UNIFORM LAW CONFERENCE OF CANADA

CIVIL SECTION

COMMERCIAL LAW STRATEGY

STATUS REPORT ON NATURAL FRANCHISE LAW PROJECT

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STATUS REPORT ON NATIONAL FRANCHISE LAW PROJECT

To be presented to the Uniform Law Conference of Canada Annual Meeting, Yellowknife, NWT, August 21, 2002

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A. Creation of Committee on National Franchise Law Project

The Uniform Law Conference of Canada ("ULCC") announced the establishment of a new project to consider and make recommendations for the adoption of uniform franchise legislation throughout Canada on June 19, 2002. This project is being directed by a working committee established by the ULCC as part of its Commercial Law Strategy.

At the present time Alberta and Ontario are the only provinces in Canada which have legislation directly regulating franchising. However, other provinces have indicated an interest in following this pattern. The ULCC believes that a uniform regulatory regime across all of Canada, bridging the interests of franchisors, franchisees and others involved in franchising, is a goal supported by all stakeholders.

The franchise law project committee is being co-chaired by two leading Canadian franchise lawyers, both based in Toronto. John Sotos, a founding partner of Sotos Associates, specializes in franchising, licensing and distribution law, served on the Ontario Government's Working Sector Team considering franchise legislation for that

province and is a major proponent of balanced franchising throughout the country. Frank Zaid, a senior partner at Osler, Hoskin & Harcourt LLP, has served as counsel to many of Canada's and the world's leading franchisors, and is Past General Counsel to the Canadian Franchise Association and Past Chair of the Council of Franchise Suppliers of the International Franchise Association.

The committee, established on a national basis to draw upon the resources of other experienced franchise lawyers and interested industry and government representatives, includes the following additional individuals:

Richard Cunningham
President
Canadian Franchise Association
Mississauga, ON

Jean H. Gagnon
Pouliot Mercure
Montréal, PQ

James E. Lockyer
Professor
Faculté de droit
Université de Moncton
Moncton, NB

Bruce Macallum
Ministry of Attorney General,
Province of British Columbia
Victoria, BC

Leonard Polsky
Gowling Lafleur Henderson LLP
Vancouver, B.C.

Daniel Zalmanowitz
Witten LLP
Edmonton, AB

Hélène Yaremko-Jarvis
National Coordinator, Commercial
Law Strategy
Uniform Law Conference of Canada
Mississauga, ON

The committee intends to engage in a wide consultative process in order to receive input and suggestions from all interested parties. In that regard, a dedicated list serve has been established for communication and submission purposes.

The National Co-ordinator of the Commercial Law Strategy of the ULCC, Hélène Yaremko-Jarvis, will be facilitating communications regarding this project and has invited individuals or organizations having an interest in being included on the list serve to contact her by telephone at (905) 813-2088 or email hmyj@rogers.com.

The work of the franchise law project committee is in the very early stages of information gathering. The purpose of this report is to provide members of the ULCC with an overview of the business context of franchising in Canada, the legal treatment of franchising throughout the world, some specific issues which may give rise to controversy in respect of a national franchise law for Canada, and other relevant matters.

B. Canadian Franchise Sector Fact Sheet

The distribution of products and services through franchised systems in Canada is very significant. According to information supplied by the Canadian Franchise Association, there are approximately 76,000 individual franchised operations doing business in Canada under 1,200 different brand names.

The franchise industry accounts for close to 100 billion in sales each year or approximately 40% of every retail dollar spent.

Over 1 million Canadians are employed in the franchise industry, or to put in another manner, 1 out of every 14 working Canadians is employed in a franchise system.

Franchising in more prevalent in Canada than in any other country. One franchise operation exists for every 450 Canadians compared to 1 for every 600 residents of the United States.

Ontario leads the franchise sector in Canada with 56% of franchise systems being headquartered in that province, most concentrated in the Greater Metropolitan Toronto Area. Approximately 65% of all Canadian franchised outlets operate in the Province of Ontario. The franchise industry has grown by an average of 5.4% over the past three years. 12% of all franchises are headquartered in the Province of Quebec while 13% are based in British Columbia and 5% in Alberta.

Although the hospitality industry constitutes the single largest sector of franchise systems representing almost 40% of franchised brand names, the franchise industry is active in most business and retail sectors.

The average initial franchise fee is $23,000 and the average equity investment required to commence a franchised business is just slightly less than $160,000. Individuals investments in franchise systems typically range from under $10,000 for small home based service systems to over $1 million for hotels and full service restaurants.

C. Status of Franchise Legislation in Canada

At the present time, there are two provinces in Canada which have enacted legislation to specifically regulate franchises. The Province of Alberta originally enacted its legislation in 1972, following a California model. The *Alberta Franchises Act*, as originally enacted, required all franchisors operating in the Province of Alberta to prepare a form of prospectus which was required to be submitted to and approved by the Alberta Securities Commission before a franchisor was entitled to offer franchises in that province. The prospectus required annual renewals. As well, any persons engaged in the sale of franchises were also required to be registered.

Following approval by the Alberta Securities Commission of the prospectus, a certificate of registration was issued. Thereafter, the franchisor was entitled to offer and sell franchises provided that it delivered to each prospective franchisee the form of prospectus as approved by the Alberta Securities Commission. Certain types of franchises were exempted from the registration process and were allowed to file a modified form of prospectus known as a statement of material facts. Certain types of transactions were fully exempted from the registration process altogether.

Over a period of time the Alberta Securities Commission developed a number of policies, most of which were not published, which were applied to determine whether a particular franchise would be allowed to be registered. In many cases the Alberta Securities Commission insisted upon certain provisions being contained in a franchisor's standard form of franchise agreement dealing with default, termination, renewal and other matters, thereby in effect regulating the relationship between the parties although the legislation did not specifically authorize or endorse this form of regulation.

After many years of complaints from the franchisor community regarding the cost, bureaucratic approach and uncertainty of the registration process, and co-incident with a provincial policy initiative to de-regulate, the Alberta government decided, in 1995, to repeal its *Franchises Act* and enacted a brand new piece of legislation under the same name.

The new Alberta *Franchises Act* completely does away with the registration and governmental review process. It provided for a standard form of disclosure document to be prepared by a franchisor, responding to certain specific items contained in the

regulations to the legislation. The content of the disclosure document and the degree of disclosure of all material facts does not involve any government filing, review or approval, but it is simply left to the parties to determine that the franchisor has complied with the legislation.

All franchisors are required to deliver their disclosure documents to prospective franchisees at least 14 days prior to the execution of any agreement relating to the franchise, or the taking of any financial consideration. Again, as in the case of the previous legislation, certain exemptions from the legislation and certain exemptions from disclosure are also provided for.

The Alberta legislation also contains a statutory duty of fair dealing in respect of the performance and enforcement of a franchise agreement by both parties. For the first time in Canadian law, the Alberta *Franchises Act* codifies a standard of dealing between franchisor and franchisee. The legislation also allows for the freedom of franchisees to associate, and contains a provision allowing the Alberta government to delegate to an industry body certain functions under the legislation, although to date no such delegation has taken place.

