HOW TO PREPARE A FRANCHISE SYSTEM FOR EXPANSION TO EUROPE

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I. INTRODUCTION

Europe is a very attractive market for foreign franchisors and still remains less challenging than markets such as China, India and Russia. In fact, doing business in European countries entails significant advantages over those other markets. These include the ever increasing use of English as the language of business, the comparatively less complex legislation on franchising, and Europeans’ continued attraction to North American franchise concepts.

The decision to expand to Europe, and arguably anywhere internationally, must be predicated upon analysis, commitments and decisions made by top levels of management.

Specifically, franchisors expanding internationally should have:

- a solid domestic foundation;
- a profitable business model;
- sufficient human and financial resources;
- determined, through research, that their concept will be viable abroad;
- the ability to offer competitive products and/or services;
- an expansion (development) plan;
- strong system standards and reporting procedures; and
- an unwavering commitment to the expansion initiative;

before they go forward with their expansion plans. Once settled, the next step involves identifying the most suitable market and location for expansion.

This paper will provide insight and guidance to assist franchisors with their expansion into Europe. It will first provide an overview of the legal environment in Europe and then examine the typical challenges and issues facing franchisors in preparation for their European expansion. Finally, the paper lays out a simple roadmap to a successful expansion.

II. A “EUROPEAN” STATE OF THE UNION

A. Inception of the Union

The European Union is a federation of states which is currently comprised of 27 European countries.

The European Union began after the end of the Second World War. The intention was to prevent another war between the former adversaries and achieve a permanent reconciliation between the erstwhile wartime enemies. For this reason, in the year 1951, Belgium, the Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands founded the “European
Coal and Steel Community” (ECSC).\(^1\) The states undertook to work together in the coal and steel industry i.e. in the areas which had been particularly important in the War.

In 1957, the six states signed the so-called Treaties of Rome,\(^2\) through which they established the “European Economic Community” (EEC)\(^3\) and the “European Atomic Energy Community” (Euratom). The aim of the European Economic Community was the creation of a common market where goods, services, capital and labor could move about freely. The European Atomic Energy Community’s goal was the peaceful use of atomic energy.

In the year 1967, the ECSC, the EEC and Euratom were consolidated into the “European Community (EC) and in 1993 to the “European Union” (EU). The most important treaty to date, the EEC Treaty, is now called the EC Treaty and still constitutes the basis of European integration. It lays down the framework for a common council and a common commission of the European Communities.

With the “Treaty concerning the European Union” signed in Maastricht in 1992, a union came into being which pursues a common foreign and security policy, which works together closely on domestic and legal policy, and grants all “Union citizens” in each member state the right to take part in local and EU elections. By 1999, the partners had introduced a common currency. The “Maastricht Treaty” entered into force on November 1, 1993.\(^4\)

The EU Treaty was revised by means of the Treaty of Amsterdam 1997\(^5\) and the Treaty of Nice 2001\(^6\), in order to guarantee improved functionality of the institutions.

The foundation treaty concerning a constitution for Europe was signed in Rome in October 2004.\(^7\) The foundation treaty was intended to provide the European Union with a uniform structure and the status of a legal entity, and to supersede the foundation treaties (primarily the EU Treaty, the EC Treaty and the Euratom Treaty) which had been in force until then. The intention was to dispense with the formal subdivision into EU and EC which had been in effect until that point in time. Compared to the Nice Treaty applicable until then, the EU was

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\(^1\) Europe’s first supranational community was formally established by the Treaty of Paris signed on April 18, 1951. The treaty came into force on July 23, 1952 and expired on July 23, 2002, exactly fifty years later.

\(^2\) The Treaties of Rome were signed on March 25, 1957 and came into force on January 1, 1958.

\(^3\) This was an international community based on supranationalism and international law, designed to help the economy of Europe and prevent future war by bringing its members together.

\(^4\) The Maastricht Treaty was signed on February 7, 1992 in Maastricht, the Netherlands, after final negotiations on December 9, 1991 between the members of the European Community, and entered into force on November 1, 1993 during the Delors Commission.

\(^5\) The Treaty of Amsterdam was signed on October 2, 1997, and entered into force on May 1, 1999. The Amsterdam Treaty meant a greater emphasis on citizenship and the rights of individuals, an attempt to achieve more democracy in the shape of increased powers for the European Parliament, a Community area of freedom, security and justice, the beginnings of a common foreign and security policy (CFSP) and the reform of the institutions in the run-up to enlargement.

\(^6\) The Treaty of Nice was signed by European leaders on February 26, 2001 and came into force on February 1, 2003. The Treaty of Nice reformed the institutional structure of the European Union to withstand eastward expansion, a task which was originally intended to have been done by the Treaty of Amsterdam, but failed to be addressed at the time.

\(^7\) The Treaty establishing a Constitution for Europe was signed in Rome on October 29, 2004 by 53 senior political figures from the 25 member states of the European Union.
supposed to receive additional authority and its institutional structure was to be modified to make it more democratic and capable of acting in an effective way. The foundation treaty needed to be ratified by all 25 of the member states. In May and June 2005, however, referenda held in France and the Netherlands rejected the constitution. Therefore, as a substitute for the failed constitution, an intergovernmental conference in the year 2007 composed the Lisbon Treaty\(^8\), which incorporated the fundamental contents of the constitution treaty. The Lisbon Treaty was not to be subject to ratification in the 2009 EU elections. On June 12, 2008, however, the Lisbon Treaty was also rejected in Ireland through a people’s referendum\(^9\). The ratification process was continued in the other member states nevertheless.

**B. Member States**

The European Communities (ECSC, EEC and Euratom) were the origins of today’s European Union. As already mentioned, their member states were Belgium, the Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands.

In 1973, six member states increased to nine: on 1 January, Denmark, Ireland and the United Kingdom joined the European Economic Community (EEC). The “southern expansion” began with Greece on January 1, 1981. Portugal and Spain followed on January 1, 1986. The federation of states comprised 15 member states on January 1, 1995 upon the accession of Finland, Austria and Sweden.

On May 1, 2004, the EU’s “eastern expansion” commenced: Poland, Slovakia, Slovenia, the Czech Republic, Hungary, Estonia, Latvia, Lithuania, Malta and Cyprus became members. Bulgaria and Romania followed on January 1, 2007.

The European Union is now home to nearly 500 million people.

**C. An Overview of the Legal Environment in the EU**

The European Union is composed of three pillars: the first is the European Communities (EC, EAEC), the second is the common foreign and security policy (CFSP) and the third consists of the police and judicial cooperation in criminal matters (PJCCM). The EU Treaty does not constitute a European protagonist as a legally independent entity with uniform authority. Rather, both the two Communities and also the current 27 member states act under the “cloak” of the EU in the second and third pillars.\(^{10}\) The classic and most substantially integrated pillars of the Union are the two European Communities (EC and EAEC) which have been furnished by the member states with their own sovereign powers on the basis of their foundation treaties from 1957. Until July 23, 2002, there was a third European Community which came into being with the European Coal and Steel Community (ECSC), which ceased to exist as a consequence of the expiry of the foundation agreement entered into for a period of 50 years.\(^{11}\) In contrast, in CFSP and PJCCM, the Union states continue to hold the pertinent authority. No transfer of sovereign powers has occurred.

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\(^8\) The Treaty of Lisbon (also known as the Reform Treaty) was signed in Lisbon on December 13, 2007.

\(^9\) A second referendum is scheduled to take place on October 2, 2009.

\(^{10}\) Andreas Haratsch / Christian Koenig / Matthias Pechstein, Europarecht 5th edition 30 (Mohr Siebeck 2006)

\(^{11}\) Andreas Haratsch / Christian Koenig / Matthias Pechstein, Europarecht 5th edition 38 (Mohr Siebeck 2006)
Because this exerts enormous influence on the law in the member states, the law of the European Communities is subdivided into primary and secondary Community law.

Primary Community law forms the quasi constitution of the Community. It stands at the top of Community-law hierarchy of norms and consequently enjoys priority over secondary Community law. The components of primary law comprise the foundation treaties of the EEC and the EAEC, including the annexes, appendices, records and later Treaty modifications. Beyond written Community law, there is also unwritten Community law in the form of general legal principles, such as the Community fundamental rights as well as customary law, which is, however, only accorded a subordinate role.

The secondary law is enacted on the basis of the primary law and is directly binding or applicable for the member states and/or for their individuals and corporations (supranational). It prevails over national law.

Article 249 of the EC Treaty contains a list of the formal legal acts which can be issued by the organs of the Community:

- directive (general regulation with direct domestic applicability, would correspond to an Act in national law);
- guideline (general regulation which is to be implemented into domestic law by the member states within a particular period; it is binding with regard to the aim, but the member states are permitted to choose the form and the means);
- decisions (binding regulation in the individual case; a decision is only binding for the parties addressed therein; this would correspond in domestic law to an administrative act); and
- recommendation and opinion (not legally binding).

D. Common Law vs Civil Law in the EU

In contrast to civil law, common law is not based on legislation, but rather on authoritative past judicial decisions (precedent cases) and this is correspondingly augmented and developed. In this respect, common law possesses customary-law traits.

In England & Wales as well as Ireland, common law applies. As a consequence of harmonizing the law of these states with EU law, there is an increasing practice of codifying current legal principles in these states.

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E. Franchise Legislation in the Different Member States

There is no unified “European” franchise law. Rather, what are authoritative are firstly the rules of the EU Block Exemption Regulation for Vertical Distribution Ties\textsuperscript{16}, and secondly the national laws of each European state, insofar as such laws have been enacted or are generally important for franchise agreements. The question as to which national legal system is pertinent can be contractually agreed by the parties. Insofar as no corresponding contractual agreement is entered into, the applicable law arises from the provisions of international private law (IPL). The following paragraphs outline in more detail franchise law in individual member states.

1. Belgium

The Franchise Act entered into force on February 1, 2006 in Belgium.\textsuperscript{17} Although the law is not limited to franchising, franchising is quite clearly to be recognized in the description of the agreements to which the law applies: agreements of commercial partnership entered into between two parties, each of whom acts in its own name and on its own behalf, through which one party grants the other party, in return for direct or indirect consideration of whatever nature, the right to use a commercial formula in one or more of the forms listed (a common trademark, a common commercial name, the transfer of know-how, commercial or technical assistance) in the sale of products or in the provision of services.\textsuperscript{18}

In the framework of the pre-contractual disclosure obligation, at least one month before entering into the franchise agreement, the franchisor must send the franchisee a written draft of that agreement as well as a further special document for pre-contractual disclosure. During that month, the franchisor may not impose any obligation on the franchisee or accept a fee.\textsuperscript{19} The pre-contractual disclosure document contains two sections. Pursuant to § 4.1 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements, the first section contains important contractual regulations insofar as they appear in the franchise agreement:

- a specification of the obligations of the parties;

\textsuperscript{16} Commission Regulation (EC) N°2790/1999 of December 22, 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices (Text with EEA relevance), Official Journal of the European Communities N° L 336/21 of December 29, 1999. This Block Exemption Regulation led to a comprehensive reform of the EC competition rules for franchising. Changes were made in particular with regard to the ability to agree on price commitments, competition prohibitions and territory/customer allocations.

