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## The Main Directions in Comparative Franchising Regulation – Unidroit Initiative and its Influence

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**Abstract:**

*Franchising is a growing and overspread business activity but its legal aspects create many potential difficulties for those intended to oblige themselves in legal relationship of franchising agreement. The legal problems in franchising arise not only because of the numerous controversies which are immanent to the franchising agreements but because franchising is not one type of agreement; it is a rather a concept which covers a number of different types of contracts in various aspects of business activities. Only 15 years ago in most national legislations, franchising was an anonymous contract (contractus innominatus) which was not the subject of the specific regulation. At the same time franchising arrangements were in the national context a subject to a considerable number of laws and regulations especially those regulating general contract principles and commercial contracts or industrial and intellectual property rights. It was the past activity of UNIDROIT (International Institute for the Unification of Private Law) which was the spiritus movens and a driving force nowadays in the actual and overwhelming process of the legislation movements in numerous countries. Those legal instruments were UNIDROIT Guide to International Master Franchising Arrangements 1998 (rev.2007) and Model Franchising Disclosure Law created in 2002 which were the soft law that has created a momentum in recent national franchising regulation. The impact of the UNIDROIT soft law legal instruments to the types, sphere of application and methods of comparative franchising regulation is to be considered in the article.*

**Keywords:** *franchising agreement, legislation, UNIDROIT Model Law, presale disclosure*

**JEL Classification:**

### 1. Introduction

The concept of franchising is based on the idea of cloning the business identity of a reputable and successful business entity. This method of vertical marketing of goods and services has emerged as a solution in the resolving of practical problems in American trade practices in the post civil war period during

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the XIX century<sup>b</sup>. The USA was the birth place of the modern franchising development and later it became the biggest exporter of the franchising systems. At the beginning of the XX century pioneers of franchising had become leaders in their own fields (automobile dealers, petrol stations, soft drink manufacturers) and after the 60s those franchisors, through the business format of franchising, increased as multinational companies which were the promoters of the globalization processes and giants of the franchising industry. Both within the national frontiers as well as in the international trade arena franchised way of doing business becomes the predominant recent phenomenon and franchised brands dominate in numerous areas of the fast-food, coffee shops, hiring cleaning service, restaurants, retail stores, health and fitness products, real estates and consulting, travelling and vacation services and broad fields of the economic activities.<sup>c</sup>

From the legal aspect franchise is an obligation contract between two partners in which the franchisor grants the franchisee the right to operate its business system in return for payment of fees and royalties. The business system typically includes transfer of intellectual property rights (such as trademarks, trade names and logos), the right to sell products or services, access to business knowledge and methods, and other physical and intangible assets. A key element of a franchise is the ongoing relationship between the parties. The franchisor often provides continuing support or direction regarding the operation of the business. The franchisee agrees to sell the franchisor's product, often exclusively, and to comply with the franchisor's standards. While the franchisee is an independent business, it will usually be required to operate in a way that is substantially similar to or indistinguishable from the franchised business.

Franchising is the business activity which emanates itself as the instrument of the law of contract which creates vertical integration between legally independent but economically interdependent entities. This interrelation of the business subjects in franchising system creates effects of the vertical integration (group of companies) as a style of management control without elements of ownership between contractual partners. In front of third parties or consumers franchise system is represented as a unified subject creating virtual identity between franchisor and franchisees which is enabled through the immanent legal technique of the autonomous law (*lex mercatoria*). The franchisee may gain the goodwill associated with the franchisor's trademark, standards for the quality and style of operation associated with the mark, and perhaps from training and advice provided by the franchisor. Still, the capital and risk incentives for operation of individual outlets remain much like those of independently owned businesses. The franchisee risks its

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<sup>b</sup> *Modern private sector franchising first appeared in the 1850s. The first franchise model is often attributed to the Singer Sewing Machine Company, which created an independent distributor network for its sewing machines.*

<sup>c</sup> *According to the Canadian Franchise Association, franchising crosses 42 sectors of the economy: Ontario Legislative Assembly, Standing Committee on Regulations and Private Bills, Hansard (March 8, 2000: Hearing on Bill 33: Franchise Disclosure Act, 1999) at 1340 (R. Cunningham, Canadian Franchise Association).*

capital to own and operate an outlet. But, unlike in an independently owned business, a franchisee generally relinquishes a great deal of control over the outlet and must share with the franchisor the revenue generated by the outlet. So franchisees pay an up-front franchise fee (entry fee); continuing royalties based upon sales as well as subject themselves to the franchisor's monitoring.

