

Franchising in Europe After 1992

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Most European developments in 1992, changes in Eastern Europe had franchising first.

CURRENT LEVEL OF FRANCHISING ACTIVITY IN EUROPE

The International Franchise Association's International Franchising, Inc., and Harvard International recently published *Franchising in the Emerging 1989-2000*. This is the only reliable continuing source of statistical information and trends in franchising.

The results, compiled by surveys of IFA member firms, include the following statistics regarding international franchising by U.S. franchisees as of 1989. There are no comparable statistics of other foreign franchisees engaged in international franchise activities in Europe.

1. The *Forecast of the Report indicates*: "[Franchising] will continue a major presence in the European Common Market when it comes into full effect."

2. In 1989, 37% U.S. franchisees (17% of all U.S. business format franchisees) were operating outside of the United States with more than 25,000 units in countries outside the United States.

3. An additional 1.7% of business format franchisees are considering operating in foreign countries by the end of 1992.

4. In 1989, there were 2,643 franchised and company-owned units in the United Kingdom and 4,973 franchised and company-owned units in continental Europe, for a total of 7,616 franchised and company-owned units in the EEC.

5. Franchised units are being opened faster in that as the number of company-owned units.

6. The percentage of income derived by the 5% U.S. franchisees

operating outside the United States is as follows:

Number of Franchisees	Percentage of Income	
	Outside the United States	More than 10%
27	35 - 40%	
46	35 - 40%	
128	25 - 30%	
272	Less than 1%	

7. 86.2% sold directly or through master franchise agreements.

HISTORICAL BACKGROUND

The countries comprising the EEC do not (as of this time) have franchise legislation and/or disclosure laws. France is currently considering a franchise disclosure law (see below). In general, franchising and other business agreements are subject to the Article 89 of the Treaty of Rome and the competition laws of each member country.

Proteptic and Its Property

Proteptic de Paris.¹ This was the Court of Justice's first opportunity to rule on the restraint of trade aspects of franchise agreements. *Proteptic de Paris*, a French franchisor of wedding dresses and accessories, used its German franchisees to take to pay royalties. The franchisees defended alleging that the franchise agreement violated Article 85(1) of the Treaty of Rome and that Commission Regulation 67/137—the block exemption for certain exclusive dealing arrangements—did not apply. The Court ruled that distribution franchise agreements are unique, because they use a single trademark, apply uniform commercial methods, and require royalty payments, and therefore go beyond exclusive or

selective distribution systems. The Court held that restraints on competition imposed on franchisees, which are strictly necessary to protect the commercialization of know-how and the franchisor's interest in its application and the preservation of the identity and reputation of the network symbolized by their mark, are "auxiliary restraints" and do not constitute serious restrictions of competition under Article 85(1). The specific restraints at issue included approval of franchisee advertising, uniform shop designs, requiring the franchisee to devote the shop primarily to the sale of brand fashion items, purchase of supplies from the franchisor or an approved supplier, restricting the franchisee from selling from other shops at the shop, and equipping the shop, training of staff, sales techniques, packaging and marketing in accordance with the franchisor's specifications.

Yves Rocher.² In a companion decision rendered the same day as *Proteptic*, the Commission also exempted from Article 85 the franchise agreement used by Société Yves Rocher, a French manufacturer and retailer of cosmetics, which distributes through mail order and through approximately 1,800 franchised units known as "Yves Rocher Beauty Centers." The Commission held that the provisions in the franchise agreement that were either necessary to protect know-how or other assistance from benefiting competitors or to preserve the common identity and reputation of the franchisor's system were not restrictions on competition under Article 85(1). The Commission specifically held that, despite the nature of the Yves Rocher system, the obligation of the fran-

*1. *Proteptic Case 16/78*, 1980 E.C.R. 353, Commission Decision 79/137 of 12/12/78.

*2. *Yves Rocher, C.I.L. 1989/2825*, Commission Decision, 1989 E.C.R. 3349.

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others to sell only products bearing the Yves Rocher trademark (a so-called "exclusive" competition). The Commission also held that the allocation of exclusive territories to franchisees increased Yves Rocher's ability to compete with its competitors.