\textsuperscript{17} The Law relative to pre-contractual information in the framework of commercial partnership agreements ("Loi relative à l’information précontractuelle dans le cadre d’accords de partenariat commercial / Wet betreffende de precontractuele informatie bij commerciële samenwerkingsovereenkomsten") (Moniteur belge / Belgisch staatsblad January 18, 2006) was adopted in Belgium on December 19, 2005.

\textsuperscript{18} Article 2 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements.

\textsuperscript{19} Article 3 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements. It stipulates that “at least one month before the conclusion of the commercial partnership agreement the person who grants the right is to provide the other with a draft agreement as well as with a special document containing the information listed in Article 4. The draft agreement and special document are to be in writing or in a durable medium accessible to the person to whom the right is granted.” The article specifically prohibits the undertaking of any obligation or the requesting or making of any payment, deposit or security before the expiry of the one-month period following the delivery of the document.
the consequences of not fulfilling the obligations;

the method of calculation of the consideration paid by the person who is granted the right, and how, if necessary, it should be reviewed in the course of the agreement and on the occasion of its renewal;

non-competition clauses, their duration and conditions;

the term of the agreement and conditions for renewal;

notice requirements and requirements for the cessation or termination of the agreement, in particular as regards charges and investments;

rights of pre-emption or call options in favor of the person who grants the rights and the rules for the determination of the value of the business when such rights or options are exercised; and

exclusivity rights reserved to the person granting the rights.

Pursuant to § 4.2 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements, the second section contains facts which contribute to the correct evaluation of the business relationships within the franchise agreement:

the name or designation of the party granting the right as well as its contact details;

when the right is granted by a legal entity, the identity and the capacity of the natural person acting in its name;

the nature of the activities of the party granting the right;

the rights to the intellectual property whose use is granted;

if necessary, the annual accounts of the last three financial years of the party granting the rights;

the experience in commercial partnership and the experience in the exploitation of the commercial formula outside a commercial partnership agreement;

the history, the state and the prospects of the market in which the activities are exercised, from a general and a local perspective;

the history, the state and the prospects of the market share of the network from a general and a local perspective;

if necessary, for each of the last three years the number of users who are part of the Belgian and international network as well as the prospects for development of the network; and

if necessary, for each of the three last years the number of commercial partnership agreements entered into, the number of commercial partnership agreements terminated by the party granting the right and by of the party receiving the right, as well as the
number of commercial partnership agreements not renewed at the end of their term; the charges and the investments to which the party who receives the right commits itself at the beginning and during the performance of the commercial partnership agreement, indicating their sums and their allocation, as well as the length of time for their amortization, the moment in time when they will be committed and their fate at the cessation of the agreement.

The reigning monarch may determine the form of the particular document referred to and s/he may also complete the list of requirements. In any case, the document must allow prospective franchisees to evaluate and understand the franchise adequately.\textsuperscript{20}

Pursuant to § 5 of the Act, if the franchisor fails to comply with the obligations after entering into the agreement, pursuant to § 4.1 and/or § 4.2 the franchisee has the right to claim that the agreement is null and void within the two-year period after entering into the franchise agreement.

The information obtained in the negotiation process must be kept confidential\textsuperscript{21} and both the agreement and the disclosure document have to be drafted in a clear and comprehensible manner; where the meaning of a provision or data is in doubt, the interpretation most favorable to the party receiving the right prevails.\textsuperscript{22}

Article 9 states that in the pre-contractual phase Belgian law shall apply and Belgian courts shall be competent if the party who receives the rights performs the activity concerned principally in Belgium.

The cessation of the franchise agreement is not governed by statute. The general principles of commercial law as well as the provisions in authorized dealer agreements are applied analogously. If the franchise agreement was entered into for an unspecified duration, it can be terminated by both parties in compliance with a reasonable termination notice period. In the event of a grave breach of contract, termination of the agreement without notice is possible.

2. Denmark

Even though Denmark constitutes a relatively small market due to its size, the country is still an interesting country in which to franchise. In recent years the franchise market has actually developed at a frantic pace. At present, some 250 franchise outlets are coming into existence each year, which employ some 50,000 Danes.

Franchising in Denmark is supported by the Danish franchise association, Dansk Franchise Forening (DFF). The association was formed with the aim of promoting franchising. Apart from EU Block Exemption Regulation number 2790/1999 dated December 22, 1999, Danish law does not have any franchise-specific laws. Rather, the general Contract Act (\textit{Aftaleloven}), the Purchase Act (\textit{Købeloven}) as well as regulations from pertinent special legal

\textsuperscript{20} Second paragraph of Article 4, www.unidroit.org
\textsuperscript{21} Article 6 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements.
\textsuperscript{22} Article 7 of the Act concerning the pre-contractual information in connection with commercial cooperation agreements.
areas apply to franchise agreements. Thus, there are numerous points of contact with special law areas such as corporate law (A/S- og ApS-loven), copyright law (Ophavretslovgivningen), trademark and utility model law (Varmærkelovgivningen og lovgivningen om mønstre), patent law (Patentlovgivningen), the Tenancy Act and the Act governing commercial Leases (Lejeloven og Erhverslejeloven), the Competition Act (Konnkurrenceloven), the Act governing market behavior (Markedsføringsloven), the Employee Act (Funktionoerloven) and finally the Product Liability Act (Produktansvarsloven). There is comprehensive legal literature in Denmark. There is consensus that the franchisee acts on its own account in dealings with the franchisor and bears the financial risk within a territory.  

Danish law does not prescribe disclosure obligations to avoid liability, but the franchisor should nevertheless avoid any misstatements or omissions of material information in its discussions with the franchisee.

Franchise agreements are not subject to any written-form requirement. However, from the perspective of practicality and contract certainty, it should be noted that a written record of the franchise agreement is essential.

With regard to contract cessation, most franchise agreements include a detailed list of reasons which trigger a right to terminate the agreement early or without notice. Insofar as additional consequences arise from contract-breaching behaviour, such as compensation or a contractual penalty or other termination grounds, these must also be expressly agreed upon. No consolidated case law exists with regard to this point, which is why it is still completely unclear to what extent the franchisee has a claim for compensation, for example.

In principle, the parties are free concerning the choice of law and in determining the legal venue. Usually, the choice of legal venue is made in the franchisor’s favor.

3. Germany

In Germany, franchising is becoming ever more common as a distribution form. In 1995, there were only 530 franchise systems in Germany, and in the interim this has increased to more than 880. Thus, Germany is one of the European countries with the largest concentration of franchised businesses.

Franchise agreements have not been expressly governed in German law to date. Numerous legal aspects are still problematic. However, there is consensus that a franchise agreement is a mixed contract. It is usually comprised of elements of license agreements, “know-how” and authorized dealer agreements. In the absence of statutory regulation, franchise law in Germany is regulated by the regulations of general civil law, commercial law, corporate law, competition law, antitrust law, consumer-protection law and employment law.

A franchise agreement can, in principle, be entered into without complying with any formal requirements. Because, however, a written form is recommendable even just for evidentiary reasons, in practice, franchise agreements are typically entered into in writing. From a legal perspective, there is a written-form requirement today if the franchise agreement contains a purchasing obligation, i.e. imposes an obligation on the franchisee to buy certain goods or services from the franchisor or from a third party named by the franchisor, and if the

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23 Morten Wegener, UfR 1990. 217, 222.
franchisee is the founder of a new business pursuant to § 507 of the German Civil Code (BGB) (
§ 505 paragraph 2, sentence 1 of the German Civil Code). If in such case the written-form requirement is not complied with, the franchise agreement is null and void pursuant to § 125 of the German Civil Code, so the franchise relationship would have to be reversed upon request by one of the parties.24

In Germany, case law imposes substantial requirements on the fulfillment of the pre-contractual disclosure obligation.25 What is decisive is that the franchisor must provide information and clarification concerning all of the items for which disclosure can be demanded pursuant to the principles of good faith (§ 242 of the German Civil Code). This means items which the franchisor must assume are of decisive importance for the franchisee’s decision to enter into the franchise agreement.26 The question as to what information is to be provided before entry into the agreement depends on each individual case, i.e. on the respective franchise system and the experience or inexperience of the potential franchisee. Accordingly, in light of the multitude and diversity of the case law, there is no structured binding itemization of the pre-contractual disclosure elements. If one proceeds from the Code of Ethics27 of the German Franchise Association, then the minimum scope of the pre-contractual disclosure obligations can be outlined as follows:

- information concerning the franchise concept;
- information concerning the franchisor's financial situation;
- information concerning the system headquarters people possessing decision-making authority;
- details about any pilot project;
- a profitability forecast, if available;
- the draft of the franchise agreement plus all usual standardized annexes and accompanying agreements;
- bank references;
- detailed information about memberships of commercial and/or national franchise associations; and

24 Moreover, the Berlin Court of Appeal (judgement dated February 11, 1993, file number: 2 W 706/93, n. v.) and the Regional Court of Munich I (judgement dated March 22, 1990, file number: 25 O 15867/98, n. v.) decided that all points fundamental to the contract fall under the written-form requirement. Pursuant to both decisions, there is a lack of written form even if the specific location of the franchisee is not given in the franchise contract. There is dispute in the literature as to whether this case law is also to be maintained today.


27 Downloadable from www.franchiseverband.com
detailed information about distribution channels for the franchise products or services.

The above-named information should be made available to the franchisee for review in a reasonable period, but at least 10 days before the agreement is signed. However, this rule of thumb by the German Franchise Association is only binding for members of the German Franchise Association.

Moreover, as already described above, German case law has dealt on several occasions with the franchisor’s obligations with regard to pre-contractual disclosure obligations. In this context, the case law unanimously assumes that the franchisor’s pre-contractual disclosure is to be judged by the requirements of clarity, completeness and the accuracy of the contents. In particular, no information may be given at random. If the various stances in the respective decisions concerning the pre-contractual disclosure situation are summarized, then ideally the franchisee should also receive the following information from the franchisor before entry into the agreement, in addition to receiving the abovementioned information on the basis of the guidelines issued by the German Franchise Association:

- information concerning the franchisor’s marketing concept’s prospects of success;
- truthful figures concerning comparable franchised businesses of the system and the fluctuation rate;
- the franchisor’s industrial property rights (particularly the existing trademark rights);
- the training of the franchisees;
- current figures of the last three franchisees signed;
- conveying the franchisor’s experiences to date in the franchised businesses or the franchisor branches serving as pilot or test operations run by the franchisor itself; and
- description of the expenditure, including the entry fee and the additional capital expenditure, taking all expenses into account, including those in the start-up phase.

