

# FRANCHISE CONTRACTS AND TERRITORIALITY: A FRENCH COMPARISON

ROBERT W. EMERSON<sup>1</sup>

## TABLE OF CONTENTS

I. INTRODUCTION.....	316
II. THE LEGAL LANDSCAPE FOR FRANCHISE CONTRACTS IN FRANCE AND IN THE UNITED STATES.....	318
A. <i>Defining the Franchise Contract in France and in the United States</i> .....	318
1. <i>France</i> .....	318
2. <i>United States</i> .....	321
B. <i>Laws Applicable to the Franchise Contract in France or the United States</i> .....	323
1. <i>In France, Legislation at the National and European Levels</i> .....	323
2. <i>In the United States, Legislation at the State and Federal Levels</i> .....	327
C. <i>Different Types of Franchise Systems in France and in the United States</i> .....	330
1. <i>French Franchise Categories</i> .....	330
Type 1: <i>The Distribution Franchise</i> .....	330
Type 2: <i>The Service Franchise</i> .....	331
Type 3: <i>The Production Franchise</i> .....	331
2. <i>“Contributing Commercial Relationships” Recognized by the U.S. Federal Trade Commission</i> .....	332
D. <i>Disclosure Information in France Contrasted with the United States</i> .....	333
1. <i>In France, Disclosures Required by the Loi Doubin and the Decree Applying that Law</i> .....	333
2. <i>In the United States, a Disclosure Required by Federal and State Laws</i> .....	334
III. FRENCH TRENDS IN LIGHT OF THE AMERICAN EXPERIENCE.....	336
A. <i>A Contractual Decline in Usage of Territorial Exclusivity Clauses</i> .....	336
B. <i>Court Decisions on Territorial Encroachment Issues</i> .....	339
C. <i>Transfer of Franchise Contracts in France</i> .....	341

---

<sup>1</sup>B.A., University of the South; J.D., Harvard Law School. Huber Hurst Prof. of Business Law & Chair, Dept. of Management & Legal Studies, Hough Graduate School of Business, Warrington College of Business Admin., University of Florida.

1. <i>The Main Provisions</i> .....	341
2. <i>Goodwill</i> .....	344
3. <i>Comparing to Transfers of the Franchise Contract in the United States</i> .....	350
IV. CONCLUSION.....	353

## I. INTRODUCTION

While the French and Americans have had longstanding cultural differences, on core values they have a strong tradition of congruence. This correspondence is perhaps best represented by the Statue of Liberty, designed by French sculptor Frédéric Auguste Bartholdi and given by France to the United States in 1889. The statue symbolizes freedom, a key republican virtue in politics and doubtless the most important ingredient in contract formation.

This article examines recent court decisions and legal commentary to consider a special intersection in the French and American law of contracts—franchising. Indeed, the franchise concept is closely tied to freedom of contract, and the term “franchise” is derived from a French word for “freedom.”<sup>2</sup> After comparing the legal frameworks of the two nations’ franchise contract law, the article focuses on issues involving pre-contract formation requirements as well as contract performance standards insofar as they concern territorial encroachment.

In France, just a few decades into the 20th Century, the ancestor of the modern franchise system appeared. In the 1930s, a company called “La Lainière de Roubaix” developed the new type of distribution under a trade name still famous in France to this day, Pingouin.<sup>3</sup>

Despite these French roots from before World War II, franchising actually hit its full developmental stride when it blossomed in the United States of America during the mid 20th Century. The automobile industry—not only the sale of cars, but also gasoline distribution—was the first sector to develop under the new supply arrangements. The franchise concept soon spread to many other sectors of the American economy, even to such niche areas as catering and tool rentals. Eventually, prominent industry and service names such as Ford, General Motors and Kentucky Fried Chicken adopted the franchise system. Thus, in half a century, from 1920 to 1970,

---

<sup>2</sup> The word “franchise” comes from the Middle Ages. The French word “franc” was used to designate the acknowledgement of a privilege. Therefore, villages that were allowed the use of a privilege normally reserved for the lords were called “ville-franches” or “franc towns.” Ministère des Petites et Moyennes Entreprises, du Commerce, de l’Artisanat et des Professions Libérales, Small and Middle Businesses, Trade, Craft Industry and Liberal Professions, *La Franchise en 10 questions* (the franchise in 10 questions), <http://www.pme.gouv.fr/informations/guide-com/telechar/franchise/franchise.html> (last visited Mar. 14, 2009).

<sup>3</sup> For a long time, Pingouin remained the most important franchisor in France.

franchising had obtained the credibility and fame needed to ensure some success, whether homegrown or as a foreign transplant, outside the borders of the United States.

In the 1960s and 1970s, the franchise system returned to France, where it has continued to have probably its strongest presence—economically, culturally, and legally—in all of Europe.<sup>4</sup> The number of franchisors and, therefore, of franchisees, would multiply in just a few years; indeed, the number of networks increased from 34 (with about 2,000 franchisees) in 1971, to 203 (with about 10,700 franchisees) in 1979.<sup>5</sup> This increase happened, however, almost too hastily; franchise professionals, as well as the public, quickly felt the need to include franchising in the country's developing jurisprudence. Today, as we count about 1141 franchise networks in France,<sup>6</sup> we may see that figure as a reflection of American influence, even though certainly the scales of economy and the cultures are different. Indeed, in the United States, there are roughly 1,500 franchisors.<sup>7</sup> Overall, the large size of both French and American franchising as well as the growth of each country's case law permit us, in this article, first to analyze and contrast the legal landscapes, including basic definitions,<sup>8</sup> for the franchise contract in France and in the United States. We then can observe French trends insofar as they reflect American franchise practices, with a specific focus on the issues of territorial encroachment, exclusivity clauses, and the transfer or assignment of franchise contracts. In exploring the possible causes of a French decline in exclusivity, we examine, compare, and explain recent striking trends in both France and the United States.

<sup>4</sup> According to the European Franchise Federation, France is the largest franchising market in Europe, both in total sales and in number of franchise networks (franchisors). Rose Marie Faria, *France Serves as a Gateway to Europe*, <http://www.franchise.org/Franchise-News-Detail.aspx?id=33190> (last visited Mar. 14, 2009).

<sup>5</sup> DOMINIQUE BASCHET, *LA FRANCHISE: GUIDE JURIDIQUE – CONSEILS PRATIQUES* 31 (2005).

<sup>6</sup> The French Franchise Federation, *Les chiffres de la franchise en 2007* (Franchise figures for 2007), 1, [http://www.franchise-fff.com/IMG/pdf/La\\_franchise\\_2007.pdf](http://www.franchise-fff.com/IMG/pdf/La_franchise_2007.pdf). See also C CSA Institute, <http://www.csa-fr.com/accueil.asp> (a survey institute in France, issuing its survey results on its web site) (last visited Mar. 14, 2009). CCSA institute, <http://www.franchise-fff.com/L-enquete-annuelle-Banque,144.html> (a briefing of the survey result). Info Franchise.com, <http://64.233.169.104/search?q=cache:BPfPRR1K09oJ:www.infofranchise.com/detail.cfm%3FIdNotizia%3D8120%26IdSezione%3D18%26strKey%3Dcom+number+of+franchise+network+in+the+USA&hl=en&ct=clnk&cd=10&gl=us> (last visited Mar. 14, 2009).

<sup>7</sup> World Franchise Council, [http://www.worldfranchisecouncil.org/control/product?product\\_id=FC\\_US](http://www.worldfranchisecouncil.org/control/product?product_id=FC_US) (World Franchise Council, figures for United States) (last visited Mar. 14, 2009).

<sup>8</sup> Dictionnaire Permanent Droit des Affaires 1363 (May 2, 2006).

## II. THE LEGAL LANDSCAPE FOR FRANCHISE CONTRACTS IN FRANCE AND IN THE UNITED STATES

### *A. Defining the Franchise Contract in France and in the United States*

#### *1. France*

In France, the franchise contract is defined<sup>9</sup> as a contract by which a person, the franchisor, grants to another person, the franchisee (an independent business party), its own distinctive signs and an original technical or commercial “savoir-faire,”<sup>10</sup> i.e., know-how, in consideration

<sup>9</sup> The Franchise European Code of Ethics, Article 1, *Code de déontologie européen de la franchise*, available at [http://www.franchise-fff.com/IMG/pdf/Code\\_deontologie\\_NB-2.pdf](http://www.franchise-fff.com/IMG/pdf/Code_deontologie_NB-2.pdf).

The definition of a franchise is not found in Commission Regulation 2790/99, On the Application of Article 81(3) of the Treaty Establishing the European Community to Categories of Vertical Agreements and Concerted Practices (Vertical Restraints Block Exemption Regulation), 1999 O.J. (L. 336) (EC). However, the guidelines to that regulation specifically discuss examples of franchising and refer to the essential elements of a franchise.

Franchise agreements contain licenses of intellectual property rights relating in particular to trademarks or signs and know-how for the use and distribution of goods or services. In addition to the license of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance. The license and the assistance are integral components of the business method being franchised. The franchisor is in general paid a franchise fee by the franchisee for the use of the particular business method.

Commission Guidelines on Vertical Restraints (EC), 13 Oct. 2000, art. 2.5 (para. 199), O.J. (C. 291). These guidelines mention the components of franchising as outlined in the now-superseded European Block Exemption on Franchises, which “still provide[s] a good expression of the general understanding of a franchise in France” (Rémi Delforge & Henri-Xavier Ortoli, *France*, in *INTERNATIONAL FRANCHISE SALES LAWS*, FR-1, FR-6 (2008, eds. Andrew P. Loewinger & Michael K. Lindsey). Commission Regulation 4087/88 of 30 November 1988 on the Application of Article 85 (3) of the European Treaty to Categories of Franchise Agreements, O.J. (L 359) 46-52 (EEC, 28 Dec. 1988). In particular, the superseded exemption defined a franchise as “a package of industrial or intellectual property rights relating to trademarks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users.” *Id.* at art. 1(3)(a). It then further delineates the concepts by defining a franchise agreement as:

an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purposes of marketing specified types of goods and/or services; it includes at least obligations relating to:

- the use of a common name or shop sign and a uniform presentation of contract premises and/or means of transport,
- the communication by the franchisor to the franchisee of know-how,
- the continuing provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement.

*Id.* at art. 1(3)(b).

<sup>10</sup> Cass. com., July 8, 1997, n° 95-17.232, *Sté Descamps c/Sté Axia 3000*. This was a case of the *Chambre Commerciale et Financière*, a section—the Commercial and Financial Chamber—of the *Cour de Cassation*.

for a royalty.<sup>11</sup> The franchisee has to use this transferred savoir-faire under the franchisor's control and with his assistance.<sup>12</sup> The French franchise agreement generally will include provisions setting the price of entry rights and royalties, establishing the length of the franchise term, stating the organization of training, controlling the use of the brand and the trade name, covering site selection, discussing the management of advertisements and of any commercial assistance, detailing territorial rights or restrictions, mandating confidentiality and noncompetition, delineating grounds for or guidelines about termination and transfer, and setting forth the controlling law.<sup>13</sup>

The French franchise contract has the particularity of being a commercial contract entered into *intuitu personae*.<sup>14</sup> This Latin phrase has been defined as "en fonction de la personne" (depending on the person) and means, in a contract, that the personal characteristics of the other party to the agreement determine the implementation and conclusion of that contract.<sup>15</sup> Indeed, the *intuitu personae* concept is not just a crucial aspect of French franchising,<sup>16</sup> but also is frequently found in French and other Civil Law legal discourse on contracts generally.<sup>17</sup> For our purposes,

---

<sup>11</sup> BASCHET, *supra* note 4, at 21 (also noting that continuing assistance is an element of franchising); JEAN-MARIE LELOUP, LA FRANCHISE DROIT ET PRATIQUE 11-12 (4th ed. 2004); GILLES THIRIEZ & JEAN-PIERRE PAMIER, GUIDE PRATIQUE DE LA FRANCHISE 12 (4th ed. 2004) (also emphasizing the franchisor's use of a coherent and comprehensive marketing scheme).

<sup>12</sup> See also Delforge & Ortoli, *supra* note 8, at FR-6-7.

<sup>13</sup> See Les Petites Affiches, November 9th, 2006, N°224, page 23, §58.

<sup>14</sup> See generally Philippe Le Tourneau, *Contrat « intuitu personae »*, J.-Cl. Civ., Fasc. 200 (2002); Louisa Igoudjil, *Le regime des contrats d'entreprise* 57 n.268 (2006), available at <http://www.iquesta.com/Memoire-These/Document/Droit/loirce041006.pdf> (Master's Thesis) (noting the difference between *intuitu personae* contracts "in consideration of the person" and contracts in which a party was selected because of his company's qualities, not his own personal characteristics – the latter being a «*contrat d'intuitu firmae*» (concerning or depending on the firm); also distinguishing *l'intuitu pecunia*, in which the capital that a party brought to the contract is more important than the party itself).

<sup>15</sup> See OCED (*L'observatoire consulaire des entreprises en difficultés* - OCED), (a business and legal organization created in 1994 in partnership with the commercial court of Paris to study and advise firms in difficulty), <http://www.oecd.ccip.fr/htm/lexique.htm#lex1> (defining numerous legal terms, including "*intuitu personae*") (last visited Mar. 14, 2009).

<sup>16</sup> Professor Philippe le Tourneau notes, "the franchise contract is necessarily marked by a strong *intuitu personae*." PHILIPPE LE TOURNEAU, *LES CONTRATS DE FRANCHISAGE* 4 (2nd ed. 2007) (trans. by Robert W. Emerson). Indeed, in its treatise, le Tourneau devotes much time to *intuitu personae*. *Id.* at 4, 56-57, 103-104, 119-120, 158-161, 202, 204-205, 238 & 257-259.