The legal instrument of the franchise agreement emerged in contractual practice and has been developed by the standard contracts of the big companies or MNE (multinational enterprises) and influenced by the private law of the national legislation that regulate the commercial aspects and its effects on a franchising systems.

Before legal activities of UNIDROIT in the field of franchising agreement<sup>d</sup> there were few national legislations which regulated franchising. After UNIDROIT issuing instrument such as Guide to International Master Franchise Arrangements in 1998 and Franchise Disclosure Model Law in 2002 there is a growing number of countries which adopt the laws in field of franchising. In spite of that it is difficult to select any particular tendency in the legislation that is adopted. It is necessary to analyze impact of mentioned international "soft law" instruments on the recent proliferation of the national franchise regulation.

## 2. The concept and the types of franchising agreements

Despite a franchise, in its earliest sense, being a "special privilege to do certain things conferred by government on an individual or corporation, and which does not belong to citizens generally of common right"<sup>e</sup> nowadays in the modern commercial environment franchising generally refers to a specific and prevalent method of doing business. This is especially the case with the most important and propulsive type of franchising which has emerged as the form of the business format franchising that emerged in the 1960s and is most commonly known today. In its traditional phase of development franchise was the type of license given by the owner of trademark or trade name permitting another subject to sell a product under owner's name or trade mark. Those were classical ways of doing business through which franchising was introduced and evolved connecting all the levels in the chain

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<sup>d</sup> The International Institute for the Unification of Private Law (UNIDROIT) is an intra-governmental organization established in 1926 in Rome aimed at unifying or harmonizing the laws of nation in area of private law [www.unidroit.org](http://www.unidroit.org)

<sup>e</sup> Black's Law Dictionary, 6<sup>th</sup> ed., s.v. "franchise". Franchise were a notion for the praxis established in the medieval England where the monarch had granted a subject the right to collect taxes; in more recent times a government may grant a utility company a monopoly franchise to encourage the development of a 'public good' by the private sector. For example the government could grants franchises to companies such as telecommunications and utility service providers to encourage the development of a 'public good' by the private sector. In the modern commercial environment, however, franchising now generally refers to a specific and prevalent method of doing business.

from manufacturer, wholesaler, and retailer to the consumer.<sup>f</sup> Most of the different categories of so called industrial franchises (product franchise) and distribution franchises are nowadays (mostly in European legal literature) considered as license agreement and exclusive distributorship agreement.<sup>g</sup> In its integrated and contemporary stage franchising has evolved to the **business format franchising** term of each relates to an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisor undertakes to assist the franchisee through advertising, promotion and other advisory services. In the recent legal theory only business format franchising (BFF) is considered as the notion which is embraced by the term franchising agreement. Beside together BFF and product distribution franchise some commentators also include business opportunity franchise.

The main feature of business format franchising is an exclusively identification between franchisor and franchisee where the later adopts franchisor's entire business system, including its product, brand name, operating manual and marketing strategy. The franchisor has elaborated and tested a specific business procedure for the distribution of goods or supplying of services, known as "*business format*" contented in Operation Manual (OM) which franchisors then proceed to grant franchisees the right to use. It is characterized by "*an almost complete merging of the business identity of franchisee and franchisor, so that the public perceives each franchised outlet as part of a larger chain of identical outlets, all offering the same high quality goods and services*".<sup>h</sup> Franchising is not possible to be considered as one type of agreement. It is a concept which covers several different types of agreements.<sup>i</sup> From the aspects of special legal techniques BFF is possible to be emanated in variety of legal relationships among which are the unit franchise contract, franchise affiliation contract, combination franchise, area representation agreement, area development franchise and master franchise agreement. **Master franchising agreement** is the most common type of franchising in international context and other forms mentioned above could be classified as **direct franchising agreements** where there is not intermediary between franchisor and franchisee. It is possible to establish franchise chain also by means of *branch* and wholly-owned *subsidiary* which are also forms of direct franchising.

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<sup>f</sup> Mendelsohn, Martin, *Franchising in Europe*, 1992, pp.1-3.

<sup>g</sup> *Industrial franchise relates to the manufacturing of goods and consists of manufacturing license based on patents and/or technical know-how combined with trade-mark licenses. Distribution franchises embraces the sale of goods and service franchises concern the supplying of services.*

<sup>h</sup> Hoffman J.P. and Levitt E.N. *Recent Developments of Importance in Franchise Law*, Gowling Henderson, Toronto, Ontario (December 17, 2005) online: <<http://gowlings.com/resources/publications.asp?pubid=1156>> (accessed: May 3, 2007).