The second province in Canada which enacted franchise legislation is the Province of Ontario. After nearly 30 years of public policy pronouncements, commitments by ministers of the Ontario Government, introduction of draft bills and the like, franchise law in the Province of Ontario became a reality in June, 2000. On July 1, 2000 the *Arthur Wishart Act (Franchise Disclosure), 2000* was proclaimed in force except for those provisions of the legislation dealing with disclosure which were proclaimed in force

effective January 31, 2001. In many ways, the Ontario legislation parallels the *Alberta Franchises Act*.

The legislation provides for the requirement of a franchisor to deliver a disclosure document responding to specified items contained in the regulation to the Act, as well as any other material facts, to a prospective franchisee at least 14 days prior to the taking of any financial consideration or the execution of any agreement. Again, as in the case of Alberta, there is no governmental review, approval or registration of the disclosure document.

The Act provides for harsh civil consequences for failure to disclose, including the right of a franchisee to whom a disclosure document has not been delivered to rescind the agreement and to recover all costs incurred in connection with the establishment and operation of the franchise, including mandatory repurchase of equipment, inventory and leaseholds used in connection with the franchise system.

The Ontario legislation also contains a provision codifying the standard of fair dealing, similar to that in Alberta. However, the Ontario standard of fair dealing goes further than Alberta's by stating that the duty of fair dealing includes, without limitation, the duty to act in good faith and in accordance with reasonable commercial standards. The duty to act in accordance with reasonable commercial standards is unique and is not contained in franchise legislation anywhere else in the world. As in the case of Alberta, the right of franchisees to associate is preserved in the Ontario legislation.

The Ontario legislation does not contain the right of the Minister to delegate responsibility for any part of the legislation to a self-governing body as in Alberta.

The regulation to the Ontario Act (which contains the disclosure document requirements) was drafted with some haste and without industry consultation in late 2000 and became effective on January 31, 2001. There are many ambiguities and uncertainties contained in the disclosure document requirements, for the most part as a result of insufficient certainty in language and a lack of guidelines.

In both Alberta and Ontario, subject to some exceptions for large franchisors, franchisors must provide to franchisees, as part of their disclosure documents, financial statements for the most recent fiscal year of the franchisor. Many franchisors, particularly those which are privately held, do not wish to have their financial statements disclosed in this manner, for both personal and competitive reasons. However, there is no means provided for in either legislation for financial statements to be maintained in privacy or pursuant to an obligation of confidentiality.

The Alberta legislation specifically allows for disclosure documents prepared in accordance with the laws of another jurisdiction having franchise legislation to be used in Alberta provided that an addendum is attached containing the specific changes from the disclosure document used in the other jurisdiction for modification and use in the Alberta. The Ontario legislation does not do so. Therefore, at the present time it is the view of a majority of lawyers practising in the franchise law field that a franchisor selling or offering to sell franchises in the Province of Ontario cannot use an Alberta form of disclosure document, but must have a separate Ontario form prepared for this purpose. Therefore, the more common view is that a franchisor wishing to franchise in both Alberta and Ontario can only use a standard form of franchise disclosure document if it is prepared in accordance with Ontario law and an addendum is subsequently attached

outlining the changes required for compliance with Alberta disclosure requirements. The reverse process is not acceptable for the Province of Ontario.

D. History of Franchise Regulation

The United States is the most developed country in the world with respect to franchise regulation and legislation. In addition to a national franchise disclosure rule applicable throughout the country and enforceable by the Federal Trade Commission, approximately 15 states in the United States have separate state legislation calling for specific forms of franchise disclosure or registration in their respective jurisdictions. A number of other laws throughout the United States also apply to franchising, including "little FTC Acts", specific industry legislation, and business opportunity laws. Increasingly, many other countries throughout the world have introduced their own forms of franchise legislation.

In the context of the Canadian economy, the debate with respect to the appropriate form of franchise legislation really relates to what would be considered to be the proper attributes of franchise regulation in Canada, as opposed to whether there should be franchise legislation.

Franchise regulation began in California in 1970 and consisted at that time of presale disclosure legislation. The legislation also included registration and approval by the State of California prior to the sale of a franchise.

Since that time, many jurisdictions have adopted simple pre-sale disclosure legislation, although others have combined such disclosure requirements with filing requirements

with the state authorities, and others have followed a stricter model by requiring both filing and registration approval.

Brazil, France, the UNIDROIT Model Franchise Legislation, Alberta and Ontario, and perhaps most importantly, the United States Federal Trade Commission Rule of 1979, use a simple disclosure model.

E. Trends of Regulation

Since disclosure laws have been enacted by governments throughout the world, two new trends have evolved in recent years.

The first trend is that in certain jurisdictions relationship laws have become part of the disclosure laws governing the franchise relation after a sale of a franchise. The second trend is that voluntary codes have been adopted by industry associations in certain countries.

The voluntary codes adopted by industry associations can include various aspects of disclosure requirements and relationship conduct, but in virtually every case where such voluntary codes have been adopted, the associations involved have lacked delegated authority by statute to regulate. The codes apply to franchisors or members of a national or supra-national franchise association, and have been introduced largely to stave off legislative intervention and provide a uniform framework for franchisor members of these associations. The codes may include a code of conduct and/or disclosure.

Voluntary codes are typically limited to pre-sale disclosure matters. However, in several jurisdictions the codes have ventured into dispute resolution services including mediation

and ombudsmen. It is possible that the voluntary codes could become law between the parties by reference to such codes in a franchise agreement, and it is also possible that, in an appropriate case, a court could establish that a trade association code provides the best practices of good conduct where the franchisor is a member of the association.

The Canadian experience is illustrated by the activities of the Canadian Franchise Association (the "CFA"). The CFA first adopted a voluntary code of disclosure and limited post-sale conduct. Subsequently, the CFA converted the voluntary code into a mandatory code for all franchisor members, and in fact adapted the code to apply to franchise supplier members as well. The CFA voluntary and mandatory codes stipulated that mediation was a desirable alternate dispute resolution technique, and in fact made arrangements for a recognized organization to become the official mediation service for the CFA. In 2001 the CFA made arrangements for an independent ombudsman to be available to assist franchisors and franchisees in respect of dispute resolution with a view to preventing claims from advancing at a time when early resolution was possible.

In Australia, a voluntary code of conduct was adopted in 1993 requiring pre-sale disclosure, a cooling off period and mandatory mediation of disputes, amongst other matters. Nearly 50% of the Australian franchisors did not register with the government to participate in the program. As a result, the Australian government adopted a mandatory franchise legislation code in 1998.

F. Disclosure Laws

The FTC example of a pure pre-sale disclosure law has been adopted by numerous other jurisdictions, including Brazil and France, besides the Provinces of Alberta and Ontario[1].

Another much-debated model of disclosure law is the UNIDROIT Model Franchise Law on pre-sale disclosure. This law was drafted by the 58-member United Nations body, UNIDROIT, to act as a model for countries planning on adopting franchise regulation. UNIDROIT's founding mandate is to help foster a uniform disclosure law across many jurisdictions.[2]

The trend in disclosure laws has been towards disclosure without registration, or what is known as 'simple' disclosure. A 1985 Federal Trade Commission (U.S.) Impact Study found no evidence that franchisees benefited from a prior approval process.[3] Without clear evidence of their benefits, registration requirements may exceed the necessary level of intervention by which the industry as a whole can benefit. The fact that some U.S. states, such as Michigan and Wisconsin, and the province of Alberta, have abandoned registration requirements, also points to this conclusion.[4]

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1 The Alberta and Ontario legislation provide one element of relationship regulation being the requirement of "fair dealing".