Computerland.² In 1987, the Computerland standard franchise agreement was reviewed by the Commission. Under the Computerland franchise agreement, the franchisee is required to operate exclusively at an approved location with a protected area having a radius of less than one kilometer. With the consent of Computerland and upon payment of a contractual fee, the franchise may be permitted to open "satellite" outlets offering approved products, provided such units are not located in another franchisee's protected area. The franchisee is required to sell only products and services acceptable to Computerland but can buy from any approved supplier. The Commission required that the in-ter-territory non-competition clause in the franchise agreement be modified to allow franchisees to acquire financial interests in competitors, provided that a controlling interest was not obtained. The Commission also required that the post-term non-competition covenant be reduced to one year after termination within a radius of 10 kilometers of the former franchisee's value. In Computerland, the Commission considered two "area development agreements."³ This aspect of the Computerland decision indicates that the Commission recognizes that multi-unit master franchise agreements can have the same pro-competitive effects as single unit franchise agreements, and, therefore, can also qualify for exemption under Article 86(1).

ServiceMaster.⁴ In August 1988, the Commission exempted the franchise agreement of ServiceMaster Limited (England). ServiceMaster franchisees perform housekeeping, cleaning and maintenance services for commercial and residential

customers using the franchisee's methods and trademarks. The franchise agreement had a location clause with a designated territory, but ServiceMaster reserved the right to operate itself or grant franchises to other franchisees within the designated territory. The franchise agreement also reserved to ServiceMaster the right to enter into contacts with national and multinational customers and that the franchisee can be required to perform the services agreed to under such contracts. The franchise agreement also provided that the franchisee cannot actively solicit customers outside its own territory but is permitted to provide services to customers located outside its territory. The franchisee may only purchase the brand and types of cleaning and other equipment that are approved by ServiceMaster and must purchase certain chemicals used in the operation of the business only by ServiceMaster or approved suppliers. The non-competition covenant provided that during the term of the franchise agreement the franchisee may not acquire a financial interest in a competing company, except for the ownership in 5% or less of the issued shares of publicly-held companies. After termination of the agreement the franchisee is prohibited for a period of one year from engaging in a business competitive with ServiceMaster within any territory within which it has provided services during the term of the franchise agreement. Outside of these territories for one year the franchisee may not solicit any customers who are customers of it during the two-year period prior to termination of the franchise agreement. The Commission held that these restrictions were not in violation of Article 86(1).

BLOCK EXEMPTION REGULATION ON FRANCHISING

According to the EC Commission, the *Yves Rocher*, *Computerland* and *ServiceMaster* decisions represented a series of "test cases" to be used in formulating a general block exemption of franchise agreements from the competi-

tion rules of the EEC. Regulation 1988 authorizes the Commission to grant "Market or 'block'" exemptions for categories of agreements that have as their objective the exclusive distribution or exclusive purchase of goods or include restrictions imposed in relation to the assignment or use of industrial property rights.

Commission Regulation 4087/88 (the "Franchising Block Exemption") was adopted by the Commission on November 30, 1988, and effective from February 1, 1989 until December 31, 1989 (EU No. 1988 L268). The U.S.A. & Canada has published the EEC Block Exemption Regulations Handbook, which contains, among other regulations, a copy of the Franchising Block Exemption Regulation. By complying with the terms of the Franchising Block Exemption, franchisors will gain automatic exemption from Article 86 of the Treaty of Rome. The following summarizes what provisions must, may and may not be incorporated into franchise agreements under the Franchising Block Exemption:

Scope of Coverage

The Franchising Block Exemption applies to distributions franchisees concerning the sale of goods and service franchisees concerning the rendition of services (i.e. business format franchisees). It does not apply to industrial franchise agreements concerning the manufacturing of goods. That is, it does not apply to wholesale franchisees. Multinational may benefit from other block exemptions if they fulfill the necessary conditions (e.g. the "Know-How Regulation" No. 300/89). The Franchising Block Exemption also does not apply to master vehicles, service stations, and beer supply, which are subject to specific block exemption regulations. The Franchising Block Exemption covers single-unit franchise agreements between the franchisor and a master franchisee, such as area development agreements and international master franchise agreements.