<sup>17</sup> Employment contracts and agency arrangements, not just franchises, are types of contracts that are "*intuitu personae*." Serge Braudo, *Dictionnaire du droit privé français*, available at <http://www.dictionnaire-juridique.com/definition/intuitu-personae.php> (last visited Mar. 14, 2009) (defining the term and with a biography of

though, this Latin term qualifies the franchise agreement as a personal arrangement in which the franchisor gives the right to use its brand as well as know-how, the franchisee brings to the relationship his or her capital, experience, and competence, and he or she commits to pay royalties as well as to respect the conditions imposed by the franchisor. As noted French franchise lawyer Dominique Baschet writes, “[m]ost contract clauses provide a unilateral *intuitus personae* in solely the person of the franchisee: the franchisor signs a franchise agreement depending on the franchisee’s skills and financial capacity.”<sup>18</sup>

It is true that the franchise agreement’s express language often flows in one direction, like a river which—in favoring the franchisor—carries the franchisee downstream toward the franchisor. As such, we can say that—judging simply by the express contractual language—the French franchise agreement is unilateral as it only refers to the *franchisor’s* looking toward the *franchisee’s* personal characteristics. However, because the franchisor is experienced and represented by counsel while the franchisee often acts alone, without legal assistance,<sup>19</sup> most commentators view the *intuitu personae* as a mutual dependence, of both franchisor and franchisee. By this light, as a practical matter, each party agreed to a franchise relationship because of the personal characteristics of the other party, and this concept may be referred to as bilateral *intuitus personae*.<sup>20</sup> Moreover, while the *intuitu personae* concept may appear alien to the eyes of American lawyers,<sup>21</sup> it is far from unique to French franchise law.<sup>22</sup>

## 2. United States

In the United States, a franchise has been defined as a “written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trademark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or

---

three works—books, articles or theses—devoted to the topic). Also, joint ventures involve “*intuitu personae*.” Igoudjil, *supra* note 13, at 57, n.267.

<sup>18</sup> «Le plupart des contrats prévoit une clause d'*intuitus personae* unilatérale en la seule personne du franchisé: le franchiseur signe un contrat de franchise en fonction des aptitudes professionnelles et des capacités financières du franchisé». BASCHET, *supra* note 4, at 430 (trans. by Robert W. Emerson).

<sup>19</sup> *Id.* at 430; LELOUP, *supra* note 10, at 268.

<sup>20</sup> BASCHET, *supra* note 4, at 430; LE TOURNEAU, *supra* note 15, at 4 & 257; LELOUP, *supra* note 10, at 268; OLIVIER VAES, FRANCHISING: GUIDE PRATIQUE POUR JURISTES 24-27 (2007) (discussing Belgian franchise law and making the same points of law and practice about the bilateral nature of *intuitu personae*).

<sup>21</sup> The term is not even found in the most recent edition of Black’s Law Dictionary (8<sup>th</sup> ed. 2004).

<sup>22</sup> Besides Belgian franchise law (VAES, *supra* note 19, at 24-27), *intuitu personae* is a key concept in the franchise law of Italy.<sup>22</sup> See Aldo Frignani & Giuseppe Tomasetti, *Italy*, in INTERNATIONAL FRANCHISE SALES LAWS, *supra* note 8, at ITAL-1, ITAL-11.

otherwise.”<sup>23</sup> Furthermore, the franchise requires that in consideration of the use of the license, the franchisee pays a franchise fee.<sup>24</sup>

Such a business relationship can have particular characteristics defined by federal or state laws. Whether the parties themselves describe the relationship as a “franchise” is immaterial. In fact, multiple statutes and regulations define the franchise relationship differently. Hence, a statute may define a relationship as a franchise under the law of one state, but under the law of another state the relationship qualifies, perhaps, as merely a form of licensing relationship or of distributorship. Bearing that in mind, we must first determine which law is applicable to the relationship in order to know whether it is a franchise or not.

At the national level in the United States, the Federal Trade Commission (“FTC”) looks to the three elements that, under its rules, compose a franchise. In order for a franchise to exist, there must be an offer of the use of a trademark, the extension of significant control but also assistance, and a required payment:

(h) Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

- (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
- (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and
- (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.<sup>25</sup>

At the state level, the laws are of two different kinds: (1) registration laws and (2) relationship laws. Registration laws govern the initial offer and sale of franchises within the state. Those laws are the most common because they are the ones encountered first by companies

---

<sup>23</sup> N.J. STAT. ANN. § 56:10-3 (West 2008).

<sup>24</sup> *Id.*; WASH. REV. CODE § 19.100.010 (2007).

<sup>25</sup> Federal Trade Commission (FTC), 16 C.F.R. § 436.1(h)(1) to (3) (2008).



heretofore unfamiliar with franchising. As for relationship laws, they regulate the post-sale relationship between franchisor and franchisee. Although these relationship laws provide varying definitions of a franchise, it is still possible to find among them some common criteria. For example, the aforesaid franchise elements of (1) compliance to a marketing plan, (2) association with the trademark, and (3) payment of a fee are the three elements composing a franchise in twelve states.<sup>26</sup> In five other states,<sup>27</sup> the licensing of the trademark, the establishment and maintenance of a *community of interest*, and the payment of a fee are the three elements constituting a franchise. Finally, four other states<sup>28</sup> have definitions that involve some elements from these previous 17 states, whether the 12 states emphasizing a marketing plan or the five referring to a community of interest.

*B. Laws Applicable to the Franchise Contract in France or the United States*

*1. In France, Legislation at the National and European Levels*

In France, for a long time, the absence of applicable texts favored the development of the franchise distribution system. The absence of a legal framework thus allowed many franchisors to mistreat franchisees. The French Franchise Federation's creation of the Code of Ethics in 1972<sup>29</sup> ("the Code" or "EFF Code") represented the first move to regulate this type of business relationship. While the goal of the Code was to make such practices more ethical, the Code ultimately had little effect on moral behavior because its enforcement was not mandatory.<sup>30</sup>

The 1972 Code of Ethics eventually became accepted at the European level under the European Franchise Federation ("EFF").<sup>31</sup> Whenever contracting parties refer expressly to this Code, or whenever the

---

<sup>26</sup> California, Illinois, Indiana, Iowa, Maryland, Michigan, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin.

<sup>27</sup> Hawaii, Minnesota, Mississippi, Nebraska, and South Dakota.

<sup>28</sup> Connecticut, Missouri, New York and New Jersey.

<sup>29</sup> Code de Déontologie Européen de la Franchise, available at <http://www.franchise-fff.com/Le-Code-de-deontologie-europeen-de.html> (last visited Mar. 14, 2009) (each national federation or association has since taken part of the Code for its own ethical standards and thereby has ensured that the Code's promotion, interpretation and adaption remain useful in that adopting country). The Code represents the will to provide for good usages; in effect, it may be considered a good manners code for European franchisors.

<sup>30</sup> Dictionnaire Permanent Droit des Affaires 1363 (May 2, 2006).

<sup>31</sup> European Franchise Federation, European Code of Ethics for Franchising, available at <http://www.eff-franchise.com/codeofethics0.html> (last visited Mar. 14, 2009). As reported by the French Franchise Federation, the Code of Ethics, originating in France in 1972, became the European Code in 1991, available at <http://www.franchise-fff.com/Nos-missions.html> (last visited Mar. 14, 2009).

franchisor is a member of one of the franchise national federations within the EFF, the Code's value is extremely significant. For instance, the Code compels a franchisor that decided to join the federation, and hence committed to the Code's requirements, to ensure that its concept is thoroughly tested, and that it is the rightful titleholder of all the signs, brands, and trade names to be used while operating the franchised business.

While a court may still turn to the EFF Code to inform itself about possible custom or usage, it is a franchisor's having joined a national franchise federation that mandates the franchisor's compliance with the Code. Because adoption of the Code is an essential element of federation membership, the franchisor's decision to join the federation makes the Code an implicit part of every franchise agreement the franchisor subsequently enters.<sup>32</sup> This Code shows the essential points that must at least be anticipated in the franchise contract, and it also presents pre-contractual rules similar to the one ultimately prescribed by French statutory and regulatory law in the *Loi Doubin* (now discussed).<sup>33</sup>

French lawmakers also eventually intervened to resolve difficulties between franchisors and their franchisees. Article 1 of a December 31, 1989 French statute applies specifically to the franchise contract and other distribution contracts.<sup>34</sup> This law is commonly known as the *Loi Doubin* after Francois Doubin, the minister who introduced it.<sup>35</sup> The statute seeks to protect potential franchisees by requiring the disclosure of sufficient pre-contractual information before the parties commit to an exclusivity agreement. The application decree of April 4, 1991 of the *Loi Doubin* details the information that must be contained in the pre-contractual document before the final contract between the franchisor and the

---

<sup>32</sup> A franchisor may avoid the Code's dictates simply by choosing not to join the federation.

<sup>33</sup> See Decree 91-337 published in the Official Journal (JO), Apr. 4, 1991, whose purpose is to apply the 1<sup>st</sup> Article of the law n°89-1008 of Dec. 31, 1989, (*Loi Doubin*) in relation to the commercial and craft businesses' development and the improvement of their economic, legal and social environment.

<sup>34</sup> Law No. 89-1008 of Dec. 31, 1989 Journal Officiel de la République Française [J.O.] [Official Gazette of France], Jan. 2, 1990. («*relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social.*» In English, "concerning the development of commercial and artisan enterprises and the improvement of their economic, legal and social environment"). Article 1 is relevant for franchising. For an English translation see CCH, *Business Franchise Guide*, ¶ 7135, available at [http://www.eff-franchise.com/france\\_franchise\\_legislation\\_loi\\_oubin\\_english.pdf](http://www.eff-franchise.com/france_franchise_legislation_loi_oubin_english.pdf).

<sup>35</sup> Doubin served in the cabinet of Prime Minister Michel Rocard from May 1988 to Jun. 1991 and of Edith Cresson from June 1991 to April 1992. From 1988 to 1991, Doubin was *Ministre délégué chargé du Commerce et de l'Artisanat* (Minister Delegate in Charge of Trade and Handicrafts), with Consumer Affairs also added to his portfolio of functions from May 1991 until Apr. 1992. See <http://www.industrie.gouv.fr/biblioth/docu/rapports/dvchron.htm> (last visited Mar. 14, 2009).

franchisee is concluded.<sup>36</sup> The decree contains three articles, the first of which specifies the information that must be disclosed. Article 2 provides that anyone who does not provide the required information as established in Article 1 of the *Loi Doubin* is liable to pay the fines meted out for fifth class offenses, and Article 3 entrusts the decree's execution to the Minister of Justice, the Minister of Industry and Development, and the Minister Delegate for Commerce and Handicrafts.<sup>37</sup> In accordance with the fourth paragraph of Article 1 of the *Loi Doubin*, the disclosure document must be delivered at least twenty days before the execution of the contract or, if applicable, before the payment of any sum of money specifically required, in order to obtain an exclusive territory.<sup>38</sup>

At the European level, Article 81 § 3 of the Amsterdam Treaty<sup>39</sup> prohibits vertical agreements and concerted practices.<sup>40</sup> In the famous *Pronuptia* case of 1986,<sup>41</sup> the Court of Justice of the European Communities considered that franchise agreements may violate Section 3 of Article 85 of the Rome Treaty (1957) that created the European Economic Community, particularly because of exclusivity supply duties. The concept of the franchise itself was jeopardized and, with it, a major and burgeoning sector of European economic activity. The *Pronuptia* court did not find that the use of franchising to distribute goods somehow violated, by itself, Article 85; instead, courts and regulators would need to evaluate, in their economic context, the actual franchise agreement provisions. So, the court opined, the ability of the franchisor to make price recommendations (but not to institute requirements, engage in concerted practices or engage in price-fixing) is permitted under Article 85.<sup>42</sup> Likewise, contract clauses

---

<sup>36</sup> Decree No. 91-337 of Apr. 4, 1991 applying Article 1 of the Law No. 89-1008 of December 31, 1989, in *Journal Officiel de la République Française* [J.O.] [Official Gazette of France], April 6, 1991 (a correction to the Decree was published in the *Journal Officiel* of May 4, 1991). For an English translation see CCH, *Business Franchise Guide*, ¶ 7136, available at [http://www.eff-franchise.com/france\\_franchise\\_legislation\\_loi\\_oubin\\_english.pdf](http://www.eff-franchise.com/france_franchise_legislation_loi_oubin_english.pdf).

<sup>37</sup> See *infra* note 40.

<sup>38</sup> *Id.*

<sup>39</sup> This treaty, signed Feb. 10, 1997, is, for purposes of the Rome Treaty (1957) which instituted the European Community, a continuation of that earlier treaty's Article 85 on competition—now renumbered to Article 81.

<sup>40</sup> See generally Lise Alm, What Is the Point of European Competition Law? - An Evaluation of the Achievement of the Single Market Goal through the Use of Article 81 of the EC Treaty (Autumn 2007) (Master's Thesis, University of Lund), available at [http://www.jur.lu.se/Internet/Biblioteket/Examensarbeten.nsf/0/630B83B62D3250A0C125738B00362C32/\\$File/exam.pdf](http://www.jur.lu.se/Internet/Biblioteket/Examensarbeten.nsf/0/630B83B62D3250A0C125738B00362C32/$File/exam.pdf).

<sup>41</sup> Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis*, 1986 E.C.R. 353.. [CJCE, January 28. 1986. Aff.161/84, *Pronuptia de Paris GmbH c/ Pronuptia de Paris Irmgard Schillgalis*.].

