International Franchising

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Vol 17 No 1 MAY 2013

Newsletter of the International Bar Association Legal Practice Division

IN THIS ISSUE

Contributions to this newsletter are always welcome and should be sent to the Newsletter Coordinator at: Francesca Turitto and Larry Weinberg at **francesca.turitto@studiolegalerlp.com** or **lweinberg@casselsbrock.com**.

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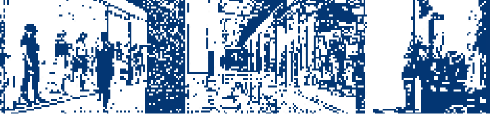
This newsletter is intended for lawyers interested in the field of international franchising. Views expressed are not necessarily those of the International Bar Association.



The year ahead

Andrew P Loewinger

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I am very honoured to serve as the new Chair of the IBA International Franchising Committee. Our immediate past Chair, John Baer, did a great job and I would like to thank John for his outstanding leadership and diligence in expanding our committee's activities, programming and membership. I would also like to thank Marco Hero for his contributions to the Committee as Vice-Chair over the past two years.

We have expanded the number of Committee officers in order to give more members an opportunity to participate in our activities. Officers for 2013–2014 can be found on page 6. We are very fortunate to have retained our fine corps of existing officers. To obtain more regional participation and expand legal coverage, we are also considering the introduction of regional representatives from different geographic regions. If you would have in interest in participating, please let me know.

We would very much encourage each of our members to participate in Committee activities. One of the easiest ways for you to become involved is to contribute articles of interest on franchising or other relevant developments in your country to this newsletter. If you have something of interest you would like to share, please contact either Francesca Turitto or Larry Weinberg.

As many of you know, we had an excellent set of programme sessions in Dublin in October 2012, along with a very well-attended International Franchising Committee dinner.

We also would very much like for you to attend the two events we host each year. We are co-hosting the 29th Annual IBA/IFA Joint Conference on 7–8 May 2013 in Washington, DC. The theme of our programme is 'The Risks and Rewards of International Franchising'.

You can access details of the programme and the registration form from the International Franchise Association's website at www. franchise.org, click on 'Events' and 'IBA/IFA Joint Conference'. If you haven't signed up yet, please do so. One of the highlights of this conference each year is our Tuesday night networking dinner.

We will also host/co-host four full sessions at the IBA Annual Conference in Boston, Massachusetts, from 6–11 October 2013. Provisional details can be found on page 8 of this newsletter. One highlight worth mentioning is a joint programme on international arbitration and franchising which will be co-presented with the Arbitration Committee.

International franchising continues to be a huge growth area in the franchise industry and for many economies around the world. We look forward to seeing all of you at our May and October programmes and to your participation in the continued growth in this dynamic area.

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Franchising – the view from around the world

We are delighted to be on duty as the new Newsletter Editors of the IBA's International Franchising Committee newsletter and sincerely hope to do a job as excellent as the one accomplished by Rocio Belda and Karsten Metzlaff, our predecessors; thank you Rocio and Karsten for your fantastic work. And a great thank you also to all contributors that helped us to make this issue of the newsletter a valuable tool, allowing franchise lawyers to read on interesting legal developments in the franchise legal world and serving as reporters on the topics discussed during our Committee sessions in Dublin, on the occasion of the IBA 2012 Annual Conference. This issue is also published in anticipation of the IBA/IFA Annual May 2013 Joint Conference in Washington, DC where we hope to see you all to enjoy our traditional dinner and an interesting and stimulating programme.

We are proud to include here a number of articles coming from practitioners living and operating in different areas of the world, within the boundaries of legal systems substantially different from each other. We will give you here a hint of their contributions, starting with Derek Ronde and Chris Horkins's article dealing with two landmark cases of 2012 in Canada. The two decisions, issued in the 'quick restaurant' service sector, certainly have the potential to stimulate a lively discussion on the topic of a franchisor's obligation (if any) to promote the success of its brand and of the franchise system and how to achieve that goal. It also considers the franchisees' chances to win a class action challenging the business decisions of franchisors in this regard.

The topic of non-compete clauses in franchise agreements in India is covered by Talha Salaria, warning us that in her jurisdiction the wording of such clauses may be viewed as an unreasonable restraint of trade and consequently null and void. Faisal Daudpota comments on a circular limiting the possibility for Pakistani companies to transfer royalties exceeding an amount of five per cent out of Pakistan and calls for the intervention of the Pakistani government to solve the issue. The possibility of unilaterally terminating a franchise agreement in China within a specific time after its execution is discussed by Dominic Hui, who also comments on a recent decision on the matter.

From a broader perspective, Jeroen Janssen summarises the golden rules for a successful franchise system and we also have a comprehensive overview of franchising in Greece and the applicable tax regime, contributed by Dimitris Costakis.

We conclude this column by hoping that you will find the newsletter interesting and reminding all readers that your contribution to the next issue will be more than welcomed. It will be a pleasure to meet with you all in Washington!

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In Memoriam

Elisabeth Ritchie

On Friday 15 March 2013, Elisabeth Ritchie, a leading franchise lawyer in Sydney, Australia passed away, two hours short of her 46th birthday after losing her battle with non-hodgkin's lymphoma.

Lis was a specialist franchise lawyer that made a substantial contribution to franchising in Australia and internationally. She was an active member of the Franchise Council of Australia for more than 15 years. Lis was also a member of the Committee of the International Division of the American Bar Association's Franchise Forum.

Lis was a great lawyer and good friend. She leaves behind a daughter and husband.

BOSTON 2013 6–11 OCTOBER

ANNUAL CONFERENCE OF THE INTERNATIONAL BAR ASSOCIATION

INTERNATIONAL BAR ASSOCIATION®

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Monday 0930 – 1230

Hot topics in international sales, franchising and product law

Presented by the International Sales, Franchising and Product Law Section

This session will comprise a series of roundtable discussions on various topics presented by the International Sales, Franchising and Product Law Section.

Wednesday 1430 – 1600

Bringing a foreign brand to the USA

Presented by the International Franchising Committee

This session will discuss the franchise legal issues and other legal issues involved in bring a brand into the United States.

Wednesday 1630 – 1730

News from around the world

Presented by the International Franchising Committee

A panel will discuss recent developments and news of interest in international franchising.

Thursday 0930 – 1230

Court decisions on pre-contractual disclosure in jurisdictions with disclosure laws (Session A)

Presented by the International Franchising Committee

Session A will discuss court decisions under various international franchise sales laws in a variety of countries.

Attorney-client privilege for in-house counsel and outside counsel (Session B)

Presented by the International Franchising Committee

Session B will address the extent to which the attorney-client privilege exists or is waived between outside counsel and in-house counsel.

Thursday 1430 –1730

Arbitrating international distribution and franchise disputes

Presented by the Arbitration Committee and the International Franchising Committee

This joint session will address the key issues that every lawyer involved in transnational disputes arising out of a commercial distribution relationship (including franchising, distributorship and agency) should be aware of.

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Session reports from the IBA Annual Conference Dublin 30 September – 5 October 2012

'Moderated speed–dating' – interactive roundtable discussions on the latest developments and 'hot topics' relevant to international sales, franchising and product law

Monday 1 October 2012

Session Co-Chairs

John Baer *Greensfelder, Hemker & Gale, PC, Chicago*

Christopher Blake *Hahn Loeser & Parks, Cleveland*

Juan Pablo M Cardinal *Richards Cardinal Tutzer Zabala & Zaefferer, Buenos Aires*

Marco Hero *PF&P Rechtsanwalte, Munich*

Sönke Lund *Monereo Meyer & Marinel-lo Abogados, Barcelona*

This informal session involved the International Sales, Franchising and Product Law Section of the IBA, which is comprised of three committees. Nominated moderators from each of these committees hosted tables that interactively discussed important 'hot topics' in a speed dating format in which participants moved every 30 minutes from table to table. This year hosted the largest attendance ever for this joint section programme.

