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International Franchising – An Overview

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INTERNATIONAL FRANCHISING – AN OVERVIEW
M. Mendelsohn (editor)

CHAPTER 10

FRANCHISING IN EUROPE - FRANCE

Olivier Gast

France is the European country in which franchising has developed the most, with approximately 500 franchisors. A considerable amount of literature exists on the subject with books and articles, and jurisprudence is starting to take it seriously.

I intend to limit myself to the legal aspects and business considerations which govern the practice of franchising in France at the present time, from the particular view point of a foreign franchisor who wishes to set up in France.

This franchisor and his lawyer will therefore be pleased to learn that France is extremely propitious to franchising, in all forms. But it is more particularly favourable to the "business format franchise". Franchising in the strict term, that is, the business format franchise which is becoming well known, even by the public, should be distinguished in France from the other methods of distributing products or services. The use of the name "franchising" in America and Canada covers methods of distribution which have already existed in France for many years but which are known under clearly differentiated names.

- concession,
- licensing,
- voluntary associations of business firms,

and in which the commercial partners are also independent, by contrast with branch managers who are salaried staff.

But these methods do not all benefit from the reputation and the favourable opinion of franchising. On the contrary, with regard to concessions, a series of resounding law suits have taken place which have tarnished the brand image of this technique leading to a mistrust of potential concessionaries. These were caused by conflicts between oil companies and concessionary service stations which threw light on the state of subjection to which the concessionaries were reduced.

The business format franchises or, more simply, franchising, is very favourably known, perhaps too much so, because certain businessmen, a little too clever, unscrupulous or ill-advised, have played on its reputation giving the name of "franchise contracts" to contracts which have none of the elements of a franchise. They have to take advantage of the misdescription of the transaction by the use of the word "franchise".

This explains why franchisee candidates who are sometimes aware of this fact, are occasionally more suspicious than might be expected and pose irrational questions which might surprise a serious franchisor conscious of the value of his products.

The fact that there is no law in France at present governing the right of franchising causes a legal void which, combined with jurisprudence which is still in a state of formation, unfortunately and inevitably leads to abuse.

The French Government is therefore considering, and have been doing so for three years, passing a law on franchising. A new commission, succeeding the first two, is being assembled again to examine this problem. Several proposals

for laws have previously been drawn up but have never been voted.

It is too soon to say what form the proposed law will take. There are two possibilities which are being discussed:

- the one that I support is an American type imposing disclosure of information before contracting,

- the other one proposes that the franchisees merge into associations, with which the franchisor would be obliged to negotiate agreements and disputes.

But we are not sure what will happen. In my view, at least three or four years will be necessary before a decision can be made, which could be no law being passed at all as the Home Trade Department's view is that such a law may not be needed.

This prospect is still far off and will not worry American lawyers who are accustomed, with their FTC and their UFOC, to having clients who are reliable in business, a reliability that the French should do well to prectice more often.

I should now like to refer to an aspect of franchising in France which is generally neglected because it is not a material, legal or economic fact - mental habits.

French people are, from many viewpoints, Latins and somewhat indisciplined for this reason. This is why, in order to succeed with franchising in France, not only is a well written contract certainly needed - the more so that there is more chance of having to produce it in Court - but also an enthusiastic and dynamic sales team to make the franchisee candidates and the recruited franchisees understand the advantages and the how and the why of everything and, particularly, to give them the impression that they are taking part in decisions, even if this is not quite true, so that their naturally critical spirit is not awakened.

In my opinion, this mental attitude governs a good part of the decisions which have to be taken on the methods of setting up and operating a franchise in France.

To be more concrete, what is the best way of setting up in France for the foreign franchisor?

There are three possibilities:

- direct licencing,
- founding of a company,
- the Master franchise.

Direct licencing is, legally, perfectly reasonable with no major disadvantages. French law allows the parties to subject the contract to French law or to foreign law, at their choice, with French or foreign courts holding jurisdiction.

I nevertheless believe that this method should be discouraged. First, because it requires a multiplicity of individual contracts and of contracting parties and, second, because of the complexity of management resulting for the franchisor irrespective of the problem of recruiting each franchisee.

Mamagement of such a portfolio of contracts would in practice be difficult if not impossible. The formalities would be multiplied by the number of contracting parties, registration of contracts with "L'Institut National de la Propriete Industrielle" (I.N.P.I.) for licencing of trade names, bank formalities for repatriation of royalties,

difficulties of supplying commercial and technical assistance to each of the franchisees.

Bank formalities concern:

- repatriation of royalties made under Bank control and after registration of the agreement at I.N.P.I. without which exchange control authorities will not authorise the transfer of royalties abroad,

- repatriation of royalities is also subject to VAT and withholding tax. The rate is usually thirty three and one third per cent (33,1/3%). But France has signed various tax treaties providing either an exemption or a reduced rate. For instance, the Franco-American convention provides a 5% rate instead of 33,1/3% (Convention of 28th July 1967 signed in Paris, Art. 11); the convention signed on the 22nd May 1968 between France and Great Britain provides there shall be no withholding tax in France except if the beneficiary of royalties owns a permanent office in France (Art.12).