<sup>42</sup> By comparison, the U.S. Supreme Court recently gave even more flexibility to franchisors or others wishing to engage in resale price maintenance ("RPM"), which constitutes a vertical restraint of trade. In *Leegin Creative Leather Products, Inc. v.*

protecting the franchisor's know-how, assistance, and network identification and reputation (e.g., trademarks) do not conflict with Article 85 while provisions for sharing markets between a franchisor and its franchisees or among a system's franchisees do constitute anticompetitive restrictions for purposes of that Article. It became clear that only the adoption of an exemption, such as the one now included in the same Article, could resolve the difficulties in interpretation and implementation, including a chilling impact on European franchising. Because some vertical agreements, such as franchise contracts, benefit customers and society, in December 1999, the European Commission adopted an exemption regulation protecting the franchise agreements. On October 13, 2000, the Commission then published Guidelines on these vertical restraints.

So, in summary, voluntary ethics principles, French disclosure rules, and European competition law provide the framework for French franchisors seeking to comply with franchise legal standards. This legal scaffolding is so meager that—for more specific issues, besides simply disclosures or antitrust—even a Civil Law country such as France leaves parties turning beyond Codes (statutes and administrative guidelines) and to case law. While French legal theory may almost abhor *stare decisis*,<sup>43</sup> the day-to-day reality seems quite different.<sup>44</sup> In the absence of non-judicial

---

*PSKS, Inc.*, 127 S.Ct. 2705 (2007), the Court applied a rule of reason approach to a supplier's action, presumably intended to manage and exert control over profits, in which the supplier implicitly or explicitly states that retailers are to sell the supplier's goods at a minimum price, i.e., no discounts below the minimum price level. (Some retailers/franchisees may, in fact, seek RPM as a way to fix prices horizontally).

<sup>43</sup> A core principle, set out very early in the French Code Civil, is: «*Il est défendu aux juges de prononcer par voie de disposition générale et réglementaire sur les causes qui leur sont soumises*». C. CIV. 5 ("It is forbidden for judges to issue rules in the form of general and binding decisions on those cases which are submitted to them" (trans. by Robert W. Emerson)).

<sup>44</sup> See Vincy Fon & Francesco Parisi, *Judicial Precedents in Civil Law Systems: A Dynamic Analysis*, 26 INT'L REV. OF LAW & ECON. 519, 519-535 (2006). (Also published as George Mason Law & Economics Research Paper No. 04-15 and Minnesota Legal Studies Research Paper No. 07-19; available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=534504](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=534504)).

The authors note that even though Civil Law jurisdictions do not adopt the *stare decisis* principle for adjudication, prior court decisions may still be persuasive inasmuch as Civil Law courts are expected to consider those decisions when there is a sufficient level of consistency in the case law. While no single decision binds a Civil Law tribunal, these decision makers will respond to a uniform set of decisions. The Civil Law courts, therefore, treat "precedents" as a source of "soft" law, considering them – but not feeling themselves bound – when rendering their own decisions. The more unvarying the past opinions, the greater the persuasive force of that case law; because disagreeing judges do not file dissenting opinions, the Civil Law cases running counter to the dominant trend are the signals of dissent among the judiciary and may influence future holdings. See also PETER NAYLER, *BUSINESS LAW IN THE GLOBAL MARKETPLACE: THE EFFECTS ON INTERNATIONAL BUSINESS* 31 (2005) (citing Code Civil Article 5, *supra* note 42, and noting that there is no French legal axiom supporting

law (e.g., legislation or administrative promulgation), the French case law for contracts governs franchise agreements and the parties thereto.<sup>45</sup>

## 2. *In the United States, Legislation at the State and Federal Levels*

Sometimes franchisor-franchisee relationships have been classified as securities under federal or state securities laws.<sup>46</sup> However, numerous decisions in the 1970s and 1980s held that a franchise did not meet the definitional threshold.<sup>47</sup> While most franchised relationships call for too

---

the concept that a French judicial determination, even one by the highest court, the Cour de Cassation, should have any binding effect on other decisions; but refuting this "theoretical position" with the "practical reality" that French court decisions (*jurisprudence*) "are widely cited by lawyers and by textbook writers," that many higher court holdings appear in law reports and "are accepted as having persuasive weight, which only increases as the courts progressively settle down to a uniform and consistent attitude on any particular point," and that "an undeviating line of reasoning—for example, of the Cour de Cassation—has an authority, judged from a practical point of view, barely distinguishable from a decision of the House of Lords").

<sup>45</sup> All the rules included in the civil code from Article 1101 to 1369 of the Civil Code

<sup>46</sup> See Kathy J. Tidd, *Is a Franchise Also a Security?*, FRANCH. L.J. 1, 1 (Winter 1988); see also *In re: Bestline Prods. Secs. & Antitrust Litigation*, 412 F. Supp. 732 (S.D. Fla. 1976) (holding that a combined multilevel and franchise system was a "security" because it satisfied the four requirements of the venerable decision, *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946): (1) an investment of money, (2) in a common enterprise or venture, (3) with a reasonable expectation of profits, and (4) to be derived from the significant or essential managerial or entrepreneurial efforts of others affecting the enterprise or venture's success); *accord*, *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974); *Stanley v. Commercial Courier Serv., Inc.*, 411 F. Supp. 818, 823 (D. Or. 1975); *SEC v. Bull Inv. Group, Inc.*, No. 74-5806-M, 1975 WL 1271 (D. Mass. 1975) (holding that arrangement whereby local "dealers" (franchisees) would solicit new customers in return for a commission was a security because ultimate success or failure of the recruitment depended upon franchiser's sales-presentation efforts); *Mitzner v. Cardet Int'l Inc.*, 358 F. Supp. 1262 (N.D. Ill. 1973) (holding that distributorship franchise was a security where franchisee's role was purely mechanical and ministerial, devoid of any power to make "meaningful or independent business decisions"); *State v. Consumer Business Sys.*, 482 P.2d 549, 554 (Ore. App. Ct. 1971) (finding that a franchise did not meet the *Howey* standard but fell under the Oregon state securities statute because of how it involved "risk capital"); Augustine & Hrusoff, *Franchise Regulation*, 21 HASTINGS L.J. 1347, 1354-63 (1970) (outlining how, under California securities law interpretation, a franchise could be considered a security).

<sup>47</sup> See, e.g., *Meyer v. Dans un Jardin, S.A.*, 816 F.2d 533 (10th Cir. 1987) (holding that boutique franchise was not a security); *Villeneuve v. Advanced Bus. Concepts Corp.*, 730 F.2d 1403 (11th Cir. 1984) (en banc) (distributorship for sale of self-watering planters was not a security); *Bitter v. Hoby's Int'l, Inc.*, 498 F.2d 183 (9th Cir. 1974) (holding that restaurant franchise was not a security since franchisees responsible for day-to-day management and operation of restaurant, despite strict franchise guidelines); *Nash & Assocs., Inc. v. Lum's of Ohio, Inc.*, 484 F.2d 392 (6th Cir. 1973); *Mr. Steak, Inc. v. River City Steak, Inc.*, 460 F.2d 666, 670 (10th Cir. 1972) (holding that restaurant franchise was not a security); *Gotham Print, Inc. v. American Speedy Printing Centers, Inc.*, 863 F. Supp. 447 (E.D. Mich. 1994) (holding that master

much initiative and effort on the franchisee's part to be a security, the reflexive notion that a franchise cannot be a security is too facile:

Franchising arrangements . . . may be securities even if the franchisees are not totally passive. Instead of insisting on abject dependence, courts focus on the extent to which the promoter or a third party is involved in the subsequent management of the franchised business. Thus, a franchise is not a security if the franchisee will be largely responsible for running it, even if the franchiser will help start the franchised business. On the other hand, franchise programs may be securities when the franchiser is largely responsible for selling to the franchisee's potential customers.<sup>48</sup>

However, the longstanding, ultimate goal of some franchisee advocates—to have franchising subject to the affirmative duty of disclosure required under SEC Rule 10(b)(5)<sup>49</sup>—failed.<sup>50</sup> The push for franchisee protections met some success in other areas, namely state legislation, common law interpretation, and via federal disclosure promulgations. In October 1979, the Federal Trade Commission established a rule entitled, “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures.”<sup>51</sup>

The FTC rule applies to all “continuing commercial relationships”; that is, so to speak, an alliance in which “the parties reasonably anticipated at the time of entering into it that it would . . . involve an ongoing course of dealing over a period of time.”<sup>52</sup> The FTC rules preempt state and local laws to the extent that those laws conflict with the federal statute.<sup>53</sup> But consistent state laws are not preempted, and the FTC further allows state

---

franchise for printing stores was not a security); *L.H.M., Inc. v. Lewis*, 371 F. Supp. 395 (D.N.J. 1974) (holding that theater franchise was not a security due to participants' “significant contributions” to the management and operation of the theater), *aff'd*, 510 F.2d 970 (3d Cir. 1975); *Fox v. Ehrmantraut*, 28 Cal.3d 127, 139, 615 P.2d 1383, 167 Cal. Rptr. 595 (1980) (California Supreme Court decision that the sale of a franchise involving the franchisee's active participation in the franchise on the franchisee's part was not a security); Mark H. Miller, *Franchising in Texas*, 14 ST. MARY'S L.J. 301, 303 n.5 (1983) (commenting on efforts to regulate franchising by defining it as a “security” but citing several case holdings for its conclusion that this approach “floundered” and was “currently out of favor”).

<sup>48</sup> Harvey Bines & Steve Thel, *Investment Management Arrangements and the Federal Securities Laws*, OHIO ST. L.J. 459, 482 (1997) (footnotes omitted).

<sup>49</sup> 17 C.F.R. § 240.10(b)(5) (2008).

<sup>50</sup> HAROLD BROWN ET AL., *FRANCHISING: REALITIES AND REMEDIES* § 6.06[1], n.1 (2008 ed.) (citing cases, legislation, and commentary from 1967 to 1983).

<sup>51</sup> 16 C.F.R. § 436 (2007) (this is the FTC rule that was amended in March 2007).

<sup>52</sup> See *Sells Enterprise, Inc.*, FTC Informal Staff Advisory Opinion, 2 Bus. Franchise Guide (CCH) ¶ 6423, Aug. 28, 1980.

<sup>53</sup> *Illinois Corp. Travel, Inc. v. American Airlines, Inc.*, 889 F.2d 751 (7th Cir. 1989).

laws inconsistent with the federal statute if they provide prospective purchasers equal or greater protection than that imposed by the FTC.<sup>54</sup>

Certainly, many states reacted faster than did the FTC. This started with California, which in 1970 enacted the first state law designed to regulate franchising generally rather than merely one industry such as automobile sales, farm equipment contracts, or alcoholic beverages.<sup>55</sup> Within the next decade, many other states followed with one or more franchise registration, disclosure, or relationship statutes (including Arkansas, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin).<sup>56</sup>

These various state laws govern the offer and sale of franchises.<sup>57</sup> But because it worried about uniformity, the Midwest Securities Commissioners association (now the North American Securities Administrators Associations, or “NASAA”) adopted on September 2, 1975 the Uniform Franchise Offering Circular Guidelines (“UFOC”). Via a 2007 amendment to the Federal Trade Commission rule on franchising, the Franchise Disclosure Document (“FDD”) replaced the UFOC.<sup>58</sup> Most UFOC provisions are found, perhaps in some altered state, in the new FDD.<sup>59</sup>

The aforementioned dual level of legislation (federal and state) makes the United States legal field appear more complicated than that of France. This structure does not make the case law any easier to understand, and this is troubling for the franchisees that are often not sure about the legal status of their business relationships, and, more particularly, about their rights and responsibilities.

<sup>54</sup> *Tousley v. North Am. Van Lines, Inc.*, 752 F.2d 96, 100-103 (4th Cir. 1985); *Morgan v. Air Brok Limousine, Inc.*, 510 A2d 1197, 1205-1207 (N.J. Super. Ct. Law Div. 1986).

<sup>55</sup> W. MICHAEL GARNER, *FRANCHISE AND DISTRIBUTION LAW AND PRACTICE* § 1:10 (2008); *Sells Enterprise, Inc.*, FTC Informal Staff Advisory Opinion, 2 Bus. Franchise Guide (CCH) ¶ 6423, Aug. 28, 1980.

<sup>56</sup> BROWN, *supra* note 49, § 6.03[1], § 6.03[1] n.1, § 6.03[3] & § 6.03[3] n.7; GARNER, *supra* note 54, § 1:10.

<sup>57</sup> Besides Iowa (which enacted a “pro-franchisee” relationship law in 1992, later reduced in scope in 2000) and Rhode Island (which in 2007 enacted a franchise relationship statute modeled after Wisconsin’s Fair Dealership Law), there have been no new state enactments and very little amending of any note. Therefore, tables from 1990 categorizing all of the states in terms of their legislative approach, *vel non*, towards franchising are otherwise still essentially accurate. See Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1567 (1990).

<sup>58</sup> See 16 C.F.R. § 436 (2008); Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities, 72 Fed. Reg. 15,444 (March 30, 2007) (to be codified at 16 C.F.R. pts. 436 and 437)..

<sup>59</sup> See Gerald C. Wells & Dennis E. Wiczorek, *A Road Map to the New FTC Franchise Rule*, 26 FRANCHISE L.J. 105 (2007).

C. *Different Types of Franchise Systems in France and in the United States*

The reasons to choose the franchise system are the same in France and the United States. For the franchisor, using the franchise system is a way to expand its capital through the entry rights, fees, and royalties it receives from its franchisees. For the franchisee, using the franchise system cannot ensure, but certainly may promote, success through the use of a tested business plan. That lessens risks, while still allowing the franchisee to own a certain level of independence. The franchisee also profits from training and educational programs, usually furnished directly from the franchisor. The franchisor takes care of advertising, with symbols and trademarks still ubiquitous. Consequently, the customers will recognize the products or services more easily.