The International Franchising Committee provided eight moderators hosting four tables, including: Dominic Hui, Hong Kong; Diemar Huemer, Legis, Vienna; Martin Schirrmacher, Hamburg; Eimear Collins, Mason Hayes & Curran, Dublin; Marco Hero, TIGGES, Munich; Olivia Gast, Gast & Menguy, Paris; Stathis Mihos, Carrefour Marinopoulos, Athens; and Fabio Bortolotti, Buffa Bortolotti & Mathis, Turin.

Topic 1

Stathis Mihos and Fabio Bortolotti hosted a table on the very practical issue of 'the European financial crisis and the consequences on distribution networks'. In particular, Stathis' experiences as legal counsel of Carrefour Greece provided insight into the reality and impact of the crisis. Measures to be taken to soften the negative consequences and different strategies were discussed. The discussion found out that communication between franchisor and master franchisee is crucial for a healthy relationship. Distance, language and cultural barriers by their very nature lift the bar significantly in this respect. The financial situation of a master franchisee seems to define worldwide their flexibility to react to a franchisor's or other business plan demands or proposals to improve the critical situation. The franchisor's positive focus on and support of a struggling master franchisee can improve a worsening situation, which if left unattended can escalate. This, in many cases, can lead to the decline or cessation of the master franchise agreement and local network.

Participants from all over the world agreed on the conclusion that counter-measures combined with assistance and focus on the master franchisee's critical situation should start as early as possible in order to increase the chances of avoiding legal or material escalation leading to significant brand damage in the local market.

Topic 2

Dominic Hui and Dietmar Huemer hosted a table discussing 'Clouds – data protection and other issues for international distribution networks'. Franchisors, too, have to decide whether or not to put their data on the cloud, private or public, and that always goes by a necessary analysis of the data status. Once a hierarchy is established in terms of sensitivity and/or privacy, then a level of confidentiality can be assigned to each and a decision made about whether to use the cloud or not. Dominic and Dietmar's conclusion was that downstream compliance for franchisees needed to be setup.

Topic 3

Martin Schirrmacher and Eimear Collins discussed the topic 'The new trend in international franchising: direct licensing – chances and risks'. While the good opportunities appear to be real, the proportion of direct licensors may not be significant enough to show that a majority have overcome the risks so far.

On the other hand, it appears that franchisor-owned retail stores are developing in certain areas, such as in the retail clothing business. Indeed, some markets are now mature and price wars are starting. Therefore, the added value is gliding from the supplier to the retail distributors. From this perspective, it makes sense for franchisors to invest in direct licensing. For example, Zara has done so by buying back their franchised retail shops.

Topic 4

Marco Hero and Olivia Gast hosted a table on the lively discussed topic of 'Apps, platforms and mobile devices – consequences for international franchise agreements'. Marco and Olivia discussed with the participants the many issues these powerful tools trigger in distribution networks. The main problems encountered are in regards control of distribution (use of 'shop and ship' accounts) and brand use, territory, ownership of customers and contractual provisions of such issues and their enforcement.

The attendees' most common comment was 'our franchise agreements get longer and longer on these matters', as the older versions do not fully address all of the possible new situations.

The session found out that in order to avoid disputes in the network it is crucial for franchisors to take the first step and develop a strong internet strategy and to take actions to embrace the new tools technology has to offer. In the meantime, it is also necessary for franchisors to update their franchise agreements, specifically through adding new standards and requirements.

The programme format was seen as an even greater success than the previous year's version, and this format will be repeated in Boston at the 2013 IBA Annual Conference with new but comparably hot topics.

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Key issues when advising master franchise and area developer relationships

Monday 1 October 2012

What happens when a franchisor enters new international markets? Often, it recruits master franchisees to open several units or it asks area developers to develop the system in certain areas. How does one best protect, in this context, the interests of the parties?

In order to find answers to these questions, in complex scenarios, the audience was guided by Ronald Gardner (Dady & Gardner, Minneapolis), Ann Hurwitz (Baker Botts, Dallas), Francesca Romana Turitto (Studio Legale Roma Lepri & Partners, Rome), and moderator and speaker, Larry Weinberg (Cassels Brock & Blackwell, Toronto).

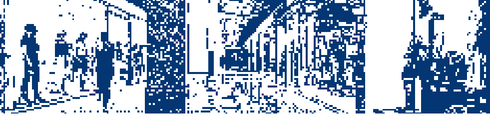
It has been illustrated how the master franchisee and the area developer play a complex and delicate role in the world of franchising, having a great bargaining power due to their strategic importance and, especially, to their local market knowledge which makes them a key instrument for developing the franchise system in a designated geographical area.

The peculiar 'balance of powers' between the franchisor and the master franchisee/area developer affects different areas of the contractual relationship; possible scenarios and practical cases were examined, even in relation to different jurisdictions, as well as solutions which may be suggested to the parties to best protect their interests.

The possible issues which often arise in such a transaction during the pre-contractual and the negotiation phase prior to the execution of the contract were discussed. Particular attention was paid to the main solutions which may be used in the contract to discipline the relationship between the parties involved, to balance their powers and protect their interests.

Then, the post-termination phase was analysed by illustrating how the relationship between the parties may be regulated after the termination of the agreement; even the 'pathological' stage of the relationship between the parties was examined by focusing the attention to the instruments available and discussing several aspects related to the dispute resolution.

Different scenarios were presented and also made more attractive by introducing and analysing practical cases and discussing the possible issues which may occur in all the phases of the contractual relationship, including the pre-contractual phase and the one which follows the end of the contractual relationship, even in the event of a conflict between the parties involved, as well as by presenting the solutions which may be suggested to the parties.



Know-how, trade secrets and trade dress protection

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Tuesday 2 October 2012

The Intellectual Property and Entertainment Committee supported our Committee in a joint session on know-how, trade secrets and trade protection. The session was Co-Chaired by Rocío Belda and Gustavo Alcocer, from the Intellectual Property and Entertainment and the International Franchising Committee respectively. They led a discussion featuring David Jacoby from New York, Eduardo Turkienicz from Sao Paolo, and Gregor Bühler from Zurich. The discussion focused on the level and scope of protection that a franchisor could obtain for the trade dress, the trade secrets and the know-how related to their franchise system.

Trade dress is protected through registration and also under statutory law in most jurisdictions; unfair competition laws generally provide a reasonable framework for protection. In Switzerland, trade dress can also benefit from protection under copyright and design rights. This notwithstanding, the speakers shared the view that a franchisor should also protect trade dress by contract.

Know-how and trade secrets cannot be protected by registration. Although most unfair competition laws protect know-how and commercial secrets, the speakers stressed the importance of providing sufficient provisions in the contract to ensure the availability of judicial relief in case of breach.

News from around the world

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Tuesday 2 October 2012

The 'News from around the world' session received reports from the host country Ireland, as well as from the United Arab Emirates, Indonesia, Italy, Angola, Nigeria, Tunisia and Indonesia.

Ireland

Imelda Reynolds began the session by reporting that the franchising sector in Ireland is growing healthily, with turnover from franchising increasing 15 per cent during the period from 2006–2010. Twenty per cent of the franchises operating in the Irish market originated in Ireland itself, while franchises originating in the UK and US accounted for another 33 per cent and 20 per cent of the market respectively. Other countries of origin include Japan and South-East Asia. The majority of franchises in Ireland are concentrated in the food and beverage sector but there is significant activity in healthcare services, business services, printing and signage, education and training, and other fields. The majority of franchises in Ireland have between one and ten units.

