FRANCHISE DEVELOPMENTS IN EUROPE

Newsletter EFL November 2016

President's note

This newsletter focuses on the Dutch Franchise Code. There has also been work on the European Franchise Federation's Code of Ethics. As most of you will know the EFF's Code of Ethics has been the basis of the Code of Ethics of national franchise associations in Europe. It has made a very substantial contribution to ensuring ethical franchising and the EFF's decision to review and update its Code should be welcomed. The revised Code contains a number of new elements such as

- a significant expansion of the commitments of both the franchisor and franchisee;
- a specific commitment by the franchisor to maintain and develop its know-how;
- a specific commitment by the franchisor to invest (financial and human resources) in the long-term development and continuity of the concept;
- a specific commitment by the franchisor to specify its internet sales policy;
- expanded franchisee commitments which clarify the independence of the franchisee as an independent entrepreneur;
- a franchisee commitment to act loyally to other franchisees individually as well as to the network as a whole;
- an unqualified commitment by both parties ("shall" instead of "should") to resolve disputes with good faith and goodwill and to seek mediation/arbitration where direct communication has failed;
- a commitment by both parties to safeguard the interests of the network as a whole in their internet policies;
- an explicit franchisee responsibility for his business plan and for truthful and transparent disclosures to franchisors during recruitment;
- a requirement that the franchise agreement sets out the franchisor's rights to the brand for at least the term being offered to each franchisee;
- the extension of the requirement that the franchise agreement offers the opportunity to amortise initial investments to include subsequent investments;
- the unqualified right offered in the franchise agreement for the franchisee to sell or transfer his business as a going concern (from "may" to "has the right").

The revisions to the Code are particularly welcome in view of the increased interest shown by the European Parliament in franchising with a view to protecting the interests of franchisees.

The EFF has asked the EFL to provide comments on its draft revisions which were recently considered at its Policy Board. Further revisions to the draft Code have been made and will be circulated to national franchise associations. We will continue to monitor and report on developments.

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Austria

Franchising and the Austrian Product Liability Act

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On January 1st 1988 the Austrian legislator published the Product Liability Act ("**PHG**"). As a result a liability system has been established that implements strict liability for loss caused by defective products. Furthermore according to this liability system it does not matter if the harmed person is a customer of the company that sold the defective product or an innocent bystander.

But which cases exactly are covered under this strict liability system? According to § 1 PHG strict liability is assumed, if due to the defect of a product a person is killed, suffers an injury to his body or health, or if any tangible property other than the product is damaged. In these situations the following parties can be held liable to compensate for the loss: The producer, the importer or the entrepreneur by whom the product was put into circulation.

The aim of this article is to describe in which scenarios the franchisor or the franchisee can be legally determined as one of the above mentioned parties under the PHG.

Franchisor

According to § 3 PHG the term "producer" describes the person who has manufactured the finished product, a raw material or component, as well as anybody who presents himself as a producer by affixing to the product his name, trade mark or any other distinguishing feature. Usually the reason why a franchisee enters into a contract with the franchisor is the value of the franchisor's name and brand that is affixed to products. Therefore even if the franchisor does not contribute a single raw material, he most likely will be legally assessed as a producer.

If the franchisor is located within the European Economic Area, he is usually held liable as a producer, due to the reasons mentioned above. If the franchisor is located outside of the European Economic Area, the injured person might not be able to claim against the franchisor. That is why in this case the PHG assumes a joint and several liability (§ 10 PHG) between the producer and the importer of the defective product. However, if the importer pays damages to the injured person, he would be entitled to claim reimbursement from the producer, if the producer at least contributed to the defect (§ 12 PHG).

Franchisee

As mentioned above, the franchisee is jointly and severally liable together with the producer, if he imports the defective products into the European Economic Area. If the franchisee purchases the products from the importer or from the producer, who is located within the European Economic Area, the franchisee is legally determined as the entrepreneur, who put the defective product into circulation. In the case of loss, he has to provide the injured party with the name of the producer or – in the case of imported products – of the importer within a reasonable period.

Can the franchisee also be legally viewed as a producer? This might be possible, if the franchisor only supplies raw materials or component parts and the franchisee assembles these parts and generates a new product. In this case the franchisor and the franchisee would be jointly and severally liable as producers.

