

UNIDROIT 2002
Study LXVIII – Doc. 39
(Original: French)

U N I D R O I T
I N T E R N A T I O N A L I N S T I T U T E F O R T H E U N I F I C A T I O N O F P R I V A T E L A W
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COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A
MODEL FRANCHISE DISCLOSURE LAW

Second session
(Rome, 8 - 12 April 2002)

Comments submitted by France

Rome, March 2002

INTRODUCTION: ON THE PHILOSOPHY OF THE DRAFT

The draft prepared by UNIDROIT has the ambition to assist the international development of franchising, particularly in developing countries where this form of distribution may be afforded a favourable reception thanks to its characteristics. The French delegation shares this ambition.

In order to attain this objective, the draft must avoid two pitfalls:

- the first consists in demanding of franchisors information which is too complex to search for or too costly to get hold of, which risks dissuading them from developing abroad;
- the second consists in excluding from the scope of the draft a certain category of franchisees by reason of their small size, thereby risking the establishment at that level of unbalanced contractual relationships between franchisors and franchisees.

The draft, as it resulted from the First Session held in Rome from 25 to 29 June 2001, does not avoid these two pitfalls. The information that franchisors are required to provide is at times too extensive. A better balance can be sought, which would permit franchisees to make an informed decision without this being prejudicial to the development of the franchise. The second pitfall, which also was not avoided, consists in excluding a certain type of franchise from the scope of the draft. However, the franchise is developed above all by small franchisees being well informed, as they are the ones called upon to develop the franchise in developing countries.

In these observations the French delegation therefore defends two principles. The first consists in not excluding small enterprises which must also have available good information. The second consists in searching for a better balance between what the franchisee must know in order to make an informed decision and what one can require of the franchisor without this being prejudicial to the international development of the franchise.

ON THE TERM “MODEL LAW”

The present draft is entitled “Model Law”. Such a title tends to substantiate the idea that this text, because it presents itself as a model, must be followed point by point. However, the Preface, in both the long and the short version, states that the text does not have a mandatory nature vis-à-vis the national laws that will be adopted.

So as to ensure a certain consistency between the title of the text and the reach of its contents, it would be better to modify the term “Model Law” and to use the term “Guide”, which would avoid all confusion in the minds of future readers.

ON THE FORMULATION “UNDER SUBSTANTIALLY THE SAME TRADE NAME”

Several provisions of Article 6 (6E, 6I, 6J, 6K) mention affiliates of the franchisor offering [granting] franchises “under substantially the same trade name”. This formulation aims to take into consideration affiliates of the franchisor which are established in countries

where the franchisor is not established and which, therefore, would have experience of relevance and this must be made known to the prospective franchisee.

This formulation presents some dangers. The absence of a definition of what is intended by a franchisee having “substantially the same trade name” as the franchisor would be a source of embarrassment for the franchisor and would constitute a legal flaw which franchisees might rush to by asking to terminate their contract in so far as they were not informed of the experience of this or that other affiliate which, according to them, had “substantially the same trade name”.

Under these conditions it would seem preferable to limit the information to be given to the franchisees to the activities of the franchisors.

Proposed revision of the text:

Delete in Article 6 all the references to affiliates having “substantially the same trade name” as the franchisor.

ARTICLE 2: DEFINITION OF A FRANCHISE

Background

The definition of a franchise as it appears in the draft alters the notion of independence of the franchisee. In fact, a franchisor could exercise “significant and continuing operational control” without the extent of this control being specified. Such a definition carries the embryo of a possible phenomenon of domination of the franchisee on the part of the franchisor, as the latter would not have any obstacles to its control over the former.

Furthermore, the extent of this control may be such that under the national laws in force the relationship between the franchisor and the franchisee might be redefined as a labour contract. The independence of the franchisee might be considered to be insufficient and a franchise agreement would not exist in such circumstances. The import of the UNIDROIT draft would then be nil. The control of the franchisor over the franchisee must instead be strictly delimited for freedom of action on the part of either party to be possible.