Ms Reynolds noted that Irish law does not contain a statutory definition of the term 'franchising' and that characterisation of a transaction as a franchise depends on the terms of the relevant contract. There are no disclosure requirements and parties are free to draft the franchise agreement in whatever way they choose. Franchise agreements in Ireland have tended to follow either the UK or US format of agreement.

Ms Reynolds noted that principles of competition law in Ireland would apply to franchises, including the Competition Act 2002 and the Declaration regarding Vertical Agreements and Concerted Practices, with guidelines that went into effect in December 2010. Such principles of competition law impose certain restrictions, including limits on overall market share, a prohibition on setting a fixed-sale price (although recommended prices or maximum prices would be acceptable) and a prohibition on non-compete clauses that remain in effect for more than five years after termination.

According to Ms Reynolds, only two significant cases related to franchising have been decided in Ireland. These include *Headline Communications Ltd v Eircom Retail Ltd*, a 2002 case that defined the contours of franchising under Irish law, and Tejo Ventures International Limited v Martin O'Callaghan, a 2009 case that upheld the issuance of injunctions to enforce post-competition restrictive covenants including a non-competition clause and a non-solicitation clause. Ms Reynolds provided a brief summary of the facts and holdings in these two cases.

United Arab Emirates

Dr Mohamed Haitham Salman of the Abu Dhabi Department of Economic Development (the 'DED') spoke about a proposed regulation in the Emirate of Abu Dhabi that would regulate franchising in that Emirate. Dr Salman noted that the government of Abu Dhabi was seeking to modernise franchising regulation in light of its Abu Dhabi 2030 economic agenda and that its proposed regulation had the following four goals:

- to provide an attractive legal framework;
- to protect the rights of both parties to franchising transactions in the Emirate of Abu Dhabi;
- to encourage SMEs in Abu Dhabi to invest in franchised businesses; and
- to encourage successful local projects to expand their markets through franchising.

According to Dr Salman, the proposed law would define the term 'franchising' and would impose a registration and disclosure requirement. The proposed law would respect the parties' freedom of contract but would provide gap-filler provisions to define the parties' mutual obligations in cases where the agreements were silent.

Dr Salman solicited comments on the proposed legislation and expressed his hope that the legislation would be enacted within one year or so.

Franchising in Africa

Kendal Tyre stated that seven out of the ten fastest-growing economies in the world are in Africa, and that Africa is experiencing a tremendous increase in disposable income. He mentioned that Lex Noir would be publishing a desktop volume entitled Franchising in Africa, which covers pre-sale disclosures, government registration requirements and several other legal issues in a number of African jurisdictions. Since the conference, the book has been published and has become available for purchase through Amazon.

Mr Tyre then proceeded to highlight issues from Angola, Nigeria and Tunisia.

Angola

Mr Tyre stated that in Angola, Law 18 of 2003 addresses franchises as well as distributorships, agencies and commercial concessions. Law 18 is based on commercial agency law concepts and provides for compensation to be paid in certain circumstances on termination.

Nigeria

Mr Tyre reported that Nigeria has no franchise-specific legislation but there are rules governing the transfer of intellectual property. Registration with the National Office for Technology Acquisition and Promotion ('NOTAP') is required.

Tunisia

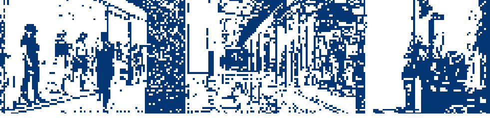
In Tunisia, a 2009 law regulates franchises and a 2010 decree supplements the 2010 law.

Indonesia

A brief report on Indonesia noted a Ministry of Trade regulation issued on 31 August 2012 that requires franchise operators to source 80 per cent of their requirements from local sources, as well as increased rumours that a new franchise law would soon be enacted.

United States

A brief report noted that the Export-Import Bank and OPIC have relaxed certain requirements and now deem brand names to be an American export; this opens the door for investment guarantees to become available in the franchising sector.



The quest for better balance – the recent judicial trend in China

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Article 12 of the 2007 Regulations

'Franchisor and Franchisee shall in the franchise agreement stipulate that the Franchisee shall be entitled to unilaterally terminate the franchise agreement within a specific time period after the execution of the franchise agreement.'

This provision was one of the new requirements when the 2007 Regulations were passed and implemented that year. It was commonly believed that the purpose of the 2007 Regulations was to allow franchisees to have a 'cooling-off' period with a right to withdraw without compensatory consequence. However, they did not provide further guidance regarding the length of such 'timeframe'. The normal practice in the industry is to afford the franchisee a 'cooling-off' period between 15–30 days, although local practices may vary.

There are no specific penalties in the 2007 Regulations for departing from Article 12, both administratively and judicially. It was commonly believed that if there was no 'cooling-off' period or a right for the franchisee to unilaterally terminate the franchise agreement within a certain period, the franchisee could still withdraw within a reasonable 'cooling-off' period. Subject to licence and use of intellectual property, this view was indeed supported by various local courts, and in the guiding opinion on certain legal issues in commercial franchise agreements issued by the Beijing City High Court issued in 2011 ('Beijing Court Opinion'), the Beijing Court indicated that :

> 'If the Franchisor and Franchisee have in the franchise agreement, or through other means, stipulated that, the Franchisee shall be entitled to unilaterally terminate the franchise agreement within a specific time period, such agreed term should be followed.
>
> If the Franchisor and Franchisee have not stipulated in the franchise agreement that the Franchise may terminate the franchise agreement unilaterally within a specific time period after the execution of the franchise agreement, the Franchisee shall still be entitled to unilaterally terminate the franchise agreement within a reasonable period of time, save and except in the situation where the business resources [ie, the trademark, know-how of the franchise system] have been used.' (Article 18)

As a matter of background, the PRC's contract law does not provide sector specific rules for franchise agreements (as opposed to construction contracts and agency contracts), and the general contract law does not grant any rights to the licensee or franchisee to terminate the licence or franchise agreement unilaterally.

A further point is that the 2007 Regulations are a set of administrative regulations issued by the State Council, which is different from legislation passed by the People's Congress. Breach of such form of administrative regulations only triggers administrative consequences within the parameters set out in the regulations, and does not annul or affect the contractual relationship.

A recent case

However, there was a departure from the above understanding in a recent Yunan case. In this case, a food safety incident took place around one year after the execution of the franchise agreement, in which the franchisor was reported as using substandard oil in its system restaurant. Due to the incident, the franchisee suffered serious loss of business and therefore filed a lawsuit seeking termination of the franchise agreement after the restaurant was closed. In the franchise agreement, the franchisee was not given a right to terminate the franchise agreement unilaterally without cause.

It appeared that as the case facts pleaded by the franchisee were not seriously challenged, the judge ruled that the absence of a unilateral termination clause pursuant to Article 12 was unfair and the franchisor, who dictated the terms of the franchise agreement, should be penalised. Hence, the franchisee could terminate the franchise agreement unilaterally as the franchisee's interests had been adversely affected.

The trend

The Yunan decision was controversial. The judge did not rely on the usual contractual termination principles such as serious breach of contract and breaches which rendered the further performance of the contract impossible and similar grounds under the PRC contract law (Articles 94 and 96), which are usually expected to be the proper grounds of termination in similar situations. The judge specifically stated that in a similar situation, the requirements in administrative regulations can be taken as supplemental principles and the usual distinctions between administrative regulations and law governing civil liabilities should be disregarded.