Definitions

Article 1 contains definitions of the following terms: "franchisee,"

¹ J. Computerland, O.J.L. 2032 (1987), Common Mkt. Rep. 2032P, ¶ 10.06.
² J. ServiceMaster, O.J.L. 2028 (1988), Common Mkt. Rep. 2028P, ¶ 10.06.

"franchise agreement," "master license agreement," "franchisor's goods," "contract premises," "know-how," "secrets," "intentional" and "identified." The Franchising Block Exemption provides that there are three elements to a franchise: (i) the use of a common name or a sign and a uniform presentation of contract premises; (ii) the communication by the franchisor to the franchisee of substantial know-how; and (iii) the communication by the franchisee to the franchisee of commercial or technical assistance.

Permissible Restrictions

Article 2 allows the following restrictions on competition (which are normally included in many U.S. franchise agreements):

1. A franchisee can agree not to do any of the following in the exclusive territory:

- (a) Not grant another franchise to another franchisee;
- (b) Not compete with the franchisee; and/or
- (c) Not supply competing goods to any third parties.

2. A master franchisee/area developer may agree not to grant franchise outside of the exclusive territory.

3. A franchisee may agree to:
 - (a) Only operate the franchise from a specific location;
 - (b) Not solicit customers outside the exclusive territory; and/or
 - (c) Not manufacture, sell or use in the course of providing services goods competing with the franchise goods (this does not include spare parts or accessories).

Conditionally Permitted Obligations

Article 3(1) allows additional permitted obligations to be imposed upon franchisees insofar as these obligations are necessary to protect the franchisor's industrial or intellectual property rights or to maintain the common identity and reputation of the franchise network. These obligations are:

1. To require the franchisee to sell or use in the course of providing services, exclusively goods meeting the franchisor's minimum objective quality specifications (this is consis-

tent with most U.S. franchise agreements).

2. To require the franchisee to purchase goods manufactured by the franchisor or by third parties when quality specifications are not possible due to the nature of the goods (this is consistent with most U.S. franchise agreements).

3. To allow in-term and post-termination (one year after termination) non-competition clauses protecting the franchisor and any other franchisee but only within the exclusive territory (this is more restrictive than under most U.S. state laws and franchise agreements).

4. To prohibit the franchisee from acquiring a financial interest in a competitor, which would give the franchisee the power to influence the economic conduct of the franchisee (this is more liberal than most U.S. franchise agreements).

5. To require the franchisee to sell the goods only to end-users, to other franchisees and to resellers within other channels of distribution supplied by the manufacturer or with its consent (this is more liberal than most U.S. franchise agreements).

6. To require the franchisee to use best efforts to sell the goods or provide the services that are subject to the franchise (this is consistent with most U.S. franchise agreements).

7. To require the franchisee to offer for sale a minimum range of goods, achieve a minimum turnover, plan its orders in advance, keep minimum stocks and provide customer and warranty services (this is consistent with many U.S. franchise agreements).

8. To require the franchisee to pay to the franchisor a specified proportion of its revenue for advertising and engage in local advertising that is subject to the franchisor's prior approval (this is consistent with most U.S. franchise agreements).

Unconditionally Permitted Obligations

In addition, the following unconditionally permitted obligations of the franchisee can be imposed:

1. The franchisee shall not disclose to third parties the know-how provided by the franchisor, including after the termination of the fran-

chise agreement (this is consistent with most U.S. franchise agreements).

2. The franchisee shall compensate the franchisor any experience gained in exploiting the franchise and to grant to the franchisor and the other franchisees a non-exclusive license for the know-how resulting from that experience. (This is different from U.S. practice whereby under most franchise agreements the franchisee licenses the sole owner of this information, not merely a non-exclusive licensee).

3. The franchisee must inform the franchisor of infringements, license, industrial or intellectual property rights and take legal action against infringers or assign the franchisee to any legal actions against infringers (this is consistent with most U.S. franchise agreements).

4. The franchisee shall only use the know-how licensed under the agreement pursuant to the franchise agreement and not use it after termination of the franchise agreement (this is consistent with most U.S. franchise agreements).

5. The franchisee shall attend or have its staff attend training courses arranged by the franchisor (this is consistent with most U.S. franchise agreements).

6. The franchisee shall apply the commercial methods devised by the franchisor, including any subsequent modification thereof, and use the license, industrial and intellectual property rights (this is consistent with most U.S. franchise agreements).

