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International Franchising

Newsletter of the International Bar Association Legal Practice Division

Vol 18 No 2 OCTOBER 2014

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Contributions to this newsletter are always welcome and should be sent to the Newsletter Editors, Francesca Turitto and Larry Weinberg, at **francesca.turitto@studiolegalerlp.com** or **lweinberg@casselsbrock.com**.

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This newsletter is intended for lawyers interested in the field of international franchising. Views expressed are not necessarily those of the International Bar Association.

Looking forward to Tokyo and Chicago

Andrew P Loewinger
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Chicago May 2014

On 6–7 May 2014 we had our 30th Annual IBA/IFA Joint Conference, with our highest attendance ever – over 135 attendees, up about ten per cent on last year. Our Newsletter Editors and the present issue of the newsletter describe the highlights of the programme. The quality of our sessions was very high, as shown by significantly improved evaluations with over 70 per cent rating the conference 'excellent' overall. And we had many excellent discussions and presentations, and a great 'vibe' among attendees.

As a benefit to both our speakers and the broader international franchising community, most of our papers at both the IBA Annual Conference and the May IBA/IFA joint conference are now also being published by the *International Journal of Franchising Law* by arrangement with the IBA. This helps to provide broader and enduring exposure for all our speakers and wider exposure for the work of the IBA's International Franchising Committee.

Opportunities for involvement in Committee activities

There remain many chances for new members to get involved in our Committee's activities. The best way to get involved remains writing for the newsletter. Proposing speaking topics also is an excellent opportunity. Please contact me or any of the officers listed on page 6 of this newsletter.

The newsletter

Once again, we present to you with our newsletter on some very timely topics. Our thanks to our Co-Editors, Francesca Turitto and Larry Weinberg, who do an excellent job. If you have article ideas or want any ideas, please get in contact with them.

International Franchising Committee moves to co-chair structure

The IBA Legal Practice Division (LPD) has approved my proposal to move to a co-chair structure for the International Franchising Committee starting in January 2015. I felt that such a structure would benefit the Committee so that the Chair's duties – organising its two annual conferences (IBA/IFA in May and IBA Annual Conference in October) and overseeing work with other committees – could be more effectively performed. We are also introducing a staggered Co-Chair arrangement to provide for more continuity at the leadership level.

Accordingly, as of 1 January 2015, I am pleased to announce that Rocio Belda de Mergelina will become Committee Co-Chair. The LPD has asked that I serve for an extra year as Co-Chair in 2015, to introduce the staggered arrangement and permit Rocio to have a full two-year term. After my term expires, Karsten Metzleff will become Co-Chair with Rocio in 2016.

Planning programme sessions for 2015

Finally, as you now read this newsletter, we are in the middle of a very small two-month window for deciding our 2015 International Franchising Committee session programmes. So, if you have an idea for a topic you'd like to present on, please let us know. We are now soliciting all Committee members and other interested parties for programme session ideas for our May 2015 IBA/IFA program and our October 2015 sessions at the IBA Annual Conference. Please submit any topics or ideas now to me or any other Committee officer.

Tokyo 2014

Our International Franchising Committee dinner will be held in Tokyo on Tuesday evening, 21 October. Please email confs@int-bar.org to purchase a ticket.

Chicago 2015

The 31st Annual joint IBA/IFA conference will again be held in Chicago, on 5–6 May 2015. Please make a note in your diaries, calendars and smart phones now to plan to attend.

Thank you for your continued support and involvement. I look forward to seeing you in Tokyo in October and Chicago in May next year.

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Welcome to another newsletter

We have now arrived at the October edition of our newsletter, with the IBA/IFA Chicago Conference already in the past and the IBA Annual Conference in Tokyo soon upon us. In this issue, you will be able to read the reports of the Chicago Conference sessions prepared by our contributors. In Chicago, we participated in a plenary session dealing with internet issues in international franchising. Again, the topic of technology and the law proves to be of immense interest, especially when discussing the possible implications of competition law on sales on the internet or the obligation to use the franchisor's central website. This year, two of the workshops held in Chicago addressed the core of the franchise relationship since in one room we had the chance to discuss the situation where a franchisee is a company bigger than its franchisor; we analysed what this situation may trigger in terms of disclosure obligations, modifications to the standard contract adopted by franchisor, and in general, the implications of this imbalance during the performance of the contract. At the same time, participants in a different room discussed various ways to deal with encroachment issues. From a much broader perspective, the third workshop provided some insights into how a franchisor's in-house counsel selects their local counsel, the more frequent areas where advice is requested, and how tasks are divided between in-house and outside counsels. At the end of the Chicago Conference, we heard about major developments during the 'News from around the World' session and participated in the plenary session on post expiration and termination issues in master franchising.

And our contributors also offer a number of interesting articles on some cutting edge subjects such as the amendments to the Australian Franchising Code of Conduct. Greg Hipwell and Jacqui Martin guide us through the many and material modifications which are on their way. For instance, civil law lawyers will be happy to know that they will not be alone in dealing with the implications of the general obligation to 'act in good faith' as this will be introduced from 1 January 2015, along with the other changes brought by a revised Code of Conduct.

Gerard Sautereau explores for us the French Loi Doubin and its pre-contractual information obligations, offering an overview of the relevant case law. Natalya Mykolska and Anzhela Makhinova update us on the new developments and trends on franchising in Ukraine, for instance in terms of case law regarding the requirement to register the franchising contract. Last but not least, again on franchising and competitions laws, you may read an interesting comparison among Canadian, American and European approaches, prepared by Stuart Freen.

We thank again the contributors of this issue and remind everyone that the newsletter is open and welcomes your articles. We strongly encourage all our readers to participate to the IBA Annual Conference in Tokyo and sincerely hope to see you there.

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In memoriam – Dennis Wieczorek

On July 13 2014 DLA Piper lost a beloved member of its family, Dennis Wieczorek, who passed away suddenly. Dennis was the Chair of the firm's Franchise and Distribution Practice Group and had been a partner with the firm for over 30 years. He joined the firm in 1977 after graduating from the Duke University Law School. Dennis was instrumental in the growth and success of the firm's franchise practice where he concentrated on US and international franchising, licensing, antitrust and distribution matters.

Dennis was General Counsel to the International Franchise Association and served on its Legal/Legislative Committee and Legislative Group. He was a past Chair of the American Bar Association's Forum Committee on Franchising and a frequent speaker on franchise and distribution topics. Dennis was renowned for his profound knowledge of franchise law and was repeatedly named a *Franchise Times* 'Legal Eagle'. He was rated by other professional publications as one of the top franchise lawyers in the US and was well known to many members of our committee. Dennis also participated in a number of franchise industry advisory groups, including the North American Securities Administrators Association Franchise and Business Opportunities Project Group.

Dennis was a wonderful colleague, friend, husband, father and leader. While he acted principally for franchisors, he worked effectively with government representatives and members of the franchisee bar to improve franchising for all those involved. His premature death is a tremendous loss for all who knew him and for the franchise law community.

TOKYO 19–24 OCTOBER 2014
ANNUAL CONFERENCE OF THE INTERNATIONAL BAR ASSOCIATION

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International Franchising Committee sessions

Monday 1430 – 1730

The Goldilocks question: is government regulation of franchising, licensing, and distribution in Asia too much, too little, or just right?

Presented by the International Franchising Committee

There is more regulation of franchising, licensing and distribution sales and relationships in Asia than on any other continent. This session will survey the laws and regulations that apply to franchising, licensing and distribution relationships under franchise and related laws in Asian countries. Local experts will discuss the breadth and impact of these laws on franchisors, licensors and others; the extent to which there is over-regulation; and techniques for dealing with these laws.

Tuesday 0930 – 1230

How to protect IP during trade fairs

Presented by the Intellectual Property and Entertainment Law Committee, the International Franchising Committee and the International Sales Committee

The Canton Trade Fair in China, hosting more than 55,000 booths, is one of the biggest fairs in the world. Each spring, some 1,450 companies from the watch, jewellery and precious-stone industries are showing their latest products at the Baselworld Watch and Jewellery Show in Switzerland. Both trade fairs have set up dispute resolution panels that intervene and decide IP disputes, which often arise between exhibitors or between an exhibitor and a third party during these fairs. This session focuses on how these dispute resolution panels work, and in particular what issues under patent, trademark and copyright law they have to deal with. Experts and lawyers from Asia and Europe will relate their experience in this field. The session will also refer to the standards and rules that WIPO has recently set in this field and discuss the issue of how these panel decisions inter-relate with the court system. A look into the future will, among other things, address the question of how that system could be applied to other similar events.

Tuesday 1430 – 1545

A marriage made in heaven? Private equity and international franchising

Presented by the International Franchising Committee

This session will review the continuing attraction of franchising and private equity to one another. It will examine why franchising is attractive as a successful business model; the growth and trends for private equity in international franchising; the key legal issues arising in the pre- and post-acquisition phases of a private equity transaction; and flashpoints for success and failure. Both legal and business perspectives will be presented.

Tuesday 1545 – 1730

News from around the world: recent developments in franchise law

Presented by the International Franchising Committee

A panel of franchise and distribution experts will discuss recent developments.

To find out more about the conference venue, sessions and social programme, and to register your interest, visit **www.ibanet.org/conferences/tokyo2014.aspx**. Further information on accommodation, tours and excursions during the conference week can also be found at the above address.

CONFERENCE REPORT

30th Annual IBA/IFA Joint Conference, Chicago, 6–7 May 2014

Wayne A Steinberg
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Internet issues in international franchising

Session Chair
Karsten Metzlaff Noerr, Berlin

Speakers
Corinne Attard Holman Webb, Sydney
Michael K Lindsey Paul Hastings, Los Angeles
John Pratt Hamilton Pratt, Warwick

Issues surrounding use of the internet have been of increasing concern to all franchisors, and the issues are even more challenging when looking at international franchising. As general counsel with WSI, a company that franchises internet and digital solutions internationally, this topic held special interest for me. The session was chaired by Karsten Metzlaff (of the German firm Noerr) and the excellent panel consisted of Corinne Attard (of the Australian firm Holman Webb), Michael Lindsey (of the US firm Paul Hastings), and John Pratt (of the English law firm Hamilton Pratt).

The panel's approach was to look in a comparative way at some of the issues that come up involving the internet, and all the panellists agreed that consideration of the implications of competition law in their respective jurisdictions is important.