<sup>i</sup> Peters L. *The Draft Unidroit Guide to Franchising – How and Why*, *Uniform Law Review*, 1996-4, pp, 694.

The *unit franchise contract* is the simplest form of BFF where the franchisor licenses the franchisee to operate a single franchise business in a specific location or a territory. The franchisee's commitment is to pay an initial franchise fee (entry fee) and ongoing royalties based on a percentage of gross sales. Among the duties on the side of the franchisee there is also the requirement the franchisee has to contribute to an advertising fund, and the franchisee also has the right to multiple franchises, so it is the right of the franchisee to opt to acquire additional franchises or right of first refusal. In the form of *affiliation* (or conversion franchise) contract the franchisor absorbs an independent business in the same field which agree to conduct future operations under the franchisor's model. Another type could be the *combination franchise* form of agreement where two or more distinct and complementary franchise system are joined in physical or functional conjunction in the manner that an outlet of one system is installed into an outlet of the "host" franchise system. Where rights represented by the franchise are granted for an entire territory (city, town, province or whole country) there are variations of territorial franchising. Among them is the *area representation agreement* where franchisor retains an independent representative to seek prospective franchisees and carry out the franchisor's obligation within a defined area in return for a share in revenue. But it is worthy to underline that franchise agreement is concluded in the form of unite franchise contract between the franchise and franchisor and not the representative. In the form of *area development franchise agreement*, the franchisor grants a franchisee the right to set up multiple outlets within a geographical area. This variety of franchising emanates through the two contracts simultaneously – one is area development and another unit agreement. The area development agreement usually deals in a general way with the terms of the franchise expansion and the number of outlets to be established, while the issue and details of the individual outlets are to be governed by unit franchise agreement. All those varieties of the BFF belong to the direct franchising agreements in spite the fact that some of them consider conclusion of more than one contract.

In the *master franchising agreement* the franchisor grants to a partner in another country (sub-franchisor) the exclusive right within the specified territory to open franchise outlets itself or to recruit other partners (sub-franchisees) to grant franchises. It appears that sub-franchisor acts as an alter ego of franchisor in the foreign country. The maintenance of exclusive rights in the master franchise depends on the fulfillment of the prescribed schedule. Master franchising is the multi-contractual arrangement with the three-tiered contractual structure because of the involvements of two agreements which connected three contractual partners: franchisor, sub-franchisor (master franchisee) and sub-franchisee (unite franchisee). First legal instrument is an international agreement between the franchisor and sub-franchisor (the master franchise agreement) and the domestic franchise agreement concluded between sub-franchisor and each of sub-franchisees (sub-franchise agreement or unit agreement). The *differentia specifica* of this contractual three-tiered arrangement is that there is no direct legal relationship between franchisor and

sub-franchisee. In the case of the breach of the agreement at the side of sub-franchisee the franchisor is not able to intervene because it is the duty of sub-franchisor. The only possibility for the franchisor in this situation is to sue sub-franchisor for non performance of the obligation to enforce sub-franchising agreement as it is prescribe in the master agreement. Revenues of the franchisor in the type of the master agreement derives from the operations of the franchise and from the sharing the franchise fees or royalty payments made to a sub-franchisor.

The franchising agreement is possible to apply in conjunction with the *joint venture franchise* whereas franchisor and franchisee enter a joint venture in which the franchisor grants a unit, area development or master franchise to the joint venture entity.

Varieties of **product distribution franchise** and **business opportunity franchise** are not always treated as the form of the franchising concept. As in product distribution franchising agreement (industrial or distributive franchising where examples are soft drink bottlers and automobile dealerships) the manufacturer is identified with the producer or supplier and obtains a license to produce, market and sell products within an exclusive distribution area, thus far in business opportunity franchise the franchisor grants the franchise the right to sell goods and services provided by the franchisor (amusement games). In spite of franchisor providing local assistance in both varieties there is less control and identity than in BFF. For these reasons those forms are often treated, from the legal aspect, as the license agreement and exclusive distributorship agreement rather than franchising agreement in *stricto sensu*.

