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O F A M O D E L F R A N C H I S E D I S C L O S U R E L A W

Draft Articles for a Model Franchise Disclosure Law with Draft Explanatory Report  
as revised by the Committee of Governmental Experts at its  
Second Session, held in Rome from 8 to 12 April 2002

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## **PREAMBLE**

The *International Institute for the Unification of Private Law (UNIDROIT)*,

*Recognising* that franchising is playing an ever greater role in a wide range of national economies,

*Being mindful of* the fact that in the legislative process, State legislators may wish to consider a number of different elements, including

- whether it is clear that there is a problem, what its nature is, and what action, if any, is necessary;
  - whether prospective investors are more likely to protect themselves against fraud if they have access to truthful, important information in advance of their assent to any franchise agreement;
  - whether the nation's economic and social interests are best served by legally requiring a balance of information between the parties to a franchise agreement;
  - whether there is a pattern of abusive conduct, or whether this conduct is isolated or limited to particular industries;
  - the nature of the evidence of abuse;
  - whether existing laws address the concerns and whether they are adequately applied;
  - whether an effective system of self-regulation exists;
  - the financial burden the new legislation will place upon franchisors and investors as compared to the benefits of legally-required disclosure;
  - whether the proposed legislation inhibits or facilitates entry to franchisors, and its effect on job-creation and investment;
- and
- the views of interested organisations, including national franchise associations;

*Recalling* that State legislators may want to adapt suggested provisions, especially with regard to the enumerated disclosure items, in response to specific circumstances of, or established methods of legislation in, each State;

*Recalling* that the text of the Model Law is accompanied by an Explanatory Report which, with a view to assisting legislators, explains the purpose of the provisions;

*Finding* that experiences with disclosure legislation has on the whole been positive;

is pleased to place the *Model Franchise Disclosure Law* presented in this document at the disposal of the international community as an example that is not compulsory for States legislators and as an instrument intended to be a recommendation for States that have decided to adopt franchise specific legislation.

## ***DRAFT MODEL FRANCHISE DISCLOSURE LAW***

### ***ARTICLE 1 (SCOPE OF APPLICATION)***

(1) This law applies to franchises to be granted or renewed for the operation of one or more franchised businesses within the [State adopting this law].

(2) Except as otherwise expressly provided in this law it is not concerned with the validity of the franchise agreement or any of its provisions.

### ***ARTICLE 2 (DEFINITIONS)***

For the purposes of this law:

**affiliate of the franchisee** means a natural or legal person who directly or indirectly controls or is controlled by the franchisee, or is controlled by another party who controls the franchisee;

**affiliate of the franchisor** means a natural or legal person who directly or indirectly controls or is controlled by the franchisor, or is controlled by another party who controls the franchisor;

**development agreement** means an agreement under which a franchisor in exchange for direct or indirect financial compensation grants to another party the right to acquire more than one franchise of the same franchise system;

**disclosure document** means a document containing the information required under this law;

**franchise** means the rights granted by a party (the franchisor) authorising and requiring another party (the franchisee), in exchange for direct or indirect financial compensation, to engage in the business of selling goods or services on its own behalf under a system designated by the franchisor which includes know-how and assistance, prescribes in substantial part the manner in which the franchised business is to be operated, includes significant and continuing operational control by the franchisor, and is substantially associated with a trademark, service mark, trade name or logotype designated by the franchisor. It includes:

(A) the rights granted by a franchisor to a sub-franchisor under a master franchise agreement;

(B) the rights granted by a sub-franchisor to a sub-franchisee under a sub-franchise agreement;

(C) the rights granted by a franchisor to a party under a development agreement.

For the purposes of this definition “direct or indirect financial compensation” shall not include the payment of a bona fide wholesale price for goods intended for resale;

**franchise agreement** means the agreement under which a franchise is granted;

**franchised business** means the business conducted by the franchisee under a franchise agreement;

**franchisee** includes a sub-franchisee in its relationship with the sub-franchisor and the sub-franchisor in its relationship with the franchisor;

**franchisor** includes the sub-franchisor in its relationship with its sub-franchisees;

**master franchise** means the right granted by a franchisor to another party (the sub-franchisor) to grant franchises to third parties (the sub-franchisees);

**material change** in the information required to be disclosed means a change which can reasonably be expected to have a significant effect on the prospective franchisee's decision to acquire the franchise;

**material fact** means any information that can reasonably be expected to have a significant effect on the prospective franchisee's decision to acquire the franchise;

**misrepresentation** means a statement of fact that the person making the statement knew or ought to have known to be untrue at the time the statement was made;

**omission** means the failure to state a fact of which the person making the statement was aware at the time the statement ought to have been made;

**State** includes the territorial units making up a State which has two or more territorial units, whether or not possessing different systems of law applicable in relation to the matters dealt with in this law; and

**sub-franchise agreement** means a franchise agreement concluded by a sub-franchisor and a sub-franchisee pursuant to a master franchise.

### **ARTICLE 3**

#### **(DELIVERY OF DISCLOSURE DOCUMENT)**

**(1)** A franchisor must give every prospective franchisee a disclosure document, to which the proposed franchise agreement must be attached, at least fourteen days before the earlier of

**(A)** the signing by the prospective franchisee of any agreement relating to the franchise, with the exception of agreements relating to confidentiality of information delivered or to be delivered by the franchisor; or

**(B)** the payment to the franchisor or an affiliate of the franchisor by the prospective franchisee of any fees relating to the acquisition of a franchise that are not refundable or the refunding of which is subject to such conditions as to render them not refundable, with the exception of a security (bond or deposit) given on the conclusion of a confidentiality agreement.

(2) The disclosure document must be updated within [X] days of the end of the franchisor's fiscal year. Where there has been a material change in the information required to be disclosed under Article 6, notice in writing of such change should be delivered to the prospective franchisee as soon as practicable before either of the events described in sub-paragraphs (1)(A) or (1)(B) has occurred.

**ARTICLE 4**  
**(FORMAT OF DISCLOSURE DOCUMENT)**

(1) Disclosure must be provided in writing.

(2) The franchisor may use any format for the disclosure document, provided that the information contained therein is presented as a single document at one time and meets the requirements imposed by this law.

**ARTICLE 5**  
**(EXEMPTIONS FROM OBLIGATION TO DISCLOSE)**

No disclosure document is required:

(A) in case of the grant of a franchise to a person who has been an officer or director of the franchisor or of an affiliate of the franchisor for at least one year immediately before the signing of the franchise agreement;

(B) in case of the assignment or other transfer of a franchisee's rights and obligations under an existing franchise agreement, where the assignee or transferee is bound by substantially the same terms as the assignor or transferor, and the franchisor has not had a significant role in the transaction other than approval of the transfer.

(C) in case of the grant of a franchise to sell goods or services to a natural or legal person who has been engaged in the same or a similar business for the previous two years, if the sales of the franchise, as reasonably anticipated by the parties at the time the franchise agreement is entered into, will not during the first year of the relationship exceed 20% of the total aggregate sales of the combined business of the franchisee and its affiliates;

(D) in case of the grant of a franchise pursuant to which the prospective franchisee commits to a total financial requirement under the franchise agreement in excess of [X];

(E) in case of the grant of a franchise to a prospective franchisee who together with its affiliates has a net worth in excess of [Y] or turnover in excess of [Z]; or

(F) in case of the renewal or extension of a franchise on the same conditions.

**ARTICLE 6**  
**(INFORMATION TO BE DISCLOSED)**

**(1)** In the disclosure document the franchisor shall provide the following information:

**(A)** the legal name, legal form and legal address of the franchisor and the address of the principal place of business of the franchisor;

**(B)** the trademark, trade name, business name or similar name, under which the franchisor carries on or intends to carry on business in the State in which the prospective franchisee will operate the franchise business;

**(C)** the address of the franchisor's principal place of business in the State where the prospective franchisee is located;

**(D)** a description of the franchise to be operated by the prospective franchisee;

**(E)** a description of the business experience of the franchisor and its affiliates granting franchises under substantially the same trade name, including:

**(i)** the length of time during which each has run a business of the type to be operated by the prospective franchisee; and

**(ii)** the length of time during which each has granted franchises for the same type of business as that to be operated by the prospective franchisee;

**(F)** the names, business addresses, positions held, and business experience of any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise;

**(G)** any criminal convictions or any finding of liability in a civil action or arbitration involving franchises or other businesses relating to fraud, misrepresentation, or similar acts or practices of:

**(i)** the franchisor; and

**(ii)** any affiliate of the franchisor who is engaged in franchising for the previous five years, and whether any such action is pending against the franchisor or its subsidiary, and the court or other citation of any of the above;

**(H)** any bankruptcy, insolvency or comparable proceeding involving the franchisor and its affiliate(s) for the previous five years and the court citation thereof;

**(I)** the total number of franchisees and company-owned outlets of the franchisor and of affiliates of the franchisor granting franchises under substantially the same trade name;

**(J)** the names, business addresses and business phone numbers of the franchisees, and of the franchisees of any affiliates of the franchisor which are granting franchises under substantially the same trade name whose outlets are located nearest to the proposed outlet of the prospective franchisee, but in any event of not more than [X] franchisees, in the State of the franchisee and/or contiguous States, or, if there are no contiguous States, the State of the franchisor;

**(K)** information about the franchisees of the franchisor and about franchisees of affiliates of the franchisor that grant franchises under substantially the same trade name that have ceased to be franchisees during the three fiscal years before the one during which the franchise agreement is entered into, with an indication of the reasons for which the franchisees have ceased to be franchisees of the franchisor;

**(L)** the following information regarding the franchisor's intellectual property to be licensed to the franchisee, in particular trademarks, patents, copyright and software:

- (i)** the registration and/or the application for registration, if any,
- (ii)** the name of the owner of the intellectual property rights and/or the name of the applicant, if any;
- (iii)** the date on which the registration of the intellectual property rights licensed expires; and
- (iv)** litigation or other legal proceedings, if any, which could have a material effect on the franchisee's legal right, exclusive or non-exclusive, to use the intellectual property under the franchise agreement

in the State in which the franchised business is to be operated;

**(M)** information on the categories of goods and/or services that the franchisee is required to purchase or lease, indicating

- (i)** whether any of these have to be purchased or leased from the franchisor, affiliates of the franchisor or from a supplier designated by the franchisor;
- (ii)** whether the franchisee has the right to recommend other suppliers for approval by the franchisor; and
- (iii)** whether any revenue or other benefit that may be directly or indirectly received by the franchisor or any of the affiliates of the franchisor from any supplier of goods and/or services to the franchisee, such as rebates, bonuses, or incentives with regard to those goods and/or services, shall be passed on to the prospective franchisee or, if not, whether a price mark-up will be made by the franchisor or the supplier recommended by the franchisor;

**(N)** financial matters, including:

- (i) (a)** an estimate of the prospective franchisee's total initial investment;
- (b)** financing offered or arranged by the franchisor, if any;
- (c)** the financial statements of the franchisor and when available audited or otherwise independently verified financial statements, including balance sheets and statements of profit and loss, for the previous three years. 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;
- (ii) (a)** If information is provided to the prospective franchisee by or on behalf of the franchisor concerning the historical or projected financial performance of outlets owned by the franchisor, its affiliates or franchisees, the information must:
  - (aa)** have a reasonable basis at the time it is made;



**(bb)** include the material assumptions underlying its preparation and presentation;

**(cc)** state whether it is based on actual results of existing outlets;

**(dd)** state whether it is based on franchisor-owned and/or franchisee-owned outlets; and

**(ee)** indicate the percentage of those outlets that meet or exceed each range or result.

**(b)** If the financial information referred to in the preceding subparagraph is provided, the franchisor must state that the levels of performance of the prospective franchisee's outlet may differ from those contained in the information provided by the franchisor.

**(O)** a description of:

**(i)** the state of the general market of the products or services that are the subject of the contract;

**(ii)** the state of the local market of the products or services that are the subject of the contract;

**(iii)** the prospects for development of the market; and

**(P)** anything else necessary to prevent any statement in the document from being misleading to a reasonable prospective franchisee.

**(2)** The following information shall also be included in the disclosure document. However, where the information is contained in the franchise agreement, the franchisor may in the disclosure document merely make reference to the relevant section of the franchise agreement. Where the following items of information are not included in the proposed franchise agreement, that fact shall be stated in the disclosure document :

**(A)** the term and conditions of renewal of the franchise, if any;

**(B)** a description of the initial and on-going training programmes;

**(C)** the extent of exclusive rights to be granted, if any, including exclusive rights relating to territory and/or to customers and also information on any reservation by the franchisor of the right

**(i)** to use, or to license the use of, the trademarks covered by the franchise agreement;

**(ii)** to sell or distribute the goods and/or services authorised for sale by the franchisee directly or indirectly through the same or any other channel of distribution, whether under the trademarks covered by the agreement or any other trademark;

**(D)** the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination;

**(E)** the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination;

**(F)** the limitations imposed on the franchisee, if any, in relation to territory and/or to customers;

**(G)** in-term and post-term non-compete covenants;

**(H)** the initial franchise fee, whether any portion of the fee is refundable, and the terms and conditions under which a refund will be granted;

- (I) other fees and payments, including any gross-up of royalties imposed by the franchisor in order to offset withholding tax;
  - (J) restrictions or conditions imposed on the franchisee in relation to the goods and/or services that the franchisee may sell;
  - (K) the conditions for the assignment or other transfer of the franchise; and
  - (L) any forum selection or choice of law provisions, and any selected dispute resolution processes.
- (3) Where the franchise is a master franchise, the sub-franchisor must, in addition to the items specified in paragraphs (1) and (2), disclose to the prospective sub-franchisee the information on the franchisor that it has received under paragraphs (1)(A), (E), (H), and (2)(C) and (F) of this article, as well as inform the prospective sub-franchisee of the situation of the sub-franchise agreements in case of termination of the master franchise agreement and of the content of the master franchise agreement.

