

The Regulation of Pre-contractual Franchise Disclosure in the European Union

Регулювання переддоговірних умов франчайзингу в Європейському Союзі

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Relevance of the topic. Franchising is a growing business activity. But its legal aspects create many potential difficulties for those intended to oblige themselves in legal relationship of franchising agreement.

Only 20 years ago in most national legislations, franchising was an anonymous contract (*contractus innominatus*) which was not the subject of the specific regulation. But now franchising is a very popular and effective business system, which is used in many progressive countries. In 2007 seventeen European countries, which are members of European Franchise Federation, counted over 9 102 franchise brands, and in 2009 – 10 176 brands. The average annual growth rate of number of brands in these EU countries, between 2007 and 2009 was 8.1%¹. The system of legal regulation of franchise relations is also gradually developing. Therefore, the research of this issue is extremely relevant.

Statement of the problem. As franchising is a business model it carries some risk. It should be used the franchise pre-contractual disclosure to ensure the interests of both parties. Currently, this institute is at the initial stages of its development in the EU. In Ukrainian legal system the pre-contractual disclosure in franchise relations isn't provided. Therefore, the research of this issue is extremely relevant.

If doing a comparative analysis of the EU and Ukraine in the field of franchising, it should be noted that franchising in Ukraine began to develop not long ago. In this country market relations were being formed in 90's, when Ukraine became independent. In Ukraine franchising agreement is called a contract of commercial concession. The first regulatory act that consolidated the provisions on commercial concession was the Civil Code (2004). But until today in Ukrainian civil law there is no concept of franchising, commercial concession only. Nevertheless Ukrainian legislation regulates commercial concessions very generalized.

In EU countries franchising was being grown earlier than commercial concession in Ukraine. For example, the European Code of Ethics for Franchising was adopted in 1972; the Loi Doubin Act in France – in 1989. In Spain the first law, which regulates the franchising relationships was adopted in 1996. European countries have more experience in the regulation of franchising. Therefore Ukraine should focus on legal experience of the EU.

Analysis of recent researches. The mentioned issue was investigated by T.M. Kerkovic, P.M. Abell, A. Fernlund, B. Marzheuser-Wood and other scholars.

Purpose of research is to analyze the legal regulation of pre-contractual franchise disclosure in the EU and Ukraine, and to find ways to improve the regulation of this institution.

Presentation of the material. All over the world the business system of franchising typically includes transfer of intellectual property rights (such as trademarks, trade names and logos), the right to sell products or services, access to business knowledge and methods, and other physical and intangible assets. A key element of a franchise is the ongoing relationship between the parties. The franchisor often provides continuing support or

¹ Franchising: a Vector for Economic Growth in Europe 2011 // European Franchise Federation [Electronic resource]. – Access mode : http://www.eff-franchise.com/IMG/pdf/Franchising_A_vector_for_Economic_Growth_in_Europe_-_2011_v472011.pdf.

direction regarding the operation of the business². The corresponding relationship between the franchisor and prospective franchisee is formed before the conclusion of franchising agreement.

In the EU there is an important institute, which is absent in Ukrainian law. It is pre-contractual disclosure, the necessity of which is caused by several factors:

- 1) franchising is a business model. So it's always associated with risk;
- 2) the financial items and market studies can cause considerable difficulty, particularly to foreign franchisors, that are not familiar with local market conditions and local prices;
- 3) one of the biggest causes of disputes between franchisors and their franchisees is a "mismatch of expectation" caused by inadequate communication between them as to what they are looking for from the relationship. Pre-contractual disclosure seeks to prevent this mismatch by ensuring that franchisees have all relevant information about the franchise before they commit themselves to it. If they have been appropriately educated they can then assess the likelihood of their expectation being met by the franchisor³.

These factors led to the need of establishing franchise disclosure.

Effective disclosure by the franchisor helps appropriately educated potential franchisees to more fully understand the franchise relationship that they are entering, as well as the legal and financial commitments they are undertaking. This reduces conflict in franchise systems.

There are three legal bases, according to which franchisor must disclose certain information to potential franchisees:

- 1) national law;
- 2) European Code of Ethics for Franchising;
- 3) the principle of pre-contractual responsibility – concept of "Culpa in Contrahendo".

The duty of pre-contractual disclosure is stipulated by law only in few countries. The disclosure law has been invented in the U.S. legislative history. This regulation requires a franchisor to provide certain information before entering into an agreement with franchisee.

The first country in Europe which established pre-contractual franchise disclosure was *France*, which passed the Loi Doubin in December 31st, 1989. The Loi Doubin was the first European Franchise Disclosure law. Under article 1 of the Loi Doubin a disclosure document containing specified information must be given to the franchisee 20 days before signature of the contract⁴.

Romania was among the first Eastern European countries to adopt franchise specific legislation. On 28th August 1997 the Romanian Government issued Ordinance 52/1997 ("the Ordinance") on the legal regime applicable to franchising. The Ordinance sets out what a franchise agreement should include and the type of information which has to be disclosed to prospective franchisees during the pre-contractual phase. The reason for this is to enable the franchisee to make an informed decision when entering into the franchise relationship. However, the Ordinance does not stipulate an exact time period within which the franchisor has to disclose the information to the prospective franchisee⁵.