There are worries that this judicial stance may expand to other incidents of non-compliance with the 2007 Regulations and ancillary rules, as the statement of the judge was relatively clear. In fact, this trend is not totally unexpected. In the Shanghai Huangpu Court research report released in 2012, the judges of Shanghai Huangpu Court mentioned that the franchisee should be given rights to unilaterally terminate the franchise agreement in certain circumstances since the franchisees are generally more vulnerable, although the Shanghai Court indirectly acknowledged that amendments should be made in the PRC contract law (as opposed to the administrative regulations).

China has experienced a rapid growth of franchising in recent years and it is anticipated that the judicial rules and practices will continue to develop. In any event and practically, for contract drafting, special attention should be paid to the consequence of the failure to observe the relevant administrative regulations and rules, while further consideration should be given to whether franchisee termination provisions should be introduced and/or expanded.

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Franchising in Greece – the legal framework and tax considerations

Is there a special legal framework for franchising in Greece?

No. Greek Law does not contain any legislative or other specific provisions regarding franchising, nor is any proposed currently. Under the Greek legal system, franchise contracts are subject to the laws and regulations of different legal fields. During the last few years, the developing law of the European Community has substantially influenced Greek law. Greece has generally complied with EC directives and regulations and has moved towards uniformity of law. Now franchising is being regulated in Greece by the new Commission Regulation (EC) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the treaty to categories of vertical agreements and concerted practices. In addition, some provisions of several Greek laws can be applied to franchising, such as:

Law 3959/2011 'On the Control of Monopolies and Oligopolies and the Protection of Competition';

- Law 2239/1994 'On Trade Marks';
- Law 146/1914 'Regarding Unfair Competition';
- Law 1733/1987 'On Transfer of Technology, Inventions, Technological Innovations and Establishment of an Atomic Energy Committee';
- Law 2251/1994 'For the Consumer's Protection';
- Law 2121/1993 'Intellectual Property';
- Presidential Decree 219/1991 'Regarding Commercial Representatives in compliance with the EEC Directive 86/653 of the European Communities Councils'; and
- the Greek Civil Code.

Nevertheless, in the absence of a well-developed body of law governing the franchise relationship, the franchise agreement should be as specific as possible in spelling out the respective rights and obligations of the parties.

Is there a code of ethics for franchising in Greece?

Yes. In January 1999, the members of the Greek Franchise Association approved the final text of a new Code of Ethics for Franchising in Greece. The text is based on the text of the European Code of Ethics, whose provisions are compulsory for the code of ethics of all franchise associations of Member States of the European Union. The Greek Code of Ethics has been approved by the European Franchise Federation and includes, in addition to the text of the European Code of Ethics, elements which fulfill the needs of the Greek business market and regulate peculiar conditions which are found in the Greek franchise market. The application of the Code of Ethics is compulsory for the members of the Greek Franchise Association.

Governing law disputes: what are the choices of the parties?

It is likely that some foreign companies will not wish to submit disputes to the jurisdiction of the Greek courts because they will fear the partiality of local courts. As an alternative, it is possible to propose that the claimant may elect to sue their opponent either before the courts in the jurisdiction where he or she has their own domicile or place of business or before the courts in the jurisdiction where the defendant has their domicile or place of business. A third alternative which may be contemplated is arbitration, since this method of dispute settlement presents many advantages in international transactions. The arbitration proceedings can of course take place in Athens and the arbitrators will apply the Greek procedural law. The language of the arbitration should be, if possible, a language common to both parties and the arbitrators, so as to avoid translation costs. Furthermore, the parties can choose mediation, which is now being applied in Greece.

Is there a special tax framework for franchising in Greece?

No. The crucial factor is whether the franchisor has a permanent establishment in Greece or not. Should the franchisor have a permanent establishment in Greece, they will be viewed by the Greek tax authorities as a Greek franchisor. Should the franchisor have no permanent establishment in Greece, which is the most possible scenario, we have to examine if there is an agreement or treaty for the avoidance of double taxation between Greece and the franchisor's country. If this is the case, the provisions regarding the taxation of royalties of such an agreement will apply. In the absence of such an agreement, royalties of intellectual property rights paid to the franchisor are taxed in Greece at a rate of 20 per cent on the gross amount, and that amount needs to be withheld by the franchisee as a prerequisite for the royalty payment to be transferred by the bank. After the withholding of the above mentioned percentage, the franchisor has no other tax obligation in Greece arising from the franchise agreement.

Furthermore, all restrictions on the movement of capital between Greek residents and residents of EU Member States and also of third countries for intellectual property rights that pertain to patents, designs, trade marks, etc have been abolished.

What are the methods for the franchisor to franchise in Greece?

There are different approaches that are commonly in use for a franchisor to franchise in Greece.

These are as follows:

- *Direct franchising:* The franchisor franchises individual franchise units directly from his or her country into Greece without the intervention of a third party, by concluding franchise agreements directly with individual Greek franchisees.
- *A branch operation or a subsidiary company:* The franchisor establishes a subsidiary company or a branch office in Greece which acts as the franchisor for the purpose of granting franchises in Greece by concluding franchise agreements with individual Greek franchisees.
- *Area development agreement:* The franchisor concludes a development agreement directly with a Greek area developer, whereby the area developer is entitled, but also obliged, to open and operate their own franchise outlets in Greece.
- *Master franchise agreement:* The franchisor concludes a master franchise agreement with the Greek master franchisee whereby the master franchisee is entitled, but also obliged, to grant sub-franchises to Greek individual franchisees by entering into franchise agreements with them, acting

as a franchisor in the Greek market. Furthermore, the Greek master franchisee is entitled to open and operate their own franchise outlets.

- *Joint venture:* The franchisor enters into a joint venture agreement with a Greek person to establish a joint venture entity, usually a company, in Greece. This company acts as the franchisor in Greece by concluding franchise agreements with individual franchisees.

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Nuances of franchise arrangements in India

The organised retail market of India is expected to more than double by 2020 to US$1.3tn, with an estimated 25 per cent average annual growth. This growth and the market in India have attracted many international players who have or are keen to set up businesses in India. A clear confirmation of this trend comes from many global players announcing big plans for India.

A number of international players wish to enter India through the franchise model. This model provides them with the necessary support, required at the initial level, to become familiar with the processes and culture of India. While this works to their advantage, one of the key aspects that any franchisor needs to bear in mind is the risk associated with the necessary disclosure of trade secrets and processes that need to be shared with the franchisee. Most franchisors insist on incorporating stringent non-compete provisions, applicable after the termination or expiry of the franchise agreement, to protect their information, proprietary rights and designs. Often it is natural to believe that the more stringent the provision, the more protection it provides to the franchisor. However, in the Indian context, that may not be the case.

Similar to other laws around the globe, The Indian Contract Act, 1872 and the Constitution of India expressly deal with the concept of 'restraint of trade' and often the non-compete clauses incorporated in the franchise agreements, unless carefully drafted, are regarded as negative covenants that attract the provisions relating to restraint of trade.

Section 27 of The Indian Contract Act stipulates that any agreement which restrains a person from carrying on a lawful profession, trade or business, is void to that extent. The only exception to this rule is if the negative covenant is 'reasonable' and not 'opposed to the public policy of India'. The apex court in India, being the Honourable Supreme Court, has held that contracts in restraint of trade are prima facie void and the onus of proof is on the party supporting the contract to show that the restraint goes no further than it is reasonably necessary to protect its interest. Therefore, the onus of proving that the negative covenant is reasonable rests on the franchisor.

While reasonableness of the negative covenant is determined on a case-by-case basis, the key question to be considered is whether the franchisee is deprived from the right to earn a living.