This is the reason for which the definition of a franchise must be limited in the draft to what is commonly permitted by all legislations, i.e. the placing at the disposal of the franchisee by the franchisor, in exchange for direct or indirect compensation, of its trade mark and/or sign, its products, its know-how and technical assistance.

On the other hand, the extent of the control exercised by the franchisor on the franchisee must be left to the free assessment of the national legislator, it being understood that the independence of the different players should not be called into question.

Proposed revision of Article 2:

Delete the present definition and replace it by the following proposal:

“a franchise agreement is a contract for distribution which associates an enterprise, owner of a trade mark or sign, the franchisor, with one or more independent tradesmen, the franchisees.

Franchise agreements consist in licenses for intellectual property rights concerning trade marks, distinctive signs or know-how for the sale and distribution of goods or services.

In exchange for direct or indirect compensation the franchisor puts at the disposal of the franchisee its trade mark and/or its sign, its products, its know-how and technical assistance.”.

Replace the present paragraph 50 of the Explanatory Report with the following:

“The franchisor must be able to make sure of the quality of the running of the franchise. It falls to the national legislator to make sure that the control that is instituted does not affect the independence of the franchisees and that under the labour law applicable in the country in question it is not possible to redefine the agreement as an employment contract”.

ARTICLE 5(B): EXEMPTION FROM THE OBLIGATION TO DISCLOSE IN CASE OF ASSIGNMENT

Background

Two options are proposed under Article 5(B). Both relate to the absence of an obligation to disclose in the case where a franchisee assigns or transfers its franchise to another franchisee. The first option states that no disclosure is necessary if the conditions which tie the new franchisee to the franchisor are the same as those which tied the old franchisee to that same franchisor, where, in other words, only the name of the franchisee has changed. The second option indicates that no disclosure is necessary if the conditions are *substantially* the same, which would increase the number of cases in which this exception would apply.

The absence of a definition of the term “substantially” makes it difficult to evaluate its exact scope. In this manner a “grey area” is introduced into the text, which is liable to nourish numerous law suits.

Under these conditions, it would be preferable to stick to a strict definition which would not allow an improper interpretation.

Proposed revision of Article 5(B)

Keep only the first option, that is to say the one that indicates that no disclosure of information on the part of the franchisor is necessary in the case of an assignment of the franchise when the contract has not been modified.

ARTICLE 5(G): EXEMPTION FROM THE OBLIGATION TO DISCLOSE IN THE CASE OF SMALL FRANCHISEES

Background

Under this provision, a franchisor in business with a small franchisee does not have to comply with the disclosure obligation provided for under the draft. The idea is to exempt agreements relating to very small economic values.

This provision presents a double danger:

- the threshold below which the franchisor would no longer be under an obligation to disclose is not defined. Consequently, any excess might be possible. It is not to be excluded that in certain countries the threshold might be so high, that franchisees, whose size would no longer really be small, would not have access to the information required to be disclosed under the draft;
- the investments of the franchisees are small only as compared to the investments that might be made by other players. But for the franchisee these investments may, especially in developing countries, constitute a substantial amount, the result of years of savings. In any event, the selection of a franchisor must also in these cases be the result of good information.

It would therefore appear to be desirable for no exception to the obligation to disclose to be introduced into the draft with respect to franchisees of a small size. This is one of the conditions necessary for the rapid development of franchising in developing countries.

Reposed revision of Article 5(G)

Delete Article 5(G).

INSERTION OF A NEW SUB-PARAGRAPH UNDER ARTICLE 6(1): STATE OF THE MARKET

Background

Currently the draft does not oblige the franchisor to provide information on the state of the market in general, or of the local market in particular, of the products and services that are the subject-matter of the contract.

This information is however indispensable for the prospective franchisee, who must have available the most accurate representation possible of the market on which it will be offering its services or its products.

Proposed insertion in Article 6(1)

“The franchisor must present the prospective franchisee with:

- the state of the general market of the products or services that are the subject of the contract;

- the state of the local market of the products or services that are the subject of the contract;
- the prospects for development of the market”.