Turning first to the European Union, for example, John Pratt noted that a key concern in the EU, when looking at what one can and cannot do on the internet, is the need to consider EU competition law. This law applies to sales both on the Internet and otherwise. When selling online there is overarching EU-wide competition law to consider (see Article 101 of the EU law), but there are also some differences from country to country within the EU. It is important to note that one cannot contract out of EU competition law by choosing a foreign governing law, as meeting the requirements of competition law in the EU is mandatory. The main objective of EU competition law is to create a single market and the free movement of goods and services within that market. Franchisors seeking to defeat claims based on competition law breaches will usually do so by seeking to comply with the EU Block Exemption. But in principle, setting minimum prices and imposing restrictions on franchisees

from selling outside their territory are 'hard restrictions' that are illegal, pursuant to Article 4. And the regulator in the EU has taken the position that sales through a website are passive sales and the Franchisor cannot impose restrictions on such passive sales being made by a Franchisee. The Franchisor can still block active selling by a Franchisee through restrictions on advertising focused specifically at customers outside its territory.

In the US, on the other hand, there has been a steady progression (at least at the federal level), easing some of the antitrust (competition law) restrictions applicable to franchising. Minimum price restraint was previously per se always illegal but as a result of changing case law (the US Supreme Court decision in the *Leegin* case being key) the federal courts will now apply a much looser 'rule of reason' analysis when deciding whether such price restraint should be permitted. By and large, vertical price restraints (eg, those imposed by a Franchisor on its franchises) will be okay but horizontal price restraints (amounting to a conspiracy amongst franchisees to fix prices) will still have a tougher time of it, even under a rule of reason analysis. In addition, states may still have their own antitrust statutes whereby setting any price restrictions whatsoever is still per se illegal in those states.

Australian competition law is apparently similar to the US approach and the primary principle applied in Australia is to recognise the parties' right to 'freedom of contract'.

Price restraint is of course just one of the issues affecting sales on the internet. If you cannot fix prices, what about imposing price differentials that requires selling at a higher price if sold online? In the EU, the guidelines to the Block Exemption have shut down that avenue since you cannot have higher prices on the internet than in a bricks and mortar location. In the US, the Robinson-Patman Act would prohibit pricing that favours stores as opposed to online, but there would still have to be a negative impact on competition for action to be taken. In Australia, on the other hand, it is unclear if dual pricing like this would be found to be 'against conscience' and therefore illegal.

Yet another issue is whether a Franchisor can impose quality restrictions on sales made online? This seems to be much less of an issue in all three jurisdictions. In the EU, imposing quality restrictions on online sales is just as permissible as it is for items sold in a store. And it would even be possible for a franchisor to require the use of a 'franchisor-provided' website as long it is commercially justified and it is not done solely to make it more difficult for franchisees to operate their own websites. In the US, a 'rule of reason' approach applies and there may be lots of legitimate reasons for imposing quality restrictions over online sales. This should also be permissible in Australia.

Is it possible to impose on franchisees a requirement that requires them to provide support for bricks and mortar stores? In the EU, the franchise agreement can require that the franchisee must have a physical outlet and that it must pay a certain percentage of its international sales to support its store(s). Both the US and Australia have a similar view of this issue.

Can a franchisor oblige its franchisees to use the franchisor's central website? In the EU, franchisees may be required to participate with a central site (including links). In Australia, according to Corinne, most franchise systems require franchisees to use a central website controlled by the franchisor. However, there may be separate pages for the franchisees to which consumers are directed. Mike advises that in the US, restrictions requiring franchisees to use the franchisor's central website would be judged under the rule of reason applicable to vertical restraints. The Franchisor would likely seek to support such restrictions as reasonably necessary to create a single unified image on the internet. The argument would be that the restrictions thereby enhance the brand and its positioning. And under a rule of reason analysis, in the US the restrictions would likely be upheld.

Can a franchisor restrict the use of a brand name in a domain name? This seems counter-intuitive, according to John. There is no reason for prohibiting use of the brand name in the EU as long as the franchisor owns the domain name. A franchisor in the US and in Australia can, however, restrict the use of a brand name in a domain name. Corinne advises that Australian franchisors typically impose very strict controls on the use of their brand name (typically this is a registered trademark) in their franchise agreements. Mike advises that in the US, restraints of this nature would likely also be upheld under the rule of reason analysis applicable to vertical restraints.

How about permitting a franchisor to sell its goods and services on the internet? While in the EU the Block Exemption is silent, one cannot stop a franchisor from having its own website. In the US, the key issue is to draft

the franchise agreement to reserve the right to sell online. However, there are some states that impose encroachment statutes restricting such reservations of rights and in certain industry sectors (eg, the auto industry) this would also be a regulated activity. In Australia, a franchisor would have to say in its franchise disclosure document that sales may be made by the franchisor online and it would have to state if profits are shared. A franchisor would not be able to sell in an otherwise restricted territory just because the sale is online.

Concurrent interactive workshops

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David and Goliath: legal issues in small franchisor/big franchisee international franchise deals and relationships

Session Chair
Pascal Hollander Hanotiau & van der Berg, Brussels

Speakers
Alessandro Barzaghi Cocuzza & Associati, Milan
Stephane Teasdale Dentons, Montreal

A very interesting topic was discussed in this workshop, namely, the situation where a franchisee is a larger company than the franchisor and the consequences of such an ‘unbalanced situation’ as a result of various legislation which protects the franchisee as the ‘weaker party’ of the contractual relationship.

Such circumstances may either exist from the beginning of the contractual relationship (eg, in the case of large franchisees in Middle Eastern countries) or arise during the performance of the contract, when the franchisee (or master franchisee) is very successful.

In the first case, when a small franchisor approaches a much larger potential franchisee (or master), the issue arose as to whether such a contract is subject to the application of a law requiring franchisors to provide prospective franchisees with pre-contractual information, and whether it should be exempted from providing such information or released from possible sanctions?

First of all, the answer would depend on what information the specific law requires be disclosed: in countries where the law only requires the franchisor to provide the prospective franchisee with some small amount of information concerning the franchisor, such as its trademark, its network etc, no particular problem will arise. The small franchisor will probably concentrate more in trying to negotiate a good contract with its counterpart.

On the contrary, this aspect could become more important in jurisdictions where the disclosure obligation is very burdensome and expensive for the franchisor, such as the US or Canada. In the US, special exemptions are provided both at a federal and at a national level, for those cases; however, during the workshop some US lawyers pointed out that those exemptions must be evaluated very carefully in order to be sure to avoid any risk.

Certainly information concerning the local market where the franchisee will be operating and developing the franchise may be more easily accessible for the franchisee than for the franchisor, especially in this ‘unbalanced’ situation.

During the discussion it was also remarked that in some civil law countries, franchisors not having complied with their disclosure obligations are only sanctioned if and to the extent that the franchisee proves that its consent was vitiated and that should the franchisor have correctly complied with its disclosure obligation, the franchisee either would not have concluded the contract or would have concluded it under different conditions. However, during the discussion, doubts were expressed on whether national courts would effectively exclude the application of those sanctions simply as a consequence of such an 'unbalanced situation'.

Moreover, in several jurisdictions sanctions are applied automatically in case of lack of provision by the franchisor of the pre-contractual information, without any further evaluation by national courts.

It is interesting to mention that pursuant to the Italian franchise law (Law No 129 of 6 May 2004), not only the franchisor but also the franchisee is bound by a disclosure obligation. Particularly, the last paragraph of Article 6 of Law 129/2004 provides that: 'The prospective franchisee (..) shall provide, in a timely, correct and comprehensive way, the franchisor with any information and data the knowledge of which is necessary or appropriate for the purpose of concluding the franchise agreement, even if such disclosure is not expressly requested by the franchisor.' Such a provision may be taken into consideration by small franchisors dealing with much larger franchisees.

Further topics were then discussed during the workshop. For instance, the difficulties for the smaller franchisor to negotiate the franchise agreement, particularly where the large franchisee tries to impose important modifications to the standard contract drafted by the franchisor.

The participants exchanged comments and experiences in this respect, also considering the extreme situation in which it becomes safer for the franchisor to step back from negotiations and walk away from the deal. An interesting piece of advice that came out of the discussion was to keep the negotiation as short as possible, otherwise the client would feel obliged to continue with the negotiation because it has already spent too much time and money on it, and it may end up accepting conditions that it should not have accepted.

Finally, the 'unbalanced position' of the parties often has implications on the subsequent phase of the performance of the contract. The participants exchanged views and experiences on situations where larger franchisees do not comply with their contractual obligations and on how difficult it is for smaller franchisors of foreign (and often far away) countries to enforce the contractual provisions.

Of course, each situation should be regarded on a case by case basis. Possible solutions may depend on the specific breach made by the franchisee, on the contractual clauses that the franchisor was able to negotiate, or on the country where the franchises are operating. In some cases, either a settlement or a transfer of the business could be negotiated, leaving termination as the solution of last resort.

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Players on the same team? Whether and how to work with counsel in other countries on cross-border franchise deals

Session Chair
Larry Weinberg Cassels Brock & Blackwell, Toronto

Speakers
Karen Satterlee Hilton Worldwide, McLean, VA
Olivia Gast Gast Avocats, Paris

This session provided an invaluable insight into how franchisors' internal counsel chooses local counsel and their expectations for them. While larger franchise systems tend to have more substantial internal legal departments with international expertise, the panel addressed several key topics for which internal counsel regularly seek outside/local guidance prior to entering a new market.

The first area the panel identified as one in which franchisors often need local counsel assistance is the use and protection of intellectual property. While systems may have secured certain intellectual property rights long before entering a particular market, when it is time to actually enter a market, systems often need assistance securing additional rights. This can be particularly important where language or cultural differences may affect the images and import of the trademark.

Next, the panel discussed the need for tax and corporate structure guidance. In particular, systems entering a new country need guidance on whether to franchise directly or use a master franchise relationship, whether to form a joint venture or other type of arrangement with a local master and how best to structure future development.

Third was the topic of payment and enforcement of system standards. The panel discussed how local counsel can play a valuable role in both helping franchisors have realistic expectations in these areas and structuring their offering to achieve maximum results with minimal controversies.

The panel then discussed the topics of choice of law/venue and dispute resolution. Here, the discussion focused on arbitration as the preferred means for dispute resolution, especially with master franchisors. This is the case because contract enforcement can often be quite difficult in local courts and may provide limited remedies. The panel also acknowledged how venue in particular may be more subject to negotiation than with US domestic franchises. Of course, these topics are also often subject to local franchise laws, which the panel also identified as a key area in which local counsel plays an essential role.

Next, the panel took up the topic of selecting local counsel. The first consideration they discussed is who should retain local counsel: the franchise system or its regular outside counsel. Each has its particular advantages and the outcome often varies from engagement to engagement. Once local counsel is selected, the next consideration is how work will be divided between them and regular counsel. This too often depends on the market at issue. While regular counsel may have more familiarity with certain jurisdictions and legal systems, expansion to certain jurisdictions will necessarily require more reliance upon local counsel.

Another key consideration in deciding how work gets assigned is determining who can get the deal done most efficiently. While all panellists were sensitive to not violating unauthorised practice of law regulations, most franchise systems have their regular outside counsel develop generic documents and expect local counsel to use these as a starting reference rather than develop agreements from scratch. Those generic documents,

however, may be of limited value when it comes to drafting a local disclosure document which the panel readily acknowledged would likely fall to local counsel to draft.

