivity Explain what intend when say product manufactured by "some proprietary methods" Explain what mean by "common ownership" Examples of countries which have regulations designed to assure fair treatment of distributors and franchisees</p>	<p>Product franchising: products/components comprising products or services features as part of the franchised system Products or services of a general nature essential to conduct of operations:</p> <ul style="list-style-type: none"> ● maintenance of quality standards ● uniformity in product offering or operations ● assurance of availability of the product that is being supplied at a reasonable price ● additional profit for franchisor from provision of the products <p>Legislative regulation of provision of goods or services What product:</p> <ul style="list-style-type: none"> ● that identified with the TM and therefore unique to the system ● those important to assure that franchisee observes quality standards ● those generally necessary for the conduct of the franchisee's operations <p>Products supplied:</p> <ul style="list-style-type: none"> ● directly by franchisor ● by approved suppliers <p>Master franchise situation</p> <ul style="list-style-type: none"> ● initial supply of products <p>Agreement between franchisor and sub-franchisor:</p> <ul style="list-style-type: none"> ● initial supply of products ● eventual transfer of technology ● applicability of quality standards ● payment of royalties <p>Cost geographical distances Taxes Need to adapt products to local requirements Restrictions on franchisees US distributors US tie purchases EEC Separate supply agreement Degree of control of franchisor over supply Change of specifications Indemnification provisions Royalty payments from local producers Sub-contracting to third party supplier Sub-contracting of services Sales contracts (Ref. Ch. 23) Provision on supplies not being delivered from franchisor as only supplier Volume rebates (Ref. Ch. 6) Advertising allowances (Ref. Ch. 6) Product mark-ups (Ref. Ch. 6) Security agreements for the supply of products Competition and restrictive trade practices</p>
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CHAPTER 12: UNIT SUB-FRANCHISE AGREEMENT

A general question raised in connection with the chapter on the unit franchise agreement was how much attention should be devoted to it considering that the guide related specifically to master franchise agreements. The Group considered that although the main emphasis of the guide should be on master franchise agreements, it was necessary to give a certain amount of information on the unit agreements. The main issues to be discussed concerned responsibility and the advantages and disadvantages of allocating the responsibility to the different parties. Thus, for example, points that should be considered concerned the language of the agreement and who had the responsibility of translating the documents and the manuals; who owned copyright in the translated version; the extent to which changes could be implemented: if the franchisor changed the system, how these changes were to be reflected in the unit agreements; if instead it was the sub-franchisor who made certain changes, the extent to which it could introduce changes in the sub-franchise agreement.

Where an issue was more fully discussed in another chapter, it was agreed that it should merely be mentioned and that the reader should then be referred to the chapter concerned. This was the case, for example, with advertising and the division of the duties and costs of the advertising between the franchisor, the sub-franchisor and the sub-franchisee.

A considerable number of questions related specifically to the tri-partite nature of the relationship and it would therefore be necessary to decide whether they should be discussed more fully in the new chapter on the tri-partite relationship, or whether they should be dealt with in any one of the chapters relating to the rights and obligations of the franchisor or of the sub-franchisor, or even in the chapter on the unit agreement.

It was observed that a number of questions might be considered irrelevant to the unit agreement, such as choice of law, but it was pointed out that all readers might not be aware of what the situation was and should be made aware of it. A short statement would be sufficient for this purpose. There might also be cases where choice of law issues might arise even in relation to unit sub-franchise agreements, such as where the sub-franchisor and the sub-franchisees were not located in the same country. This was frequently the case for franchising in Central and Eastern Europe, as sub-franchisors often preferred to operate out of Western Europe.

As regarded the ownership of improvements made to the system, although the details should not be gone into, it was necessary to describe what the situation was as regarded improvements made by each of the parties, indicating the links to national laws that might provide for protection with respect to, *inter alia*, patents and inventions of employees. There were, for example, certain jurisdictions in which it was not possible to force the person making the improvements to transfer ownership. This question was however closely related to that of the nature of franchising, as the purpose was to reproduce a successful system. If improvements, or other modifications, could be made and implemented without prior approval by the franchisor, the network would no longer be uniform and its very nature as a franchise might be questioned as a consequence. Furthermore, if an improvement or modification was suggested and approved by the franchisor, then the franchisor would in all likelihood wish to introduce that modification throughout the network, so that all members of the network could benefit therefrom and so as to keep a uniform standard.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 12 New chapter number: 9 [Schulz]	Unit sub-franchise agreement	<p>Preliminary remarks: methods to ensure influence of franchisor on sub-franchisee:</p> <p>a) Strict compliance with standard form contract</p> <p>Obligation of sub-franchisor to translate the SFA into the local language</p> <p>Warrant no changes without prior consent</p> <p>Obligation on part of franchisees to meet franchisor's current admission standards</p> <p>Right of franchisor to approve sub-franchisees</p> <p>Copy of sub-franchise agreement to go to franchisor</p> <p>b) Only specific structure required:</p> <p>Issues which may be part of the structure</p> <p>Indication of mandatory provisions</p> <p>Copy of sub-franchise agreement to franchisor</p> <p>Sub-franchisor warrants supervision of intellectual and industrial property</p> <p>Automatic termination of SFAs in case of termination of MFA</p> <p>Automatic assignment to franchisor of sub-franchisor's rights</p> <p>Breach of SFA considered breach of MFA</p> <p>Remedying of breach of SFA with compensation paid directly to franchisor</p> <p>Sub-franchisor to provide initial and additional training programmes</p> <p>Sub-franchisor to further develop the system and products</p> <p>Prior approval required for implementation of developments and improvements</p>	<p>Would the ethical guidelines of the franchisor apply also to the sub-franchisor?</p> <p>Should the franchisor be able to approve the sub-franchisees also in an international setting?</p> <p>What are the consequences for liability if the franchisor receives a copy of each sub-franchise agreement?</p> <p>Advertising in a three-tier system: what are the relations between the different tiers? Ref. Ch. 10</p> <p>What would the relations be if the franchisor wishes to approve each sub-franchise contract esp. for questions of liability?</p> <p>Presumably the key - provisions indicated as mandatory are not always mandatory in all countries</p> <p>Who can proceed against breaches?</p> <p>How can the sub-franchisor warrant that the termination of the MFA would automatically lead to the termination of the SFA?</p> <p>Presumably a breach of the SFA would be considered a breach of the MFA only if it is not remedied - the franchisor would probably not know about it anyway. Is it really possible for this to be provided for in the MFA?</p> <p>How is it possible for compensation for the breach to be paid by the sub-franchisee directly to the franchisor if there is no relationship between them?</p> <p>Add breach by sub-franchisor</p> <p>Discussion of the ownership of improvements and compensation for these improvements</p> <p>Indicate the situation for each of the cases when the improvements are made by:</p> <ul style="list-style-type: none"> • the franchisor • the sub-franchisor • the sub-franchisee <p>Duties to implement changes in the course of the agreement Ref. Ch. 15</p>	<p>Preliminary remarks:</p> <p>(1) division of responsibility between franchisor, sub-franchisor and sub-franchisee Ref. Ch. tri-partite and Chs. 7 and 8</p> <p>(2) methods to ensure influence of franchisor on sub-franchisee:</p> <p>a) Strict compliance with standard form contract</p> <ul style="list-style-type: none"> • Obligation of sub-franchisor to translate the SFA into the local language • Warrant no changes without prior consent • Obligation on part of franchisees to meet franchisor's current admission standards • Right of franchisor to approve sub-franchisees • Copy of sub-franchise agreement to go to franchisor <p>b) Only specific structure required:</p> <ul style="list-style-type: none"> • Issues which may be part of the structure • Indication of mandatory provisions • Copy of sub-franchise agreement to franchisor (discuss as possible option) • Sub-franchisor warrants supervision of intellectual and industrial property • Automatic termination of SFAs in case of termination of MFA • Automatic assignment to franchisor of sub-franchisor's rights • Breach of SFA considered breach of MFA • Remedying of breach of SFA with compensation paid directly to franchisor • Sub-franchisor to provide initial and additional training programmes • Sub-franchisor to further develop the system and products • Prior approval required for implementation of developments and improvements Ref. Ch. 15 • Choice of law: situations in which relevant and Ref. Ch. 21 <p>Answers to questions raised</p>

CHAPTER 13: INTELLECTUAL AND INDUSTRIAL PROPERTY

Mr Konigsberg offered to take over the drafting of Chapter 13, which unfortunately Mr Burst had not been able to do. A proposal to merge Chapters 13 and 14 (Know-How) was rejected, although it was agreed that a co-ordination of the two chapters was necessary and that the authors should consult to avoid over-lap. On the whole, there was agreement that Chapter 13 should deal with rights that were created by statute, i.e. the form of intellectual property for which protection could be received by applying to a government agency, whereas Chapter 14 should deal with rights that were protectable under the contract, i.e. rights for which it might or might not be possible to obtain protection but if protection was obtained it was not by virtue of an initial government action. It was therefore proposed that the names of the chapters should be changed to reflect this reality, more particularly so as the term "industrial property" was increasingly being dropped and as the concept of know-how differed from country to country. Mr Frignani, who was responsible for Chapter 14, offered to assist Mr Konigsberg with Chapter 13, and Mr Konigsberg suggested that he himself would deal with the trademark aspects if Mr Frignani dealt with the industrial property. In the end, it was left to the authors of the two chapters to come to an agreement on how to divide responsibility for the drafting of Chapter 13.