**ARTICLE 7**  
**(ACKNOWLEDGEMENT OF RECEIPT OF DISCLOSURE DOCUMENT)**

The prospective franchisee shall at the request of the franchisor acknowledge in writing the receipt of the disclosure document.

**ARTICLE 8**  
**(REMEDIES)**

- (1) If the disclosure document or notice of material change:
- (A) has not been delivered within the period of time established in Article 3;
  - (B) contains a misrepresentation of a material fact; or
  - (C) makes an omission of a material fact;
- then the franchisee may on 30 days prior written notice to the franchisor terminate the franchise agreement and/or claim against the franchisor for damages suffered from the conduct described in (A), (B) and (C), unless the franchisee had the information required to be disclosed through other means, did not rely on the misrepresentation, or termination is a disproportionate remedy in the circumstances.
- (2) The remedies granted to the franchisee pursuant to this article must be exercised no later than the earlier of:
- (A) one year after the act or omission constituting the breach upon which the right to terminate is based;
  - (B) three years after the act or omission constituting the breach upon which the right to claim for damages suffered is based;
  - (C) one year after the franchisee becomes aware of facts or circumstances reasonably indicating that it may have a right to claim for damages suffered; or

**(D)** within 90 days of the delivery to the franchisee of a written notice providing details of the breach accompanied by the franchisor's then current disclosure document.

**(3)** The rights provided by paragraph (1) of this Article do not derogate from any other right the franchisee may have under the applicable law.

**(4)** All matters regarding termination and damages, which have not been expressly regulated in this article, shall be governed by the applicable law.

**ARTICLE 9**  
**(TEMPORAL SCOPE OF APPLICATION)**

This law applies whenever a franchise agreement is entered into or renewed after the law enters into force.

**ARTICLE 10**  
**(WAIVERS)**

Any waiver by a franchisee of a right given by this law is void.

## **DRAFT EXPLANATORY REPORT**

### **I. PREFACE**

1. The *International Institute for the Unification of Private Law (UNIDROIT)* is pleased to place the *Model Franchise Disclosure Law* presented in this document at the disposal of the international community. The Model Law is intended to provide national legislators who have decided that legislation specifically aimed at franchising should be introduced into their legal system with a source of inspiration, with an instrument that they may consult and use as a model or blueprint should they deem it appropriate. It is a model, and therefore in no way binding. The text of the Model Law is accompanied by an Explanatory Report which explains what the purpose of each provision is, and in some cases explains how the provision should be interpreted, with a view to assisting the legislator in evaluating whether or not the provision in question is necessary and/or suitable in the particular national context. Where a provision is self-explanatory, no comment has been provided.

2. The Model Law is intended to encourage the development of franchising as a vehicle for conducting business. As a pro-commerce document, it recognises that franchising offers the potential of increased economic development, especially among countries seeking access to know-how.

3. The Model Law is a disclosure law. A disclosure law may be considered to be a means to create a secure legal environment between all the parties in a franchise arrangement. To that end, the Model Law ensures that the prospective franchisees who intend to invest in franchising receive material information about franchise offerings, thus permitting them to make an informed investment decision. In addition, the Model Law brings security to franchisors in their relationships with franchisees, administrative authorities and courts.

4. State legislators who take the Model Law into consideration when drafting franchise legislation should however consider that some disclosure requirements may discourage foreign investors from expanding into their market. Therefore, legislators should weigh the interests of both the franchisor and franchisee when considering whether to adopt any specific disclosure requirement. For example, the imposition of specific accounting standards may inhibit franchisors from expanding. The State should weigh the importance of requiring its accounting standard against the desire for greater foreign expansion in their market.

5. The instrument opted for is a Model Law and not an international convention. Of the different types of instrument that are possible, international conventions are the most rigid. The intention with an international convention is that it more or less as it stands should become part of the national law of the Contracting States. The possibility to vary the contents of conventions is very limited, as States will only be able to make reservations to specific provisions, and even that may not be possible if the provisions of the convention itself specify that no reservation is possible. How international conventions are incorporated into the national legislation will vary from country to country, as will the position of international conventions in the hierarchy of laws. The main advantage of stringent instruments such as international conventions is the fact that they provide for as great a legal certainty as is reasonably possible precisely because the texts adopted are incorporated into the legislation

of the Contracting States essentially without modification. The other face of the medal is that States may consider certain modifications to be imperative, and that as Contracting States they would not be able to make these changes to the text. The result may be that instead of ratifying or acceding to the convention, they take inspiration from it, just as if it were a model law, and introduce the changes they need.

6. Model laws are more flexible than international conventions. In this case the intention is from the beginning to permit States to make the changes they consider to be necessary to cater for the specific needs of the country. A further advantage is that it is possible to include in a model law a number of provisions that the experts preparing the law deem to constitute the most appropriate solution to a specific problem, even if some States may want to modify the suggested provision when they take inspiration from it for their national legislation. Whether or not a State does modify a model law, and the extent to which it does so, will depend on the reasons for which it has decided to introduce legislation. The price to pay for this greater flexibility is of course less uniformity, as a number of provisions will differ from country to country. The underlying principles should however remain the same.

7. The different instruments that may be adopted have different addressees. Model laws, as international conventions, are clearly addressed to legislators. The *Model Franchise Disclosure Law* is in the first instance designed to assist the legislators of countries that have decided to adopt legislation for the first time. However, it cannot be excluded that it may eventually replace or integrate existing legislation, should the national legislator decide that the law of his or her country is unsatisfactory for any particular reason and that the regulation proposed by the Model Law is to be preferred.

## **II. BACKGROUND TO THE DRAFT MODEL LAW**

8. The origins of the *Draft Model Franchise Disclosure Law* go back to a proposal made by the Canadian member of the Governing Council of UNIDROIT in 1985. In those years UNIDROIT was engaged in the preparation of what were to become the *UNIDROIT Conventions on International Financial Leasing and International Factoring*,<sup>1</sup> and the Council member saw the preparation of uniform rules on franchising as a natural development in the process of preparation of uniform rules for the new types of agreement that were emerging at the time. There had furthermore been a number of instances of sharp practices within Canada that it was feared might spread also to other countries with the international expansion of franchising.

9. Acting on this proposal, the Governing Council requested the UNIDROIT Secretariat to draw up a preliminary report with a view to deciding whether franchising should be included in the Work Programme of the Institute. This preliminary study was presented to the Governing Council at its 65<sup>th</sup> session in 1986.<sup>2</sup> At the time, franchising was still in its infancy in Europe and hardly used or heard of in other parts of the world, with the exception of North America where it had originated. The information gathered was therefore not vast, particularly when compared to the information available today.

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<sup>1</sup> Adopted in Ottawa in 1988.

<sup>2</sup> See C.D. 65 - Doc. 12, also published as Study LXVIII - Doc. 1, UNIDROIT 1986.

10. It was consequently with a view to eliciting further information that the Governing Council requested that the report, together with a questionnaire, be submitted to Governments, professional circles and recognised experts in the field. At its 67<sup>th</sup> session the Governing Council was seized of a survey of the answers to the questionnaire.<sup>3</sup> Following an examination of this report, and taking into consideration also the imminent adoption by the European Communities of what was to become the franchising Block Exemption Regulation,<sup>4</sup> the Governing Council decided to postpone any decision on future work on franchising and requested the Secretariat to submit a paper examining the actual terms used in franchise agreements to its 68<sup>th</sup> session (1989).<sup>5</sup>

11. For a certain number of years thereafter the main activity on the part of UNIDROIT in the field of franchising was the monitoring of both national and international developments. There were a number of reasons for this. A prime factor was that at the time there was still a quite considerable opposition among the legal advisers of the operators (mainly franchisors) to the development of an international instrument. It was therefore felt advisable to await developments to see whether the need for an international instrument that had been perceived by the proponent was less urgent than anticipated, taking into consideration the sharp practices that had led to the proposal in the first place and how these sharp practices had been dealt with, or whether in the meantime the developments in the industry had not instead occasioned an even greater need. Internal, organisational reasons also played their part in the decision to await developments, in that other projects that had started earlier were given higher priority.

12. At its 72<sup>nd</sup> session, held in June 1993, the Governing Council of the Institute decided that the time had come for a *Study Group on Franchising* to be set up. The terms of reference of the Study Group as defined by the Governing Council were to examine different aspects of franchising and 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, in particular in case of termination of the master franchise agreement. 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 that might be envisaged.

13. The first meeting of the Study Group was held from 16 to 18 May 1994. The Group examined both national and international franchising, analysing the problems that existed and considering whether these problems could be solved by an international instrument prepared by UNIDROIT.

## 1. *INTERNATIONAL FRANCHISING*

14. In relation to international franchising, the Study Group focused its attention on master franchise agreements, which it recognised as the vehicle most commonly adopted for international expansion. It considered in particular

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<sup>3</sup> See C.D. 67 - Doc. 9, also published as Study LXVIII - Doc. 2, UNIDROIT 1988.

<sup>4</sup> 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, in OJ EEC L 359/46 of 28 December 1988.

<sup>5</sup> See C.D. 68 - Doc. 11, also published as Study LXVIII - Doc. 3, UNIDROIT 1989.

- the nature of the relationship between the master franchise agreement and the sub-franchise agreements;
- problems associated with the three-tier structure of the relationship between franchisor, sub-franchisor and sub-franchisees, particularly in relation to termination;
- the settlement of disputes;
- applicable law and jurisdiction; and
- disclosure.

15. The Study Group reached the conclusion that the items examined did not lend themselves to treatment in an international convention. Although nothing would actually prevent the elaboration of an international convention, the proposed subject-matters would require a considerable number of mandatory provisions. The stringent nature of an international convention would furthermore not permit adaptations that some States might feel to be essential for the adoption of the convention. The combination of the mandatory nature of the provisions and the binding nature of the convention would not augur well for the adoption of the convention by the different nations of the world. The utility of such an instrument might therefore seriously be questioned. A broad consensus was instead reached on the fact that a guide would serve a useful purpose for international franchising and would be of invaluable assistance to business community and legal advisers alike.

## 2. *DOMESTIC FRANCHISING*

16. As concerns domestic franchising, the Study Group concentrated on the question of disclosure. In this context it examined

- the experiences of countries which have, or have attempted, some form of regulation in this area;
- the role of franchise associations; and
- the importance of the codes of ethics adopted by those associations.

17. The Study Group reached a lesser degree of consensus on the question of whether any initiative should be undertaken in relation to domestic franchising, although there was consensus on the fact that the information gathered in the process of the preparation of the legal guide to international franchising would be of considerable assistance in clarifying the issues involved.

18. As regards the selection of the subject-matter to be dealt with, the Study Group observed that one of the characteristics of franchising was that a large number of areas of law were involved, a majority of which had already been regulated. It would be extremely difficult to justify adopting a discipline specifically for franchising in relation to, for example, contract law, choice of law and jurisdiction, or intellectual and industrial property law.

19. As regards those areas that were of more direct relevance to franchising and that might indeed be considered peculiar to it, such as disclosure and the issues raised as a result of what could be termed the three-tier structure of master franchise arrangements (for example, the effects of the termination of the master franchise agreement or of its coming to an end on sub-franchise agreements and other questions relating to the relationship between the parties), the Group examined the different approaches that had been adopted by States. It noted that the States that had adopted legislation on franchising had adopted either

disclosure legislation, which was limited to the regulation of the information that a franchisor should provide a prospective franchisee with in order to permit the prospective franchisee to make an informed decision as to whether or not to acquire the franchise, or what are known as relationship laws, which regulate specific terms of the franchise relationship (questions such as, for example, whether the franchisee has a statutory right to renew the agreement, and whether the franchisee has a right to cure when he/she breaches the contract). In this connection the Group observed that in some countries the legislation was linked to a registration requirement, which considerably increased the burden that was placed on the franchisor.

20. In general terms the Group arrived at the conclusion that the experience of States with relationship laws had been negative, whereas experience with disclosure legislation had on the whole been positive. Furthermore, the fact that it was perfectly feasible to reach agreement on the information that it was desirable for a franchisor to disclose to a prospective franchisee whatever the business sector, and therefore to attain a degree of uniformity across the board as regards disclosure, whereas it was far more problematic to devise common norms for relationship issues in view of the great variety of relationships that existed within the context of franchising, led the Group to decide that the subject-matter to be dealt with in any regulation at international level should be disclosure.