In a landmark case of *Gujarat Bottling Co Ltd v Coca Cola,*[1] the franchisor, Coca Cola, entered into a bottling agreement with Gujarat Bottling Company, the franchisee, to bottle, sell and distribute beverages, known and sold under its registered trademarks with standard restrictive covenants applicable during the term of the agreement and during the notice period for termination of the agreement. Subsequently, the shareholding of the franchisee was transferred to Pepsi, a competitor of the franchisor, which restrained the franchisee from dealing with Pepsi products during the notice period for termination of the agreement. While passing judgement in this case, the Honourable Supreme Court of India, in the year 1995 opined that 'since the negative stipulation… is confined in its application to the period of subsistence of the agreement and the restriction imposed therein is operative only during the period of the agreement, the said stipulation cannot be held to be in restraint of trade…' .

Similarly, in the year 2002, the High Court of Madhya Pradesh,[2] a state in central India, held that '... on the facts and circumstances of the case, it cannot be held that, the franchisee would not conduct the same or similar courses as those covered under the agreement for a period of six months after the termination of the agreement is in restraint of trade, but was for advancement of trade'. In this case, the franchisee had been running tuition classes pursuant to the franchise arrangement with the franchisor. The High Court based its reasoning on the fact that for 'smooth flow of trade and commerce and especially for business and franchise agreements, such a covenant limited in point of time and for the courses covered by the agreement should be permissible and would not be in restraint of trade'.

On the other hand, in a case where the negative covenant applied beyond the term of the contract, the High Court of Delhi,[3] in the year 1998, held that:

> 'Since the restraint is so wide that it applies to an unlimited period in respect of wide area and after determination of the contract it may appear that the restrictions imposed are void under Section 27 excepting one restriction to the effect that the defendant/franchisee while forming or modifying its constitution shall not at any time during or after the contract period keep or use any name which is in any way identical to the name or logo of the franchisor, for this type of restriction is in accordance with the Trade and Merchandise Marks Act.'

Therefore, in the Indian context, the franchisors need to be especially diligent and watchful to ensure that the clauses relating to non-compete and preservation of their intellectual property and business concepts are drafted in such a manner that they provide the maximum protection, not in isolation or in the context of the agreement but in the context of the judicial precedents that are applicable to such situations.

Notes

1 M/s Gujarat Bottling Co Ltd & Others v The Coca Cola Co & Others, 1995 AIR 1995 SC 2372.

2 Manish v Sandeep, 2002 (3) MPHT 565.

3 IEC School of Art & Fashion v Mr Gursharan Goyal & Others, 72 (1998) DLT 833.

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The ten franchise commandments for a successful franchise system – is your franchise system franchiseproof?

This article discusses the essence of a good, solid franchise system. Can your franchise system take a beating?

Is your franchise system franchiseproof and resistant to influences from outside, and can it cope with changing market conditions?

In the first place, a developed franchise system or formula with matching operational method and fee structure presumes that the partnership should benefit both the franchisee(s) and the franchisor. The developed franchise system should be based on an earning model for the franchisee allowing him/her to generate a reasonable entrepreneurial income within a reasonable span of time. Naturally the franchisee must make reasonable efforts to operate the franchise business according to the business format of the franchisor.

The viability of a successful franchise system is based on the following ten franchise commandments. A franchise system is franchiseproof if these ten conditions are satisfied:

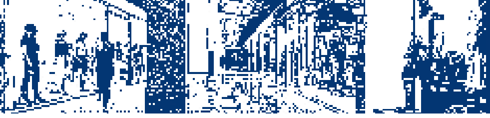
1. A developed franchise system, the franchise business format, must be distinctive and competitive in its speciality. Every self-respecting franchise organisation specialises in a particular product or product range or specific services and the sale thereof.

2. The franchisor must be good at, if not excel in, its speciality and keep the related franchise know-how up to date. It is also necessary to adapt the formula to ever-changing market conditions. Changes in trends, difficult-to-predict consumer behaviour, product innovations, advancing technology and changes in competitive relations are factors that have an impact on a franchise system.
3. A distinctive franchise system derives its added value from being and staying good at the developed speciality (the know-how) and the ability to translate this speciality into effective business operations focused on sales. The flexible implementation of changes in business operations is, in principle, the job of both the franchisor and franchisee.
4. The franchise system developed is only complete when it is provided with a brand label. The logo, trade name and characteristics of the corporate design are essential components of a franchise system and the franchise network. The recognisability of a formula among customers as a result of the logo and/or uniformity in doing business is decisive for the franchise system's added value.
5. The franchise organisation is solid and durable if the franchisor aims for continuity. In that context, the franchise organisation must on the one hand be equipped for expansion of the formula, while on the other the franchisor must be able to keep the growth and continuation of the franchise network operationally manageable.
6. The franchisor must organise the cooperation with its franchisees in a structured manner. The franchisor communicates with its franchisees in a group context and on an individual basis. Effective communication implies two-way traffic, whereby the franchisor is also open to input from its franchisees.
7. It is essential that the franchise organisation invest in customer orientation (approaching customers) and customer satisfaction (retaining customers). Expansion or growth of a franchise system is only possible if the customer believes in your product, your speciality, your service provision. Also make a distinction between customer groups here.
8. The franchise cooperation must comply with the applicable legislation and regulation, customary practice in the particular industry and long-term use in the franchise practice.
9. The franchise agreement must be attuned to the content, object and philosophy of the franchise system. On the one hand the rights, obligations and responsibilities of the contract parties (the franchisor and franchisee) must be specifically and clearly formulated, while on the other the provisions of the franchise agreement must enable adjustments or expansions to the formula.
10. The (legal) character of the franchise cooperation entails an obligation of loyalty to the franchise network for the franchisor and franchisee, in addition to the promotion of individual business interests. This obligation of loyalty consists of two elements: (i) the positive obligation to endeavour to maintain the uniformity and quality of the franchise system; and (ii) the duty to refrain from actions or omissions which could damage the partnership.

In summary, a franchise system is franchiseproof if:

- there is a distinctive franchise system (franchise business format);
- the franchise organisation is durable and equipped to grow and maintain the franchise network; and
- the franchisor pursues qualitative entrepreneurship and facilitates a balanced franchise cooperation with its franchisees.

The commandments described are based on my research, experience and current franchise practice. These commandments should be seen as a franchise toolkit to optimise your franchise system, franchise organisation and franchise cooperation.



Limitation on repatriation of royalties out of Pakistan – an imprudent and unlawful measure that hinders development of franchise markets

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It is crucial to franchisors to be able to collect franchise royalties in foreign markets where they have invested, created employment and introduced superior goods, services and technology. However, as a result of one instance, since 2001 international food chains operating in Pakistan have faced the challenge of not being able to repatriate royalty revenues out of Pakistan due to a policy of the country, which is highlighted in this article.

It is the Foreign Exchange Circular No 03 ('Circular'), dated 24 March 2001, issued by Pakistan's central bank, that is, the State Bank of Pakistan ('SBP') that obliges certain Pakistani commercial banks[1] to observe the thresholds as per the original text reproduced below:

> 'The remittance of Royalty/Franchise and Technical Fee or Service Charges in Agriculture, Social Infrastructure and Service Sector projects including international food chains may be allowed according to the following guidelines:
>
> i. The initial lump sum fee payable to the foreign investor/the party providing technical expertise and/or allowing use of their brand name, should not exceed US$100,000 – irrespective of number of outlets under one franchise.
>
> ii. A maximum of five per cent remittance of net sales (excluding 15 per cent sales tax) in the food sector may be allowed as Franchise Fee only for those items, which are core items of the franchise and are the specialties of the trade name. The payment of such fees be allowed on monthly basis. No item will be eligible for twice payment of Royalty/Franchise Fee. In other words, the payment of Royalty Franchise Fee shall not be admissible for those items whose franchise is not held by the food chains and/or which are sold under some other brand name, eg, soft drinks etc.
>
> iii. Percentage/amount of fees, etc for other non-manufacturing projects may also be upto the maximum of five per cent of not sales (excluding 15 per cent sales tax).
>
> iv. Initial period for which fees be allowed to projects in non-manufacturing sectors including international food chains should not exceed five years. Subsequent extension in time period will be considered and allowed by the Government/State Bank of Pakistan provided these projects also make investment in allied upstream projects.'

