

# Legal Update From Around the World

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# European Franchise Laws Update February 2006

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## European Union

- Huge Market
  - 460 million people; US\$12 trillion
- The old and the new
  - Core affluent developed economies
  - Former communist states
- Average per capita purchasing power US\$28,100 (2005 IMF estimate)
- But: wide discrepancies: priorities in choosing where to go to
- Populations

# Emerging Franchising Specific Laws

- No “pan-European” regulation (except Anti-Trust Block Exception Regulation)
- Piecemeal emerging national laws (some with common and unusual characteristics)
- Similar patterns in “sophisticated franchise markets”
- MPs lobbying by Franchise Associations, based on UNIDROIT model disclosure law, influenced by existing French, Spanish and Italian laws
- Persistent draft maverick bills in Belgium and Sweden

# Emerging Franchising Specific Laws (cont'd)

- Attempted interference in relationship NB termination and renewal
- **“Benign”** – UK: (France, Spain and others where existing (sensible) contract and misrepresentation etc laws are used
- **Difficult and more dangers**
  - Germany, Austria (risk theories infect elsewhere)
  - “good faith” and non-specific but thorough disclosure obligations: significant changes to model contracts required

# Emerging Franchising Specific Laws (cont'd)

- Expiry and termination compensation entitlement
- **Some difficulties in franchise specific laws** (lack of knowledge)
- **Russia** (chapter 54 in Civil Code)
  - vicarious liability of franchisor for defective goods or services sold by franchisee
  - automatic right to renew on same terms if properly performed
  - unless franchisor does not reissue to anyone else
  - if franchise again within 3 years - former franchisee compensation for losses, or offer new contract



# Emerging Franchising Specific Laws (cont'd)

- **Lithuania** – followed Russian approach
- **Moldova** – (Civil Code and more detailed specific law)
  - post-term restraint: defined territory not more than one year and compensation may be payable
- **Ukraine**
  - registration of contract
  - obligation to supervise quality of “concessionaire’s” services and products
  - restrictions prohibiting sales to others outside the territory - void

# Emerging Franchising Specific Laws (cont'd)

- franchisor vicarious liability for franchisee product and service defects
- renewal right
- right to claim reduction in fees if trademark changed
- **Belarus**
  - registration with IP Office
  - sub-franchisees must terminate when head-franchise agreement terminates
  - franchisor subsidiarily liability for defective goods and services sold by franchisee; jointly liable for goods **produced** by franchisee



# Emerging Franchising Specific Laws (cont'd)

- change of trade mark, franchisee must agree; fee reduction
- **Albania**
  - mutual fiduciary pre-contract information obligation – indemnity for breach
  - may be entitlement to compensation to enforce up to one year post-term restraint
- **Romania**
  - franchisor mandatory disclosure (including data to evaluate investment; profit)
  - may be obligation to register with Competition Council (turnover and market share test);
  - IP Office registration

# Emerging Franchising Specific Laws – Recent Developments

- **Sweden**
  - long history
  - sanity prevails!
  - judge study and report
  - no need for relationship/termination rules
  - disclosure ‘Law on the Duty of Franchisor to Provide Information’ May 2006; in force 1 October 2006
  - broad definition of franchise
    - “the use of the special business idea of the franchisor for the marketing and sale of goods or services, against compensation paid to the franchisor...”
    - use of distinctive marks and IP rights of franchisor

# Emerging Franchising Specific Laws – Recent Developments (cont'd)

- cooperate on recurrent controls of observance
- Disclosure (also applies to assignment situation) “**well before**” agreement signed: no less than 3 weeks, might be more if complex information
  - in writing
  - Give “*the information needed in the consideration of the circumstances with respect to the implications of the agreement and other conditions*”
  - clear and understandable
- Specific Information which must be given about:
  - the activity to be run

# Emerging Franchising Specific Laws – Recent Developments (cont'd)

- other franchisees in their areas
- fees and “other economic conditions for the franchise activity”
- intellectual property rights
- tied goods/services franchisee must buy or rent
- scope of in-term and post-term non-competes
- term, renewal, termination: circumstances and economic consequences of termination
- what dispute procedures; liability for costs

# Emerging Franchising Specific Laws – Recent Developments (cont'd)

## – Failures to disclose properly

- Unusual: franchisee, associations of entrepreneurs, trade association eg Franchise Association can sue for order to disclose; and fine
- ie compulsory disclosure and criminal
- Misrepresentation – possibility of damages and rescission depending on facts: not dealt with in this law