The literature in Germany has generally unanimously concurred with the decisions rendered by the Higher Regional Court of Munich. However, the franchisor does not have to explain every single point or volunteer information about facts and circumstances which the franchisee does not ask about in the framework of the pre-contractual disclosure. What is decisive is that the franchisor must explain all of the points for which clarification can be required in accordance with the principles of good faith (§ 242 of the German Civil Code). This means the franchisor must disclose all the information which the franchisor assumes or at least

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29 OLG Rostock, NJW 1996, 53
would have to assume is of decisive importance for the franchisee’s decision to enter into the franchise agreement.\textsuperscript{31}

There are no binding format requirements on whose basis the pre-contractual disclosure obligations must be fulfilled. It is possible, purely theoretically, to provide disclosure to the potential franchisee orally. However, a purely oral disclosure in the pre-contractual sphere is not recommended from a procedural perspective, because evidentiary problems for the franchisor could arise in litigation as a consequence.

If the franchisor does not sufficiently comply with its pre-contractual disclosure obligation, this leads to a compensation claim under the principle of so-called \textit{culpa in contrahendo} (Latin legal term meaning fault when entering into contract)\textsuperscript{32} pursuant to § 311 paragraphs 2 and 3 and § 280 of the German Civil Code.\textsuperscript{33} Pursuant thereto, the franchisee must be put in the position he would have been in had the franchisor complied with its disclosure obligation.\textsuperscript{34} If the franchisee had not entered into the agreement if full disclosure had been given, the agreement is annulled. The franchisor must refund all of the franchise fees and also reimburse the franchisee for all of the investments which the franchisee has made in connection with the franchise operation. However, any income earned from the franchise operation is to be deducted from that sum.

The antitrust-law appraisal of individual clauses is conducted in German law pursuant to the Act Against Restrictions of Competition (GWB). However, European antitrust law is becoming increasingly important for distribution-agreement franchising practice. Insofar as franchise agreements are apt to detrimentally impact on trade between member states to a noticeable degree, the provisions of European antitrust law are to be taken into consideration (Article 81 of the ECT). Moreover, the Vertical EC Block Exemption Regulation (number 2790/1999) generally allows many competition-restricting arrangements in franchise agreements where the relevant market share is less than 30%.

4. Finland

There are no legislative regulations specific to franchising in Finland. The most important principle in Finland with respect to franchise agreements is that of the general freedom of contract. As in Denmark, franchise agreements are governed by various statutory regulations. Depending on the specific nature of the franchised business, various laws govern the material content of a franchise agreement. Trademark law, employment law, consumer protection laws, ...

\begin{footnotesize}
\begin{itemize}
\item[31] Bundesgerichtshof (BGH), BB 2001, 1167; OLG Nürnberg, NJW-RR 2001, 1558
\item[32] Rudolf von Jhering is deemed to be the discoverer of \textit{culpa in contrahendo}. Pursuant to this legal concept, even the commencement of contract negotiations can lead to the consequence that a relationship under the law of obligations (similar to a legal transaction) exists between the parties involved, from which rights and obligations stem. Thus, a relationship of trust similar to a contract already exists during contract negotiations, whose culpable breach can lead to compensation. In particular, there is an obligation to disclose important facts. Deliberate deceit during contract negotiations is therefore impermissible, for example.
\item[33] Originally the German Civil Code did not recognise any corresponding legal concept, according to the prevailing legal opinion. Accordingly, the case law saw a corresponding gap in the German Civil Code and filled it by developing the legal concept of \textit{culpa in contrahendo}. Since the 2001 reform of the law of obligations, the legal concept has been governed by statute (now § 311.2 in association with § 280.1 and § 241.2 of the German Civil Code).
\item[34] BGH, NJW 1981, 1673
\end{itemize}
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company laws and other legislation must always be taken into account when drafting the agreement.

While there are no such special provisions in Finland, the Unfair Trade Practices Act\(^{35}\) prohibits the use of false and misleading expressions concerning one's own business operations or those of another party which are of a character apt to affect the supply of or demand for a commodity. This provision may well also be regarded as applicable to franchise agreement negotiations, i.e. the franchisor must provide an accurate description of its operations. If a franchisor breaches this requirement and gives a prospective franchisee an untrue or overly favorable impression, then this may constitute grounds for rescinding or terminating the entire agreement.

The Finnish Franchising Association (FFA) has issued a Code of Ethics\(^{36}\), which the members of the Association are required to comply with when entering into agreements. This Code of Ethics may be regarded as a good guide when drafting agreements for all franchising chains, even when the chain does not intend to join the Association. By complying with the Code, a chain may be confident that its agreement and operating practices are of a high ethical standard and thus have a sustainable footing.

In principle, in Finland, a franchise agreement can be entered into free of formal requirements, i.e. orally. In practice, however, as complex combination agreements, franchise agreements are always entered into in writing.\(^{37}\)

Because franchise agreements are not subject to any special statutory regulations in Finland, the consequences of cessation or termination are appraised in accordance with the agreement and the general contract-law provisions.

In principle, the contracting parties are free in their choice of the applicable law. In extreme cases, a choice-of-law clause which is unreasonable or inappropriate pursuant to the Act governing pecuniary legal transactions can be invalid.\(^{38}\)

Almost without exception, franchise agreements stipulate arbitration as the means of settling disputes. Because of this, there is very little public material on legal proceedings arising from franchising disputes.\(^{39}\)

5. France

France was the first country in Europe to adopt legislation relating to franchising. On December 31, 1989, the so-called Doubin Law\(^{40}\) was adopted, whose first article is relevant to

\(^{35}\) The Unfair Trade Practices Act, 1061/1978

\(^{36}\) The Code can be found on the FFA's website in Finnish. The code follows the EFF's (European Franchise Federation) Code of Ethics very closely – it is actually an almost identical translation of it.


\(^{39}\) The only Supreme Court judgement pertaining to a franchising operation is judgement No 1996:27 holding that the use of an arbitration clause in a franchise agreement is acceptable and that the said clause is binding.
franchising. It should be considered a disclosure law, whose details were subsequently laid down in government decree no. 91-337 of April 4, 1991 (“the Decree”). It should be noted that this law is not franchise-specific, but nevertheless covers franchising.

Article L330-3 of the French Commercial Code imposes pre-contractual disclosure obligations. It applies to all agreements where one party transfers to another party the right in a company name or a trademark and allocates to that other party an exclusive or quasi-exclusive territory for the exercise of those rights and thus is also applied to franchise agreements. The Doubin Law applies only to franchises which impose exclusive or quasi-exclusive obligations on the franchisee. According to Delforge/Ortoli, the Decree only refers to the disclosure of the “scope of the exclusivities” contained in the proposed franchise agreement, which is generally understood as applying to the contractual commitments or restrictions on the franchisee in relation to supply, territory, non-competition, etc. A quasi-exclusive commitment is generally understood as being a commitment amounting to an exclusivity of 70 to 80 percent or more. It is not necessary that the exclusivity or quasi-exclusivity be stipulated in the agreement for the disclosure requirements to apply. It is enough that it exists as a matter of fact in the relationship between the parties. If the franchise relationship does not have the requisite degree of exclusivity or quasi-exclusivity, the Doubin Law will not apply and disclosure is not required.

Given the legal uncertainty regarding this issue, it is recommended that franchisors comply with the disclosure requirements each time a franchise agreement requires exclusive commitments on the part of the franchisee.

The pre-contractual disclosure must be given at least 20 days (a) before the franchise agreement is signed, or (b) before payment of a fee by the future franchisee. If the twentieth day falls on a Saturday, Sunday, or public holiday, the franchisor and the franchisee must wait until the following business day before signing the agreement.

Article L330-3 of the French Commercial Code stipulates that the following information must be provided to any prospective franchisee or prospective master franchisee:

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40 Law No. 89-1008, concerning the development of commercial and artisanal enterprises and the improvement of their economic, legal and social environment (Loi n° 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social, in Journal Officiel, January 2, 1990. This law is more commonly known as the Loi Doubin after the minister who introduced it. It is now incorporated into the Code of Commerce of France, article L330-3)


43 This is evidenced by a decision of the Supreme Court dated October 19, 1999 (Prodim v. Decroix), arrêt n°1557, pourvoi n°97-14.367.


on the franchisor: company name, location, description of its activity, capital, registration number, bank accounts, identity of the entrepreneur or of the managers, all indications regarding their professional references, date of the company’s creation, principal stages of its evolution over the past five years, annual financial statements of the two last financial years or the annual reports for the last two years, if the company’s shares are publicly traded;

on the licensed trademark: registration, registration number, date of acquisition of the trademark or date and duration of the license of the trademark, if applicable;

on the state and prospects of the market;

on the network: list of the member companies with the indication of the operating mode, list of the companies (maximum 50) located in France with which the franchisor has entered into the same agreement and the date of entry or renewal, indication of the number of companies which have left the network during the previous year and of the reason why they have left the network; and

on the agreement: the term and condition of renewal, termination and assignment of the agreement and the scope of the exclusive rights.

If the franchisor does not provide comprehensive or correct disclosure before the franchise agreement is signed, then the franchisee has a claim for compensation against the franchisor. Article 2 of the Decree stipulates specific fines for failure to comply with disclosure obligations, even if such failure is not intentional. In addition to these fines, other non-franchise-specific criminal offences may apply in certain circumstances in connection with disclosure of information, such as fraud, false advertising, or abuse of power. Moreover, the franchisee has a claim for nullification of the agreement if it would not have entered into the agreement had the franchisor complied with its disclosure obligations. As a result of case law in recent years, this nullification is no longer automatic. The courts have only nullified the franchise agreement or declared franchise agreements null and void if the franchisor’s failure to disclose prevented the franchisee from contracting knowingly. If the agreement is successfully nullified, the franchisee has a claim for refund of franchise fees already paid, as well as for compensation for the loss suffered during the life of the franchise.

6. Greece

There is no franchise law in Greece. Consequently, one must refer once again to the general principles of law. As in other European countries such as Great Britain or Luxembourg,

47 The amount of the fine is low (EUR 1,500.00 for a single breach and EUR 3,000.00 for a repeat breach).
48 Article 313-1 of the French Criminal Code.
49 Article L 121-1 of the French Consumer Code.
50 Article L 122-8 of the French Consumer Code and Article 313-4 of the French Criminal Code.
the Code of Ethics will primarily apply to franchisors who are members of the Greek Franchise Association.

Moreover, although Greek law does not recognize a pre-contractual disclosure obligation to avoid liability, it is advisable as a matter of good business practice for franchisors to provide comprehensive and accurate information to prospective franchisees about the proposed franchised business.

In Greece, it arises from the principle of freedom of contract that contracting partners are completely free in their choice of the applicable law. However, it should be noted that matters which have purely national impact may not be decided upon by foreign courts. Thus, in addition to the choice of law, the fact that in some cases there is a mandatory legal venue in Greece should be kept in mind.53

7. Great Britain

There is no specific franchise legislation in Great Britain. In this respect, entry into a franchise agreement does not require any special form.54 There is no statutory provision concerning pre-contractual disclosure. However, it is recommended that franchisors adhere to the Guidelines (Code of Ethics) of the British Franchise Association (BFA), pursuant to which, inter alia, they should provide full and accurate written disclosure of all information material to the franchise relationship. This may include disclosing information regarding the franchisor's company and a detailed description of the franchise concept.