2 Lena Peters, Research Officer for UNIDROIT, states in, "The UNIDROIT Model Franchise Disclosure Law" that UNIDROIT is an inter-governmental organization with 58 member States, the purpose of which, is " to examine ways of harmonizing and coordinating the private laws of States and of groups of States, and to prepare gradually for the adoption by various States of uniform rules of private law" (Article 1 of UNIDROIT statutes)

3 Study quoted in "Legislative Update in Debate" in *Franchising Roundup*, Bret Lowell, Andrew Selden, Neil Simon (Forum on Franchising, American Bar Association, 1993 Annual Forum vol. 1), p. 19

4 Michael G. Brennan of Piper Rudnick, "A Critical Review of Malaysia's Proposed Franchise Legislation" (CCH Business Franchise Guide, 2002)

One significant difference that has emerged in the various disclosure laws enacted is whether the format of disclosure is fully standardized or includes an open-ended provision to capture the unique facts of a given franchisor. The Australian Code of Conduct, and the UNIDROIT Model Franchise Law, both require inclusion of any material facts[5], these being any issues that impact on the overall health of a franchisor in addition to prescribed disclosures.

Every disclosure law requires disclosure of particulars of the franchisor. The UNIDROIT Model Franchise Law also requires in-depth information about the network, requiring names and addresses of nearby franchises and also a list of all franchisees that have left the system and their reasons for leaving. Many disclosure laws also require information regarding any convictions and pending litigation, both against senior staff and the corporation. Additionally, most jurisdictions impose personal liability on those signing the disclosure document.

The UNIDROIT Model Franchise Law requires that the franchisor disclose any benefits derived from nominated suppliers. The primary objective of this item of disclosure is to circumscribe the initial investment required of the franchise purchaser.

Disclosure laws usually require the supply of current, audited financial statements of the franchisor to the prospective franchisee. Most regulations provide for exemptions,

[5] "material fact" as defined by the *Arthur Wishart Act*, includes any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise;

typically for large franchisors and/or to investors purchasing opportunities of relatively moderate value.

Disclosure documents typically require that the franchisor state its duties and obligations in writing concerning the key elements of the franchise. This includes any obligations that are downstream of the actual purchase and represent significant value to the overall business opportunity. Training programs are a good example of services that are promised at the point of purchase but later can become a matter of contention as to substance or quality.

Australia's model is the most comprehensive regulatory environment of franchising in the world. It also includes a number of relationship provisions in the following areas:

(a) consents to transfer of a franchise cannot be unreasonably withheld;

(b) termination requires notice of any breaches, with a reasonable time to cure and mandatory mediation;

(c) a general release of liability as a condition for renewal or transfer is invalid;

(d) an audit of advertising funds and remittance of financial statements on an annual basis to franchisee is mandatory;

(e) a franchisor cannot interfere in the right of franchisees to associate;

(f) a franchisor must provide a franchisee with copies of all agreements relating the franchise; and

(g) the statute is enforceable by both private civil action and governmental enforcement through the Australian Competition Authority.

Some developing countries also have relationship laws, which are federally regulated, including Albania, Indonesia, Malaysia , China and Korea.

G. Relationship Laws

The most fundamental form of conduct regulation anywhere could be termed fairness, general conduct or relationship regulation. Its origin, for franchising purposes, could be attributed to the common law duty of "good faith and fair dealing".

The effect of this duty has left a great deal of uncertainty in its application as in a number of cases it has not prevented terminations which could be construed as within the contractual rights of the franchisor and yet short of malicious or fraudulent intent.

In addition to Australia's relationship laws and operating in conjunction with them are a more generalized body of conduct laws known as The Trade Practices Act. These laws are more specific and more effective than general conduct common law standards:

> Section 52 prohibits misleading or deceptive conduct. Section 51A states that a person making any statement regarding a future event (such as a projection as to turnover) must be able to prove that he or she had reasonable grounds for making it. Section 51AC provides that a corporation must not, in trade or commerce, engage in conduct that is 'unconscionable.' All of these sections can be read together.

Many American States and Australia have also enacted higher standards of conduct or standards applicable to particular areas of the franchise relationship prone to conflict such

as matters of termination. This higher standard often has a procedural component and/or an ethical standard.

"Good cause" is a standard of conduct defined individually by each State. The areas to which this standard applies are those that have seen the most conflict such as renewal of term, termination, and transfer. By example, the State of Hawaii defines good cause as: "the franchisee's failure to comply with any lawful, material provision of the franchise agreement after notice and opportunity to cure".

Relationship legislation will mandate a notice period for any material default and often a cure period in which these defaults can be remedied.

The mechanics of disclosure laws and relationship laws can be witnessed in the seven areas of potential conflict that are common to franchisor-franchisee disputes. These are: earnings claims, grounds for termination, renewal of contracts at end of term, transfers or sales by franchisees, rebates or supplier benefits/discounts to franchisor, pooled advertising funds, and limits or extent of territory.

(a) **Earnings Claim Format**

The manner in which projections are drawn can provide a distorted picture of the earning potential of a location. Disclosure regulation typically provides for some form of standardization as to how forecasts should be created and requires disclosure of the basis, in fact, for these forecasts. Article Six of the UNIDROIT Model Franchise Law, states as follows:

> If information is provided to the prospective franchisee by or on behalf of the franchisor concerning the historical or projected financial performance of outlets owned by the franchisor, its affiliates or franchisees, the information must:
>
> (i) have reasonable basis at the time it is made;
>
> (ii) include the material assumptions underlying its preparation and presentation;
>
> (iii) state whether it is based on actual results of existing outlets;
>
> (iv) state whether it is based on franchisor-owned and/or franchisee-owned outlets; and
>
> (v) indicate the percentage of those outlets that meet or exceed each range or result.

In addition, the franchisor is required to state the general market for the product or service being sold by its system, the state of the local market, and prospects for development of the market. UNIDROIT's model is an open disclosure law. Hence earnings claims would also need to provide any additional facts that are material to the sale of the particular franchise.

The unresolved debate over earnings claims revolves around whether such claims should be a mandatory area of disclosure or not. Arguably, the earnings history of a franchise offering is the most important piece of information of interest to a prospective franchisee. Even in the most highly regulated environments, such as the United States, only 20% of franchisors ever make earnings claims. As a result, many have argued that earnings claims disclosure should be made mandatory. However, the issue is complicated by the

application of a mandatory policy to new franchisors who do not have historical information and wish to use forecasts or future oriented earnings claims.

(b) Exclusivity of Territory

As a system matures and reaches saturation in a market, the problem of encroachment between franchisees of the system can occur. Some franchisors have a temptation to oversell a territory, especially since losses in revenue are largely passed down to the previous franchisees within that territory.

The UNIDROIT Model Franchise Law requires, as part of disclosure, a concise statement that defines the nature of a territory and a statement to the effect whether this is non-exclusive or exclusive.