There are different types of franchise systems in France and in the United States. However, it is fair to say that they end up overlapping each other. Indeed, as explained *infra*, three types of franchise are recognized in France, and all three are compatible with the two types of franchise that exist in the United States.

1. *French Franchise Categories*

In France, the Cour de Justice des Communautés Européennes recognizes three types of franchise systems: (1) the distribution franchise, (2) the service franchise, and (3) the production franchise.<sup>60</sup>

Type 1: The Distribution Franchise

The object of the distribution franchise is to distribute the products made, or ordered to be made, for the franchisor, and to then sell them through its franchising network. This is done under a single trade name that identifies the network and warrants the same “savoir-faire,” or know-how. Distribution franchise systems are most commonly used in the furniture,<sup>61</sup> textile,<sup>62</sup> and “do it yourself” areas.<sup>63</sup>

---

<sup>60</sup> Dictionnaire Permanent Droit des Affaires, p. 1364, May 2, 2006.

<sup>61</sup> See, Cuisinella, created in 1959, franchised in 1990, classified as a franchise of distribution, in the furniture area (Kitchen furniture distribution), available at <http://www.observatoiredefracnchise.fr/creation-entreprise/franchise-cuisinella-378.htm> (last visited Mar. 14, 2009).

<sup>62</sup> See, Mango, created in 1984, franchised in 1992, in the textile area (Designed clothes distribution), available at <http://www.observatoiredefracnchise.fr/creation-entreprise/franchise-mango-1429.htm> (last visited March 14, 2009).

<sup>63</sup> See, M. Bricolage, created in 1965, franchised in 1980, in the “do it yourself” area, available at <http://www.observatoiredefracnchise.fr/creation-entreprise/franchise-mr-bricolage-590.htm> (last visited Mar. 14, 2009).



### Type 2: The Service Franchise

The service franchise system offers a service under the franchisor's trade name, brand name, or brand itself that is then carried out according to the instructions of the franchisor.

In this type of franchise network the know-how is of even greater importance, and thus implies a strong collaboration between the parties. The advertisement investments here are substantial. This type of franchise system is normally used in economic sectors such as catering,<sup>64</sup> car or truck rental,<sup>65</sup> transportation of goods, cleaning and drying,<sup>66</sup> temporary work, and wedding planning.

### Type 3: The Production Franchise

The production franchise system, also known as the industrial franchise, happens when the franchisee makes the products himself, but according to the franchisor's instructions. These products are then sold, in consideration for a royalty, under the franchisor's brand.<sup>67</sup> More

<sup>64</sup> See, Haagen-Dazs, created in 1990, franchised in 1991, classified as a franchise of service (ice cream parlor and fast food), *available at* <http://www.observatoiredefranchise.fr/creation-entreprise/franchise-haagen-dazs-shops-1599.htm> (last visited Mar. 14, 2009); Pizza Hut, created in 1958, franchised in 1989 (pizza fast food), *available at* <http://www.observatoiredefranchise.fr/creation-entreprise/franchise-pizza-hut-174.htm> (last visited Mar. 14, 2009); McDonald's, created and franchised in 1955 (hamburger fast food), *available at* <http://www.observatoiredefranchise.fr/creation-entreprise/franchise-mc-donald-s-444.htm> (last visited Mar. 14, 2009).

<sup>65</sup> See, "Rent a car," created in 1996, franchised in 1997 (Car rental service), *available at* <http://www.observatoiredefranchise.fr/creation-entreprise/franchise-rent-a-car-127.htm> (last visited Mar. 14, 2009).

<sup>66</sup> See, 5 à Sec, created and franchised in 1968 (Service to the Individual, clothes cleaning and ironing), *available at* <http://www.observatoiredefranchise.fr/creation-entreprise/franchise-5asec-285.htm> (last visited Mar. 14, 2009).

<sup>67</sup> For example, in France a fast-growing alternative to the traditional franchise, in certain industries such as retail clothing sales, is the commission-affiliation. See, Laure Guiserix, "Commission-affiliation: risques partagés," *Franchise-Magazine.com*, Aug. 25, 2008, *available at* <http://www.franchise-magazine.com/actualite/conseils/commission-affiliation-risques-partages-43.html> (last visited Mar. 14, 2009) ("Commission-Affiliation: risk-sharing") (describing a system that has grown from 30% of clothing store operations in 2005 to 46% three years later, and that continues to grow; while losing some control over its operations, a commission-affiliate is freed from having to purchase its inventory prior to selling that inventory; for clothing stores, with much stock and much quick change in stock due to seasonal changes, the arrangement frees the affiliate of a monetary outlay of between 20,000 and 150,000 euros); Anne-Laure Allain, "Chattawak : l'affiliation sans contrefaçon," *Franchise-Magazine.com*, March 12, 2008, *available at* <http://www.franchise-magazine.com/actualite/breves/chattawak-s-affiche-dans-la-capitale-3880.html> (last visited Mar. 14, 2009). In the commission-affiliation, the "franchisor" retains ownership of the stock (e.g., clothing) in the franchisee's store. The contract for a commissionaire-affiliation contains elements characteristic of both a commission-based relationship, as the sales are made in the commissioner's name on

frequently, however, the franchisee resells the products to the franchisor who then distributes them to the public.<sup>68</sup>

## 2. “Contributing Commercial Relationships” Recognized by the U.S. Federal Trade Commission

The FTC recognizes two forms of “continuing commercial relationships”: (1) franchises, and (2) business opportunity ventures. Franchises may be considered of two different types: package (business format) franchises and product franchises.

In package franchises, the franchisor licenses a franchisee to operate a pre-packaged business format that is identified by the franchisor’s trademark. In France, this type of system would be classified as a service

---

the principal’s behalf, and of an affiliation, as each distributor is a member of the network organized by the principal (in that way, like a franchisee part of a franchised network). The distributor has, *inter alia*, these characteristics: independent ownership of its business; an exclusive right to procure supplies under the supplier’s trade name, using the supplier’s corporate name as a shop sign (displayed at the sales outlet to the exclusion of any other sign) and in all relations with other suppliers (e.g. in its checks or charges) and with customers (e.g., cash register receipts); a duty to sell only to consumers; a consignment of products to which the supplier retains title; and compensation by commission on turnover (sales) of the stock (the inventory). By not having to pay in advance for its stock, the commission-affiliate frees up funding and lessens its need for financing, but—in return—he loses some control over his business, with choice of the stock and its price greatly curtailed if not eliminated. To avoid price-fixing by the principal, the commission-affiliate may for some merchandise alter (really, lower) the price established by the principal, but that difference in price comes totally out of the commission-affiliate’s ultimate “take” (commission) on sales. Interview with Alex Raymond, counsel for the Fédération Française de la Franchise (June 13, 2008). In a Cour de Cassation ruling that overturned a widely reported Court of Appeal holding from September 2006 (Cour d’Appel Paris, 5<sup>e</sup> civ. A, Sept. 13, 2006), the French high court in effect established that franchisors can create and maintain commission-affiliations without fear that later, upon any cessation of the relationship, the franchisee will successfully contend that it was a mere exclusive agent (not really an independent franchisee), and thus entitled to a large severance allowance (in the case of Chattawak, that was two years of lost commissions—at least 145,000 euros—according to the Paris Court of Appeals holding). Cass. com., Feb. 26, 2008, Arrêt No. 289 F-D (*S.A.S. Chattawak v. Société Chantal Pieri*). The key thing to maintaining the affiliate’s independence and franchise status is to ensure that the contract explicitly stipulates such independence and that the franchisee be permitted to place its own name on signs and otherwise indicate to customers its own independent status, not entirely invisible behind the name of the franchisor-supplier. Gilles Menguy, *La commission affiliation*, FRANCHISELAND.COM, available at <http://www.franchise-land.com/la-bible-de-la-franchise/les-autres-formes-de-commerces-independants-organises/la-commission-affiliation-16.html> (last visited Mar. 14, 2009).

<sup>68</sup> For example, Coca-Cola, created in 1889, is an industrial franchisor. The franchisees are Coca Cola producers, <http://www.thecocacolacompany.com/ourcompany/index.html>

Yoplait, created in 1965, is franchised in 1965, available at [http://www.yoplait.fr/page.php/en/49\\_174.htm](http://www.yoplait.fr/page.php/en/49_174.htm) (last visited Mar. 14, 2009).

franchise.<sup>69</sup> Package franchises include, for example, motel chains and tax preparation services.

In product franchises, the franchisee is licensed to distribute goods manufactured by the franchisor and bearing the franchisor's trademark. Automobile and gasoline distributorships are classic examples of this type of franchising arrangement.<sup>70</sup> In France, product franchises would be considered distribution franchises.

As for American business opportunity ventures, they are not considered franchises. These undertakings represent a simpler relationship, a business scheme used typically for vending machine routes and businesses involving the assembly of parts in the home. Hence, the United States divides franchising into two classifications (package franchises - also known as business format franchises - and product distribution franchises), whereas France breaks down franchising into three categories (distribution, service, and production franchises).

#### *D. Disclosure Information in France Contrasted with the United States*

In both France and the United States, to create a franchise relationship, certain information must first be disclosed. As a skeleton is to a body, this preliminary, decidedly regulated step of the franchise relationship is the most important part of entering into a franchise agreement. From there, the parties are free to add the musculature to the franchise arrangement (the skeleton)—that is, to exercise freedom of contract and build a customized contract.

##### *1. In France, Disclosures Required by the Loi Doubin and the Decree Applying that Law*

The Decree of April 4, 1991,<sup>71</sup> implemented in the commerce code under Article L 330-3, provides that twenty days before the signature of the contract, the franchisor must give the franchisee certain information documents and a contract project. This information includes the contacts of the franchisor's headquarters, the nature of the activity, the amount of

---

<sup>69</sup> LE TOURNEAU, *supra* note 15, at 23-31 (on «franchisage de service»).

<sup>70</sup> Such specific industries, not franchising generally, are the only ones subject to federal statutes. See, e.g., Automobile Dealers Franchise Association, 15 U.S.C. § 1221-1225 (2008) (enacted in 1956 and popularly termed the "Dealer's Day in Court Act"); Petroleum Marketing Practices Act, 15 U.S.C. § 2801-2806, 2821-2824, 2841 (2008) (enacted in 1978).

<sup>71</sup> Decree 91-337 of April 4, 1991, Journal Officiel de la République Française [JO], whose purpose is to apply the 1<sup>st</sup> Article of the law n°89-1008 of Dec. 31, 1989, (Loi Doubin) in relation to the commercial and craft businesses' development and the improvement of their economic, legal and social environment.

capital, the record number to the commercial and corporations' registry, the bank's contacts, and the history of the company.<sup>72</sup>

Failure to tender all the information in a timely manner may result in both civil and criminal sanctions. As a criminal sanction, a 1500 euros fine will be levied on the franchisor who fails to comply with these disclosure requirements.<sup>73</sup> In addition, franchisees can also seek civil damages for harm caused by the franchisor's failure to surrender the documents, for harm caused by inaccuracies in the information, and for harm resulting from early or abusive termination.<sup>74</sup>

Furthermore, in the case of mistake or misrepresentation, Article 1109 of the French Civil Code alternatively gives the franchisee the option of voiding the contract.<sup>75</sup> This dual civil remedy became clear on December 2000, when a franchisee appealed a decision rejecting his claim to declare the franchise contract void due to the franchisor's failure to comply with the pre-contractual disclosures requirement. The Cour de Cassation<sup>76</sup> determined that such failure does void the contract, but only in cases where consent was procured through mistake, misrepresentation, or duress.<sup>77</sup>

## *2. In the United States, a Disclosure Required by Federal and State Laws*

The information required in France is very similar to that provided under both U.S. federal and state laws.

To protect prospective franchise purchasers, the Code of Federal Regulations (Title 16 C.F.R. §436) requires disclosure of essential and reliable information.<sup>78</sup> While the federal disclosure regime does not mandate registration, some state disclosure laws do dictate that franchisors

---

<sup>72</sup> Further elaborating, the franchisor must state the system's date of creation, recall every major step of the business and presentation of the network, and thus include a list of each company, with its address, that was related to the system (presumably, had a franchise contract) but who ceased to be part of the network in the preceding year. For each such former franchisee, the franchisor is to specify the conditions under which the franchise was terminated, indicate the length of any proposed contract or renewal conditions, as well as any transfer conditions and field of exclusivity. *Id.*

<sup>73</sup> *Id.* at n.41.

<sup>74</sup> *Id.*

<sup>75</sup> CODE CIVIL [C. CIV] art. 1109 (Fr.): « *Il n'y a point de consentement valable si le consentement n'a été donné que par erreur ou s'il a été extorqué par violence ou surpris par dol* » ("There is no valid consent if the consent was given by mistake or if it was taken by duress or misrepresentation").

<sup>76</sup> Cass. com, Dec. 5, 2000, pourvoi n°97-21.631.

<sup>77</sup> See also Cour d'Appel de Lyon (CA Lyon) January 24, 2008, pourvoi n°06/07033, deciding the franchise contract was void due to misrepresentation by the franchisor, in failing to inform the franchisee about the condition of the franchise in the precontractual documents.