Thus the given Circular, in effect, limits a franchisee's ability, as well as its bank's ability, to transfer royalty fees out of Pakistan up to a maximum of five per cent.

However, the aforesaid Circular is not a statutory law, as SBP does not have the powers to issue laws, rules or regulations. SBP itself is a creation of a statute. At most, this Circular is an executive order and does not apply to any person other then the Pakistani banks as identified above. SBP derives authority to issue such executive-order-nature circulars pursuant to the Foreign Exchange Regulations Act, 1947 ('FERA 47').

The given Circular (strictly speaking) is in itself, in the author's view, illegal and invalid under section 4 of the Protection of Economic Reforms Act, 1992, ('PERA 92'), which, subject to certain exceptions, maintains that '[a]ll citizens of Pakistan resident in Pakistan or outside Pakistan and all other persons shall be entitled and free to bring, hold, sell, transfer and take out foreign exchange within or out of Pakistan in any form and shall not be required to make a foreign currency declaration at any stage nor shall anyone be questioned in regard to the same'.

So, in conclusion there is currently in place an executive-order-nature circular from the SBP that is limiting the capacity of Pakistani companies to transfer royalty/franchise fees out of Pakistan up to a maximum of five per cent, and such Circular is invalid in the light of section 4 of PERA 92. It remains to be seen if and when Pakistan's government will address this issue and remove this hurdle to encourage franchise market development in the country.

Notes

1 Namely: ABN Amro Bank NV, Al-Baraka Islamic Bank BSC, Allied Bank of Pakistan Limited, American Express Bank Ltd, Askari Commercial Bank Limited, Bank Al Falah Ltd, Bank Al Habib Ltd, Bolan Bank Ltd, Citibank NA, Crescent Commercial Bank Limited, Dawood Bank Limited, Deutsche Bank AG, Doha Bank, Faysal Bank Ltd, First Women Bank Ltd, Habib Bank AG Zurich, Habib Bank Ltd, Hong Kong & Shanghai Banking Corporation, Industrial Development Bank of Pakistan, KASB Bank Limited, Metropolitan Bank Ltd, Meezan Bank Ltd, Muslim Commercial Bank Ltd, National Bank of Pakistan, NDLC-IFIC Bank Limited, Oman International Bank SAOG, Pakistan Industrial Credit & Investment Corporation Ltd, PICIC Commercial Bank Ltd, Prime Commercial Bank Ltd, Rupali Bank Ltd, RBB, Saudi Pak Commercial Bank Ltd, Soneri Bank Ltd, Standard Chartered Bank, The Bank of Khyber, The Bank of Punjab, The Bank of Tokyo Mitsubishi Ltd, Union Bank Ltd, United Bank Ltd, and Zarai Taraqiati Bank Limited.

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'Change before you have to': franchise lessons from Canada's 'donut wars'*

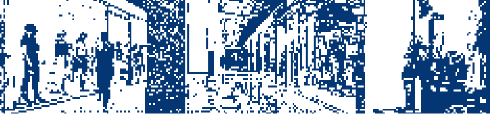
Canada's two most significant franchise law decisions of 2012 demonstrate the fierce competitiveness of the quick-service restaurant ('QSR') industry in Canada and the need for franchisors to adapt to changing market conditions by enacting well thoughtout system-wide changes or potentially face the economic and legal repercussions of failing to keep up.

The Ontario Superior Court of Justice decision in *Fairview Donut Inc v TDL Group Corp ('Tim Hortons')*, which was recently upheld by the Ontario Court of Appeal, tells the story of a successful franchisor whose system-wide changes were upheld by the court over the objections of some disgruntled franchisees.[1] In contrast, the Quebec Superior Court's decision in *Bertico v Dunkin' Brands Canada Ltd ('Dunkin' Donuts')* concerns a once-dominant franchise system that was, despite its best efforts, unable to keep up with a competitor – which, somewhat ironically, happened to be Tim Hortons – that was making inroads into its established territory in the province of Quebec.[2] While Tim Hortons' sweeping changes were found to be a valid action within the bounds of its franchise agreements, Dunkin Donuts' alleged failure to stave off competition and prevent the franchise system's decline was found to be a breach of the franchisor's obligation to its franchisees to protect and develop the brand.

While these two cases may, at first blush, seem at odds, they share the common thread that franchisors are not only within their rights in enacting broad changes to stay relevant in the market, but (and to the dismay of franchisors) the court may ultimately focus on the result of those changes.

Tim Hortons case

The *Tim Hortons* case was a proposed class action under Ontario's Class Proceedings Act, launched by a number of franchisees of the iconic Canadian coffee and donut (doughnut) franchisor Tim Hortons. The franchisees' claim arose from the franchisor's introduction of a new lunch menu and the switch from baking donuts and pastries from scratch onsite to a 'par-baking' system known as the 'Always Fresh conversion'. Where franchisees were formerly required to hire bakers to make baked goods from scratch at each individual store, the new par-baking system involved partially baking donuts and pastries at a central facility, then flash-freezing and shipping them to stores where they were finished in specialised ovens. This eliminated the need to employ professional bakers at all franchise locations and ensured consistency across the franchise system. The franchisees alleged the new lunch menu and



'Always Fresh' conversion required them to buy ingredients and supplies at above-market prices and sell certain menu items at break-even or a loss, which they alleged was a breach of their franchise agreements with Tim Hortons.

The plaintiff franchisees, proposing to represent a class spanning 500–800 franchisees operating approximately 2,400 stores across Canada, claimed that the prices of certain ingredients they were required to buy from Tim Hortons became commercially unreasonable, eroding their ability to make a profit. They alleged several causes of action including breach of contract, misrepresentation, unjust enrichment, price maintenance and breach of the statutory duty of good faith under Ontario's Arthur Wishart Act (Franchise Disclosure) and similar franchise legislation in other provinces.

In the Ontario Superior Court of Justice decision, the court gave extensive reasons granting summary judgment to Tim Hortons and dismissing the franchisees' action. In granting summary judgment, the Court acknowledged that, despite the voluminous record before the Court, the case was not complex and essentially boiled down to the interpretation of the applicable legislation and franchise agreements.[3]

The Court found no basis for the plaintiffs' claim that Tim Hortons was obligated to offer franchisees the lowest available prices in the marketplace for products and supplies, writing:

> 'What matters, at the end of the day, is whether the franchisee makes sufficient profit overall to justify his or her investment and to remain in the business. The suggestion by the plaintiffs that the franchisor has an obligation to price every menu item so that they can make a profit on that particular item is not supported by the contract, by the law or by common sense. It is simply not the responsibility of the court to step in to recalibrate the financial terms of the agreement made by the parties.'[4]

The Court found that the franchise agreements did not confer a right for the franchisees to sell every menu item at a profit. If franchisees were losing money on lunch menu items, they were likely making up the difference through increased sales of higher-margin items such as coffee. The court similarly found that the Always Fresh conversion, in particular, was a net benefit to franchisees, as it effectively outsourced a baking process that was 'time consuming, aggravating and wasteful'.[5] Despite the increased unit cost to franchisees for baked good products under the Always Fresh system, avoiding the rising costs of labour and ingredients related to the former scratch-baking process validated the franchisor's wisdom in requiring franchisees to abide by the system-wide change.