Finally, the panel discussed the criteria they use to select outside counsel. While the importance of each criterion varies from engagement to engagement, the key considerations are: (i) value for service; (ii) willingness and ability to prepare reasonable budgets; (iii) speed of service; (iv) ability to keep communications short and to the point; (v) problem solving ability; (vi) technology sufficient to interface with client's technology platform; and (vii) recognising that it is not all about winning, but rather reaching an acceptable business outcome.

Corporate counsel focus: encroachment issues around the world

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Session Chair
Jane LaFranchi Marriott International, Inc, Bethesda, MD

Speakers
Rocío Belda de Mergelina Garrigues, Madrid
Erik H Karp Witmer, Karp, Warner & Ryan, Boston
Ted Pearce Nexsen Pruet, Charlotte, NC

Jane LaFranchi, Rocío Belda de Mergelina, Erik Karp and Ted Pearce hosted a workshop on the topic of encroachment issues.

The discussion focused on encroachment which the highly experienced Ted Pearce suggested may be defined as a franchisee's territorial exclusivity less sales rights reserved by the franchisor.

Ted Pearce explained that 'in the old days' it was quite common that franchisees were granted a territorial exclusivity in a specific radius from the franchise unit. However, today things have become more sophisticated and franchise agreements quite often contain elaborate and complicated provisions on rights of the franchisor to sell directly into the franchisees' 'exclusive' territory. Such rights include franchisors opening of new units in the 'exclusive' territory, sales through different channels (internet, etc) and sales through other systems/brands, for instance a franchisor's right to appoint franchisees of hotels of different brands in the same territory.

Quite often, a franchisee will suffer financially as a result of the above which, according to Erik Karp, is often described as a franchisor's right to system expansion. There are examples in case law where the courts have found that franchisors have gone too far in their 'system expansion' and have been found to be liable towards the franchisees.

There are various ways to deal with encroachment issues. Sometimes franchisees will have a right of first refusal with relation to new franchise units to be established in the territory. Also, franchisees may have a right to also sell their products or services over the internet (which right exists under EU competition law as so-called 'passive sales' as explained by Rocío Belda de Mergelina). More recently, encroachment is also handled through impact policies. As an example, Jane LaFranchi mentioned that Marriott had developed and implemented impact policies in the US through which you can calculate compensation to be paid to the franchisee based on the (calculated) impact on the franchisee, if any.

There was general consensus in the debate that transparent impact policies would be a relevant option to consider to balance the interest of the franchisees and franchisors.

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News from around the world

The second plenary session of the day brought us updates and news from Belgium, Brazil, Canada, Germany, Indonesia, South Korea and Turkey, as well as a presentation from the US Commercial Service.

Canada

Dominic Mochrie was the first speaker and reported on the forthcoming franchise law in the Province of British Columbia (BC), recent court decisions, and the now-effective Canadian Anti-Spam Legislation (CASL). Dominic reported that on 31 March 2014, the British Columbia Law Institute released its 'Report on a Franchise Act for British Columbia'. The BCLI recommended that BC enact a franchise law similar to legislation currently in effect in the provinces of Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island. There is no federal franchise legislation in Canada. Draft legislation is expected soon.

There were two recent cases decided in Ontario addressing issues related to disclosure and waiver. With respect to disclosure, the Ontario Court of Appeal made another decision in the *Springdale Pizza* case (2014 ONSC 530). In March, the court held that some disclosure may be so deficient as to be deemed as no disclosure at all. This holding opens the window to rescission to two years (as for no disclosure) rather than 60 days (defective disclosure). The court further held that franchisees are not responsible for providing disclosure documents to purchasers and franchisors cannot rely on any documents provided by selling franchisees to satisfy the franchisor's disclosure requirement. The court held that the resale exemption to franchisor's disclosure requirement will be narrowly limited to circumstances where the franchisor is minimally involved and the transfer is not affected by or through the franchisor.

In the *Cora Franchise Group* case (2014 ONSC 600), the court held that a general release required by a franchisor in exchange for the franchisor's consent to the franchisee's assignment of its franchise agreement was void. The Arthur Wishart Act (AWA), Ontario's franchise law, makes void any provision that purports to waive a franchisee's rights arising under the AWA. The franchisor in *Cora* argued that the release was meant to waive only the franchisee's non-AWA claims but the court disagreed, finding the 'general release' was too broad as drafted and therefore void as a violation of the anti-waiver provisions of the AWA. This decision is under appeal.

Dominic gave an update on the Canadian Anti-Spam Legislation (CASL) that came into effect on 1 July 2014. CASL requires senders of commercial electronic messages (CEM) to first receive permission from the recipients. CEM includes e-mail, text messages and instant messages. The law also requires senders to clearly identify the sender, provide contact information for the sender, and allow for a simple unsubscribe mechanism so recipients can later opt-out if they so choose. The law does have extra-territorial application because CEM includes messages sent from or to a computer system accessed in Canada.

Brazil

Luciana Bassiani gave an update on Brazil's new Anti-Corruption Act and its impact on franchising. The Act became effective on 28 January 2014 and allows for the imposition of civil liability on individuals as well as entities for the corrupt acts of their employees. The Act imposes strict liability for legal entities regardless of intent or fault.

The ACA prohibits giving unjust advantage to domestic or foreign public officials or related third parties. Prohibited acts include actual payments or giving undue advantage to public officials or related third parties. The ACA imposes sanctions for violations including:

- fines of 0.1 per cent to 20 per cent of gross revenues;
- listing the company as a 'punished company';
- piercing of the corporate veil to implicate managing officers for punishment and fines;
- penalties may be reduced for self-reporting or cooperation (can reduce fine by up to two-thirds); and
- franchising companies should be aware and protect themselves with clear codes of conduct and training on correct conduct with public officials and include direct reference to compliance with local anti-corruption laws in franchise and other distribution agreements.

Germany

Dr Dagmar Waldzus gave us an update on a couple of recently-decided cases, but first provided a framework for understanding these latest trends. Germany is a civil law country and has no franchise law legislation; however the German Civil Code obligates all contracting parties to act in good faith: 'an obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration.'

While there are no statutory pre-contractual disclosure requirements, guidelines for pre-contractual franchise disclosure or communications come from other commercial areas of law such as M&A, consumer protection, product liability and franchise law. Additionally, the Code of Ethics of the German Franchise Association applies to all members.

Over time, there has developed a list of 'must have' disclosure items before a franchisor contracts to sell a franchise in Germany, including how the system works, 'know-how' relevant to the operation of the business, major obligations of the franchisor, any lack of protection of essential intellectual property rights, sufficient evidence of successful pilot operations, franchisee's costs and capital requirements, and franchisee's required commitment to work. Other disclosures are required and depend on the proposed location of the franchised business, profitability prospects, pending litigation if the outcome might determine the franchisee's potential for success, and clarification of statistical projections if requested by the franchisee.

In recent years, courts in Germany have provided further guidance about the type of disclosures franchisors should be giving. In 2011, the Higher Regional Court of Hamm held that profitability forecasts must take into consideration the franchisee's planned location. In 2013, the Higher Regional Court of Dusseldorf held that franchisors must present data and information sufficient to permit the franchisee to create a realistic forecast of the profitability of the proposed franchised business. The franchisor need not provide calculations for profitability, but it must provide relevant and current data; old data is not sufficient. The courts will hold experienced franchisors to a higher standard, requiring more information from more experienced franchisors.

A franchisor considering entering the German market should be well aware of these pre-contractual obligations, despite the fact that Germany has no statutory franchise law.

South Korea

Will Woods gave an update on the 14 February 2014 amendments to the Korean Fair Franchise Transactions Act. A few of the changes that took effect in February are retroactive and will apply to contracts already in place at the time of the amendments.

Retroactive amendments include:

- franchisors must have 'just cause' to require upgrades or improvements to franchised locations;
- franchisors are required to share the cost of required upgrades: 20 per cent if relocation or expansion is not required, 40 per cent cost share if relocation or expansion is required; and
- franchisors are prohibited from requiring franchisees to operate their business during hours that are deemed 'unreasonable', and a franchisee may reduce their hours under certain circumstances, including illness that prevents the franchisee from operating the business during night time hours.

Contracts entered into on or after 14 August 2014 will require the franchise agreement adequately describe the franchisee's 'business territory'. The franchisor is also obligated to provide certain territorial protections by refraining from granting additional franchises or opening company locations within the described territory. This requirement applies to all franchisors regardless of whether they have provided any kind of protected territory in the past.

Indonesia

Will Woods also gave an update on the August 2012 Regulation issued by the Indonesia Ministry of Trade. The 2012 Regulation is intended to protect local businesses, promote the sale of locally made products, and close loopholes that allowed franchises to operate under improper business licences.

Key changes to the law include:

- prohibiting the franchisor from granting franchises to affiliates;
- requiring at least 80 per cent of the raw materials or inventory sold by franchisees be locally made;

- franchisors must include a description of sourcing materials when making an application to obtain its franchise business registration certificate;
- the primary operations of the franchised business must match the technical operating licence;
- the franchised business must display a special logo issued by the MOT to registered franchisors and franchisees to indicate the business is properly licensed; and
- franchisors are prohibited from appointing a new franchisee if the prior franchisee's agreement was terminated prior to expiration unless the early termination was mutual or the franchisor receives a court order.

Belgium

Pascal Hollander reported updates on the 2014 amendments to the Belgian Law on Pre-Contractual Information regarding Agreements to Form a Commercial Business Relationship. The amendments took effect on 31 May 2014 as part of the new Belgian Economic Code, and apply to contracts entered into or modified after 31 May. The existing law required franchisors to provide franchisees with pre-contractual disclosures at least one month before the execution of the franchise agreement. Failure to deliver the required disclosures allows the franchisee a two-year rescission period. The amendments made a few material changes to the existing law:

- franchisors are required to give pre-contractual disclosures to new franchisees but also a simplified disclosure document one month before renewing an existing franchise agreement or modifying an agreement that has been in effect for longer than two years;
- existing franchisees who do not receive a simplified disclosure document prior to renewing their agreement may now also request rescission; and if disclosure prior to renewal or modification is inaccurate or incomplete as to a material term, the franchisee may ask for rescission with respect only to those terms;
- franchisees may waive their right to rescission, but only after a one-month cooling off period has passed, and only if their waiver expressly states the grounds on which they would claim rescission;
- if the franchisor modifies the pre-contractual disclosures after they have been delivered to the franchisee, a new waiting period of one month begins at the time of the new disclosure; and
- contracting parties are now permitted to enter into a confidentiality agreement during the one month waiting period after the franchisor delivers the pre-contractual disclosures.