<sup>78</sup> 16 C.F.R. § 436 (2008). See

<http://www.ftc.gov/os/2007/01/R511003FranchiseRuleFRNotice.pdf>

register a detailed offering circular before soliciting prospective franchisees. As stated *supra*, under the UFOC, effectively replaced in March 2007 by the FDD, the franchisor typically must still submit an application and file a fee with the appropriate state authorities. The FTC Rule, until the 2007 amendment, contained just twenty itemized requirements.<sup>79</sup> Some state authorities had to approve all of the information and material before the offer of any franchise. Now, with the amended FTC Rule, the FTC requires franchisors to disclose twenty-three items, before a potential franchisee might commit to a franchise agreement.<sup>80</sup> Franchisors must deliver the FDD fourteen calendar days before the franchisee signs any franchise or other binding agreement with, or pays any consideration to, the franchisor or any affiliate, or earlier upon a prospect's reasonable request.<sup>81</sup> Franchisors must deliver execution-ready copies of the franchise agreement seven calendar days before it is executed, with this waiting period applying only if the franchisor unilaterally (*i.e.*, not in response to franchisee-initiated negotiations) makes material changes to the terms of the basic franchise agreement attached to the FDD.<sup>82</sup>

The remaining thirty-five states simply have followed the FTC, and therefore need not register at the state level. What distinguishes these state laws from corresponding French laws is that the FTC provides three possibilities of disclosure whereas in France there is no choice. Indeed, first the American franchisor can choose to make a complete and accurate disclosure to all potential buyers. This should reduce the potential for sales abuse by fraudulent franchisors. The second possibility is to not make any disclosure—ignore the FTC Rule. But, in that case, the franchisor would be strictly liable for any violation of the FTC Rule; making him subject to civil penalties of up to \$11,000 per violation, as well as a permanent injunction

---

<sup>79</sup> Standard Registration Documents, including among others, information about the franchisor, its predecessors and Affiliates, the business experience, the litigation and bankruptcy history, the initial franchise fee and other fees, the initial investment, the restrictions on sources of products and services, the franchisee's obligations, the financing, the franchisor's obligations, the territory, the trademarks, the patents, copyrights and proprietary information

<sup>80</sup> The FTC's Franchising Rule, as amended in 2007, requires disclosures about these 23 items: (1) The Franchisor and any Parents, Predecessors, and Affiliates, (2) Business Experience, (3) Litigation, (4) Bankruptcy, (5) Initial Fees, (6) Other Fees, (7) Estimated Initial Investment, (8) Restrictions on Sources of Products and Services, (9) Franchisee's Obligations, (10) Financing, (11) Franchisor's Assistance, Advertising, Computer Systems, and Training, (12) Territory, (13) Trademarks, (14) Patents, Copyrights, and Proprietary Information, (15) Obligation to Participate in the Actual Operation of the Franchise Business, (16) Restrictions on What the Franchisee May Sell, (17) Renewal, Termination, Transfer, and Dispute Resolution, (18) Public Figures, (19) Financial Performance Representations, (20) Outlets and Franchisee Information, (21) Financial Statements, (22) Contracts, and (23) Receipts. 16 C.F.R. § 436.5 (2008).

<sup>81</sup> 16 C.F.R. § 436.2(a) (2008).

<sup>82</sup> 16 C.F.R. § 436.2(b) (2008).

against future violations.<sup>83</sup> Note that here, the mere noncompliance is sufficient to prevail in an enforcement action. Third, the franchisor can comply with the FTC Rule, but omit certain required information. This omission would, however, significantly ease the burden of proof in both private actions for misrepresentations, as well as FTC enforcement actions. Indeed, the showing that the franchisor did not fully comply with the required disclosure elements could be evidenced by the fact that there is either no record of such a disclosure, or that existing records are of just a partial disclosure.

### III. FRENCH TRENDS IN LIGHT OF THE AMERICAN EXPERIENCE

As instruments drafted by franchisors, both French and American franchise contracts try to control the spread of franchisee rights or franchisor obligations beyond what the law—statutory, regulatory, or adjudicator—already dictates. Three types of franchise exclusivities exist: (1) supply exclusivity, where the franchisee is the only one to be supplied by the franchisor in a delineated territory; (2) trade name exclusivity, by which the franchisor agrees not to establish another retail outlet in the granted area; and (3) brand exclusivity,<sup>84</sup> that guarantees to the franchisee the sole right to use the franchisor's distinctive signs within the delineated territory. The longstanding franchising contretemps of encroachment can involve all three types, although most cases—particularly those fixed on non-Internet issues—center on trade name exclusivity, with brand issues second and with supply topics a distant third. Often advocates and judges spend little, if any, time distinguishing these types of rights, as encroachment simply covers a gamut of sins the franchisor purportedly committed. This article thus focuses, as do courts and commentators, on trade name exclusivity.

#### *A. A Contractual Decline in Usage of Territorial Exclusivity Clauses*

In French franchising, the presence of a territorial exclusivity clause used to be paramount, and often is still very important, in the eyes of the franchisees. Such protections have diminished, however, as France has started to abandon what once might have been seen as a franchising sacrament. This decline mirrors the United States' trend from twenty years

---

<sup>83</sup> 15 U.S.C. § 45(l) (2008).

<sup>84</sup> See Cour d'Appel de Paris (C.A), Apr. 5, 2006, Juris-Data n°298242, deciding that the franchisor's contractual failure can result as much as from the "active" infringement of the trade mark exclusivity clause, as from its "passive" infringement coming from the franchisor's incapacity to protect the exclusivity granted to the franchisee.

ago, where the franchising parties' private law choices (their agreements) increasingly omitted territorial exclusivity provisions.<sup>85</sup>

The waning use of exclusivity clauses comports with French law. As goes French practice, so goes its law, at least for franchise contracts. That is plain to see when exclusivity is, at least in theory, *not* an essential point in the franchise contract. Indeed, without such a clause, a franchise contract remains valid in France. As maturing franchise systems no longer need to entice franchisees with exclusive territories,<sup>86</sup> some French franchise experts contend that exclusive territory clauses have gone from being almost universal to being an increasingly infrequent contract provision.<sup>87</sup> Still, it has

<sup>85</sup> Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C.L. REV. 905, 968 (1994) (two surveys of franchise agreements, one in 1971 and the other 22 years later, show that the number of contracts granting exclusive territories for franchisees went from 60% in 1971 to only 46% in 1993); *but see* IFA EDUC. FOUNDATION, INC., THE PROFILE OF FRANCHISING, VOLUME I: A STATISTICAL PROFILE OF THE UNIFORM FRANCHISE OFFERING CIRCULAR (UFOC) DATA 72-73 & 107 (1998) (examining UFOC statements for 1,156 franchise systems filed during 1996 and finding that 73% of them grant some form of exclusive territory, as described geographically, in miles, by population, or by number of vehicles; for the fields specifically studied in the surveys referenced in Emerson, *Franchise Contract Clauses*, *supra* note 84—restaurants and fast-food outlets—almost 300 UFOC statements (99 for restaurants and 197 for fast-food establishments) reflected grants of exclusivity at a much higher rate (80% for restaurants, and 69% for fast-food units) than found in the two earlier surveys). *See* Roger D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING 223 (2005). While the number of exclusive territories has risen, according to the author's study of 100 fast-food, restaurant, and ice cream parlor franchise agreements dated from August 2005 to April 2007 (finding that 60% granted exclusive territory to the franchisee), the numbers expressly without exclusive territory has also risen – to 32% (data on file with author). Robert W. Emerson, *Franchise Phrasing: Strong Words, But Weak Faith* (August 10, 2008) (unpublished manuscript, on file with author).

<sup>86</sup> In France, for example, more established American franchisors, such as McDonald's, Midas, Quick, and Century 21, refuse to grant exclusivity, as they have the name recognition and market power to acquire the interest and investment of prospective franchisees without such contractual impediments to system expansion. Laure Guiserix, *Clauses d'exclusivité, À observer de près* (Exclusivity clauses to watch closely), FRANCHISE MAGAZINE, Oct./Nov. 2007 (No. 202); *accord*, THIRIEZ ET PAMIER, *supra* note 10, at 197.

<sup>87</sup> The movement away from territorial exclusivity may be found in all French franchising, not just the larger, more established systems, according to Maître Jean-Marie Leloup. LELOUP, *supra* note 10, at 48. But many others disagree. THIRIEZ ET PAMIER, *supra* note 10, at 196-97 (stating that a territorial exclusivity clause is widespread – 90% of the cases – and then opining that the existence of such a clause is considered to be a fundamental element of the franchise, with its absence underlining for many observers a danger («son absence soulignée par des nombreux observateurs comme un danger»)—then commenting that this danger can be seen in certain hotel chains with unhappy consequences for the franchisee without the protection of exclusivity—“when your shop is instructed to stay open until two in the morning without your consent, then you'll decide you're unhappy!”) (trans. by Robert W. Emerson); Guiserix, *supra* note 85 (contending that exclusivity clauses are “still

been observed that most of the franchisees require some type of exclusivity.<sup>88</sup> According to Professor Didier Ferrier, a noted expert on French distribution law, including franchise contracts, “‘territory exclusivity’ in the franchise contract must be understood as an element of the skill/know-how (*savoir-faire*), that is to say, as the territorial basis of the franchisor’s initial success in his distribution model, and hence of each franchisee’s success.”<sup>89</sup>

We can temper this assertion by looking at trends. While it stays true at the early points in the network development process, once that network is well established and prosperous, the supposed charms of exclusivity may lose their luster. It may then be the case that the franchise system, in order to stay successful, at that stage needs to expand and even, in the eyes of some franchisees, perhaps to encroach on individual units’ markets.<sup>90</sup>

However, some authors observe a shift to a total abandonment of territory exclusivity in the last few years. This seems to contradict other analyses on such clauses. Indeed, in practice-oriented articles the territory exclusivity clause has masqueraded itself as an unavoidable usage of the franchise. In fact, “about two thirds of the trade names choose it,” according to Jean-Baptiste Gouache, a lawyer who specializes in counseling commercial networks, particularly franchised systems.<sup>91</sup>

This movement would find its roots in the expansion of competition law and economic pressures. Because competition law forbids absolute

---

provided in the majority of networks” and that, although “no legal text requires the territory exclusivity clause, it is still considered as a constitutive element of the contract by [organized franchisees and distributors], with it “in practice...viewed as an unavoidable usage in the franchise system” (trans. by Robert W. Emerson).

<sup>88</sup> Guiserix, *supra* note 85.

<sup>89</sup> Interview with Didier Ferrier, professor of law, Université de Montpellier, Montpellier, France (June 15, 2008) ; *see also* LELOUP, *supra* note 10, at 68-69 (trans. by Robert W. Emerson) (quoting from Prof. Ferrier - *«L'exclusivité territoriale dans la franchise doit être conçue...comme un élément du savoir-faire, c'est-à-dire comme l'assiette territoriale de la réussite initiale du franchiseur dans son point de distribution modèle, et par la suite de la réussite de chaque franchise»*). Many authors were divided on the point whether the exclusivity is essential to the franchise contract, and Didier Ferrier is seen as the one who has the most elaborated position. On the necessity of exclusivity, *see* Aldo Frigani, “Nuove Riflessioni in Tema di franchising”, *GIURISPRUDENZA ITALIANA*, 1980 disp.8a 9a, parte IV; Against the necessity: Th. Bourgoignie, *Journal des Tribunaux*, Bruxelles 12 jan.1974 ; J. Azéma, *Le droit français de la concurrence*, op.cit, n°350.

<sup>90</sup> *See* Cass. com, Jan. 14, 2003, in which a franchisor was found to have not infringed upon the franchisee’s territorial exclusivity when it sold products in a territory the franchise agreement had conceded to the franchisee.

<sup>91</sup> Guiserix, *supra* note 85 (trans. by Robert W. Emerson). Gouache concedes there may be some decline, generally and within particular systems as they mature. But he does not see this as particularly noteworthy. Interview with Jean-Baptiste Gouache, avocat, Paris, France (June 13, 2008).



territory exclusivity,<sup>92</sup> this concept becomes less attractive. Instead, market share will be the criteria to determine whether exclusivity is permitted. The exemption regulation allows it up to 30% of market share of the relevant market in question,<sup>93</sup> and thus network growth and territorial issues can remain factually complicated and legally muddled.

In a nutshell, we can say that French franchising activities appear to be following in the steps of American franchise practices, even if French jurisprudence has yet to show all the signs of that “pursuit.”<sup>94</sup> That is because in the United States, much more so than France, the priority is network expansion.<sup>95</sup> In America, territory clauses are not nearly as prevalent. Still, they may be crucial for the protection of some franchisees’ own businesses. So, in order to bolster and maintain the franchise system, the parties may come to agree on a limited territorial right for franchisees; this common ground is a compromise - some protection for franchisees, some remaining liberty to expand for the franchisor. Invoking their common interests in expansion *and* protection, the franchise parties and the courts may, in effect, use for territorial development and protection issues the “good cause” or good faith and fair dealing standard developed in termination cases such as *Dayan v. McDonald’s Corp.*<sup>96</sup>

#### *B. Court Decisions on Territorial Encroachment Issues*

In France, courts recently have answered, negatively, the question whether *de facto* territorial exclusivity is recognized in French law. Cases continue, however, as the jurisprudence, at least in sheer volume, has yet to evince the decline in exclusivity that may be found in practice. Perhaps this is to be expected, as actual usage of territorial clauses weakens but many franchisees still have certain cultural, if not legal, expectations of territorial protection.<sup>97</sup> Nevertheless, as long as the contract fails to stipulate territory exclusivity, even if in practice the franchisee may have received some sort

---

92 INTERNATIONAL FRANCHISING LAW, Vol. 1, at 33-France (Dennis Campbell ed., 2005) (“However, clauses stipulating that a franchisee is prohibited from selling to clients outside its area are void both under French law and Community law, since this would result in a division in the market”).

93 *Id.*

94 See Les Petites Affiches, La Loi, Le Quotidien Juridique, Nov. 9, 2006, N°224, studying the recent Court cases, does not reveal already the trend that the use of the exclusivity clause is declining.

95 For many, if not most, franchisors, rapid territorial development is the essence of a franchise.

96 *Dayan v. McDonald’s Corp.*, 466 N.E.2d 958, 994 (Ill. App.Ct.1984) (found good cause for termination because franchisee failed to maintain quality, service, and cleanliness standards).