7. The franchisee shall comply with the franchisee's standard for the equipment and the premises and/or means of transport (this is consistent with most U.S. franchise agreements).

8. The franchisee shall allow the franchisor to inspect the premises and/or means of transport, including the goods sold and the services provided and the inventory and accounts of the franchisee (this is consistent with most U.S. franchise agreements).

9. The franchisee shall not relocate the franchised premises without the franchisor's prior consent (this is consistent with most U.S. franchise agreements).

10. The franchisee shall not assign the rights or obligations under the franchise agreement without the franchisor's consent (this is consistent with most U.S. franchise agreements).

Compulsory Provisions

Under Article 4, the following provisions must be contained in any franchise agreement in order for the Franchising Block Exemption to apply:

1. The franchisee must be free to obtain its goods from other franchisees or other authorized distributors (this is more liberal than provided in most U.S. franchise agreements).

2. Where the franchisor obligates the franchisee to become guarantor, the guarantee obligation shall apply as to any goods supplied by any member of the franchise network or other distributors that give similar guarantees in the Common Market (this is consistent with most U.S. franchise agreements).

3. The franchisee must indicate its status as an independent contractor, but this should not interfere with the trademark signage (this is consistent with most U.S. franchise agreements).

Prohibited Provisions

Article 5 prohibits the inclusion of any of the following provisions, otherwise, the Franchising Block Exemption is not available:

1. Agreements between competing manufacturers/suppliers of identical or similar goods or services (this is similar to the prohibitions under U.S. antitrust laws).

2. Prohibiting the franchisee from obtaining supplies or goods of a quality equivalent to those offered by the franchisor, subject to the franchisor's right to approve supplies (this is similar to U.S. anti-tying restrictions).

3. A franchisor refusing to designate as an approved supplier, a supplier proposed by the franchisee (such refusal is for reasons other than protecting the franchisor's industrial or intellectual property rights, or maintaining the common identity and reputation of the franchise network (this is similar to U.S. anti-tying restrictions)).

4. Prohibiting the franchisee from continuing to use the license know-how after termination of the franchise agreement (while the franchise has become generally known or easily accessible other than by breach of an obligation by the franchisee (this is fairly consistent with U.S. state trade secret laws).

5. A prohibition against the franchisor from setting its own prices. The franchisor cannot set either minimum or maximum prices although the franchisee can recommend prices (this is similar to U.S. antitrust laws).

6. Prohibiting the franchisee from contesting the validity of the franchisor's industrial or intellectual property rights (this is a common prohibition in U.S. franchise agreements).

7. Restricting a franchisee's ability to sell goods or provide services to end users because of their place of residence (this is similar to U.S. antitrust laws).

Deception Provisions

Under Article 6, any agreement that fulfills the conditions of Article 4 can take advantage of the Franchising Block Exemption even though it contains restrictions on competition that are not covered by Article 2 and 3 but do not come within Article 5 (e.g. a territoriality provision) provided the agreements in question are notified to the Commission in accordance with Commission Regulation Number 27 and the Commission does not oppose such exemption within a period of six months from such notification.

Withdrawal of Exemption

Under Article 8, the Commission can withdraw the benefit of the Franchising Block Exemption if an agreement, although in compliance with the Franchising Block Exemption, nevertheless has certain effects that are incompatible with Article 85(3), and in particular where territorial protection is awarded to the franchisee, and

1. Access to the relevant market or competition is significantly restricted by the cumulative effect of parallel networks of similar agree-

ments established by competing manufacturers or distributors.

2. The goods or services do not face, in a substantial part of the Common Market, effective competition from goods or services that are identical or considered by users as equivalent in terms of their characteristics, price and intended use.

3. The parties, or one of them, prevent end-users from obtaining, directly or indirectly, the goods or services because of their place of residence.

4. Franchisees engage in price fixing.

5. The franchisee uses its inspection right, its right to restrict allocation or its consent to the transfer of the franchise agreement for reasons other than protecting trademarks.

COMPETITION LAWS OF MEMBER COUNTRIES

A number of the member countries have enacted their own competition laws.