All reflected forms of franchising agreements are adaptable for both domestic and international franchising. The body of legal issues differs according the type of direct franchising (operating through unit agreement, affiliation or combination franchise, branches or subsidiaries), area development or master franchise agreement which is applied in specified business operations. But all those varieties touch upon great many different areas of law such as contract law, agency law, industrial and intellectual property law, competition law, corporate law, taxation or labor law and other areas which are regulated by national legislation. So it was extremely difficult for the body such as UNIDROIT to regulate all those numerous aspects of franchising or adopt a specified discipline which is typical for franchising from the prospective of contract law, choice of law or intellectual or industrial property law. Besides, there are other difficulties in regulating franchising agreement.

### **3. The main reasons for difficulties in franchise regulation**

Beside numerous varieties in which franchising legal relationships could be emanated, wide area of laws which are involved in franchising activities, unresolved legal nature of franchising agreement etc. the most obvious reason which oppose the efforts of international franchising regulation were reluctance of global community of franchisors opposing ideas of franchising regulation for many years.

At the same time, the most obvious reason for the regulation of franchising arrangements was the practical problems which have been raised in the franchising activities. In the majority of cases those problems stressed the the abuses on the part of the franchisor under circumstances of the gross disparity in the contractual balance of the parties in the franchising contracts. The parties frequently have dramatically unequal bargaining power: the franchisor is often a large, sophisticated business organization with significant franchising experience and control over the terms of the franchise agreement, while the franchisee may have little business experience and, in any case, often must 'take or leave' the franchise agreement as offered. The franchisee must rely to some extent on the franchisor's representations with respect to the potential for business success. In some cases, disreputable franchisors use high-pressure sales tactics and provide inaccurate or misleading financial information. When problems occur in the franchising business, a franchisee suffering business difficulties will be less likely than the franchisor to have the financial resources available to fund litigation. There can be a significant imbalance in the amount and quality of information available to the parties during negotiations and at the time the franchise agreement is signed.

Contractual practices have reflected the most common of those abuses which include too stringent provisions related to the control exercised by the franchisor or as regards the rights retained by the franchisor to terminate the agreement, inadequate rights of the other party to terminate for breach of the franchisor, omissions in the process of structuring franchising agreement in way that legal vacuum is created without mutual rights on the side of the franchisee to terminate agreement because of the breach on the side of the franchisor, inadequate assistance or training which is franchisor obliged to offer to the franchisee or extremely high prices of those services offered by the franchisor or his related companies. Although the dispute and litigation history shows that abuse is in the prevalent way on the side of the stronger party – franchisor – it is possible especially in the form of the master franchise or area development franchising that the franchisee could abuse its contractual position.

The main areas of franchising dispute, especially in the U.S., Canada and Australia franchising practice, relate to the information and power imbalance which include lack of pre-contractual disclosure, deceptive practices regarding misrepresentations of the nature of franchise, the range of supplies, equipment and training, the value and profitability of the franchise, prior experience and reputation of the franchisor, take it or leave it nature of the contract which causes unfair contract terms, complexity of the documentation. Good faith principle of contract law is the crucial in the franchising contract <sup>j</sup>

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<sup>j</sup> Terry, A. , di Larnia C. *Franchisor Opportunism, Commercial Morality and Good Faith, presented paper, EMNet 2009 – Sarajevo, 4th International Conference on Economics and Management Networks*

In the absence of franchise-specific legislation, the relationship between the franchisee and franchisor is governed by the terms of the franchise agreement and the law of contract. In most circumstances, a franchise agreement is a commercial contract between independent parties with no fiduciary or employment obligations. A franchise agreement is also often a 'contract of adhesion'. This is, in general, a written contract drafted by one party on a form regularly used by the drafter and presented to the other party on a 'take it or leave it' basis; the other party enters into relatively few such transactions in comparison with the drafter and his or her principal obligation is the payment of money.

There are three critical components of most of the franchise systems - the brand, the operating system, and the ongoing support and training provided by the franchisor to the franchisee:

(1) The brand creates the demand, allowing the franchisee to initially obtain customers.

(2) The operating system essentially "delivers the promise," thereby allowing the franchisee to maintain customer relationships and build loyalty.

(3) The ongoing support and training provide the impetus for growth, providing the franchisee with the tools and tips to expand its customer base and build its market share.

Besides all legal and contractual problems caused by the complex nature of the franchising agreement it is worth mentioning that franchising can be regulated with three types of legal rules: disclosure law, relationship law and registration law. The disclosure law which has been invented in the U.S. legislative history requires a franchisor to provide certain information before entering into an agreement with franchisee, whereas the relationship (obligation) law regulates contractual relationship between franchisor and franchisee. The registration law is indented to the administrative procedure which prescribes obligation of notification or registration of the franchising agreement prior or after its conclusion.