Franchising in *Spain* is regulated by Law 7/1996 regarding Retail Commerce and Royal Decree 2485/1998. There are also certain rules and principles (including agency laws), contained in the Spanish Civil Code and Commercial Code. Article 62 of the Law requires franchisor to deliver a pre-contractual disclosure document at least 20 days prior to the execution of a contract or the payment of a fee. The disclosure document must be in writing and be "accurate and non-deceiving"⁶. All information necessary to allow the potential franchisee to decide whether he should join the franchise network must be disclosed.

² Kerkovic T.M. The Main Directions in Comparative Franchising Regulation – Unidroit Initiative and its Influence / T.M. Kerkovic // European Research Studies. – 2010. – Vol. XIII. – Is. 1. – P. 104.

³ Abell P.M. The Regulation of Franchising in the European Union / P.M. Abbel. – London : University of London, 2011. – P. 273.

⁴ Loi Doubin French act of 31st December 1898 № 89-1008 [Electronic resource]. – Access mode : http://www.eff-franchise.com/IMG/pdf/Loi_Doubin-complete_text_in_French_JORF_no_1_2_jan.pdf.

⁵ Marzheuser-Wood B. Franchise disclosure items in Europe / B. Marzheuser-Wood. – London : Field Fisher Waterhouse LLP, 2009. – [Electronic resource]. – Access mode : <http://www.fieldfisher.com/pdf/Franchise-disclosure-in-Europe.pdf>.

⁶ Spain Royal Decree 2485/1998 [Electronic resource]. – Access mode : <http://www.boe.es/buscar/doc.php?id=BOE-A-1998-27168>.

Italian Law № 129 “Regulation on franchising” which came into force on 25th, May 2004 regulates certain aspects of franchising in Italy. The law has been controversial. It imposes a commercial disclosure obligation on the Franchisor. At least 30 days before the date of execution of the franchise contract, the franchisor must deliver to the franchisee a definitive draft of the contract together with a disclosure document containing certain commercial information. But there is an exemption. Foreign franchisors that enter the Italian market for the first time do not have to satisfy the disclosure obligations⁷.

Until February 2006 there was no legislation in *Belgium* specifically dealing with franchise disclosure. The new Belgian franchise law came into effect on 1 February 2006. The law gives rise to a duty of pre-contractual disclosure. A disclosure document must be handed to the franchisee by the franchisor one month before the parties enter into a binding agreement. No payment may be taken from the franchisee before proper disclosure has been made⁸.

In *Sweden* the Disclosure Act 2006 came into force on 1st October 2006. It sets out a requirement to disclose certain information a reasonable period of time before a franchise agreement is entered into. Some authors have suggested that a reasonable period of time would be 14 days⁹.

Apart from national law the duty to disclose some information is required also by *the European Code of Ethics*. In 1972 the European Franchise Federation (“EFF”) has developed a Code of Ethics for Franchising, which makes it clear that pre-contractual information is a requirement. Article 3.3 of the Code of Ethics provides: “In order to allow prospective individual franchisees to enter into any binding document with full knowledge, they shall be given a copy of the present Code of Ethics as well as full and accurate written disclosure of all information material to the franchise relationship, within a reasonable time prior to the execution of these binding documents”¹⁰.

It should be noted that the European Code of Ethics does not determine a particular period of time before the signing of the main agreement for which franchisees must be given a disclosure act. It is determined only that it should be a reasonable time.

This requirement is valid only in countries, which have adopted the Code of Ethics and which national franchise associations form part of the European Franchise Federation. These countries are: Austria, Belgium, Croatia, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Netherlands, Poland, Portugal, Slovenia, Sweden and the United Kingdom.

The duty to disclose some information about the franchise is derived from the concept of “*Culpa in Contrahendo*”.

The *Culpa in contrahendo* principle is similar to the obligation of good faith with the exception of its usage during pre-contractual negotiations. There are only two common law jurisdictions within Europe – the United Kingdom and the Republic of Ireland – neither of which recognize the *Culpa in Contrahendo* principle. It is, however, recognized in one form or another in most other European jurisdictions¹¹.

The *Culpa in Contrahendo* principle is mainly used in the judicial proceedings in such countries as Finland, Netherlands, Denmark, Greece, Germany, Austria, Poland.

Therefore, most attention should be paid to national law, as it has higher legal force than legal principles and Code of Ethics, which has advisory nature.

Franchise agreement is quite a free contract. Almost all aspects of the relationship between franchisor and franchisee are fixed in the contract. But the one thing that necessarily has to be enshrined in law is the duty of pre-contractual disclosure. And this duty have to be fixed by law. But as mentioned above, only several countries in the EU have adopted such law in their legislation.