The introduction of the lunch menu and the Always Fresh conversion were both found to be within the bounds of Tim Hortons' contractual powers under the franchise agreements and, further, both were found to be perfectly rational business decisions made with regards to the interests of Tim Hortons as well as its franchisees. Tim Hortons had no obligation to prefer the interests of franchisees to its own in enacting such changes, especially when the evidence demonstrated that the franchisees were in fact earning a substantial return on their investment in their franchises.

The plaintiffs appealed the motion's court decision to the Ontario Court of Appeal, the highest appellate court in the province, only with regards to the dismissal of the breach of contract and statutory duty of good faith claims. Upon the conclusion of two days of argument, the three-judge panel dismissed the franchisees' appeal from the bench.

The Court of Appeal was emphatic in their endorsement of the motion court's decision, stating they agreed completely with the conclusions on the breach of contract and duty of good faith claims. On the breach of contract claim, the Court of Appeal made particular note of the motion court judge's conclusion that, when enacting system-wide changes, 'the franchisor is entitled to consider the profitability and prosperity of the system as a whole'.[6] Turning to the good faith claim, the Court praised the motion's judge for having 'carefully and comprehensively reviewed the record on this issue which strongly documented the extent and fairness of Tim Hortons' process for considering their franchisees' position with respect to the transition to a new donut production system'.[7]

An application for leave to appeal of the Court of Appeal's decision to the Supreme Court of Canada was filed in February 2013.[8] Leave, however, is unlikely to be granted given the Court of Appeal's strong endorsement of the motion court's reasons. *Tim Hortons* will likely remain a landmark decision for the duty of good faith and franchise class actions in Canada.

Dunkin' Donuts case

Not long after the decision in *Tim Hortons* was released, a judge of the Superior Court of Quebec ruled in favour of a group of 21 former Dunkin' Donuts franchisees in that province, finding the franchisor, Dunkin' Brands Canada Ltd ('Dunkin'), liable for having failed to 'protect and enhance the Dunkin' Donuts brand in Quebec' in accordance with its obligations under the franchise agreements and ordered Dunkin to pay nearly CA$16.5m in damages to the former franchisees who had lost their businesses.[9]

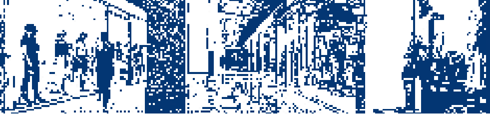
The franchisees' claim arose from Dunkin's alleged failure between 1995 and 2005 to protect and enhance the brand in Quebec, which they allege resulted in the collapse of the Quebec franchise system and the loss of their franchised businesses. Dunkin was, for many years, a dominant presence in Quebec. It enjoyed a market-leading share of the quick service coffee and donut market. In the face of stiff competition from Tim Hortons, however, Dunkin's presence in the Quebec market declined sharply. In the mid 1990s, Dunkin led the Quebec coffee and donut market, in terms of both total sales and number of stores. Over the course of the 2000s, however, Dunkin suffered what the court referred to as 'a stunning fall from grace' in the province, losing nearly all of its Quebec franchise locations.[10] Dunkin's total number of Quebec franchises decreased from 210 stores in 1998, to 115 in 2003, 41 in 2008, 25 in 2011 and just 13 remaining open in June 2012 when the Court released its decision.

While the franchisees alleged that this collapse of Dunkin's Quebec franchise system was the result of their franchisor's failure to meet its contractual obligation to protect and enhance the brand in Quebec, Dunkin argued it was attributable to factors outside its control, namely, the underperformance of franchisees and what came to be known as the 'Tim Hortons phenomenon'. Beginning in 1996, Tim Hortons, whose dominant presence in English Canada had never translated into a similar presence in Quebec, began an aggressive plan of expansion into the Quebec market. Tim Hortons' success in expanding into Quebec mirrored Dunkin's decline. As the Court noted, Tim Hortons' stores multiplied five times from 60 to 308 stores between 1995 and 2005, while Dunkin's market share in Quebec plummeted from 12.5 per cent to 4.6 per cent over a similar time period.[11]

Dunkin contended that it had made numerous attempts to combat the 'Tim Hortons phenomenon' and had provided ample support to its Quebec franchisees. This support included conducting research and development in new products, menu changes designed to increase profitability, financial assistance programmes for struggling franchisees, investments in Quebec-focused marketing campaigns and a remodeling incentive programme to encourage franchisees to renovate their stores, especially those in close proximity to newly opened Tim Hortons locations. Many of these initiatives were met with resistance by reluctant franchisees. The remodeling programme, in particular, suffered from poor take-up among franchisees and ultimately did not accomplish its intended goal. Despite the evidence put forward that Dunkin had invested considerable resources in supporting the Quebec market, as much or more in fact than it did for many other regions, the Court was unconvinced by Dunkin's arguments that its actions were an adequate response to the increased competition from Tim Hortons, finding the franchise system's decline to be proof positive that Dunkin's measures were 'too little way too late'.[12]

Instead, the Court accepted the franchisees' argument that the preamble of Dunkin's franchise agreements created a primary obligation for the franchisor to protect and enhance the Dunkin Donuts brand in Quebec. The failure to do so amounted to a breach of that obligation:

> 'But the greatest failing of all was [Dunkin's] failure to protect its brand in the Quebec market. No doubt the host of failings chronicled by the Franchisees contributed to the collapse of the Dunkin Donuts' brand in Quebec. A successful brand is crucial to the maintenance of healthy franchises. However, when the brand falls out of bed, collapses, so too do those who rely upon it. And this is precisely what has happened in this case. [Dunkin] had assigned to itself the principal obligation of protecting and enhancing its brand. It failed to do so, thereby breaching the most important obligation it had assumed in its contracts. It must accept the consequences of such a failure. As noted above, Franchisees cannot succeed where the System has failed. After sustaining several years of stagnant sales,



narrowing profit margins and then losses, the Franchisees have all had to close their stores. Their losses follow hard upon the heels of [Dunkin's] failures as night follows day.'[13]

In finding that the preamble imposed this obligation on Dunkin, the Quebec Court appeared to disregard that the financial success of the franchisees was expressly disclaimed in the body of the agreement. It is unclear from the Court's decision how the vague and broadly conceived positive obligation to 'protect and enhance the brand' is reconciled with the express disclaimer elsewhere in the contract.

The Court awarded the full amount of damages claimed by the franchisees for losses sustained beginning in 1996, the first instance where franchisees formally warned Dunkin of the 'fox looking to enter the hen-house', finding that Dunkin's failure to adequately heed these warnings about Tim Hortons was a breach of its contractual obligation to protect the brand.[14] The Court accepted the franchisees' unorthodox method of damages calculation using the 'comparable sales' of Tim Hortons franchises in Quebec to calculate the amount of lost profits the Dunkin franchisees had suffered due to the franchisor's breach of contract. In essence, the Court endorsed a damages calculation that based the plaintiffs' losses on the operating results of their competitors from Tim Hortons on the purely speculative assumption that the plaintiffs would have enjoyed similar successes but for Dunkin's breach of the obligation to protect and enhance the brand. This method of calculating damages is both unorthodox and unprecedented.