It was suggested that this chapter should begin by listing the intellectual property rights that were commonly found in franchising and that were protectable, going on to describing how they might be licensed and used by the network. It was necessary to explain what was covered by intellectual property in the franchising context, to describe its elements, the rights associated with the intellectual property and how those rights could be exploited by a licence, or by whatever other method, by third persons. It was stated that although the details of trademark law or copyright law should not be entered into, it was necessary to deal with differences in approach to copyright and to indicate that in some countries copyright came into existence simply by use, whereas in other countries registration was necessary.

An integral part of this chapter was considered to be any representations or warranties that might relate to the trademarks and the obligations that flowed from them.

A further question to be dealt with was who could take action for trademark infringement and how such disputes were settled.

Chapter	Title	Content first draft	Content as revised
Chapter 13	Intellectual and industrial property	Not presented	General description of intellectual and industrial property Differences between different countries Intellectual and Industrial property rights in franchising Licensing of intellectual and industrial property rights Sub-licence of trademarks: direct franchising to each franchisee (ex Ch. 3) Representations and warranties in general and obligations that flowed from that
New chapter number: 12 [Konigsberg]	New title: Rights created by Statute		<ul style="list-style-type: none"> • Extent to which franchisor can be expected to warrant its ownership of the intellectual property it is licensing • Warranty sub-franchisor has right to grant the rights it is granting Registered users Right to take action against infringements

CHAPTER 14: KNOW-HOW

General points raised in relation to this chapter were the need to make it less academic in style, the need to delete the references to the European Community Block Exemption Regulation¹ unless strictly necessary and the need to modify the references to national legal systems, referring instead more broadly to families of legal systems ("common law", "civil law"). Any more specific references that were felt to be necessary might be left to the Annex.

While the chapter should no longer contain any references to the European Block Exemption Regulation, it was suggested that it would be useful nevertheless to refer to the concept it contained in the part of the definition of franchising that dealt with secrecy, where the Regulation spoke of the franchisor's know-how being the totality of the package rather than individual parts which might themselves be in the public domain, as it was that package that was unique. It was the way in which that existing know-how was brought together in that package that had considerable value.

The need to make certain distinctions and to explain more fully certain differences that existed in relation to know-how was discussed. First and foremost a distinction should be drawn between know-how that was protectable and that which was not protectable. Further distinctions and explanations should be given with respect to proprietary and non-proprietary know-how, secret and generally available know-how, the protection of know-how by contract, know-how that was protectable against a third party who was not a party to the agreement and know-how that was protectable against a party who had executed a document acknowledging that this was secret. Furthermore, with respect to the party who received the know-how, the question of whether it was possible to protect that know-how post-term had to be examined, considering that once the franchisees had acquired that knowledge, it would not be possible for them to return it.

A general point that was raised concerned the question of warranties and the extent to which the sub-franchisor had to warrant that it had been given the rights that it was granting sub-franchisees. It was considered that this should be mentioned in the chapter relating to the obligations of the sub-franchisor, although it was also suggested that Chapter 4 might be the right place in which this general point could be discussed, and subsequently picked up by each chapter which dealt with a right granted. Thus, the chapter on intellectual property would consider the question of the warranties that the sub-franchisor might have to give specifically in relation to intellectual property rights. Similarly, that chapter should also consider the extent to which the franchisor itself should be expected to warrant its ownership of the intellectual property it was licensing. The same reasoning would apply to the chapter on know-how.

One issue that was not presently covered in the chapter, but which it was suggested might be covered, concerned whether or not it was possible to protect confidential information without having a written agreement. This confidential information did not in actual fact have to be secret know-how, it could be any other document or information that the franchisor had indicated should be confidential.

Of importance in relation to the protection of know-how were the transfer of technology laws applicable in a number of countries. The definition of know-how contained in these laws would often be broad enough to cover also commercial information, which was the type of know-how concerned in franchising. It was therefore felt that the chapter should refer also to this.

Another point of interest was the question of what the situation was when a third person, *bona fide* or otherwise, acquired knowledge of the know-how. The Group concluded that in some jurisdictions the sub-franchisor or sub-franchisee would still be bound by the confidentiality agreement, whereas in others it would not, as the obligation would cease to exist as soon as the information was no longer secret.

¹ 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, O.J. EEC L 359/46 of 28 December 1988.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 14 New chapter number: 13 [Frignani]	Know-how New title: Rights protected by contract	<p>Discussion on the difference between know-how and trade secrets and confidential information</p> <p>References to national laws and to the EEC Regulations</p> <p>What may be regarded as know-how:</p> <ul style="list-style-type: none"> • technical secrets • commercial secrets - condition to receive protection <p>Functional role of know-how in franchising contracts</p> <p>The identification of know-how as secret, substantial and identified</p> <p>The difference between the assignment and the licensing of know-how</p> <p>The transfer of know-how in franchising contracts</p> <ul style="list-style-type: none"> • the franchisor reserves the right of further exploitation • operations manual • training of the franchisee and staff • practical try-outs of the commercial techniques <p>Clauses used to protect the know-how:</p> <ul style="list-style-type: none"> • confidentiality • grant-back • field of use restriction <p>Post-termination:</p> <ul style="list-style-type: none"> • confidentiality • non-competition clauses - problems with identification of territory <p>Sub-franchisor acting as middleman</p> <p>Area development agreement directly or through subsidiaries</p> <p>Contractual protection of know-how: in MFA and/or SFA</p> <p>Liability for breach by sub-franchisees</p> <p>Prior approval by franchisor</p> <p>Legal remedies:</p> <ul style="list-style-type: none"> • Protection under criminal law • Protection in tort - unfair competition • Protection in contract 	<p>Exploitation always takes place through third parties: who are the third parties?</p> <p>Terminology: "undertaking" "piercing the corporate veil"</p> <p>Qu confirmation that confidential information is less protected than trade secrets, particularly for the duration of non-disclosure contractual clauses</p> <p>Qu as to the written form for the know-how licence agreement</p> <p>Qu: the duration of a licence of know-how cannot exceed the moment in which the entire know-how falls under the public domain and if mean validity or value will be reduced</p> <p>Qu: If the know-how is completely and correctly identified, any violation of a contractual clause concerning the know-how will amount to a fundamental breach</p> <p>Qu: Identification of territory for post term protection: why should it be any territory other than that allocated to the former franchisee?</p> <p>If the sub-franchisor acts as a middleman, is that really a case of franchising?</p> <p>How would it work with area development agreements through subsidiaries?</p> <p>The clauses protecting know-how should surely be in both MFA and SFA</p> <p>Difference between creating an obligation and enforcing it?</p> <p>Qu: if the sub-franchisor does not manage a franchised undertaking franchisor may not be obliged to communicate all the information which the law of its country required be disclosed to prospective franchisees</p> <p>Qu: disclosure of information be either franchisor or sub-franchisor: what are the relations between the parties?</p> <p>Qu: duties of non-disclosure can legitimately be imposed on employees in all industrialised countries</p> <p>Qu: Confidential information forming the only subject-matter of the agreement</p>	<p>General remark on general theory of confidentiality and non-competition</p> <p>Discussion on the difference between know-how and trade secrets and confidential information</p> <p>Differences between proprietary and non-proprietary know-how</p> <p>Differences between secret and generally available know-how</p> <p>Difference between protectable and non-protectable know-how</p> <p>Know-how that is protectable against third person who is not a party to the agreement and that which is protectable against a party who has executed the agreement</p> <p>Protection of know-how by contract</p> <p>Protection of confidential information without having a written agreement</p> <p>What may be regarded as know-how:</p> <ul style="list-style-type: none"> • technical secrets • commercial secrets - condition to receive protection <p>Functional role of know-how in franchising contracts</p> <p>Know-how as technology under the technology transfer legislation of some countries</p> <p>The identification of know-how as secret, substantial and identified</p> <p>The difference between the assignment and the licensing of know-how</p> <p>The transfer of know-how in franchising contracts</p> <ul style="list-style-type: none"> • the franchisor reserves the right of further exploitation • operations manual • training of the franchisee and staff • practical try-outs of the commercial techniques <p>Clauses used to protect the know-how:</p> <ul style="list-style-type: none"> • confidentiality • grant-back • field of use restriction <p>Post-termination:</p> <ul style="list-style-type: none"> • confidentiality • non-competition clauses - problems with identification of territory <p>Area development agreement directly or through subsidiaries</p> <p>Contractual protection of know-how: in MFA and/or SFA</p> <p>Liability for breach by sub-franchisees</p> <p>Prior approval by franchisor</p> <p>Legal remedies:</p> <ul style="list-style-type: none"> • Protection under criminal law • Protection in tort - unfair competition • Protection in contract