97 Franchisee advocates remain adamant that franchisees ordinarily expect, and have the right to expect, market protections from the possible predations of their own franchisor. Interview with Serge Meresse, avocat, Paris, France (June 17, 2008).

of protection, then merely implied terms will not be enforceable.<sup>98</sup> In *Cass. Com., 19 novembre 2002*, the franchisee complained that the franchisor had infringed his “de facto” territorial exclusivity. The lower court found for the franchisee, but the Cour de Cassation reversed on the basis of Civil Code Article 1134.<sup>99</sup> The contract simply had not provided any express territorial exclusivity.

The November 19, 2002 decision may be juxtaposed with the views American courts have offered in similar situations. In *Scheck v. Burger King Corp.*,<sup>100</sup> the franchisee claimed that the franchisor had breached an implied covenant of good faith and fair dealing by opening another franchised restaurant just two miles away from the franchisee’s location. Agreeing with the franchisee, the Court said that even though the franchise contract explicitly denied the franchisee any territorial rights, the franchisor had to take into account the effect that opening additional franchises would have on a nearby franchisee. Although most cases have rejected the reasoning in *Scheck*,<sup>101</sup> a number of decisions have furthered *Scheck*’s anti-encroachment principles. For example, in *Burger King Corp. v. Weaver*,<sup>102</sup> the Court held that Burger King’s “longstanding policy against encroachment and cannibalization” forced the conclusion that neither of the franchise agreements granted Burger King the absolute right to establish new franchises at any location, therefore allowing the franchisee to bring his claim under the implied covenant of good faith.<sup>103</sup> Likewise, in *Vylene v. Naugles*,<sup>104</sup> the franchisee of a Mexican food restaurant chain complained about the franchisor’s establishment of a new unit 1.4 miles away. Following the *Scheck* reasoning, the U.S. Court of Appeals for the Ninth Circuit concluded that this new establishment was a breach of the covenant of good faith and fair dealing. One year later, another circuit court, the Eleventh Circuit, also followed *Scheck*’s interpretation in *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*<sup>105</sup> Examining encroachment case law, the Court noted, “the great weight of authority” maintains that (1) the implied covenant will not override express terms in a written franchise agreement, and (2) citing *Scheck*, “when there is no such language the franchisor may not capitalize upon the franchisee’s business in bad faith.”<sup>106</sup>

---

<sup>98</sup> Cass. com., Nov. 19, 2002, pourvoi n° 01-13.492.

<sup>99</sup> Code civil [C. CIV.] art. 1134 (Fr.) (2008). More is discussed *infra*.

<sup>100</sup> See *Scheck v. Burger King Corp.*, 798 F. Supp. 692, 697 (S.D. Fla. 1992).

<sup>101</sup> See *Fickling v. Burger King Corp.*, 843 F.2d 1386 (4th Cir. 1988).

<sup>102</sup> See *Burger King Corp. v. Weaver*, 798 F. Supp. 684, (S.D. Fla. 1992).

<sup>103</sup> *Id.* at 689-90.

<sup>104</sup> *Vylene v. Naugles*, 90 F.3d 1472, 1477 (9th Cir. 1996) (noting, “The bad faith character of the move becomes clear when one considers that building the competing restaurant had the potential to not only hurt [franchisee] Vylene, but also to reduce [franchisor] Naugles’ royalties from Vylene’s operations”).

<sup>105</sup> *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*, 139 F.3d 1396 (11th Cir. 1997).

<sup>106</sup> *Id.* at 1403.

In contrast to the controversial *Scheck* holding,<sup>107</sup> the Cour de Cassation's November 19, 2002 holding may at first glance seem to demonstrate a certain carelessness, if not cluelessness, about good faith and fair dealing values. However, if we look closely at the Article on which the Cour de Cassation based its decision, evidently there was no misconception at all. Indeed, Article 1134 of the Civil Code, alinea 1 and 3, says: "Agreements lawfully entered into take the place of the law for those who have made them. They must be performed in good faith."<sup>108</sup>

Therefore, the Cour de Cassation overturned the lower court's broad interpretation of franchisee territorial protection and decided that good faith performance was *not* impaired because the agreement failed to address the issue of territorial exclusivity.

In the end, we can say that the overall trend in France today is to take into account only what is written in the contract, as the French courts strictly interpret the contract. In the United States, it is still unclear when the implied covenant of good faith and fair dealing may prevail over what is expressly written in the contract.

### C. Transfer of Franchise Contracts in France

#### 1. The Main Provisions

As no rules of the French Civil Code specifically apply to the franchise contract, the franchise agreement falls under the category of unnamed contracts, or "*contrats innomés*."<sup>109</sup> However, as we have seen above, some information must be disclosed in the pre-contractual information document to all potential franchisees. For example, the franchisor must disclose the conditions of the transfer of the contract. Furthermore, antitrust guidelines<sup>110</sup> recognize that the franchisee has to

<sup>107</sup> *Scheck* was later overturned and usually disparaged in subsequent case law. See *infra*. *Scheck* has been criticized, ignored, and distinguished in a number of subsequent opinions. See e.g., *Burger King Corp. v. Weaver*, 169 F.3d 1310, 1317 (11<sup>th</sup> Cir. 1999) (concluding that *Scheck*'s reasoning is illogical and unconvincing); *Barnes v. Burger King Corp.*, 932 F. Supp. 1420, 1437-38 (S.D. Fla. 1996) (rejecting the *Scheck* court's reading of the franchise agreement); *accord*, *Chang v. McDonald's Corp.*, 105 F.3d 664 (9<sup>th</sup> Cir. 1996) (rejecting the approach of the *Vylene* case, discussed *supra*). But see Charles S. Hale II, *Market Impact in the Information Age: Protecting Hotel Owners from Hotel Management Companies*, 108 W. Va. L. Rev. 573, 580 (2005) (noting, "Although the *Scheck* opinion has been criticized and distinguished, it has been followed where franchise agreements are silent as to the rights of franchisors").

<sup>108</sup> C. CIV. 1134 (2008) (trans. by Robert W. Emerson) «*Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. Elles doivent être exécutées de bonne foi*»).

<sup>109</sup> ALAIN BENABENT, *DROIT CIVIL LES OBLIGATIONS* 15 (10th ed., Domat, 2005) (droit privé, Montchrétien, «*Contrats nommés et contrats innomés*»).

<sup>110</sup> Commission Regulation 2790/99, On the Application of Article 81(3) of the Treaty Establishing the European Community to Categories of Vertical Agreements and Concerted Practices (Vertical Restraints Block Exemption Regulation), 1999 O.J. (L.

obtain the franchisor's assent before any transfer of franchisee rights and duties under the franchise contract is made.<sup>111</sup> If the contract contains no provisions at all regarding the transfer of that contract, then the nature of basic French franchise law concepts still inhibits transfer. This is because the franchise contract is built around essential "personal" characteristics, such as the licensing of the trade name and the know-how, and the contract is entered into in consideration of the person of the other party.<sup>112</sup> Indeed, the franchisor does not want to entrust his most valuable assets to just anyone, and certainly not to the first candidate who meets whatever threshold the franchisee has for assigning the contract. Therefore, the franchisor cannot be forced to work with another contracting party other than the franchisee with whom he signed the contract. The Cour de Cassation held, "the fact that a contract has been concluded in consideration of the person does not prevent the transfer of the latter's rights and duties to a third party, so as long as the other party has agreed to it."<sup>113</sup> This decision has been read *a contrario* by most French legal practitioners, who understand that *intuitu personae* contracts require the consent of the transferred party to be valid. The decision also means that other types of contracts do not require such consent.

A similar question arises in the reciprocal situation: Is franchisee consent required prior to a franchisor's assignment of the contract to a third party? Case law suggests that the answer to this question is yes.<sup>114</sup> The answer had remained unclear for a long time, until two cases in May 1997. In one of these cases, decided on May 6, 1997, the Cour de Cassation held that the Cour d'Appel did not offer a legal basis for its decision when that lower appellate court failed to consider the transfer issues.<sup>115</sup> For a supply contract between supplier and customer, had the customer agreed to the substitution of his co-contractor—i.e., to having a different supplier? Such substitution took place after the court had mandated that the customer, who had ordered materials from the supplier, pay the costs to another company

---

336/25) (EC). These are the December 1999 guidelines on vertical restraints, thereby completing the exemption regulation.

<sup>111</sup> See *supra* Article L330-3 of the Commerce Code.

<sup>112</sup> The concept of *intuitu personae*, in the franchising context, is discussed *infra*.

<sup>113</sup> See Cass. com., Jan. 3, 1992, N°90-14.831 (trans. by Robert W. Emerson) («*Le fait qu'un contrat ait été conclu en considération de la personne du cocontractant ne fait pas obstacle à ce que les droits et obligations de ce dernier soient transférés à un tiers dès lors que l'autre partie y a consenti*»).

<sup>114</sup> See *infra* text accompanying notes 114-117 (the discussion of the two French cases of May 6, 1997).

<sup>115</sup> Cass. com., May 6, 1997, N°96-16.335, «*Attendu qu'en se déterminant par de tels motifs, sans rechercher si, dans le contrat conclu entre la société CVS et la société Rougeot ou ultérieurement, cette dernière société avait donné son consentement à la substitution de sa cocontractante, la cour d'appel n'a pas donné de base légale à sa décision*».

to which the supplier had entrusted the resale of its production.<sup>116</sup> Such consent to contractual assignment is a fundamental matter of inquiry before a party, such as a franchisee, may be ordered to deal with someone other than the original contracting party (e.g., the original franchisor).

In another case, also on May 6, 1997, the Cour de Cassation reviewed a maintenance contract, reserving to the company in charge of maintenance the ability to “freely transfer [to another company] . . . the rights [e.g., profits] and duties coming from . . . the contract.”<sup>117</sup> So, the high court decided, a lower court was correct in holding that, with this contractual stipulation giving the maintenance company the complete right to choose its own substitute, the parties foresaw no need to obtain the customer’s consent, or even inform him, before the maintenance company proceeded, at some future time, to obtain a substitute; the customer could not oppose that substitution.<sup>118</sup>

Combined, these two cases indicate, by analogy, that network parties, such as franchisor and franchisee, are not simply bound by the longstanding legal doctrine of *intuitu personae*. Instead, courts must focus on the parties’ own contract provisions, or lack thereof. For an assignment from one franchisor to another franchisor, the franchisee must have already consented contractually (a form of prospective agreement) when the franchise agreement was formed, or else that franchisee is free to reject the new franchisor. The *intuitu personae* factor does not function anymore as a criterion to determine under which condition the transfer of a contract should require the franchisee’s consent.<sup>119</sup> Franchisors can include in the contract a provision that allows them to freely transfer the franchise contract. This is an *ab initio* authorizing clause, “une clause d’autorisation *ab initio*,” meaning that, from the very start, the franchisees agreed to the possibility of the contract’s transfer. This clause should cover the methods in which the franchisees will be informed of the transfer, and of the identity of the new franchisor.<sup>120</sup>

In the United States, the franchisor typically insists on a clause reserving to it the right to assign the contract—the franchise agreement thus expressly states that the contract is freely transferrable from one franchisor to another.<sup>121</sup> Interestingly, almost all of the franchisors deny this right to

<sup>116</sup> Cass. com., May 6, 1997, No. 96-16.335.

<sup>117</sup> Cass. com., May 6, 1997, No. 95-10.252 («Un contrat de maintenance ayant réservé à l’entreprise chargée de celle-ci la faculté de librement céder... les droits et obligations issus du ... contrat ou substituer toute société de son choix dans le bénéfice des droits et la charge des obligations en résultant »).

<sup>118</sup> *Id.* («Un tribunal retient justement, en se référant à cette stipulation contractuelle de substitution qui ne prévoyait ni l’information du client ni un agrément par lui, que le client ne pouvait s’opposer à son application»).

<sup>119</sup> See Les Petites Affiches, 9 Novembre, 2006, N°224, p. 30, §82.

<sup>120</sup> *Id.* at 31, §89.

<sup>121</sup> Robert W. Emerson, *Franchise Contract Clauses*, *supra* note 84, at 970 (66% of the contracts in 1993 provided for such transferability); Robert W. Emerson, *Franchise*

their franchisees.<sup>122</sup> With such non-reciprocity, it is clear that the *intuitu personae* concept would be, at least in practice, truly an alien idea to most American franchisors. After all, these franchisors tend to insist that the contract covers *everything*, even allowing for a new franchisor to be imposed on the franchisee without the franchisee's prior or subsequent assent. That is the situation, those franchisors reason, because the franchisee's concurrence was already obtained via the original franchise agreement.

In France, franchisors can require, specifically in the "clause d'agrément," or agreement clause, that they have rights of approval over the franchisee's successor.<sup>123</sup> For example, a boilerplate clause recommended by franchise lawyer and author Jean-Marie Leloup asserts: "[t]he present contract is not transferrable except for a franchisee's passing on his goodwill to a successor, provided that the franchisor approves this successor-candidate . . . . The franchisor is the sole judge of the candidate's chances of success, and his ability to reproduce faithfully the transferred know-how."<sup>124</sup> Despite its negative form, this formulation does recognize the transferability of the contract. Moreover, such a clause may safeguard the network's longevity without interfering with the franchisee's freedom to sell his goodwill with the trade name.<sup>125</sup> Nevertheless, in that case, the purchaser has to be the franchisee's successor to his goodwill.

## 2. Goodwill

In France, until 2002, goodwill was considered solely the property of the franchisor.<sup>126</sup> This put French franchisees in a difficult position vis-

---

*Phrasing, supra* note 84 (77% of the contracts in 2008 provided for such transferability).