ARTICLE 6(1)(G): CONVICTIONS

Background

This provision requires franchisors to disclose relevant details relating to any criminal convictions or any finding of liability in a civil action [or arbitration] involving the franchisor, its affiliates or its managers for the previous five years. The information relating to these convictions would be limited to those that relate to the franchising activity or to any other commercial activity.

The will to reassure the franchisee as to the seriousness and honesty of its future franchisor is legitimate. Having said this, this ambition must not lead to the establishment of procedures that are so complex and so costly that there would be a risk of dissuading the franchisor from developing its franchise in countries in which such a level of constraints has been reached.

The present formulation of the text leads to a number of difficulties:

- the information required is too exhaustive. The franchisor will have difficulties in determining everything that may constitute acts or practices similar to fraud or to misrepresentation. In attempting to attain the exhaustiveness of the information, one places the franchisor in an awkward position;
- the franchisor will be forced to set up a specific organisation, capable of searching into the past of the managers, of the franchise and of the affiliates, which is more or less what could result from this provision. This would involve new costs which would inevitably have repercussions on the franchisee.

The exhaustive character of this provision is all the more undesirable as it risks operating against its intended purpose. The franchisee will have to sort out what concerns the franchise from what concerns the managers, the affiliates and the predecessors, and the convictions that are important from those that are less so. This would require the franchisee to be proficient in law, moreover in the law of different countries as the provision is not limited geographically, and it is not sure that the franchisee possesses this knowledge.

Rather than exhaustive information, which would require substantial legal knowledge to be properly understood, it is preferable to inform the franchisee of what is essential, that is, of the criminal convictions of the franchisor in the exercise of its activity. The information required in this provision must therefore be limited to the legal person which signed the contract.

Proposed revision of Article 6(1)(G)

Replace the present provision by the following formulation:

“relevant details relating to any criminal convictions or any finding of liability in a civil action involving the franchisor in the exercise of its activity for the previous five years”.

ARTICLE 6(1)(H): BANKRUPTCY

Background

This provision obliges franchisors to disclose relevant details concerning any bankruptcy or insolvency situations in which they have been involved, or in which their managers or affiliates have been involved.

Again, such a provision gives rise to a double risk:

- that of increasing the obligations of the franchisor which would have to put in place a specific organisation;
- that of informing the franchisees on issues in relation to which it would be difficult for them to sort out the information that is secondary from that which is essential.

The purpose of the Model Law is not to drown the franchisee in a flood of information which it would not be able to assimilate unless it had specialised legal and financial knowledge, but to provide it with information which has already been processed, apt to permit it to make an informed decision.

The present formulation of the provision involves too large a number of persons and companies. It would be preferable to limit disclosure of this information to the franchisor. Furthermore, the reference to “comparable proceeding” should be deleted as it is insufficiently precise.

Proposed revision of Article 6(1)(H)

Replace the present provision by the following formulation:

“relevant details concerning any bankruptcy or insolvency proceeding involving the franchisor during the previous five years”.

ARTICLE 6(1)(M): PURCHASE AND PRICING ARRANGEMENTS

Background

This provision obliges the franchisor to disclose its policy as regards the supply of goods and services and the pricing arrangements associated therewith.

This provision presents two dangers:

- it obliges the franchisor to refer to know-how of which the franchisee would otherwise not acquire knowledge except through relations with the franchisor; know-how which, in this case, would not be covered by a confidentiality agreement;

- it risks having a perverse effect, by which the franchisees would be tempted to juggle with the competition between different franchisors, so as to have at their disposal the most competitive supply rates.

Thus, by retaining this provision, the risk is taken of revealing the heart of the trade of the franchisor without its receiving anything in return, which would put a break on the development of the franchise.

Proposed revision of Article 6(1)(M)

It is proposed that Article 6(1)(M) be deleted.

ARTICLE 6(1)(N)(I)(C): FINANCIAL STATEMENTS OF THE FRANCHISOR

Background

This provision obliges franchisors to disclose their financial statements. This information is in fact indispensable for franchisees to be well informed.