CHAPTER 15: SYSTEM CHANGES

While the Group agreed on the importance of dealing with both system changes that were required at the outset to adapt the system to the cultural and legal needs of the host country and system changes that were required in the course of the relationship as a result of developments or changed circumstances, there was no agreement on the exact location of this discussion. One view was that the need for initial system changes should be discussed already in the Introduction, while another was that the present chapter should be expanded to include both initial and subsequent system changes. A third alternative was for the chapter on rights and obligations of the franchisor to expand the references to initial system changes that it already contained. In the end there was agreement on the fact that a general discussion should be envisaged early on in the guide, but that a decision on the final location should be left until such time as a revised draft of Chapter 15 was available.

The chapter on system changes was in fact considered to be one of the most important of the guide, as it dealt with how changes should be effected, who could effect changes and who would own the changes once effected, as well as with the general questions of whether there should be changes, whether there could be any changes. In general it considered changes that might be imposed by law as opposed to changes that might be imposed by culture, as the latter would in most instances be changes that had to be made from the outset.

The importance of the chapter lay in the fact that most master franchise agreements were long-term agreements and that over time conditions would change. It would therefore be necessary to modify the agreement to take new developments into account and a procedure had to be provided for. As to the origin of the changes, it was pointed out that the way the chapter was drafted it seemed to provide merely the franchisor with information on how to effect the changes it wanted to introduce, and not the other parties. The guide was however not intended only for franchisors, so the drafting of the chapter would have to change substantially to take into account the points of view of the other parties concerned. It might, for example, be necessary for the sub-franchisor to initiate changes to comply with the legal regulations applicable in its country. A question to be considered in this connection was then whether or not the franchisor would be able to veto any such changes. The situation might be different where the changes the sub-franchisor intended to introduce were not dictated by the necessity of complying with the law, but were improvements that the sub-franchisor felt it was making to the franchise system.

It was suggested that the guide should indicate to franchisors the advisability of informing the sub-franchisor and sub-franchisees of the practical feasibility and advisability of certain changes it wished to introduce into the system, bringing evidence from the experience of its own outlets or of selected sub-franchise outlets.

Chapter	Title	Content first draft	Queries / comments	Contents as revised
Chapter 15 New chapter number: 14 [Zeidman]	System changes	<p>Role of change in the franchise relationship</p> <ul style="list-style-type: none"> • franchisor's need for flexibility • franchisee's need for certainty <p>Changes in a franchise system often related to stage of development of system</p> <p>Factors determining change:</p> <ul style="list-style-type: none"> • shifting demographics • changing consumer tastes • new technologies • new competition <p>Importance of franchisor's ability to adapt to change</p> <p>Change in international relations</p> <p>Legal principles affecting capacity to respond to change:</p> <p>Contract law issues</p> <ul style="list-style-type: none"> - implied duties - good faith and reasonableness <p>Statutory issues</p> <ul style="list-style-type: none"> - good cause <p>Where change is most likely to be necessary</p> <ol style="list-style-type: none"> 1. Nature of the business <ul style="list-style-type: none"> - location and nature of facility - territorial rights - customers towards which aimed products and services offered - methods of marketing and delivery 2. External appearance <ul style="list-style-type: none"> - trademark/trade dress - renovation 3. Changes in obligations of franchisee <ul style="list-style-type: none"> - new obligations - higher standards of performance 4. Changes of franchisor's activities 5. Techniques for effecting change <ul style="list-style-type: none"> - use of the term of the contract - making change dependent on the happening of objectively determined events - use of documents other than the franchise agreement - circumstances which may provide appropriate opportunities to effect change - corrective and enforcement mechanisms - other drafting techniques - making changes more palatable 6. Changes of particular significance in international context <ul style="list-style-type: none"> - different vehicles- cost factors - practical differences - language - culture 	<p>Too franchisor biased</p> <p>Qu: whether some of the changes suggested as possible can be considered ethical, e.g. closer proximity of franchise outlets than originally bargained for</p> <p>Terminology: "undeveloped country"</p> <p>Qu if competition by franchisor through other distribution systems ethical: different approach in other chapters</p> <p>Qu possible abuses in relation to capital expenditure for up-grading of equipment - may be necessary</p> <p>Unilateral modification by franchisor: qu if do not need to have a new agreement if increase obligations of franchisee: not what bargained for, could be a situation of hardship and abuse</p> <p>Qu increase in territory of franchisee as opposed to decrease</p> <p>Why would the franchisee not be the best party to do the market research considering it is the franchisee which operates in the territory?</p> <p>New obligations of franchisee: does this relate only to some specific types of obligations?</p> <p>Qu if effects of certain events such as revocation of exclusivity should be treated here or as sanctions for non-performance</p> <p>Incorporate provision of manual <u>by reference</u>?</p> <p>Franchisee's desire to extend term - surely subject to negotiation</p> <p>Hidden changes appear to be disguised as sanctions</p> <p>Explain "national account"</p> <p>Define doctrine of "compulsion"</p> <p>Qu meaning "regional and/or national accounts"</p> <p>Ref to "combination franchising" more as illustration</p>	<p>Role of change in the franchise relationship</p> <ul style="list-style-type: none"> • franchisor's need for flexibility • franchisee's need for certainty <p>Changes in a franchise system often related to stage of development of system</p> <p>Factors determining change:</p> <ul style="list-style-type: none"> • shifting demographics • changing consumer tastes • new technologies • new competition <p>Importance of franchisor's ability to adapt to change</p> <p>Change in international relations</p> <p>Legal principles affecting capacity to respond to change:</p> <p>Contract law issues</p> <ul style="list-style-type: none"> - implied duties - good faith and reasonableness <p>Statutory issues</p> <ul style="list-style-type: none"> - good cause <p>Where change is most likely to be necessary</p> <ol style="list-style-type: none"> 1. Nature of the business <ul style="list-style-type: none"> - location and nature of facility - territorial rights - customers towards which aimed products and services offered - methods of marketing and delivery 2. External appearance <ul style="list-style-type: none"> - trademark/trade dress - renovation 3. Changes in obligations of franchisee <ul style="list-style-type: none"> - new obligations - higher standards of performance 4. Changes of franchisor's activities 5. Techniques for effecting change <ul style="list-style-type: none"> - use of the term of the contract - making change dependent on the happening of objectively determined events - use of documents other than the franchise agreement - circumstances which may provide appropriate opportunities to effect change - corrective and enforcement mechanisms - other drafting techniques - making changes more palatable 6. Changes of particular significance in international context <ul style="list-style-type: none"> - different vehicles- cost factors - practical differences - language - culture <p>Modify agreement (ex Ch. 3)</p> <p>Specify whether modifying the agreement would require the franchisor to enter the market</p> <p>Consider changes initiated by sub-franchisor and sub-franchisees</p> <p>Ownership of system changes</p>

CHAPTER 17: INSURANCE AND INDEMNIFICATION

While in general it was considered that the draft of this chapter raised the correct issues, even if it would have to be re-written in narrative form, it was agreed that it should be made clear that this chapter did not deal with indemnifications for damages suffered as a result of a party not fulfilling its obligations under the agreement.