Conclusion

If the franchisee purchases the products from a producer, who is located within the European Economic Area, and sells these products without any modification, he usually won't be liable under the PHG. The situation might be different, if he imports or modifies the products. Then franchisee and franchisor might be jointly and severally liable.

The franchisor is most likely liable under the PHG. If he is located within the European Economic Area, he is liable as producer. If he is located outside the European Economic Area, the importer usually will have to pay damages to the injured person. However, eventually the franchisor might be held liable for reimbursement, if he at least contributed to the defect in the product and did not validly exclude his liability by contract. Liability for damages towards the customer or an innocent bystander can neither be excluded nor limited beforehand (§ 9 PHG).

Belgium

Belgium's Supreme Court Issues its First Judgments Interpreting the Belgian Disclosure Act

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Ten years after the adoption by the Belgian Parliament of the Disclosure Act, and less than two years after its amendment and incorporation into the new Belgian Business Law Code (hereafter "BBLC"), as Book X Title 2 thereof, the *Cour de cassation / Hof van Cassatie*, Belgium's Supreme Court, rendered its first two decisions interpreting provisions of the Disclosure Act.

In a nutshell, the Disclosure Act requires that the franchisor remits a Disclosure Document to the franchisee and sets a cooling-off period of one month from such remittance before the franchise agreement can be entered into. In case of non-compliance with these requirements, the Disclosure Act provides that the franchisee may, within two years of the entering into force of the franchise agreement, invoke the nullity thereof.

In a first decision rendered on 17 September 2015, the *Cour de cassation / Hof van Cassatie* has adopted a flexible view of the requirement that, in order to be admissible, the nullity of the agreement under Article X.30 must be *invoked* within two years from the signing of the agreement. For the Supreme Court, it suffices that the franchisee informs the franchisor that it considers the agreement null and void within the two-year time period, and it is therefore not required that the franchisee commences legal action about it during this time period. The Court also held that the fact that the franchisee has initially performed the agreement without complaining does not imply that he has waived his right to have the agreement annulled.

In a second decision issued on 12 May 2016, the Supreme Court took a much stricter approach in interpreting the requirement of compliance with the one-month cooling-off period, by holding that such time period must be calculated from the day following the date of remittance of the Disclosure Document. In an extremely harsh judgment, it therefore quashed the decision of the lower court that had refused to annul a franchise agreement where the franchisor had remitted its Disclosure Document on 26 September and the parties had signed the franchise agreement on 26 October. Since, according to the Supreme Court's interpretation, the one-month period started running only on 27 September, the franchise agreement signed on 26 October had thus been signed before the expiry (at midnight) of the cooling-off period, and the franchisee was therefore entitled to invoke and obtain the annulment of the franchise agreement! This is an overly formalistic reading of Article X.30 BBLC and franchisors should therefore be warned of the danger of too eagerly and too quickly signing an agreement.

The contrasted approach of the Supreme Court (formalistic as far as the cooling-off period is concerned; much more flexible as far as the limitation period for the annulment of the agreement is concerned) can be seen as signaling the Court's bias in favor of franchisees in its interpretation of the Disclosure Act. As other provisions of the (badly drafted) Disclosure Act are likely to be interpreted by the *Cour de cassation* in the future, franchisors should exercise utmost care in performing their disclosure obligations in Belgium.

Czech Republic

Strengthening of Intellectual Property Right Protection

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A new ruling of the European Court of Justice (7 July 2016, C-494/15) has brought good news for franchisors owning trademarks. The ECJ held that trademark owners may invoke their rights not only against the primary infringer but also against any person or body which provides services to the respective infringer, e.g. the landlord of commercial premises.

In the Czech Republic, several owners of reputable trademarks (designer clothing and cosmetics manufacturers) discovered that a major Prague marketplace had been selling counterfeits of their products. In response, the owners applied for a court order to the effect that the marketplace owner must refrain from leasing commercial space to the persons infringing their trademark rights. They did so based on the argument that, first, the Enforcement of Intellectual Property Rights Directive (2004/48/EC) of 29 April 2004 enabled trademark owners to seek remedies from 'intermediaries' whose services are used by the infringers to violate intellectual property rights, and, second, that in any event the court should follow the European Court of Justice ("ECJ") ruling from case

C/324/09 of 12 July 2011 (*L'Oreal v eBay*) where such remedy was recognized, albeit within the context of an on-line marketplace.