Some franchisors, particularly in the hotel/accommodation properties sector, have developed impact policies to compensate franchisees for lost revenues as a result of encroachment.

(c) Termination Conditions

Since termination, especially where sunk costs of the franchisee are significant, can be a form of de facto expropriation, most disclosure documents require an upfront understanding between the parties as to grounds for termination.

Disclosure laws often require that all termination conditions be set out in the agreement and some relationship laws go further to require notice periods on any action for termination by the franchisor.

Laws with regards to termination usually require some form of due process and good cause on the part of the franchisor. Australia's fairness regulation provides for written notice periods to effect termination and mandatory cure periods. Notice periods help prevent immediate actions by the franchisor and help create a window for settlement before drastic solutions such as re-possession.

California's State law, among other states, goes still further and takes the position that termination can only be affected for "reasonable grounds" these being defined as,

(i) bankruptcy, insolvency or assignment to creditors;

(ii) abandonment, except for causes outside of franchisee's control;

(iii) franchisor and franchisee agree to terminate;

(iv) material misrepresentation regarding the acquisition of business or franchisee engages in conduct which reflects materially and unfavourably upon operation of business;

(v) conduct that is unfavourable to business or reputation;

(vi) failure to comply with laws after 10 days notice;

(vii) repeated failure to comply with good cause standard;

(viii) foreclosure;

(ix) conviction for offence related to franchise; and

(x) endangerment of public health or safety.

(d) **Transfers and Sales**

Since franchisors often employ selection criteria in choosing candidates for the position of franchisee, a replacement franchisee may need certain qualifications. The franchisee may wrongfully assume it has rights to sell its business. Equally, a franchisee may pass away or become incapacitated and wish to transfer the franchise to its estate or family.

The various disclosure laws require some clarity of the franchisor's position and to have this made known to the franchisee before purchase.

Australia's fairness law goes further and states (section 20(1)) that the franchisor must consent to transfers and these will not be unreasonably withheld as a matter of law. Some U.S. state laws do the same.

(e) **Renewal**

Since franchisees can have built up significant additional equity through the goodwill of the business, they risk to lose this goodwill if denied renewal at the end of term. Hence renewal terms are part of the value of a grant of franchise and should be brought to the attention of the parties.

Disclosure laws often will require that renewal conditions be set out and if renewal does not exist then this position of the franchisor must be stated as such.

Relationship laws, on the other hand, such as those found in some U.S. states may impose the standards of good faith and good cause on refusals to renew an agreement. Some require lengthy notice periods, in order to give adequate time to the franchisee to plan its

financial affairs. Some laws go further still and mandate renewal if no material breach has occurred and remains ongoing.

A twist on mandatory renewal is found in California's law which requires 180 notice, and also requires that the franchisee have the right to transfer the franchisee to a candidate that materially meets the franchisor's selection criteria. In essence, the law attempts to prevent expropriation of goodwill while still allowing the franchisor to end a particular relationship.

(f) Rebates

Many disclosure laws require disclosure of the franchisors' practices in respect of rebates (whether they retain the rebates or pass them on to franchisees in whole or in part).

(g) Advertising Funds

Most disclosure laws require that disclosure set out advertising fund obligations of the franchisee, whether they will be audited, and by what method. Australia's legislation actually requires that such funds be treated as trust funds and be separately audited and reported and repaid to franchisees periodically.

H. Industry Specific Relationship Laws

Some jurisdictions have relationship laws protecting specific classes of franchisees such as automobile dealers, gasoline station operators and farm implements dealers. In most cases, these statutes preempt general franchise regulation.

The laws are typically brief and industry specific, and:

(a) forbid the termination of the dealer prior to the end of the term without good cause;

(b) prevent a franchisor from refusing to renew a dealership agreement without good cause; and

(c) require the franchisor to repurchase inventory upon termination;

(d) prevent franchisors from interfering with the formation franchisee or dealer associations;

(e) govern transfer of dealership interest; and

(f) impose the duty of good faith and fair dealing upon franchisors.

I. Other Federal Laws

In Canada, since franchise laws are the subject matter of the exclusive jurisdiction of the provincial governments, other areas affecting franchising in general which are the subject matter of federal jurisdiction must also be considered. There are many other areas of federal laws which impact upon franchising that which are typically covered in franchise disclosure or relationship laws, including:

(a) competition laws;

(b) intellectual property statutes including, in particular, trade-marks; and

(c) common law pronouncements and decisions, dealing in particular with restricted trade practices, non-competition covenants and the general contractual duty of good faith and fair dealing.

J. General Reasons for Franchise Regulation

Uniform provincial legislation will benefit all parties concerned or interested in franchising throughout the country. Uniform legislation will help franchisors standardize

their procedures and documentation and accordingly save costs which might otherwise be passed on to franchisees and ultimately to consumers.

Franchisees will be given legal protection where none currently exists since it would be expected that many provinces will adopt franchise legislation once a simplified model has been proposed.

Uniform legislation will also help both franchisors and franchisees resolve disputes by defining one standard code of dealing, and possibly one standardized method of dispute resolution.

At the present time, the perceived driving force behind the interest of many franchisees in franchise legislation is the lack of presale information provided to prospective franchisees and, in some cases, unfair treatment of franchisees following the acquisition of a franchise.

A complete lack of presale disclosure means that franchisees are often entering into long term agreements and complex arrangements without an adequate opportunity of receiving relevant background information. There is little doubt that unfair practices are harmful to franchising in the general context as an industry, both for franchisors and franchisees, as well as for investors in franchise systems.

The international trend, as well as the national interest in Canada, has been towards an increased interest in introducing some form of franchise legislation.

There are a number of reasons why franchise legislation is desirable both from a government policy point of view and from a private interest perspective.

From the government perspective, franchise legislation will help to protect small business owners, hopefully prevent unnecessary disputes, and provide consumer confidence in the stability of franchisee units. Further, given the substantial number of employees, service providers and third party suppliers to franchise systems, any steps taken by government or otherwise to assist the stability of franchisees will have a multiplier effect on those persons collaterally involved in employment, service provider or supplier relationships with franchise systems.

Frequently, there is an inequality of bargaining power between franchisors and franchisees. As in many other industries, the agreements may take the form of adhesion contracts in the sense that a franchisee may be required to sign the franchisor's standard form of documents without change or not be able to proceed with the transaction.

Franchisees in many cases are unsophisticated business investors and, particularly in smaller franchise systems, may be entering business for the first time. Their family savings or assets may be at risk through the granting of security to the franchisor or lending institutions financing a transaction.

Both franchisors and franchisees share a common interest in having franchise legislation enacted, but have a inherit conflict of interest in respect of the type of legislation.

Franchisors derive revenues from a number of areas, including initial fees, royalties, leases, transfers and product rebates and sales. Franchisors also receive income based on the level of a franchisee's gross sales, but not on the franchisee's profitability.

Franchisors usually have more protection afforded to them in a franchise agreement by reason of their control over the preparation of such agreements and their dominant economic power.

Franchisees are often at a disadvantage in respect of information provided to them, and their inability to shift the economic risks of the relationship.

Voluntary codes by trade associations have inherent drawbacks in that they are not subject to governmental or statutory delegation of authority. Therefore, the most common remedy available to an industry association is expulsion of an non-compliant member. Associations are generally ill equipped to handle any quasi juridical processes involving dispute, and non-members of the associations are unaffected by the policies or codes of conduct of the association in question.