21. As regards the instrument to be adopted, the characteristics of the different types of instrument that might be adopted led the Group to decide that the most suitable instrument would be a model law.

22. The Study Group in the end decided to recommend to the Governing Council that the question of the possible preparation of an international instrument for domestic franchising be deferred, and that it be taken up again once work on the guide had been completed.

23. In February 1998 the Governing Council of UNIDROIT authorised the publication of the *UNIDROIT Guide to International Master Franchise Arrangements*, which appeared in September 1998. At that same session, the Council accepted a proposal by the Secretariat of the organisation that the Study Group on Franchising should proceed with the preparation of a model law.

24. The proposal submitted by the Secretariat was based upon the growing interest in the preparation of an international legal instrument demonstrated by members of the Study Group, even by a number of members who had been sceptical or even contrary to the initiative when it had first been proposed in 1986. This growth of interest was largely due to the increasing attention devoted to franchising by legislators and the consequent proliferation of franchise laws, not all of which had, in the view of the members of the Study Group, given sufficient consideration to the specific nature and characteristics of franchising, thereby unintentionally putting the future development of franchising in the country concerned at risk. If UNIDROIT prepared a model law, which by definition would be a balanced instrument considering the nature of the organisation and the guarantees offered by its past history, this would make available to legislators an instrument that would effectively promote the development of franchising.

25. In consideration of the above, the Governing Council accepted the proposal put forward by the Secretariat and decided to authorise the Study Group on Franchising to



proceed with the preparation of a model law. The proposal was finally endorsed by the General Assembly of the Institute at its 52<sup>nd</sup> session on 27 November 1998, in the context of the approval of the Work Programme for the triennial period 1999 – 2001.

26. Following the decisions taken by the Governing Council and General Assembly of the organisation, a Drafting Committee of the Study Group on Franchising met in Rome from 14 to 16 January 1999 to prepare a first draft of the future model law. This first draft was submitted to the Governing Council of the Institute at its 78<sup>th</sup> session in April 1999, and was examined in detail by the Study Group in Plenary at its Fourth Session on 9 and 10 December 1999.

27. The discussions at the Fourth Session of the Study Group opened with a consideration of the decision to prepare a model law. Although a majority of the members of the Study Group were clearly in favour of the preparation of such an instrument, a couple of members questioned the decision, suggesting instead that UNIDROIT could make a more valuable contribution to the development of franchising by assisting Governments in a consultant capacity. While not discarding this idea, the majority of the Study Group in the end came out strongly in favour of the adoption of a model law, in part for the reasons specified above, and in part in consideration of the fact that the recent trend towards legislation was not likely to abate and that it therefore made good sense to elaborate a uniform instrument.

28. At its 79<sup>th</sup> session (April 2000) the Governing Council was seized of the text of the draft as revised by the Study Group at its Fourth Session. The Fifth and final Session of the Study Group, at which the draft text of the model law, plus the Explanatory Report that accompanies the text, were finalised with a view to their submission to a Committee of Governmental Experts, was held on 7 December 2000.

29. The First Session of the Committee of Governmental Experts convened to examine the draft Model Franchise Disclosure Law was held from 25 to 29 June 2001, and the Second, and final, Session was held from 8 to 12 April 2002. The draft articles and draft Explanatory Report, as adopted by the Committee of Governmental Experts, will be submitted to the Governing Council of UNIDROIT in September 2002.

### **III. GENERAL CONSIDERATIONS**

#### **1. THE SCOPE OF APPLICATION OF THE MODEL LAW**

30. The territorial scope of application of the Model Law is specified in Article 1, and the temporal scope of application in Article 9 (see below). As regards the subject-matter dealt with, the Model Law is limited to pre-contractual disclosure. The Model Law does not deal with the relationship between the parties, nor does it deal with the consequences of termination.

31. The Study Group at its Fourth Session examined proposals that had been tabled for the broadening of the scope of application of the Model Law. There was however a clear majority in favour of limiting the model law to pre-contractual disclosure and against dealing with questions relating to the relationship between the parties in view of the inherent

difficulties in establishing a uniform regulation of such relationships. This consideration was due to the numerous differences that existed between different franchises, not only between trade sectors, but also between franchise systems within the same trade sector. While there are a number of provisions that are to be considered essential to any franchise relationship and that are normally present in the franchise agreement, it is next to impossible to state that they have to be couched in certain terms or have to contain certain elements. On the other hand, it is possible in a disclosure law to require that information regarding those terms be disclosed to the prospective franchisee. This will indirectly result in a requirement that the agreement or disclosure document contain those elements. In favour of disclosure-only legislation was also the realisation that, while constituting what apparently is only a small part of franchising, disclosure is crucial. It was observed that a major issue in the majority of cases dealing with franchising is the allegation by the franchisee that the franchisor has not provided the franchisee with adequate information prior to the conclusion of the agreement.

32. The Model Law is intended to apply to both domestic and international franchising, and to different types of franchise agreement, such as traditional unit agreements, master franchise agreements and development agreements. The Model Law is also intended to cover any new forms of franchise arrangements that might develop in the future.

33. The Model Law does not require disclosure on the part of the franchisee, only on the part of the franchisor. The reason for this is that the experience and economic size of franchisors, which permit them to have access to legal counsel, do not make it necessary to provide franchisors with the same degree of protection as franchisees. Furthermore, as is the case with other entrepreneurs, it is normal business practice for franchisors to ask prospective franchisees for information. Franchisors will naturally want to be able to assess the capabilities and reliability, as well as the financial conditions, of prospective franchisees before entrusting them with the development of a business that carries their trade name.

## 2. *THE PREAMBLE*

34. The States which assembled in the Committee of Governmental Experts to adopt the Model Law contained in this document decided that a statement indicating the convictions and intentions of the States should be included as a Preamble to the document. This Preamble may be seen as a message addressed to the States that intend to consult and use the Model Law as a basis for their national legislation. It recognises the fact that franchising plays an ever greater role in a wide range of national economies. While recommending the Model Law to States that have decided to adopt franchise-specific legislation, it lists a number of factors that legislators might wish to consider when they evaluate firstly, whether or not to introduce franchise-specific legislation, and, secondly, when they so decide, what kind of franchise-specific legislation to introduce. It clearly indicates that State legislators have no obligation to introduce the Model Law, which is a natural consequence of the inherent nature of model laws.

## **IV. COMMENTARY ON THE PROVISIONS OF THE DRAFT MODEL LAW**

35. The Model Law has a total of ten articles. As it is a disclosure law, all the provisions are linked to disclosure, even if they go beyond the mere listing of the items to be

disclosed. Article 1 specifies the territorial scope of application of the Model Law, and Article 9 the temporal scope of application. Article 2 provides definitions of terms used in the Model Law. Article 3 deals with the delivery of the disclosure document, Article 4 deals with its format, Article 5 lists a number of cases in which the franchisor is exempted from the obligation to disclose, and Article 7 deals with the acknowledgement on the part of the franchisee that he/she has received the document. Article 6 is the core provision of the Model Law and lists the items of information that a franchisor must disclose to a prospective franchisee. Article 8 deals with the remedies available to the franchisee in case of breach on the part of the franchisor of his/her duty to disclose, and Article 10 with waivers.

1. *ARTICLE 1 - SCOPE OF APPLICATION*

36. Paragraph (1) of Article 1 delimits the territorial scope of application of the Model Law by specifying that:

1. the Model Law is intended to apply to franchises (which are defined in Article 2), and therefore not to other types of agreement;
2. it is to apply to franchises granted or renewed for the operation of one or more franchised businesses, which clearly indicates that the franchises covered include both simple unit franchises and master franchise or development arrangements; and
3. it is to apply in the State adopting the Model Law. In other words, it applies to franchises that are operated in the national territory of the State adopting this law irrespective of whether the franchise originates as a domestic franchise or as a foreign franchise. It is not intended to apply to franchises that are exported from a country that has adopted the Model Law into a country that has not, nor is it intended to apply to a franchise which is not operated in the country even if the agreement has been signed there. The last words of the Article are left in square brackets to permit States to identify the territory within which the law applies in a manner consistent with the formulation normally adopted in their country.

37. It should be noted that for the purposes of the Model Law the term "State" is intended to include the territorial units making up a State which has two or more territorial units, whether or not possessing different systems of law applicable in relation to the matters dealt with in the law (Article 2).

38. In the context of the scope of application of the law, the State legislator may wish to consider whether, in an international situation, the parties should or should not be able to escape the application of the law by selecting as the law applicable to their contract the law of a country which has not introduced the Model Law into its national legislation.

39. The State legislator may also wish to consider whether the law should apply only in cases in which a franchise agreement is concluded at the end of the negotiations between the parties, or whether it should also apply if a franchise agreement is not concluded. Of relevance in this context is Article 8, which provides for remedies both for the case when the franchisor has not provided the disclosure required, and for the case when the disclosure is defective due to either a misrepresentation or an omission of a material fact. If a franchise is granted, then, in accordance with Article 8(1), if prior to its being granted the required disclosure was not made, the franchisee is entitled to terminate the franchise agreement and/or claim damages. If no franchise is granted, then the franchisor will not be liable under

this law, but the franchisee may have recourse to any other remedy that is available under the applicable law (Article 8(3)).

40. As indicated above, the Model Law is a disclosure law, and as such regulates the disclosure that the franchisor should provide the prospective franchisee with prior to the signing of the agreement. It does not, however, address the question of the validity of an agreement once it has been concluded. Paragraph (2) therefore explicitly states that except as otherwise expressly provided by the Model Law, it is not concerned with the validity of the franchise agreement or any of its provisions.

## 2. ARTICLE 2 - DEFINITIONS

*“affiliate of the franchisee”*

*“affiliate of the franchisor”*

41. The Model Law refers to the “affiliates” of both the franchisee and the franchisor. The definition of “affiliate” corresponds to the standard definition of affiliate used for corporate law purposes. The Model Law uses the term “affiliate” to cover also those who in other legislation are called “associates”. In the context of franchising, however, State legislators may wish to consider what type of control should be exercised by a natural or legal person for them to qualify as an affiliate.

42. In the case of an “affiliate of the franchisee”, the intention is to cover the different legal entities into which a franchisee might be organised. The intention is clearly not to include also the franchisor, even if the definition refers to a natural or legal person who “directly or indirectly controls [...] the franchisee”. While the franchisor does have what has been called “operational control”, this control refers to the possibility to ensure that the franchisee conform to the business formula of the franchise, and not to control in terms of share-holding presence. The control referred to in the definitions of the affiliates of the franchisee and franchisor instead refers to precisely this share-holding presence. Clearly, not only the franchisor of the particular franchise is excluded from the definition of the affiliate of the franchisee, but any other franchisor that the franchisee might be a franchisee of, such as, for example, where the franchisee is a franchisee of both a convenience store and a fast food restaurant.

43. In the case of an “affiliate of the franchisor” the intention is to cover both parent and daughter companies, as well as companies on the same organisational level as the franchisor. The Model Law also refers to “subsidiaries” (see Article 6(1)(G)), with the intention of covering only daughter companies. Also in this case the franchisor has a share-holding presence.

*“development agreement”*

44. Development agreements are agreements that are used to develop large territories. They are often used as an alternative to master franchising. The distinction between the two is that in master franchising the franchisor grants the sub-franchisor (also called the “master franchisee”) the right not only to operate franchise outlets itself, but also to grant sub-franchises to sub-franchisees in the territory the franchisor has granted it the right to develop. The sub-franchisor therefore to all intents and purposes acts as franchisor in that

territory. There are in such cases normally no relations between the franchisor and the sub-franchisees, except in exceptional cases (for instance for the purposes of the granting of intellectual property rights in some countries). In the case of development agreements, the franchisor grants the other party (in English normally called the “developer”) the right to develop more than one franchise in the territory. Often, there will be a framework development agreement covering the arrangement as a whole, and separate unit agreements for each unit.

*“disclosure document”*

45. The information that a franchisor must provide a franchisee with is normally included in a document that is separate from the franchise agreement, even if the two documents are handed over together. In fact, the agreement is often an exhibit of the disclosure document. Although the definition does not state so explicitly, to facilitate consultation on the part of the prospective franchisee the information to be disclosed should be contained in a single disclosure document, as opposed to several, although items such as financial statements might usefully be annexed to that document (see Article 4(2)).