Because franchise agreements in Great Britain are not subject to any special statutory regulations, the cessation of a franchise agreement is not governed by statute either. Usually, franchise agreements are entered into for a specific period, in which regard the franchisor reserves the right to effect early termination if the franchisee does not comply with its contractual obligations. It is advisable to include a list of contract breaches which justify an early termination of the agreement. If as an exception the franchise agreement does not contain any termination clause, then the usual provisions of contract law apply i.e., the terminating party is obliged to comply with a reasonable notice period which can be dispensed with if the other party breaches such an essential contract obligation that this justifies an immediate termination of the franchise agreement pursuant to Common law.55

Moreover, the following factors are also of fundamental importance for the franchise relationship pursuant to the legislation in Great Britain:

- The franchisor can also be liable pursuant to the Consumer Protection Act.56 Anyone whose name is applied to a product or is the holder of a trademark is regarded as though they were the manufacturer of the product. Therefore, irrespective of fault, that party is liable for all damages or loss which arise from defective products;

• If the franchise agreement contains a trademark license, a registration should be effected in the trademark register; and

• If the franchisee practices a trade, a permit pursuant to the Consumer Credit Act\(^\text{57}\) is necessary.

8. Ireland

There are no special statutory franchise regulations in Ireland. Accordingly, franchise agreements are governed by general legislation. The principle of freedom of contract applies in Ireland. Equally, the parties are free in their choice of the applicable law. When configuring franchise agreements, it is self-evident that European antitrust law is to be complied with, as in other European countries.

9. Italy

There has been a Franchise Act (the “Act”) in Italy since May 6, 2004.\(^\text{58}\) It is a brief law, comprised of only 9 articles.\(^\text{59}\)

Article 6 of the Act contains regulations concerning the pre-contractual disclosure obligations which require each party to behave towards the other with loyalty, honesty and good faith. The franchisor must supply the franchisee with correct and comprehensive data before the agreement is signed. But the franchisor must also provide the franchisee with all the information that is necessary for signature of the agreement. The difference is that the franchisor must give this information if the franchisee requests it, whereas the franchisee must give the franchisor the information even if such information is not requested. Pursuant to Article 4 of the Act, the franchisee must have received the agreement together with further information at least 30 days before the agreement is signed. Among the required disclosures by a franchisor to a prospective franchisee are a list of franchisees currently operating, information on franchisees who have left the system and information on judicial or arbitral proceedings initiated against the franchisor both by franchisees and other private parties, or by public authorities.

Other key information that must be provided by any franchisor includes, pursuant to Law 129/2004:

• the franchisor’s intellectual property;

• a summary of the key elements of the franchise system; and

• certain information about the franchisor’s company.

If one party makes a false declaration before entering into the agreement, then the other party has a claim for cancellation of the agreement.\(^\text{60}\)

\(^{57}\) Consumer Credit Act of 1974.

\(^{58}\) Law no. 129 bringing “Provisions for the discipline of commercial affiliation” (franchising) (“Legge 6 maggio 2004, n. 129 Norme per la disciplina dell’affiliazione commerciale”).

\(^{59}\) Similar in purpose to the French “Loi Doubin”.

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Pursuant to Article 3 of the Act, the franchise agreement must be recorded in writing. A breach of this requirement leads to the agreement being null and void. The Act stipulates that agreements not in written form which were entered into earlier than the Act’s entry into force must be formalized in writing within one year of the Act’s entry into force.61

10. Latvia

Latvia is the only Baltic state without any specific franchise legislation. However, several laws regulate questions related to franchise transactions:62

- the Commercial Law of May 4, 2000 which applies to commercial transactions taking place in Latvia includes franchising;63

- the Lithuanian Law on Competition of October 23, 2001 applies to franchise transactions if one of the parties, either the franchisor or the franchisee, has its business in Latvia. Latvian national competition and anti-trust regulations have to follow in general the European regime of Articles 81 and 82 EU and the EU Directive on Vertical Restraints for Transactions in the Internal Market;

- Latvia has promulgated several laws on the regulation of intellectual property rights, including the Patent Law of March 30, 1995 which applies to registered inventions; and

- of great importance for franchising is the Law on Trademarks and Indications of Geographical Origin of June 16, 1999, which protects franchisors’ national brands in the territory of Latvia.

There is a provision in Latvian civil law which stipulates that a claim may be judicially asserted only if there is a written agreement. As a consequence, the franchise agreement should be composed in written form.

11. Lithuania

In Lithuania, the Civil Code enacted in 200164 contains franchise regulations dealing with franchise agreements and sub-franchise agreements.65 The Lithuanian Civil Code sets out several binding regulations for franchise agreements, which cannot be modified by individual agreement between the respective contract parties.

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60 Article 8 provides that a party may request the annulment of the contract and compensation for damage or loss if the other provided false information.
61 Article 9 of the Law no. 129/2004 bringing “Provisions for the discipline of commercial affiliation”
62 Marco Hero, Franchising in Eastern Europe: Franchise Law in the Baltic States, 5, IBA Annual Convention, Prague 2005
63 Taking place means that at least one of the parties, either the franchisor or the franchisee, has to be commercially active in the territory of Latvia.
64 The Lithuanian Civil Code was adopted on September 6, 2000. Chapter XXXVII of the Civil Code (Articles 6.766 – 6.779) is devoted to franchising. The Chapter follows the Russian Civil Code closely, except that in Lithuania, the Code Civil speaks of “franchising”, whereas in the Russian law, it refers to “commercial concession”.
65 Article 6.768 Lithuanian Civil Code.
Lithuania has harmonized its Act on Competition n°VII-1099 (as of March 23, 1999) with the European Union’s legal provisions and regulations on competition. Comparable to the situation in Latvia, international franchisors should consequently base their franchise agreements with Lithuanian franchisees on Articles 81 and 82 of the EU and the EU Directive on Vertical Restraints, and check for any mandatory or differing national special features, particularly if the franchisor supervises the national marketing activities in Lithuania.\textsuperscript{66}

Lithuania has enacted several laws on the protection of intellectual property rights, including the Trademark Act (as of January 1, 2001), the Patent Act (as of December 21, 2000) and the Design Act (January 1, 2003). Additionally the Act on Copyright and Related Rights (as of March 21, 2003) applies to original literary, scientific and artistic works which are the result of the creativity of an author expressed in any objective form.

Under the Lithuanian Civil Code, the written-form requirement must be complied with by those entering into franchise agreements.\textsuperscript{67} A breach of this requirement leads to nullity. Moreover, it is stipulated that the franchise agreement must be registered in the Commercial Register where the franchisor is also registered.\textsuperscript{68} International franchisors should therefore register their franchise agreements with Lithuanian franchisees to be able to prosecute infringements of the license by third parties.

It may be observed that although the chapter which is devoted to franchising does not deal with disclosure in any detailed manner, Article 6.770 does stipulate that the right-holder (i.e. the franchisor) has the obligation to submit technical and commercial documentation to the user, and provide other information necessary for the user to exercise the rights granted to it under the franchise agreement.

Pursuant to Lithuanian law, a franchisee which has duly fulfilled its contractual obligations has a claim to be granted a new franchise agreement on the same conditions after the expiry of the current franchise agreement.\textsuperscript{69} The franchisor can only contest this claim if it does not enter into a franchise agreement with any third party in the same area. Otherwise, the franchisor is obliged to pay compensation to the former franchisee.

The Lithuanian Civil Code also stipulates binding requirements for franchisees. They are obliged to follow and exercise the granted rights in accordance with the conditions of the franchise agreement and must follow the franchisor’s directions. At all times, the franchisee must make its status as a franchisee known in business transactions. The franchisee is also obliged to keep confidential any information which is considered to be information belonging to the franchise system. It remains to be seen how far the term “information” is congruent with the European view of “know-how” as described in the EU Directive on Vertical Restraints.\textsuperscript{70}

\textsuperscript{66} Marco Hero, Franchising in Eastern Europe: Franchise Law in the Baltic States, 7, IBA Annual Convention, Prague 2005.

\textsuperscript{67} Article 6.767 Lithuanian Civil Code.

\textsuperscript{68} Lithuanian “Register of legal persons”

\textsuperscript{69} Article 6.774 of the new Lithuanian Civil Code.

\textsuperscript{70} Marco Hero, Franchising in Eastern Europe: Franchise Law in the Baltic States, 11, IBA Annual Convention, Prague 2005.
12. Luxembourg

There is no franchise legislation in Luxembourg. Luxembourg also has the principle of freedom of contract. Equally, the contracting parties are free in their choice of the applicable law, but that choice may not breach the rules of public order ("ordre public"). There is no obligation to register franchise agreements or have them approved.

The pre-contractual disclosure obligation is assessed in Luxembourg in accordance with the general principles. In practice there, as in other European countries such as Greece and Great Britain, it is predominantly the European Code of Ethics for Franchising issued by the European Franchise Federation which is complied with.

13. The Netherlands

There are no special statutory regulations concerning franchising in the Netherlands either. The franchise agreement is a contract under the law of obligations in the sense of Article 6:213 BW.\(^{71}\) Insofar as competition provisions are affected by antitrust provisions, franchise agreements in the Netherlands must be registered. In principle, there are no formal requirements. Only when trademark licenses are contained in the franchise agreement must the contract be recorded in writing, pursuant to Article 11(a) paragraph 1 of the Benelux Trademark Act.\(^{72}\)

Because the cessation and termination of franchise agreements is not covered by Dutch legislation, the general pecuniary rules concerning the dissolution of bilateral agreements are applied. An augmentation function can be afforded to the criterion of reasonableness and equitableness.\(^{73}\)

14. Austria

Austria does not have specific franchise legislation. Since January 1, 2006, there is no longer an obligation to register franchise agreements. Austrian franchise agreements are subject to general civil-law provisions which regulate agreements, consumer protection, competition and intellectual property rights.\(^{74}\) Austrian statutes and other laws only govern franchise agreements indirectly, insofar as mandatory provisions of the Austrian General Civil Code (ABGB), the Austrian Consumer Protection Act (KSchG) and the Austrian Sales Agent Act (HVertrG) apply analogously thereto.\(^{75}\) However, it should be noted that certain commercial agency law provisions, particularly the provisions of § 24 and § 25 of the HVertrG, are applied

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\(^{74}\) Austrian case law has developed a liability as a consequence of a breach of disclosure requirements and duties of care, above all from an analogy to § 874 and § 878 of the ABG (Austrian Civil Code).

analogously to franchise systems by Austrian courts\textsuperscript{76} as well as by the European Court of Justice\textsuperscript{77}. However, this view is only held in some of the literature.\textsuperscript{78} Other authors reject an analogy to the HVertrG.\textsuperscript{79} In general, it could only be said that the legal basis of the franchise agreement in Austrian jurisprudence has not yet been sufficiently developed.\textsuperscript{80}

Because there is no comprehensive franchise legislation in Austria, it should also to be noted that the EC Block Exemption Regulation (BEO) for Vertical Agreements, which cite the contract provisions prohibited by antitrust law, was introduced into Austria through decree as well. This BEO thus also applies for purely national franchise systems, i.e. even if EC antitrust law is not to be applied.