Turkey

Dogan Eymirlidglu made an unscheduled presentation to the group on a recent court of appeals decision that creates uncertainty regarding disclosure requirements in Turkey. Like other civil law countries, Turkey does not have franchise legislation. Mr Eymirlidglu explained that a recent court decision adopted the disclosure guidelines of the Turkish Franchise Association, a private trade group. The concern is that the decision may create a new legal obligation of requiring franchisors to give pre-sale disclosure to franchisees that did not exist under existing law.

US Commercial Service

Ryan Kanne gave a presentation on the services available to US companies doing business outside of the United States. The US Commercial Services (USCS) has offices in over 108 US embassies and consulates in 72 countries. The mission of the USCS is to assist US business with trade counselling, market intelligence, business matchmaking, and commercial diplomacy.

Similar assistance is available to other nationals from government agencies such as the Canadian Trade Commissioner Service, the UK Trade & Investment Agency, Austrade and APEX-Brasil.

Post expiration and termination issues in master franchising: The fate of the unit franchises and other issues

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Speakers
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Leonard Polsky of Gowling LaFleur Henderson in Vancouver moderated a session by Mark Abell of Bird & Bird, London, Ruby Asturias of Pacheo Coto, Guatemala and Sun Chang of Lee & Ko, Seoul, South Korea looking at the issues which arise when a master franchise agreement terminates or expires. What happens to unit franchisees that are 'orphaned' by the death of the primary contract and how can the franchisor protect its brand and its business in the territory?

If the relationship between a franchisor and master franchisee deteriorates leading to a termination of the master agreement or the agreement expires, there is often no direct link – whether legal or practical – between the franchisor and the unit franchisees. The first issue that the panel addressed was whether the master franchisee's company-owned or affiliate owned units would expire or be terminated. The answer depends on whether the units operate under the terms of the master franchise agreement or under separate unit franchise agreements and whether there are any cross default mechanisms written into the agreements. Without careful thought and drafting, the rights to operate the units may subsist notwithstanding the termination/expiry of the master franchise agreement.

If the master franchise agreement ends in an orderly way, then both parties are able to cooperate in negotiating the terms of the wind down of the master franchisee's business. However, if one of the parties disputes the termination, the situation may be far more problematic. Whilst each of the panellists examined the legal positions in their respective jurisdictions, the overall conclusion was that there will undoubtedly be issues unless the agreements are carefully thought through and drafted, the parties to the agreements work together to find a solution to their issues and any exit is agreed as far as is practicably possible.

How does the franchisor preserve the franchise system and the brand in the territory?

Once the master franchise agreement has been terminated, the franchisor has to consider how it will protect both the existing franchise system and its brand. Whilst local laws vary, in each of the jurisdictions represented by the speakers, the first step is to look at what the master franchise agreement and unit agreements state. In each of the jurisdictions represented the parties have a fairly wide degree of contractual flexibility to agree what will happen when the master agreement comes to an end and it is important that they do so as there is no guidance from statutes or franchise regulations.

When negotiating and drafting both the master and unit franchise agreements, the franchisor needs to consider carefully with its advisors and local counsel what rights it wishes to have at the end of the master agreement. Does it want to have step in rights to enable it to step into the shoes of the master franchisee and take on responsibility for the orphaned unit franchisees or does it want all rights of the unit franchisees to terminate automatically when the master agreement comes to an end? Sometimes it can be difficult to decide at the outset of the relationship what is going to happen when it comes to an end but it is vital that the issue

is carefully considered by the franchisor so as to be prepared. The speakers stressed that these rights need to be included in the unit franchise agreements, not just the master franchise agreement, otherwise the rights will not be binding on the unit franchisee. Whilst the franchisor will not normally be a party to the unit franchise agreement, as a named third party beneficiary of certain rights, the franchisor will (in all the speakers' jurisdictions) be able to enforce those rights against the unit franchisee.

Alternative options prior to termination

Termination is regarded as the last resort; if provisions are made in the master franchise agreement, discussions and mediation can be used to try and resolve issues which arise.

The speakers also discussed the use of alternative options to termination which can be drafted into the agreement to deal with underperformance issues. Such options can include the franchisor's right to reduce the size of the territory, make the territory non-exclusive, offer direct support to unit franchisees in return for a share of the franchisee fee, and minimum performance requirements setting the required number of outlets and/or product purchases.

Conclusions

The speakers agreed that in an ideal world, the wind down of a master franchisee's business will be agreed and the parties will be open and transparent with each other and will work together to ensure the continued success of the franchise business in the territory. Whilst that can sometimes be achieved, well advised franchisors should carefully consider these issues when drafting and negotiating master and unit agreements and should work with local counsel in the relevant jurisdiction to ensure that their intellectual property rights and interests in the territory are properly protected in the event of a non-amicable end to the relationship.

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Amendments to the Australian Franchising Code of Conduct

On 4 January 2013, the Federal Government announced a review of the Australian Franchising Code of Conduct ('Code') by franchising expert Alan Wein. The purpose of this review was to determine how to enhance the Code to better serve Australia's franchise systems. The Wein Report was presented to the Government on 30 April 2013 and made 18 recommendations. The recommendations were for the most part directed at policy issues, although there were some specific wording changes proposed. On 17 June 2013, the government welcomed the recommendations and announced a consultation process with key stakeholders to assess the regulatory impact of the proposed amendments to the Code.

On 2 April 2014, the Federal Government produced an exposure draft of the revised Code for comment ('Exposure Draft'), accompanied by a statement from the Minister for Small Business, the Hon Bruce Billson MP, entitled 'The Future of Franchising'. The amendments to the Code are scheduled to take effect on 1 January 2015, however it is envisaged that there will be further amendments following public submissions on the Exposure Draft and a final version of the revised Code is likely to be produced in October or November 2014.

This article focuses on some of the key amendments to the Code set out in the Exposure Draft. It also comments on the introduction of the Motor Dealers and Repairers Act 2013 in NSW and the Federal

Government's recent proposal to extend the unfair contract term protections for standard form consumer contracts under the national Australian Consumer Law to cover small businesses.

Amendments to the Code

The revised Code will apply to franchise agreements entered into, renewed or extended on or after 1 January 2015. Existing agreements will continue to be regulated by the current version of the Code until renewed or extended.

Master franchise arrangements

A key area of reform for international franchising systems is the removal of the double disclosure requirement for master franchise arrangements. Under the revised Code, a master franchisor need not comply with the disclosure requirements in part 2 of the Code, in relation to a subfranchisee. This means that where a subfranchisor grants a franchise to a subfranchisee, only the subfranchisor will need to provide disclosure to the subfranchisee, not the master franchisor. Currently, both the subfranchisor and the master franchisor are required to provide disclosure (separately or by way of a joint disclosure document). This requirement currently applies to all master franchisors including those domiciled outside of Australia, notwithstanding that the master franchise agreement may be subject to the laws of a country other than Australia.

The Minister for Small Business has noted that 'this will reduce the unnecessary compliance burden which exists in multi-tiered systems.'

Disclosure of online trading

Franchisors will be required to disclose whether they, an associate, the franchisee or other franchisees may make goods or services available online.

If goods or services may be made available online by the franchisor, an associate of the franchisor or other franchisees, the franchisor would also need to disclose:

- the extent to which those goods or services may be supplied into the territory of the franchise; and
- in the case of goods or services made available via a third party website, the domain name or URL of the third party website and full registration details of the domain name.

If goods or services may be made available online by the franchisee, the franchisor would also need to disclose:

- the extent to which those goods and services may be supplied outside the territory of the franchise; and
- whether the franchisee must supply goods or services sold by the franchisor, and if so, the terms and conditions on which that supply must be made.

A franchisor would also be required to disclose:

- details of whether goods or services may be made available online via a third party website, and if so, whether any conditions or restrictions apply to the use of the third party website;
- details of whether the franchisor requires the franchisee to enter into an agreement with a third party in relation to making goods or services available online; and
- details of any profit sharing arrangements that apply in relation to goods or services made available online and whether these arrangements may be unilaterally changed by the franchisor.

Currently, there is no disclosure requirement in the Code dealing specifically with online sales, although depending upon the arrangements in place, some arrangements may be caught by more generic disclosure provisions (for example, if a franchisee is required to obtain IT services from the franchisor). The new disclosure requirements would impose far more onerous and detailed disclosure requirements upon franchisors and, given the detail required, would require franchisors to develop a consistent and comprehensive policy in order to meet those disclosure requirements.

Good faith

The Exposure Draft includes an express obligation for each party to a franchise agreement to act towards another party with good faith in respect of any matters arising under or in relation to the franchise agreement and the Code. It is expressly noted that this includes an obligation for a person:

- to act honestly and not arbitrarily; and
- to cooperate to achieve the purposes of the franchise agreement.

It further provides that the obligation to act in good faith also applies to a person who proposes to become a party to a franchise agreement in respect of:

- any dealing or dispute relating to the proposed agreement;
- the negotiation of the proposed agreement; and
- the Code.

A civil penalty of 300 penalty units applies for a breach of the good faith provision.

The Franchise Council of Australia has commented that the good faith provision in the Exposure Draft 'does not reflect either the Wein Report recommendation, or what was understood to be the consensus position reached during the industry consultation.' While the Wein Report recommended that the Code be amended to include an express obligation to act in good faith, it noted that such an obligation should 'not be defined, [but that] instead the unwritten law relating to good faith should be incorporated in a manner similar to the unconscionable conduct prohibition set out in section 20 of the Australian Consumer Law'. The Franchise Council of Australia has commented that rather that inserting the common law duty which 'assesses good faith in the context of all relevant circumstances' the Exposure Draft introduces a 'new and different statutory duty'.

Minister for Small Business, Bruce Billson MP, has since noted that 'good faith' under the code 'will have the same meaning as in common law, but we will be providing some guidance for participants around what might be considered good faith.' Further amendments may therefore eventuate.

Marketing funds

In his statement releasing the exposure draft, the Minister for Small Business noted that the revised Code introduces 'greater transparency for the way in which marketing funds are used and accounted for.'

The revised Code requires franchisors to:

- maintain a separate bank account for marketing and advertising fees contributed by franchisees;
- contribute to the marketing fund in respect of company run stores, on the same basis as franchisees; and
- only use marketing funds to:
  - meet expenses that are:
    - specifically disclosed in the disclosure document;
    - legitimate marketing or advertising expenses; or
    - have been agreed to by the majority of franchisees;
  - pay the reasonable costs of administering and auditing a marketing fund.

It is yet to be seen whether these amendments will appear in the final version of the revised Code. Currently, there is no obligation for company owned stores to contribute to the marketing fund alongside franchisees, nor to maintain a separate bank account for marketing funds. The Franchise Council of Australia has noted that 'the proposed changes to the marketing fund provisions need to be considered in the context of the fact that the old Code and the new Code will need to coexist.'