#### **4. UNIDROIT and its activities in area of franchising**

The International Institute for the Unification of Private Law is an inter-governmental organization which goal is unification and harmonization of the law of nation in the area of private law. UNIDROIT's 63 member States are drawn from the five continents and represent a variety of different legal, economic and political systems as well as different cultural backgrounds. Since establishment by the League of Nations in 1926 in Rome UNIDROIT has over the years prepared over seventy studies and drafts. Many of these have resulted in international instruments, including international Conventions and Model Law, drawn up by UNIDROIT and - in the case of Conventions - adopted by diplomatic Conferences convened by member States of UNIDROIT. The most important instruments in the field of the law the commercial contracts are 1964 Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (The Hague); 1964 Convention relating to a Uniform Law on the International Sale of Goods (The

Hague); 1970 International Convention on the Travel Contract (Brussels); 1983 Convention on Agency in the International Sale of Goods (Geneva); 1988 UNIDROIT Convention on International Financial Leasing (Ottawa); 1988 UNIDROIT Convention on International Factoring (Ottawa); 2002 Model Franchise Disclosure Law, 2008 UNIDROIT Model Law on Leasing and besides Convention and Model laws the most important instruments of the soft law were Principles of International Commercial Contracts (1994; enlarged edition 2004) and Guide to International Master Franchise Arrangements (1998 2nd ed. 2007).

The most important legal instruments regarding franchising in international context are UNIDROIT (International Institute for the Unification of Private Law) “*Guide to International Master Franchise Arrangements*” (Rome 1988, rev. 2007) containing high – level information of all problems in different stages of conclusion and implementation of franchising agreement not limited to legal issues only, and UNIDROIT “*Model Franchise Disclosure Law*” devoted to the franchisor’s duties to disclose material information to franchise, which is together with its Explanatory Report clearly addressed to national legislators, as the “soft law” instrument of the new “*lex mercatoria*”.

The Model Law<sup>k</sup> is a disclosure law which is indented to encourage development of franchising by creating secure legal environment between all the parties in the franchising arrangement. Since it was created as a model law for the countries with intent to regulate franchising for the first time this instrument of unification of the law of franchising is more flexible than international convention. The Model Law is applied to both domestic and international franchising and to different types of franchise agreement but disclosure requirement is required only on the part of the franchisor. Disclosure requirement on the part of the franchisor is formulated as a duty of franchisor to deliver a disclosure document which contains a prescribed types of information together with the proposed franchising agreement, at least fourteen days in advance of either the signing of any agreement that relates to a franchise or prior the payment of any of fees relating on the transfer of the franchise. Beside definition of the franchising which covers broad varieties of the franchising agreements (master, unit, area development agreement etc.) and together with the commitment of writing form of the disclosure document Model Law prescribes broad list of disclosed information concerning the franchisor and its network (legal name, legal form and address, principal place of business) and its financial statements, business experience, intellectual property rights (Art. 6 (1)) then in the same article Model promulgates the information related to a important clauses of the franchising agreement such as term and conditions for the renewal of the franchise, conditions for termination, limitations to a territory or customers, in-term and post-term non compete clauses (Art.6(2)). In the case of master franchise agreement the Model Law prescribes beside other information and duty of the sub-franchisor to disclose to the sub-franchisee the destiny of the sub-franchise agreements in case of

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<sup>k</sup> *Model Franchise Disclosure Law , Explanatory Report, UNIDROIT, 2002*

termination of the master franchise agreement and of the content of the master franchise agreement. The remedies against the omission of the franchisor to deliver the document with prescribed information are a possibility on the side of franchisee to terminate the agreement and ask for damages under the rules of the applicable law (Art. 8).

## **5. Recent national legislation on franchising**

Franchising has got its start in the USA where the first obstacles and difficulties arose and the USA has been the first jurisdiction which resorted to legislation as a means of reducing or eliminating those problems (Federal Trade Commission Rule 1979). The method of this initial wave of franchising specific legislation attempted to require and regulate the content of certain presale disclosure to prospective purchasers. The presale disclosure legislation in the USA was uniformly administered by security regulators and at the same time it secured appropriate due diligence before entering into legal relationship. In the first period franchisor was required to register with the appropriate state agency, but later registration of the franchisors has been deleted as a requirement. Notwithstanding presale disclosure requirement, some of the abusive conduct continued, mostly on the part of the franchisor. It was the reason for number of the U.S.A. states to enact franchise relationship laws. One of the most frequent issues addressed in that legislation is a prohibition against termination of franchisees with "good cause".