However, to require franchisors to hand over financial statements which are less than three months old at the time of the delivery of the disclosure document, in cases where the only financial statements available at the time of delivery of the disclosure document would be more than six months old, appears to be too heavy a burden. It would presuppose that the franchisors have the capability to prepare interim accounting and financial documents every six months.

On the other hand, the formulation of the provision must also apply to young companies, the creation of which goes back less than three years.

Proposed revision of Article 6(1)(N)(i)(c)

Delete options 1 and 2.

To option 3, add the following sentence:

“Franchisors, the creation of which goes back less than three years, are under an obligation to disclose the same documents prepared since they began their activity”.

ARTICLE 8: LANGUAGE USED IN THE DISCLOSURE DOCUMENT

Background

The present formulation of this Article is not satisfactory as the prospective franchisees will not have the assurance of being able to read the disclosure document in their own language. In fact, the franchisor will be able to write the document in the language which it principally uses in its activities. The franchisee will of course have the right to oppose this. It however risks being placed in a position of such dependency, particularly if it is small, that it will be able to do nothing other than agree to the request of the franchisor. The reservation

which is drafted into the formulation is a pure *pro forma* reservation which would not resist in practice, considering the difference in size between an international franchisor on the one hand and franchisees on the other. It is therefore up to the text to assure the security that practice could easily put aside.

In this framework, it is appropriate to distinguish between a sub-franchisor (master franchisee) who covers a large area, and the sub-franchisees or franchisees who are active on only a small territory. The former's experience of international commercial relations assumes the capability to understand a text in a language which is not its own, but which is the one mainly used in its activity. For such a person, the present formulation of the text poses no problems. Instead, for the small franchise units present on small territories, for which this may represent the first business relationship with a foreign company, it is vital that they are able to read the disclosure document in their own language. The cost that the translation of this document represents could be such that they would be dissuaded from developing their franchise.

Proposed revision of Article 8

"The disclosure document and prospective franchise agreement shall be written in a clear and comprehensible manner in the official language of the principal place of business of the prospective franchisee. However, a disclosure document and a franchise agreement addressed to a sub-franchisor may, if the sub-franchisor agrees, be written in the language principally used by the franchisor or by the sub-franchisor in their respective businesses".

Proposed revision of the Explanatory Report

Delete the first two sentences of paragraph 124.

ARTICLE 9: REMEDIES

Background

If the franchisee considers that it has not received the disclosure document within the set time-limits, or if this document contained a misrepresentation or omitted a material fact, then it has the right to request the termination of the agreement. It is up to each State to use the term most appropriate in its language, bearing in mind that this termination must not have retroactive effects.

It should not be possible for the franchisee to declare termination without this termination having previously been the subject of a decision by a third party or of a mutual agreement with the franchisor. The franchisee should not be able to take the place of the judge, nor should it prejudge the consent of the franchisor and itself decide as regards the termination.

The present formulation of the draft in its English version leaves uncertainty as regards the unilateral character of the decision of the franchisee. In fact, the expression "the franchisee is entitled to terminate the franchise agreement" leads one to think that the franchisee has itself the right to put an end to the contract that ties it to the franchisor, without the franchisee necessarily having to submit the matter to the franchisor or to a judge. This

incertitude does not exist in the French version of the draft, which states that the franchisee “a le droit de *demander* la résiliation” [“is entitled to *ask for* the termination”]. It does not say that it has the right to terminate the agreement itself.

In these circumstances, it would be better to modify the English version of Article 9 of the draft to make it clear that termination is a right of the franchisee, but that this right should not be used in an improper manner, i.e. unilaterally, without a decision having been made beforehand by a third party or without a mutual agreement with of the franchisor.

Proposed revision of Article 9 (English version)

Replace “entitled to terminate” by “entitled to ask for the termination of”.

Paragraphs (1) and (2): “If the disclosure document [...], the franchisee is entitled **to ask for the termination of** the franchise agreement [...]”.

Paragraph (3): “The right **to ask for the termination of** the franchise agreement [...]”.