The case eventually made its way to the Supreme Court of the Czech Republic which stayed the proceedings and referred a question to the ECJ for a preliminary ruling. In particular, it asked whether a marketplace operator could truly be ordered to put a halt to the actions of its lessees which resulted in the infringement of trademark rights.

The ECJ held that where a person provided to third parties a service consisting of leasing marketplace premises and thus enabled such third parties to sell counterfeits from such premises, then that person was indeed an 'intermediary' within the meaning of the Directive. Therefore, even an operator of a physical marketplace could be ordered to prevent infringement by its lessees, i.e. to terminate its lease agreement with the infringers and to implement measures which will impede further infringement of trademark rights (e.g. by the inclusion of appropriate terms in new tenancy agreements).

While the ECJ decision at issue is helpful to trademark owners (including franchisors), it may simultaneously create a higher burden on the providers of services. This is because the ECJ has adopted such a broad interpretation of the term 'intermediary' that one cannot rule out the seemingly absurd conclusion that a utility supplier or an authority granting a trading licence may also be such an intermediary. Seeing as no clear boundaries have been set for this interpretation, it is likely that the ECJ will – In the interests of the fundamental freedom to conduct a business as well as the general doctrine of legitimate expectation – have to revisit this issue in a more exacting manner in the future. Until then, however, national courts will be bound by the ECJ's ruling and service providers will have to remain in the dark as to whether they are intermediaries whose services are used by third parties to infringe intellectual property rights. Another conclusion which can be drawn from the ECJ's interpretation is that, in the future, service providers may, aside from being ordered to implement preventive measures, also be obliged to provide to the trademark owner various other remedies, including those of a financial nature. In the case at hand, the trademark owners had at first instance demanded that a public apology be published by the intermediary at its own expense in a leading national newspaper. Time will show how the ECJ's decision develops and is applied in practice.

Netherlands

The New Dutch Franchise Code

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1. Introduction and Background: Unrest in the Market and Developments Leading up to a Push for Regulatory Action

In the Netherlands, there is no statutory law on franchising (or on distribution). The Dutch Civil Code, as well as the specific rules on trademarks, trade name and competition law are applicable to franchising. Since late 2013, franchisees and their spokesmen and lawyers have, through actively seeking publicity regarding incidents where franchisees complained about specific behaviour of the franchisor and through a lobby with Parliament and the Minister, pressured law makers to adopt mandatory rules on franchising to protect franchisees. This paper sets out the background, views and actions of lawmakers and response from the market to date on these actions.

2. The views of the Department and The Publication of the Dutch Franchise Code

So far, Minister Kamp of the Department of Economic Affairs has rejected mandatory laws. Instead, a push has been made for self-regulation by the franchise sector. The Minister established a committee with representatives of franchisors and franchisees to draft self-regulation. This committee started its work on 5 December 2014 on the Dutch Franchise Code ("the Code").

The final version of the Code was presented to Minister Kamp on 17 February 2016. Minister Kamp stated that the success of the Code will depend on the level of adoption of the Code by the franchise sector. In order to guarantee a broad implementation and compliance with the Code, Minister Kamp has stated that he will look into a way to give the Code a '**statutory hook**'. It remains to be seen, however, how the Minister can do this without going through a formal lawmaking process.

3.1. Structure of the Code and General Comments

The Code includes: i) an introduction ii) a chapter with definitions iii) three chapters outlining the obligations of the parties accompanied with an explanatory part that is 'inextricably linked' with the clauses of the Code and iv) a chapter regarding dispute resolution.

The interests of foreign franchisors have not in any way been considered or addressed in the Code.

3.2. Introduction of the Code

The introduction of the Code states that the Code includes self-regulatory rules of conduct which have been evolved after consultation between franchisors and franchisees. The Code takes the European Code of Ethics for Franchising as a starting point. The Code is a guiding framework consisting of codes of conduct that include modern and broadly accepted views about good conduct for franchisors and franchisees. These codes of conduct clarify the 'reasonableness and fairness' that franchisee and franchisor have to take into account prior to, during and after their relationship. The Code includes a 'comply or explain' principle. Parties should apply the provisions of the Code, but parties may decide not to apply certain elements of the Code which are not relevant for them and if so an explanation has to be provided as an annex to the franchise agreement.