*“franchise”*

46. The definition of a franchise, with the description of its essential elements, is intended to make it clear that for the purposes of the Model Law a franchise is what is known as a “business format franchise”, and not what is known as an “industrial franchise”, which has been defined as concerning the manufacturing of goods and as consisting in manufacturing licences based on patents and/or technical know-how combined with trademark licences, a “distribution franchise”, defined as concerning the sale of goods, or a “service franchise”, defined as concerning the supplying of services.<sup>6</sup>

47. In the definition of a franchise, “direct or indirect financial compensation” is qualified by the proviso at the end of the definition, which states that it shall not include the payment of a *bona fide* wholesale price for goods intended for resale. The intention is to exclude instances in which a simple sale of goods, as opposed to the granting of a franchise system, is involved. The need to make this distinction is the result of the proliferation in some countries of brand merchandising. In brand merchandising there are degrees of control over the operation of the business, but these controls are not such as to make the outlet a franchise, even if a certain amount of confusion might arise as they may include, for example, the business being permitted to place the franchisor’s trade name above the door, assistance on the part of the franchisor, or even a certain amount of control over how the outlet is operated. The qualifying term “financial” indicates that the form of compensation envisaged here is monetary, and not non-monetary.

48. The specification “selling goods or services” is intended to make it clear that cases in which services are not provided against financial compensation, in other words are not “sold”, are not covered by the Model Law.

49. The definition indicates that the franchisee engages in the selling of goods and services “on its own behalf”. This is intended to make it clear that the franchisee is

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<sup>6</sup> See Commission Regulation (EEC) No 4087/88 on the application of Article 85(3) of the Treaty to categories of franchise agreements, in OJ EEC L359/46 of 28 December 1988, Recitals 3 and 4.

independent from the franchisor, that the franchisee is an entrepreneur in its own right who invests and risks its own funds and that the franchisor and the franchisee are not liable for each other's acts or omissions.

50. The definition indicates that the control exercised by the franchisor must be a "significant and continuing operational control". The type of control referred to, is not share-holding control, but control over certain functions, so as to ensure that the franchisee operates the franchise following the franchise system developed by the franchisor and that the quality of the performance is the same irrespective of outlet. There are, for example, hotel franchise systems with centralised booking systems, and other systems in which the accounting is centralised. In most cases, however, the control exercised by the franchisor is not this strict, but is merely aimed at ensuring the observance of the prescriptions of the franchise system and the quality of the goods or of the performance of the services: in short, the amount of control that is necessary to maintain the good reputation of the system and of the trademark involved. The nature of the franchisee as an independent entrepreneur must in no case give rise to doubt. The control should however not be so lax, that it is possible for the franchisor to elude its disclosure obligations by claiming that the control it exercises over the franchisee is either not sufficient, or not sufficiently efficient, for it to qualify as "significant and continuing".

51. Reference is made in the definition to "a system designated by the franchisor". This terminology is used with a view to including cases in which the franchisor is not the owner of the trademarks or distinctive signs involved. There may, for instance, be cases in which the franchisor has designed a system, such as a fast food operation, in which a drink of a particular brand is an important element, even if the franchisor has nothing to do with its production and does not own the trademark. This idea is repeated further on in the definition, which specifies that the system designated by the franchisor "is substantially associated with a trademark, service mark, trade name or logotype designated by the franchisor".

52. Know-how is a fundamental element of the franchise system. The term designates the knowledge acquired and experience gained by the franchisor in the years he/she has been engaged in the business of the franchise. It is the know-how that is transmitted to the franchisee that is particularly precious and permits the franchisee to engage successfully in the business without having to make unnecessary mistakes and without having to make unnecessary investments.

53. Assistance is in most cases offered to the franchisee by the franchisor. The amount of assistance, whether the assistance is only the assistance required initially to start the business, or whether it will continue over time, with a more or less active role played by the franchisor and the franchisor's staff, will vary from franchise to franchise. There is no rule determining how much assistance is necessary, each franchise has its own requirements. In fact, there are even franchises in which no assistance apart from the initial assistance is offered by the franchisor. The definition simply refers to "assistance" to indicate that also franchises that do not offer continuing assistance are covered by the Model Law.

54. The definition of a franchise indicates that both know-how and assistance must be present in a franchise system, although, in consideration of the differences that exist between different countries, it does not specify the nature or the quantity of the know-how and assistance. National legislators may therefore wish to consider whether systems that either do not have know-how or do not have assistance should qualify as franchises. If they

feel that such systems should be covered by this law, then they might usefully modify the definition to read “know-how *or* assistance” instead of “know-how *and* assistance”.

55. The requirement that the system prescribe “in substantial part the manner in which the franchised business is to be operated” and “include significant and operational control by the franchisor” is intended to make it clear that what is intended is not merely the control exercised over the use of the trademarks that would be exercised in a trademark licence agreement, but the control that the franchisor exercises over the very nature of the business, such as, for example, the control exercised over the hours of operation of the outlet. To be noted, however, is that this control is operational control, and not a share-holding presence (see paragraph 50 above).

56. The definition of a franchise further specifies that it includes the rights granted by a franchisor to a sub-franchisor under a master franchise agreement, the rights granted by a sub-franchisor to a sub-franchisee under a sub-franchise agreement and the rights granted by a franchisor to a party under a development agreement. The Model Law uses the word “party” in relation to the development agreement because of the near impossibility to translate the English term “developer” into other languages.

*“franchise agreement”*

57. The definition of “franchise agreement” should be read together with the definition of “franchise”. Considering that “franchise” includes also the rights granted under master franchise, sub-franchise and development agreements, the term “franchise agreement” includes also master franchise agreements, sub-franchise agreements and development agreements.

*“material change”*

58. The Model Law defines a “material change” in the information required to be disclosed by the effect it might have on the decision of the prospective franchisee to acquire the franchise. Whether or not the change in the information will be considered to be material will depend on the answer to the question whether a reasonable prospective franchisee in the same circumstances would have acquired the franchise even if he/she had been aware of the change. If the answer is yes, then in all likelihood the change will not be considered material, whereas if the answer is no, it probably will be.

*“material fact”*

59. The Model Law defines also a “material fact” by the effect it might have on the decision of the prospective franchisee to acquire the franchise. Thus, again, whether or not a certain item of information is considered to be material will depend on the answer to the question whether a reasonable prospective franchisee in the same circumstances would have acquired the franchise even if he or she had been aware of the information. If the answer is yes, then in all likelihood the information will not be considered material, whereas if the answer is no, it probably will be.

*“misrepresentation”*

60. “Misrepresentation” is a concept that is well-known in the common law legal systems, less so in the civil law. As formulated the definition catches not only untrue statements wilfully made, but also statements that have been made without sufficiently careful consideration on the part of the person making the statement. What is known as “innocent misrepresentation”, i.e. where the person making the statement is not aware that it is untrue, is however not covered. The Model Law refers to the “person making the statement” because although in most cases that person will be the franchisor, statements may also be made, or information provided, by affiliates or officers or directors of the franchisor. It should be noted that the relevant statements are statements of material facts, not statements regarding matters of little or no importance, and that “material facts” have been defined as information that can reasonably be expected to have a significant effect on the decision of the prospective franchisee to acquire the franchise. The effects of negligent, or intentionally wrongful, statements of material facts may be quite considerable, not only because the franchisee might have been induced to acquire the franchise as a result of the misrepresentation, a decision he/she might not have taken had he/she been aware of the true state of affairs, but also because the franchisee might suffer loss or damage as a consequence. Article 8(1) of the Model Law therefore provides that a franchisee who suffers as a result of the misrepresentation of a material fact is entitled to terminate the franchise agreement and/or claim damages, unless the franchisee had the information required to be disclosed by other means, did not rely on the misrepresentation, or, as regards termination, unless termination would be a disproportionate remedy in the circumstances. It should be noted that the right of the franchisee to terminate and or claim for damages does not derogate from any other right the franchisee might have under the applicable law (Article 8(3)).

*“omission”*

61. The reasoning underlying the definition of “omission” is the same as that underlying the definition of “misrepresentation”: the effects of an omission may include the prospective franchisee being induced to acquire a franchise he/she might not otherwise have acquired, with the franchisee suffering loss or damage as a consequence. Article 8(1) therefore provides that if there is an omission of a material fact in a disclosure document the franchisee is entitled to terminate the franchise agreement and/or claim damages, unless the franchisee had the information required to be disclosed by other means, did not rely on the misrepresentation or, as regards termination, unless termination would be a disproportionate remedy in the circumstances. Again, the right of the franchisee to terminate and/or claim for damages does not derogate from any other right the franchisee might have under the applicable law (Article 8(3)).

3. *ARTICLE 3 - DELIVERY OF DISCLOSURE DOCUMENT*

62. *Paragraph (1)* indicates when the disclosure document must be given to the prospective franchisee. The specified fourteen-day time-period is a compromise between the twenty days that some national legislations require and the seven or five days required by others. Fourteen days are a time-period that permits the prospective franchisee to examine the document and also to obtain expert advice. Two moments in time are identified as triggering the disclosure obligation: the signing by the prospective franchisee of any



agreement relating to the acquisition of a franchise, with the exception of agreements relating to the confidentiality of the information that is delivered or is to be delivered to the prospective franchisee by the franchisor, and the payment by the prospective franchisee to the franchisor or an affiliate of the franchisor of any fees relating to the franchise. However, the phrase “any fees relating to the franchise” should not be read to include reimbursements made by a potential franchisee to a franchisor for actual out-of-pocket expenses incurred in connection with exploratory visits to the prospective franchisee or preliminary meetings during which the franchise system or possible sale of a franchise is discussed. Nor would they include reimbursements made for such things as due diligence investigations or market or legal research related to the market where the prospective franchisee proposes to operate the franchise. This paragraph also specifies that the franchise agreement must be attached to the disclosure document, as it will normally be an exhibit of that document.

63. Confidentiality agreements are excluded as a trigger for the duty to disclose as they might operate very early on in the preliminary talks between the franchisor and the prospective franchisee, before the prospective franchisee has made any commitment. The reference to “any agreement relating to the franchise” is a reference to any document that makes the prospective franchisee commit to an investment relating to the franchise. If there is no commitment on the part of the prospective franchisee, then the franchisor should not be under an obligation to transmit the detailed information that a disclosure document contains to the prospective franchisee, not the least because this information includes also confidential information that the franchisor should not have to risk being made public. As, however, a certain amount of confidential information must of needs be communicated to the prospective franchisee in the course of the preliminary talks, it is legitimate for the franchisor to require that the prospective franchisee keep this information confidential and that for this purpose a confidentiality agreement be entered into by the negotiating parties without the duty to disclose being triggered.

64. The information referred to is not only the information contained in the disclosure document, but also any other information that the franchisor transmits, whether written or oral. The signing of a confidentiality agreement may be a condition that the prospective franchisee must comply with in order to receive the disclosure document. This is justified considering the nature of the information contained in the disclosure document, which is not only statistical information relating to, for example, how many franchisees belong to the network, but also information on the franchise system, the methods developed by the franchisor to run the franchise and the intellectual property.

65. *Paragraph (2)* introduces the requirement that the disclosure document be updated within an unspecified number of days of the end of the franchisor’s fiscal year, as the Model Law requires that when available, audited or otherwise independently verified financial statements must be attached to the disclosure document (see Article 6(1)(N)(i)(c)). The number of days is left unspecified to permit each State to decide the number of days it considers to be the most appropriate. The end of the fiscal year is a natural point in time, as the franchisor, as any other businessperson, will be required to fulfil the obligations applicable in his/her country of origin. However, although the updating is tied to the end of the franchisor’s fiscal year and therefore to the production of annual financial statements, the formulation is left flexible, as the applicable rules differ from country to country. The intention is to avoid placing a burden on the franchisor that would be disproportionate to the benefit gained by the franchisee, considering that the obligations vary not only from country to country, but also depending on the structure of the franchisor. At the very least, the time

period selected should be reasonable to allow sufficient time for the franchisor to complete its obligations. Paragraph (2) however also provides that where there has been a material change in the information required to be disclosed under Article 6, notice in writing of such change should be delivered to the prospective franchisee as soon as practicable before either of the events described in Sub-Paragraphs (1)(A) or (1)(B) has occurred. This proviso has been added to cover cases where material, or highly significant, changes occur that a prospective franchisee should be informed of, but that for reasons of time have not been covered in the normal updating of the disclosure document. For example, if the franchisor in month ten after the updating changes the supplier of a product that is a cornerstone of the franchise system, the prospective franchisee should be informed of this change. It should be noted that if a prospective franchisee receives a disclosure document and a material change occurs subsequently, but before the franchise agreement is concluded, the prospective franchisee may under national law be entitled to receive disclosure thereof, possibly in the form of a new disclosure document that reflects the situation after the material change has occurred. In some countries such a requirement would be covered by what are known as “anti-fraud” provisions. As this new disclosure by nature is an integration of the disclosure that has already been made, it would normally not be necessary for a new waiting period to start.

66. In a number of countries the future parties to an agreement discuss a proposed agreement, introduce the changes they agree upon, and then again examine the draft as agreed upon, with the waiting period established for its examination starting to run again every time a modification is made to the draft. The most common situation in the case of franchising is however that the prospective franchisee negotiates with a franchisor to obtain better conditions or concessions. The prospective franchisee will therefore be fully aware of what he/she has been successful in obtaining from the franchisor and will not need to receive a new agreement for consideration. Rather than introduce a chain of negotiation and waiting periods, Article 3(1) of the Model Law provides that the proposed franchise agreement must be attached to the disclosure document.