It was also felt that the chapter should deal with the fact that in many jurisdictions its subject matter would be unknown, as the taking out insurance to support a third party liability case would not be a common practice. This was an issue that should probably be mentioned also in the chapters on choice of law and jurisdiction.

Furthermore, it was agreed that the reference to the European Community Block Exemption Regulation should be deleted, as it raised issues that were too geographically limited and of no interest to a majority of the prospective readers of the guide.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 17 New chapter number: 16 [Schulz]	Insurance and indemnification	Obligation of sub-franchisor to take out insurance Copy of insurance policy to franchisor Qualifications of insurer Conditions for the insurance policies Duty of sub-franchisor to ensure sub-franchisees pay insurance Franchisor may take out insurance coverage if sub-franchisor does not Sub-franchisor to assume sole responsibility for any loss, damage cost or expense and conditions when shall indemnify franchisor Notification of claims by franchisor to sub-franchisor Conditions when sub-franchisor to indemnify and hold franchisor harmless Franchisor may elect to assume defence/settlement of claim No personal liability of directors etc. of franchisor Conditions when Franchisor shall indemnify and hold harmless sub-franchisor and sub-franchisees and directors etc. Sub-franchisor to notify franchisor of liability claim Franchisor agrees to indemnify and hold sub-franchisor harmless for economic loss due to application EEC Reg. Sub-franchisor may elect to undertake or assume defence or settlement of claim at franchisor's risk and expense.	17.1 For what is insurance taken out and why? On what would the minimum insurance coverage be estimated? 17.3 What about the liability of the franchisor? 17.6 Would the insurance be taken out by the franchisor in the name of the sub-franchisor? What about the case where the franchisor is the beneficiary? 17.8 Presumably where the proceedings are against the franchisor for fault of the sub-franchisor 17.12 Presumably this is when the sub-franchisor acts on behalf of the franchisor? 17.4 What claims are referred to by "any such claim"?	Indications of what the chapter deals with (not compensation for non-performance) General description to explain situation to users in countries where taking out insurance to support a third person liability case is unknown Obligation of sub-franchisor to take out insurance Copy of insurance policy to franchisor Qualifications of insurer Conditions for the insurance policies Duty of sub-franchisor to ensure sub-franchisees pay insurance Franchisor may take out insurance coverage if sub-franchisor does not Sub-franchisor to assume sole responsibility for any loss, damage cost or expense and conditions when shall indemnify franchisor Notification of claims by franchisor to sub-franchisor Conditions when sub-franchisor to indemnify and hold franchisor harmless Franchisor may elect to assume defence/settlement of claim No personal liability of directors etc. of franchisor Conditions when Franchisor shall indemnify and hold harmless sub-franchisor and sub-franchisees and directors etc. Sub-franchisor to notify franchisor of liability claim Sub-franchisor may elect to undertake or assume defence or settlement of claim at franchisor's risk and expense.

CHAPTER 18: SALE, ASSIGNMENT OR TRANSFER OF RIGHTS

The issues raised in the draft chapter on the sale, assignment or transfer of rights were considered to be correct, although it was felt that a distinction should be made between assignment by the franchisor and assignment by the sub-franchisor, the latter of which was not dealt with in sufficient detail.

In this connection the question of the franchisor retaining a right of first refusal if the sub-franchisor wished to assign its rights to a third party should be discussed, as should the conditions that might be found in the master franchise agreement for the franchisor to give its consent to the transfer or assignment. A particularly contentious condition which should be referred to was that of the sub-franchisor releasing the franchisor of all claims that the sub-franchisor might have for past defaults of the franchisor, or the condition that the acquirer of the sub-franchisor's business should enter into a new master franchise agreement as opposed to taking an assignment. The advantages and disadvantages of each of the conditions discussed for all parties concerned should be examined in the chapter. A provision that was typical in domestic agreements, but which was also to be found in international master franchise agreements, was a clause that provided that the franchisor could freely assign the unit agreement without the consent of the sub-franchisee and that once it had been assigned, and to the extent that the obligations were assumed by the assignee, the assignor (i.e. the franchisor) would be relieved of all responsibility.

The possible assignment on the part of the sub-franchisee should also be taken up, although an indication that the conditions were very similar to an assignment by the sub-franchisor, with the possible exception of the amount of resources required, was felt to be sufficient.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 18 New chapter number: 17 [Jesse]	Sale, assignment or transfer of rights	<p>Importance of providing for a transfer already at the time of the agreement</p> <p>Motives for transfers:</p> <ul style="list-style-type: none"> • tax considerations • internal corporate governance • facilitation of ownership succession • disability or death • financial reasons • changes in outlook <p>Reasons for restrictions on right to transfer</p> <ul style="list-style-type: none"> - franchisee - franchisor in MFA <p>Franchisor's written consent</p> <p>Examples of conditions for transfer</p> <p>Franchisor's right to acquire if franchisee wants to sell</p> <ul style="list-style-type: none"> - reasonableness standard <p>Transfers of interests that are to occur under specific circumstances, e.g. bankruptcy</p>	<p>Not sufficient distinction between transfer by franchisor and by sub-franchisor</p> <p>Not sufficient on sub-franchisor</p>	<p>Importance of providing for a transfer already at the time of the agreement</p> <p>Motives for transfers:</p> <ul style="list-style-type: none"> • tax considerations • internal corporate governance • facilitation of ownership succession • disability or death • financial reasons • changes in outlook <p>Reasons for restrictions on right to transfer</p> <ul style="list-style-type: none"> - franchisee - franchisor in MFA <p>Franchisor's written consent</p> <p>Examples of conditions for transfer</p> <p>Franchisor's right to acquire if sub-franchisor wants to sell</p> <ul style="list-style-type: none"> • reasonableness standard • conditions for acceptance of the sale/assignment or transfer by the sub-franchisor • franchisor relieved of responsibility <p>Franchisor's right to first refusal</p> <p>Transfers of interests that are to occur under specific circumstances, e.g. bankruptcy</p>

CHAPTER 19: EXPIRY

In the course of the discussion on the chapter on termination it had been decided to restructure the chapters so as to have a chapter dealing with remedies for non-performance, which would include but not be limited to termination, and another chapter on the end of the agreement and its consequences, irrespective of whether the agreement came to an end as a result of the expiry of the term or as a result of termination for non-performance. The sections dealing with the end of the relationship presently contained in Chapter 20 should therefore be transferred to Chapter 19 and modified as necessary. The order of the two chapters should also be reversed. Any differences as to consequences between the end of the relationship being caused by termination or by expiry should be evidenced, such as, for example, the question whether sub-franchisees had a right to compensation if their contracts were automatically terminated as a result of the termination of the master franchise agreement despite the fact that the sub-franchisees were fully performant, and if so from whom they could claim compensation.

The possible automatic termination of the sub-franchise agreements upon the termination of the master franchise agreement, the problems associated with differences in length of the term of the master franchise agreements and that of the sub-franchise agreements, were all issues of considerable importance that had to be dealt with in some detail. Linked with this was the question of whether or not the franchisor could be obliged to accept an assignment.

A question that had been touched upon briefly and which was referred to in the chapter on ancillary documents was that of termination by mutual agreement. Yet another issue that could be of importance and that might arouse concern in particular in developing countries, and which should therefore be dealt with, was the question of termination as a result of "good cause", i.e. if the franchisor finds that it is no longer economically viable to keep a network or an outlet and therefore terminates the agreement. The consequences of any such policy, the possibility to avoid any such measure or to guard against its consequences, should be considered.

Issues associated with termination that should be considered included whether the franchisor should be obliged to take over an agreement and whether the sub-franchisor could claim compensation for what in effect was the take-over of its business; whether the franchisor would want to take over a network which might be very badly run, or whether it could pick and choose the outlets it would want to keep on; questions of compensation due to the franchisor for restoring a mismanaged network; what would happen to issues dealt with under ancillary agreements, such as leases; how payment would be made for such ancillary agreements considering that that was something that the franchisor should perhaps not confiscate; whether the franchisor could take them over as part payment or full payment of any costs incurred in restoring the network; the legal vehicles by which the different options could be achieved and the advantages and disadvantages of the different legal vehicles; the de-identification of the franchise outlets; and non-competition provisions

Other issues that should be referred to were problems associated with the fact that as a foreigner the franchisor might not be permitted to carry on a business in a given country, in which case the franchisor would have to have recourse to other locals to take over from the sub-franchisor. Furthermore, for the benefit of sub-franchisees mention should be made of the possibility to negotiate a term according to which, to the extent that the master franchise agreement was terminated, the franchisor would enter into a new agreement for the un-expired term. This was admittedly a contentious point, but it was felt that it should be referred to, even if with due caution.