<sup>122</sup> Robert W. Emerson, *Franchise Contract Clauses, supra* note 84, at 969 (95% of the contracts in 1993 reserving to the franchisor a right of first refusal on the franchisee's proposed transfer/sale of the franchise to another party; 93% of the contracts in 1993—and almost as many, 83% in 1971—requiring that the franchisee obtain the franchisor's approval before selling, assigning or otherwise transferring the franchise); Robert W. Emerson, *Franchise Phrasing, supra* note 83 (100% of the contracts in 2008 reserving to the franchisor a right of first refusal on the franchisee's proposed transfer/sale of the franchise to another party; 99% of the contracts in 2008 requiring that the franchisee obtain the franchisor's approval before selling, assigning or otherwise transferring the franchise).

<sup>123</sup> LELOUP, *supra* note 10, at 267 (para. 1508). *Clauses soumettant la transmission du contrat à l'agrément du franchiseur* (Provisions conditioning the transfer of the contract to the franchisor's agreement).

<sup>124</sup> *Id.* (trans. by Robert W. Emerson) («Le présent contrat est intransmissible sauf au successeur du franchiseur dans son fonds de commerce à condition que ce successeur ait été agréé préalablement par le franchiseur, seul juge des chances de succès du candidat et de son aptitude à réitérer fidèlement le savoir-faire transmis»).

<sup>125</sup> Franchise Magazine *Contrats de Franchise, Décrypter les clauses*, Laure Guiserix (Franchise Contracts, To Decipher the Clauses), Avril/Mai 2007, N°199.

<sup>126</sup> See Cass. com, Mar. 27, 2002 (described below in note 127),

à-vis the landowners of their commercial premises, who often refused to renew leases on the grounds that the franchisees were not the owners of the goodwill.<sup>127</sup>

The Cour de Cassation put an end to the franchisee's predicament with a decision (called the *arrêt Trévisan*) on March 27, 2002.<sup>128</sup> The Court recognized that the franchisor is the owner of the national clientele, whereas the franchisee is the owner of the local clientele.<sup>129</sup> This meant that all franchisees were the owners of the goodwill on the local scale.

Therefore, taking into account the importance of their local clientele, the franchisee owner of the goodwill can either benefit from the renewal right of the commercial lease, or can be granted an important eviction indemnity. However, as can be seen in a 2007 decision where the court decided that the franchisee was still entitled to the goodwill,<sup>130</sup> this position still needs to be reaffirmed by the court. Indeed, even though franchisees had won in the past, some landowners still continued to ignore the franchisee's goodwill rights.<sup>131</sup>

---

<sup>127</sup> The decree of Sept. 30, 1953, regulates in France the relationship between the lessor and the lessee in regard to the renewal of the commercial leases. This decree has just been integrated into the 'Code de commerce', in Mar. 25, 2007, under the Articles L 145-5 to L 145-60. Under now Article L 145-8 of the Code de commerce, the commercial lease renewal right can only be asked by the owner of the goodwill (*fonds de commerce*).

<sup>128</sup> See Cass. com, Mar. 27, 2002. A lessor, the owner of a commercial lease, delivered a refusal of renewal to his lessees. The lessor said that the franchisee did not indicate that it had its own clientele, linked to its professional activity and independent of its attractiveness due to the franchisor trade name. Consequently, it could not justify the contention that it had its own goodwill, and left the franchisee unable to insist on a right to benefit from the commercial lease status (which extended only to the goodwill holder, the franchisor). The court affirmed, "if the clientele is at the national level, attached to the notoriety of the franchisor's trade name, the local clientele only exists by the fact of the means put in work by the franchisee, including the corporal elements of its goodwill, stock, materials..., and the incorporeal element, that is the commercial lease. This clientele is itself a part of the goodwill of the franchisee, because, even though the latter is not the owner of the trade name put at his disposition during the execution of the franchise contract, it is created by its activity, with means that he puts at work at his own risks, because contracting personally with the suppliers or investors].

<sup>129</sup> *Id.*

<sup>130</sup> See Cass. com, Oct. 9, 2007: *pourvoi n° 05-14118*. The lower court had decided that the franchisee was not entitled to damages for the loss of his customers because the franchisee could not bring any proofs that could be put in direct and necessary relation with the franchisor. The Cour de Cassation said that the lower court had however recognized that the franchisee could claim its own customers and that the termination of the contract was due to the franchisor, from what it could be deduced that the former franchisee became dispossessed from its customers. Therefore, the franchisee was entitled to recover from this loss.

<sup>131</sup> Interview with Monique Ben Soussen, avocat, Paris, France (June 13, 2008); interview with Hubert Bensoussan, avocat, Nantes and Paris, France (June 17, 2008); interview with Serge Meresse, avocat, Paris, France (June 17, 2008).

As owners of the local goodwill, the franchisees can decide to transfer it. This represents a threat to the franchisor. Indeed, for the sake of the network, the placement of the franchised stores is of substantial importance because the franchisors want to preserve existing stores. Therefore, in order to prevent such a loss, they often include a provision called a preference clause (*«clause de préférence»*). Under a preference clause, a franchisee, in the event he or she decides to sell merchandise, commits to giving priority to the franchisor, who thus enjoys a preemptive right under predetermined conditions. Hence, with a preference clause in the franchise contract, whenever the franchisee decides to sell his goodwill, the franchisor will be the first person to whom the sale is offered. If the franchisor does not accept the offer, then the franchisee is free to sell his goodwill to any other potential buyer.<sup>132</sup>

A 2005 appellate court decision illustrates this mechanism.<sup>133</sup> In that case, a franchisor, aware of the offer made by the franchisee through the preference clause, did not exercise his preemptive right to acquire the goodwill.<sup>134</sup> After denial of purchase by the franchisor, the franchisee sold his goodwill to another party.<sup>135</sup> The franchisor then filed a complaint against the new goodwill owner because that owner did not follow the original franchise contract's requirements.<sup>136</sup> The appellate court said that the franchise contract had been terminated by the transfer of the goodwill, and hence the franchisor could only sue the original franchisee for damages, not the successive purchaser of the goodwill.<sup>137</sup> The new owner of the goodwill had explicitly agreed that he would not pursue the franchise contract.<sup>138</sup>

Some law practitioners believe that the transfer of a goodwill amputated from the franchise contract should barely be called a true goodwill sale.<sup>139</sup> Their thesis is that goodwill is created by the clientele for which it exists. Therefore, a goodwill sale happens only when the elements that attract the clientele are transferred. They suggest that franchisors

---

<sup>132</sup> In essence, the preference clause functions similarly to a right-of-first-refusal. See CA Nîmes, Sept. 8, 2005, unpublished, RG n°03/03202. In this case, a franchisor, aware of the offer made by the franchisee through the preference clause, did not request the acquisition of the goodwill. The franchisee then sold his goodwill to a successor. The franchisor then complained against the new goodwill owner because he did not pursue the franchise contract. The appellate court said that the franchise contract had been terminated by the transfer of the goodwill, and hence the franchisor could only sue the franchisee for damages and not the purchaser of the goodwill.

<sup>133</sup> See CA Nîmes, Sept. 8, 2005, unpublished, RG n°03/03202.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> Les Petites Affiches, La Loi, Le Quotidien Juridique, Nov. 9, 2006, N°224, page 32-33.



should, in every contract, put a preference clause and an agreement clause (the franchisors need to be part of, and determine authorization for or against, any franchise transfer to a third party). That way, the franchisor's approval of the transferee is still required, and the franchisee will not be freed from the contract by the franchisor's rejection of his offer. However, this reasoning will be hard to reconcile with decisions similar to the appellate court's holding. Indeed, the appellate court's decision clearly shows that the franchisor had no legitimate claim upon the transferee of the goodwill once the former had refused an offer under the preference clause. Protection against such a circumstance could be reached through a franchisor-franchisee contract provision that goodwill may only be transferred in conjunction with a transfer of the franchise contract itself.

As for the franchisees, they can transfer the franchise contract and the goodwill through a clause called the "free circulation clause, under termination if unsatisfactory performance" (*«Clause de libre - circulation, sous condition résolutoire de performance»*): Under these circumstances the franchise contract and the goodwill (*«fonds de commerce»*), ordinarily non-transferable without first obtaining the franchisor's approval, can be freely transferred from the franchisee to the franchisee's successor; the franchisor is instead reserved a period – generally, several months – to judge the transferee's abilities working within the franchised network and, thus, to decide whether to confirm the transfer. Because of the uncertainties of such a trial period, careful transferees seek a stipulation for returning money to them from the franchisee in the event of a non-confirmation that is not the transferee's fault. Indeed, these clauses are rare,<sup>140</sup> undoubtedly due to the difficulties and insecurity for the transferee as well as the increased oversight required of the franchisor.

In the United States, as in France, court decisions have shown some inconsistencies in deciding whether the goodwill is severable or not, and hence there is uncertainty in determining the ownership of the franchise goodwill.<sup>141</sup> In *Bray v. QFA Royalties LLC*, the court granted the franchisee's motion for preliminary injunction and prohibited Quiznos from terminating a franchisee for conduct that in Quiznos's "sole judgment" materially impaired its goodwill.<sup>142</sup> The court was presented with two types of goodwill: 1) the "business goodwill," or also referred to the "community goodwill," which the franchisees argued they would lose if Quiznos was allowed to terminate; and 2) the goodwill associated with the Quiznos brand (trademark goodwill), which Quiznos argued would be materially

---

<sup>140</sup> See LELOUP, *supra* note 10, at 267 (para. 1507).

<sup>141</sup> See e.g., *Arnott v. American Oil Co.*, 609 F.2d 873, 882 (8th Cir. 1979); *Lee v. Exxon Co.*, 867 F. Supp. 365, 366 (D.S.C. 1994); *Bray v. QFA Royalties LLC*, 486 F. Supp. 2d 1237 (D. Colo. 2007); *Pirtek USA, LLC v. Zaetz*, 408 F. Supp. 2d 81, 81 (D. Conn. 2005); *Atlantic Richfield Co. v. Razumic*, 390 A.2d 736, 742 (Pa. 1979). All these cases are discussed in the text in the following two paragraphs.

<sup>142</sup> 486 F. Supp. 2d 1237, 1237 (D. Colo. 2007)

impaired if the termination was not immediate.<sup>143</sup> The court granted the franchisee's motion and said that to allow Quiznos to terminate the franchise agreement would cause irreparable harm to the franchisee's "community goodwill."<sup>144</sup> The court further found that there was insufficient evidence to show that a continued relationship between Quiznos and the franchisee would cause further material harm to Quiznos' trademark goodwill.<sup>145</sup> In so ruling, the court implicitly recognized the ownership of the two different, but related, types of goodwill—the "community goodwill" owned by the franchisee and the trademark goodwill owned by the franchisor. Moreover, in *Pirtek USA, LLC v. Zaetz*, the franchisor moved for a preliminary injunction to enforce a non-compete agreement with Zaetz, an ex-franchisee.<sup>146</sup> Pirtek, the franchisor, alleged that Zaetz illegally transferred the goodwill he developed as a Pirtek franchisee to his son who opened a competing business in place of Zaetz, thereby violating the non-compete agreement between Pirtek and Zaetz.<sup>147</sup> The court denied Pirtek's motion. It reasoned partly that Pirtek's goodwill was continuing to be developed through a new Pirtek franchise in the same territory and, therefore, any loss in goodwill as a result of the Zaetz's son's opening a competing business at the former Pirtek site did not amount to irreparable harm.<sup>148</sup> Similar to *Bray*, the court seems to have recognized that a franchisee can further develop a franchisor's trademark goodwill. However, contrary to *Bray*, the court here seems to imply that, ultimately, all goodwill belongs to the franchisor.

In *Arnott v. American Oil Co.*,<sup>149</sup> the Eighth Circuit stated that goodwill is owned jointly by the franchisor and the franchisee. The Court reasoned that the franchisee is the common builder of both his own goodwill, and the franchisor's goodwill.<sup>150</sup> However, other cases show that the issue remains unsolved.<sup>151</sup> In *Lee v. Exxon Co.*,<sup>152</sup> when the franchisor

---

<sup>143</sup> *Id.* at 1249-50.

<sup>144</sup> *Id.* at 1249.

<sup>145</sup> *Id.* at 1250-51.

<sup>146</sup> 408 F. Supp. 2d 81, 81 (D. Conn. 2005).

<sup>147</sup> *Id.* at 81, 84.

<sup>148</sup> *Id.* at 86.

<sup>149</sup> *Arnott v. American Oil Co.*, 609 F.2d 873, 882 (8th Cir. 1979).

<sup>150</sup> *Id.*

<sup>151</sup> There are, for example, cases holding against the franchisee's holding any goodwill. See, e.g., *Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.*, 874 F.2d 431, 435-439 (7th Cir. 1989) (in ruling that franchisor Quality Care properly terminated the Gorensteins' franchise for failure to pay royalties, the court's discussion suggests that the goodwill associated with Quality Care's trademark could not be separated from the franchisor and that, therefore, the franchisor had the right to maintain complete control over the goodwill); *Int'l Multifoods Corp. and Affiliate Cos. v. Comm'r.*, 108 T.C. 25 (1997) (discussed *infra* text accompanying notes 154-159); *Canterbury v. Comm'r.*, 99 T.C. 223, 249 (1992) ("We find that petitioners [franchisees] acquired no goodwill that was separate and apart from the goodwill inherent in the McDonald's franchise"); *Lieb v. Comm'r.*, 33 T.C.M. (CCH) 1231, at 8<sup>th</sup> para. (1974) ("we are firmly convinced that

decided not to renew the agreement, a franchisee had no choice but to buy the goodwill that he had been developing. The franchisor's action was in favor of the non-interested party; therefore, such action did not take into account the franchisee's circumstances, but that of the future buyer of goodwill.<sup>153</sup> Compare with *Atlantic Richfield Co. v. Razumic*,<sup>154</sup> where the court decided that the franchisee was creating goodwill for the franchise and *a fortiori* creating goodwill for both the franchisor and himself. Thus, the goodwill issues remain unresolved in many situations and before many courts.

