INTRODUCTION

Franchising is a commercial mechanism for re-engineering businesses by enabling them to unlock the commercial value and potential of their intellectual property rights in domestic and international markets.

Franchising substantially contributes to the GDP of a number of EU member states. In the UK in 2009 it contributed £11.8 billion,1 in Germany €48 billion2 and France €47.6 billion.3 The estimated turnover of franchising in the EU is over €215 billion (US$300 billion) generated by over 9971 franchises.4

Franchising normally stimulates economic activity by improving the distribution of goods and/or the provision of services as it gives franchisors the possibility of establishing a uniform network with limited investment, which may assist the entry of new competitors in the markets particularly in the case of small and medium sized enterprises. It allows independent traders to set up outlets more rapidly and with a higher chance of success than if they were to set up without the franchisor's experience and assistance. Franchisors therefore have a better opportunity to compete with larger distribution undertakings.5

Franchising also generally allows consumers and other end users a fair share of the resulting benefits, as they combine the advantage of a uniform network with the existence of traders personally interested in the efficient operation of their business. The homogeneity of the network and the constant co-operation between the franchisor and the franchisees ensures the constant quality of the products and services. The favourable effect of franchising on inter brand competition and the fact that consumers are free to deal with any franchisee in the network guarantees that a reasonable part of the resulting benefits will be passed on to consumers.6

6 Ibid.
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It is therefore a significant economic activity in the EU. However, a comparison with the level of franchising activity in the US and Australia suggests that it is markedly underdeveloped in the EU. This in turn suggests that franchising has potential for substantial further growth in the EU.

1.3 A mixture of economic, cultural and historical factors account for much of this comparative underdevelopment of franchising in the EU. The lack of a supportive, pan-EU, homogeneous regulatory environment is also a contributory factor. It is suggested that a uniform and supportive regulatory environment would help to facilitate and encourage the further growth of franchising in the EU, particularly between member states and so support the single market in a significant manner. As stated in existing EU legislation, the differing approaches to regulating commerce found in EU member state laws are detrimental to the functioning of the single market and substantially reduce its ability to stimulate trade between member states by improving the distribution of goods and provision of services within the EU. This heterogeneous regulatory environment is detrimental to both the protection available to franchisors and franchisees vis-à-vis each other and to the security of commercial transactions. These differences substantially inhibit the conclusion and operation of franchise agreements where franchisor and franchisee are established in different member states.

1.4 The trade in goods and services between member states should be carried on under conditions which are similar to those of a single market. There is therefore a need to approximate the legal systems of the member states to the extent required for the proper functioning of franchising in the common market.

In pursuing the goals of economic growth, job creation, consumer satisfaction and commercial innovation franchising needs to be encouraged. Franchising contributes to the establishment of a single European Market. It facilitates cross-frontier development as it is based on the leverage which an established name or idea can give a relatively small investment to enable the product or

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7 600 000 franchised businesses generating an estimated total turnover of US$12 trillion in 2005 according to Iuliana, S. and M. Mihaela, 2009, 'The High Impact of Franchising on Economic Affairs in Some of the EU Members', Annals of Faculty of Economics, volume 1, issue 1, pages 251–6 (Published by the University of Oradea, Faculty of Economics). The turnover of franchised businesses in the USA is estimated at US$8868.3 billion, in Australia US$130 million and the EU$300 billion; see 2.9 below for fuller analysis. http://steconomice.uoradea.ro/anale/volume/2009/v1-international-relations-and-european-integration/39.pdf

8 An estimated turnover of US$130 billion in a country with a GDP that is less than 10% of that of the EU (Franchise Council of Australia – www.franchise.org.au).

service involved to spread quickly, far and wide. Franchising is a commercial phenomenon particularly well suited to the challenges of the single market. The combination of a franchisor’s know-how and a franchisee’s enterprise can boost economic activity and employment, while enlarging the range of goods and services on offer to the public. Franchising makes products and services available to a wide public and does not have to stop at national frontiers. The regulatory environment should therefore be re-engineered to enable franchising to fulfil this potential. Given the heterogeneous policy legacies in the EU member states as well as the diverse preferences of national governments and other domestic actors, a one-size-fits-all approach is neither politically feasible nor normatively desirable. A certain amount of flexibility and variation will therefore be needed to successfully re-engineer the regulatory environment. It is therefore suggested that a directive would be the appropriate catalyst for the required re-engineering.

There is a rich seam of commentary on the regulation of franchising but there is little work which considers franchising’s under-contribution to the EU’s economy or the extent to which the EU regulatory environment contributes to this and could be re-engineered to increase cross border business by promoting the use of franchising in the EU. In ‘Franchise Sector Regulation: The Australian Experience’ Terry concludes that ‘a healthy franchising sector requires adequate and appropriate infrastructure to which the legal environment is central’. Unfortunately there is little research into the legal environment in the EU.