Austrian case law\textsuperscript{81} has put forward liability as a consequence of a breach of disclosure requirements and duties of care, above all, from an analogy to § 874 and § 878 of the AGB. In order to escape liability under so-called \textit{culpa in contrahendo} (same principle as in Germany) both the franchisor and also the franchisee assume extensive pre-contractual explanatory obligations in the framework of contractual negotiations. In imitation of \textit{culpa in contrahendo}, Article 3.3 of the Austrian Code of Ethics prescribes for members of the Austrian Franchise Association that the franchisor must provide the potential franchisee with complete, truthful and precise written information regarding all decisive aspects of the franchise system. Written information which serves as advertising for franchisees must be factually correct regarding future events, figures and profits. To the extent that the franchisor does not inform the franchisee otherwise, the party interested in the franchise can assume that the system has been tested sufficiently and extensively in a pilot operation.\textsuperscript{82}

Pursuant to judgments handed down by the Austrian Supreme Court (OGH), a franchisor is liable for revenue forecasts if it was grossly negligent when drawing up such forecasts.\textsuperscript{83} Inversely, however, there is no obligation imposed on every franchisor to make market studies and revenue forecasts available to interested parties. In particular, it is not necessary for the franchisor to give a profitability guarantee.\textsuperscript{84}

\textsuperscript{76} The Austrian Supreme Court (OGH) is increasingly answering in the affirmative the question of analogous application of the Commercial Agent Act ("HVertrG") to franchisees, e.g. OGH April 10, 1991, 9 Ob A8, 9/91 or also OGH December 17, 1997, 9 Ob 2065/96h.
\textsuperscript{77} EuGH November 09, 2000, C-381/98
\textsuperscript{78} Schlemmer, Der Franchisevertrag, RdW 1984, 303
\textsuperscript{79} Christoph Liebscher, Die analoge Anwendung von § 25 HVertrG auf Franchiseverträge, WBI 1992, 105
\textsuperscript{81} OGH January 19, 1989, 7 Ob 695/88, WBL. 1989, 131
\textsuperscript{82} Article 1 Code of Ethics.
\textsuperscript{83} OGH January 19, 1989, \textit{loc.cit}.
\textsuperscript{84} Eckhard Flohr, Franchise-Vertrag 3rd edition 56 (Beck 1998).
If one contractual party neglected to inform the other contractual party of important facts, compensation must be paid for all detriment which the contractual party has suffered due to the culpable neglect. These are referred to as bad-faith damages.\textsuperscript{85}

15. Poland

Poland does not have specific franchise legislation. Pursuant to Polish dogma, franchise agreements are treated as unnamed agreements. Even though no nominal franchise agreement is entered into between the parties, the agreements are defined as “nameless agreements” by Article 353 of the Polish Civil Code (ZGB). Because the entire context of the franchise agreement is not governed by the Polish Civil Code, within the framework of general freedom of contract, the parties are in principle able to freely configure the franchise agreement, whose contents are usually based on experience in other countries.\textsuperscript{86} Moreover, because at least one, but normally both, of the contracting parties are business people, the franchise agreement is a commercial contract.\textsuperscript{87}

Entering into a franchise agreement is not subject to any particular formal requirement, but without exception it is usual practice for the agreement to be entered into in writing. In such case, Article 77 in association with Article 73 § 1 of the Polish Civil Code apply. Pursuant thereto, a termination, modification or cancellation of the agreement requires the written form as well.\textsuperscript{88}

Because Polish legislation does not prescribe any particular provisions for this type of agreement, and because no consolidated case law exists in this regard either, in order to safeguard the interests of the parties, it is advisable to include provisions in the agreement which govern the cessation/termination of franchise agreements and to stipulate their legal consequences. If the parties do not include corresponding provisions in the agreement, the general principles for bilateral agreements laid down by the Polish Civil Code (Articles 354 and 355 of the ZGB) apply.

16. Portugal

Portuguese law does not have any special statutory regulations concerning franchise law. At present, so-called “unnamed” agreements are entered into, which fall under Act Nr. 1 Article 405 of the Civil Code: “the two contracting partners can freely define the contents of the contract and negotiate agreements which do not fall under the legislation or also agree on exception clauses, in the framework of the existing laws”.

\textsuperscript{87} See judgement by appeal court dated March 4, 1998, I Aca 636/98, OSA 1999/11-12/50; Fuchs, Umowy Franchisingowe, Kraków 1998 r.
The general legal provisions on agreements (Civil and Commercial Codes) and on standard contractual clauses\(^89\) apply. Insofar as these agreements contain licenses of intellectual property rights and detailed clauses governing the scope of the franchisee’s use of the franchisor’s trademarks and know-how, the Industrial Property Code is applicable. Decree-Law nº 383/89 of November 6 on the objective responsibility of the producer and Decree-Law nº 178/86 of July 3 on agency (particularly provisions on termination and client indemnity), may also be of relevance.

Because they often contain restrictions on competition (exclusivity, selectivity and non-compete clauses for example), franchise agreements may raise various issues under competition law and ultimately be considered as null and void.\(^90\)

17. Sweden

On October 1, 2006, a Franchise Act\(^91\) entered into force in Sweden regarding the pre-contractual disclosure obligations. It is a very short Act, comprising only six articles and is based on the Unidroit Model Franchise Disclosure Law.\(^92\)

Pursuant to § 3 of that Act, the franchisor must inform the franchisee in writing of certain facts and circumstances which are relevant for entry into the franchise agreement sufficiently early\(^93\) before execution of such franchise agreement. § 3 lists the minimum information which must be provided:

- a description of the business that the franchisee will be operating;
- information about other franchisees with which the franchisor has entered into franchise agreements, within the same franchise system and scope;
- information on the remuneration that the franchisee will pay the franchisor and other financial terms for the business;
- information on intellectual property rights that will be licensed to the franchisee;
- information on products or services that the franchisee is obliged to purchase;
- information on all limitations on competition during and after cessation of the franchise agreement;

\(^89\) Decree-Law No. 446/85 of October 25.
\(^90\) See Article 81(1) and (2) of the EC Treaty and corresponding Article 4 (1) and (2) of Law 18/2003 of June 11.
\(^91\) The Law on the duty of a franchisor to provide information (May 24, 2006, Law no. 2006:484) - Lag om franchisegivares informationsskyldighet (24 maj 2006, SFS 2006:484).
\(^92\) Adopted on September 25, 2002. So far, no country has adopted the model as a binding regulation for franchise disclosure. However, Sweden approached the question of regulating franchising and disclosure by extensively analysing the Unidroit Model Law.
\(^93\) The law does not give any indication as to how far in advance disclosure must be made before entry into the contract. The commentary on the draft law states that this was a conscious decision, as it was felt that the needs might differ from case to case, and that therefore courts should be free to decide if the respective period of time was adequate.
information on terms of the franchise agreement, terms for amendments and renewal of
the franchise agreement as well as termination and cessation and the financial
consequences for the franchisee upon termination or cessation; and

information on how disputes are resolved and how costs arising from disputes will be
allocated, and other relevant information (such as other agreements required by the
franchisor, etc…)

If a franchisor does not comply with its information obligation pursuant to § 3, then
pursuant to § 4, a claim can be filed at a court concerning this agreement and future
agreements for the necessary information to be made available. However, the franchisee
is not entitled to a claim for compensation.

18. Spain

In Spain, there is a statutory regulation concerning franchising in Article 62 of Act 7 from
1996 dated January 15, 1996 ("LCM") regarding the regulation of the retail industry. Article
62 of the LCM contains a brief definition of franchising and obliges the franchisor to provide
interested parties with information about its franchise system. In addition, the franchisor must
have franchise agreements registered at a Registry as determined by the pertinent authorities.
Registration also concerns master franchising, in which case the sub-franchisor is required to
file a certain amount of information relating to the franchisor and the master franchise
agreement too (name, corporate designation, registered address of the franchisor, legal status
and duration of the master franchise agreement), as well as the contract which evidences the
transfer from the franchisor.

Pursuant to Article 62 paragraph 3 of the LCM, the franchisor must provide
comprehensive information to the franchisee regarding the franchise system before the
franchise agreement is signed or before the franchisee pays the franchisor any amount prior to
executing the agreement. The itemized list in Article 62 of the LCM is not exhaustive in this
respect.

Through Royall Decree number 2485/1998 dated November 13, 1996, Article 62 of Act
7/1996 was enacted with regard to the regulation of the franchise economy and a franchisor
register was created which constitutes a unique information system in Europe. Pursuant to
Article 3 of Royal Decree 2485/1998, the franchisor has to provide potential franchisees with

94 § 4 indicates that a franchisor who has entered into a franchise agreement without having fulfilled its obligation in
accordance with § 3 may, with reference to that agreement and future agreements, be ordered to give information in
conformity with that paragraph. Such an order may also be directed towards someone who is employed by the
franchisor or who acts on its behalf.

95 Ley 7/1996, de 15 de enero, de Ordenación del Comercio Minorista, Boletín Oficial del Estado, number 15 of

96 It is similar in spirit to the French Loi Doubin, but is specific to franchising, which it defines.

97 Real decreto 2485/1998 de 13 de noviembre, por el que se desarrolla el artículo 62 de la Ley 7/1996, de 15 de
enero, de Ordenación del Comercio Minorista, relativo a la regulación del régimen de franquicia, y se crea el Registro
de Franquiciadores, Boletín Oficial del Estado, number 283 of November 26, 1998. For an English translation, see
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specific information at least 20 days before signing the franchise agreement or any down-payment or the receipt of any pre-contractual documents, which specific information includes:

- information on the company;
- a valid title for the use of the franchise trademark and/or distinctive signage in Spain;
- a description of the business sector;
- the characteristics of the franchise;
- the structure of the franchise network in Spain; and
- the essential elements of the franchise agreement.

To safeguard the rights of franchisees, a franchisor register has been created, which is subordinate to the Head Office of Domestic Trade of the Ministry for the Economy and Finance. Before commencing the awarding of franchise rights, natural persons and legal entities must be registered in this register if the activity is to be exercised in the area of more than only a “Communidad Autónoma” (autonomous region). Royal Decree 2485/1998 states that a franchisor must register within one year of establishment by providing documentation to the registration authorities as follows:

- details of franchisor's intellectual property;
- a business report setting out the size and numbers of the franchise network, including all relevant data concerning franchise activities for the past two years;
- information about the franchisor;
- information about the franchise agreement; and
- information about the commercial situation.

Although Royal Decree 2485/1998 does not specify the penalties for failing to comply with the disclosure requirements, the legal consequences under general contract law can occur. A nullity declaration can entail a civil-law liability with a compensation obligation if in addition to the illegal behaviour (i.e. failure to comply with one of the pre-contractual obligations), there are pecuniary loss and causation. Local practice indicates that the possible penalties include government fines ranging from EUR 1,000.00 to 3,000.00 and the rescission of the franchise agreement.  

19. Hungary

There are no special statutory regulations on franchise law in Hungary. Franchise agreements in Hungary are entered into as atypical agreements. They are not governed either by the country’s Civil Code or by special legislation. Franchising in Hungary is primarily based

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on the Duty Codex of the European Union, which has been a part of the Hungarian legal system since January 1, 1991. However, pursuant to § 205 paragraph 3, sentence 2 of the Civil Code, the franchisor is subject to an extensive pre-contractual disclosure obligation consisting in the disclosure of the general contracting conditions forming part of the contract which must have previously been made available to the other party for perusal.