Pre-sale disclosure is the common element of most legislative regimes. It is a useful tool for helping investors, and serves to provide a definition of what is meant by a "franchise". It is most important to maintain the consistency of requirements imposed upon franchisors, the definition of a "franchise", statutory codes of conduct, and disclosure items in provincial franchise statutes.

The value obtained by reason of the registration of disclosure documents is debatable since it has been proven in a number of jurisdictions that franchisees do not necessarily obtain a greater degree of protection by reason of governmental review and registration of franchise documents than they would obtain by compliance with standard disclosure items. Registration, however, can be useful if there is an informed, meaningful and

objective approval process which serves to protect unsophisticated investors. As well, a review process may provide an appropriate venue for franchisee complaints.

Registration jurisdictions, however, often adopt a bureaucratic attitude such that franchisors are inhibited by inconsistent application of standards, or, in fact, from lack of an open and level application of standards. The trend among registration jurisdictions in recent years has been to move to a more simplified form of pre-sale disclosure and, in some jurisdictions, simple filing with a government office but no review or registration.

Appropriate relationship regulation may serve the purpose of protecting the reasonable expectations of both parties if the standard provisions of the legislation mirror good business practices of responsible franchisors. Such legislation may also assist to guide the parties in appropriate conflict resolution practices.

The appropriate regulative response for the call for franchise legislation is no longer determined by a choice between government regulation and industry self-regulation. The concept of "responsive" regulation involves developing a regulatory model which incorporates the policy elements of governmental oversight with elements of self-regulation. No model of franchise regulation can be effective without both elements.

K. Future Work of the ULCC Franchise Law Project

The challenge before the ULCC franchise law project is to recommend the appropriate model keeping in mind the experience shown in other jurisdictions and the type of legislation currently in place in two major provinces in Canada. Further, recommended model legislation will have to take into account the particular requirements of Quebec's Civil Code so that enforcement and interpretation considerations of the model legislation will have equal applicability in both common law and civil law jurisdictions.

The committee will be convening a full in-person meeting in September, 2002 after the ULCC Annual Meeting. The committee will be looking for suggestions from the ULCC Annual Meeting and will adopt as its priority schedule the following:

(a) suggestions as to the type of franchise legislation likely to be considered;

(b) recommendations from all stakeholders as to most important areas for consideration;

(c) integration of common law and civil law concepts;

(d) consideration of pros and cons of current franchise legislation in Canada; and

(e) working outline of key issue areas for inclusion in model legislation.

The committee will seek regular input from all interested parties in an effort to arrive at a balanced uniform act which will benefit from widespread support of stakeholders and thus can be capable of broad implementation throughout Canada.

We look forward to reporting to you in the future.

July 26, 2002

Attachment – Summary of International franchise Laws

Summary of International Franchise Laws

Albania

In 1998, Albania introduced franchise provisions into the Civil Code with a broad definition of franchising. The franchisor is obliged to protect the rights of the franchise from infringement by third parties and to support the franchisee by providing necessary information and instruction.

During pre-contractual negotiations both parties must exchange relevant information to the franchise. The parties must provide the information in good faith and are bound to keep the information confidential.

The contract must be in writing and must specify both the obligations of the parties and the duration of the contract. In the case of indefinite duration or a term of more than ten years, either party can withdraw on one year's notice. After the contract has come to an end, the parties have a reciprocal obligation to compete fairly. The franchisor may restrict the franchisee from competing on the local market for up to one year after the contract has ended.

The franchisor is entitled to damages when the franchisee breaches contractual obligations. When one party infringes contractual obligations and places the trade activity at serious risk, the other party has the right to withdraw from the agreement without being bound by its term.

Argentina

In 2001, Argentina was considering adopting legislation to guide franchise relationships.

Australia

In December 1990, a Franchising Task Force was appointed to examine and report on potential self-regulatory codes for countering marketing failure in franchising. The Task Force developed a voluntary self-regulatory Franchising Code of Practice. In 1994, the functioning of the Code was reviewed and led to a debate as to the necessity of franchise legislation as 40-50% of franchisors chose not to register under the Code. Moreover, there was a significant number of non-registered franchisors who failed to provide adequate disclosure, a cooling off period, or standards of conduct contained in the Code.

In October 1998, a mandatory *Franchising Code of Conduct* became fully operational. Any agreement existing before October 1 is only covered to the extent that the Code's provisions are applicable to that agreement. The Code imposes comprehensive disclosure requirements. A franchisor is required to prepare a disclosure document which must be updated annually within three months after the end of the franchisor's financial year. The franchisor must give a copy of the Code and the disclosure document to the prospective franchisee at least 14 days before the prospective franchisee enters the franchise agreement or pays a non-refundable amount. A seven day cooling off period is required after the signing of the franchise agreement. In relation to conduct, the Code guarantees a franchisee the right to association and prescribes the preparation of financial statements for required cooperative funds.

The Code also imposes a requirement for the mandatory mediation of franchising disputes as a prerequisite to litigation. A franchise agreement must contain an internal complaint handling procedure which complies with the procedure outlined in the Code.

The Federal Government amended the Code by introducing the Trade Practices Regulation 2001. The Regulations were made on June 28, 2001 and commenced on October 1, 2001. The Code has been amended to give a franchisee current information that is material to running the franchise. The amendments include the following: (1) a Short Form Disclosure Document for the sale of a franchise with expected revenues less than $50,000, (2) removal of the existing requirement on a franchisee to provide a disclosure document where that franchisee is selling a franchised business to another franchisee, and (3) permission to allow electronic delivery of documents.

Barbados

In Barbados, the Franchises Registration and Control Act provides for the licensing, registration and control of a franchise. No person can operate a business in Barbados using another person's mark, product, service, technique, device, copyright, industrial design or invention unless he obtains a franchise from the owner. Moreover, any person wishing to operate a franchise must first obtain a license from the Minister of Finance. Upon receipt of an application, the Minister publishes a notice inviting objections to the issuance of the license in the Official Gazette. The Minister then considers the application together with any objections.

Any non-citizen or non-permanent resident wishing to operate a business in Barbados using its own mark, product, service, etc. or any person, including a citizen or permanent resident, wanting to operate a business using somebody else's mark, product, service, etc. must go through the Act's application process. Accordingly, Barbados has effectively precluded foreign franchise owners from operating a franchise business in Barbados either directly (e.g., through a subsidiary) or indirectly (through a franchisee) without exposing their program to the application process, since objections often are raised.

Brazil

On December 15, 1994, a law relating to franchising contracts was adopted. The law applies to franchises operated on Brazilian national territory and to master franchises.

The law deals primarily with disclosure. The information must be provided in writing at least ten days before the execution of the franchise agreement, preliminary franchise agreement or payment of any fee by the franchisee. If these requirements are not met, the franchisee may annul the agreement and request compensation for damages suffered. Recourse is also available where the franchisor includes false information in the disclosure document.

Canada

There is no federal franchising legislation in Canada. However, both Alberta and Ontario have statutes dealing with franchising.