Capital expenditure

Under the revised Code, a franchisor must not require a franchisee to undertake significant capital expenditure in relation to a franchised business during the term of the franchise agreement. The following are, however, specifically excluded from the definition of significant capital expenditure:

- expenditure that is disclosed to the franchisee in the disclosure document before entering into, renewing or extending the scope of the franchise agreement;
- expenditure incurred by all or a majority of franchisees and approved by a majority of franchisees;
- expenditure incurred by the franchisee to comply with legal obligations;
- expenditure agreed by the franchisee; and
- expenditure that the franchisor considers necessary as capital investment in the franchised business, justified by a statement of the following:
  - the rationale for making the investment;
  - the amount of capital expenditure required;
  - the anticipated outcomes and benefits; and
  - the expected risks associated with making the investment.

The Minister for Small Business has noted that the amendments are intended to '[e]nhance protections for franchisees against significant capital expenditure imposed by franchisors.' Nonetheless, provided a franchisor discloses the capital expense in the disclosure document, the reforms will not prevent franchisors from requiring franchisees to pay for capital expenditure items such as store fits outs.

Restraint of trade

A particularly contentious amendment to the Code has been the introduction of a new provision providing that a restraint of trade clause has no effect after the agreement ends if:

- the franchisee has sought to renew the agreement on substantially the same terms;
- the franchisee was not in breach of the agreement;
- the franchisee has not infringed the intellectual property of the franchisor during the term of the agreement;
- the franchisor does not renew the agreement; and
- the agreement does not allow the franchisee to claim compensation in the event the agreement is not renewed, or the compensation given was merely a nominal amount and did not genuinely compensate the franchisee.

The Franchise Council of Australia has recommended that the provision allowing the clause to be triggered where a franchisee claims compensation, but is given only a nominal amount that does not genuinely compensate the franchisee, be deleted. It notes that it would mean that if a franchisee claims compensation for non-renewal even where there is no right of compensation and the franchisor denies the compensation, the franchisee is not bound by the restraint. This, it noted 'is not what the Wein Report intended.'

The Franchise Council of Australia also notes that the clause 'should apply on renewal, but not on "extension" being at the end of the period when the franchisee's rights have expired.'

Restraint of trade provisions are a key component of most franchise agreements and form an integral part of protecting franchise networks from the misuse of confidential information by current and former franchisees. Nonetheless, it is likely that the proposed reforms will proceed, subject to some amendments to address the risk of the provision being abused by franchisees.

Penalty regime

A significant feature of the revised Code is the introduction of pecuniary penalties of 300 penalty units for a wide range of breaches. In order to allow for the imposition of pecuniary penalties in this manner, the government introduced the Competition and Consumer Amendment (Industry Code Penalties) Bill 2014 into parliament on 17 July 2014. The Bill amends the Competition and Consumer Act 2010 to allow:

- an industry code (such as the Code) to prescribe pecuniary penalties not exceeding 300 penalty units for civil penalty provisions of the industry Code; and
- the ACCC to issue infringement notices of 50 penalty units for a body corporation and ten penalty units in any other case, where it has reasonable grounds to believe a person has contravened a civil penalty provision of an industry code, as an alternative to issuing proceedings for an order under section 76 for the payment of a pecuniary penalty.

The Minister for Small Business noted that allowing the ACCC to issue infringement notices for breaches of the Code 'adds increased flexibility and agility to the regulator's enforcement armoury' and 'allows breaches to be dealt with in a time and cost-efficient manner without the need for a court order in appropriate circumstances.'

The Franchise Council of Australia initially expressed concern as to the extent of the pecuniary penalties in the Exposure Draft, noting that there was ' no distinction between fundamental breaches, and trivial breaches' and that 'penalties have been introduced in areas where they are totally inappropriate' such as mediation. The government appears to have taken this feedback on board and in his second reading speech for the Bill, Minister for Small Business Bruce Bilson MP specifically noted that '[p]ecuniary penalties will only apply to provisions of the franchising code that are fundamental to the purpose of the code and where noncompliance is likely to cause significant detriment to the other party.' All eyes will be on the final version of the revised Code when it is introduced later in the year to determine which provisions will be subject to pecuniary penalties.

Other legislative developments

Franchising has been the focus of particular legislative scrutiny in recent times. At the end of 2013, NSW introduced the Motor Dealers and Repairers Act 2013 which was ostensibly legislation to modernise the regulation of the sale and repair of motor vehicles at the dealer level. The NSW government's decision to push through part 6 of the Act came as a surprise to many in the automotive industry, who expressed serious concern about its far reaching implications. Part 6 of the Act prohibits

'unfair' provisions in a 'supply contract' and 'unjust conduct' that 'occurs in connection with a supply contract and is dishonest or unfair' or is 'authorised by an unfair term of a supply contract.' Under that Act, a supply contract is 'unfair' if:

- it would cause a significant imbalance in the parties' rights and obligations under the contract; and
- it is not reasonably necessary in order to protect the legitimate interests of the party who would be disadvantaged by the term; and
- it would cause detriment (whether financial or otherwise) to a party if it were to be relied upon.

Part 6 of the Act goes on to provide examples of 'unfair' contract provisions, which include terms that permit one party but not another to terminate the contract, penalise a party for breach of contract, vary the contract, or vary the goods to be supplied under the contract. The nature of dealer arrangements is such that most dealer sales and service agreements include these types of terms to cope with innovation and developments in and changes to product ranges and operating policies. In NSW, it may now be necessary to have a negotiation with individual dealers each time a manufacturer wants to implement such a change.

The Federal Government has also announced that it is committed to extending the unfair contract term provisions for standard form consumer contracts within the national Australian Consumer Law to cover contracts with small business. Currently, these provisions render unfair terms in standard form consumer contracts void. The Federal Government has issued a consultation paper and submissions were due to close on 1 August 2014. It is understood that the proposed legislation may apply generally to franchise agreements. At this stage there is no draft legislation and only a consultation process. However, there is real concern amongst the franchise community that unfair contract term legislation will be introduced in a business to business context.

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Pre-contractual information obligations in France relating to franchise agreements

Before 1986, all was quiet on the franchising front as there was no specific domestic nor European legislation on franchising. Business was booming. In France, franchise agreements and litigation on franchising were dealt with according to French Civil Code and the law of contracts and there was no need for a specific legislation.

Suddenly, the *Pronuptia* case caused an uproar in Europe: a German lower court held that all common franchising contractual provisions in the *Pronuptia* franchise agreement were anti-competitive under Article 85(1) of the Treaty of Rome of 1957. The franchisor appealed the decision to a German court of appeal which referred the matter to the European Court of Justice under Article 177 of the Treaty.

In a landmark ruling dated 28 January 1986, the European Court of Justice held that franchising was *sui generis* and that Regulation No 67/67/EEC of the Commission of 22 March 1967 was not applicable to distribution franchise agreements.[1] After this ruling, five decisions exempting franchise agreements were notified by the European Commission to Yves Rocher, Computerland, Charles Jourdan, Service Master and Pronuptia. In addition, the first Block Exemption Regulation for categories of franchise agreements was adopted by the European Commission on 30 November 1988 effective from 1 February 1989.[2]

The focus was on franchising: France was the very first country in the Western World,

years after the United States, to adopt on 31 December 1989 a law on pre-sales disclosure implemented by a Decree of 4 April 1991, applicable to all new agreements entered into since 8 April 1991.[3] The law is now incorporated under Articles L330.3 and R330-1 of the French Code of Commerce.

This disclosure obligation was the result of the work of a group of franchise experts appointed in 1984 by the French Minister of Commerce. The committee's work had stressed the importance and necessity of pre-sales disclosure by franchisors to franchisees before the execution of any agreement and the necessity to enact new legislation on that point. The fact is that franchise networks had filed for bankruptcy in the previous years and that there was a call for action both from franchisees and franchisors to adhere to good market practices.

Other European countries (Belgium, Spain and Italy, to name but a few) went on with their own specific franchise legislation in the years following.

A quarter of a century after the *Loi Doubin*, this article will address:

- the pre-sales disclosure obligations of the franchisor in France; and
- the implementation of this legislation by French courts.

The pre-sales disclosure obligations of the franchisor

The law

Article L330.3

Any person who grants to another person the licence to use a trade name, a trademark or a logo, subject to the commitment of exclusivity or quasi exclusivity for the exercise of the latter's activities shall, prior to the execution of any agreement negotiated in the two parties' mutual interest, furnish to the other party a document giving honest information permitting the other party to make an informed decision.

This document, the contents of which shall be provided for by a decree shall contain, among other things, information on the age and the experience of the licensor's business, the status and the possibilities of growth of the market, the importance of the retail network, the term, renewal, termination and conditions of transfer of the agreement and the scope of any exclusivities granted.

When payment of any monies shall be demanded prior to the execution of the agreement hereabove mentioned especially in order to be granted the rights of exclusivity of a territory, the undertakings made in consideration of such payment shall be described in writing as well as the reciprocal obligations of the parties in case of forfeiture.

The document provided for under paragraph 1 as well as the proposed agreement shall be delivered at least 20 days before the execution of the agreement or, if the case arises, before payment of the monies described at the paragraph hereabove.

Article R330.1

The document contemplated by the first paragraph of Article 1 of the law of 31 December 1989 cited above must contain the following information:

First, the address of the principal office of the undertaking and the nature of its activities with a description of its legal form and the identity of the principal manager if the enterprise is unincorporated, otherwise, the principal management personnel if the enterprise is a legal entity; where applicable, indicate the total capital of the enterprise.

Second, the registration number of the enterprise on the Commercial and Companies Register or on the Registry of Independent Entrepreneurs, as well as the date and registration or application number of the trademark and, in the case where the mark which is the subject matter of the contract was acquired by assignment or licence, the date and corresponding record number of the National Trademarks Registry, including in the case of trademark licence arrangements, the period for which the licence was granted.

Third, the address(es) of the bank(s) used by the enterprise. This information may be limited to the five principal banks used by the enterprise.

Fourth, the date of the founding of the enterprise with a summary of the principal developments during its history and the history of its network of licensees, where applicable, as well as all information necessary to assess the business experience of the enterprise or its management.

The information mentioned in the preceding paragraph may be limited to the five years immediately preceding the year during which the document is delivered. This information must include a description of the market in general and

the local market for the goods or services which are the subject matter of the contract and a description of the prospects for the development of the market.

There must be annexed to this part of the document the annual financial statements for the last two fiscal years or, for companies authorised to offer shares or debt obligations to private individuals, the reports prepared for the last two years pursuant to the third paragraph of Article 341-1 of Law No 66-537 of 24 July 1966 on commercial companies.