F. European Union – Block Exemption Regulation

The review of franchising within the Communities began with a landmark case decided by the European Court of Justice (ECJ): the famous “PRONUPTIA” case (1986). The case was referred to the European Court of Justice under Article 177 of the EEC Treaty by the German Federal Court of Justice for a preliminary ruling on the interpretation of Article 85 of the EEC Treaty and Commission Regulation No 67/67/EEC of March 22, 1967 and on the application of Article 85(3) of the Treaty to certain categories of exclusive dealing agreements. It concerned the franchisee’s obligation to pay the franchisor arrears of fees. The Court came to a series of conclusions of general applicability in its discussion of the Pronuptia case. Inter alia, the Court ruled that the franchisor must be in a position to protect certain interests vital to the business and to the identity of the system (for example the know-how), although the provisions must be essential for this purpose. However, certain categories of clauses that limit the franchisee’s activities (for example price determination clauses) were not considered acceptable by the Court.

Article 81 of the European Community Treaty (ECT) is one of the central Community competition rules for companies. Pursuant to Article 81 paragraph 1 of the ECT, agreements between companies, resolutions in favor of commercial federations and coordinated behaviour which are apt detrimentally to affect trade between the member states are forbidden if they intend or cause perceptible restrictions on competition. Agreements which breach this prohibition are null and void pursuant to Article 81 paragraph 2 of the ECT. In principle, this regulation would also apply to cross-border franchise agreements, i.e. cross-border franchise agreements would be regarded as cartels and would thus not be permitted. To prevent franchise agreements from being registered individually with the EU Commission and being individually exempted from the EC cartel prohibition, following the Pronuptia decision, the Commission of the European Communities adopted the EU Block Exemption Regulation for

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99 Case 161/84 of January 28, 1986: decision by the European Court of Justice in the case of Pronuptia de Paris GmbH (Frankfurt am Main) and Pronuptia de Paris Irmgard Schillgalis (Hamburg).

100 Art. 81 §1 ECT stipulates that “the following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.”

Franchise Agreements\textsuperscript{102} which came into effect on February 1, 1989. As of December 31, 1999, this EU Block Exemption Regulation expired and was replaced by the EU Block Exemption Regulation for Vertical Distribution Ties, dated December 22, 1999.\textsuperscript{103} This Regulation will continue to apply until May 31, 2010. It is probable that it will be renewed after that date in one form or another. It should be noted that in accordance with Article 12(2) of this Regulation, the prohibition laid down in Article 81(1) of the European Community Treaty did not apply during the period from June 1, 2000 to December 31, 2001 with respect to agreements already in force on May 31, 2000 which did not satisfy the conditions for exemption provided for in this Regulation but which satisfied the conditions for exemption provided for in Regulations (EEC) No 1983/83, (EEC) No 1984/83 or (EEC) No 4087/88.

This Regulation reflects a broader view of the distribution sector and is founded on a more economic viewpoint of the impact of restraints in an agreement than the more legalistic viewpoint that prevailed in Regulation N° 4087/1988. The text of this Block Exemption Regulation does not mention franchising, even though the Guidelines which accompany the text make it quite clear that it also applies to franchising.\textsuperscript{104} The contents and impacts of the EU Block Exemption Regulation for Vertical Distribution Ties are described below.

In accordance with its wording, the Vertical BER only exempts vertical restrictions from the prohibition imposed by Article 81 paragraph 1 of the ECT. Pursuant to Article 2 paragraph 1 of the Vertical BER, vertical restrictions are restrictions of competition which are contained in vertical agreements. Vertical agreements are agreements or coordinated behaviour between two or more companies where each is active at a different production or distribution level for the purpose of executing the agreement, and which pertain to conditions on which the parties purchase, sell or resell on particular goods and services.\textsuperscript{105} Thus, the EU Block Exemption Regulation for Vertical Distribution Ties is applicable to franchise agreements, and also master


\textsuperscript{104} Commission Notice, Guidelines on Vertical Restraints, O J 2000, C 291/1; A first version of draft guidelines was published by the Commission at O J 1999, C 270/12. See also Terhorst, above n 1, 363; The Guidelines will be revised after a period of four years. See Commission’s Press Release of May 24, 2000 accompanying the Guidelines, IP/00/520; Terhorst, above n 1, 344; For an analysis of the legal status of the Guidelines see Bechtold, above n 9, 53; Bauer and Bronett, above n 1, paragraph 244.

\textsuperscript{105} Article 2 §1: “Pursuant to Article 81(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 81(1) shall not apply to agreements or concerted practices entered into between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services (“vertical agreements”).”

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franchise agreements. Pursuant to Article 3 paragraph 1 of the Vertical BER, the exemption only applies if the franchise system’s share of the relevant market does not exceed 30%.\textsuperscript{107}

The Vertical BER is based on the principle that all vertical restrictions which do not fall under the prohibited clauses are permitted. Pursuant to Article 4 of the Vertical BER, the BER does not apply to franchise agreements which have the following purpose:

- fixed prices and minimum prices;
- maximum prices and recommended prices which in reality amount to fixed prices or minimum prices due to pressure;
- restriction of active onward sale, with the exception of a restriction of active onward sale in areas or in customer groups which the franchisor has allocated exclusively to another franchisee or has reserved for itself, insofar as these restrictions are directly imposed upon the franchisees; or
- restriction of cross-supplies between franchisees within one franchise system.

If Article 4 of the Vertical BER is breached, the entire franchise agreement does not fall under the Block Exemption Regulation. Rather, the entire agreement is null and void for cartel reasons.

Article 5 of the Vertical BER includes restrictions which are invalid under the prerequisites named therein, whose invalidity leaves the rest of the franchise agreement unaffected. \textit{Inter alia}, this concerns the following regulation:

- direct or indirect non-compete obligation which is agreed for an indefinite period or for a period of more than 5 years; this period does not apply if the goods or services to which the vertical agreement pertains are sold by the franchisee at premises or on real properties which are owned by the franchisor or are leased by the latter from third parties.\textsuperscript{108} In such case, the competition prohibition may be extended beyond the period of 5 years to the period in which the franchisee uses the premises and real properties. Nevertheless, artificial ownership constructions to circumvent the general five-year limit will not benefit from this exception;\textsuperscript{109}

- direct or indirect post-contractual non-compete obligation, obligating the buyer, after the cessation of the agreement, not to manufacture, purchase, sell or resell goods or services, unless such obligation:

\textsuperscript{106} Eckhard Flohr, Franchise-Vertrag 3\textsuperscript{rd} edition 10 (Beck 1998).
\textsuperscript{107} Article 3 §1: “Subject to paragraph 2 of this Article, the exemption provided for in Article 2 shall apply on condition that the market share held by the supplier does not exceed 30 % of the relevant market on which it sells the contract goods or services.”
\textsuperscript{108} See Article 5(a) of the Regulation and the Guidelines paragraph 59.
\textsuperscript{109} See the Guidelines paragraph 59; Whish, above n 16, 918; Subiotto and Amato, above n 1, 182; Schultze, Pautke and Wagener, above n 1, paragraph 674. \url{http://www.austlili.edu.au/au/journals/MqBLJ/2004/4.html - fn172}
relates to goods or services which compete against the contract goods or services;

- is limited to the premises and land from which the buyer operated during the contract period;

- is indispensable to protect know-how transferred by the supplier to the buyer;

and provided that the duration of such non-compete obligation is limited to a period of one year after the cessation of the agreement; this obligation is without prejudice to the possibility of imposing a restriction which is temporally unlimited with regard to the use and disclosure of know-how which has not entered the public domain;

• prohibition against competing products in a selective distribution system: direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.

Due to the improved structure of the Regulation compared with those of its predecessors, Regulation 2790/1999 generates three main advantages: more categories of vertical arrangements are block-exempted and are thus considered to satisfy the conditions of Article 81(3) of the EC, firms are in principle more free to shape agreements according to their commercial needs, and vertical agreements entered into by market-dominant firms can no longer benefit from block exemption. 110

G. Protection of IP

A prerequisite for a sustainable and enduring franchise system is inter alia the protection of its trademark rights. If a franchise system wants to expand beyond national borders, the trademark protection must be sought internationally. The franchisor can:

1. apply for a Community trademark for the entire territory of the EU from the Office for Harmonization in the Internal Market (OHIM) in Alicante (Spain);

2. extend the trademark protection worldwide to particular states via a national basis trademark at the World Intellectual Property Organization (WIPO) in Geneva; or

3. apply for a national trademark in every state in which the franchisor wants to have its trademark protected.

The Community trademark system 111 is based on the Community Trademark Directive (CTD). Due to the unity of the Community trademark, pursuant to Article 1 paragraph 2 of the CTD, this can only be registered for the entire territory of the EU. This is a substantial advantage for the franchisor, because through one application the franchisor acquires trademark protection in 27 states at a cost which is much lower than that of filing separate


111 The Community trademark (CTM) concept originated in 1964 in a draft of a “Convention on European Trademark Law”. However, it was not until 1980 that the first proposal for a regulation dealing with the CTM appeared.
applications in each member state, which simplifies trademark policies at European level.\textsuperscript{112} The Community trademark fulfils the three essential functions of a trademark at the European level: it identifies the origin of goods and services, guarantees consistent quality through evidence of the company’s commitment to the consumer, and is a form of communication, a basis for publicity and advertising. Use of the trademark is not required to secure registration or renewal. Furthermore, \emph{bona fide} use on a reasonable scale in a single member state is normally sufficient to maintain the validity of the CTM registration throughout the EU, and prevent it from being vulnerable to cancellation through non-use over a five-year period. On the other hand, trademark protection fails as soon as a registration obstacle exists in even only one member state. In such case, however, the franchisor still has the option of converting the Community trademark application into national applications (Article 108 of the CTD). Pursuant to Article 108 paragraph 3 of the CTD, national applications which arise from conversion from a Community trademark take advantage of the application date of the Community trademark in the pertinent member state, so as a whole the negative impacts of a proprietary right rejection by the OHIM remain manageable for the franchisor. Another disadvantage of the CTM registration is that the period until receipt of registration has proven to be lengthy. Moreover, an earlier registration in one member state alone may defeat a CTM application in its entirety. In addition, if applications are met with several oppositions, the costs of dealing with the oppositions may be high. The Opposition Division of OHIM may award attorney fees to the other party, but these fees are awarded on a set scale and costs awards are very low. Furthermore, the increasing size of the EU increases the probability of there being third parties which consider that a CTM application conflicts with their trademark rights, and oppose the application accordingly.

The Madrid system for the international registration of trademarks\textsuperscript{113} can be used only by someone who:

1. has a real and effective industrial or commercial establishment in a country which is a member of the Madrid System;
2. is domiciled in a country which is a member of the Madrid System; or,
3. is a national of a country which is a member of the Madrid System.