The first franchising legislation was followed by the autonomous regulation made by the most important franchising association such as International Franchise Association (IFA) and European Franchise Federation (EFF) which provides the pre-contractual duty of disclosure in their Code of Ethics for Franchising. The regulation which is important for franchising agreement, in spite of the fact that it is out of force from 31 May 2000 and limited only to the field of competition law is the European Union Commission Regulation (fostered after famous "Pronuptia" case) No.4087/88 the most important part of which, in the matter of disclosure, is the definition of franchising which is broadly adopted in the franchising legal literature as well as in legislation process.

In the last 15 years (the period corresponds to the past activity of UNIDROIT in the area of franchising) an increased number of the countries (especially developing countries and countries with economics in transition) have regulated franchising. Nowadays approximately 30 states have incorporated rules on franchising in domestic regulations.<sup>1</sup> There are different methods which could be

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<sup>1</sup> *The author spent 2 month research period at the UNIDROIT Library in Rome working on project "Enacting Franchising Disclosure Law in Serbia" in 2005. The Report on Research Project has been adopted from the Governing Council of UNIDROIT in May 2005. The opinion and attitudes in this articles are author's and doesn't represent the official opinions of UNIDROIT.*

used as the guide through the national legislation (type of provisions, type of law to be adopted - disclosure, relationship or registration law, type of legislative technique, etc).<sup>m</sup> The method chosen in this article is the method of legislative technique which regulates franchising in national jurisdiction. The instruments which are used in those regulations vary from the specific franchising law legislations – *lex specialis*, enactment the provision related on franchising in national Civil Code, franchising regulation in other different area of law (for example law that regulate intellectual property) and limited number of countries regulated franchising through governmental regulation.

The most numerous are the countries which adopted specific franchising regulation. As it is stressed the first law on franchising was adopted in the USA in 1979, where franchising originated and US federal law on franchising was adopted in 1979 as Federal Trade Commission (FTC) Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures. It was the first law which regulates the information a franchisor is required to supply the prospective franchisee with (so called *franchising disclosure law*) in order to provide it with all the elements necessary to evaluate the franchise it is proposing to acquire. It is the federal law and FTC Rule applies in all fifty states and it is indented to provide a minimum pre-contractual protection of the franchisee. It therefore applies wherever states have not adopted more stringent requirements. This law is still in force although an amended Rule has been adopted and effective as from July 2007. The North American Securities Administrators Association (NASAA) has adopted a Uniform Offering Circular (UFOC) that indicates 22 types of information which should be furnished to a prospective franchisee.

Canada has the longest experience with franchising legislation as well as provinces Alberta, Ontario and Prince Edward Island have franchise specific regulation from 1995. France was the first European state which enacted franchising specific disclosure law in 1989 (*Loi Doubin*). Specific franchising regulation in form of the law has also Brazil 1994, Malaysia 1998, Kazakhstan and Korea in 2002, Italy 2004, Belgium 2006, Sweden 2006. Other countries that regulate franchising enacted the provision on franchising in their Civil Code.

After Albania in 1994, this method has been used by Russian Federation 1996, Georgia 1997, Belarus 1998, Lithuania 2000, Kazakhstan 2002, Moldova 2003, and Ukraine 2004. Each of the mentioned legislations uses the method enacted in Russian Civil Code (Part 2, Articles 1027-1040)<sup>n</sup> which doesn't deal with

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<sup>m</sup> The most useful in that area are the articles by Peters, L. "The Draft UNIDROIT Model Franchising Disclosure Law and the Move Towards National Legislation", ULR 2000-4, pp.717-735; The Draft Unidroit Guide to Franchising-How and Why?, ULR1996-4, pp694-707. as well Annex 3 to Guide to International Master Franchise Arrangements – "Legislation and Regulations relevant to Franchising" also on UNIDROIT web site which is periodically updated

<sup>n</sup> UNIDROIT Guide on International Master Franchise Arrangements, Rome, rev. 2007, Annex 3, pp. 296.

disclosure in any detailed manner, but instead regulates certain aspects of the relationship between the parties. They *inter alia* deals with the form and registration of the contract, sub-concessions, the obligation of the parties and the consequences of the termination of the exclusive right granted in the agreement.