Alberta

Historically, Alberta had specific franchising legislation providing for both registration and disclosure. On November, 1, 1995, new franchise disclosure laws and implementing regulations became effective abolishing the requirement for registration. The law retains the pre-sale disclosure obligation. The franchisor must give a prospective franchisee a copy of the disclosure document at least 14 days before the franchisee signs any agreement or pays any consideration.

In addition to disclosure, the Act details exemptions from the duty to disclose, cancellations, damages, rights and remedies, general regulations, self-government and transitional provisions. The law also provides for a duty of fair dealing in performance and enforcement.

Ontario

On May 17, 2000, the Ontario Legislature adopted the Arthur Wishart Act (Franchise Disclosure). All provisions of the Act came into force on July, 1, 2000, excluding the disclosure provisions. The Implementing Regulations became effective January 31, 2001. Finally, on June 29, 2001, Ontario amended the Act to give the Lieutenant Governor in Council the right to define any word or expression used in the law that has no yet been defined. The Act applies to franchise agreements entered into after the effective date and to the renewal of an existing agreement after the effective date.

The Act governs both the disclosure and relationship between the parties. The franchisor must provide the disclosure document not less than 14 days before the earlier of signing the franchise agreement or paying consideration. A franchisee can rescind the agreement no later than 60 days after receipt if the disclosure document is not provided on time.

The Act also provides for a duty of fair dealing in performance and enforcement. This duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards. A right of action for damages is available for a breach of this duty. Moreover, the franchisee has a right to associate without any interference from the franchisor.

Other provisions detail when the Act does and does not apply, exemptions from the duty to disclose, the right of a franchisee to rescind the agreement, when damages may be claimed for misrepresentation or failure to disclose, the non-derogation of other rights and exemptions.

Other Provinces

In late 1993, the Canadian Franchise Association adopted a voluntary pre-sale disclosure scheme. As of November 4, 1996, the Association requires mandatory pre-sale disclosure as a condition of membership.[i]

<u>China</u>

On November 14, 1997 the *Circular of the Ministry of Domestic Trade Concerning the Promulgation of the Measures for the Administration of Franchise Operations (for Trial Implementation)* was adopted for the purpose of standardizing franchise operations, protecting the lawful rights and interests of the franchisor and franchisee and the promotion of chain businesses. The circular applies to enterprises, individuals and other economic organizations that engage in franchise operations in the People's Republic of China. It is a general guide to basic rights and obligations and provides a basic framework for the operation of franchises in China.

The circular requires the written disclosure of franchise information to prospective franchisees and imposes a general good faith requirement on both sides. The franchisor must submit its disclosure information to the China Chain Enterprises Association. The Association is responsible for formulating rules and codes of conduct for franchise operations and promoting franchise development. Franchisee disclosure is also mandated in China requiring the applicant to provide an accurate account of its capabilities. Finally, the circular specifies that disputes arising in the course of the franchise agreement must be dealt with in accordance with the legal procedures stipulated in the contract.

On June 15, 2002, the China Chain Store & Franchise Association hosted the 4th China Franchise Convention & Exhibition where it revealed that laws regulating franchising activities are expected to be introduced within the second half of the year. The Franchise Law purports to define the rights and obligations for both franchisor and franchisee, specify the capacities required for operating a franchise businesses in China and provide the contents of the franchise contract as well as the liabilities for breach of contract.[ii]

France

On December 31, 1989 France adopted Law No. 89-1008 (Loi Doubin) relating to the development of commercial enterprises and the improvement of their economic, legal and social environment. The first article is relevant to franchising. It is a disclosure law which covers franchising but is not franchising specific. It applies to all franchise, trademark, distribution and license agreements. The details of the law are laid out in government decree No. 91-337 of April 4, 1991.

The disclosure document must be delivered by the franchisor at least twenty days before the execution of the contract or before the payment of any sum of money by the prospective franchisee. It must be in writing and it must set out the circumstances fairly and accurately enabling the franchisee to make an informed decision. Disclosure must also include information relating to banks and annual financial statements for the last two fiscal years. The Disclosure Document is not required to be written in French but an implied obligation exists particularly in the case of an unsophisticated franchisee. Failure to deliver the Disclosure Document constitutes a criminal offence under the French Criminal Code and is punishable by fine and/or imprisonment for up to one month.

Indonesia

On June 18, 1997 the Indonesian Government issued *Government Regulation No. 16/1997* relating specifically to franchising. The Regulations were issued to develop and promote participation in franchise businesses. They require the disclosure and registration of both the franchise agreement and the disclosed information with the Ministry of Industry and Trade. The franchise agreement must be in writing, in the Indonesian language, governed by Indonesian law and must be at least five years in duration. Moreover, both the franchisor and franchisee must give priority to the use of local products or raw materials and the franchisor must give priority to small and medium scale enterprises. The Regulations further provide that the franchise agreement must contain provisions for dispute resolution. Finally, the Regulations contain sanctions for a franchisee in contravention of the registration or reporting requirements.

Franchising is permitted in provincial capitals or areas in second-level regions that the Minister of Industry and Trade stipulates. An exception to this rule is for uniquely and traditionally Indonesian goods, foods or drinks which may be carried out in the entire territory of Indonesia by small and medium scale enterprises or with participation from small and medium scale enterprises.

Italy

There is no Italian statute in force dealing with franchising. However, in 1995 the Italian Franchise Association implemented a voluntary self-regulatory code of conduct requiring franchisors to provide a disclosure document to prospective franchisees. Disclosure must include the franchisor's balance sheet for the previous three years, a copy of the Regulations and the European Code of Ethics for Franchising (ECEF).[iii]

The code also requires fairness in contractual terms. The contract must be in writing, must provide for adequate territory of exclusivity for the franchisee and must provide for adequate duration. Rules governing the termination of the contract must also be included.[iv]

Japan

There are no laws in Japan specifically regulating the franchise industry. A general duty of disclosure is provided for in the 1973 Medium-Small Retail Business Promotion Act. The Act is not franchise specific and only Articles 11 and 12 are of relevance to franchising. The Act is of relevance only to retail franchising.

The Japan Franchise Association is the only authoritative association that has set out guidelines, which are similar to the guidelines outlined by the International Franchise Association. Moreover, Japan regulates franchising through antimonopoly laws of the Fair Trade Commission, Product Liability Law, trademark laws and contract principles under the Japanese Civil Code.[v]

Korea

On April 7, 1997, the Fair Trade Commission of Korea adopted *Notice No. 1997-4* specifying criteria which constitutes unfair trade acts in franchising. The Notice aims to promote rational trade practices in franchising and prevent unfair trade acts. The Notice requires a general duty to disclose information necessary for a prospective franchisee to make an informed decision however, does not include a list of information that must be disclosed. The Notice also deals with the business relationship.

Malaysia

On December 24, 1998, the Malaysian *Franchise Act* was given Royal Assent but did not come into effect until October 8, 1999. In addition to protecting franchisees, the legislation aims to promote the development of entrepreneurs, create opportunities to become franchisors and franchisees, and regulate the development of franchising to maximize success and prevent abuse. The Act covers franchises to be operated within Malaysia and requires comprehensive registration, disclosure and relationship law.