The Madrid System makes it possible to obtain trademark protection in a whole series of states (currently 84 states)\textsuperscript{114} by simply filing one application directly with their own national or regional trademark office. A prerequisite is a national trademark as the basis trademark which is extended to other states. An international trademark so registered is equivalent to an application or a registration of the same mark effected directly in each of the countries designated by the applicant. If the trademark office of a designated country does not refuse protection within a specified period, the protection of the trademark is the same as though it had been registered by that Office. The Madrid system also simplifies the subsequent management of the trademark, as

\textsuperscript{112} The countries covered are Austria, Benelux (Belgium, the Netherlands and Luxembourg), Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom. The initial registration period is ten years from the date of filing the application.

\textsuperscript{113} The Madrid system for the international registration of trademarks (the Madrid system) established in 1891 functions under the Madrid Agreement (1891) and the Madrid Protocol (1989).

\textsuperscript{114} A list of the member countries can be found at: http://www.wipo.int/export/sites/www/treaties/en/documents/pdf/madrid_marks.pdf
It is possible to record subsequent changes or to renew the registration through a single procedural step. In contrast to the Community trademark, it is not a single supra-national right which is acquired through the international registration, but rather a multitude of individual (national) trademarks. The Madrid system thus only leads to a cost reduction and procedural simplification, but does not give rise to the existence of a special international proprietary right. The pertinent regulations concerning the Madrid system are contained in the Madrid Trademark Treaty, also known as the Madrid Protocol (MP), and in the record concerning the Madrid Protocol (RMP). However, it must still be noted that the international registration for a period of 5 years remains dependent on the continued existence of the basis trademark. If that basis trademark is successfully contested by means of a central attack, then the entire international registration collapses. It is not possible to effect a conversion like with the Community trademark. In light of this, it can sometimes be advisable for the franchisor to apply for registration of the trademark directly in every relevant state.

III. TRADITIONAL CHALLENGES TO EXPANSION INTO EUROPE

A. Finding Suitable Partners

In Europe, business opportunities abound for North American companies and franchisors in particular. The European Union represents a vast area of free trade with over 500 million consumers. What’s more, Europeans’ buying power makes it particularly favorable for the production or selling of goods and services. One of the keys to a successful expansion in this unique environment is finding the suitable partner. Whether direct franchising or setting up other forms of partnerships such as master franchises, area developers or joint ventures, recruiting a European partner is imperative to ensuring a good understanding of the market, its actors, its culture and - even more - the challenges of importing and promoting the brand.

This said, selecting a suitable partner can prove challenging. Moreover, linguistic and cultural differences can heighten that challenge. Franchisors should seek out candidates who have some experience in dealing with North American companies and who thus understand North American business culture. Suitable candidates should also possess the financial ability and character to be good promoters of the brand. It should be noted that many well-established European companies are looking to diversify or expand their brand portfolios. These companies often present great potential for partnerships. They generally possess the experience, the resources and most importantly, the knowledge of the market to grow a new brand successfully.

As in many other jurisdictions, franchisors have varied resources at their disposal to seek out potential partners. These include local franchise associations, trade missions and franchise expos, other franchisors, the U.S. Commercial Service, local trade offices, local chambers of commerce, the IFA, local counsel as well as business advisors and consultants.

Due diligence concerning any and all potential candidates is key. The time, energy and cost of up-front due diligence will largely outweigh the grief and aggravation caused by the lack of due diligence beforehand and the cost of protracted litigation, in a foreign country, after the franchisor has realized that it has chosen the wrong partner. Accordingly, franchisors would be

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115 Ulrich Hildebrandt, Marken und andere Kennzeichen: Einführung in die Praxis § 30 mn. 1 (Heymanns 2006).
116 Ulrich Hildebrandt, Marken und andere Kennzeichen: Einführung in die Praxis § 30 mn. 1 (Heymanns 2006).
117 Article 6 paragraph 3 of the MP; Article 6 paragraph 3 of the RMP
well advised to conduct in-depth investigations into the individuals and companies with which they are considering partnering.

Finally, finding a suitable partner may prove not only challenging but also an exercise in patience. A word to the wise: finding the right partner is worth the wait. So take your time. Some franchisors have taken years to find the right fit with European partners. Conversely, other franchisors, particularly in the QSR industry, entered the European market in the nineties too aggressively, often with the wrong partner, and damaged the brand image for a decade before being able to return.

B. Language

Foreign franchisors, including U.S.–based franchisors, have been expanding their brands outside their own borders for decades by entering into marketplaces where the language is not predominantly English, such as Central and South America, Asia and the Middle East. Although there is a variety of languages in Europe, contrary to popular belief, English is widely used and generally readily spoken in Europe as a common language to communicate in the business world.

In spite of the relative presence of the English language, franchisors will nevertheless be required to adapt to the practices of specific European countries, whether legally or culturally, in terms of the translation of their legal or other documentation, as well as the presentation and marketing of their products or services. In France, for example, although franchise and other ancillary agreements (including operations manuals) are not legally required to be translated into French, it is recommended that this be done. In fact, from a cultural and marketing point of view, franchisors would be well advised to have all of their documentation translated into French if they want to successfully undertake expansion into France. Translation into the local official languages are of fundamental importance for other European countries too, such as Spain, Italy, Portugal, Italy and Greece, to name but a few. Moreover, franchisors would also be well advised to consult local counsel to determine the existence of applicable language legislation to determine the extent of the translation that needs be done.

In addition, some countries have several official languages such as Belgium (French, Flemish and German) or Switzerland (French, Italian, Swiss German) or differing languages dominating significant regions of a country (e.g. Spanish and Catalan).

Even countries with the same language such as Germany, Switzerland and Austria still differ in technical and legal terminology (an auditing firm is a Wirtschaftsprungsgesellschaft in Germany, but might be named Treuhandgesellschaft in Switzerland)

Other examples include countries such as Spain which requires franchisors to register/provide disclosure documents as well as standard agreements in a certified Spanish translation, including international trademark certificates. In Germany, the laws on general terms and conditions require franchisors to provide franchise agreements in the language in which the negotiations took place.

C. (Business) Culture

European business culture can be considered different from that of North American business culture, much like Asian business culture is also different. To gain some insight into European business culture, one must first be reminded of European history, where in the not so
distant past and even still today, royalty and its surrounding environment constituted the ruling
class of the business world. In contrast, North America saw the rise of the entrepreneur, where
one could rise from very little to reach the same level as royalty. Thus, entrepreneurship, in
Europe, is to a certain extent a relatively new concept and has gradually made its way on a
larger scale into the business world only in the last few decades. Franchising, as a business
model, while ancient in its original form, is relatively new in its current form in Europe and is
slowly integrating itself as a successful business model. Consequently, as newer "kids on the
block", Europeans are cautious when entering into franchise relationships with North Americans,
whether with regard to the terms of their contractual agreements or with regard to the
expectations they will have vis-à-vis their prospective franchisor.

A typical example consists in the nature of the relationship to be established. In some
instances, European companies or individuals have preferred a form of joint venture
arrangement with their North American partners rather than the more popular master franchisor
or area developer arrangement. The reason is quite simple: Europeans often welcome, if not
require, the financial and operational participation of their foreign partner in the establishment
and development of a new concept to ensure franchisor involvement and commitment and to
share the risk. This attitude contrasts starkly with that of Middle Eastern franchisees, who are
more often than not content with developing the concept on their own with much less expected
franchisor involvement. U.S. counsel should also remind their client franchisors that they will
face significant cultural differences between the member states themselves. This is only natural,
and has historical origins which are reflected inter alia by the considerable cultural differences
between the Spanish, the Italians and the English, and even between neighboring countries
sharing the same language and a similar history, such as Germany and Austria.

Because every member state of the European Union possesses its own cultural core it is
very unlikely that a European franchise expansion strategy can encompass all EU states at the
same time through one master or similar structure. In fact, there are several examples where
general EU territory approaches have failed due to the fact that the master was able to
understand and adapt the U.S. concept to its own country but not to others in the EU.

D. Supply Chain

Depending on the industry sector of the franchise concept (QSR, services, products or
others), the supply of products, materials or equipment (either for furnishings of franchised units
or for retail sale) can pose certain challenges. Among these is the availability of such products,
materials or equipment in the European countries targeted for expansion. In reality, most
European countries will have identical or similar products, materials or products available
locally. However, in some instances, such products, materials or equipment may come at
significantly increased costs which may possibly force the franchisor to re-evaluate its economic
model.

An alternative to purchasing products, materials or equipment locally may be to import
them from abroad, whether from North America (where franchisor’s supply chain is presumably
well established) or elsewhere. This may pose yet other challenges, which again may affect the
franchisor’s economic model, in the guise of import duties. They result in the local country’s
policy to protect domestic production of products against foreign imports at lower costs. In the
absence of treaties favoring certain categories of imports, duties can amount to 40%, 50% and
even 60%, which can have a disastrous effect on the franchisor’s economic model and thus
detrimentally impact on the development of the concept in a specific country.
At present, there are no free trade treaties (such as NAFTA) between North American countries and the European Union, even though the EU has negotiated such treaties with certain North African and Middle Eastern countries. Franchisors should examine the viability of importing products, materials or equipment into European countries before deciding to purchase them locally.

Another factor to be considered are labelling requirements. While minimum labelling requirements for products are harmonized by EU law such as nutritional facts and ingredients, labelling requirements can differ from country to country whether because of language or other National regulations.

IV. TYPICAL ISSUES FACED BY FRANCHISORS WHEN EXPANDING INTO EUROPE

A. Adapting a Concept to a Different Cultural Environment

It’s been said that all politics are local. The same could be said of franchising, despite its reputation as being a repetitive and perhaps rigid way of doing business. Nevertheless, franchisors need to adapt their concepts to local habits and customs if they are to be successful, particularly in Europe where lifestyles and culinary culture, in the case of the food industry, are very demanding. By way of example, Domino’s Pizza Inc. learned this lesson the hard way when it ultimately withdrew from Italy because Italians found the sauce and toppings offered on pizzas to be too bold and too heavy, in short, too “American”.

From a broader perspective, franchisors will need to look at their concept as a whole from the brand name and identity, to products, to execution, to client service and even re-examine the entire operations to ensure that all aspects of the execution of the concept are well adapted to the specific European countries in which they plan to expand. Franchisors should also pay specific attention to the existing competition in the target country. Learning from what their competitors are doing will help them focus on the changes, if any, that need to be made in order to adapt their concepts to local peculiarities and make them successful.

Other key factors that require careful consideration are the start-up cost and franchise fees, which are often higher than those found in the U.S.A. or elsewhere. For instance, in Spain, competing Spanish franchise systems often propose start-up costs and fees that are less significant than U.S. or other European systems. Ten (10) years ago, when franchising in Spain was practically nonexistent, a high master franchise fee was a normal and accepted requirement. Meanwhile, comparable tendencies can be reported in other countries such as Germany and Austria. Today, U.S. companies need to be more flexible and adapt to existing market conditions. It is also widely accepted that (master) franchisees are equally required to adapt systems to local market conditions at their own cost and risk.

North American systems should therefore closely review what competing systems are offering in the Spanish market before establishing their market entry strategy.