# Emerging Franchising Specific Laws – Recent Developments cont'd)

- **Belgium**

- History of bills: relationship provisions; ignoring UNIDROIT and France, Spain, Italy
- BFF sponsored bill did so: became law on 19 December 2005; in force 1 February 2006
- broad scope and applies (not just to franchises) where use of a concept/system *with one of*: common brand, transfer of know-how, provision of commercial or technical assistance
- Disclosure basis
- At least one month before signing or any payment; including deposit:
  - copy contracts



# Emerging Franchising Specific Laws – Recent Developments (cont'd)

- “Information Document” which contains:
  - Summary of important contractual provisions egs
    - » obligations and consequences of failure to perform
    - » fee calculation
    - » term, renewal
    - » non-competes
    - » purchase options and valuation principles
    - » exclusive rights reserved to franchisor
  - care to avoid conflict with contract itself!

# Emerging Franchising Specific Laws – Recent Developments (cont'd)

- Franchisor/Franchisee information:
  - franchisor name and contacts
  - individual acting for company
  - franchisor activities - describe
  - IP rights granted
  - last 3 years annual accounts
  - franchisor's experience “in partnership”
  - history, state and commercial perspectives of the market –  
general and local
  - numbers in network, each of last 3 years

# Emerging Franchising Specific Laws – Recent Developments(cont'd)

- breach of last 3 years number of agreements:
  - signed
  - terminated by franchisor
  - terminated by franchisee
  - not renewed at end of term
- expenses and investments franchisee will incur initially, and throughout term: amounts and what for?
- Sanctions for failure to do so
  - In first 2 years, franchisee can claim nullity: restitution to previous position – reimburse fees and possible loss reimbursement
  - Throughout the term: nullity of the particular provision which was not disclosed eg a non-compete restriction

# Emerging Franchising Specific Laws – Recent Developments(cont'd)

- “ambiguities construed in favour of franchisee”: larger agreements!
- Comment
  - compliance relatively straightforward
  - France, Italy, Spain and Belgium – pretty similar disclosure documents; fairly slight adaptation
  - still MP lobby for a relationship law: “Commission” to observe operation of the law: not likely at least until operation of new law can be evaluated

# Emerging Franchising Specific Laws – Recent Developments(cont'd)

- **Greece** - in the pipeline
  - latest news – Minister's decision for radically simple approach
  - previous draft bill, based on disclosure, scrapped
  - new draft to be prepared by mid March
  - no disclosure, no registration, no piloting, no relationship provisions
  - Simple definition of franchise and know-how, and provisions to protect know-how
  - possibly legislation by mid-year/autumn

# Emerging Franchising Specific Laws – Recent Developments(cont'd)

- **Spain**

- 7 April 2006 amendment to 1998 Regulations establishing Franchisors Registry; effective 17 May 2006
- Objectives:
  - Registry to become updated source for accurate info on franchisors, not just census
  - differentiate franchising from other activities often confused with franchising (additions to definition of “franchising”)
- Additional info for existing franchisors to be registered by 30 June 2006



# Emerging Franchising Specific Laws – Recent Developments (cont'd)

- New items required for registration:
  - length of time franchisor has been in franchising
  - copy master franchise agreement with overseas franchisor
  - documentary evidence of authority of individual representing a company
  - original and translation into Spanish required