Belgium

1. The Belgian Government maintains a very positive attitude toward foreign investment.

2. The Belgian Government is neutral toward franchising.

3. Bills concerning the regulation of franchise agreements have been introduced in Parliament, but these bills have not resulted in the promulgation of a franchise law.

4. There is no legislative, current or proposed, that would require foreign franchisees to register with or seek the approval of any ministry or agency prior to selling a franchise.

Denmark

1. The attitude of the Danish Government and legislature toward foreign investment has traditionally been hospitable.

2. The government has a neutral attitude toward franchising because it is a new, developing business concept in Denmark.

3. There is no legislation or act that is pending particularly focused on franchising.

4. There is no law requiring the registration of a franchise in Denmark.

France

1. The attitude of French authorities toward foreign investments has been to establish a system of authorizations and declarations for foreign investments in France, such as loans, guarantees, shareholding in French companies, purchase of real estate, etc.

2. There is no specific attitude of the French Government with respect to franchising in general, or the entry of foreign franchising in France.

3. Draft regulations under a proposed French Franchise Disclosure Law were promulgated by the French Minister of Commerce late last year. The regulations have yet to be enacted.

Germany

1. The attitude of the Federal Republic of Germany toward direct foreign investment has been to treat foreign investors on the basis of equality of domestic investors.

2. The German Franchise Association in Munich is a useful source of information for franchising in Germany. It may now be said that the general attitude is very positive.

3. No legislation is in existence in Germany that specifically refers to defining franchising.

4. The utilization of Germany has not altered the current situation.

Italy

1. While there is no legislation that would particularly favor foreign over domestic investment in Italy, a persistently high level of chronic unemployment has led Italy very favorably inclined toward foreign investment.

2. There is no particular attitude of the government with respect to franchising, domestic or foreign.

3. There is no franchise legislation being introduced in the Italian Parliament and none is expected in the foreseeable future.

The Netherlands

1. The attitude of the Netherlands Government is traditionally favorable toward foreign investment.

2. The attitude of the Netherlands Government is favorable toward franchising in general. For-

eign and national franchising are equally favored. American experience in franchising is welcome.

3. The Netherlands have not adopted any legislation specifically concerning franchising. Official policy is not directed specifically at franchising, but is generally favorable.

4. No legislation concerning franchising is pending.

Spain

1. The Spanish Government favors the increase of foreign investment in the domestic economy.

2. Although the concept of franchising is comparatively new in Spain, official agencies have a positive attitude toward it.

3. Franchising is not regulated in Spanish legislation. There is no legislation specifically referring to franchising.

United Kingdom

1. The government encourages foreign investment, particularly in manufacturing and where it involves activities with potential for significant employment generation. The government recognizes that franchising offers considerable potential for business formation and job and wealth creation in the U.K.

2. The only U.K. legislation that may particularly focus on franchising is the Fair Trading Act of 1975. Part IX is devoted to pyramid selling schemes and could affect the structure of a franchise where it is intended to submit subfranchise agreements.

3. The Restrictive Trade Practices Act of 1976 may apply if an exclusive territory is granted to a franchise. Otherwise, franchise agreements do not have to be registered with the Office of Fair Trading.

4. The U.K. Government announced in late 1980 that a review is being conducted of its legislation, and it is possible that some changes may be introduced.

INTERNATIONAL FRANCHISING MODELS

Methods of Expansion

There are a number of ways by which a foreign franchisor can ex-

pand into Europe. These include:

1. The opening of company-owned and operated units.
2. Direct franchising.
3. A branch or subsidiary operation.
4. Master franchise agreements.
5. Joint ventures.

Expansion Factors

The best format depends on a number of factors, including:

1. Existing management resources of the franchise.
2. Capital resources of the franchise.
3. Foreign investment restrictions and/or tax incentives.
4. Currency restrictions.
5. Foreign exchange and foreign trade restrictions.
6. Tax treaties and treaties.
7. Industrial and intellectual property laws.
8. Corporate laws.
9. Import/export controls.
10. Excise taxes and duties.
11. Political and economic stability issues.

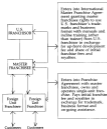
Time and the scope of the outline prevents delving into all of these issues. Nevertheless, each of these issues must be looked at at the time that expansion is contemplated to determine the best approach. As previously indicated, since most foreign franchises sold in Europe are sold directly or through master franchise agreements, we will concentrate on international master franchising agreements.