Fifth, a description of the network of licensees which must include:

- A list of the firms which are members of the network with, for each one, an indication of the operating method agreed upon.
- The addresses of the firms in France with which the party proposing the contract is linked by contracts of the same type as the proposed, along with the date of signature and renewal for each one of those contracts.
- Where the network consists of more than 50 firms, the information required pursuant to the preceding paragraph is only required for the 50 firms which are closest to the location of the proposed new operation.
- The number of firms which were members of the network under contracts of the same type as that proposed and which have ceased being members of the network during the year preceding that during which the document is delivered. This document must state whether the contract expired or whether it was cancelled or voided.
- If applicable, the presence in the trade zone of the outlet contemplated by the proposed contract of each establishment which offers, with the express permission of the party proposing the contract, the goods or services which are the subject matter of that contract.

Sixth, a description of the term of the proposed contract, the conditions for renewal, termination and assignment as well as the scope of any exclusivity.

Furthermore the document must describe the nature and amount of expenses and capital investment related to the particular trademark licensed which the recipient of the proposed contract must make before commencing operation.

Article 2

Any person who puts at the disposal of another person a trade name, trademark or commercial symbol, while requiring from such other person a commitment of exclusivity or quasi-exclusivity with respect to the conduct of such other person's business without delivering to such other person, at least 20 days prior to signature of the contract, the disclosure document and the draft contract mentioned in Article 1 of the Law of 31 December 1989 described above, shall be subject to fines applicable to fifth class offences.

In the case of a repeat offence, the fines contemplated for the repeated commission of fifth class offences shall apply.

The author's comments based on his business practice

The *Loi Doubin* is applicable to the pre-contractual period of all forms of distribution and licensing agreements (distributorship, agency agreements, etc) and not only to franchise agreements, when exclusive rights are granted; nevertheless, it does not supersede EU legislation which, for the time being, does not envision pre-sales disclosure.

The law is applicable when the use of a trade name, a trademark or a logo is granted. The French word '*marque*' includes both trade and service marks. Needless to say, it makes clear the importance of prior registration in France or in the EU of such a mark or logo.

It is applicable to all franchisors, whether natural persons or corporations, whatever their country of incorporation and/or of origin, and whatever the type of agreement used, as a matter of public order. More and more foreign companies entering the franchising business have a tendency to comply with the disclosure document obligation, 'just in case'.

There is no official form of disclosure 'document' which must give the information listed under R330.1 and provide the exhibits required. It is strongly advisable that: (i) all information and documents given be protected under a secrecy and non-disclosure agreement; and (ii) if no agreement is entered into, such documents be returned to the offering party. It is highly recommended that the document be in French for clarity purposes should the matter be brought to French courts even if French judges understand foreign languages.[4]

There is no requirement of any registration of the disclosure document with any third party, and no government agency has been established for that purpose. This is important as it means that no competitor may have access to confidential information given by its own competitors to candidates. It is then

up to the parties to give evidence in court, if necessary, that such information was given in writing 20 days prior to the execution of the agreement. The word 'day' is referring to *a calendar* and not *business* day. It is strongly recommended that proof of date of delivery and of delivery of the document to the candidate be kept by all means (registered letter with recorded receipt, personal notification, etc).

Non-compliance with the information disclosure is a criminal offence punishable by a fine from €458 to €915 and/or imprisonment from ten days to one month. In the case of a repeated offence, the offence is punishable by a fine from €915 to €1,830 and/or imprisonment from one to two months, at the request of one of the parties or of the prosecutor's office.[5]

As we will see hereunder, other remedies of a civil and commercial nature (claims for damages, cancellation of agreement, etc) are not excluded by law, according to Articles 1101 to 1369-11 of the French Civil Code.

Implementation of this legislation by French courts

Under Article 3 of the French Civil Code, judges may not give decisions which set a binding precedent. Although courts cannot be bound by previous rulings, they may rule on the basis of prior holdings where there is a strong link between the principle and the resolution of the case. The following is a very small selection of published court cases showing that the courts are making a case by case basis appreciation of the merits of the matter.

Is the Loi Doubin applicable to international transactions?

There are only two, but contradictory, court decisions:

- *No*: On 30 November 2001, the Court of Appeal of Paris ruled that Article L330-3 is not applicable to an international franchise agreement governed by Spanish law.
- *Yes*: Ten years later, on 25 October 2011, the same Court of Appeal of Paris ruled that, on the contrary, Article L330-3 was applicable as a matter of public order to an international franchise agreement governed by the law of Québec.

When should the pre sales disclosure document be given?

'The legal disclosure obligations must have been met at the time when the parties have reached an agreement, which may be at the time of execution of the agreement. This is when the statutory deadline must be assessed'.[6]

'A Party cannot combat the implementation of Article L330-3 by claiming to have given all documents required by law when this was done a few months after the execution of the agreement'.[7]

Nevertheless the court always verifies if the lack of information (ie, the lack of the disclosure document) was misleading to the other party. Quite often, it will rule that 'the lack of information has no consequence on the validity of the agreement if the distributor hasn't been misled'.[8]

What kind of information should be given?

'The law does not ask the franchisor to make a market study and it is up to the candidate to make his own analysis, but when the franchisor makes such a market study, it must make a sincere presentation of the local market, according to Article L330-3 of the Code of Commerce'.[9] In other words, the franchisor should not volunteer to give more information than what is legally required.

'The lack of delivery of "important information" on the return on investment does not justify cancelling the contract as the distributor (ie, the franchisee) was an expert in its field and had been able to appreciate the risks of such a business'.[10]

'Lack of communication of easily accessible and insignificant information has no consequence on the distributor's consent. Where lacking information on the bank, which cannot seriously be considered as invalidating the consent of the franchisees and the audited accounts, a copy of which could be ordered at the local register of commerce'.[11]

On the contrary, a franchise agreement can be terminated when the pre-sales disclosure document gave a vague and imprecise presentation of the franchise and did not give any information on the situation of the local market.[12]

Conclusion

The *Loi Doubin* has not led the French franchise community to the catastrophe that Cassandras were predicting back in 1989: too much 'confidential' information given to competitors, too much time wasted to issuing needless documents, money wasted on useless information, etc.

On the contrary, one of its merits, if any, has been the obligation for the franchise industry to make an analysis or a reassessment of their business models. After all, isn't giving 'honest information permitting the other party to make an informed decision' a good way of doing business?

Notes

1 Case 161/84, 28 January 1986 ECJ – *Pronuptia de Paris Gmbh Frankfurt am Main v Pronuptia de Paris Irmgard Schillgallis Hamburg* (ECJ).
2 Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Art 85(3) of the Treaty to categories of franchise agreement.
3 Law No 89-1008 of 30 December 1989, '*relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social*' (OJFR 2 January 1990, 9), nicknamed '*Loi Doubin*' from the name of the Minister of Commerce who introduced it to parliament.
4 French is the official language of the French Republic and the use of the French language is recommended in business dealings (Law No 94-665 of 4 August 1994 on the use of the French language) .
5 Based on the available case law information, this criminal aspect of the law has never been enforced.
6 Cour de Cassation Chambre Commerciale 17 July 2001.
7 Cour de Cassation Chambre Commerciale 25 September 2007 No 05-20922.
8 Court of Appeal of Paris, 7 July 1995, Cour de Cassation Chambre Commerciale 10 February 1998; Cour de Cassation 21 November 2001.
9 Cour de Cassation Chambre Commerciale 19 January 2010 No 09-10980; Cour de Cassation Chambre Commerciale 27 April 2011 No 10-15436.
10 Cour de Cassation Chambre Commerciale 7 July 2004.
11 Cour of Appeal, Toulouse, 26 January 2006.
12 Cour de Cassation Chambre Commerciale 6 May 2003 No 01-00515.

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Franchising and competition laws: Canadian, US and European approaches

Franchising is prone to certain types of potentially anti-competitive behaviour, largely due to an inequality of bargaining power between franchisors and franchisees and the high degree of franchisor discretion found in franchise contracts. There are powerful economic incentives for franchisors to extract unearned rents from franchisees. As more and more franchisors expand internationally, what is legal under the competition laws of one jurisdiction may be offside in others. In some cases the behaviour relates to franchisors and their franchisees; in other cases it involves franchisors and consumers, or franchisors and suppliers. In this article, the author examines how common franchising activities are regulated under the competition laws of Canada, the United States and the European Union.

Contractual framework

Franchise relationships are governed by written contracts between franchisors and individual franchisees. These agreements generally take the form of licence agreements with many controls on how the franchisee may operate. Franchise agreements are usually offered on a take-it-or-leave-it basis with little room for the franchisee to negotiate. Whether by choice or by necessity, franchisors reserve a high degree of discretion in the agreements. Areas of franchisor discretion may include the right to set the products and prices on offer, the right to manage lists of approved suppliers, and the discretion to offer a franchisee a new agreement when its previous term comes to an end.

There are generally considered to be two varieties of franchising: product franchising and business format franchising. Competition law concerns will vary depending on the type

of franchise in question. Product franchising describes arrangements where a manufacturer grants an independent dealer the right to sell its product. In addition to being granted the right to purchase the product, the dealer/franchisee is granted certain other rights such as the right to use the manufacturer's trademarks. Business format franchising describes arrangements where a franchisor has developed a successful, proprietary, and replicable method of doing business. The franchisor licenses the business system itself, together with the system's trademarks, to an independent franchisee. Controls over how a franchisee may do business are typically tighter in business format franchises since the 'product' is often a service, and consistency across the franchise system is essential to building and maintaining consumer goodwill.

Applicable competition laws

In Canada, anti-competitive acts are regulated under the federal Competition Act.[1] The equivalent statute in the United States is the federal Sherman Act,[2] and to a lesser extent the Clayton Act[3] and the Robinson-Patman Act.[4] Some states in the United States also have state competition laws that supplement or replace the federal acts.

Within the European Union, anti-competitive acts are governed at both the EU level and at the Member State level. Activities which affect trade between Member States are governed by Article 101 and 102 of the Treaty on the Functioning of the European Union (TFEU),[5] whereas matters affecting only one state are governed by that state's local competition laws. However, the European Court has in the past noted that franchise agreements are capable of affecting trade between multiple Member States, even if the franchisor and franchisees are all located within a single country, if the practices have an exclusionary effect.[6]

Uniform pricing

The most obvious area where franchisors run afoul of competition laws is in their treatment of franchisees. Franchisees are, in a sense, a captive market. Franchisors can therefore leverage their substantial discretion under franchise agreements to force franchisees to do things which, while they benefit for the franchisor, may be found to be at variance with the law.

Product pricing is an area that many franchisors seek to control. The franchisor may wish to control both the minimum amount that the franchisee may charge as well as the maximum amount which the franchisee may charge. This creates consistency across franchised locations. However, it also allows franchisors to effectively control a franchisee's profit margin (particularly if the franchisor also controls the supply of products).