Much academic research into the role of franchising in inter state trade within the EU has focused upon its vertically integrated nature and potential to prevent, restrict and distort competition between member states. This line of analysis focuses upon the Pronuptia decision of the European Court of Justice, the various decisions of the Commission on the impact of what was then Article 85 of the Treaty of Rome, the Franchise Block Exemption, the two Vertical

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Restraint Block Exemptions that superseded it\textsuperscript{15} and relevant member state decisions such as Crehan.\textsuperscript{16}

1.6 Crossick and Mendelsohn,\textsuperscript{17} Schmitz and Hamme,\textsuperscript{18} Ritter, Rawlinson and Braun\textsuperscript{19} and a long catalogue of other commentators have gone into great detail about the need for franchisors to be able to impose certain restrictions on their franchisees to protect their image and reputation, grant exclusive territories, tie in goods and services and so on. Korah\textsuperscript{20} and Mendelsohn and Rose\textsuperscript{21} in particular have produced long, valuable and detailed texts. However, all of these commentaries are concerned solely with the Vertical Restraints that exist in a franchise relationship and how and in what circumstances they can, or should be seen as, being pro-competitive. They do not consider how the differing legal provisions of EU member state law or typical provisions found in franchise agreements support or undermine the economic drivers of franchising or reduce the consequential risks.

1.7 This book analyses the way in which competition law protects the public interest in franchising by preventing distortion of the market but in contrast to existing works, looks beyond the technical way in which anti-trust laws are applied to franchising. It places the regulation of vertical restraints in franchising into the bigger picture of how franchising can be best regulated. It concludes that the ‘per se’ approach adopted by the European Commission is inappropriate. Instead it recommends one more in line with the Chicago School’s ‘rule of reason’ approach – as recommended by the Organisation for Economic Cooperation and Development (OECD) and evidenced in the Leegin decision of the US Supreme Court. This would mean focusing less on intra brand competition and allowing franchise chains to compete on a level playing field with corporate chains in terms of retail price maintenance, and harmonised multi-channel strategies, including use of the internet. This ‘Exchange of Benefits’ approach will help promote and encourage the use of franchising and be pro-competitive.

\textsuperscript{15} Regulation (EC) No. 2790/1999.
The UNIDROIT Study of Franchise Regulations\textsuperscript{22} is not restricted to the EU but is applicable to it. Unlike this book it is limited to pre-contractual disclosure and does not analyse the contents of franchise agreements and how they might be regulated. Its consideration of the issues involved in disclosure is somewhat shallow and its conclusions are little more than a patchwork based upon the preferences of the individual practitioners involved in the study. This study is not restricted to consideration of pre-contractual disclosure. Its consideration of disclosure is based upon how it can be formulated to best protect the interests of both franchisor and franchisee. Its conclusions on disclosure are far more radical than those of UNIDROIT, recommending for example franchisee disclosure at the request of the franchisor and considering whether liability for non-disclosure should be strict or dependent upon ‘defective consent’.

The Report of the Study Group on a European Civil Code (‘the Study Group’) seeks to identify how to overcome obstacles to the functioning of the internal market. It, inter alia, proposes a way in which to harmonise the regulation of franchising in the EU. It does so based upon its stated objective to produce ‘a set of codified principles which constitute the most suitable private law rules for Europe wide application’.\textsuperscript{23}

Since the Commission on European Contract law (led by Professor Ole Lando) in 1982, the European Parliament’s first resolution on private law in 1989 and the Commission’s subsequent communication on European contract law in 2001 there has been a good deal of academic debate about the development of private law. This led to the establishment of various research projects\textsuperscript{24} and the European Commission’s Action Plan for a more coherent European Contract law.\textsuperscript{25} Reactions to the Action Plan were summarised in ‘European Contract Law and the revision of the acquis: the way forward’\textsuperscript{26} (‘The Way Forward’). The second part of The Way Forward dealt with the preparation of a common frame of reference (CFR) to ‘improve the quality and consistency of the acquis in the area of contract law’.\textsuperscript{27} Academics have played a central role in elaborating the CFR:\textsuperscript{28} the so-called ‘Network of Excellence’.\textsuperscript{29}

\textsuperscript{22} UNIDROIT Model Franchise Disclosure Law – September 2002.
\textsuperscript{23} http://www.sgecc.net accessed 14 August 2009.
\textsuperscript{24} Such as the Trento Common Core Project of European Private Law and the Research Group on the Existing European Community Private law (Acquis Group).
\textsuperscript{27} The Way Forward, pp. 9–13.
\textsuperscript{28} The Acquis Group and the Insurance Group.
\textsuperscript{29} See www.copecl.org. The Network of Excellence was funded by the Commission in May 2005 under the Sixth Framework Programme for Research.
This produced specific recommendations for the regulation of franchising in the EU. This study group (‘the Study Group’) has stated that the principles impacting upon franchising have not been drafted with a specific protection aim, but to save transaction costs for the parties by providing for ‘possible problems, solutions which parties would presumably agree to’. Nevertheless, the Study Group aimed to achieve a balance between the competing interests of the parties and so did not only seek to reflect the common core of solutions in the EU member states as regards franchising but other sources such as the UNIDROIT model disclosure law and the International Chamber of Commerce’s model for International Franchising Contract.