These inconsistent decisions are a result of the different characteristics that goodwill has been given. For example, in *Int'l Multifoods Corp. and Affiliate Cos. v. Comm'r*,<sup>155</sup> franchisors argued that goodwill was included in the franchise package in cases involving termination, trademark infringement, antitrust tying, and taxes.<sup>156</sup> The Court in that case held that the goodwill inherent in the Mister Donut business in Asia and the Pacific was embodied in, and inseverable from, the franchisor's interest and trademarks that were conveyed to the defendant; the income attributable to the sale of P's franchisor's interest and trademarks constitutes U.S. source income. In *International Multifoods Corp.*, the franchisor sold its franchisor's interest, along with any goodwill, to a Japanese corporation, Duskin Company.<sup>157</sup> The franchisor claimed that the goodwill was severable from the franchise and should be considered foreign source income for tax purposes.<sup>158</sup> The IRS argued that goodwill cannot be severed from the franchise and that any sale attributable to the franchise is U.S. source income.<sup>159</sup> Here, the court held that the goodwill was inseparable from the franchise.<sup>160</sup> It reasonably follows, according to the court's position, that the franchisor's former franchisees purchased a franchise package that included goodwill.

---

Radio [the franchisee] had no goodwill to sell. This Court has previously held that where, as here, a business sells brand name products pursuant to a nontransferable franchise which is terminable at will by the franchisor upon sufficient notice, the franchisee can possess no goodwill, for goodwill, if any, is inextricably connected to the franchise and ceases to exist when the franchise terminates"). For a general discussion of the issues, see Benjamin A. Levin & Richard S. Morrison, *Who Owns Goodwill at the Franchised Location?* 18 FRANCHISE L.J. 85 (1999).

<sup>152</sup> Lee v. Exxon Co, 867 F. Supp. 365, 366 (D.S.C. 1994).

<sup>153</sup> *Id.* at 368.

<sup>154</sup> *Atlantic Richfield Co. v. Razumic*, 390 A.2d 736, 742 (Pa. 1979).

<sup>155</sup> *Int'l Multifoods Corp. and Affiliate Cos. v. Comm'r*, 108 T.C. 25 (1997).

<sup>156</sup> *But see Drexel v. Union Prescription Ctr., Inc.*, 582 F.2d 781, 786 (3d Cir.1979), where the franchisor argued that goodwill is severable and retained by the franchisor in cases involving termination, vicarious liability, and taxes.

<sup>157</sup> *Int'l Multifoods Corp. and Affiliated Cos. v. Comm'r*, 108 T.C. 25, 30 (1997).

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

### 3. *Comparing to Transfers of the Franchise Contract in the United States*

In the United States, there are two basic types of laws that restrict the franchisor's ability to withhold consent to the transfer of a franchise.

The first type is found in three states – Arkansas, Nebraska, and New Jersey – and it primarily requires the franchisee to request the franchisor's consent and to disclose information about the prospective transferee.<sup>161</sup> The approval is assumed to have been granted by the franchisor, unless within sixty days it gives reasons for objection, which can only be for a material reason relating to the proposed transferee's character, business experience, or financial ability.<sup>162</sup> A fourth state, Iowa, has the most comprehensive statute on franchisee transfers, one providing that the franchisee is permitted to transfer its franchise, subject only to the franchisor's imposition of its "reasonable current qualifications" for new franchisees; there must be "a legitimate business reason" for these franchisor-mandated prerequisites, and the Iowa franchise relationship enumerates three conditions a franchisor may impose upon a transfer: satisfaction of any amounts due to the franchisor or its affiliates, successful completion of a training program, and the payment of a reasonable transfer fee.<sup>163</sup> Also, according to court interpretation of the California and Michigan franchise laws, the franchisor can demand that the franchisees provide the franchisor with a release; otherwise, the franchisee would have failed to cure a default in the franchise contract and can be kept from transferring the franchise.<sup>164</sup>

The second type of statute found in a few American states requires "good cause" in order for a franchisor to withhold consent to a transfer.<sup>165</sup> Hawaii, for example, specifies that good cause exists when the franchisee

---

<sup>161</sup> The mandated information includes the transferee's name, address, statement of financial qualifications, and business experience during the past five years. ARK. CODE ANN. § 4-72-205 (2008); NEB. REV. STAT. § 87-405 (2008); N.J. STAT. ANN. § 56:10-6 (2008).

<sup>162</sup> *Id.* Moreover, under New Jersey law, the franchisor's rejection of a proposed transfer may have to meet a reasonableness standard. *In re Headquarters Dodge, Inc.*, 13 F.3d 674 (3d Cir. 1993).

<sup>163</sup> IOWA CODE §§ 523H.5, 537A.10(5) (2008). Training programs are typical features of franchising. Robert W. Emerson, *Franchise Phrasing*, *supra* note 84 (finding that, as of 2008, 98% of surveyed franchise agreements expressly provided for training and that 66% further stated that the training was to be at the franchisee's expense). Likewise customary is the fee that a franchisee must pay the franchisor for transferring the franchise to someone else – a fee separate from any amounts due the franchisor from the proposed new franchisee. *Id.* (96% of surveyed franchise agreements have such a fee, with the most common amount being \$5,000, but almost half charging more than that amount).

<sup>164</sup> *Alberts v. Southland Corp.*, Bus. Franchise Guide (CCH) ¶ 10,873 (S.D. Cal.1996); *Franchise Management Unlimited, Inc. v. America's Favorite Chicken*, 561 N.W.2d (Mich. Ct. App. 1997), *order vacated on other grounds*, 590 N.W.2d 570 (1999).

<sup>165</sup> *See, e.g.*, HAW. REV. STAT. § 482E-6(2)(I) (2008); MICH. COMP. LAWS § 445.1527(g) (2008); MINN. STAT. § 80C.14, subd 5 (2008).

or its proposed transferee has failed to pay sums already due or to cure any outstanding defaults, or when the proposed transferee is a competitor of the franchisor or has not met the franchisor's reasonable qualifications and obligations; under the Hawaiian statute, the franchisor only has thirty days to approve or disapprove a transfer, with the franchisor obliged to assert in writing the reasons for any disapproval.<sup>166</sup>

Note that this "good cause" concept is not implemented in France, where the withholding of transfer is discretionary (according to the Cour de Cassation, it is merely subject to an *a posteriori* control of any abuse of that right).<sup>167</sup> Therefore, only in France, and not in states using this type of statute, can the franchisor avoid explaining his motivation for withholding consent—that is, unless such an explanation is expressly required in the contract, something that is highly unlikely.<sup>168</sup>

When there is no state statute that requires the franchisee to obtain the franchisor's approval of a proposed transfer, the franchisor presumably has the right to disapprove a transfer only if that right is set forth in the franchise agreement; however, this franchisor power is so commonplace, indeed so close to being a universal contract provision, that its absence may leave one questioning the competence of franchisor's counsel for its omission.<sup>169</sup> It is hard to imagine a franchisor not reserving unto itself the

<sup>166</sup> HAW. REV. STAT. § 482E-6(2)(I) (2008). Under the Arkansas, Nebraska, or New Jersey statutes, if, within sixty days after receiving notice of the franchisee's intent to transfer the franchise, the franchisor has not acted, then the franchisor's approval is deemed granted. ARK. CODE ANN. § 4-72-205 (2008); NEB. REV. STAT. § 87-405 (2008); N.J. STAT. ANN. § 56:10-6 (2008).

<sup>167</sup> See PIERRE MOUSSERON, ET AL., *TECHNIQUE CONTRACTUELLE* 482, 1246 (Editions Francis Lefebvre 2005).

<sup>168</sup> Cass. com, July 2, 2002, Juris-Data N°015113. Holding about a concession contract, expressly concluded *intuitu personae*, submitting the transfer to a third party to the agreement of the franchisor, who committed himself to «fairly examine and with all the care required the proposed change and to communicate quickly his decision to the concessionary that the appellate court could deduce that the refusal must have been justified by requirements related to the safeguard of the legitimate commercial interest, and that, to avoid all arbitrary decision, it belonged to him to motivate it, for the only purpose to allow the concessionary to verify that the decision was grounded on a fair and careful examination, in conformity with his contractual commitments. «*Mais attendu qu'ayant relevé que le contrat de concession, expressément conclu intuitu personae, prévoyait que son transfert au profit d'un tiers était subordonné à l'agrément du concédant et que ce dernier s'était engagé à "examiner équitablement et avec tout le soin requis le changement proposé et communiquer rapidement sa décision au concessionnaire", la cour d'appel a pu en déduire que le refus d'agrément par le concédant devait être justifié par des impératifs tenant à la sauvegarde de ses intérêts commerciaux légitimes et que, pour éviter tout arbitraire, il lui appartenait de le motiver, à seule fin de permettre au concessionnaire de vérifier que sa décision était fondée sur un examen équitable et soigneux, conforme à ses engagements contractuels* ».

<sup>169</sup> See Robert W. Emerson, *Franchise Contract Clauses*, *supra* note 84, at 948. (determining that, as of 1993, 95% of surveyed franchise contracts had franchisor right-

right to disapprove of franchise transfers, such as when the transferee fails to meet specified criteria, including good moral character and business reputation, good credit rating, adequate financial resources, and prior experience. Additionally, a franchisor can always merely deny the transfer through the franchisor's right to deny any transfer. In that case, the franchisor provides the contract with a provision clearly stating that no transfer will be approved. Perhaps the absence of significant case law is a sign that the transfer option is barely used, although just as probable are conclusions that do not result in meaningful, appellate litigation.

A franchisor can also condition the transfer on the satisfaction of requirements imposed upon the transferor and the transferee.<sup>170</sup> Unfortunately, there are very few cases that can illustrate this situation. Similarly, in France, a franchisor can include a right of first refusal in the contract, giving it sufficient time to evaluate an offer and determine whether he wishes to take the offer.<sup>171</sup> This right is included in a great majority of French franchise contracts.<sup>172</sup>

From all these dispositions, it is interesting to note that at no point is the expression "*intuitu personae*" mentioned in American law. However, it seems obvious that the concept of the franchise contract being concluded in consideration of the person is embodied in the American legal system. Indeed, whenever a provision states that the franchisor has the right to disapprove a transfer, such as the one stipulating the "right of first refusal," the concept of "*intuitu personae*" is present, in spirit if not in actual word usage, and the franchisor can decide whether the prospective new franchisee will qualify as a franchisee. Now, the question of whether it is

---

of-first-refusal clauses); Robert W. Emerson, *Franchise Phrasing*, *supra* note 84 (finding that, as of 2008, 100% of surveyed franchise agreements either outright prohibited a franchisee's transferring the franchise or had a provision mandating that the franchisee must obtain the franchisor's approval before selling, assigning or otherwise transferring the franchise; further finding that 100% of surveyed franchise agreements granted to the franchisor a right of first refusal on the franchisee's proposed transfer/sale of the franchise to another party).

<sup>170</sup> Robert W. Emerson, *Franchise Phrasing*, *supra* note 84.

<sup>171</sup> The right-of-first-refusal clause, granted to the franchisor by the franchisee, is termed a "*pacte de preference*" and is a well understood and accepted part of French franchise contracting and jurisprudence. LELOUP, *supra* note 10, at 273-274 & 273 n.1 (citing formbooks, treatises, and court decisions).

<sup>172</sup> Simon Associés (a Paris law firm specializing in franchise law), La Lettre de la Franchise, mai-juin 2007, at 1, *available at* [http://www.franchisenet.fr/\\_obj/AB32557B-5F0A-4E83-A8366755A3AC9A6E/outline/Lettre\\_Franchise\\_SimonAssociés\\_MaiJuin.pdf](http://www.franchisenet.fr/_obj/AB32557B-5F0A-4E83-A8366755A3AC9A6E/outline/Lettre_Franchise_SimonAssociés_MaiJuin.pdf). (in discussing two recent Cour de Cassation commercial cases, states that the franchisor's right of first refusal allows the franchisor, as owner of the trademark, to maintain its position and preserving its network; "[t]he clause giving a preference to the franchisor when transferring the franchise business is very common" (trans. by Robert W. Emerson) ; *accord*, LE TOURNEAU, *supra* note 15, at 259-260).

reciprocal or not has never been debated in U.S. courts; rather, it seems to be managed contractually.

#### IV. CONCLUSION

Both franchise contracts and the legal framework in France and the United States governing such contracts do not differ much.<sup>173</sup> We have seen that the most important phase of the contract, which is closely regulated by both countries, is in fact the phase preceding the actual signature of the contract: the disclosure of the pre-contractual information. This is indeed what guarantees the success of the franchise business, as it provides a protection for the franchisee, and in the end, the consumer. Furthermore, we can say that both French and American franchise contracts have their specificities and nuances. However, American franchise law and practice still strongly influence France, particularly on exclusivity and encroachment. The new trend appears to be an abandonment of what once was a predominant clause, the provision establishing exclusive territories. So, rather than contractually stipulated market protections, the more amorphous concept of encroachment, drawing mainly from tort law and implied contract terms, may already have become the burning, new issue for French franchise law, fifteen years after American law reached and then quickly dismissed many of the same rationales for finding and then punishing alleged encroachment. While this new contractual practice – non-territoriality – may be harmful to some franchisees, it may have long-term benefits for the franchise system, at least once the legal issues of encroachment have played themselves out.

---

<sup>173</sup> As Ann-Cecile Benoit, a Parisian franchisee advocate notes, often the language and principles to arrive at a result are different in French and American law, while the results reached are far less distinct. Interview with Ann-Cecile Benoit, avocat, Paris, France (June 17, 2008). Different paths to the same destination, one might say.