In 2009, the Canadian Competition Act was amended and so-called 'price maintenance' was converted into being a reviewable practice.[7] Setting minimum or recommended prices in Canada is now only an offence if the conduct has had, is having, or is likely to have an adverse effect on competition in the market. The conduct may only be enforced by the federal government's Competition Bureau, and the Bureau only has powers to order the offending party to stop the practice, that is, they may not levy fines or impose jail time. It is not an offence in Canada to set maximum retail prices.

Since 2007, the United States has had a similar regime to Canada at the federal level at least. In the case *Leegin Creative Leather Products, Inc v PSKS, Inc*,[8] the Supreme Court reversed the longstanding doctrine which said that vertical price controls are illegal per se. Instead, vertical price controls are considered on a case-by-case basis using the 'rule of reason' approach. Under this rule, the fact finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. However, 16 states, including California and New York, have state laws under which resale price maintenance agreements continue to be illegal per se.[9]

Setting minimum or fixed retail prices in the EU is a serious offence, although setting maximum or recommended prices is generally permitted. Setting minimum or fixed prices for the resale of products is considered a 'hardcore' restriction under Article 4(a) of the Vertical Agreements Block Exemption,[10] and there is therefore a presumption of illegality. This can be contrasted with the federal law in both the US and Canada, where setting minimum prices is now legal unless the practice has an adverse effect on competition.

Territorial restrictions, tied selling and other non-price vertical restraints

Aside from setting the prices at which franchisees may resell products, franchisors may also wish to impose non-price restrictions on how franchisees may sell goods and services to the public. Common examples include allocating territories and obligating franchisees to enter into non-competition and exclusive dealing agreements. Another common practice is tied selling, where a franchisee is forced to purchase unwanted products (typically the franchisor's proprietary products) in order to gain access to a desirable product (the franchise rights themselves).

In Canada, vertical non-price arrangements and tied selling are reviewable by the Competition Bureau, and such practices will be prohibited if they have the result that competition is or is likely to be lessened substantially. Tied selling is generally only prohibited if it has an exclusionary effect on suppliers competing with the franchisor. In other words, the Act is concerned with other third party suppliers being blocked from selling to franchisees, not with the interests of the franchisees themselves. Accordingly, a franchisor would need to have substantial market power in order to attract liability, since without market share a single franchisor/supplier would not be able to have a significant effect on competition in the market as a whole.

In the United States, non-price vertical restraints are subject to the rule of reason. Restraints on intra-brand competition are generally held to be legal. The Supreme Court has recognised that restraints among franchisees in a system generally promote competition on the whole.[11] With respect to tied selling, absent market power on the part of franchisors, courts have held that it is not illegal to impose supply restrictions because franchisees generally receive disclosure of the purchasing restrictions prior to signing franchise agreements.[12]

In Europe, most types of non-price restraints are permissible because they fall within the Vertical Agreements Block Exemption. The approach in Article 101 of the TFEU is to impose a broad prohibition on all arrangements that could be considered anti-competitive, and then carve out specific 'block exemptions' for arrangements that are considered safe or pro-competitive. The types of restraints on trade found in most franchise agreements are generally made permissible by the Vertical Agreements Block Exemption so long as: (i) they are not minimum price restrictions; (ii) they are not restrictions on who a franchisee may passively sell to; and (iii) the franchisor's market share does not exceed 30 per cent. Non-competition covenants are only permissible if they are necessary to maintain the common identity and reputation of the franchised network.[13]

Rebates and supply arrangements

Depending on the industry, franchisors may seek to collect rebates from suppliers. Franchisees must purchase goods from certain designated approved suppliers. The suppliers, however, have an arrangement with the franchisor whereby any rebates (volume-based or otherwise) are paid directly to the franchisor. The arrangement works for suppliers because they gain access to an entire franchise system. Franchisors gain an additional source of revenue. Franchisees, meanwhile, will either have no right to receive rebates under their franchise agreements or will not know about the rebates.

The state of the law in Canada is in flux. In the recent case of *Fairview Donut Inc v The TDL Group Corp*,[14] a court held that an agreement between a franchisor and its exclusive supplier to sell products to franchisees at a high mark-up was not a conspiracy or price maintenance under the Competition Act. Another case dealing specifically with alleged kickbacks between a franchisor and its supplier is currently before the courts and will be decided in the next few months.[15] That case may determine whether franchise supply arrangements can run afoul the Competition Act in Canada. Supplier arrangements that are unfair to franchisees may also violate the 'good faith' provisions of provincial franchise laws.

In the United States, the Robinson-Patman Act is an area of concern for franchisors receiving rebates. The law prohibits price discrimination by requiring sellers to offer the same price terms to customers at a given level of trade. Section 2(c) prohibits price discrimination resulting from unearned, undisclosed rebates. A franchisee would, however, need to suffer some damages before it could make out such a claim. The franchisor would also have a defence available to it that the rebates were paid for services rendered such as locating and negotiating with suppliers.

In the EU, supplier rebates will rarely be an issue under competition law unless the franchisor is dominant. Instead, they are treated as contractual matters between franchisors and franchisees.

Advertising

Franchisors often manage advertising for their entire system and accordingly they must take care to learn about local advertising laws. Advertising laws vary significantly from jurisdiction to jurisdiction. For example, comparative advertising is illegal in Canada if a competitor's trademark is being used on goods themselves, although it may be legal in other types of advertisements.[16] This can be contrasted with the United States and the EU, where comparative advertising is generally permitted provided it is not misleading.

Misleading advertising is policed by the federal Competition Bureau in Canada and is a criminal offence under the Competition Act. To a lesser extent, advertising in Canada is also subject to the Trade-marks Act and the common law. In the United States, the Federal Trade Commission and state consumer protection agencies are tasked with regulating advertising, and relevant legislation includes the Lanham Act, state legislation and the common law. In Europe, regulation and enforcement is generally handled at the member state level, although EU directives have largely standardised the laws. The advertising industries in each of the jurisdictions above also self-regulate to some extent. While a comprehensive review of international advertising laws is outside of the scope of this article, suffice it to say that it is an area rife with pitfalls for unwary franchisors and must be thoroughly researched prior to expansion.

Conclusion

The topics above are just a few examples where different jurisdictions' competition laws treat franchise-related activities differently. In some cases the laws are similar in effect, but the context and principles guiding them are different. Accordingly, certain types of borderline activities may be permissible in one jurisdiction but prohibited in another. In other cases the laws are just plain different and a franchisor expanding from one jurisdiction to another needs to be aware how their practices will be treated. Franchisors would be wise to thoroughly investigate the competition laws of any jurisdiction they are planning on expanding to and adapt their systems accordingly.

Notes

1 RSC 1985, c C-34.
2 15 USC ss 1–7.
3 15 USC ss 12–27.
4 15 USC ss 13.
5 Consolidated Version of the Treaty on the Functioning of the European Union, 2008 OJ C 115/47.
6 *Pronuptia de Paris GmbH, Frankfurt am Main v Pronuptia de Paris Irmgard Schillgalis*, Hamburg (Case 161/84) [1986] 1 CLMR 414.
7 Competition Act, s 76(1)
8 551 US 877 (2007).
9 Jeffrey A Brimer, Alison C McElroy and John H Pratt, *Going International: What Additional Restraints Will You Face?* American Bar Association, 34th Annual Forum on Franchising (2011).
10 Comm'n Reg No 330/2010 ('Vertical Agreements Block Exemption').
11 *Continental TV, Inc v GTE Sylvania Inc*, 433 US 36 (1977).
12 Allan Hillman, 'Franchise Tying Claims; Revolution or Just a "Kodak Moment"?' (Summer 2001) 21 Franchise Law Journal 1.
13 Vertical Agreements Block Exemption, Art 5.1; Comm'n Notice, Guidelines on Vertical Restraints, OJ C130, 19 May 2010.
14 2012 ONSC 1252, aff'd 2012 ONCA 867.
15 *Quizno's Canada Restaurant Corporation v 2038724 Ontario Ltd*, 2010 ONCA 466, leave to appeal dismissed. Sotos LLP represents the plaintiffs in this case.
16 *Clairol International Corp v Thomas Supply & Equipment Co* (1968), 55 CPR 176.

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Ukraine: recent case law on franchising (new developments and trends)

Franchising has been gradually capturing the Ukrainian market. According to the Franchising Association of Ukraine, as of today about 400 franchising chains operate in the Ukrainian market and this data demonstrates annual increase of about 20 per cent. Notwithstanding the substantial Ukrainian market potential for further franchising expansion, there are lots of pitfalls hindering successful franchising development in Ukraine, for example: (i) the equivocal legislative regulation; (ii) strict foreign currency regulation; (iii) misunderstanding by the franchisees of the nature of franchising; (iv) the franchisee's unwillingness to strictly follow the franchisor's standards; (v) 'historical' disrespect for the franchisor's intellectual property rights; and (vi) commercial secrets. The absence of well-established, firm practice in the ruling and interpretation of franchising related issues by the Ukrainian courts also pours oil on the flames. In view of the above, in this article we provide a general overview of a few judgments recently rendered by the Ukrainian courts to throw light on benchmark trends of franchising development in Ukraine without focusing on analysis of the legality and substantiation of the said judgments.

To register or not

The Civil Code of Ukraine and the Commercial Code of Ukraine, two principal legislative acts regulating franchising in Ukraine, require that the franchise agreement, amendments thereto as well as termination thereof shall be subject to the state registration. The state registration shall be carried out by the body that performed state registration of the franchisor as a legal entity or as an individual, that is, entrepreneur. If the franchisor is registered abroad, the franchise agreement shall be registered by the body that performed state registration of the franchisee.

Even though failure to register the franchise agreement does not entail either nullity or invalidity thereof, absence of the state registration results in the following negative consequences directly set forth by the Civil Code and the Commercial Code:

- the parties to the franchise agreement shall be entitled to refer to the said agreement as well as amendments thereto in their relations with the third party only after its state registration; and
- the parties are deprived of the right to refer to this agreement in case a dispute arises.

The major problem with the state registration of the franchise agreements in Ukraine is that the Ukrainian legislation does not stipulate a registration procedure, applicable terms or fees. Therefore, there is no uniform approach of the competent authorities, that is, some of them refuse to register franchise agreements in the absence of the relevant implementing legislation, some merely put on a relevant agreement stamp 'registered' which makes its legal status unclear. Therefore, it has become standard practice in Ukraine not to register the franchise agreement.

Generally the case law[1] confirms that non-registration of the franchise agreement shall not result in its invalidity/nullity as: (i) Ukrainian law does not stipulate a registration procedure and, thus, the relevant bodies have duly refused to register the franchise agreements; and (ii) pursuant to the Civil Code and the Commercial Code, failure to register the franchise agreement shall not result in its invalidity, that is, the parties are not entitled to refer thereto in relations with the third parties.

However, one of the cases[2] discusses the parties to the franchise agreement and scrutinises the registration issue.