The ‘Amsterdam Group’ was established to work with national reporters who were asked to answer several questionnaires concerning the main legal issues as regards commercial agency, franchising and distribution. After formulating its proposals the Amsterdam Group discussed them with an Advisory Council consisting of various academics. The Working Party’s recommendations were then reviewed by the Co-ordinating Committee which comprises some 50 professors from around the EU.

The recommendations can therefore be seen as an authoritative academic work on the regulation of franchising in the EU. However, it is not free of political influence and some commentators feel that its exclusion of other stakeholders coupled with the Commission’s clear political agenda of ‘Europeanisation’ undermines its objectivity and value. The Amsterdam Group’s proposal can be seen as little more than a distillation of existing jurisprudence in EU civil law jurisdictions. It fails to consider the valuable insights offered by non legal academic analysis of the nature of franchising. This results in an extremely narrow understanding of how legal regulation can support and encourage the

33 The Dutch group of reporters consisted of researchers of different European jurisdictions who provided information on their own legal systems: Georgios Arnokourous (Greek Law), Odavia Bueno Diaz (Spanish Law), Rui Miguel Patricio Cascao (Portuguese Law), John Dickie (Common Law), Christoph Jeloschek (Austrian Law), Roland Lohnert (German Law), Andrea Pinna (French Law), Manola Scotton (Italian Law), Hanna Sivesand (Swedish Law), Muriel Veldman (Dutch Law), Aneta Wiewiorowska (Polish Law).
34 The members of the Advisory Council on Commercial Agency, Franchise and Distribution Contracts are Professor Johnny Herre (Stockholm), Professor Jérôme Huet (Paris), Professor Ewan McKendrick (Oxford), Professor Peter Schlechtriem (Freiburg i.Br.), Professor Hugh Beale (London/Warwick) and Professor Christina Ramberg (Stockholm).
efficient exploitation of the single market by companies through the medium of franchising.

However, some commentators believe that applying the recommendations of the Amsterdam Group will 'most probably lead to a win-win situation for the parties on franchising …' 36 Bueno Diaz's consideration of Franchising in European Contract Law37 is a prime example. It is focused on the Study Group's proposals for commercial agency, franchising and distribution contracts. It restricts itself to comparing it with the provisions of the French Loi Doubin (Article 330 of the Civil Code) and the Spanish Retail Law (Article 62 of Law No. 7/1996). It compares the policies that underpin the respective laws in franchising in France and Spain and identifies the Study Group's proposals as the rational choice for parties involved in franchising in the EU. This study takes a much broader focus. It identifies the reasons for franchising's popularity, analyses the way it is currently regulated in the EU, recommends the re-engineering of the regulatory environment so that the legal eco-systems more closely reflect the impact of three commercial imperatives – market confidence, pre-contractual hygiene and protecting the interests of franchisors and franchisees through a mandatory taxonomy for franchise agreements.

The most fundamental difference is that, whereas the Study Group does not meaningfully distinguish franchising from commercial agency and distribution, this book argues that franchising is markedly different to them and should be recognised as a 'type-agreement' in its own right. This study also identifies good faith as an important ‘doctrinal tool’ in dealing with the franchise relationship and disputes that arise out of it. After considering the influential German approach to good faith based on BGB 242, the French concept of Bonne Fois and England's ad hoc approach, it recommends a more refined approach based upon prohibiting unconscionable conduct and misleading and deceptive behaviour.

In contrast to the Study Group's proposal for a European Commercial Code, this book proposes the enactment of a Directive that will harmonise EU member state law by making franchising a recognised 'type-contract' with mandatory, non-mandatory and essential rules. By dealing with detailed obligations and rights of the parties this approach will allow a level of flexibility that is likely to promote the use and sustain the success of franchising within the EU.

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37 Ibid.
context of each member state's legal tradition. This contrasts with the technocratic and politically driven agenda of the Study Group.