Post-termination non-competition provisions were not always admitted. This was true in particular of conversion franchises. If someone converted their existing business to a franchised business and the agreement came to an end, it was not possible to prohibit them from continuing the business they were conducting before they entered the franchise. It was felt that this matter might be dealt with in terms of a right or an option to acquire the business on termination at full market value. In this context options to acquire businesses as a tool for overcoming problems with some of the post-termination restraints might also be worth considering.

Chapter	Title	Content first draft	Queries / comments	Content as revised
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<p>Chapter 19</p> <p>[Jesse]</p>	<p>Expiry</p> <p>New title: The End of the Relationship and its Consequences</p>	<p>General comments on links between the units and the franchisor through the sub-franchisor</p> <p>Effects of expiry on unit agreements operated by sub-franchisor as franchisee</p> <p>Renewal in case of MFA</p> <p>Fulfilment of obligations by sub-franchisor</p> <p>Sub-franchisor to cease activities as sub-franchisor</p> <p>Provision of goods and services to units</p> <p>Advertising funds</p> <p>Franchisor to step into the shoes of the sub-franchisor</p> <p>Purchase by franchisor from sub-franchisor of supplies and materials identified with the system</p> <p>Sub-franchisor's units</p> <p>SFA should contain provision to facilitate reorganisation of relationship</p> <p>Distinction between the units operated by the sub-franchisor directly</p> <p>Assignment of SFA to franchisor</p> <p>Termination of trademark licence of sub-franchisee when MFA terminates</p> <p>Franchisor party to sub-franchise agreement</p> <p>- liability</p> <p>Development term/regular term</p> <p>Copy of SFA to franchisor</p> <p>Fundamental information on sub-franchisees to franchisor</p> <p>Records or copies to be given to franchisor or designee upon termination</p> <p>Fee for transfer:</p> <p>- pricing formula</p> <p>Post-term non-competition clause.</p>	<p>Would the franchisor always purchase the supplies and materials identified with the system?</p> <p>The statement: "The SFA should also contain a provision which states the sub-franchisee's acknowledgement that the termination of the MFA will result in the termination of the sub-franchisee's licence to use the trademark and other proprietary rights of the franchisor which have been licensed to the sub-franchisee through the MFA"</p> <p>- relate to the assignment clauses which are supposed to guarantee a continuance of the SFA</p> <p>Explain better the relationship between assignment and the fact that the sub-franchisee is no longer allowed to use the TMs etc.</p> <p>Explain better the situation where the sub-franchisor operates its own units and one goes bankrupt - the effects on the others</p>	<p>General comments on links between the units and the franchisor through the sub-franchisor</p> <p>Effects of expiry on unit agreements operated by sub-franchisor as franchisee</p> <p>Renewal in case of MFA</p> <p>Fulfilment of obligations by sub-franchisor</p> <p>Sub-franchisor to cease activities as sub-franchisor</p> <p>Provision of goods and services to units</p> <p>Advertising funds</p> <p>Franchisor to step into the shoes of the sub-franchisor</p> <p>Purchase by franchisor from sub-franchisor of supplies and materials identified with the system</p> <p>Sub-franchisor's units</p> <p>Possible automatic termination of sub-franchise agreements</p> <p>SFA should contain provision to facilitate reorganisation of relationship</p> <p>Distinction between the units operated by the sub-franchisor directly</p> <p>Assignment of SFA to franchisor</p> <p>Different assignment options: advantages and disadvantages</p> <p>Termination of trademark licence of sub-franchisee when MFA terminates</p> <p>Franchisor party to sub-franchise agreement</p> <p>- liability</p> <p>Development term/regular term</p> <p>Copy of SFA to franchisor</p> <p>Fundamental information on sub-franchisees to franchisor</p> <p>Records or copies to be given to franchisor or designee upon termination</p> <p>Fee for transfer:</p> <p>- pricing formula</p> <p>Post-term non-competition clause</p> <p>The case of conversion franchises</p> <p>Possibilities of compensation for sub-franchisees if MFA terminated for non-performance of sub-franchisor</p> <p>Termination by mutual agreement</p> <p>Termination for good cause</p> <p>Compensation to sub-franchisor for the clientèle</p> <p>Compensation to sub-franchisor for loss of business if franchisor is at fault</p> <p>Nomination of second sub-franchisor and possible conflicts between two networks</p> <p>Fate of equipment and stock</p> <p>Fate of leases etc.</p> <p>Possibility to continue using the TMs until compensation and de-identification</p> <p>Possibility to buy the trademark rights from the franchisor for use in that country</p> <p>Effects of bankruptcy on franchisor's rights under the agreement.</p>
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CHAPTER 20: TERMINATION

The Group decided that in addition to termination other remedies short of termination should be covered by the guide. It was therefore decided that the chapter on termination should become a chapter on "Remedies for Non-Performance" and that it should be placed before the chapter on the expiry of the agreement. The latter should further become a chapter on the end of the agreement, independently of whether the end of the agreement was due to non-performance of an obligation or to the expiry of the contract. A number of possible remedies were therefore added for consideration in the chapter.

It was also decided that at the beginning of the chapter mention should be made of extra-contractual means to find a negotiated solution before the remedies available were resorted to. In any event, the chapter would have to be considerably expanded upon as the issues were not discussed in sufficient detail.

It was agreed that the remedies that a sub-franchisor might have in case of non-performance by the franchisor should also be considered, even if the very nature of the agreement made the provisions seem biased in favour of the franchisor. Once the sub-franchisor had been installed, the franchisor's on-going obligations were low-key. Particular questions, such as whether or not the sub-franchisor could stop paying royalties to the franchisor but still continue to use the franchisor's name if the franchisor did not perform, also needed to be addressed.

It was stressed that indemnification provisions should be reciprocal and that the remedies indicated were not mutually exclusive.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 20 New chapter number: 18 [Mendelsohn]	Termination New title: Remedies for Non-Performance	<p>Background</p> <p>Termination by franchisor:</p> <ul style="list-style-type: none"> • issues such as insolvency and bankruptcy • operational issues • failure to maintain development schedules <p>Material or substantial defaults</p> <p>Consequences of termination for sub-franchisor</p> <p>Consequences of termination for sub-franchisees:</p> <p>assignment of SFAs</p> <p>- questions which form the subject of negotiation</p> <p>Termination by sub-franchisor</p> <p>Consequences for network if sub-franchisor entitled to terminate for material default of franchisor</p>	<p>Statement: "The sub-franchisor does not have the same urgent needs if there is a default by the franchisor" - Why? If services or products do not arrive it will not be able to service the network</p> <p>Statement: "Where the franchisor has terminated under the provisions of the agreement it may have to seek court orders to enforce its rights in any event" - the same holds true for the sub-franchisor</p> <p>Presumably the sub-franchisor would be entitled to terminate the MFA for default on the part of the franchisor under normal contract law</p> <p>Qu. of compensation if sub-franchisor loses business when the franchisor is at fault</p> <p>Qu. lack of disclosure</p> <p>Qu. right to cure default</p>	<p>Background</p> <p>Negotiated solution</p> <p>Remedies short of performance:</p> <p>loss of exclusivity:</p> <ul style="list-style-type: none"> • fine or penalty to be paid • increases of royalty payments or loss of benefit of sliding scale • loss of right to renew • reduction in or loss of the right to open additional units • payment of compensation for failure to keep the development schedule • reduction of the contractual territory • keeping exclusivity for only part of the territory • additional training at sub-franchisor's expense • additional support at sub-franchisor's expense • notices to cure • rescheduling of debt • renegotiation • loss of development rights with the right to continue with the units presently opened • specific performance • injunctive relief • sue for money damages <p>Termination by franchisor:</p> <ul style="list-style-type: none"> • issues such as insolvency and bankruptcy • operational issues • failure to maintain development schedules <p>Material or substantial defaults</p> <p>Consequences of termination for sub-franchisor</p> <p>Consequences of termination for sub-franchisees:</p> <p>assignment of SFAs</p> <p>- questions which form the subject of negotiation</p> <p>Force majeure as an excuse for non-performance</p> <p>Remedies available to sub-franchisor:</p> <ul style="list-style-type: none"> • agreement turned into barebones licence • sub-franchisor allowed to buy the trademarks of the system for use in that country • other remedies short of termination • termination <p>Consequences for network if sub-franchisor entitled to terminate for material default of franchisor</p>

CHAPTER 21: CHOICE OF LAW

A first observation made by the Group in relation to choice of law was that whereas in previous years franchisors had tended to want their national law to apply to both the master franchise agreement and the sub-franchise agreements, this was no longer true. There was however still a tendency for master franchise agreements to be subjected to the law of the franchisor, one reason often put forward being that the franchisor was granting master franchise agreements all over the world and wanted the same law to apply to all.