International Master Franchising

An international master franchise agreement is similar to the subfranchise concept. The foreign franchisor grants to the master franchise an exclusive territory (e.g. country) and the master franchise is responsible for selling and servicing foreign unit franchisees within the exclusive territory.

Basic Structure of International Master Franchise (all subject to negotiation)

1. The master franchise is granted an exclusive territory (e.g. country) and must develop a prescribed number of franchisees pursuant to a schedule of development contained in the International Master Franchise Agreement. The



master franchisee may or may not be granted the right to open its own units.

2. The foreign franchisee gives to the master franchisee rights to the trademarks and other proprietary marks, the business format, loss of the materials, initial training (franchisee) and other assistance.

3. The master franchisee usually pays an up-front master franchise fee to the foreign franchisor for the International Master Franchise Agreement.

4. The master franchisee signs the franchise agreement with the Foreign Lead Franchisee (the foreign franchisee is not a party). The master franchisee assumes all sales and servicing functions, including training and on-going support of the foreign unit franchisee.

5. The master franchisee receives all initial franchise fees and royalties from the foreign unit franchisee and remits a portion of each (e.g., one-third to the foreign franchisor).

Reasons Why a Foreign Franchise Might Want an International Master Franchisee Instead of Opening Company-Owned Units or Direct Franchising

1. Rapid expansion.
2. Greater innovation.
3. Reduced staff.
4. Sharing of risk.
5. Access to other ideas.
6. Local presence and knowledge.
7. Greater incentive for master franchisee to sell and service franchisee.
8. Foreign investment restrictions.
9. Alleviate various tax and tariff problems.

Disadvantages to International Master Franchise Relationship

1. Loss of control.
2. Loss of revenue.
3. Increased risk of vicious liability.
4. Difficulties in enforcement.
5. Conventions required by master franchisee.

Key Issues in Structuring an International Franchise Agreement

In negotiating and drafting an International Master Franchise Agreement, the following key issues should be addressed:

1. Description of the right to be granted by the foreign franchisor to the master franchisee, including the proprietary marks, know-how,

confidential information, manuals, right to franchise, etc.

2. The master franchise territory.
3. Exclusivity.
4. Initial term and renewal term.
5. Duties of the foreign franchisee.
6. Master franchise fee, sharing of initial franchise fee and royalties and other fees such as renewal fee and transfer fee (including type and method of payment, risk of currency fluctuations, exchange controls and inflationary safeguards).
7. Profit-sharing of fees and gross up provisions.
8. Duties of the master franchisee.
9. Schedule of development.
10. Proprietary marks.
11. Confidential manuals and confidential information.
12. Accounting and records.
13. Transfer of interest (units or stock).
14. Default and termination.
15. Obligations upon termination.
16. Independent contractor and independent status.
17. Representations and warranties.
18. Choice of law and venue.

THE FUTURE OF FRANCHISING IN EUROPE

The Single European Act will eliminate fully the internal barriers within the EC by 1992. These barriers relate to physical barriers, such as the movement of people and goods, technical barriers, such as product specifications and professional qualifications and fiscal barriers such as the harmonization of tax rates and a common currency. For the post-1992 Single European Market, franchising may be one of the best marketing formats to take advantage of the removal of these barriers.

The Franchising Book Description results in some certainty in developing franchise agreements and franchise systems. Consideration must be given to the target member country's competition and special franchising laws and local laws, which could impact upon franchising and franchise operations.

While certain barriers will be removed and greater legal certainty

vide, there still will be the need for adapting the franchise system on a country-by-country basis to address language differences, cultural and lifestyle differences, individual tastes and habits and national characteristics. Therefore, a local presence is always advisable. Consequently, in-

ternational master franchising will continue to be the most desirable expansion format, particularly for smaller foreign franchisees.

This exception, the developments culminating in 1992, and the immense changes in Eastern Europe will likely attract more foreign

franchisees as part of the burgeoning global economy. Franchising is a universal marketing concept subject to refinement based on country laws, culture and consumer tastes. The elimination of the trade barriers in 1992 will only fuel the franchising fire.