#### 4. ARTICLE 4 - FORMAT OF DISCLOSURE DOCUMENT

67. *Paragraph (1)* requires disclosure to be provided in writing. The need for written disclosure is both natural and evident, not only because the prospective franchisee must be in a position to examine and evaluate the information he/she is given, and he/she would be able to do so only with the greatest difficulty if the disclosure were oral, there is also a need for both parties to be able to provide evidence of disclosure, and this evidence will exist only if the disclosure is written. This does not mean that the disclosure must be paper-based: Article 6(1) of the *Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (UNCITRAL)* states that “[w]here the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference”, where a data message is “information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy” (Article 2(a)). The provision included in the UNCITRAL Model Law represents modern international standards. Whether or not individual States are prepared to accept that also electronic documents fulfil the writing requirement will vary from country to country.

68. *Paragraph (2)* indicates that any format may be used for the disclosure document, provided that the information is presented as a single document at one time and meets the

requirements imposed by the Model Law. There are a number of institutions, both national and multi-national, that have adopted specific forms that must be followed and complied with for the disclosure requirements to have been met. This provision is intended to permit franchisors who have used such forms to utilise them to fulfil the requirements imposed by the Model Law with a minimum of expense being incurred and effort being invested in making the necessary adaptations. The requirement that the information be presented as a single document at one time is intended to ensure that the franchisor does not hold back important or sensitive information until the very last moment, thereby misleading the prospective franchisee as to the importance of the information and lowering his/her attention.

#### 5. *ARTICLE 5 - EXEMPTIONS FROM OBLIGATION TO DISCLOSE*

69. The purpose of the pre-contractual disclosure of information is to permit a prospective franchisee to make an informed decision as to whether or not to acquire a franchise. There are however a number of cases in which disclosure is not necessary, and these are listed in Article 5.

70. *Paragraph (A)* excludes disclosure where the prospective franchisee has been an officer or director of the franchisor or of an affiliate of the franchisor for at least one year immediately before the signing of the franchise agreement. The reason for this is evident: as an officer or director of the franchisor or of an affiliate of the franchisor, which as defined in Article 2 is a natural or legal person who directly or indirectly controls or is controlled by the franchisor, or is controlled by another party who controls the franchisor, the prospective franchisee can be expected to have all the information he/she needs to make an informed decision. If the list of items to be disclosed contained in Article 6 is examined, it is clear that an officer or director will have access to such information.

71. *Paragraph (B)* excludes disclosure in the case of an assignment or other transfer of a franchisee's rights and obligations under two specific conditions, both of which must be met for the exemption to apply. First, the assignee or transferee must be bound by substantially the same terms as the assignor or transferor: i.e. when the only significant change is the name of the franchisee who signs the agreement. The reason for this is that in such cases a franchisee who transfers or assigns a franchise agreement should transmit everything to the new franchisee, including the information he/she received at the beginning of his/her franchise relationship with the franchisor, and if nothing significant is to change in the relationship except one of the parties, new disclosure is not required if the second condition is met. The second condition is that the franchisor must not have been involved in the transaction, other than merely approving the transfer. Where the franchisor is not involved, the transferee does not rely on any representations of the franchisor made to induce the transfer. However, if the franchisor makes new representations to the transferee, the transaction may be considered to be substantially similar to the sale of a new franchise, thus triggering the franchisor's disclosure obligation.

72. It should be noted that the assumption is that the assignor or transferor will transmit all the information received originally from the franchisor to the assignee or transferee. It cannot be excluded, however, that the assignor or transferor will transfer only part of the information, perhaps because he/she wishes to leave the franchise network, and that therefore information that is likely to influence the decision of the assignee/transferee negatively may not be transmitted. Such behaviour on the part of the assignor or transferor

could however be considered to be akin to misrepresentation, and the assignor/transferor might therefore be liable vis-à-vis the assignee/transferee.

73. *Paragraph (C)* refers to what are known as “fractional franchises”. These are franchises in which the franchisee is not new to the situation, but has been active in the business concerned, or in a similar business, for a certain period of time (in the Model Law for the previous two years), and where the franchisee is intending to take over will represent no more than a certain percentage of his/her business; where, in other words, the franchisee is simply adding another line of products to his/her business. The provision also gives the parameters for deciding whether or not the conditions for exemption are fulfilled, namely if the sales of the franchise, as reasonably anticipated by the parties at the time the franchise agreement is entered into, will not during the first year of the relationship exceed 20% of the total aggregate sales of the combined business of the franchisee and its affiliates, i.e. if the expected sales from the proposed franchise will be less than 20% of the total sales of the franchise together with the sales of the business of the franchisee to which the franchise is added. The reference to the affiliates of the franchisee is intended to cover cases in which the franchisee’s business is organised in a number of separate entities, meaning that the new franchise would not exceed 20% of the total aggregate sales of those entities combined.

74. *Paragraphs (D) and (E)* are intended to exempt the franchisor from disclosure when the prospective franchisee is a franchisee of substance, who either commits to a total financial requirement under the franchise agreement in excess of an unspecified amount, or who, together with its affiliates, has a net worth or turnover in excess of an unspecified amount. The concept of “financial requirement” is broader than the concept of “investment”, and includes also items of expenditure that are not considered to be investments for balance sheet purposes, even if they are necessary for the business. Examples of investments are the machinery which is used by the company, and examples of requirements that are not investments are the stocks of products acquired for resale. The net worth referred to is the real net worth of the person according to the principles of accounting that apply in his/her country. The figures in the provisions are intentionally left blank, as what qualifies as a large requirement in one country may not be a large requirement in another, and what is a large requirement in one industry may not be large in another. For example, the financial requirements of a retail outlet are considerably lower than those of a hotel. Franchises with large financial requirements are invariably heavily negotiated, and it is to be expected that entrepreneurs who commit large sums and who negotiate deals of such financial importance do not require the protection of this disclosure law. It should be noted that the large requirements that are intended are those where there is an effective commitment on the part of the prospective franchisee. In summary, it may therefore be said that the total requirement aimed at in *Paragraph (D)* is an requirement that suggests a person of such level of sophistication and knowledge that he/she has access to the advice of legal counsel and does not require the protection of this law, whereas the person considered in *Paragraph (E)* is one who by virtue of his/her net worth or turnover is assumed to have such a level of sophistication and prior business experience that he/she does not require the protection of this law.

75. Cases of renewal or extension of a franchise on the same terms are exempted in *Paragraph (F)*. In these cases the relationship continues without modification, and as the franchisee therefore has all the information he/she needs as he/she is already committed to the relationship, there is no need for disclosure.

## 6. ARTICLE 6 - INFORMATION TO BE DISCLOSED

76. *Article 6* divides the information to be disclosed into two distinct groups: the first contains the information that the disclosure document *must* contain (Article 6(1)), the second indicates further information that the disclosure document *should* contain, but which may be omitted if the contract itself provides it in adequate detail (Article 6(2)). In other words, *Paragraph (1)* refers to information that is normally not included in the franchise agreement, most of which is information regarding the franchisor and the franchise network and does not relate to the rights and duties of the parties. *Paragraph (2)*, on the other hand, requires disclosure of information that is normally dealt with in the franchise agreement itself, as in most cases it is of the greatest importance to the relationship. The reason it is listed in this Article despite the fact that it will in most cases be contained in the agreement itself, is that it is not always adequately dealt with in the agreement.

77. Together, the two paragraphs require the franchisor to provide information on all the component parts of what is normally considered a franchise: the intellectual property, the control rights of the franchisor and the rights and obligations of the parties, as well as any other information that a prospective franchisee might require to make an informed decision as to the franchise. In addition, *Paragraph (3)* provides that in the case of a master franchise the sub-franchisor must not only provide the prospective sub-franchisee with information relating to itself, it must also pass on certain information relating to the franchisor that it has received from the franchisor.

78. The list of items of information to be disclosed contained in Article 6 is very detailed. The purpose of this is to ensure to the greatest extent possible that the attention of the users of the Model Law is drawn to most, if not all, items of importance in an evaluation of a franchise. The amount of detail that the legislator referring to the Model Law will include in any proposed legislation will depend on the drafting style of the country as well as on other legislation that already applies to franchise agreements in that country and that may cover any particular item listed in Article 6.

### **(1) Paragraph (1)**

79. *Paragraph (1)* opens with a statement of principle, namely that “[i]n the disclosure document the franchisor shall provide following information”. The list includes the items that a majority of the participants in the meetings of the Study Group first, and the Committee of Governmental Experts thereafter, considered to be essential for a prospective franchisee to make an informed decision. It should however be recalled that this instrument is a Model Law, and that therefore national legislators are free to shorten or to lengthen the list by excluding some of the items or by adding to this list other information to be disclosed, thereby adapting it to local needs and to local drafting traditions. The comments contained in the Explanatory Report are intended to facilitate the task of the national legislators by explaining the reasons for which the items were included in the list.

80. *Sub-Paragraphs (A), (B) and (C)* relate to the name and address of the franchisor. The “legal name” referred to in *Sub-Paragraph (A)* is the official name of the franchisor, i.e. if the franchisor is a company that requires registration, the name that is registered. The “legal address” is the address at which the franchisor is registered. The “legal form” refers to the structure of the franchisor. It is important for the franchisee to know

whether the franchisor is, for example, a limited liability company or a corporation, as this will give a clear indication of the liability of the franchisor vis-à-vis the franchisee and the clients of the franchisee. Further to be disclosed is the address of the principal place of business of the franchisor in the State where the prospective franchisee is located, which may be different from the address of the registered office of the franchisor. This is relevant in particular in an international situation, if the franchisor has an independent branch or subsidiary in the foreign country. In this case the address of that branch or subsidiary would be the legal address whereas the headquarters of the franchisor in its country of origin would be the principal place of business. *Sub-Paragraph (B)* refers to the trademark, trade name, business name or similar name under which the franchisor carries on or intends to carry on business. This covers the name under which the business is conducted, irrespective of whether or not it is registered in a register, the intention being to make it possible for the prospective franchisee to research the franchisor company to discover whether, for example, it has any liens against it or not. The scope of Paragraph (B) is limited to the State in which the prospective franchisee will operate the franchise business, as information of this kind is of interest primarily, if not exclusively, when it relates to the State concerned, and not to other States.

81. *Sub-Paragraph (C)* requires disclosure of the address of the principal place of business of the franchisor in the State where the prospective franchisee is located. This is important firstly, to permit the franchisee to have an interlocutor in his/her State should this be necessary, and secondly, for reasons of security: the franchisee may be in need of suing the franchisor and of having access to the assets of the franchisor in his/her own State.

82. *Sub-Paragraph (D)* requires the franchisor to provide a description of the franchise to be operated by the prospective franchisee. It should be noted that in some countries a franchise agreement would not be valid without such a description.

83. *Sub-Paragraph (E)* requires the business experience of the franchisor and of those of its affiliates that grant franchises under substantially the same trade name to be disclosed, including the length of time they have each run a business of the type to be operated by the prospective franchisee (*Sub-Paragraph (E)(i)*) and the length of time they have each granted franchises for the same type of business as that to be operated by the prospective franchisee (*Sub-Paragraph (E)(ii)*). The difference between these two items may be illustrated by an example in which *Sub-Paragraph (E)(i)* refers to the length of time the franchisor and each of its affiliates have been active in the restaurant business in general, and *Sub-Paragraph (E)(ii)* refers to the length of time the franchisor and each of its affiliates have run a pizza restaurant in particular.

84. *Sub-Paragraph (F)* requires disclosure of information regarding any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise. The information to be disclosed is not only the name, business address, and the position such persons hold (Executive Director, Chief Executive Officer, etc.), it is also their business experience. The term "senior management responsibilities" indicates the persons who exercise business functions and these are not necessarily limited to the Executive Director or the Chief Executive Officer. The official titles and the exact responsibilities involved will vary from country to country.

85. *Sub-Paragraph (G)* requires information to be provided on both criminal convictions and findings of liability in civil actions and in arbitral proceedings of the franchisor

and any affiliate of the franchisor who is engaged in franchising. What the Sub-Paragraph requires to be disclosed is the existence of convictions and findings of liability in civil actions and arbitrations relating to fraud, misrepresentation, or similar acts or practices. This means that if there are convictions or findings of liability that do not relate to fraud, misrepresentation, or similar acts or practices, such as for example fining for throwing chewing gum paper on the ground, that need not be disclosed. What is important is information that might be important for an assessment of the character and general honesty of the people listed in the provision. That is the reason for which the requirement relates not only to franchises, but also to other businesses: a franchisor may have been engaged in another type of commercial enterprise before becoming a franchisor, and might have been found guilty of fraud. It is important for a prospective franchisee to be informed of such a conviction, as it would be very important for him/her to be able to decide whether or not he/she wants to trust the franchisor. It should however be noted that whereas there are countries in which information such as this is considered to be important and in which requiring its disclosure would be permissible, there are others in which it is not. In the latter, requiring the disclosure of criminal convictions would be against the laws on privacy and on the integrity of the individual, at times it would even be against the constitutional guarantees a State offers its citizens. States which have legislation to this effect will normally not be in a position to adopt, or interested in adopting, a provision providing for the disclosure of sensitive personal data such as criminal convictions.