Prior to making an offer, a franchisor must register the franchise with the Registrar of Franchises. The application must be made on the prescribed form and must annex the completed disclosure document, a sample of the franchise agreement, the operations manual, the training manual, a copy of the latest audited accounts, financial statements, and the reports of the auditors and directors of the applicant. An approved application may be subject to further conditions by the Registrar. A registered franchisor must file an annual report to the Registrar with updated disclosures.

Disclosure is required at least 10 days before the agreement is signed and must be in the prescribed format. The disclosure documents given to the prospective franchisee are the same as those handed to the Registrar. A seven day cooling off period is permitted to the franchisee. If the agreement is terminated at this point, the franchisor may retain a sum of money to cover reasonable expenses incurred.

The Act requires a five year minimum for duration of the agreement and provides for mandatory renewal at the request of the franchisee. Notice of termination and an opportunity to remedy the contract is also required. However, no franchisor may terminate a franchise agreement before expiration except for good cause which is defined in Article 31(2). Finally, the Act requires that franchisors and franchisees pursue the best franchise business practice of the time and place.

Contravention of the Act is a criminal offence punishable by fine or even imprisonment for a second offence. The court may also declare the franchise void and order refunds of all payments to the franchisee. The franchisor can also be prohibited from entering into new agreements.

Mexico

On June 27, 1991, Mexico enacted the Industrial Property Law obligating franchisors to disclose information to prospective franchisees. Regulations implementing these provisions came into force in December of 1994. Pre-sale disclosure is required as well as the filing of information about the franchisor and the registration of trademark rights to the franchisee. The agreement must be translated into the Spanish. These rights are to be registered with the Ministry of Commerce and Industrial Development.

Nigeria

Since 1979, franchise agreements in Nigeria must be registered with the National Office of Industrial Property under the National Office of Industrial Property Decree within 60 days after execution. Section 6.2 of the Act sets forth numerous conditions, often discretionary, pursuant to which registration can be denied.

New Zealand

In 1996, the Franchise Association of New Zealand published a Code of Practice governing its members. The Code contains disclosure requirements, a cooling off period and a code of ethics. The Code also sets forth a mandatory dispute resolution procedure. Moreover, the franchisor must provide continued business and technical assistance to the franchisee while the franchisee must conduct business in accordance with the systems specified by the franchisor.

Philippines

Historically, the Philippines reviewed registered franchise agreements in accordance with the policies set forth in its transfer of technology laws. On January 1, 1998, a new Intellectual Property Code became effective. The Code refers to a Technology Transfer Arrangement, which includes a contract or arrangement involving the transfer of systematic knowledge to manufacture a product, the application of a process, or the rendering of a service. The Code lists prohibited clauses that will adversely affect competition and mandatory clauses that must be included in the agreement. If the agreement conforms to the Code's requirements, it does not need to be registered with the Intellectual Property Office which administers the Code.

A bill to establish a franchise disclosure and relationship law was introduced in Congress on January 13, 1999 to promote fair and equitable franchise agreements, establish uniform standards of conduct and create uniform private remedies. The proposal would mandate presale disclosure to prospective franchisees, require good cause for termination of the agreement, including advance notice and a 30 day opportunity to cure the default, and would impose a duty of good faith on parties to a franchise agreement.[vi]

Romania

On August 28, 1997, the Romanian Government issued *Ordinance 52/1997* applicable to franchising. The Ordinance was modified and approved by the Romanian Parliament on April 9, 1998. The law requires general disclosure and specifies that the franchisor must provide the prospective franchisee with any information necessary to make an informed decision. The law also provides that the franchisor must have significant business experience in the commercial activity being franchised.

The franchise agreement must define the obligations and liabilities of each of the parties and must be free from ambiguity. The term of the agreement must be sufficiently long to permit the franchisee time to recover its investments. The franchisor must notify the franchisee of any breach of contractual obligations and must permit the franchisee a reasonable time to remedy the breach. Moreover, the franchisor may impose a non-competition and confidentiality clause for as long as the exclusivity of the agreement is in force. Post-contractual relations are also based on the rules of fair competition. Finally, the franchise agreement must set out provisions covering dispute resolution.[vii]

Russia

Russian legislation regulates the relationship between the parties but does not regulate disclosure. Provisions are contained in the Russian Civil Code which came into effect in March, 1996. The Code refers to "commercial concessions" but clearly makes reference to franchising in describing aspects of the relationship. The law instructs the franchisor on what must be in the contract, the form and registration of the contract, and the obligations and limitations of the parties. The contract of concession must be in written form and must be registered by the agency.[viii] The renewal of the contract, its amendment and termination are also dealt with under the law. Either party has the right to recede from the contract at any time by notifying the other party six months in advance, unless the contract specifies an earlier date.

Saudi Arabia

On March 31, 1992, the Commercial Agencies Regulations and its Implementing Rules were extended to franchising agreements by Ministerial Resolution No. 1012 of the Ministry of Commerce. The Ministry of Commerce adopted a Franchising Model Agreement as a guide to drafting franchises. Franchisees are required to register their franchise agreements in the Commercial Agencies Register. The Ministry of Commerce can reject an application for registration if the Saudi national has been forbidden to carry on commercial activities or is incompetent to do so, or if the registration documents are inconsistent with the regulations.

South Africa

There is no official government franchising policy in South Africa. However, both the Competition Board and the Business Practices Committee have established codes of good conduct in relation to franchising and advertising franchise opportunities. The Competition Board was established under the Maintenance and Promotion of Competition Act to promote competition in the marketplace while the Business Practices Committee was established under the Harmful Business Practices Act to control harmful business practices.

The Franchise Association of South Africa has a mandatory code of ethics for members which requires a written disclosure document to be delivered to the prospective franchisee at least 7 days prior to signing the franchise agreement. The disclosure document must outline the details of the franchise operation.[ix]

Spain

In 1996, Spain introduced provisions relating to franchising in Article 62 of Law No. 7/1996 relating to the retail trade. All franchisors must enter the franchise in a registry. The law dictates what the franchisor must disclose before the franchise agreement or pre-contract agreement is signed or before the payment of any sum of money by the prospective franchisee. Non-observance of the franchisor to register is considered a serious offence.

In 1998, the implementing regulations were adopted to guarantee the centralization of information relating to franchisors. The Regulations specify the information that franchisors must disclose, provide for the creation of the register and state the basic rules regulating the procedure for registration.

Taiwan

Historically, franchising in Taiwan required four levels of government approvals or registration. First, government assurance and guarantee for the repatriation of the franchise fee or royalty in the foreign currency had to be obtained to assure that payments could be made. Approval under the Income Tax Law and the Regulation Governing the Criteria and Standards for Tax Auditing were required so the franchisee could write off the payment of the franchise fee as a corporate expense and receive the resulting tax deduction. The franchise agreement had to be registered with the Investment Commission, Ministry of Economic Affairs under the Statute for Technical Cooperation. Finally, the license agreement for a service mark or a trademark had to be registered with the Republic of China Trademark Office.

On September 1, 1999, Taiwan introduced pre-contract disclosure laws. The disclosure document has to contain 8 categories of information and must be delivered to the franchisee 10 days before signing any agreements.