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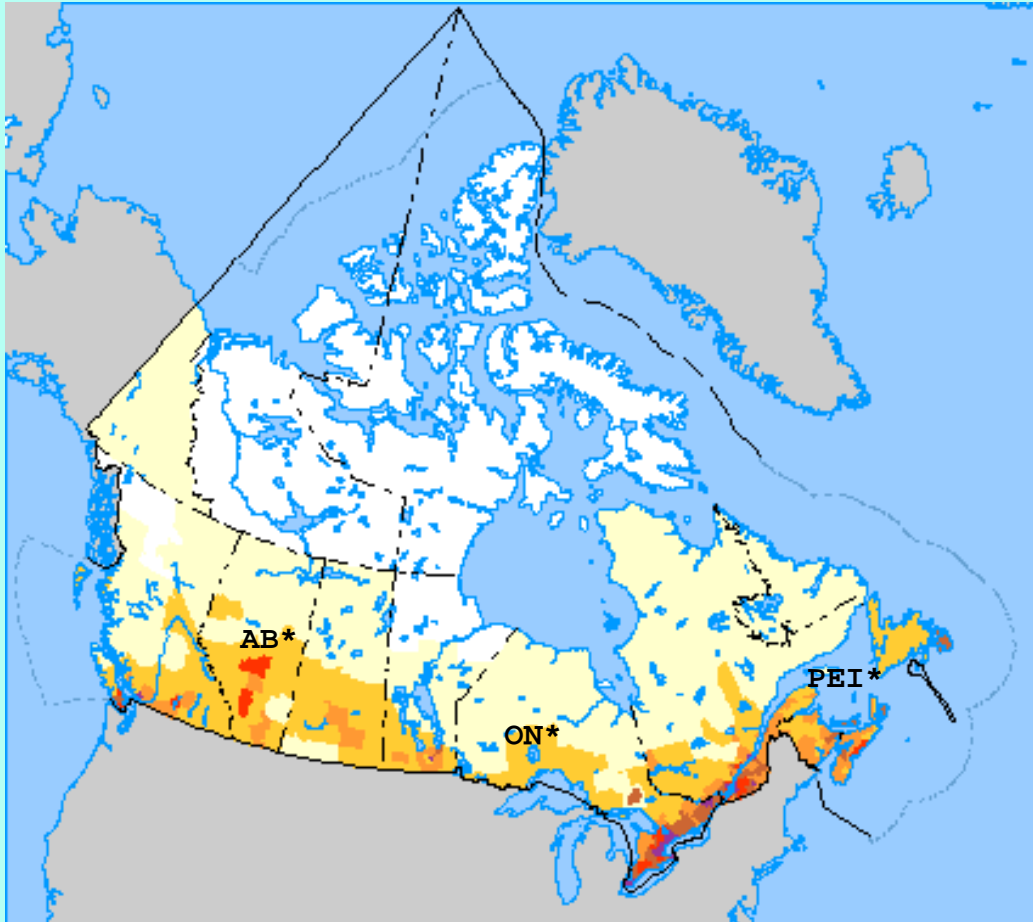
# Franchising in the Americas Canada, Mexico and Brazil

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# Canada



## POPULATION BY PROVINCE, 2003

|                  |                   |
|------------------|-------------------|
| Canada           | 31,714,637        |
| Nfld. & Labrador | 520,170           |
| <b>P.E.I.*</b>   | <b>37,941</b>     |
| Nova Scotia      | 936,878           |
| New Brunswick    | 750,460           |
| Quebec           | 7,503,502         |
| <b>Ontario*</b>  | <b>12,280,731</b> |
| Manitoba         | 1,164,135         |
| Saskatchewan     | 995,003           |
| <b>Alberta*</b>  | <b>3,164,400</b>  |
| British Columbia | 4,158,649         |
| Yukon            | 31,371            |
| NWT              | 42,04             |
| Nunavut          | 29,357            |

**\*Province with franchise legislation**

# Canada: What is a Franchise?

- franchise legislation in force in 3 provinces:  
Alberta, Ontario, Prince Edward Island
- franchise legislation proposed in one province: New Brunswick
- all statutes define a “franchise”: Alberta differs from Ontario, PEI and New Brunswick which are virtually the same

# Canada: What is a Franchise?

- Ontario, PEI and New Brunswick definitions are much broader than Alberta definition and may include product distributorships and business opportunities
- all definitions include a master franchise
- Alberta definition includes reference to a “franchise fee”

# Canada: What is a Franchise?

- Ontario, PEI and New Brunswick definition: A + B or C
  - A.
    - 1. right to engage in a business;
    - 2. requirement by contract or otherwise to make a payment or continuing payments to a franchisor or franchisor's associate; and



# Canada: What is a Franchise?

3. in course of operating the business or a condition of acquiring the franchise or commencing operations

AND

- B.
  1. franchisor grants the right to sell or distribute goods or services substantially associated with franchisor's or franchisor's associate's trademark, logo, advertising or other commercial symbol

AND

# Canada: What is a Franchise?

2. franchisor or franchisor's  
associate exercises significant  
control over  
  
OR  
  
offers significant assistance in  
franchisee's method of operation  
  
OR

# Canada: What is a Franchise?

C. 1. franchisor or franchisor's associate grants franchisee representation or distribution rights, whether or not trademarks, logo, advertising or other commercial symbol is involved, to sell or distribute goods or services supplied by franchisor or a designated supplier

AND

# Canada: What is a Franchise?

2. franchisor or franchisor's associate or designated third person provides location assistance, including securing retail outlets or accounts for goods or services or securing locations or sites for vending machines, display racks or other product displays

# Canada: What is a Franchise?

- important issues:
  1. no franchise fee requirement
  2. requirement to make a payment or continuing payments
  3. payment in course of operating the business
  4. goods or services substantially associated with trademark

# Canada: What is a Franchise?

5. significant control or significant assistance
6. captures many product distribution arrangements
7. includes business opportunities if location assistance is provided
8. includes motor vehicle dealerships, soft drink bottlers, farm implement dealers (but not by definition)