The Dunkin' Donuts decision was met with a significant degree of surprise and concern by the Franchise Bar. The decision is currently under appeal to the Quebec Court of Appeal. It is likely that key aspects of the appeal will deal with the overriding interpretation that the trial judge placed upon the franchise agreement regarding the 'duty to protect and enhance the brand', the failure to adequately consider the evidence put forward by Dunkin regarding the many actions it did take to support its Quebec franchise system and stave off competition from Tim Hortons, and the excessive damage calculations.

Until the appeal is heard, it is unclear what impact Dunkin' Donuts will have on Canadian franchise law. First, it was decided under civil law principles which do not apply in the rest of Canada outside of Quebec, where common law principles govern. Secondly, it ostensibly casts upon franchisors an obligation to effectively guarantee the financial success of their franchisees in the face of legitimate competition. This would stretch commercial law principles beyond their breaking point from the perspective of many commentators, and make franchisors de facto insurers of their franchisees' success. While traditionally franchisors have been found to have an 'obligation of means' – in that they must proactively support and assist their franchisees – the Quebec Court in Dunkin' Donuts imposed a new and unintended 'obligation of result' with dire consequences if that result, namely financial success, is not delivered. The obligation to 'protect and enhance the brand' appears to require not only that a franchisor take action to stave off competition, but that that action be successful – notwithstanding the ease with which a court may stand with the benefit of 20/20 hindsight and judge what the appropriate business decision in the moment might have been. Ultimately, this challenges not only the longstanding 'business judgment' rule, namely that Canadian courts will afford deference to reasonable business decisions made in good faith regardless of result, but also the underlying principle of franchising that success is a common objective shared by both franchisor and franchisee, and not a legal obligation resting solely with one party to the franchise relationship.[15]

If upheld on appeal, Dunkin' Donuts will be a daunting precedent for Canadian franchisors due to its controversial and expansive take on franchisors' contractual obligations.

The take-away: change is good

Tim Hortons and Dunkin' Donuts are similar in that they both touch on the franchisor's legal responsibility and financial imperative to remain relevant in a dynamic and competitive industry by carefully considering and taking action to promote and enhance the viability of the franchise system. Franchisors that make calculated decisions to promote the profitability of the system as a whole, like Tim Hortons, are unlikely to attract liability for sweeping, system-wide changes. On the other hand, if Dunkin' Donuts is upheld on appeal, franchisors like Dunkin, whose efforts to adapt and remain relevant did not result in financial success for franchisees, may face significant liability for failing to live up to any perceived contractual obligation to protect and enhance the brand.

It is important to remember that both of these decisions were ostensibly grounded in the law of contract and ultimately turned on the interpretation of provisions in the respective parties' franchise agreements which may not be similar to the provisions in other franchise agreements at issue in future cases. However, the terms of the franchise agreements at issue and the disputes in both cases are common enough that it is possible to draw broader conclusions applicable to all franchise systems. Franchisors will always have an economic incentive to adapt and protect their brand. Tim Hortons confirms that enacting broad, system-wide changes to adapt and protect their brand is within the franchisor's power.

A key factor underlying both decisions is economic success. In Dunkin' Donuts, the Court found that the collapse of Dunkin's franchise system in Quebec at the hands of competition from Tim Hortons was tied to Dunkin's failure to adequately respond to the warnings of franchisees about the 'Tim Hortons phenomenon'. The decline of Dunkin's Quebec franchise system was held up by the Quebec Court as proof that its efforts to combat the 'Tim Hortons phenomenon' and support its franchisees were not sufficient to meet their contractual obligations. In *Tim Hortons*, the franchisees' complaints about being forced to sell certain menu items at a loss or being required to purchase new products at above-market prices were offset by evidence that the system and the individual franchisees remained profitable and economically viable. As the Court in *Tim Hortons* noted, the franchisees' 'real complaint is not that they don't make a reasonable profit… but rather that they don't make more profit.'[16] The Court ultimately held that the franchisor's obligations did not extend so far as to require that the franchisees earn as much profit as possible on every item sold.

What remains to be seen is what result would occur in a case where, like in *Tim Hortons,* the franchisor made a calculated decision to enact system-wide changes to maintain the health and viability of the franchise system but, like in *Dunkin' Donuts*, the system suffered a decline in the face of competition from other brands. What if, despite the wealth of evidence in Tim Hortons supporting the well-intentioned decision making behind 'Always Fresh', and the finding that *Tim Hortons* was within the confines of the franchise agreements, the move had not produced the intended result of increasing franchisee profitability and success? Would a court taking a similar view to that of the Quebec Court in *Dunkin' Donuts* find the franchisor's actions to be valid regardless of the outcome? Or would the court find the franchisor had not acted quickly or decisively enough to remain relevant and competitive in the QSR market? The curious logic of *Dunkin' Donuts* certainly raises the question of how far the court will step in to decide exactly what the franchisor's obligation to 'protect and enhance' the brand requires. How close will the court come to second-guessing the business judgment of franchisors when well-intentioned changes go awry or fail to live up to expectations? As always, future cases will be determined on the unique facts of each case and the terms of the agreements at issue, but for now the 'donut wars' gives us at least one important lesson – in a dynamic and competitive QSR market, franchisors must certainly strive to adapt to change.

Notes

* The title of this article is attributed to Jack Welch.

1 Fairview Donut Ltd v TDL Group Corp Ltd, 2012 ONSC 1252 [Tim Hortons OSCJ]; aff'd by 2012 ONCA 867 [Tim Hortons ONCA].

2 Bertico Inc v Dunkin' Brands Canada Ltd, 2012 QCCS 2809 [Dunkin' Donuts].

3 The Court did certify the action as a class proceeding, but that certification was rendered moot as a result of the summary judgment decision.

4 Tim Hortons OSCJ, see note 1 at paragraph 679.

5 Ibid, at paragraph 428.

6 Tim Hortons ONCA, see note 1 at paragraph 5.

7 Ibid, at paragraph 6.

8 Fairview Donut Inc v TDL Group Corp Ltd, 2013 CarswellOnt 1782 (SCC).

9 Dunkin Donuts, see note 2 at paragraphs, 1, 128.

10 Ibid, at paragraph 30.

11 Ibid, at paragraph 38.

12 Ibid, at paragraph 71.

13 Ibid, at paragraph s 57–58.

14 Ibid, at paragraph 96.

15 For discussion of the 'Business Judgment Rule' in Canadian law, see BCE Inc v 1976 Debenture Holders, 2008 SCC 69; see also Peoples Department Stores Inc (Trustee of) v Wise, 2004 SCC 68.

16 Tim Hortons OSCJ, note 1 above at paragraph 41.

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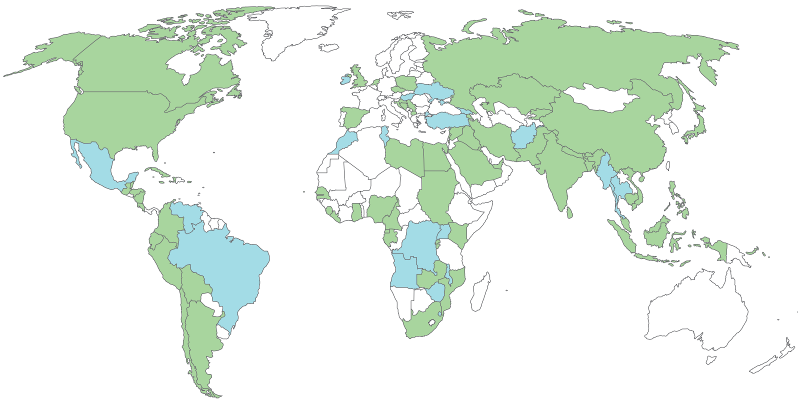

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