A number of countries has included provisions related to the franchising in the existing or new law which regulate other aspects of economic life other than franchising (Mexico 1991, Croatia 1994, Spain 1996). Finally, countries such as Indonesia and Romania (1997), China (2004) and Vietnam (2006) enacted detailed franchising regulation in the form of Decree which regulate legal regime applicable on franchising in very detailed manner.<sup>o</sup>

## **6. The influence of the UNIDROIT Model Franchise Disclosure Law on the chosen method of franchise agreement legislation**

There are significant trends in the adopted legislation: a very limited number of countries hasn't even mentioned disclosure requirements but provides very rigid and restricted provisions regulating contractual relationship between franchisor and franchisee (Russia, followed by the Kazakhstan, Lithuania and Belarus); some legislation only mention disclosure without any details but at the same time regulate in a very detailed way questions concerning contract specification, such as obligation and liability of each of the parties, renewal of the franchising agreement (Malaysia, Albania, China, Romania). A number of countries have a registration requirements with the different object to be registered (Spain, Russian Federation) and the main feature of Malaysian and Indonesian regulations is the existence of very stringent, detailed and burdensome provisions on registration which purpose is not only informational, but the registration requirements start to be specific procedure for the approval of the franchise business which, along with the protectionist as well as domestic party highly protective provisions contained in both acts, is very discouraging for franchisors and takes to much burden on their side. For the same reasons registration requirements have been nullified in some legislations (Canada-Alberta). Most of the franchise laws contain the disclosure requirements which obligate franchisor to disclose different categories of information, and the amount of detail is different in national legislation. The longest lists are contained in the U.S. and Australian legislative (their experience with the abuse being the longest) which is in accordance with common law legal technique of providing big number of clauses in order to cover all specific situation – method of *numerus clausus*, and the civil law countries and those which followed the method of providing more general provisions which will be made concrete within the case law, have a shorter list of information which the franchisor is mandatory to provide a prospective franchisee with. The new Italian franchising legislation represents this civil law method, containing general provisions with the broader definitions of franchising, its varieties, and obligations of the parties as well as the

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<sup>o</sup> *Ibidem*, pp. 294-301/.

limited number of disclosure requirements. In the German and Austrian Law there is a general duty of information in accordance with general principles of contract law, and despite there is no any specific franchising law in the both countries, the case law is on the very sophisticated level, treating in many cases the consequences of infringements of franchisor's duty to inform franchisee in pre-contractual period<sup>p</sup>

Italian experience with the franchising and the new legislation enacted in 2004, together with the commentary in the legal literature on that issue<sup>q</sup> were very precious reflecting that the law is compromise of interests of all subjects involved in franchising, and especially the role of Franchising Association in process of law drafting and implementation.

Sweden also promulgated disclosure regulation in franchising agreement in 2006 when the Swedish Parliament, after many years of discussions and a number of proposals, adopted a franchise-specific law: the Law on the duty of a franchisor to provide information (24 May 2006, Law no. 2006:484) (Lag om franchisegivares informationskyldighet). It is a disclosure law, which deals with pre-contractual disclosure, comprising only six articles.

The Table 1 contains comparative approach to a national franchising legislation which embraces both methods of regulation and used legislative

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<sup>p</sup> *LG Hanover, 11 April 1995-140267/94 and BGH NJW 1987,41,42. In spite of the facts that neither German nor Austrian legislation provides some specific franchising legislation, there are in the last years some movement toward. To avoid problem of unamortized investments of franchisee after the termination of the franchising agreements Austria has enacted the new §454 in the Austrian Commercial Code (came into force on August 21, 2003) which is applicable to all kinds of vertical agreements including franchising agreements in which the commitment of the investment has been agreed after this provision has come into force. The new provision provides that entrepreneurs have the right to compensation in respect of their investment after the termination of a distribution contract with the binding entrepreneur, according the some conditions provided by this article for investment and for the termination of the contract. More, Speigelfeld, Austria – Compensation for Franchisee's Investment, International Journal of Franchising Law, Vol.2, Iss.1,2004,pp.28. Furthermore, there is the provision in the German HGB art.89(b) regulating the mandatory compensation has to be paid to a commercial agent for his loss of "goodwill" (after EC Directive on Commercial Agents such compensation has to be paid in all EU member states), and this provision applied from the German courts by analogy to franchising agreements. Besides, there is of the significant importance for franchising agreements also the reform of German BGB made in 2002 in the sphere of the breach of contract. In , Zimmerman,R.,Breach of Contract and Remedies under the New German Law of Obligations, in Centro di studi e ricerche di diritto comparato e straniero, Roma , 2002.*