## Canada: What is a Franchise?

- Alberta definition of franchise:
  - right to engage in a business:
    1. goods or services are sold or distributed under a marketing or business plan prescribed in substantial part by franchisor or its associate
    2. substantially associated with trademark, logo or advertising of franchisor or its associate

AND

# Canada: What is a Franchise?

- 3. (A) (i) continuing financial obligation to franchisor or its associate  
AND  
(ii) significant continuing operational controls  
OR  
(B) payment of a “franchise fee”

# Canada: What is a Franchise?

- Alberta definition of “franchise fee”:
  - direct or indirect payment to purchase a franchise or to operate a franchised business

## Canada

- does not include:
  1. purchase of reasonable amount of goods at reasonable wholesale price;
  2. purchase of reasonable amount of services at reasonable price; or
  3. reasonable service charge to a credit or debit card issuer

# Brazil: What is a Franchise?

- Franchise Law defines a “commercial franchise” as “a system whereby a Franchisor licenses to the Franchisee the right to use a trade-mark or patent, along with the right to distribute products or services on an exclusive or semi-exclusive basis and, possibly, also the right to use technology related to the establishment and management of a business or operating system developed or used by the Franchisor, in exchange for direct or indirect compensation without, however, being characterized as an employment relationship.”

# Mexico: What is a Franchise?

- “a franchise exists whenever, in conjunction with a license to use a trade-mark granted in writing, technical knowledge is transmitted or technical assistance is furnished in order to enable the licensee to produce or sell goods or render services in a uniform manner and with the operating, commercial and administrative methods established by the holder of the trade-mark, with the goal of maintaining the quality, prestige and image of the products or services distinguished by the trade-mark.”



# When to Disclose

- **Canada:** at least 14 days prior to earlier of: (i) signing of any agreement related to the franchise; or (ii) payment of any consideration by franchisee.
- **Brazil:** at least 10 days prior to the execution of the franchising agreement, preliminary franchising agreement, or payment of fee by franchisee.
- **Mexico:** at least 30 days prior to the execution of the franchise agreement.

# Financial Statement Requirements

- **Canada:** disclosure document must contain financial statements prepared in accordance with GAAP. Financial statements must be for most recently completed fiscal year of franchisor's operations.
- **Brazil:** disclosure document must contain the franchisor's "balance sheets and financial statements" for the prior two fiscal years. (In practice, INPI requires financial statements for prior three fiscal years).
- **Mexico:** no requirement to disclose financial information of the franchisor.

# Canada: Foreign Offering Circulars

- **Alberta:** franchisor may use a disclosure document authorized under the franchise law of another jurisdiction. Need a “wraparound”
- **PEI:** franchisor may use a disclosure document authorized under the franchise law of another jurisdiction. Need a “wraparound”
- **Ontario:** No “wraparound” provision. Franchisors should prepare an Ontario-specific disclosure document.
- **New Brunswick:** No proposed regulations issued.
- **ULCC:** No “wraparound” provision.

# Foreign Offering Circulars

- **Brazil:** no express “wraparound” provision”
- **Mexico:** no express “wraparound provision”

# Canada: Failure to Disclose

- failure to deliver a disclosure document or if contents do not meet legislation:
  - rescission of franchise agreement
  - notice of cancellation
  - 2 year limitation if no disclosure
  - 60 days limitation if deficient disclosure
- no fines or criminal offence

# Canada: Failure to Disclose

- rescission by franchisor or franchisor's associate includes:
  - refund of money received
  - purchase of required inventory at price paid
  - purchase of required supplies at price paid
  - compensation for losses incurred in acquiring, setting up and operating the franchised business



# Canada: Failure to Disclose

- action for damages for loss suffered as a result of misrepresentation in disclosure document or failure to comply with disclosure requirements
- action against:
  - franchisor
  - franchisor's agent

# Canada: Failure to Disclose

- franchisor's broker
- franchisor's associate
- persons signing disclosure certificate
- all other rights at law preserved
- joint and several liability

# Brazil: Failure to Disclose

- franchisee may request an annulment of any franchise agreement entered into
- franchisee may request reimbursement of franchise fees and/or royalties, plus damages and losses.

# Mexico: Failure to Disclose

- administrative violation: potential fines, temporary or definitive closure of franchisor's business, administrative arrests for up to 36 hours
- franchisee may claim damages and losses due to lack of accuracy in disclosure document
- inaccurate disclosure document may also result in nullity or invalidity of franchise agreement at request of franchisee

# Language Requirements

- **Canada:** no explicit language requirement for franchise disclosure documents. English and French are the official languages of Canada.
- **Brazil:** no explicit language requirement for franchise disclosure documents.
- **Mexico:** no explicit language requirement for franchise disclosure documents.