- customs and import-export controls:

All imports of foreign goods of a value equal to or greater than 125,000 FF must be transacted through an "intermediaire agree" (authorised intermediary). They usually are Bank agencies authorised by the Ministry of Economy.

If the franchisor wants to keep active of the chain, it is more convenient to set up a company in France with French partners. There is no insurmountable obstacle to this but, nevertheless, I believe that the method should be reserved for the biggest companies which possess the required financial facilities and who have decided to make the necessary investments in personnel and in capital.

I believe that the third method, the Master franchise, is best for the majority of cases because it gives the greatest technical flexibility and therefore relatively close control of the Master franchisee.

It is moreover the Master franchisee method which is most commonly used by foreign franchisors in France. Master franchise contracts can, of course and as in the case of direct franchising, be subject to French law or to foreign law and to the jurisprudence of French or foreign courts.

If foreign law is chosen, it is advisable to ascertain whether:

(a) it contains any provisions contrary to French law and order (which is relatively rare) which could cause the contract to be void or unenforceable under French law;

(b) the foreign law stipulated in the contract can be applied by the French courts or a decision taken by a foreign court can be enforced in France.

If French law is chosen, care must be taken to avoid the traditional traps of French contractual law of which the most important are the following:

- abusive clauses of which the meaning is difficult to define and which can only be decided by courts in the last resort; An example of such a clause would be one which sought to restrict the liability of the franchisor.

- in the event that the contract provides that the Master franchisee shall draw supplies exclusively from the franchisor or from a supplier designated by it, the contract must contain a price clause which determines the price of the future merchandise or at least makes it determinable. Such a provision must not be capable of existing for more than ten years otherwise the whole agreement will be null and void;

- a possibility that the contract may be treated as a contract of employment or as one with an ipso facto corporation. This risk is very frequent in matters governed by domestic law but is practically nil in the case of a Master franchisor residing abroad, at least with regard to a work contract. The risk is further reduced by providing that a Master franchise contract is entered into with a company and not an individual.

In the event that the franchisor should interfere too greatly in the business of the Master franchisee, it is still possible that the Court could hold that the essence of the arrangement created an ipso facto corporation and treat the contract on that basis. The problem is aggravated by the foreign element and it is difficult to judge how the court will respond in such a case.

An important formality relating to the law of trade names must not be neglected:

- firstly, it is plain that a trade name which is owned by the Master franchisor must be registered in France to obtain maximum benefit of legal protection.

- secondly, and this aspect is sometimes neglected, the contract by which the trade mark is licenced to the Master franchisee must be registered at the I.N.P.I. The Master franchisee must also register each of the contracts by which it sub-licences the name to its own franchisees. This is a simple formality which is not costly. If this is not done, regretably problems of procedure may arise if legal action is needed in France for infringement. Neither the franchisee nor the Master franchisee will be able to take action against infringers and only the Master franchisor will be able to act which will evidently have considerbale effect on the amount of damages because only the injury suffered by the Master franchisor will be taken into consideration when the assessment of damages is made.

As a French lawyer and considering the matter from the point of view of the Master franchisee, I have frequently found that Master franchisors make the same mistakes. I have not yet met an American franchisor who has decided to sell his Master franchise in France <u>after</u> first carrying out a serious market study of the French market compared with the American market, or after setting up a store directly with the object of testing the reaction of French consumers when faced with the imported products and services.

The result is almost invariably that the market potential is miscalculated usually resulting in an overestimate of the potential. This leads to clauses relatihg to quotas or to rates of market penetration in the Master franchise contract which are much too onerous and unrealistic. The Master franchisee will probably not, in practice, effectively impose the clauses but it remains a fact that they usually cause tension in the relationships between Master franchisor and Master franchisee. The Master franchisee almost invariably is disappointed because he has not anticipated the relatively long time required for consumer acceptance needed for success in France to be compatible with that of the product or services in the United States or in England.

When the Master franchisee has paid a relatively high price for his Master franchise and when he has devoted all his forces to it, the feeling of disappointment inevitably causes embarrassment and friction between the franchisor and the franchisee, even if the franchise is successful but on a

more moderate scale than contemplated by the parties.

With regard to the other problems resulting from French domestic law, it is the Master franchisee who will be responsible for drawing up his own franchise contract in conformity with applicable law. He must notably take pains to respect the official policy on prices and also the law on competition.

I advise that the Master franchise contract should stipulate that the Master franchisor has the right to approve the contract written by the Master franchisee so that he can make sure that the basic interests of the franchise chain and of its public image are respected.

The problem of Master franchises is that of the choice of a partner. This is the crucial problem of the technique because the success or failure of the transaction depends on it. The public image which the franchise system will acquire in France depends heavily on this choice of partner.