86. The provision only requires disclosure relating to the franchisor and affiliates of the franchisor. There are however also other people about whom States may wish to consider whether they should require disclosure. The first such category of people are predecessors of the franchisor. Predecessors of the franchisor may be defined as any legal entity from whom the franchisor has directly or indirectly acquired the major portion of the franchisor's assets. This refers not only to the sale of the franchise system to a new franchisor, but also to cases where franchisors with problems set up a second corporation to sell franchises in order to hide the problems and to defraud investors. The disclosure of the litigation of predecessors may therefore be required in order to avoid such possibilities of fraud. The second category of people include the persons who have senior management responsibilities for the franchisor's business operations in relation to the franchise. The disclosure of information relating to these persons is not required by the Model Law, as it may in some countries be against the constitutional rights of the individuals concerned, or against the rules on privacy. The reason is that in some countries it is not possible to disclose information such as that required by this Sub-Paragraph about third persons without violating their rights. In these cases a franchisor who discloses this information would be open to liability charges. In other countries, this information would on the contrary be public, and would therefore be accessible by other means. In these countries it would therefore be perfectly legitimate to require that the information be disclosed.

87. The time period relevant for the disclosure requirement under Sub-Paragraph (G) is five years. Furthermore, if there are any pending charges or actions against the franchisor or its subsidiaries relating to fraud, misrepresentation, or similar acts or practices, this fact must also be disclosed. The purpose of this requirement is to alert the prospective franchisee to the fact that disputes are in existence, so that the prospective franchisee can evaluate the possible consequences of the disputes for him/her future activity as a franchisee. The Model Law does not require details to be provided, only the information that the actions or arbitrations have been initiated. It is then up to the prospective franchisee to request further information from the franchisor or the subsidiary of the franchisor, should he/she deem it

necessary. To this end, the court citation, or in the case of arbitration the citation used for the arbitral proceeding, must be disclosed, i.e. the registration number or similar information. States may of course limit disclosure to final decisions, thus excluding pending actions. In making its evaluation as to whether or not to require information on pending actions, the legislator will naturally consider national customs and traditions. Thus, in some countries making the existence of pending actions known would in no way constitute a declaration of guilt on the part of the franchisor, but would on the contrary promote confidence in the honesty of a franchisor who reveals their existence. In other countries the mere fact that an action is pending would be considered negative: even if subsequently the innocence of the franchisor or subsidiary were to be established, their reputation would be damaged and their business would consequently suffer. It should be noted that for pending actions information has to be disclosed about the franchisor and its subsidiaries, not affiliates. This is the consequence of a conscious decision to limit the information that has to be provided. Who is to be considered a subsidiary will be determined in accordance with the applicable law.

88. It should be noted that the term “finding of liability” used in Sub-Paragraph (G) is intended to refer also to permanent injunctions, but not to interim or temporary injunctions.

89. In view of the importance of information on criminal convictions and findings of liability in civil actions or arbitrations in the evaluation of the character, honesty and reliability of the franchisor, there is no geographic limitation to the provision. This means that the franchisor must disclose such information irrespective of what country it relates to. In this context it should however be borne in mind that the information should always relate to fraud, misrepresentation, or similar acts or practices, which is a natural limitation given that an honest franchisor is not likely to be guilty of such offences. Furthermore, in countries that are geographically close, decisions rendered in one country are highly likely to be of importance also in the neighbouring countries. The apparently unlimited scope of Sub-Paragraph (G) is to be considered together with Article 8, which deals with remedies *inter alia* for the omission of a material fact. An act which might be considered an offence in one culture, but which might not be an offence in another culture, need not necessarily be considered to be a material fact, in which case there would be no liability if it were omitted. In general, however, if the conviction or finding of liability relates to fraud, misrepresentation, or similar acts or practices, however they are defined, this would be considered material and would therefore have to be disclosed.

90. *Sub-Paragraph (H)* requires the disclosure of information on any bankruptcy, insolvency or comparable proceeding involving the franchisor and its affiliates for the previous five years as well as, again, the court citation. The “comparable proceedings” referred to in the provision include any State-run or State-controlled proceeding, any proceeding under the supervision of a judicial authority, but not purely private reorganisations such as management buy-outs. The importance for a prospective franchisee to receive information of this nature is evident, again with a view to evaluating the reliability and honesty of the franchisor.

91. *Sub-Paragraphs (I), (J) and (K)* relate to the franchisees of the network. *Sub-Paragraph (I)* requires the disclosure of the total number of franchisees and company-owned outlets of the franchisor and of the affiliates of the franchisor that grant franchises under substantially the same trade name, in other words the total number of those that would normally be considered as being part of what is referred to as the “network”. In this case the “network” is the network at world level. In the case of a master franchise the sub-franchisor



would be required to disclose the number of franchisees and company-owned outlets in the world as a whole in compliance with Paragraph (3) of Article 6, according to which the sub-franchisor is required to pass on the information specified in the provision that he has received from the franchisor to the sub-franchisees, and that information includes also information on the total number of franchisees and company-owned outlets.

92. *Sub-Paragraph (J)* requires the franchisor to provide the prospective franchisee with the names, addresses and business phone numbers of the franchisees, and of the franchisees of any affiliates of the franchisor which are granting franchises under substantially the same trade name whose outlets are located nearest to the proposed outlet of the prospective franchisee in the State of the franchisee and/or contiguous States, i.e. in States that share a common border with the State of the franchisee, or, if there are no contiguous States, in the State of the franchisor. The Sub-Paragraph allows States to introduce a limitation in the information to be provided, in that it leaves the number of names and addresses to be given blank. The purpose of this provision is to enable the prospective franchisee to contact franchisees already in the network to ask them for information about their experience with the franchise and the franchisor. Where there are few or no franchisees in the State of the prospective franchisee, it is important for the prospective franchisee to be able to contact franchisees who are located in other States, particularly if the other States are close and are not too different culturally. Cultural closeness may at times be more important than strict contiguity, in that if two States are culturally close, their reality may be similar or of relevance to franchisees in the other State. If there are no States contiguous to the State of the prospective franchisee, then it might be useful for the prospective franchisee to be able to contact franchisees in the State of origin of the franchisor. For prospective franchisees it is important to have information as to the location of the franchisees of the network, particularly those close to the proposed outlets for their franchises, as this will give some indication of the assistance that the franchisor is able to provide. By extension, it is even more important for the prospective franchisee to be able to ascertain the assistance the franchisor actually provides to franchisees in the network, and also what relations exist between the members of the network and in particular between the members of the network and the franchisor.

93. *Sub-Paragraph (K)* follows on from Sub-Paragraph (J), in that it requires disclosure of information about franchisees of the franchisor, and about franchisees of affiliates of the franchisor that grant franchises under substantially the same trade name, that have ceased to be franchisees during the three fiscal years before the one during which the franchise agreement is entered into. The reasons for which they are no longer franchisees must be given. It is not necessary to give details, merely indicating that the former franchisee belongs to one of the following categories would fulfil the disclosure requirement: voluntarily terminated or not renewed; terminated due to bankruptcy or insolvency; terminated by a decision of a court or arbitrator; reacquired by purchase by the franchisor, or by the affiliate of the franchisor where applicable; otherwise reacquired by the franchisor or by the affiliate of the franchisor; refused renewal by the franchisor or by the affiliate of the franchisor; and terminated by the franchisor or by the affiliate of the franchisor. Information of this kind, even if succinct and without further detail, enables the prospective franchisee to understand if the franchisees are satisfied with the franchise they have acquired and with the franchisor, as franchisees who are not satisfied are unlikely to renew their agreements. Similarly, a franchisor who terminates large numbers of franchisees might be problematic to deal with, and it is important for the prospective franchisee to know this. Furthermore, the type of policy that the franchisor company adopts towards its franchisees in terms of whether or not it

systematically reacquires franchises and runs them thereafter as company-owned outlets, is important for the prospective franchisee to be informed of.

94. The franchisor's intellectual property is fundamental to the franchise relationship. It is the franchisor's trademark that the public recognises and it is the trademark that, together with the other intellectual property, including the know-how, make up the franchise system. As franchisees pay the franchisor to be able to benefit from the intellectual property relevant to the franchise, it is very important for the prospective franchisee to be informed of the exact limits of his/her rights, and also to know the rights, and the limits to the rights, of the franchisor or, in the case of master franchising, of the sub-franchisor. *Sub-Paragraph (L)* therefore requires the disclosure of information regarding the franchisor's intellectual property that is to be licensed to the prospective franchisee, in particular trademarks, patents, copyright and software. In particular, it requires the disclosure of information relating to the registration and/or the application for registration, if any, of the intellectual property, to the name of the owner of the intellectual property rights and/or the name of the applicant, if any, to the date on which the registration of the intellectual property rights licensed expires, and to litigation or other legal proceedings which could have a material effect on the franchisee's legal right to use the intellectual property under the franchise agreement in the State in which the franchised business is to be operated.

95. This information is extremely important, in particular in States in which the registration procedure takes a long time. If the franchisor grants franchises before the intellectual property (in particular the trademark) has been registered, then if the registration is refused, a situation could arise whereby the franchisor and all the franchisees of the network do not have the right to use the trademark in that State. The consequence might be that the business is forced to change trademarks, with all the related expenses and with the risk of losing credibility with the public.

96. The provision refers to litigation or other legal proceedings "which could have a material effect on the franchisee's legal right [...] to use the intellectual property". This formulation is intended to cover cases where a franchisor or franchisee has brought an action to prevent a third party from using a trademark and has lost. The franchisor's right to use the mark would not be affected, but his/her business might be, as he/she would be unable to stop the third person from using the mark.

97. *Sub-Paragraph (M)* deals with a very important aspect of the franchise relationship, namely the supply arrangements. The provision requires the franchisor to provide information relating to the categories of goods and/or services that the franchisee is required to purchase or lease. It divides these categories of goods and services into two groups and requires the disclosure document to specify first, whether any of the categories of goods have to be purchased or leased from the franchisor, affiliates of the franchisor or from a supplier designated by the franchisor (*Sub-Paragraph (M)(i)*), and whether the franchisee has the right to recommend other suppliers for approval by the franchisor (*Sub-Paragraph (M)(ii)*). The reason this distinction is made, is that there are products, goods or services that are either characteristic of the franchise and are only available from the franchisor, its affiliates, or suppliers that the franchisor has a particular relationship with, or that are so linked to the quality of the goods or services presented to the public that the franchisor needs to be able to control that they are obtained from controlled sources, and that on the other hand, there are goods or services for which it is not as essential to use the sources of supply specified in *Sub-Paragraph (M)(i)*, but for which a certain control is necessary. In these latter

cases it is sufficient for the franchisee to obtain the approval of the franchisor for these alternative sources of supply. If the franchisor is satisfied that the alternative suppliers meet the quality standards necessary for the franchise, then the franchisor would be able to refuse approval with difficulty. There is of course a third group, which is not mentioned in the Sub-Paragraph, and that is those goods for which it is neither necessary for the franchisee to purchase them from the franchisor or a supplier designated by the franchisor, nor to obtain the approval of the franchisor. These are goods or services that are not characteristic of the franchise or for which it is not necessary for the franchisor to maintain a certain control. This would be the case, for example, with the vegetables used in a restaurant business, for which the franchisee must use the normal care of a professional in his/her line of business, but for which a control on the part of the franchisor is not necessary.

98. It should be observed that in Sub-Paragraph (M)(i) the Model Law uses the term “purchase” also for services. This is to make it clear that the services are not offered free of charge, but have to be paid for by the customers.

99. In addition to information on the goods or services, the franchisor is required to disclose also information on whether any part of the revenue or other benefits that may be directly or indirectly received by the franchisor, or any of the affiliates of the franchisor, from any supplier of goods and/or services to the franchisee, such as rebates, bonuses or incentives with regard to those goods and/or services, will be passed on to the prospective franchisee or, if not, whether a price mark-up will be made by the franchisor or the supplier recommended by the franchisor (*Sub-Paragraph (M)(iii)*). The provision states “directly or indirectly” as the franchisor might, for example, be getting an equity interest, i.e. shares or other rights, in a business instead of money.

100. Sub-Paragraph (M)(iii) is intended to provide the franchisee with information enabling him/her to make a proper evaluation of the ties that exist between the franchisor or the franchisor’s affiliates and the suppliers. If a franchisee is required to purchase from a particular supplier, he/she wants to know whether or not the terms he/she is offered are fair, and in order to make this evaluation he/she will want to be able to compare the price he/she is charged by the franchisor, the franchisor’s affiliates and other suppliers designated by the franchisor with the prices available freely on the market for equivalent goods and services. If the franchisor receives rebates from the designated suppliers, this might also be a factor that the prospective franchisee will want to take into consideration when he/she evaluates the correspondence of what he/she is offered to how much the franchisor earns from him/her, not the least because the costs of the franchisee are likely to increase if the franchisor or the other persons indicated receive such revenue or benefit, as part of what the franchisee pays will be handed over to these people.