It was suggested that it would be wise to insist in the guide on the advisability of including a definite choice of law in the agreement. It should be pointed out that if there were no choice of law different laws might be applicable to the different agreements that made up the franchise arrangement - different laws might, for example, be applicable to the sales contract and the licence contract, as there were connecting factors linking those particular contracts to different laws. Opinions were divided on the advisability of having different laws apply to the master franchise agreement and the sub-franchise agreement, but there was agreement on the fact that this question had to be discussed in the guide, with indications of advantages and disadvantages given for the various options. The problems of enforcement should also be stressed, as if American law was applicable to the contract it might for example be difficult to enforce the protective provisions of that law in France, Italy, Spain or Portugal. There were certain criteria that an objective individual could apply to make an objective choice of law and these criteria should be listed.

It should also be pointed out that there were certain areas of law that it was not possible to contract out of, areas of public policy, such as competition law.

On the other hand, if a franchisor intended to enter a country that did not have a developed set of commercial laws, or where foreigners notoriously could not get justice, that franchisor would not be willing to be subjected to the law of that country, no matter what criteria might be met. The relevance of arbitration was particularly apparent in these cases. In any event, the guide should not take a position on whether arbitration was preferable to litigation through the State court system.

The section on mediation also required more detail, considering that it was becoming a more usable tool than either arbitration or litigation, especially in the international field.

It was stressed that ultimately choice of law, and also choice of forum, were concerned with enforcement. What had to be decided was what was the best place and what law was the most appropriate should something go wrong. Enforcement was one of the variables that led down the public policy route, because the areas that needed to be enforced, certainly from the franchisor's point of view, came almost exclusively under the heading of public policy issues. There were issues that could not be subjected to a foreign law by the master franchise agreement, the most significant of which was intellectual property.

In addition to questions of enforcement, it was pointed out that substantive questions of law might be of importance in selecting the applicable law. An example of such a substantive question of law was whether or not at the end of the relationship the sub-franchisor and sub-franchisees could claim an indemnity from the franchisor or sub-franchisor respectively. In any event in the vast majority of cases substantive issues would arise in the country in which the whole business transaction was going to be implemented.

Compromise solutions were considered, such as provisions that indicated that the party instituting proceedings must do so in the defendant's jurisdiction and must apply the law of the defendant's country. Another alternative was to have the law of the territory where the franchise was to be operated apply to public policy issues and the law of the franchisor's territory apply to all other issues. It was suggested that such compromise solutions might be referred to, even if not discussed in detail.

It was pointed out that the areas that were most contested were fees, development schedules and choice of law and jurisdiction.

Lastly, it was observed that paragraph 19 of the draft implied that the *United Nations Convention on Contracts for the International Sale of Goods* would always apply, whereas it would only apply if and to the extent that a sale of goods was involved.

Chapter	Title	Content first draft	Queries /comments	Content as revised
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<p>Chapter 21</p> <p>New chapter number: 20</p> <p>[Rose]</p>	<p>Choice of law</p>	<p>Principal types of international franchise agreements</p> <p>Factors determining choice of law</p> <ul style="list-style-type: none"> - enforceability of contractual obligations - enforceability through litigation <p>Most likely disputes for:</p> <ul style="list-style-type: none"> - failure to pay fees - failure to meet quality control standards - trademark abuse - sub-franchisor's claim of franchisor defaults - actions to terminate the franchise agreement <p>Areas of likely disputes:</p> <ul style="list-style-type: none"> - failure to supervise - failure to develop territory - claims against sub-franchisees <p>Necessity to evaluate advantages/disadvantages of different choice of law options</p> <p>Applicable legislation: mandatory: anti-trust</p> <p>Areas of substantive law to examine in making the choice</p> <p>Differences between developed / not developed system of business law</p> <p>Limitations of right to choose</p> <p>Law applicable to SFA</p> <p>Same/different law applicable to MFA and SFA</p> <p>International Instruments:</p> <ul style="list-style-type: none"> - CISG - Principles 	<p>Sub-franchisees will normally not have direct relations with franchisor</p> <p>In list of sub-franchisor's claim of franchisor defaults, what other possibilities would there be?</p> <p>In actions to terminate the franchise agreement - possibly more common in reverse order</p> <p>Is it really likely that the franchisor would proceed directly against the sub-franchise trying to enforce quality control standards?</p> <p>11. More likely scenario in country of sub-franchisor (a developed franchise system will proceed from a country with a developed business system)</p> <p>In practice for a MFA the law chosen will be the franchisor's and not the sub-franchisor's</p> <p>If the international conventions are part of the domestic legal system it will in all likelihood not be possible to exclude their application</p> <p>Need to distinguish the situation of intellectual property rights in relation to which the local law will in all likelihood be mandatory</p>	<p>Factors determining choice of law</p> <ul style="list-style-type: none"> • enforceability of contractual obligations • enforceability through litigation <p>Most likely disputes for:</p> <ul style="list-style-type: none"> • failure to pay fees • failure to meet development schedules • misrepresentation • failure to meet quality control standards • trademark abuse • sub-franchisor's claim of franchisor defaults • actions to terminate the franchise agreement <p>Areas of likely disputes:</p> <ul style="list-style-type: none"> • failure to supervise • failure to develop territory • claims against sub-franchisees <p>Necessity to evaluate advantages/disadvantages of different choice of law options</p> <p>Applicable legislation: public policy or mandatory: anti-trust, intellectual property</p> <p>Possibility to have different laws apply to different agreements in the MFarrangement</p> <p>Compromise solutions</p> <p>Situation when sub-franchisor and sub-franchisees not in the same country (e.g. Eastern Europe)</p> <p>Areas of substantive law to examine in making the choice</p> <p>Differences between developed / not developed system of business law</p> <p>Limitations of right to choose: in some countries choice of law not permitted</p> <p>Law applicable to SFA</p> <p>Same/different law applicable to MFA and SFA</p> <p>International Instruments:</p> <ul style="list-style-type: none"> - CISG - Principles <p>See indications in Ch. 3, plus with reference thereto, if appropriate:</p> <ul style="list-style-type: none"> • refer to mandatory provisions of the local law • franchisor needs to enforce TM rights: explain why the law of the territory applies • explain why arbitration is favoured over litigation in MFAs • explain negative effects of choosing US law • explain why the franchisor can determine the law which is applicable to a contract to which it is not a party <p>Arbitration and mediation</p> <p>The situation of federal States</p>
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CHAPTER 22 CHOICE OF FORUM

In general terms reference was made to the decisions taken not to refer to legal doctrines such as the Calvo doctrine and not to include examples of contract clauses. Furthermore, it was observed that statements that might be considered to include certain value judgments, such as those referring to the honesty and efficiency of national courts, should also be avoided. Regrettably, the state of ratifications that had been included in the chapter referred not to the *1965 Hague Convention on the Service abroad of Judicial and Extra-Judicial Documents in Civil and Commercial Matters*, but to the *1961 Convention Abolishing the Requirement of Legalisation for Foreign Public Documents* and this should be corrected.

In connection with the enforcement of foreign judgments, it was observed that there were countries in which a treaty was required for such an enforcement and that this should be stressed in the guide. These differences in possibility of execution existed also between the countries of the European Union, with the consequence that despite the *Brussels/Lugano/San Sebastian Convention on jurisdiction and the enforcement of judgments in civil and commercial matters* the regulation of this matter was not as uniform as was described in the chapter.