A. THE SCOPE OF THIS BOOK

1.17 This book studies the regulation of Business Format Franchising in the European Union. It analyses the way in which it is currently regulated by both franchise specific and general commercial law. It also considers how the current regulatory environment might be improved. As the UK, Germany and France together accounted for 50% of the €215 billion (US$300 billion) franchising turnover in the EU in 2009, it focuses on these three member states. It contextualises this focus by a comparative reference to the US and Australia (both of which are Federal States with highly developed regulatory regimes).38 It also tests its conclusions against empirical research amongst the relevant stakeholders, including franchisors, franchisees, potential franchisees and professionals engaged in franchising. The desirability of protecting the rights of franchisees is not disputed within this book. However, it will be underlined how this should not be the only purpose of regulation and that a balance must be struck between the protection of the rights of franchisees and the need to re-enforce the economic drivers that encourage both franchisors and franchisees to become involved in franchising in the first place. It is suggested that excessive protection of franchisees can have detrimental effects on both franchising and on the Single Market. This book suggests that such a critical balance can be achieved through a directive which re-engineers the regulatory environment in the EU by accentuating the impact of three commercial imperatives (market confidence, pre-contractual hygiene and a mandatory taxonomy of rights and obligations) upon the various legal eco-systems. These commercial imperatives re-enforce the economic drivers that attract franchisors and franchisees to franchising and reduce the inherent consequential risk to an appropriate level.

This book suggests that franchising has failed to fulfil its potential in the EU, that this is in part due to the regulatory environment and that this failure can be remedied by re-engineering the legal eco-systems that comprise the regulatory environment in the EU. It draws three basic conclusions.

38 And (mostly in footnotes) to the other 24 EU jurisdictions and the 21 jurisdictions outside of the EU that have franchise specific laws.
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The first conclusion is that franchising is a specific, distinct and uniform type of commercial activity with positive influence in the EU, which stimulates economic activity by offering economic advantages to all those involved and improving distribution and giving businesses increased access to other member state markets. However, it is not fulfilling its full potential to contribute to the realisation of the single market. This book reaches this conclusion after considering franchising’s basic architecture, its historical development, its rationale and its contextualisation, differentiating it from other business models and identifying why franchisors and franchisees are attracted to franchising and are prepared to accept the inherent consequential risks. It then benchmarks the contribution of franchising in the EU against its contribution in the USA and Australia and concludes that it is not fulfilling its potential in the EU.

The second conclusion is that the regulatory environment in the EU is responsible for this underachievement of franchising in the single market. This book concludes that regulation of franchising in some form is required and considers the difficulties encountered by member states in seeking to regulate it. It considers the differing approaches of EU member states to constructing franchising’s contractual environment, its impact on the risks to which franchisors and franchisees are exposed and the commercial drivers that attract them to franchising. It considers the impact of the self-regulatory system in the EU and then considers both the lack of homogeneity between the legal eco-systems that comprise the regulatory environment within the EU and the failure of those legal eco-systems to re-enforce the economic drivers that attract franchisors and franchisees to franchising or to reduce the inherent consequential risk. It analyses the nature of these shortcomings and the difficulties they impose upon franchising.

The third conclusion is that the regulatory environment in the EU can be re-engineered to enable franchising to better fulfil its potential in the EU. This book proposes that this should be done by re-engineering the regulatory environment so that it imposes a harmonised approach across the EU which aims to accentuate the impact of three commercial imperatives; promoting market confidence, pre-contractual hygiene and imposing a mandatory taxonomy of rights and obligations on to the franchise relationship. The harmonisation of laws within the EU has always been difficult. This book also considers whether the trend amongst some academics and the EU ‘technocracy’ to advocate the abandonment of the traditional methods of achieving this (Directives and Regulations) in favour of a European Civil Code is an appropriate way in which to re-engineer the regulatory environment for franchising.
The heterogeneous approach of EU member states to protecting franchisees is at odds with the political and economic desirability of encouraging the use of franchising in the single market. It is suggested that the solution should be based upon accentuating the impact of three commercial imperatives upon the legal eco-systems in the EU. These are the need to re-enforce market confidence, the need to ensure an appropriate level of pre-contractual hygiene and the need to impose a mandatory taxonomy of rights and obligations upon the franchise relationship. A draft EU Franchise Directive is proposed in Appendix 1. This work then explores whether and how such a new regulatory environment could solve the problems under consideration, and how it could be implemented on an EU-wide basis. This involves analysis of the contractual architecture, economic drivers, commercial interests and, most importantly, the EU member state and other legal eco-systems.

The subject matter at hand has been approached from the perspective of (1) the law impacting upon the use of franchising as a way of doing business across European Union member state borders and so promoting the single market, and (2) the business efficacy of the regulatory environment of the EU as it relates to franchising. The issues relating to intellectual property and the constitutional law of the European Union reach beyond the scope of this book, and are therefore mentioned throughout the work, but are not deeply analysed. Where deemed necessary, various references have been made to contract law, the duty of good faith, anti-trust law, commercial agency law, distribution law, unfair competition law, consumer protection law, employment law, private international law, and other member state law. Nevertheless this book does not purport to deliver a broad in-depth or authoritative analysis of any of these. This book does not purport to provide a full and in-depth analysis of German or French law.