101. *Sub-Paragraph (N)* deals with financial matters. The items which the Model law requires to be disclosed are listed in a number of sub-paragraphs, the first of which lists “an estimate of the prospective franchisee’s total initial investment” (*Sub-Paragraph (N)(i)(a)*). Information on the prospective franchisee’s expected total initial investment is clearly important for the prospective franchisee to be able to evaluate whether or not he/she can afford to acquire the franchise. An element that has been excluded from the estimate that a franchisor must provide a prospective franchisee with, is the minimum working capital required. The reason for the exclusion is that in order to estimate the minimum working capital the franchisor would need to make a profit forecast and such a forecast would be too uncertain for a franchisor to make. The provision therefore requires only that the franchisor

provide an estimate of the prospective franchisee's total initial investment. The precise manner in which such an estimate should be presented to the prospective franchisee is left to the franchisor to decide. While disclosure of initial costs is obviously material to the prospective franchisee, this may prove quite difficult for a franchisor to provide, especially a franchisor entering a foreign market for the first time. Indeed, in such circumstances, the local prospective franchisee may be in the best position to calculate costs, such as local real estate and labour costs, and the franchisor may be relying on the prospective franchisee to supply that information. Accordingly, the franchisor is required to provide the prospective franchisee with only a reasonable cost estimate based upon information the franchisor already possesses or can easily obtain. The franchisor need not incur the cost of preparing, for example, in-depth market analyses of the foreign country. Rather, an estimate may be based upon the sale of a substantially similar franchise in another identified country. As the cost disclosures are only estimates at best, they should never be considered a guarantee, and prospective franchisees should understand that the ultimate cost of developing a franchise may be substantially revised during the course of negotiations.

102. *Sub-Paragraph (N)(i)(b)* requires disclosure of financing opportunities offered or arranged by the franchisor. There are franchisors who set up special financing schemes that they make available to their franchisees, or who come to an agreement with a bank under which the bank agrees to provide the franchisees of the franchisor with financing at particularly advantageous rates. If such schemes are available, the Model Law requires that they be disclosed.

103. *Sub-Paragraph (N)(i)(c)* requires the disclosure of the financial statements and, where available, audited or otherwise independently verified financial statements of the franchisor, including balance sheets and statements of profit and loss, for the previous three years. Normally these documents are attached to the disclosure document as annexes. If the franchisor is not in a position to provide statements for the previous three years because the franchisor company has newly been created, it is nevertheless under an obligation to disclose the same documents prepared since it began its activity. The reason for this requirement is that prospective franchisees should have access to this information also in cases where the franchisor has only recently been created. Furthermore, if a franchisor is required to provide the financial statements and is not in a position to do so, without this obligation the franchisor would either be liable for not having fulfilled its obligations, or would not be able to franchise until after three years.

104. The provision refers to both "financial statements" and "audited or otherwise independently verified financial statements" in recognition of the fact that requirements differ considerably from country to country. In fact, in certain jurisdictions audited financial statements are not required at all. In some countries, for example, statements are "audited" if they are audited by a certified public accountant. In others, the corporations can have a director in charge of auditing, the duties of such an officer differing from country to country. In others yet again corporations may have an official in charge, who however is not an employee even if the position he/she holds is similar to that of a director of the company. This official is in such cases legally independent from the executive officers.

105. Not only does the type of "auditing" differ from country to country, also the requirements for different types of business differ. For example, in some countries small and medium-size enterprises are not obliged to make an official audit, as only undertakings on the stock market are under an obligation to have their statements audited every year.

106. For a prospective franchisee what is important is to be able to evaluate the financial solidity of the franchisor company and to assess the development and development potential of the network. The franchisee will therefore by preference require statements that have a certain official character, even if they have not been audited by a public official. This is the reason the Model Law provides that where available, “audited or otherwise independently verified financial statements” should be provided. The possibility offered franchisors not to provide financial statements that have been audited or independently verified is a recognition of the fact that the expenses that especially smaller franchisors would incur if they were required in all cases to provide audited or independently verified financial statements, even when this is not required by their national legislation, would be excessive.

107. The Model Law does not specify which State’s accounting principles shall be used in preparing financial statements. A disclosure document could conceivably include financial statements prepared according to the accounting principles of the franchisee’s State, the franchisor’s State, or the State of the proposed franchised unit if different from the franchisee’s State. Imposing specific accounting standards, however, may raise the franchisor’s costs of conducting business, thereby discouraging expansion into new markets. A franchisor seeking to expand into a new market, for example, may have already expended substantial fees to have its financial statements audited in compliance with its State of origin’s accounting principles. The additional cost of revising or preparing additional financial statements to satisfy a foreign State’s accounting principles may be so high as to discourage many franchisors from offering new franchise opportunities there. At the same time, legislators may want to protect prospective investors from relying on financial reports which are difficult to understand or which present financial information in ways which differ materially from standard financial disclosures used in their State of origin. Therefore, when considering accounting standards, legislators should weigh the potential barriers to entry that imposing specific accounting principles might erect against the State’s interest in facilitating access to franchise opportunities.

108. A number of franchisors provide prospective franchisees with statistical information on the financial performance of outlets owned by the franchisor, the franchisor’s affiliates, or the franchisees of the network. Such information can relate to both the financial performance of the past and to estimated or projected performance of the future (so-called “earnings claims”). As prospective franchisees often rely on such figures, also because a prospective franchisee will normally want to know how much he/she can be expected to earn before deciding whether or not to invest in a franchise, *Sub-Paragraph (N)(ii)(a)* provides that such information must have a reasonable basis at the time it is made (*Sub-Paragraph (N)(ii)(a)(aa)*); must include the material assumptions underlying its preparation and presentation (*Sub-Paragraph (N)(ii)(a)(bb)*); must state whether it is based on actual results of existing outlets (*Sub-Paragraph (N)(ii)(a)(cc)*); must state whether it is based on franchisor-owned and/or franchisee-owned outlets (*Sub-Paragraph (N)(ii)(a)(dd)*); and must indicate the percentage of those outlets that meet or exceed each range or result (*Sub-Paragraph (N)(ii)(a)(ee)*).

109. The reason for which the above requirements have been included under *Sub-Paragraph (N)*, is that whatever the basis upon which the estimates presented by the franchisor have been made, the prospective franchisee is entitled to know what form of selectivity has been used, so as to place him/her in a position to decide whether or not to rely

on, or pay attention to, the information the franchisor has provided him/her with. This is important also as a result of the fact that the estimates made by the franchisor will be based on information provided by franchisees or other third parties, and the franchisor will in most cases not be in a position to check the information. It should however be noted that the franchisor is liable only in case of misrepresentation (Article 8), and that Article 2 defines misrepresentation as “a statement of fact that the person making the statement knew or ought to have known to be untrue at the time the statement was made”. The requirements under Sub-Paragraphs (N)(ii)(a)(dd) and (ee) have been included because very often the outlets owned by the franchisor perform better than the outlets owned by franchisees, and if this is the case then the prospective franchisee is entitled to know. If the outlets of the franchisor perform 100 and those of the franchisees only perform 50 or less, this is relevant to the prospective franchisee, as is information on the income ranges of the franchisor-owned outlets compared with those of the franchisee-owned outlets.

110. Not all franchisors provide information on projected earnings, but where they do, it is important for the prospective franchisee to be made aware of the fact that no matter what the projections state, there is nothing to guarantee that he/she will be able to reach those levels of earnings. For this reason *Sub-Paragraph (N)(ii)(b)* states that if the financial information referred to in Sub-Paragraph (N)(ii)(a) is provided, the franchisor must state that the levels of performance of the prospective franchisee’s outlet may differ from those contained in the information provided by the franchisor.

111. *Sub-Paragraph (O)* requires the franchisor to provide the prospective franchisee with a description of the state of the general, as well as of the local, market of the products or services that are the subject of the contract, and the prospects for development of the market. Although the requirement appears to be detailed, what is intended is not a full market analysis, but a brief presentation including information on, for example, the turnover of the business sector, the number of enterprises in that sector, and the legal rules that are applicable. This information is particularly important in countries where the franchisor has not previously been active, and for which the franchisor does not have any information relating to the franchise business to provide the prospective franchisee with.

112. *Sub-Paragraph (P)* is the last item of the list. It is a general catch-all clause requiring the disclosure of anything else necessary to prevent any statement in the document from being misleading to a reasonable prospective franchisee. This provision was introduced because it is impossible to list all items of information that might be necessary to a prospective franchisee. There may be information that relates exclusively to the franchise at hand, which might seriously impact upon the prospective franchisee’s decision to enter into a franchise relationship, but which is not expressly required to be disclosed by the Model Law and might be hidden from the prospective franchisee without a catch-all provision. Examples of such information are the fact that the franchisor is about to sell the network, or that an important competitor is about to enter the market in the territory that the prospective franchisee is to develop, or that a key-employee is about to leave.

## **(2) Paragraph (2)**

113. As indicated in paragraph 76 above, *Paragraph (2)* of Article 6 lists a number of items of information which must be disclosed in the disclosure document unless they have been adequately dealt with in the franchise agreement, in which case the franchisor may in the disclosure document simply make reference to the relevant section of the franchise

agreement. The information listed in this Paragraph is fundamental to the franchise and is therefore in most cases present in the franchise agreement itself, the question is whether or not it is adequate. Its fundamental nature is such, that prospective franchisees need to be alerted even to the absence of any of these items of information in the agreement. For this reason, the chapeau of Paragraph (2) specifies that if the items of information listed in the Paragraph are not included in the proposed franchise agreement, that fact shall be stated in the disclosure document.

114. The Model Law does not specify what kind of treatment would be adequate for the purposes of this provision, as there is no absolute criterion that may be applied: what is adequate in one agreement may not be so in another. The Model Law has therefore opted for a greater flexibility which will permit the judges seized of the different cases to make a case-by-case assessment on the basis of the facts and circumstances of the case.

115. The first item of the list is the term and conditions of renewal of the franchise, where “term” indicates the length of time for which the franchise has been granted (*Sub-Paragraph (A)*).

116. *Sub-Paragraph (B)* requires the franchisor to provide a description of the initial and on-going training programmes. The reason this item has been included in this Sub-Paragraph is that unfortunately franchisors often do not provide adequate information, even if they do provide some. As the franchisee pays sometimes large sums for the training programmes he/she has to follow, it is fair for the franchisor to inform him/her of such matters as, for example, the duration of the training course, both in terms of days per week and hours per day, the cost of the courses, whether or not continuing training is compulsory and if so how often.

117. *Sub-Paragraph (C)* relates to the extent of any exclusive rights that are granted by the franchisor to the franchisee, including exclusive rights relating to territory and/or to customers. In franchise relationships the exclusive rights granted by a franchisor to the franchisees of the network are normally considered fundamental. One very important exclusive right relates to territory. In this case the franchisor grants the franchisee the exclusive right to develop a certain territory, and undertakes not to grant other franchisees the right to open outlets within that territory. The provision refers to the extent of the exclusive rights granted, because the territorial exclusivity might not relate only to the granting of rights to other franchisees, it might also extend to the franchisor him or herself, in that the franchisor might undertake not to open any company-owned outlets in that territory. The word “extent” indicates that the franchisor should specify whether the exclusive right he/she grants extends also to include these other possibilities.

118. *Sub-Paragraph (C)* also requires the franchisor to disclose whether he/she has retained the right to use, or to licence the use of, the trademarks covered by the franchise agreement (*Sub-Paragraph (C)(i)*) or to sell or distribute the goods and/or services authorised for sale by the franchisee directly or indirectly through the same or other channels of distribution, whether under the trademarks covered by the agreement or any other trademark (*Sub-Paragraph (C)(ii)*). Information on these items is important, as they might influence the business of the franchisee. In the case of *Sub-Paragraph (C)(i)*, for example, if the franchisor retains such rights, a franchisee who sells pizzas under a trademark may find that the franchisor has licensed the right to use that same trademark to a producer of flea-repelling dog collars, which might influence the franchisee’s possibilities to sell pizzas. In the

case of Sub-Paragraph (C)(ii), the franchisee might find that the franchisor distributes the goods or services through the department store at the end of the block, possibly at lower prices, or that the same products are distributed at a lower price under another trademark, thereby undercutting the sales of the franchisee. It is therefore of the utmost importance for the franchisee to be informed of any such retention of rights by the franchisor.

119. In accordance with *Sub-Paragraph (F)*, the franchisor should furthermore disclose whether or not the exclusive rights he/she has granted are limited in any way. For example, the exclusive right that relates to the customers will normally take the form of an exclusive right to sell to customers in a particular territory and not to others. In other words, a franchisee within a territory would not be able to accept a telephone order from a customer in the territory of another franchisee. The franchisor should therefore specify what limitations a franchisee has as regards the customers to which he/she is entitled to sell. Other limitations that the franchisor should disclose to the prospective franchisee are restrictions or conditions that the franchisor imposes on the franchisee in relation to the goods and/or services that the franchisee may sell, for example whether the franchisee is under an obligation to sell only products with the franchisor's trademarks, or whether he/she is entitled to sell also a number of other products, or whether the franchisee is prohibited from selling products of a certain brand (*Sub-Paragraph (J)*).