Two companies concluded a franchise agreement. In order to duly perform the relevant registration requirement, the parties first tried to register the franchise agreement with Obolon District State Administration (the local body that performed state registration of

the franchisor as a legal entity). Having received an official refusal, the parties approached the State Service for Intellectual Property (the 'State Service') because the Draft Law,[3] which was adopted by the Parliament of Ukraine in its first reading, states that the State Service shall be the responsible authority for the state registration of the franchise agreements. However, in the absence of the relevant registration procedure, the State Service also refused to register the franchise agreement.

Thereafter, the parties have duly performed under the franchise agreement. The franchisor granted the franchise, while the franchisee paid royalties and included their amounts into the deductible expenses for taxation purposes.

Further, the franchisee was subject to the tax audit. Following the results of the said audit, the tax service alleged that as the franchise agreement was not duly registered, it shall be regarded as unconcluded and, thus, the parties shall not refer thereto in relations with any third parties, including tax authorities. Therefore, the tax service alleged that the franchisee unduly included royalties into the deductible expenses and, thus, undervalued its tax obligations. As a result, the tax service requested the franchisee to pay the tax obligations due and the relevant penalties.

The franchisee challenged the tax service's decision before the court. The court ruled that as the parties have not challenged before the court the above refusals of the Obolon District State Administration and the State Service, they have not duly performed their obligation as to state registration of the franchise agreement. Therefore, the agreement shall be regarded as unconcluded and not vesting any rights or obligations on the parties. Thus, the tax service acted lawfully while declaring that the royalty related expenses should not have been included into the tax deductible expenses.

Thus, it goes without saying that the state registration issue shall be seriously considered by the parties, especially in view of the fact that under the existing case law, the third party are defined very broadly, that is, as any persons, except for the parties to the agreement, including other natural persons, legal entities or state agencies. Thus, it may well be that in addition to the tax authorities, the customs authorities and the banks may refuse to accept the franchise agreement in the absence of its due state registration. In view of the above risks of the non-registration of a franchise agreement, it is highly advisable to apply to the competent authorities for the state registration thereof to at least receive an official refusal to perform such registration as this may act as a 'safe harbour' in case of disputes and will confirm the parties' intent to act in good faith.

Payment conditions

Quite often the parties do not pay attention to the payment conditions wording. At best, the franchise agreements stipulate a franchisee's general obligation to pay for the franchise, payment amounts and frequency. However, the franchise agreements are silent on 'procedural' issues, for example, who shall calculate amounts due, how invoices shall be issued, whether the parties shall issue acceptance acts and how they shall be executed, agreed, etc.

The *Euro Khata* case[4] demonstrates that it is crucial to stipulate in the franchise agreement all payment terms and conditions as precisely as possible. The parties concluded a licence agreement in respect of the opening and operating of Euro Khata (*ЄвроХата*), a fast food restaurant. The court ruled that the said agreement was by its nature a franchise one and, thus, applied the respective provisions of the Ukrainian legislation. Under the franchise agreement, the franchisee shall pay franchise fees on a monthly basis within five working days after issuance of the relevant invoice by the franchisor. The act for acceptance of the services and works rendered by the franchisor shall be duly signed by both parties on a monthly basis. If the franchisee does not receive an invoice within the set term, the franchisee shall calculate on its own the amount due to the franchisor and shall pay it within the precisely identified period.

The franchisor duly granted to the franchisee the relevant franchise and according to the franchise agreement terms sent to the franchisee by post the invoices and draft acceptance acts executed on its behalf. However, the franchisee failed to take out the relevant documents from the post office and, thus, had never executed the acceptance acts from its side and failed to pay the amounts due. Due to this failure, the franchisor notified the franchisee on the franchise agreement termination and brought a claim before the court for franchise fees due for the whole period of franchise operation by the franchisee.

The court of the first instance ruled that the acceptance acts should be a ground for the invoice issuance and calculation of the franchise amounts due. Since there were no acceptance acts duly executed by both parties as set forth by the agreement, the franchisor was not entitled for any payments.

The appellate court did not follow the first instance court's approach. The appellate court ruled that the franchisor duly sent to the franchisee the relevant invoices and acceptance acts by post. Due to unknown reasons, the franchisee neither objected against the received invoices or acceptance acts nor paid the franchise related fees. Since the franchise agreement stipulated the franchisee's obligation to calculate the franchise fee due and to pay it (even in the absence of the invoice from the franchisor), the franchise agreement did not interrelate the payment of the franchise fees and execution of the relevant acceptance acts by the franchisee. In view of the above, the appellate court satisfied the franchisor's claims in full.

Verification issues

The *Chudo Pich* case[5] demonstrates that unilateral documents on a franchisee's breach of the franchise agreement issued by the franchisor following the results of onsite inspections performed by the franchisor shall not be considered by the Ukrainian courts as legal and admissible evidence of the franchisee's breach.

The parties concluded four franchise agreements for setting up and operating four franchise bakeries under the Chudo Pich (*Чудо Піч*) brand. The franchise agreements stipulated, among other things, liability for the following franchisee's breaches: (i) usage of other trademarks in the franchise outlets; (ii) sale of freshly baked products, which were supplied by companies other than the franchisor; (iii) violation of sanitary and hygiene standards; (iv) utilisation of equipment supplied by the franchisor in violation of the franchise agreement; and (v) violation of maximum resale prices established by the franchisor, etc. Additionally, pursuant to the franchise agreement, the above breaches shall be confirmed by the relevant decision of the franchisor executed in writing and signed by its representative(s) providing the relevant evidence confirming occurrence of violation (eg, acts, photos) and sent to the franchisee.

The relevant franchisor's representatives conducted one-side onsite inspections of the franchise bakeries and identified the following breaches of the agreement:

- utilisation of the franchisor's equipment in violation of the franchise agreement;
- usage of other trademarks in the franchise outlets; and
- sale of freshly baked products, which were supplied by other companies than the franchisor.

According to the inspection results, the franchisor calculated penalties under the franchise agreement and demanded its payment by the franchisee. As the franchisee refused to pay the above penalties, the franchisor brought a claim before the court requesting, among other things, to oblige the franchisee to pay the penalties calculated. However, the court has not satisfied this franchisor's claim as the court considered the documents resulting from a one-side onsite inspection as not being legal and admissible evidence to confirm the franchisee's breach.

Trademarks to be licensed

Quite often unregistered trademarks or other intellectual property rights objects (the 'IP objects') are licensed under franchise agreements in Ukraine. According to the Civil Code of Ukraine, if certain IP objects are effective only after registration thereof (eg, trademarks, inventions, utility models, etc), the latter may be licensed only after such registration. Thus, all IP objects to be licensed under the franchise agreements should be duly registered in Ukraine under national or international procedures. Notably, as of today there is no case law addressing the legal consequences of licensing the unregistered IP objects under a franchise agreement, that is, whether they shall be regarded as invalid or even null and void. However, the major risk of use of unregistered IP objects is that neither the franchisor nor the franchisee will be able to fully protect and to prohibit unauthorised use of the IP objects by a third party. The recent case law[6] revealed an additional risk of tax deductibility of the royalties paid for the unregistered IP objects use. The said case law confirmed the tax authorities' position that royalties paid for usage of the IP objects that are not duly registered shall not be tax deductible. Hence, franchisors and franchisees should make all efforts to protect the status of their IP objects in Ukraine.

Notes

1 The Decision of the Commercial Court of City of Kyiv of 14 March 2013 Case No 910/26026/13.
2 The Resolution of Ternopilskiy District Administrative Court dated 1 November 2011 Case No 2-a/1970/2606/11.
3 Draft Law 'On Amending the Civil and Commercial Codes of Ukraine (related to the franchise agreements)' No 8515 of 16 May 2011.
4 The Resolution of Zapirizhskiy Appellate Commercial Court dated 9 November 2011 Case No 4/381/09-13/33/10.
5 The Resolution of Lvivskiy Appellate Commercial Court of 3 June 2013 Case No 5015/3673/12.
6 The Resolution of Ternopilskiy District Administrative Court of 1 November 2011 Case No 2-a/1970/2606/11.

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ANNUAL CONFERENCE OF THE INTERNATIONAL BAR ASSOCIATION

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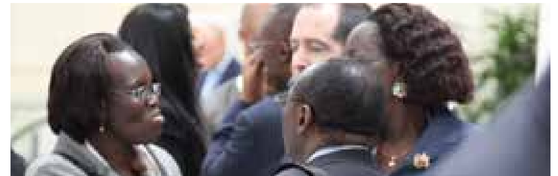

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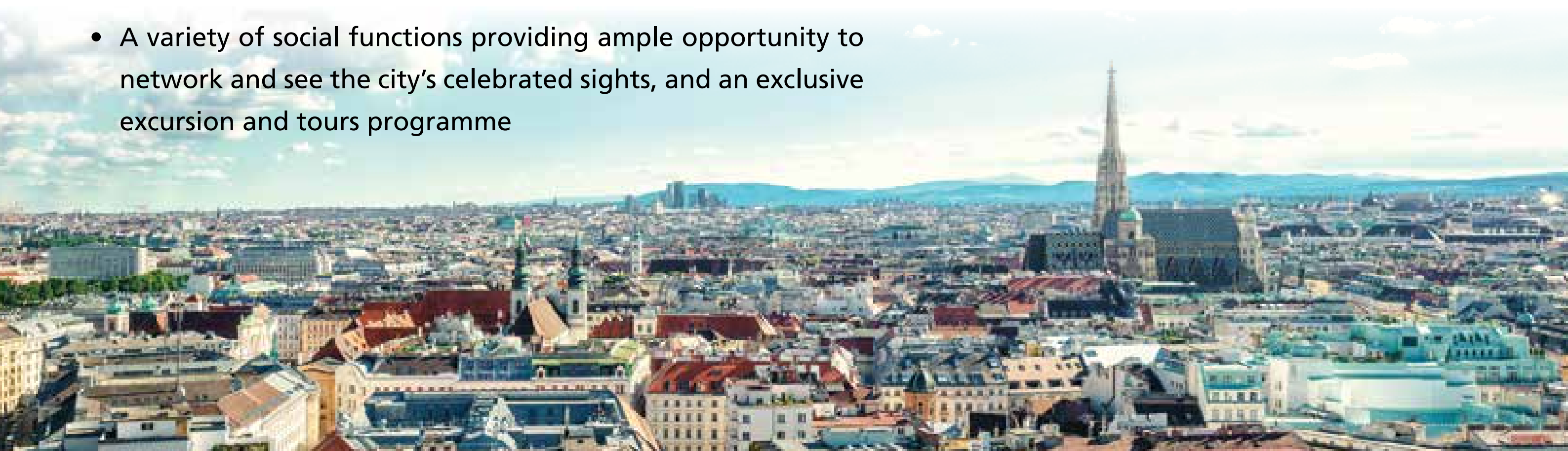

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