The last part of the introduction states that the Code will not affect franchise agreements that were in force on the date of implementation of the Code. However, for these agreements the Code can be used as guidance. The Code applies to new franchise agreements as well as existing agreements which are extended after the date of implementation of the Code, whether expressly or tacitly.

3.3. Chapter 1: Definitions

Chapter 1 of the Code includes the definitions of 'franchise', 'franchise formula', 'franchisor', 'franchisee', 'franchise agreement', 'knowhow', 'non-compete' and 'exclusivity'. Some definitions seem unnecessarily vague and certain definitions are circular or contain implied obligations. Many of the definitions seem not to be fully in line with the definitions developed in Dutch case law and/or the market. For example, a direct or indirect fee seems necessary for the agreement to qualify as a franchise, but under Dutch case law this is not required.

3.4. Chapter 2: General Principles and Obligations

Regarding the general principles set out in the Code the principles of uniformity, collectivity and entrepreneurial freedom for the franchisor and franchisee are indeed key. However, the relevance of maintaining the reputation of the brand and the franchised network and monitoring the quality of franchisees should also be added to the Code. Most obligations in this chapter seem largely in line with the European Franchise Code and/or standards developed in Dutch law but a few obligations breach key principles of Dutch law.

Widely accepted are obligations on the franchisor to ensure that his business concept has been successfully tested in practice for a reasonable period of time, before rolling it out as franchise. This is not part of Dutch legal doctrine, but the European Code of Ethics for Franchising refers to 'a pilot' that should be the basis for the roll-out of a franchise network. The franchisor is required to be the owner of the intellectual property, put effort in the development of the concept, safeguard the uniformity of the network, ensure franchisees to comply with the franchise agreement, handle commercial, logistical and operational elements of the concept, provide practical means and assistance, offer trainings and at the request of franchisee provide recommendations to improve the revenues of franchisee.

Vague and controversial obligations regarding communication between the parties and the decision making process affecting the franchise have been set out. The Code states that franchisor and franchisee should foster the establishment and maintenance of an independent franchisee body and that franchisor and franchisee should decide together which topics shall be subject to advice or approval of the franchise representative body. The Code further requires that the franchisor should have a 'defined process for consultation' with franchisees. These obligations in fact create the obligation to have an association of franchisees, which may not always be necessary and should not be an obligation.

Furthermore, the Code states that the franchisee representatives should agree on subjects which have a material effect on franchisees' businesses. If the franchisor is not able to agree with the representative on these topics, the franchisor cannot unilaterally implement any such changes. This goes much further than Dutch law. Further franchisors should not be prevented from making changes relating to updating or improving the franchise concept in response to market changes, or key aspects of logistics, IT and other operational aspects. This is, and should remain, not only the task but also the prerogative of the franchisor. Moreover, this obligation leads to a de facto right in favour of franchisees to veto certain developments proposed by the franchisor which does not work in a franchise network.

The Code acknowledges that the collective interest of the network prevails over individual franchisee

interests. The Code states that the franchisor and franchisee should agree on an appropriate 'arrangement' in the situation that an individual franchisee does not agree on a major change of the concept that was adopted with sufficient support of the other franchisees. The purpose is to limit the damage for both parties together and separately, and therefore it may be necessary for the franchisee, who does not agree with the decision, to be exempted from post contractual obligations except from confidentiality obligations. The danger is that this would enable franchisees to engineer an exit free of onerous post termination obligations.

The Code states that the franchisor may only oblige the franchisee to conclude an agreement with a third party insofar as it is required for the proper performance of the franchise agreement. The explanatory notes state that the franchisor must accept that franchisees purchase products from suppliers of its own choice for goods and services which do not relate to the franchise concept.

Even more controversial is the obligation on the franchisor not to reject an extension/new agreement, a request to terminate the agreement an assignment of the agreement to a successor, on unreasonable grounds. This does not fit well with the Civil Code and case law in the Netherlands, where freedom of contract is a key principle.