120. *Sub-Paragraphs (D)* and *(E)* relate to the termination of the franchise agreement, that is, to the wilful termination of the agreement, not to the agreement simply coming to an end as a result of the expiration of its term. *Sub-Paragraph (D)* requires the franchisor to provide information on the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination, and *Sub-Paragraph (E)* requires the franchisor to provide information on the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination. This double requirement is important, as all too often franchise agreements will provide a long list of instances in which the franchisor is entitled to terminate, and nothing at all on when the franchisee is entitled to terminate. It is also important for a prospective franchisee to know what the effects of such termination would be, whether or not he/she would retain rights to, for example, the clients, so as to enable him/her to evaluate the loss he/she might incur in the case of termination.

121. *Sub-Paragraph (G)* specifies that the franchisor should provide information on both in-term and post-term non-compete covenants. Non-compete covenants, also called non-competition clauses or agreements, prohibit franchisees from competing with the franchisor or the franchise network both during the franchise relationship (for example, the franchisee might not be permitted to be a shareholder in a competing business or to open a business of his/her own that competes with the franchise) and after the relationship has come to an end. The post-term non-compete covenant will specify a certain period of time (for example, the franchisee is not allowed to engage in a business that competes with the franchise for two years after the agreement has come to an end) and may also specify within which territory it applies (the former exclusive territory of the franchisee, or for example within an x-kilometre-range of franchises belonging to the network). The possible conflict of such provisions with the competition law applicable in States should be noted in this connection.

122. *Sub-Paragraphs (H)* and *(I)* relate to fees and other payments. *Sub-Paragraph (H)* requires disclosure of the initial fee (also called the "entrance fee"), which is the one-off sum of money that the franchisee pays for the right to franchise. The provision requires



disclosure of whether any portion of the fee is refundable and the terms and conditions under which a refund will be granted. *Sub-Paragraph (I)* instead requires disclosure of other fees and payments, including any gross-up of royalties imposed by the franchisor in order to offset withholding tax. Amongst the most important of the other fees referred to are advertising fees. These are fees paid to the franchisor for organising the advertising of the network at national level. The costs of such national advertising are shared between the franchisor and the franchisees of the network, each of which pays a certain amount to the franchisor at pre-established intervals. Local advertising is normally entrusted to the franchisee directly. The “gross-up of royalties” are the sums of money that some franchisors require the franchisees to pay to compensate the franchisor for having to pay withholding tax on the royalties he/she receives. The sum will therefore correspond to the sum the franchisor has to pay as withholding tax. In this manner the franchisor will receive the full amount that he/she is owed as royalties, as the franchisee is the one who in effect pays the withholding tax. This increases the burden on the franchisee, who finds that he/she not only has to pay the royalties, he/she also has to pay the withholding tax on the franchisor’s behalf. It is therefore important for the prospective franchisee to have information on any such demands on the part of the franchisor.

123. *Sub-Paragraph (K)* requires the franchisor to disclose the conditions under which both the franchisor and the franchisee are entitled to assign or transfer the franchise to other parties. Such conditions include, for example, whether the franchisor’s consent must be obtained for an assignment or transfer, whether the franchisor must approve the new franchisee, or even if the franchisee must compensate the franchisor for the training that the new franchisee will be required to undergo before he/she begins to operate the franchise.

124. *Sub-Paragraph (L)* requires the disclosure of any forum selection or choice of law provisions, as well as any dispute resolution processes that have been selected. In the past in particular, and to a lesser extent today, in international situations franchisors often impose the provisions relating to these items. The consequence is that the forum selected is a forum that the franchisor finds convenient, often in his/her own country, and that the law that applies to the contract is the law of the State of origin of the franchisor. This might give rise to problems for the franchisee, who will be less familiar with the law of the State of origin of the franchisor, and who will also have to face considerable expenses when suing the franchisor in the franchisor’s State. Dispute resolution processes might include arbitration and other alternative dispute resolution processes such as mediation. In such cases it is important for the prospective franchisee to know what arbitration rules will apply and what chamber or court of arbitration will be seized of any dispute, in particular considering that the expenses faced by the parties may differ considerably from chamber to chamber or court to court, not the least for such matters as the translation of documents.

### **(3) Paragraph (3)**

125. *Paragraph (3)* specifically relates to the master franchise situation. In accordance with the definition of “franchisor” in Article 2, for the purposes of the Model Law “franchisor” includes also the sub-franchisor in the sub-franchise relationship. This means that the information that Article 6 requires the franchisor to disclose to the prospective franchisee must be disclosed by the sub-franchisor to the prospective sub-franchisee. This information will however relate to the sub-franchisor and to the sub-franchisor’s business, whereas it could be important for the prospective sub-franchisee to receive a certain amount of information also about the franchisor. For this reason, Paragraph (3) identifies those items of

information that a prospective franchisee should receive as regards the franchisor, and states that the sub-franchisor must pass on this information that he/she has received from the franchisor to the prospective sub-franchisees. In addition, the sub-franchisor is required to inform the prospective sub-franchisee of the situation of the sub-franchise agreements in case of the termination of the master franchise agreement (i.e. whether or not they will be automatically terminated or whether the franchisor or a new sub-franchisor will take them over), and of the content of the master franchise agreement.

#### 7. *ARTICLE 7 - ACKNOWLEDGEMENT OF RECEIPT OF DISCLOSURE DOCUMENT*

126. The purpose of the disclosure document is to provide the prospective franchisee with information permitting him/her to make an informed decision as to whether or not to acquire the franchise proposed to him/her. The information the disclosure document contains is therefore of vital importance. Furthermore, Article 8 permits the franchisee to terminate the franchise agreement or claim damages if the franchisor does not disclose, if the disclosure document contains a misrepresentation, or if there has been an omission of a material fact. It is therefore important for the franchisor to be able to prove that the franchisee did receive the disclosure document. *Article 7* acknowledges this importance by stating that, at the request of the franchisor, the prospective franchisee shall acknowledge in writing that he/she has received the disclosure document. National legislators may wish to consider whether or not such an acknowledgement of receipt of the disclosure document should be made mandatory. The purpose of such a mandatory provision would be to alert the attention of the prospective franchisee to the importance of the disclosure document, and also to ensure that franchisors do provide prospective franchisees with disclosure as required.

#### 8. *ARTICLE 8 - REMEDIES*

127. The remedies available to the franchisee under *Article 8* for non-compliance on the part of the franchisor with the requirements of the Model Law are in essence limited to two, namely termination and damages, although Paragraph (3) does indicate that the rights to terminate and/or claim damages do not derogate from any other right the franchisee may have under the applicable law. In addition to the Model Law, the scope of which is limited to disclosure, other laws may also apply to the franchise agreement and the franchisee may have access to other remedies under those laws.

128. The article uses the term “termination” to indicate the wilful ending of the agreement. The reason this terminology has been chosen is that other terms, such as “rescission” in English or “annulation” in French, have different meanings in different countries and the intention of the drafters of the Model Law was to use as neutral a term as possible. State legislators may therefore wish to consider carefully the term that in their languages and legal systems is the most appropriate to translate the term “termination” as used in the Model Law.

129. The “neutral” content of the term “termination” is emphasised by Article 8(4). The reference (*renvoi*) to the applicable law in Sub-Paragraph (4) means that all matters that have not been expressly regulated in Article 8 “shall be governed by the law governing the franchise agreement” (for example, the *ex tunc* or *ex nunc* effects of termination, the consequences of termination for the payments made by the franchisee, and whether the

ending of the contractual relationship requires a judicial decision). Similarly, the applicable law governs all issues pertaining to the damages claimed by the franchisee in case of breach of the disclosure obligation. Except for matters expressly regulated in Article 8, such as the events triggering the right to sue for damages in case of violation of the disclosure obligations under Article 6 and the statute of limitations period (Sub-Paragraphs (2)(B) and (C)), the remaining matters shall be governed by the applicable law. Thus, for instance, the applicable law decides whether the right to sue for damages is based on the concept of fault or strict liability and the extent of the damages (i.e. *damnum emergens* and/or *lucrum cessans*). The term “applicable law” denotes the substantive law governing the franchise agreement. In domestic transactions it will usually be the substantive law of the State where both parties to a franchise agreement conduct their economic activities. In transnational transactions the applicable law is established on the basis of the pertinent conflict of laws rules.

130. *Paragraph (1)* states that the franchisee is entitled to terminate, but intentionally does not specify whether it is sufficient for the franchisee to communicate his/her intention to terminate to the franchisor, or whether the franchisee must apply to the judicial authority to have the agreement terminated. This question is left to the applicable law, by reason of the differences that exist between different legal systems (see paragraph 129 above).

131. *Sub-Paragraphs 1(A), (B) and (C)* define the triggering events, the conduct that gives rise to a cause of action or claim by the franchisee relating to an improper disclosure or to a failure to disclose. If one of the events listed has occurred, thus giving rise to a remedy, the franchisee has the right to elect, on 30 days prior written notice to the franchisor, to terminate the franchise agreement and/or to claim against the franchisor for damages. Damages are a remedy additional to termination. *Paragraph (1)* then lists some of the exceptions or defences that are available. First, “unless the franchisee had the information required to be disclosed through other means”, then, second, that the franchisee “did not rely on the misrepresentation”. The third exception relates to termination only, and is that termination would be “a disproportionate remedy in the circumstances”. In other words, in the circumstances termination is not justified considering the relatively minor damage that has occurred because of the failure to meet the disclosure requirements. In these cases the right to claim damages would of course remain. *Paragraph (2)* indicates the periods within which claims have to be asserted. Claims for damages and claims for termination are dealt with separately. Thus, as a claim for termination is major, significant, and relatively drastic, it must be asserted relatively soon after the events giving rise to the claim have occurred, namely within one year after the act or omission constituting the breach upon which the right to terminate is based (*Article 8(2)(A)*). On the other hand, a claim for damages is subject to a three-year period of limitation (see *Article 8(1)(B)*). Furthermore, damages must be claimed no later than one year after the franchisee becomes aware of facts or circumstances reasonably indicating that he/she may have a right to claim for the damages suffered (*Article 8(1)(C)*). There is no differentiation between the claim that must be asserted if the franchisor calls the mistakes that have been made to the attention of the franchisee. In this case the franchisee, once he/she has been notified by the franchisor of the violations, must react within 90 days and assert his/her claims, whether they be for termination or for damages (see *Article 8(1)(D)*). The franchisee must exercise his/her right to terminate within the time-limit that falls due first.

132. It should be noted that cases where the disclosure document is not delivered within the time-frame specified in Article 3 are intended to cover also cases where the disclosure document is not delivered at all.

133. Article 8 is to be considered together with Article 6, which lists the items that must be disclosed. The right of the franchisee to terminate or claim damages depends on whether the information misrepresented or omitted was material, that is, whether or not it was so important that the franchisee would not have entered into the agreement had he/she been aware of the misrepresentation or omission. What information is to be considered material will depend on the franchise concerned.

134. *Sub-Paragraph (2)(D)* is designed to permit a franchisor who has blundered into an unintentional breach to inform his/her franchisees of the mistake and to offer them the opportunity to terminate the agreement if they so wish, or, if the franchisees decide not to terminate, to request written confirmation from them that they know what has happened. The Sub-Paragraph requires the franchisor to provide the franchisees with a current disclosure document. This requirement applies also if the franchisor no longer franchises, as it is by providing updated information that he/she remedies the fact that he/she earlier provided misleading information, or did not provide the information required at the time it should have been provided. In other words, the providing of a current disclosure document represents what in the common law is known as “cure”. It is not sufficient for the disclosure document to be merely the most recent one, the disclosure document must be current as at the time the notice under Sub-Paragraph (D) is transmitted to the franchisee, because “the most recent” disclosure document may be several years old, whereas what is necessary is for the franchisee to have up to date information. This is particularly important if the franchisee is to be able to make an informed decision as to whether or not to terminate the agreement.

#### 9. *ARTICLE 9 – TEMPORAL SCOPE OF APPLICATION*

135. *Article 9* deals with the temporal scope of application of the Model Law, and provides that it applies whenever a franchise agreement is entered into or renewed after the Model Law has entered into force. There is in other words no obligation on the part of the franchisor to provide a disclosure document that fulfils the requirements of the Model Law for old agreements without there being a case of renewal or extension, clearly within the limits specified under Article 5.

#### 10. *ARTICLE 10 - WAIVERS*

136. *Article 10* is intended to protect franchisees, by providing that it is not possible for franchisees to waive any rights that they have been given under the Model Law. In the past franchisors have been known to have required prospective franchisees to renounce certain rights when they entered into the agreement. Under the Model Law such a requirement would be against the law.