The problem of injunctive relief and other interim measures and the power of judges and arbitrators to grant such interim measures was discussed. While both judges and arbitrators could grant interim measures, it was observed that normally the State court systems would be more efficient in this regard, as any such measure adopted by an arbitrator could only be enforced through a court. Furthermore, the time required for the convening of the arbitral tribunal introduced a further element of delay. It was therefore suggested that if the parties to a franchise agreement did opt for arbitration, they could exclude any such matters as might require urgent interim measures from the application of that provision and instead have recourse to the national court system for those matters.

A discussion ensued on the possibility of claiming certain infringements, such as the infringement of a trademark, without first terminating the agreement. Opinions were divided, one being that it would be necessary first to terminate the agreement and then to proceed against the former sub-franchisor (in which case questions might be raised as to whether or not arbitration was going to preclude the franchisor from the immediate remedies it required and also whether or not courts would admit clauses which excluded certain issues from arbitration), the other being that it was perfectly possible to separate the issues in the agreement and have some subject to arbitration and others not. As the guide was not intended to take any definite position, it was decided that the issue should be raised and discussed even if no conclusion was reached.

With particular reference to arbitration, the Group felt that the *1958 New York Convention on the recognition and enforcement of foreign arbitral awards* needed to be examined in greater depth.

Other issues to consider in relation to arbitration was the great costs involved and the situation when both the master franchise agreement and the sub-franchise agreement were subject to arbitration. A clear distinction had to be made between arbitrating on an international master franchise agreement and arbitrating on a domestic unit franchise agreement.

It was further suggested that the guide should examine situations in which recourse to the State courts might be preferable to arbitration, such as cases involving allegations of fraud and disputes that required a discovery procedure, even if it was possible to provide that the rules of discovery of country X should apply also when having recourse to arbitration.

A reason given for the favouring of arbitration in international master franchise relationships rather than in other commercial transactions was the fact that innocent third-party by-standers were not always taken into account by a court, whereas they would be in an arbitration.

Chapter	Title	Content first draft	Queries / comments	Content as revised
Chapter 22 New chapter number: 21 [Rose]	Choice of forum	<p>Criteria choice of forum</p> <p>Arbitration</p> <p>Advantages of foreign court: effective enforcement</p> <p>Recognition of Choice of Forum Clauses</p> <p>Choice of forum prescribed by law</p> <p>Need to assess how clause will be interpreted</p> <p>Distinction between prorogation and derogation</p> <p>Circumstances where choice of forum not upheld</p> <p>Recent trend to uphold choice if exclusive</p> <p>Brussels and Lugano Conventions: - application - exclusive jurisdiction</p> <p>1965 Hague Convention</p> <p>Recognition and enforcement of foreign judgments</p> <p>Separate enforcement proceedings by bringing action on foreign judgment</p> <p>Sue on original cause of action US</p> <p>Choice of arbitration: - reasons for arbitration as an alternative - recognition arbitral awards: 1958 New York Convention - effects arbitration: preclude party from going to court - causes of action beyond contract interpretation: - costs - selection of:</p> <ul style="list-style-type: none"> ● administrative body ● arbitration rules 	<p>Qu whether other regional instruments which should be cited</p> <p>Litigation/arbitration: normally alternatives which do not appear in same contract</p> <p>Add mediation</p> <p>Add more about negotiation</p>	<p>Criteria choice of forum</p> <p>Arbitration</p> <p>Mediation</p> <p>Negotiation</p> <p>Advantages of foreign court: effective enforcement</p> <p>Recognition of Choice of Forum Clauses</p> <p>Choice of forum prescribed by law</p> <p>Need to assess how clause will be interpreted</p> <p>Distinction between prorogation and derogation</p> <p>Circumstances where choice of forum not upheld</p> <p>Recent trend to uphold choice if exclusive</p> <p>Brussels / Lugano / San Sebastian Conventions: - application - exclusive jurisdiction</p> <p>1965 Hague Convention on the service abroad of judicial and extra-judicial documents in civil and commercial matters</p> <p>Recognition and enforcement of foreign judgments</p> <p>Separate enforcement proceedings by bringing action on foreign judgment</p> <p>Sue on original cause of action US</p> <p>Choice of arbitration:</p> <ul style="list-style-type: none"> ● reasons for arbitration as an alternative ● injunctive relief and other interim relief ● recognition arbitral awards: 1958 New York Convention ● enforcement: problems in countries where treaty necessary ● effects arbitration: preclude party from going to court ● causes of action beyond contract interpretation: ● costs ● selection of: <ul style="list-style-type: none"> ● administrative body ● arbitration rules ● arbitration at different levels: franchisor/sub-franchisor; sub-franchisor/sub-franchisee ● distinction arbitration of international MFA and arbitrating a domestic unit agreement <p>Cases for which courts might be preferred:</p> <ul style="list-style-type: none"> ● fraud ● disputes requiring the gaining of information

CHAPTER 23: ANCILLARY DOCUMENTS

It was pointed out that of the numerous ancillary documents that a franchise arrangement might include, this chapter considered those that in the experience of the author were the most common or most important. Joint ventures had been included as ancillary documents to underscore that in addition to a franchise a joint venture might be desirable as a technique for effecting a franchise, that it was not used *instead of* a franchise but *along with* a franchise. Similarly letters of intent had been included simply as a preliminary version of the description of the relationship for a limited number of franchises, usually large investment-type franchises.

It was suggested that manuals should also be referred to in the chapter on ancillary documents despite the fact that there was a chapter that specifically dealt with manuals. The reason was that in some jurisdictions, especially civil law jurisdictions, a franchise would be treated as a contract of adhesion and as a result any external document would have to be provided to the sub-franchisor or (sub-)franchisee prior to the execution of the contract. The issue had been raised in civil law jurisdictions as to whether, to the extent that the franchisor wished to bind the sub-franchisor to the operations manual, the sub-franchisor had to be given that document in advance of execution.

It was also agreed that the section that dealt with agreements on methods of payment should be called "Letters of credit and stand-by letters of credit".

Added to the items dealt with was a new sub-section 2(b)(1) on security agreements under agreements for the supply of products.

In relation to financial arrangements, it was suggested that any kind of financial arrangement might form the subject of an ancillary agreement between the foreign franchisor and the local sub-franchisor, if financing or partial financing was provided from abroad and if it was not a purely internal matter of the sub-franchisor.

One type of agreement that it was felt should be dealt with among the ancillary agreements was the confidentiality agreement that franchisors at times required that sub-franchisees and even the executives of sub-franchisees, sign. That document, and that document alone, would then be sent to the franchisor even if the actual franchise agreement was not transmitted by the sub-franchisor to the franchisor. This was a type of agreement that might be more common in domestic franchising than in international franchising, but which was to be found and which should be referred to.

Chapter	Title	Content first draft	Queries / comments	Content as revised
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<p>Chapter 23</p> <p>New chapter number: 22</p> <p>[Zeidman]</p>	<p>Ancillary documents</p>	<p>Introduction with general definition</p> <p>Purposes of ancillary documents</p> <p>Examples of ancillary documents:</p> <p>1) Ancillary documents commonly used with MFA:</p> <ul style="list-style-type: none"> ● confidentiality agreement ● non-competition agreements ● guarantee and indemnity ● transfer agreements ● release <p>2) Ancillary documents that may be required for the franchised business:</p> <ul style="list-style-type: none"> ● supply agreements <ul style="list-style-type: none"> ● equipment purchase or lease agreement ● software licence agreement <p>3) Ancillary documents required by the structure of certain transactions:</p> <ul style="list-style-type: none"> ● letters of intent ● joint venture agreements ● agreements on methods of payment ● agreement evidencing financing arrangements <p>4) Ancillary documents that may be required by local law:</p> <ul style="list-style-type: none"> ● trademark licence agreement ● registered user agreement. 	<p>Bias in favour of franchisor: need more descriptions of the situation from the point of view of the sub-franchisor/sub-franchisee</p> <p>Qu. can a franchisor actually enforce a non-competition clause binding e.g. sub-franchisee and its employees?</p> <p>Qu relationship between supply agreements and standard terms or general conditions of trade</p> <p>Qu use of software by sub-franchisees</p>	<p>Introduction with general definition</p> <p>Purposes of ancillary documents</p> <p>Examples of ancillary documents:</p> <p>1) Ancillary documents commonly used with MFA:</p> <ul style="list-style-type: none"> ● confidentiality agreement ● non-competition agreements ● guarantee and indemnity ● transfer agreements ● release <p>2) Ancillary documents that may be required for the franchised business:</p> <ul style="list-style-type: none"> ● supply agreements <ul style="list-style-type: none"> - security agreements Ref Ch. 11 ● equipment purchase or lease agreement ● software licence agreement <p>3) Ancillary documents required by the structure of certain transactions:</p> <ul style="list-style-type: none"> ● letters of intent ● joint venture agreements ● letters of credit and stand-by letters of credit ● agreement evidencing financing arrangements <p>4) Ancillary documents that may be required by local law:</p> <ul style="list-style-type: none"> ● trademark licence agreement ● registered user agreement.
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CHAPTER 24: PERMISSION REQUIREMENTS

It was observed that originally the title of the chapter had been "Obtaining approval of agreement from regulatory authorities in host country (if necessary)" and had at the time been conceived as covering issues such as whether or not the franchise agreement had to be registered to permit the expatriation of funds. It had not been intended to relate to the domestic implications for the sub-franchisor, as the sub-franchisor was deemed to be knowledgeable about carrying on business in its country of origin.