3.5. Chapter 3: Acquisition, Publicity and Mutual Information Facilities/Obligations and Preliminary Contracts

It is recommended that the franchisor states explicitly when selecting candidates that he conforms to the Dutch Franchise Code. This begs the question what happens if he chooses not to state this. Lobby groups such as Vakcentrum and FaNed have repeatedly made clear that they want a 'statutory hook', but the essence of self-regulation is that the sector drafts a code, and that parties voluntarily choose to comply, or not.

The Code imposes specific information obligations imposed on the franchisor. Article 3.4. of the Code states that a franchisor should provide within a reasonable time (4-6 weeks, according to the explanatory notes) before the conclusion of the franchise agreement written, complete and accurate information to the franchisee so that the franchisee does not feel rushed into the deal.

Article 3.6. of the Code lists the specific information the franchisor has to provide to franchisee. This includes information on the business and financial position of the franchisor, published annual reports and profit/loss accounts, the franchise concept and pilots, if any, complete and recent overview of all franchisees including their contact information, whether there has been an earlier franchise business on the location; historical information regarding revenues of this business and the reasons for termination of a previous franchise agreement and accompanying documents, information on other distribution channels intellectual property rights, information franchise association and preferably, a thorough, transparent substantiated revenue and cost forecast with location research, historical data and a clear investment and exploitation budget. Finally, anything else relevant for the franchisee to reach a decision should be provided!

Finally, article 3.9 of the Code includes separate information obligations regarding 'preliminary agreements' – agreements that will be signed prior to or during the negotiations of the franchise agreement.

3.6. Chapter 4: Specific Obligations Regarding the Franchise Agreement

Some obligations that are stated in Chapter 4 of the Code speak for themselves: the franchise agreement should comply with national and European law and the agreement should protect the interests of the franchisor and franchisee. Others really do not, for example the obligation that the agreement has to be drafted in the national language of the franchisee's place of residence or translated by a certified translator. This is not required by Dutch law, and is also not common practice.

3.7. Chapter 5: Principles regarding dispute resolution

Chapter 5 of the Code contains two provisions about dispute resolution. The franchisor and franchisee must strive to resolve disputes in mutual cooperation within a reasonable period.

Secondly, if the franchisor or franchisee believe that the other party does not comply with the law, the agreement or the Code, franchisor or franchisee may ask a dispute committee for advice about the dispute. This provision raises several questions. First, which persons are part of the dispute committee; outsiders, experts, franchisees or persons related to franchisor and how have these persons been selected? Secondly does the advice of the committee exclude the referral of the dispute to a court – in my view probably not.

4. Status Quo of the Code and (Preliminary) Conclusions

Some franchisors have indicated that they have adopted the Code and have adjusted their agreements accordingly. Many franchisors, have to date not adopted the Code. I expect that courts will be reluctant to apply the Code if it is not declared applicable. Courts may perhaps use the Code in their assessment of the Dutch principle of reasonableness and fairness, but there is no case law yet where a court has made reference to the Code. Also, in the past courts have rarely referred to the European Code of ethics, even if the parties were bound by it through the agreement or their membership of the NFV. In any case it will take a while before the dust will have settled and we can say anything for sure on how courts will deal with the Code. The Netherlands has a tradition of developing self regulation, and it varies per sector and per topic how it exactly plays out.

It is also still possible that the Minister finds a way to place a 'binding' effect on the Code. It remains to be seen if and how that could be done. To be continued!

Portugal

Standard Contract Terms and Conditions in Portugal

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The Supreme Court of Justice ("STJ") of Portugal recently handed down its judgment as to the interpretation of some provisions of Decree-law no. 446/85, dated 25 October 1985. This statute comprises the legal regime in Portugal regarding so-called standard contract terms and conditions.

The highest court was asked to pronounce on the question of whether a bank may, or may not, set-off its claim against a customer with the balance of the customer's account existing at the bank.

The STJ said that a set-off such as this goes against good faith and is thus illegal under section 15 of Decree-law no. 446/85.

The STJ, in the same judgement, said that a bank may not transfer in full, or in part, a contract with a customer to another financial institution within the bank's group.

The Court said that the bank, although based on a clause in the contract entered into with its customer authorizing it to make such a transfer, is not entitled to do so because that clause is illegal under section 18 (a) of the same statute.

Franchisors should be aware that their standard term contracts could be subject to similar scrutiny.