B. Nature of Relationship with European Partners/Franchisees

When expanding into foreign markets, and into Europe in particular, franchisors typically select one of the following franchising models or variations thereof.
i. Master Franchising

Master franchisees act as the sub-franchisor in the designated market. They are responsible for recruitment, training, support, collections and standards enforcement. They execute franchise agreements directly with unit franchisees. They are also responsible for developing the market and are thus usually subject to a development schedule within a defined timeframe. Finally, master franchisees typically pay a master franchisee fee to the franchisor and share the royalties collected from the unit franchisees.

In Europe, this model is quite prevalent because it has proven to be the preferred model of North American franchisors. In fact, North American franchise systems have found that granting rights to a local partner presents many advantages which have proven successful. Among them, the master franchisee will have intimate knowledge of its own local market and thus be in a much better position to develop and support that market. This is particularly true in Europe, where numerous basic elements, such as eating habits, for example, are different than those of North America. Consequently, North American concepts may need to be modified slightly to fit the particular habits of the French, the Spanish or the Germans, to name but a few. Franchisors have also found that master franchisees better understand how to identify challenges and how to get them resolved. Consequently, working with a master franchisee who knows how to effectively implement an expansion program will prove to be a mutually profitable model for both the franchisor and the master franchisee.

ii. Area Representative

The area representative model differs from the master franchising model in that the area representative recruits unit franchisees, and they in turn execute franchise agreements directly with the franchisor. The area representative serves as a developer of franchises within a defined territory for a determined period of time. It is responsible, under a development schedule, to recruit and open unit franchises subject to the franchisor’s approval. In addition, area representatives often provide the training, support and service for the unit franchisees in the market. The area representative is likely to pay a fee for the development rights and typically share the initial franchisee fee paid by unit franchisees as well as ongoing royalties with the franchisor. Area representatives may also be required, at times, to operate their own unit franchisees. In Europe, area representatives are less prevalent than master franchising. The reason is that it requires more franchisor involvement yet less franchisor control, given that the area representative is literally the face of the franchisor in the market.

iii. Joint Venture

Joint ventures involve partnering with local parties to undertake expansion in a particular market. Franchisors typically create a local entity in which they will be a majority or minority stakeholder with the local partner, depending on the degree of control they wish to exercise. The franchisor contributes the license of its trademarks, its know-how, manuals, concept and sometimes capital and the local partner contributes capital, human resources and its knowledge of the market.

Interestingly, this franchise model is increasingly popular in Europe. In contrast to other models, Europeans like to be “accompanied” in their journey to success in franchising. They appreciate, and in some instances require, direct involvement of the franchisor, be this by way of financial investment or otherwise in the expansion initiative. In a joint venture arrangement, some Europeans feel supported and truly partnered with their North American co-contractor,
who must commit resources to the project. In turn, franchisors also feel involved in the
development of the market and supported by local management which is knowledgeable of
same. Franchisors may also provide their own personnel, who will learn and acquire a better
understanding of that market in order to compete more effectively.

iv. Multiple Unit or Area Development

In this particular model, franchisors typically grant rights to a large geographical area
such as an entire country or multiple countries where the area developer opens and operates
multiple units directly. The area developer is likely to pay a significant initial franchise fee and
subsequent royalties, as well as be subject to a rigorous development schedule to be completed
over a defined period of time.

C. Financing Issues

Franchisors will find that financing for individuals in European countries, particularly in
these more troubled times, can also prove quite challenging. The reality is that credit, in
Europe, even in the best economic climate, is not as readily available to middle class individuals
as it is in North America. Potential franchisees will typically be called upon to provide 30% to
50% of the total investment from their own personal liquid assets, which may come from
savings, an inheritance, a gift or a loan from family or friends. Traditional banks will typically
fund the balance of the investment if the bank is convinced that the proposed franchised
business is viable and profitable. Government loans or subsidies are available but more difficult
to secure. Public entities such as Oséo, in France, may facilitate access to bank credit by
partially guaranteeing the reimbursement of loans or by co-financing projects with banks. Other
entities in other countries also perform the same function. In other countries, private banks such
as UBS in the U.K. or Deutsche Bank in Germany have set up special franchise financing
mechanisms to assist franchisees in accessing credit.

In contrast to the U.S., franchisees in the restaurant and hospitality industry in particular
can also often make use of financial incentives or financing offered by brewing companies which
is common and perfectly legitimate in many European jurisdictions.

Franchisors may also opt to help their franchisees with financing to lower the
requirement for significant personal funds. This financial support can take the form of a loan or
participation in the franchised business. Another common form of financial support to
franchisees in Europe is the concept of a lease-management agreement where the franchisor
remains the owner of the business. Moreover, leasing companies increasingly offer specific
solutions for financing franchisees’ store equipment, machinery, trucks etc, such as UVW
Leasing in Germany. Thus, these forms of relationship allow franchisees to limit their initial
investment.

However, all of these solutions will restrain the franchisee’s autonomy and should be
temporary whenever possible. Conditions for the franchisor’s exit should also be determined in
advance. A final note on loans made to franchisees by franchisors: in some European countries,
courts have sometimes treated franchisor financing as a pledge of the franchisee’s success.
Franchisors would therefore be well advised to refrain, whenever possible, from financing
franchisees.
D. Support and Assistance of Franchisors

Almost every EU member state has a national franchise association. However, not all of them have been accepted by the European Franchise Federation, due to a lack of minimum standards operation and ethics. Moreover, Eastern European member states in particular do not yet have in-depth experience in franchising, due to the lack of renowned international franchise systems establishing professional franchise structures in those countries.

At the same time, the European Franchise Federation has 17 member associations (as of September 2008: Austria, Belgium, UK, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, the Netherlands, Portugal, Slovenia, Sweden, Switzerland and Turkey, www.eff-franchise.com). All of these EFF Member Franchise Association members are dedicated to supporting and assisting any national or international franchise systems in establishing professional franchise structures under the umbrella of the European Franchise Federation’s Code of Ethics. The National franchise associations are always a very good first source to locate national specialists with respect to general franchise consulting, legal experts, brokers and other associated professionals in the industry.

In most European countries, one will also find largely established and successful franchise consultancies, brokers, legal counsel, marketing agencies and other professionals. As the quality and pricing varies significantly, it is best to use personal contacts with local legal counsel and/or the National franchise associations in order to obtain a first overview of information concerning such local assistance. It is also best to seek parallel or second opinions whenever possible.

E. Real Estate Issues

Location, it is said in French, is the “nerf de la guerre” (or nerve centre of the war). The choice of a franchise location is a key decision and in many instances, a key element of a successful franchised business. Real estate in European countries, aside from being often very expensive (depending on whether it is located in a major city or not), presents the same commercial similarities as in North America. However, from a legal point of view, real estate and leases in particular present marked differences.

In civil-law European countries, a commercial lease offers its beneficiary - a business owner, artisan or professional - unique protection from the landlord. The reason is that legislation is aimed at protecting entrepreneurs and their businesses while ensuring the security of their leases. It is believed that entrepreneurs should be able to count on being able to remain in their leased premises for a significant period of time because the goodwill associated with the business is dependant on it. This special protection is sometimes referred to, in France, as the “commercial property” because the tenant is legally entitled to renew its lease. Consequently, for the duration of the lease (a minimum of 9 years), the tenant can practically not be evicted, save in exceptional circumstances, and unless it is compensated by the landlord. As for the rent, it can be revised periodically but it is limited by a legal ceiling, which prohibits excessive increases. In turn, except as stipulated otherwise in the lease, the tenant has the opportunity to vacate the premises every 3 years. The tenant may also sell its business, including its rights in the lease. However, the tenant’s rights will not prevail over the landlord’s right to recover its premises at the end of the lease or at the end of a 3-year period in specific circumstances, such as construction, reconstruction, personal occupancy, demolition or other serious and legitimate reasons, such as failure to pay rent. Otherwise, the tenant will be entitled to the renewal of its
lease for the same period and with rent subject to a legal ceiling. Alternatively, it is entitled to receive compensation equal to the value of its business or to its rights in the lease.

Franchisors will appreciate that the legal right afforded to tenants in Europe constitutes a significant departure from the prevalent legislation in North America for commercial leases. The legal status of a commercial lease also means that leases constitute an asset of a business which can be leveraged significantly. In fact, European financial institutions will often take the presence of a secured lease into account when considering the financing of a franchise.

Many franchisors also choose, when possible, to lease strategic locations themselves and then sublease them to franchisees in order to secure specific properties to promote their connection to the brand. Another option involves requiring franchisees to negotiate transfer options in favor of franchisors at the end of the franchise and/or lease agreement which options are stipulated in the franchise agreement. However, such options do not work in several (Eastern) European countries where transfer clauses are often generally rejected.

F. Use of Corporately-Owned Stores

North American franchisors have often found that expanding abroad into certain markets, particularly in Europe, first through the use of corporately-owned stores presents many advantages over the use of other models such as master franchising, area development and joint ventures. Among these, the establishment of a corporate store allows the franchisor to test its concept in the new chosen market. The corporate store will often serve as a pilot operation to test the products sold and to adapt them, if necessary. A corporate store also allows the franchisor the opportunity to become acquainted with the habits and customs of the local culture. In the QSR industry, several North American systems have opened one or more corporate stores in France, Spain and Italy to establish brand presence in the market, sometimes discretely, in order to assess their concept and its viability in the market before they embark on a full-blown expansion initiative with a master franchisee or area developer.

In addition, the use of a corporately-owned store presents other advantages such as testing the economic model or profitability of the concept, testing strategic locations, establishing flagship stores which will serve as windows for marketing purposes as well as training centers for eventual franchisees and their employees. Profitable and well-run corporate stores can also eventually be sold to franchisees.

Among the disadvantages are the significant investments in capital and human resources required to find and secure a location, identify and secure the supply chain, recruit local staff and generally provide the support and service which individual outlets require, and all of this must be done from a significant distance. Finally, franchisors inevitably need to recruit local management people who are familiar with the customs and habits of the market. These resources will be subject to local labor laws which, in France and other European countries, are much more burdensome then they are in North America. For instance, dismissal of employees requires real and serious reasons, working hours are less flexible, and companies are required to invest significantly in “social security insurance charges” which include health insurance, unemployment insurance, retirement contributions, training and housing.
V. A ROADMAP TO A SUCCESSFUL EXPANSION INTO EUROPE

In summary, legal counsel should advise franchisor clients on the following guiding principals while assisting in their European expansion process:

- Start with one country
- Find the right partner to develop in a specific country
- Understand the legal environment
- Adapt the concept to the different cultural and business environment
- Enlist the assistance of competent specialized legal counsel
- Honor your unwavering commitment to succeed
- Be patient

VI. CONCLUSION

Expansion to Europe is business wise and a natural and fruitful step for many experienced and well-established North American franchisors. The market is vast and full of opportunities. The differences between the different EU markets can be challenging but also thrilling for any franchisor. However, North American franchisors have typically tended to underestimate the cultural differences between the member states as well as the need for market research and adaptation to local special features. If franchisors take the time to identify the key issues they need to address, there is no reason why an expansion initiative to Europe cannot become the next successful milestone in the international expansion of their franchise systems.