⁷ Marzheuser-Wood B. Franchise disclosure items in Europe / B. Marzheuser-Wood. – London : Field Fisher Waterhouse LLP, 2009. – [Electronic resource]. – Access mode : <http://www.fieldfisher.com/pdf/Franchise-disclosure-in-Europe.pdf>.

⁸ Law relative to pre-contractual information in the framework of agreements of commercial partnership [Electronic resource]. – Access mode : http://www.eff-franchise.com/IMG/pdf/Belgium_-_Franchise_Legislation_on_Precontractual_.pdf.

⁹ Marzheuser-Wood B. Franchise disclosure items in Europe / B. Marzheuser-Wood. – London : Field Fisher Waterhouse LLP, 2009. – [Electronic resource]. – Access mode : <http://www.fieldfisher.com/pdf/Franchise-disclosure-in-Europe.pdf>.

¹⁰ European Code of Ethics for Franchising (1972) / European Franchise Federation [Electronic resource]. – Access mode : <http://www.eff-franchise.com/spip.php?rubrique13>.

¹¹ Hage-Chahine N. *Culpa in Contrahendo* in European Private International Law: another Look at Article 12 of the Rome II Regulation / N. Hage-Chahine // *Northwestern Journal of International Law & Business*. – 2012. – Vol. 32. – Is. 3. – P. 456.

I am of the opinion that other members of the EU also have to adopt disclosure law in their legal systems. In this case it's rational to use the Model Franchise Disclosure Law to simplify this process and ensure a high level of harmonization of the laws of certain countries in the EU. This model document was developed by the UNIDROIT (The International Institute for the Unification of Private Law).

The Model Law is a disclosure law. A disclosure law may be considered to be a means to create a secure legal environment between all the parties in a franchise arrangement. To that end, the Model Law ensures that the prospective franchisees who intend to invest in franchising receive material information about franchise offerings, thus permitting them to make an informed investment decision. In addition, the Model Law brings security to franchisors in their relationships with franchisees, administrative authorities and courts¹².

It should be defined in Franchise Disclosure law what should be disclosed and what should not.

In this case it is suggested that the amount of information disclosed can be largely irrelevant. Indeed, above a certain threshold there is an inversely proportionate relationship between the amount of information disclosed and its effectiveness. The greater the volume of information given, the less likely it is that franchisees will analyze it¹³.

The Article 6 of the Model Law divides the information to be disclosed into two distinct groups: the first contains the information that the disclosure document must contain (Article 6(1)), the second indicates further information that the disclosure document should contain, but which may be omitted if the contract itself provides it in adequate detail (Article 6(2)). In other words, Paragraph (1) refers to information that is normally not included in the franchise agreement, most of which is information regarding the franchisor and the franchise network and does not relate to the rights and duties of the parties. Paragraph (2), on the other hand, requires disclosure of information that is normally dealt with in the franchise agreement itself, as in most cases it is of the greatest importance to the relationship. The reason it is listed in this Article despite the fact that it will be contained in most cases in the agreement itself, is that it is not always adequately considered in the agreement¹⁴.

Conclusion. As a result of our investigation we concluded that pre-contractual disclosure of information plays an extremely important role in relations between the parties of franchising. Exactly this legal institution protects the interests of the parties of franchising before the emergence of contractual obligations, and it avoids mismatch of expectations of the parties.

Only a few countries in the EU have enshrined disclosure obligation in their law. In many other European countries, this obligation follows from provisions of the European Code of Ethics or the *Culpa in Contrahendo* principle, which haven't so high legal force as the law. That's why the countries of the EU that haven't enshrined pre-contractual disclosure obligation in their legal systems should adopt a disclosure law. And to simplify this procedure, it is advisable to use the Model Franchise Disclosure Law developed by the UNIDROIT.

Within the European integration process and further development of market relations Ukraine should also adopt a disclosure law. Before this, it would be rational to change the commercial concession conception to franchising conception in Ukrainian civil law system. This will avoid collisions in process of European integration and adaptation of Ukrainian national law to EU law.

Summary

The article reveals the role and importance of pre-contractual disclosure in franchising relationships. This is a relatively new institution not only in European but also in international practice, therefore it needs further investigation. The article analyzes the main trends of legal regulation of obligatory disclosures before signing the franchise agreement in certain EU countries.

¹² Model Franchise Disclosure Law. Commentary on the Provisions of the Model Law / International Institute for the Unification of Private Law [Electronic resource]. – Access mode : <http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>.

¹³ Abell P.M. The Regulation of Franchising in the European Union / P.M. Abbel. – London : University of London, 2011. – P. 273.

¹⁴ Model Franchise Disclosure Law. Commentary on the Provisions of the Model Law / International Institute for the Unification of Private Law [Electronic resource]. – Access mode : <http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>.

Анотація

У статті розкривається роль і значення переддоговірних умов франчайзингових відносин. Це відносно новий інститут не тільки в європейській, а й у міжнародній практиці, тому потребує подальшого дослідження. У статті аналізуються основні тенденції правового регулювання обов'язкових розкриттів до підписання договору франшизи в деяких країнах Європейського Союзу.

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