Spain

Price Fixing in Franchising: The Case of Foster's Hollywood

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Price fixing is considered to be one of the most serious anti-trust infringements. It is currently regulated by the European Regulation 330/2010 on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements.

Price fixing is prohibited although it is possible to set non mandatory recommended prices and to set maximum prices.

The sanction for price fixing is the nullity of the franchise agreement and the possibility of fines.

Price fixing can arise through indirect means such as the centralized printing of menus containing prices.

The Spanish authority which supervises the correct application of the antitrust rules is the National Commission of Markets and Competence (Comisión Nacional de Mercados y Competencia), ("NCMC"), whose resolutions are public. The NCMC has recently published an agreement reached in March 10th 2016 with a Franchisor to prevent a sanction for price fixing. The content of the agreement may be considered a "safe harbour" for any other Franchisor wishing to prove that it is not fixing prices.

The case arose in 2014 from a complaint by a Foster´s Hollywood franchisee. The NCMC investigation stated that the Franchisor had different prices according to geographical areas. Furthermore, the Franchisor printed annually the franchisee´s menus with their prices. Most Franchisees could directly modify the prices but they had to ask the Franchisor for previous written authorization for changes to the menus and to prices for highly alcoholic drinks and certain promotions could not be modified.

The agreement reached by the Franchisor with NCMC has four parts. First, prior to printing the menu, the Franchisor commits to send a template with two columns to its Franchisees: one with the recommended/maximum prices and the other empty so that the Franchisee can fix his prices. The difference between the old and the new system is that the Franchisee can, instead of asking for a price change, change the prices himself.

Secondly each Franchisee will be able to modify the prices of any product through the internet and the Franchisor commits to processing each request to print the prices (at the Franchisee expense). In this way, instead of asking for an authorization to change the prices, the Franchisees can change the prices via the internet at any time.

Thirdly the Franchisor commits to regularly sending an email to its Franchisees with the restaurant prices stating that printing the prices by the Franchisor is only a question of effectiveness but that the Franchisees can change the prices as they wish at their own expense.

Fourthly the Franchisee must be able to set the price of the menus and drinks (highly alcoholic drinks included) and will be able to undertake local promotions with previous notice to the franchisor of at least 3 weeks so as to check its viability and ensure that it complies with the franchisor's corporative image.

These commitments are likely to be relevant to similar franchise networks as good practice to avoid price fixing.

United Kingdom

Two EU Developments

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Data Protection – Safe Harbour and the EU-US Privacy Shield

The eighth data protection principle provides that organisations that wish to transfer personal data outside of the EU should assess whether that country ensures an adequate level of protection for individuals. Some countries are deemed adequate by the European Commission. The US is not deemed to have an adequate level of protection for individuals, but historically, transfers to organisations in the US were authorised provided that, amongst other ways, the organisation receiving the personal data in the US was part of the Safe Harbour agreement.

Last year, the Court of Justice declared that the Safe Harbour did not provide adequate protection to individuals. However, since 1 August 2016, US businesses have been able to sign up to the EU-US Privacy Shield and the European Commission has confirmed that that scheme provides adequate protection to allow personal data to be transferred to the US. The Department of Commerce in the US will oversee certification under the scheme and has a dedicated website: https://www.privacy-shield.gov/welcome. If a business is not certified, then it cannot rely on the Privacy Shield to transfer personal data to that business, although there are other ways legally to transfer data to the US, by, for instance, the use of Standard Contractual Clauses and Binding Corporate Rules.

New EU Directive on Trade Secrets

On 8 June 2016 the European Parliament published a new Directive giving protection to undisclosed know-how and business information ("trade secrets").

The Directive obliges Member States to provide better protection for commercial secrets within two years. The Directive provides some useful definitions and principles regarding the protection of trade secrets.

The Directive in defining what are trade secrets will allow franchisors to identify what parts of their information and know-how will be treated as a trade secret.

Article 2 of the Directive defines "trade secret" as information which satisfies the following requirements. It must:

- be secret, in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known or readily accessible to persons within the circles that normally deal with the kind of information in question;
- has commercial value because it is secret;
- has been subject to reasonable steps to keep it secret.

As a result it will be important for franchisors to adopt measures to keep their know-how secret.

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