Thailand

The IFA reports that Thailand's Commerce Ministry is considering the adoption of franchise regulations to ensure fair treatment of both franchisors and franchisees.[x]

Turkey

Under Article 6 of the Communique Number 1, all license, know-how and technical assistance and management agreements must be approved by the Foreign Capital General Directorate. Article 6 does not specify franchise agreements among the agreements which require approval by the Directorate however franchise agreements are generally submitted and reviewed. The review process disfavors arrangements that may have an anti-competitive effect and lack of dispute resolution procedures.

United States

On October 21, 1979, the Federal Trade Commission Trade Regulation Rule entitled *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures* (the "FTC Rule") became effective. The FTC Rule applies to all commercial relationships which meet the definition of a "franchise," unless an enumerated exclusion or exemption is available. The law requires disclosure; however, there are no registration or filing requirements.

Compliance with disclosure requirements may be accomplished by following the Uniform Franchise Offering Circular Guidelines introduced by the North American Securities Administrators Association. The Guidelines prescribe the format for disclosure which is intended to provide a prospective franchisee with sufficient information to make an informed investment decision. Since a disclosure document complying with the Guidelines meets the requirements of the FTC Rule, virtually all franchisors doing business in the U.S. follow that format.

The FTC Rule requires a franchisor to give pre-sale disclosure at the earlier of "the first personal meeting" or at the "time for making disclosures." A "first personal meeting" is a face-to-face meeting between a prospective franchisee and a franchisor, franchise broker, or any agent, representative or employee of either. The "time for making disclosures" is defined as the earlier of: (1) the execution by the prospective franchisee of any franchise agreement or any other agreement imposing a binding legal obligation on the prospective franchisee in connection with the sale, or proposed sale of a franchise; or (2) the payment of any consideration by the prospective franchisee. In addition, a franchisor must deliver a copy of the franchise agreement and related agreements at least five business days prior to the date the agreements are to be executed. Compliance with the FTC Rule delivery requirements constitutes compliance with delivery requirements in every state.

Franchisors must observe both federal and state requirements. Accordingly, the FTC Rule only applies to the extent that state laws are less restrictive. To date, fifteen states have enacted

franchise registration and/or disclosure laws seeking to protect prospective franchisees by ensuring they are fully informed.[xi]

Industry Associations

The International Franchise Association (IFA)

The IFA Code of Ethics is a statement of the goals to which all members of the IFA aspire in the conduct of their franchise relationships. The Code is not intended to anticipate every possible occurrence on a franchise relationship, but rather to articulate the values upon which the members of the IFA will structure their franchise relationships and strive to conduct their business. The enforcement mechanism for the IFA Code provides that whenever the IFA becomes aware of a possible violation of the IFA Code by an IFA member, the President of IFA may conduct an investigation into the alleged violation and report to the IFA Executive Committee. The IFA Executive Committee has the ultimate authority to review such allegations, and to determine what, if any, sanctions against a member company may be appropriate. These sanctions may range from reprimand of the company to suspension or, in extreme instances, termination, of IFA membership.[xii]

The American Association of Franchises and Dealers (AAFD)

The American Association of Franchisees and Dealers is a non profit trade association representing the rights and interests of franchisees and independent dealers throughout the United States. The AAFD was formed in 1992 with the goal of promoting fairness in franchising. It provides a broad range of member services designed to help franchisees and has published standards of Fair Franchising Practices for the franchising community. The mission of the Fair Franchising Standards Committee is to develop standards relating to various business and legal aspects of the franchisor/franchisee relationship so that a more equitable franchise agreement becomes the standard for the franchise community which reflects and balances the legitimate business interests of the franchisor and the legitimate business interests of its franchisees.[xiii]

Venezuela

Since 1992, Venezuela has been governed by the Law to Promote and Protect the Free Exercise of Competition which prohibits anti-competitive restrictions used in franchise agreements. However, the Superintendent for Promotion and Protection of Fee Competition issued regulations allowing franchise agreements to be exempt from the law in Venezuela on January 7, 2000. The regulations operate similarly to the former EU Block Exemption on Franchising and allow territorial and distribution restrictions on both franchisor and franchisee unless certain prohibited terms are included.

EU Block Exemption

The former EU Franchise Block Exemption, which applied throughout all countries of the European Union, expired on May 31, 2000. On June 1, 2000 the Vertical Restraints Block Exemption came into force applying to all vertical restraints, including franchising. Companies that had franchise or distribution agreements in place when the Block Exemption went into effect had until December 31, 2001 to conform those existing agreements to the new Block Exemption.

Separate Guidelines on setting forth an enforcement policy for franchising activities were issued before the law became effective.

Vertical Restraints with less than a 10% market share will continue to be outside the new Block Exemption under the *de minimis* rule. The new Block Exemption provides a safe harbor for a vertical restraint if the market share in the relevant market is 10% or more but does not exceed 30%. In 2002, the EC issued a new notice on agreements of minor importance that provides more safe harbors for companies with a small market share.

The final Block Exemption contains a list of so-called black or hard core clauses, and agreements containing such black clauses will not be exempt. In addition, a member state will be able to withdraw the benefit of the block exemption if the vertical agreements have the characteristics of a distinct market. The draft has a 2-year transitional period for provisions in existing agreements that comply with the former Franchise Block Exemption.

Unidroit

The International Institute for the Unification of Private Law (UNIDROIT) has drafted a Model Franchise Disclosure Law aimed to provide national legislators with a blueprint for developing franchise legislation. The Model Law is intended to apply to both domestic and international franchising, and to different types of franchise agreements including traditional unit agreements, master franchise agreements, and development agreements. The Model Law is limited to pre-contractual disclosure and does not deal with the relationship between the parties. Exemptions from the obligation to disclose are also provided.

Disclosure is required only by the franchisor and must be delivered in conjunction with the proposed franchise agreement at least 14 days before the earlier of the signing of the agreement or payment of any fees relating to the acquisition of the franchise by the franchisee. While there is no prescribed format for disclosure, the disclosure document must be provided in writing (which may be electronic), in a comprehensible manner, and in the official language of the principal place of business of the franchisee.

The Model Law also outlines the information necessary for disclosure to the franchisee. Among other things, the Model Law requires verified financial statements, including balance sheets and statements of profit and loss, for the previous three years, limitations imposed on the franchisee, and terms and conditions of renewal of the franchise. The franchisor may require the prospective franchisee to sign a statement acknowledging the confidentiality of the information relating to the franchise or the franchisor. Moreover, as a condition for its signing the franchise agreement, the franchisor may require the prospective franchisee to acknowledge in writing the receipt of the disclosure document.

If the disclosure document is not delivered within the period of time permitted, the franchisee is entitled to terminate the franchise agreement or any pre-contractual arrangement unless the franchisor can prove that at the time of the conclusion of the franchise agreement the franchisee had the information necessary to make an informed decision. The franchisee can also terminate the franchise agreement if the disclosure document contains a misrepresentation of a material fact or omits to state a material fact required to be disclosed unless the franchisor can prove that the franchisee did not rely on the misrepresentation or that the investment decision of the franchisee was not influenced by the omission. The right to terminate the franchise agreement

must be exercised no later than the earlier of one year of the act or omission constituting the breach or within 90 days of the delivery to the franchisee of a written notice providing details of the breach accompanied by the franchisor's then current disclosure document.

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