# Governing Law, Venue & Jurisdiction

- **Canada:** franchise agreement provisions purporting to restrict application of law of province or to restrict jurisdiction or venue to a forum outside of province are void.
- **Brazil:** No requirements
- **Mexico:** franchise agreements must include provisions establishing applicable law and venue.



# Fair Dealing or Good Faith Statutory Requirements

- **Canada:** each franchise agreement imposes a duty of fair dealing in its performance and enforcement
- **Brazil:** no fair dealing requirement
- **Mexico:** no fair dealing requirement (but parties cannot agree on stipulations that violate public policy or moral standards)

# The Pacific Rim

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| TYPE OF REGULATION | Disclosure | Conduct | Disputes | Registration | Pre-conditions | Foreign rules |
|--------------------|------------|---------|----------|--------------|----------------|---------------|
| Australia          | X          | X       | X        |              |                | X             |
| China              | X          |         |          | X            | X              | X             |
| Indonesia          | X          |         |          | X            |                | X             |
| Japan              | X          | X       |          |              |                |               |
| Kazakhstan         | X          | X       |          | X            |                |               |
| Korea              | X          | X       | X        |              |                |               |
| Malaysia           | X          | X       | X        | X            | X              | X             |
| Taiwan             | X          |         |          |              |                |               |
| Vietnam            | X          | X       |          | X            | X              | X             |

| DISCLOSURE RULES | By Franchisee | By Franchisor | Days | Prescribed form | Franchisee advice | Continuing disclosure |
|------------------|---------------|---------------|------|-----------------|-------------------|-----------------------|
| Australia        |               | X             | 14   | X               | X                 | X                     |
| China            | X             | X             | 20   |                 |                   | X                     |
| Indonesia        |               | X             | -    |                 |                   |                       |
| Japan            |               | X             | -    |                 |                   |                       |
| Kazakhstan       |               | X             | -    |                 |                   |                       |
| Korea            |               | X             | 5    | X               |                   |                       |
| Malaysia         |               | X             | 10   | X               |                   |                       |
| Taiwan           |               | X             | 10   |                 |                   |                       |
| Vietnam          | X             | X             | 15   | X               | X                 | X                     |

| ITEMS DISCLOSED | Experience | Litigation | Start costs | Fees and payments | Financial statements | Supply conditions |
|-----------------|------------|------------|-------------|-------------------|----------------------|-------------------|
| Australia       | X          | X          | X           | X                 | X                    | X                 |
| China           | X          | X          |             | X                 | X                    | X                 |
| Indonesia       | X          | X          |             |                   | X                    |                   |
| Japan           | X          | X          |             | X                 | X                    | X                 |
| Kazakhstan      | X          | X          |             |                   |                      |                   |
| Korea           | X          | X          | X           | X                 | X                    | X                 |
| Malaysia        | X          | X          | X           | X                 | X                    | X                 |
| Taiwan          | X          | X          |             | X                 |                      |                   |
| Vietnam         | X          | X          | X           | X                 | X                    | X                 |

| DISCLOSURE RE CONTRACT | Franchisee obligations | Franchisor obligations | Territory | IP rights | Transfer | Termination |
|------------------------|------------------------|------------------------|-----------|-----------|----------|-------------|
| Australia              | X                      | X                      | X         | X         | X        | X           |
| China                  |                        |                        |           | X         |          |             |
| Indonesia              | X                      | X                      |           |           | X        | X           |
| Japan                  |                        |                        |           | X         | X        | X           |
| Kazakhstan             |                        |                        |           | X         |          |             |
| Korea                  |                        |                        | X         | X         | X        | X           |
| Malaysia               | X                      | X                      | X         | X         | X        | X           |
| Taiwan                 |                        |                        | X         | X         | X        | X           |
| Vietnam                | X                      | X                      | X         | X         | X        | X           |



| FRANCHISE AGREEMENT | Term | Renewal | Fees | Cooling off | Disputes | Termination |
|---------------------|------|---------|------|-------------|----------|-------------|
| Australia           |      | X       |      | X           | X        | X           |
| China               | X    |         | X    |             |          | X           |
| Indonesia           | X    |         | X    |             |          | X           |
| Japan               |      |         |      |             |          |             |
| Kazakhstan          |      |         | -    |             |          | X           |
| Korea               |      |         | X    |             | X        | X           |
| Malaysia            |      | X       | X    | X           |          | X           |
| Taiwan              |      |         | X    |             |          | X           |
| Vietnam             | X    | X       | X    |             |          | X           |