<sup>q</sup> *Frignani,A., Proposed Franchise Bill for Italy and Laws Fostering Franchising (Financial Incentives) , in Interantional Journal of Franchising Law, Vol.1,Iss.2,2003,pp. 6-14; Peters,L.,Una lege per franchising, Diritto del Commercio Internazionale, Aprile-Giugno, 2004,pp.323-335; Frignani,A. Italian Senate Rules on the Regulation of the Franchise, unofficial translation, in International Journal of Franchising Law, Vol.2,Iss.3,pp.36-38.*

instrument in countries which already adopted franchising regulation in one way or another.

## **7. Conclusion**

The comparative analyses of the type of the provisions which regulate franchising adopted in recent period lead to the observation that with the exception of the Russian Civil Code (and legislation which is inspired by Russian legislation) all franchise laws in different ways and extents deal with disclosure requirement as a reflection of the UNIDROIT past activity in the field of franchising. As an additional method of protection a number of countries impose relationship norms in their legal instruments. Other norms and regulations are inspired by domestic conditions and with the intent of the legislator to protect domestic franchisee and domestic products or industry.

In the process of creation legislation in particular issue legislators are usually inspired with the experience and legislation of the countries with similar legal tradition. It is obvious that franchising legislation in several countries is very similar, such as for example solutions in Lithuania, Kazakhstan and Belarus are very similar to those in Russian Civil Code, or disclosure requirements are very broad in the common law countries such as in the U.S. and in Australia. Beside aspect common legal tradition, legislator trying to regulate franchising consider the legal solutions as well from the countries with which they have close economic or historical connections, or take over solutions from the countries which business intent to attract. UNIDROIT Model Franchise Disclosure Law is an international legal instrument which solutions inspired many of the national legislators to take over disclosure method in regulation of franchising agreement. Although there are many differences between the type of the instrument regulated franchising agreement, differences between the texts, in amount of detail, national laws of franchising mostly required the same type of information as the Model Law prescribes. The UNIDROIT Model Franchise Law and recent franchise legislation have the same approach and are moving in the same direction in spite the fact that Model Law deals only with the issue on disclosure and most of the legislation foreseen both disclosure and relative law on the franchising agreement.

Important conclusion for the countries intent to introduce franchise specific regulation is disclosure requirements are the prevalent issue in franchising specific regulation. But beside clean disclosure regulation a growing number of countries accepts another method which combine relationship with disclosure law on franchising. The obligation – relationship norms which regulate contractual aspects of franchising agreements together with disclosure requirements which will protect parties in the pre-contractual stage of the relationship would be an important method in the process of creation of legal security as well as a healthy commercial law environment for future development of franchising.

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**TABLE 1: Comparative law on franchising**

	CIVIL CODE	OTHER LAW or CODE	LEX SPECIALIS	GOVERNMENTAL REGULATION	RELATION-SHIP (OBLIGATION NORMS)	DISCLOSURE NORMS	REGISTRATION NORMS	YEAR
Albania	#				#	#		2001.
Australia					#	#		2006.
Belarus	#				#		#	1999. rev.2005.
Belgium			#			#		2006.
Brazil			#		#	#		1994.
Canada -Alberta			#		#	#		1995.
Canada-Ontario			#		#	#		2000.
Canada-Prince Edward Island			#		#	#		2007.
Croatia		#						1999.
Estonia		#			#			2002.
France			#			#		1989.
Georgia	#				#			1997.
Indonesia				#	#	#	#	1997 rev.2006
Italy			#		#	#		2004.
Japan		#				#		2002.
Kazakhstan			#					2002.
Lithuania	#				#			2000.
Malaysia			#			#	#	1998.
Mexico		#			#	#	#	2006.
Moldova	#		#		#		#	2003.1997 lex spec.
PR China				#	#			2004.
R Korea		#			#	#		2002.
Romania			#		#	#		1998.
Russian Fed.	#				#		#	1996.
Spain		#				#	#	1998.
Sweden			#			#		2006.
Ukraine	#				#			2004.
USA			#			#		1979.
Vietnam				#		#		2006.

Source: Unidroit Guide to International Master Franchise Arrangement (1998,rev.2007)  
[www.unidroit.org](http://www.unidroit.org)

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