The author had changed this title so that the chapter contained a more general discussion of the permits that might be required for the franchise. Admittedly many of the points raised concerned a great number of different types of business transaction and not only franchising, but the Group felt that this was useful considering all the different addressees of the guide, which included franchisors who were not familiar with the international aspects of licensing and franchising and franchisees who might not be familiar with cross-border transactions at all and therefore needed some guidance as to the issues they would want to address. One member of the Group indicated that he routinely prepared a checklist of this kind to consult host country counsel to be sure that everything necessary was covered. A distinction had to be made between the cross-border dimension, where approval was required for currency transfers and the registration of foreign agreements, and the domestic dimension for which certain other permits were required, whether or not the business had an international dimension to it. The purely domestic dimension could be ignored, or referred to only very briefly for particular requirements such as, for example, those that were industry-specific. It had to be made clear that the indications given were not exhaustive but rather illustrative.

An item which it was felt should be covered was the question of the withholding tax, i.e. the fact that one might have to obtain permission from a bank in the host country in the process of paying the withholding tax when the royalties were transmitted abroad. The need to consider state or local laws when reviewing the permits required should also be stressed.

The problem of protective guilds which existed in many countries in particular industries was also considered. The importance of the existence of these guilds should be stressed, as they affected the saleability of the franchise business by limiting the market.

Another issue that should be dealt with was which of the parties should be under an obligation to obtain the required permits. In some cases the very nature of a permit indicated quite clearly what party should be responsible for obtaining the permit, but it was nevertheless an important point as it was associated with what at times were quite significant costs in compliance. This cost would naturally have an impact on the fees that were due.

It was decided that a general reference to permission requirements should be given in the introductory chapter, with an indication that everything that might be necessary for the local market should be examined. Readers should then be referred to Chapter 24 for more specific information and for consideration of the cross-border aspects.

Although it was felt that the attention of the reader had to be drawn to the fact that various kinds of permission were required, it was observed that it was very difficult to list them as they varied from country to country and case to case. An example was the sales tax registration which was still required in India.

Chapter	Title	Content first draft	Content as revised
Chapter 24 New chapter number: 23 [Peters]	Permission requirements	<ul style="list-style-type: none"> • the setting up or incorporation of branch offices, subsidiaries, joint ventures, holding companies • permits required for foreign investments • registration under the competition act, including for any exemption schemes • registration of trade marks, trade names, symbols, patents and designs • registration in the registers which cover the transfer of technology • registration and obtaining of permits for agents • registration in commercial registers • permits required for the purchase of real estate • work permits for the foreign personnel of the franchisor • permits for the exportation of the profits • permits in general required under the legislation on currency restrictions • import or export licences • permits required as a result of import or export restrictions • permits required for the availability of domestic credit • any permits specific to the trade concerned. 	<ul style="list-style-type: none"> • the setting up or incorporation of branch offices, subsidiaries, joint ventures, holding companies • permits required for foreign investments • registration under the competition act, including for any exemption schemes • registration of trade marks, trade names, symbols, patents and designs • registration in the registers which cover the transfer of technology • registration and obtaining of permits for agents • registration in commercial registers • work permits for the foreign personnel of the franchisor • permits for the exportation of the profits • permits in general required under the legislation on currency restrictions • import or export licences • permits required as a result of import or export restrictions • withholding taxes • permits required for the availability of domestic credit • any permits specific to the trade concerned. • costs associated with the obtaining of permits • what party is obliged to obtain the permit

CHAPTER 25: USE OF TEST PERIOD ARRANGEMENTS

Chapter 25 had originally been allocated to Mr Burst, who unfortunately had been unable to draft it. As test periods had been referred to in Chapter 8, Mr Mendelsohn offered to expand this section to include a more ample discussion. It was therefore decided to delete Chapter 25 as such, its contents being transferred to Chapter 8.

Chapter	Title	Content first draft	Content as revised
Chapter 25 [Mendelsohn]	Use of test period arrangements	Not presented	Incorporated under Chapter 8

CHAPTER 26: OTHER PROVISIONS

The examination of the chapter dealing with "Other provisions" led the Group to the conclusion that the material did not warrant a whole chapter. While it was considered that in a book that defined a relationship between a franchisor and sub-franchisor it was worthwhile to mention that the same clauses that in fact appeared in most commercial contracts were also to be found in those agreements, it was felt that this did not require extensive discussion and was therefore best left to the chapter on drafting. In the discussion in the drafting chapter readers might be alerted to any provisions of particular importance, such as the entire agreement clause which was of particular importance in litigation between franchisors and franchisees which was based on allegations of misrepresentation. Notice provisions might also be of

considerable importance internationally because of the time required for, and the unreliability of, international transmission of documents and notices.

The provisions of the unit franchise agreement that had been examined in this chapter were furthermore best considered in the chapter on the unit agreement.

Chapter	Title	Content first draft	Content as revised
Chapter 26 [Peters]	Other provisions	<p>Clauses that may appear in both master franchise agreements and unit franchise agreements include</p> <ul style="list-style-type: none"> • clauses relating to severability • entire agreement clauses • waivers • force majeure and hardship • clauses relating to the nature of the agreement • cumulative rights and • damages <p>Clauses which may appear by preference in unit franchise agreements include provisions relating to</p> <ul style="list-style-type: none"> • the death or incapacity of the franchisee • the death or incapacity of the principal • guarantors - obligations - death or incapacity • heirs and successors • acknowledgement of receipt of documents - disclaimers • severability of restrictions • verification of information received (accounts) • labour relations • unions, committees and associations • standard terms • telephones • franchisor's right to communicate with franchisee's customer • deductions from the account • essential clauses • good faith and • special clauses. 	<p>Clauses that may appear in both master franchise agreements and unit agreements transferred to the drafting chapter</p> <p>Clauses relating to the unit agreement to be considered by the chapter on the unit agreement</p>

ANNEX

A number of the draft chapters contained references and even description of national legislation specifically relating to, or of importance to, franchising. The European Community Block Exemption Regulation was also referred to extensively. Considering that it was unrealistic to aspiring to anything near comprehensiveness as concerns national legislation, and considering also the fact that any such references would quickly become out of date, it was decided that the introductory chapter should contain a short reference to legislation that could be of relevance, and that any more specific indications should be left to an Annex. This Annex should also include more extensive references to the European Community Block Exemption Regulation, as well as any other references that could most usefully be dealt with in such an Annex to the guide.

Chapter	Title	Content first draft	Content as revised
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Annex [Peters]		New	<p>Information on national legislation</p> <ul style="list-style-type: none"> • specific to franchising • of relevance to franchising, in particular <ul style="list-style-type: none"> • protective laws (consumer protection laws applied by analogy) • legislation regulating post-term confidentiality • legislation regulating post-term non-competition <p>Information on the EEC Exemption Regulation Problems associated with entering into the general international trade agreement Respective bargaining power of parties can trigger doctrines of contracts of adhesion: Germany: body of law dealing with contracts between parties of different bargaining power, harsh and oppressive conduct, etc. Representations and warranties: misrepresentation (e.g. UK Statute)</p>
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UNIDROIT STUDY GROUP ON FRANCHISING

Second Session, Rome, 29 - 31 January 1996

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